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FOREIGN ECONOMIC POLICY

HEARINGS

BEFORE THE

SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY

OF THE

JOINT COMMITTEE ON THE ECONOMIC REPORT

CONGRESS OF THE UNITED STATES

EIGHTY-FOURTH CONGRESS

FIRST SESSION

PURSUANT TO

SEC. 5 (a) OF PUBLIC LAW 304

79TH CONGRESS

NOVEMBER 9, 10, 14, 15, 16, AND 17, 1955

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FOREIGN ECONOMIC POLICY

WEDNESDAY, NOVEMBER 9, 1955

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met at 10 a. m., the Honorable Richard Bolling, chairman of the subcommittee, presiding.

Also present: Grover W. Ensley, staff director; Charles S. Sheldon II, staff economist; and Henry P. Balivet, Jr., administrative assistant to Senator Flanders.

Mr. BOLLING. The subcommittee will be in order.

This is the first year in which the Joint Committee on the Economic Report has organized a formal subcommittee on foreign economic policy. From time to time we have considered problems arising in this field as they impinge upon the stability and growth of domestic commerce. Creation of this subcommittee is in recognition of the extreme importance of our international economic relations, not only for their indirect effects on domestic economy, but also for their pervasive influence on shaping our lives as a consequence of events abroad.

Last January, at the time the full committee held its hearings on the President's economic report, a day was devoted to problems of foreign economic policy. These discussions revealed that there were a number of unanswered questions and problems bearing further investigation, if the Congress was to have the guidance it requires. We need to coordinate our economic policies over a broad field of concern that cuts across the lines of authority of the several standing committees involved in the preparation of specific legislation. It is the function of the Joint Committee on the Economic Report, and, consequently, of its duly constituted subcommittees, to explore these problems which shape our overall economic policy.

Our interest is to bring harmony among many separate pieces of legislation to promote their consistent application toward fulfillment of the objectives of the Employment Act of 1946. We are charged with responsibility, both for studying broad policy and for keeping the Congress informed on economic developments of which it should know in order to act intelligently and consistently in the national interest.

As a result of the January report hearings the committee voted to create this subcommittee. This investigation is intended as an orderly examination of principles and their interrelations, from which a consistent policy may be developed. If we can arrive at a better understanding of the workings and consequences of trade, of economic cooperation, and of investment, we shall have advanced the public interest and the cause of sound government.

We view these hearings, then, as an educational effort, an education of ourselves and this audience, of our fellow Members of Congress, and of the general public to the extent they will read our published hearings or follow the accounts carried by the press.

The selection of witnesses for these hearings was planned with considerable care. We have developed a list of questions to be explored, which were the chief ones raised in our January hearings. We have invited witnesses to appear primarily on the basis of their personal qualifications as knowledgeable and articulate spokesmen on the subjects under consideration.

In the interest of broad representation we have tried to insure that divergent viewpoints will find reflection here. Many groups from industry, finance, labor, agriculture, universities, and research organizations are represented indirectly by these men who serve them. This has been done largely to insure that various viewpoints will find expression rather than to make any pretense that the special interests of all such groups have been given voice.

Our time has been too limited to do more than plan a program which would treat a series of questions, and from among a number of qualified witnesses to select those who could come without undue burden to help us explore these matters. Our plan is to ask each formally invited witness to present an oral statement of his views or findings, as forcefully as he can within our very strict budget of time Within reason, full texts of statements and supporting data will be printed in the record of the hearings. Our plan will be to hold interruptions of statements to a minimum, then to reserve approximately half our time for commentary on the statements.

I want to announce that Senators Douglas and Fulbright both send their regrets that they will not be able to take part directly in the hearings. But they will be reading the transcripts and sharing in the drafting of a report on our findings. Senator Flanders will join us later. The emergency of his wife's being in the hospital is keeping him away today. Representative Talle also will join us later during the hearings.

I need not repeat how important we feel these hearings are to the strengthening of our foreign economic policy. It was for this reason, hoping for a strong policy statement at the highest level, that we invited the Secretary of State to appear to deliver an opening address. We are all aware that he is away, involved in very important negotiations in Geneva. We suggested that if Mr. Dulles could not come that we would appreciate having another official of high enough rank to answer policy questions if we should choose to explore such matters with him. We suggested that the new Deputy Under Secretary for Economic Affairs might come. But the Department felt that Mr. Prochnow is too new in his job to be familiar with the entire range of matters which might come up.

We suggested alternatively the name of Mr. Thruston B. Morton, Assistant Secretary, who is very well known and respected here on the Hill. He is in Geneva, too.

I understand Senator Flanders aided us by requesting the appearance of Mr. Herbert Hoover, Jr., the Under Secretary. Mr. Hoover was unable to come.

In the place of these officials we requested we have with us today from the Department of State the Deputy Assistant Secretary of State for Economic Affairs, Dr. Thorsten V. Kalijarvi. We will appreciate hearing his statement offered in behalf of the Department of State, and we assume the statement will be the view of this administration toward foreign economic policy.

Dr. Kalijarvi, you may proceed with your statement.

STATEMENT OF DR. THORSTEN V. KALIJARVI, DEPUTY ASSISTANT SECRETARY OF STATE FOR ECONOMIC AFFAIRS

Dr. KALIJARVI. Mr. Chairman and members of the subcommittee, first, may I identify my colleague. He is Isaiah Frank, Deputy Director of the Office of International Trade and Resources of the Economic Area of the Department.

The schedule for these hearings is most interesting. You are seaching for answers to difficult questions. We, too, are searching for answers to most of the same questions. Consequently, I am pleased to participate in your deliberations and only wish that I could spend the week listening to your speakers and discussion.

Foreign economic policy is but another name for the economic aspects of foreign policy. It has been surveyed before. It will be surveyed again. In fact, it seems to be one of the most surveyed subjects under the sun. In the daily operations of the Government it has become a major consumer of time and brain power.

Why is it necessary to give all this attention to foreign economic policy? This occasion justifies our reminding ourselves of some of the reasons.

We may note as a starting point the astounding economic development of the United States during the last 75 years. These years have seen our free-enterprise economy become the richest and most dynamic ever known, and they have witnessed the growth of this country into a massive force in world affairs. The result has been to attach an unusual importance for the world as well as for ourselves to what we do in trade, in finance, in communications, and in the development of resources.

Our ascendancy as a world power has coincided with swift changes abroad. During the last 75 years alliances have changed, 2 world wars have been fought, empires have broken, states have been born and others have died. Western Europe, which for centuries had been the economic, political, and military power center of the world, suffered economic devastation and a debilitating drain on its manpower. This meant that Western Europe immediately after World War II had to look to the United States not only for economic aid, but became much more concerned with the economic foreign policy of this country than ever before.

Other concurrent events left their impression also. Communist Russia became a major world power and began an aggressive campaign to spread its system everywhere. The attendant splitting of the world into two power groups gave additional political significance to our economic foreign policies.

At the same time huge populations in the so-called underdeveloped countries of the world began to assert themselves and seek political independence and economic betterment. They were no longer satisfied with their lot and began to seek improved standards of living. They needed food, shelter, aid of all sorts, technical assistance, and finance, to mention only a few items. They became a new force in world politics. The principal source of aid to these regions was the United States, and the way in which she conducted her economic foreign policies was followed with keenest attention and fraught with far-reaching consequences.

Science and technology pushed back the economic frontiers, drew the nations closer together and intermeshed their economies more intricately. Science and technology also produced new means of destruction capable, it is asserted, of ending human life on this planet. Most nations, large and small, aspired to become industrialized and to measure their strength and well-being in terms of industrial plants. Revived economies in the world produced more intense trade competition, thereby projecting foreign economic policies into a position of increased importance.

These were some of the forces that focused attention on our entire foreign policy, and nowhere more than on the economic aspects. They made countries feel greater need of one another than ever before. The United States, for the first time in a century and a half, found it necessary to join other countries in a number of formal international arrangements. International cooperation on a large scale became the order of the day—not just for companionship, but because it was a necessity in a shrinking world.

Could the new cooperation be only political and military, and ignore economics? It could not. At the very time when the nations were fast becoming economically more interdependent, the United States found itself the economic giant of them all.

With about 7 percent of the world's population we had become the producer of more than 40 percent of the world's goods and services, and our exports and imports had exceeded those of any other country. Our own history had taught us the importance of economic development to the well-being and safety of people. With the whole world awake to this importance, it was inevitable that a large part of our foreign policy would be economic in nature.

We know now that our choice of foreign economic policies not only determines the kind of business opportunities that beckon us from abroad but it affects our economic welfare here at home and also our security. This committee knows from congressional deliberations on such matters as foreign economic aid and military assistance that our economic actions can either strengthen or weaken the free world community, on which our national safety depends. In short, foreign economic policy, like the rest of foreign policy, has a bearing on every American citizen's well-being and safety—and his chances of keeping his political liberties, his chances of conducting his business activities amidst a free environment, even his chances of keeping his life.

Thus, the American people have a big stake in the direction in which their Government moves when it determines foreign economic policy. Now, let us see what direction they have, in fact, chosen through their elected representatives in the White House and the Congress.

They have elected to move toward increased economic intercourse with other free countries—the expansion of international trade and communications, the freer flow of capital, the providing of aid to underdeveloped countries, the bolstering of the economies of countries of the free world, and the encouragement of international travel.

The objective is to advance the economic well-being and the national security of both ourselves and others at the same time. We are linked together—we rise or fall together. Increased economic intercourse among the free countries is a source of strength for all who participate.

Sometimes one hears voiced the fear that our policies may weaken our national economy. There is no thought of sacrificing our own economic strength; on the contrary, one of the main purposes of the Federal Government, as listed by the President in his state of the Union message last January 6, is—

> to help keep our economy vigorous and expanding, thus sustaining our international strength and assuring better jobs, better living, better opportunities for every citizen.

The current foreign economic policy does not conflict with that great purpose, but boosts it by helping to assure a rising standard of living for our own people.

The President has said it is to the advantage of each nation to reduce the barriers to international trade and investment. In his annual Economic Report of last January 20, he said:

> Our own interest clearly calls for a policy that will in time extend into the international field those principles of competitive enterprise which have brought our people great prosperity with freedom. Against the Communist ideology of the omnipotent state, owning all means of production and dominating all economic activity, the United States holds forth the ideals of personal freedom, private property, individual enterprise, and open markets.

The President, after receiving the recommendations of the Commission on Foreign Economic Policy last year, drew up a program of steps within our power. He first presented it to the Congress in his message of March 30, 1954, and has kept it up to date by other messages. This committee, of course, is familiar with the program.

The President asked for new authority for reciprocal tariff reductions; simplifications of customs procedures; more incentives for private investment abroad; more technical and economic assistance for economic development; economic support for friendly nations that are building their military defenses faster than their economic resources would permit; legislation to encourage foreign travel and participation in trade fairs; authority to join with other countries in establishing an Organization for Trade Cooperation and an International Finance Corporation.

The Congress has gone a long way toward enacting the President's program. For example: This year the Trade Agreements Act was extended for 3 years with new authority to make tariff concessions on a reciprocal basis; and tariff negotiations with 25 other countries will begin in January. Membership in the International Finance Corporation was authorized, and we hope this new institution for fostering private investment will be in actual operation early in 1956. A substantial foreign-aid program was approved by the Congress, and the free world is steadily growing stronger with the help of these funds.

Legislation to establish simple, clear, and logical standards for the valuation of imported goods was adopted by the House and is pending before the Senate Finance Committee. Another pending item is a bill to encourage foreign investment by reducing the tax rate on business income earned by American firms abroad.

Also still to be accomplished is the establishment of the Organization for Trade Cooperation. Now that the Trade Agreements Act has been extended for 3 years, the Organization for Trade Cooperation is the capstone in the President's program remaining to be set in place by the Congress.

Largely at the initiative of the United States, 35 countries which carry on more than four-fifths of the entire foreign trade of the world have reached tentative agreement on the Organization for Trade Cooperation.

The Organization would administer the trade arrangements which the nations have already agreed upon in the General Agreement on Tariffs and Trade. It would also provide a forum for consultations on trade questions, sponsor trade negotiations among the sovereign countries in the group, study trade problems, and publish trade information. The terms of the agreement are well suited to the interests of the United States. The new organization would make it possible to deal more effectively with foreign restrictions against our trade and, in fact, would help bring about an orderly expansion of mutually helpful trade among the nations.

Thus the new organization would meet a real need in the conduct of our international relations. Its very existence would have a beneficial effect, for it would be undeniable evidence that the major countries were truly determined to continue their progress toward closer economic relations.

The President has asked the Congress to approve United States membership in the Organization for Trade Cooperation. It is our earnest hope that early approval will be forthcoming in the coming session for this measure, which is so important to our national interest.

Foreign policy, of course, includes many other economic matters: For example, the fostering of airline operations throughout the world; the sending of a portion of our surplus farm products to foreign countries; and the restriction of strategic exports to the Soviet bloc. Much attention is given to foreign exchange problems, including the convertibility of currencies. And we devote much time and thought to our participation in international organizations that deal with economic problems, such as the International Bank, the International Monetary Fund, the Organization for European Economic Cooperation, the Colombo Plan Consultative Committee, and various agencies of the United Nations.

Now, all programs cannot go forward at the same speed, and occasionally there are specific instances where, for one reason or another, trade restrictions are increased rather than reduced. On balance, though, I think it can be truly said that both the President and the Congress have set a course in the general direction of increased economic intercourse with other countries in the common interest of all; that this is the will of the majority of the American people, and that it is very much the national policy of the United States.

So far, we have talked about the importance of foreign economic policy and the course the United States is taking. Finally, we should spend a few minutes talking about the sources of our problems.

Setting a true course to steer by doesn't eliminate all the obstacles in the way. And the administration of foreign economic policy is well known for having its share of obstacles and dilemmas.

The same is true of foreign policy in general, but the economic sector possesses a set of problems that are peculiarly its own.

For one thing, it is not easy to distill out the purely economic from other considerations. In a way it is misleading to use the term "foreign economic policy" at all, for there is no clear line of separation. For example, what are thought of as economic problems often have great political significance in our relations with other countries.

But perhaps an even more basic reason for the peculiar difficulties that we have mentioned is that foreign economic policy is located in that turbulent area where our internal and external affairs meet.

In other words, foreign economic policy is two things at the same time:

It is foreign policy, governing our relations with other countries and having exactly the same objectives as any other aspect of foreign policy—namely, the security and well-being of the United States as a whole.

It is also the policy governing that part of our domestic economy which projects beyond our borders.

Now, sound foreign relations and a prosperous domestic economy are not in conflict. They go along together. Nevertheless, at the point of merging traffic a high degree of dexterity is called for, and even then there are sometimes collisions and uncertainties over the right-of-way. It is often not easy to balance the many interests involved.

The question of surplus farm commodities is a good illustration. The basic problem here is the place of American agriculture in the economy. Meanwhile, however, the Government has the surpluses. It is trying to dispose of them as constructively as possible, and to use them in a way that would expand commercial markets, not displace them. There are ways of disposing of surpluses constructively; and one of the most hopeful is to send them to underdeveloped countries where new development projects are putting people to work and are thus increasing the demand for food and textiles.

If, however, we were to dump these surpluses where they would disrupt the normal commercial markets of other countries or our own farmers, we would be doing more harm to our country than good. There are limits to which we can dispose of our surpluses abroad constructively. The United States share of international markets for cotton, for example, have shrunk from 50 percent to less than one-third.

The question of how far we can go in given instances to regain these markets through Government action lies in that area of "merging traffic" between domestic and foreign policy.

The domestic involvement in foreign economic policy is reflected in the number of Government departments and agencies which participate in such decisions.

To reduce a tariff rate by even a penny, for example, requires the attention of the United States Tariff Commission, the Department of State, the Department of the Treasury, the Department of Defense, the Department of Agriculture, the Department of Commerce, the

Department of Labor, the Department of the Interior, and the International Cooperation Administration of the Department of State, all of which consult about it, jointly hold public hearings, and agree on recommendations which must be finally approved by the President of the United States.

It is easy to see why all these agencies would need to take part; it is natural and inevitable that they should. There is a similar interagency flavor to other foreign economic matters, such as export controls, and the like; and there is a full assortment of interagency committees, some of them at the Cabinet level, where views are coordinated.

All this is right, proper, and necessary. It guarantees that all interests, including all domestic interests, will be taken into account. It does not, of course, make foreign economic policy any less foreign policy.

When an administration decision is reached on an important question of foreign economic policy, perhaps after long hours of interagency discussion, the decision must be made, of course, with a view to the best interests of the country as a whole.

Entirely aside from our internal difficulties in arriving at decisions, there is a further fact which is always with us; other countries are involved in these matters and we cannot accomplish all our objectives through decisions of our own.

This can be illustrated by reference to the underdeveloped countries of south and southeast Asia.

For a number of very good reasons it is to the enlightened self-interest of the United States to assist in the economic development of those countries by helping them to secure the capital and technical skills which they badly need.

But the major part of the captial for the immense task of raising the living standards of hundreds of millions of people must come from within. We could do nothing to help effectively if they were not willing to help themselves. Of course, they are; and they are making progress.

We know, too, that their economic progress can be stimulated through an increasing flow of private investment capital.

This Government can take certain steps to encourage our own citizens and companies to invest abroad. But that is only part of the story, for here, again, one cannot expect a truly effective volume of private capital to flow into lands where it is regarded with suspicion.

In many countries which are now in the greatest need of economic diversification and development, there are deep prejudices against foreign private capital. These prejudices are understandable even though regrettable. Frequently they are part of the heritage of long colonial periods. The achievement of political independence has been accompanied by exaggerated fears of economic penetration and a misguided view of capitalists as imperialists or robber barons. However, this seems to be no bar to their seeking Government capital from other countries.

On a more technical plane, countries with balance of payments difficulties have sometimes been reluctant to undertake the burden of servicing increased private foreign investment, little recognizing that the stimulating effect of foreign capital and know-how could contribute materially toward alleviating these very difficulties. Again, some countries fear private foreign capital as a form of exploitation, particularly where natural resources are involved.

Happily, these fears and prejudices are undergoing change. In these countries there is a greater recognition that the real problem is to attract foreign capital for productive investment and not to guard against it. They are observing the beneficial results where private investment and enterprise are encouraged. They are beginning to understand that modern capitalism recognizes the responsibilities that accompany its expansion.

It will take time for these progressive attitudes to overcome the deep-seated fears and prejudices, but they can be overcome with patience, understanding, education, and example.

Perhaps the most influential factor is the growing recognition of the extent to which the economic development of the free-enterprise United States has benefited our people and narrowed the income gap between rich and poor. A recent survey by the Twentieth Century Fund calls attention to the trend toward equalization of living standards in the United States, and especially to the new and improved products that technology has created and that mass production and mass distribution have made available for mass consumption. Then the report says this:

> Worth mentioning is the fact that this momentous development has been taking place not in Communist Russia but in capitalist America. Of all the great industrial nations, the one that clings most tenaciously to private capitalism has come closest to the socialist goal of providing abundance for all in a classless society.

This surely is one of the most significant facts of our time.

Mr. Chairman, I hope that these few remarks on foreign economic policy—what it is, why it is important to the American people, and why it isn't easy to administer—will serve as a general preface to the chapters which your expert witnesses are ready to unfold.

Mr. Bolling. Thank you very much, Dr. Kalijarvi.

I plan in the proceedings, when other Members of either the Senate or House are here, to call on them and then call on the staff, and finally ask some questions myself. In the absence of other members today I call on Mr. Balivet, of Senator Flanders' staff, to see if he has some questions.

Mr. Balivet. Dr. Kalijarvi, Senator Flanders wonders whether it would be feasible to encourage closer trading relations among the free countries of Asia, including Japan and India, to strengthen their economies, and likewise closer trading relations among the European countries, as a region, in order to possibly permit what we have here in the way of a mass market, the kind of a mass market which seems to lead to lower costs of production and a higher standard of living. Essentially, the question is one of a possibility of regional blocs, leading toward a freer type of trade within regions. Does the State Department feel that this is a feasible and realistic possibility in the way of a policy?

Dr. Kalijarvi. We have been aware of Senator Flanders' interest in this matter for some time, and it is of great interest to us. There are some aspects we should like to point out in connection with this, which cause us concern as to just how we ought to proceed, or how one ought to proceed along this line.

For example, our objective has been to foster and strengthen the free economies wherever we can and we have been very much concerned about keeping away restrictions that might affect adversely such trade as we may have with the areas we are speaking of. We have therefore had some doubts about any regional arrangement, for the simple reason that such arrangements tend to become restrictionist in some aspect.

We are therefore very much in doubt as to how fast we ought to move in pursuit of the kind of scheme that Senator Flanders has in mind for several reasons: In the first place, because of the restrictionist aspect that I have given you; in the second place, because of the limited character of the opportunities that lie at the present with south and southeast Asian countries, such as Indonesia, Malaya, and so forth. These are single commodity countries that have a very limited capacity to absorb Japanese goods.

We are also concerned about certain of these countries with their traditional patterns of trade, which run counter to the type Senator Flanders proposes—for example, the Philippines with their ties with the United States; the French and their Indochinese ties; the Dutch and their Indonesian ties, to indicate the kind of relationships that now exist. The proposed scheme would move in a pattern contradictory to the traditional pattern.

Then there are a number of problems growing out of the war that are of a psychological character and exist perhaps only for the present moment. They take such concrete form as, for example, reparations, which are still under discussion between Japan and some of the countries that are entitled to reparations under the Japanese Treaty. All of these do not necessarily constitute obstacles for us. They are rather areas which require further exploration. They mark steps that have to be successfully taken along the way toward any accomplishment of the goal Senator Flanders seeks.

We recognize the desirability of finding new markets for Japan, and certainly we are motivated by the same kind of objectives as Senator Flanders.

We have, for instance, pressed as hard as we have been able to increase the trading opportunities for Japan worldwide. We have pressed for a new agreement, trade agreement with Japan. We were in the lead and pressed for Japanese membership in the General Agreement on Tariffs and Trade, or GATT. We realize there are certain inhibitions upon the recognition of some 15 of the countries—14 or 15 of the countries. We are trying to have those countries remove these inhibitions as fast as they can and some of them, such as the United Kingdom, permit most-favored-nation treatment to Japanese goods, so that in effect a great deal of the trade which would be moving under the GATT is actually moving on the same principle. Thus, in a little different way from the one which Senator Flanders contemplates, we are attempting to achieve the same objective. That does not mean that we have ruled out Senator Flanders' scheme. It is just that we feel that this is not the point at which you move in on this sort of thing.

I have tried to indicate some of the implications that are significant for American business as it attempts to move abroad. We would be grateful for any questions, suggestions, or comments which Senator Flanders would have to make, or any points which you would like to raise.

Mr. BOLLING. Dr. Sheldon is staff economist for the Subcommittee on Foreign Policy.

Dr. SHELDON. I don't believe I have anything to add to the questions which Mr. Balivet has raised.

I do want to point out on the 16th of this month we are going to devote a session to exploring some of these regional possibilities, and we hope that this will throw some additional light on the problem. We are very grateful to have the position of the Department of State made clear at this time.

Mr. BOLLING. Dr. Ensley, the staff director of the joint committee.

Dr. ENSLEY. I believe in the interest of time this morning I will forego questions. Thank you.

Mr. BOLLING. I have one question, Dr. Kalijarvi.

I spent a few weeks out of this country in Europe, and it happened I was there about the time that the President made his decision on bicycles. I assume, of course, that the Department of State is more aware than I of the impact, not so much economic as psychological of the decisions on watches and bicycles. At least I am sure the Department of States is as concerned as I am about this.

I wonder what the particular reaction of the Department of State was as to how things were going in this particular area of foreign policy?

Dr. KALIJARVI. You mean the restrictive measures?

Mr. BOLLING. In the negative aspect, the watch decision, bicycle decision, the decision with regard to where the generators would be purchased, and in the positive aspect our apparent failure which resulted in an agreement of exchange of arms for agricultural commodities between Czechoslovakia and Egypt. I wonder what the assessment was of our current successes in these fields?

Dr. KALIJARVI. Well, Mr. Chairman, I don't know exactly how to get hold of that one. There are 2 or 3 things that I might bring out. The first is a little discourse, with your permission, that I would like to make pointing out how recent economic development of the world affects our own economy here.

At the end of the war, as a result of the terrific destruction that had been created everywhere there was no question about markets for our production. Any thing we could turn out we could sell, providing other countries had the necessary dollars.

Since then, however, with the reviving of economies of the world, there has been a revival of competition as well, and that competition has directly affected our own industries here in the United States, and in terms of that competition certain forces have come into existence which were not in existence, or were not noticeable, immediately after the war. Therefore, the kinds of consideration that we are operating under now are somewhat different from those we operated under previously.

Secondly, there is the point that I have already indicated, namely, that foreign policy—economic foreign policy—and the problems growing out of it, operates in that area where our own domestic policies extend into the foreign field. That is what is happening in all of these matters.

Now, in answer to your question, we feel that the record has been very good, that is, the overall record. The spectacular things in life hit the headlines, not the normal operations; your home life and my home life never make the headlines. If it does, in most instances it is because something unfortunate has happened. That is very much the way it is with respect to the operations here under consideration. The normal operation is not the bicycle case, or the Swiss watch case, or the matter of petroleum imports, or any one of a number of things that constitute restrictive actions.

I don't think that you could freeze any economic or social process into a sterile and fixed program, and at the same time expect that it is going to be dynamic and effective. You need some escape valves. What you have in the Swiss watch case, in the bicycle case, and various other cases that we have seen recently, are operations of an escape valve variety. Furthermore, when you look at the record of the number of contracts that have been awarded to foreign concerns, and the ones that have been denied, you will find that there, again, the record is not bad for the overall standpoint. And there is another aspect of this matter, since you have mentioned the awarding of contracts. It seems to me that in our work we have run into a number of differentials abroad of the same kind that we have applied in contracts we have awarded. So this does not represent a retrogressive step.

I think most of these cases are efforts to accommodate the forces with which any government operates, to the general broad policy, and constitute exceptions to the normal operations.

Mr. Bolling. I would like to pursue this a little further. There are words in your statement, words with which I heartily agree, some of which are quotations from the President, some of which are your own. You speak of free competition and open markets, and I have the feeling, and perhaps the State Department isn't aware, or perhaps I am in error, that sometimes economic decisions have a psychological impact far beyond their economic significance. I was very much impressed in my short time in Europe by the almost incredible impact of the decision which perhaps had almost no economic significance, at home or abroad—real economic significance—the bicycle incident, in its impact on the attitude of businessmen and the attitudes, consequently, of Government officials. I am wondering if we are not putting ourselves in the position of constantly reiterating our dedication to the idea of competitiveness, then when competitiveness starts to hurt, as it perhaps have in the last few years, protecting, in effect, or attempting to protect industries which have not through a free-enterprise process been successful in competing.

This raises in my mind a problem which is not one of expediency, or accumulation to pressure, but seems to me an elemental problem of American principle.

Dr. Kalijarvi. Mr. Chairman, I don't think there is one particle of difference between us in that concern, and I think that you have placed your finger on what constitutes a major concern with the Department. However, none of these decisions is a single departmental decision. They are all interagency decisions, and I wish to assure you that what one does as an agency is to present the point of view of the agency.

Now, we are often described as pleading the case of the foreign country, and that is an accusation that is hurled at us. Well, we plead the case of the United States with the foreign country, so it works out both ways, but in these matters we present the very type of thing which you have indicated, and then the decision is taken on the basis of that, plus the domestic considerations, plus any other questions that are involved in the case.

Mr. BOLLING. I don't think I will pursue this further, except to say you described it as an interdepartmental decision. It is, in fact, a Presidential decision.

Dr. KALIJARVI. Yes; it is a Presidential decision. We are not taking issue with that.

Mr. BOLLING. Thank you very much, Dr. Kalijarvi.

A review of the schedule for these hearings will show that following this statement from the Department of State, we are turning this morning to the concrete problems of making international comparisons. We can view this phase of our study in two ways. It represents, first, a bridge from the general investigations of the adequacy of economic statistics which are carried on by the joint committee. Those hearings were concluded only yesterday.

Secondly, the session this morning serves as a fitting introduction to the discussions which will follow. I am sure that much of the talk in succeeding sessions will involve us in making comparisons with conditions and costs in other countries. For this reason we have invited some of the best qualified experts in the country familiar with such problems to come here this morning.

Prof. Max F. Millikan is our next witness. Dr. Millikan is the director of the Center for International Studies at the Massachusetts Institute of Technology. A distinguished career in academic work and Government service in a broad range of economic fields as well as in international affairs make him singularly qualified to speak to us today on the subject of the problems of comparing international differences in costs of production, living standards, and economic progress.

Professor Millikan.

STATEMENT OF DR. MAX F. MILLIKAN, PROFESSOR OF ECONOMICS, AND DIRECTOR, CENTER FOR INTERNATIONAL STUDIES, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Dr. MILLIKAN. Mr. Chairman, the topic I have been asked to discuss with you is the problems of comparing international differences in costs of production, living standards, and economic progress. Experts on this subject fall into two classes: the practical statisticians who actually make such comparisons and the theorists who prove conclusively that it is meaningless to try. My experience with digging out the raw numbers needed for international comparisons is much less than that of others from whom you will hear. The easiest thing for me to do, therefore, would be to summarize for you all the traps and pitfalls into which those who need to use such numbers can fall. They are seldom what they seem, partly because the data are inevitably poor, but more important because a close look at the very idea of comparing costs of production, living standards, and rates of economic growth reveals that these are much more elusive and less simple concepts than they seem at first sight. I shall give you some illustrative examples presently.

But while the logical exercise of uncovering all the ambiguities and sources of error in measures of cost of production or income per capita is an inviting one for a professor and is an essential experience for any student of economics, it is perhaps not the best way to begin a series of congressional hearings on foreign economic policy. We must use such measures in practice, however misleading the professional may feel they are. The degree of precision, either statistical or conceptual, that one needs in such data depends on what one wants to use them for. There are some conclusions which will not be significantly affected by adding or subtracting 20 percent from the numbers on which they are based. Others will be drastically altered by a 1 or 2 percent difference. If we are comparing output per head per year in India with a United States figure of about $2,300, it does not make much difference whether the Indian figure is $60 or $100. But it may be of crucial importance whether this figure, whatever it is, is increasing by 50 cents per year or falling by 50 cents. Thus, I can't avoid some discussion of why we want comparisons if I am to talk about how meaningful they are.

I should like to consider briefly three types of international comparisons: (1) Costs of production, (2) levels of output or income per capita, and (3) rates of economic growth. For each type I should first like to suggest an important use to which we might want to put the data if we had it. I shall then illustrate some of the ambiguities and difficulties in finding meaningful numbers. Finally, I shall express some judgments as to whether, in the light of these ambiguities, the available data are good enough to be used for the purpose in question. The discussion can, of course, be no more than illustrative since a complete discussion of any one of these measures would occupy a fat volume.

There is one difficulty worth mentioning at the start since it crops up in virtually all attempts at international comparisons. This is the problem of how to translate a figure expressed in one currency into terms of another currency. This is normally done by using an official rate of exchange. Even in a situation where currencies are freely convertible and where the rate of exchange reflects the judgments of a developed exchange market as to the relative values of currencies, there are many purposes for which rates of exchange seriously distort relative values. In such a situation the values of things traded in international commerce will be brought into relation to each other through the foreign exchange market, but the values of wages, rents, goods, and services produced and consumed entirely on the home market, and the like, cannot easily be translated from one currency into another by using exchange rates. In the post-World War II world of exchange and price controls, quotas, and restrictions, and multiple exchange rates there is, first, the question frequently of which of a number of different rates of exchange to use and, second, of whether any of the rates available translate values from one currency into another with accuracy for the purpose in hand. This distortion may well be a matter not of 1 or 2 percent but, rather, of 20, 50, 100, or more percent.

This leads to a conclusion of great importance for many kinds of international comparisons. Wherever it is possible to make a comparison which avoids the necessity of translating values from one currency into another we can be very much more sure of our conclusions than where we are forced to make such a conversion. I will give examples of what I mean later.

Let us now turn to a consideration of international comparisons of costs of production. A prime reason why we are interested in such comparisons is that we hope they will throw light on the probable consequences for us and for other nations of altering our tariff policy. Are costs in other countries such that if we adopt a more liberal trade policy many American manufacturers will be subject to intense competition? Are they such that if other countries liberalize their tariffs American exporters will have important competitive opportunities now denied them? This will be considered at length in other sessions of these hearings, and it is not my purpose to enter at this point into any detailed discussion of these issues. I should merely like to suggest, for illustration, certain uses and especially abuses of the available data.

There is one superficially appealing kind of cost of production comparison which I believe can be shown to be meaningless. One sometimes hears discussions which imply that there is some sort of average of costs of production for all kinds of output in a country which can be compared with a similar average for other countries, so that one can say that country X is a "high cost" or a "low cost" country relative to country Y. This frequently springs from the observation that there are very great differences in average wage levels between countries. Since wages are in many lines of activity the largest component of cost, a country where wages are high is thought of as a high-cost country which must somehow protect itself against countries with lower wage levels. In fact, of course, labor cost depends not only on average wages but also on productivity or output per man-hour. Broadly speaking, in those economies like the United States where average wages are high, output per man-hour is also high. Indeed, the high wages are a result of and are made possible by the high productivity of labor. Particular industries in a country may, of course, have a competitive advantage over similar industries in other countries because they have achieved lower labor costs, but I would suggest that it is not fruitful to speak of a country as a whole as having lower labor costs than another country.

Some meaning can be given to this concept. A country whose population is large relative to its other resources can afford to use more labor and less of other inputs in many of its economic activities. But while such a country will often have low wage levels because its per capita product is low, its labor costs translated at ruling rates of exchange will frequently be as high as or higher than those of less populous areas. In the event that labor costs, if one could measure them, should turn out to be lower, on the average, in one country than another, this would be because other input costs are relatively higher. There is a sense, of course, in which a country can secure a general competitive advantage in international competition by depressing the external value of its currency. No useful purpose seems to me to be served by describing the resulting situation as one in which average costs of production are in some sense lower in the country in question. The data required to recognize this problem and formulate measures to deal with it are principally monetary and balance of payment data of a kind that will presumably be discussed later in these hearings.

When other costs are added in, the concept of average costs of production for an economy as a whole makes even less sense. There is, of course, great policy interest in international comparisons of costs in particular industries, for the light they might throw on the consequences of various tariff policies. Unfortunately, when we try to look at a particular industry by itself and compare its costs of production in a variety of different countries we run into analytic difficulties that make clear-cut conclusions very hard to arrive at. One can, of course, get information on the prices at which commodities produced in various countries are selling on the international market. But these prices are influenced powerfully by a large number of factors other than those which determine long-run costs of production. Exchange rates applicable to particular kinds of products are frequently artificially set, sellers are subject to a wide variety of rules and regulations concerning what they can do with the foreign exchange proceeds of any sale they make, governments frequently appear directly as buyers or sellers or indirectly as subsidizers or taxers, applying criteria other than strictly economic ones, competition among private firms is seldom of a kind to insure a correspondence between sales price and cost, and so forth.

Further, the modification of existing barriers to trade would lead to a variety of changes which could be expected to modify relative costs in various ways. Costs will be affected by the volume of business which various firms are able to achieve by the kind of investment which may be stimulated by the opening of a new market, by the changes in monopolistic market control which may result from opening a market to new competitors, and by many other factors. When we turn to products not now traded internationally which might enter international commerce if barriers were substantially lower, the complications of estimating relative international costs become even more formidable.

All this would not lead me to conclude that comparisons of costs in a particular industry in different countries are wholly impossible, but I would hazard the guess that we cannot rely on such comparisons as an aid to policy except in rather rare cases. For broad policy purposes there is a kind of cost comparison which may have some utility, and which should, in my opinion, be attempted on a wider scale. This is the comparison of relative costs as between industries in one country with similar relations in another country. This kind of comparison has the very great virtue of not requiring that figures expressed in one currency be translated into another. To compare the ratio between the cost of steel and the cost of aluminum in the United States with a similar ratio for England it is not necessary to convert costs in either country into the currency of the other. By this process a series of patterns of relative costs can be developed for each of a number of countries and compared with each other.

What does this tell us? It gives us an indication of the industries in which a country has a relative rather than an absolute cost advantage. Economists are, I think, agreed that in the long run it is this relative advantage which determines the pattern of trade in a free system. Absolute advantage computed by applying a current exchange rate can and will change as exchange rates fluctuate. Indeed, any country which appears to have a general absolute advantage across the board will inevitably lose it because it will be unable to maintain the exchange rate of which it is a reflection. But relative advantage springs from much more fundamental characteristics of a nation's economy such as its distribution of resources, the pattern of skills it has developed over the years, and the like. These will determine the pattern of trade which will be to its advantage and which it can maintain in the absence of barriers to free international interchange.

There are many conceptual and statistical problems in the determination of even these relative cost patterns. Some economists would hold that these problems are too formidable to permit the use even of this limited statistical tool of comparison. I would agree that broadly we cannot base a tariff policy primarily on international cost comparisons. This would be wrong in principle as well as impossible in practice. We must rather rely on our conception of the way a free market operates, and if we conclude from this reasoning that our welfare would be increased by tariff reduction, take the plunge with faith in our conviction that whatever adjustments occur the end result is likely to be an improvement. I do believe that statistical investigation can give us hints as to the kinds of adjustments we are likely to have to face and can make it possible for us to prepare more intelligently to face those adjustments.

I would like now to turn to the second area of international comparison, the comparison of living standards. To judge how useful the available data are we must once again consider what policy purposes this kind of data can serve in order to pass judgment on whether the data is or can be accurate and definable enough to serve those purposes. I must here step out of my terms of reference briefly in order to identify what seems to me to be one of the most critical objectives of foreign economic policy today. We are in the midst of a revolution in the hopes and expectations of peoples everywhere which is without parallel in the world's history. The vast bulk of the world's population has until remarkably recently lived as its fathers and grandfathers and great-grandfathers lived without suspecting that any different kind of life was possible. Two world wars combined with a phenomenally rapid spread of communication to the remotest parts of the world have profoundly shaken the stability of these traditional patterns of life and outlook. While this is most dramatically apparent in the so-called underdeveloped areas of Asia, Africa, and Latin America, there are important segments of the populations of the more advanced countries of Western Europe whose aspirations have outgrown their present ability to satisfy them. This climate of instability and awakened hopes is one in which extremist movements advocating change by violence flourish. Specifically at the moment communism is making vigorous and in places all too effective efforts to exploit these awakened aspirations to extend its power and influence. To the degree that it is successful, American security is directly threatened.

The success of extremist movements, like communism, will depend on the degree to which the newly aroused peoples of the world feel that existing institutions are thwarting their aspirations for change and self-improvement. If they are able to make some headway in solving their problems, if they become absorbed in the details of constructive activity to improve their own lot and are encouraged by a sense of movement to believe that further progress is possible, they will be resistant to appeals to join movements of protest. If progress in the present context appears hopeless, spreading the gap between their aspirations and the performance of their societies may well push them into violence.

What is the relevance of this for United States foreign economic policy? We have emerged in the past 20 or 30 years into a position in which we are the dominant influence on world economic developments. As Dr. Kalijarvi has pointed out, almost everything we do has an influence on the opportunities people elsewhere have to meet their own economic problems successfully. Our monetary policy, our foreign trade policy, our policy with respect to capital movements, our policy on agricultural surplus disposal, our technical assistance effort, our atomic energy program, our military programs, and many other aspects of our behavior will affect the progress made by people everywhere toward the new goals that many millions are adopting, and will thus affect profoundly our international, political, and security objectives. I believe it must be one of our dominant objectives to frame our foreign economic policies in such a way as to promote the development abroad of democratic stable societies capable of meeting the aspirations of the broad masses of their members for progress.

It is not my function to elaborate on how we should do this. The relevance of this objective to our need for international comparisons of living standards and also of economic growth is, of course, that we need some measures or indexes of our success in promoting growth. The problem, of course, is to compare the growth of aspirations with the growth of capability to satisfy them. The first half of this is a problem not in economic but in attitudinal and political measurement. But the economic component is vital.

What can we learn from international comparisons of living standards which will throw light on this problem? There are several ways we can approach the measurement of living standards. The two most important are budget studies and per capita national income or product estimates. Budget studies are direct examinations of levels and patterns of consumption of sample groups of families. Their purpose is to tell us how such groups of families, usually selected so as to be representative of some segment of a population such as small farmers, urban workers in large cities, and the like, spend their incomes. For economies in which a good deal of economic activity is conducted within the household without money payments—the growing of food consumed on the farm, the household's manufacture of its own clothes, and the like—an attempt is often made to estimate and place a value on what is called nonmonetized production and consumption.

There are many problems and difficulties, both conceptual and statistical, in conducting and interpreting such studies. But the main objection to placing primary reliance on them as indexes of living standards all over the world is that they are so expensive to conduct that it is unlikely that more than a small fraction of the kinds of foreign families in which we are interested could be covered by such studies at a practical cost.

There are other problems. In many foreign countries an important fraction of the things that go to make up the welfare of the average citizen is supplied through collective effort. A study of family expenditure or even of family consumption cannot easily be made to reflect benefits received in education, public health, transportation, water supply, group recreation, and the like. Adjustments indicating orders of magnitude could perhaps be made for these, but in view of the cost it is too much to hope that for some time to come the evidence from such studies will be more than spotty. They can be used, of course, as a very useful check on the meaning and significance of the other measure of living standards; namely, per capita national income or product.

This is a measure which is derived by estimating the value of all the economic output of a country and dividing by its population. The resulting figure can then be compared with similar figures for the United States and other countries to get an indication of the average economic status of the people of different countries. There are a great many reasons why such estimates cannot be taken as any but the roughest sort of indication of an order of magnitude. Some of these reasons relate to problems of collection and classification of data which are in principle capable of being improved. Others, however, are so deep, in the very concepts being employed that statistical refinement cannot remove them. I shall try to indicate why, in spite of all these difficulties, the figures are nonetheless of considerable utility for policy.

The first problem is, of course, that averages for a whole population tell us nothing about the distribution of income within the population. A country might well have an impressive national income per capita, but if a substantial fraction of that income went into extremely luxurious consumption by a very small elite at the top, the per capita figures would misrepresent the condition of the bulk of the people. We badly need more evidence on income distribution in foreign countries to supplement our national product data. In practice, this is a less serious limitation than it might appear in theory. The very poor countries of the world are so poor that unless incomes were fairly evenly spread there would be mass starvation. There are, of course, individuals who by individual standards are very wealthy, but the total incomes of such individuals are so small a fraction of the national income that spreading them equally over the population would not significantly affect the average. Most of the countries of Asia and Africa are in this class. At the other end of the scale, income distribution in the more developed countries is sufficiently similar, as we know from spot investigations, so that the broad conclusions as to living levels drawn from per capita national income data are not seriously suspect. An exception probably has to be made here for the U. S. S. R., whose national product has a composition and a distribution so different from that of western societies as to make any conclusions about welfare from national aggregates highly suspect.

A second problem arises from the fact that different things are included in what is regarded as economic activity in different cultures.

In primitive societies many of the things that would be bought and sold in America are produced and consumed at home. Efforts are made in social accounting to value and include some of these, like agricultural production; but others, like personal services, are virtually impossible to estimate. This is not, of course, a problem limited to primitive societies. A favorite textbook problem is to inquire what happens to the national income of a country when a man marries his housekeeper. In the United States a substantial volume of what used to be regarded as economic activities because they were paid for have now dropped out of national income because the services in question are now performed by husbands in the leisure time made available by the shorter workweek. One of my female European acquaintances has quipped that of all the labor-saving devices in the Amercian home the most important is the American husband. Nonetheless, it is probably a safe generalization that the national income of the underdeveloped countries is consistently understated relative to the developed countries because so many activities that should be included are left out.

A third problem arises from the fact that national income estimates make no allowance for the amount of input of effort required to produce the national product. Since in the less-developed countries hours of work tend to be longer, though not universally, the tendency here is to understate the differences between developed and underdeveloped. Another difficulty relates to how we draw the line between consumption and intermediate products that are really to be considered as stages in the production of something else. In the United States we count commuter fares and gasoline used in driving to and from work as part of the value of consumers' incomes. Perhaps they should be regarded as costs of production and excluded from the value of things available for enjoyment.

A serious problem arises from the fact that people in different cultures place different values on different kinds of output. A bumper crop of wet Brussels sprouts would be a bonanza in England, but I can think of places where it would be regarded as a national disaster. In a dispute in Boston just after the outbreak of World War II in Europe over a cost of living wage increase, a worker of Italian extraction refused to accept the Bureau of Labor Statistics estimates showing moderate increases on the ground that olive oil had doubled in price because supplies from the Mediterranean were shut off. There was justice in the claim that for him the cost of living had nearly doubled.

How much difference do these considerations make? They raise questions sufficiently disturbing to suggest that no weight should be placed on minor differences revealed by international comparisons. But whatever adjustments one makes in the figures to correct for considerations like the above, international differences are so large that certain broad conclusions of importance for policy remain. One of my colleagues has tried to adjust the per capita national income figures for 1950 for some of the Asian nations to allow for some of these difficulties. Against a figure for the United States of about $1,550—this figure is lower than the $2,300 given earlier partly because this is for 1950 rather than 1953 and partly because this is national income rather than gross national product—his adjustments raise the figure for Asia as a whole excluding the Middle East from $58 to $185 and for Africa, excluding Egypt, from $48 to $177. In each case the figure for the underdeveloped area is more than tripled. The superiority of the United States is reduced by this process from thirtyfold to under tenfold. Nevertheless, the picture remains one of an extraordinary contrast between a wealthy country and two areas of extreme poverty.

An interesting study was recently published by Milton Gilbert and Irving B. Kravis which computes the national products for 1950 of the United States and 4 European countries by 2 alternative methods, one using United States prices, the other using European prices as weights. The results were as follows:

Per capita gross national product as a percent of that of United States

	In United States prices	In European prices
Italy	30	22
Germany	43	33
France	53	42
United Kingdom	63	53

The resulting values for any one country differ by as much as 30 percent under the two methods. Nevertheless, the comparative broad picture is not radically changed. Here is a group of countries which, by contrast with the Asian and African group, are not one-thirtieth to one-tenth as well off as the United States, but, rather, one-fifth to one-half as well off. You will note also that the relative positions of the various countries has not changed.

We can conclude from data of this kind, whatever its limitations, that there are major differences in living standards in various parts of the world, that there is a group of countries at the bottom of the scale represented by the Asian and African Continents, another group farther up including many of the Latin American States, another group still nearer our level in Western Europe, and a few somewhat doubtful cases like the U. S. S. R. A further negative policy conclusion can easily be supported by this data. The magnitudes of capital, effort, and resources required to raise most of these countries to levels approximating ours are clearly so great that to adopt this as our objective in the short run would be ridiculous, whatever its desirability. It is clear that for some decades to come the underdeveloped areas of the world are going to remain relatively poor and that great international differences in living standards are going to persist.

Turning to our third measure of economic progress, one could easily draw from what I have said the conclusion that it can neither be measured nor effectively covered. In my view both conclusions would be quite wrong. Only an incorrect statement of our objective would make the above conclusions pessimistic. To achieve the political and psychological and even the economic results emphasized above as important to us it is neither necessary nor desirable to try to raise the rest of the world in one fell swoop up to our level. What is required is that there should develop in the newly aroused areas of the world a sense of progress and movement and a growing confidence that by their own efforts they can move forward. The rate of change does not have to be great in absolute terms. One or two percent per capita per year can have a profound influence in improving both attitudes and political performance. On the other hand, a change of zero, or worse, a decline of 1 or 2 percent per year per capita sustained for several years can start a spiral of political and social as well as economic deterioration which in the end is bound to leave the society in chaos or in the grip of a totalitarian philosophy. Since in many of the less-developed areas of the world population is growing at a rate between 1½ percent and 2 percent a year, a static national produce such as has characterized many of the world's economies for fifty-year periods in recent history can mean declining welfare for the average man. A feudal society with limited horizons could tolerate this development. The new fluid societies where awareness is flowering almost certainly cannot.

The small margin of difference between success and failure should encourage use to recognize the importance of our actions. If they can influence that small margin by an even smaller margin they may yet be decisive. In terms of our immediate concern with data and measurement, what are the possibilities open to us of knowing whether there is progress or not? If we cannot tell whether Asian income per capita is $58 or $185, how can we possibly tell whether it is increasing by 50 cents a year or declining by a similarly insignificant amount? Actually we can define change in a given country with enormously greater precision than we can define differences between countries, and we can define change from year to year with more confidence than the same magnitude of change from decade to decade or century to century. The problems of defining international differences almost all arise from the fact that we are trying to compare things that in a great many different ways are incomparable. This finds its statistical expression in the fact that we find it very difficult to decide at what rate to convert estimates in one currency into another currency. When we are measuring change within a country this difficulty disappears, and with it most of the variation of our per capita income estimates. Much of what remains rests on decisions as to whether to include or exclude certain items and as to the principles to be used in valuing them. So long as we keep our ground rules constant we have every reason to believe that we can detect, at least over several years, rates of change as small as 1 or 2 percent.

We must, of course, be on our guard about the ground rules. One particular danger is that as the coverage of national statistical reporting improves in various countries, we will mistake greater coverage for higher output. This is especially likely where, as in the case of most of the underdeveloped countries, an increasing share of economic activity is being brought within the monetized, exchange sector of the economy. The temptation of national statistical authorities will, of course, always be, when in doubt, to adopt the practice that is most likely to show growth. We should not be too contemptuous of this tendency, since progress is partly real and partly symbolic, and the symbols, if they are believed in, are as important to our ends as the reality. Nevertheless, it is clearly to our interest to encourage the maximum understanding of and uniformity in reporting among the various nations of the world so that we will all be able to agree on whether and to what extent the progress so important to our own interest is in fact taking place.

Dr. Rice is much better equipped than I to discuss this aspect of the problem.

(Dr. Millikan's prepared statement follows:)

STATEMENT OF MAX F. MILLIKAN, PROFESSOR OF ECONOMICS AND DIRECTOR, CENTER FOR INTERNATIONAL STUDIES, MASSACHUSETTS INSTITUTE OF TECHNOLOGY, BEFORE SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY, JOINT COMMITTEE ON THE ECONOMIC REPORT, NOVEMBER 9, 1955

The topic I have been asked to discuss with you is the problems of comparing international differences in costs of production, living standards, and economic progress. Experts on this subject fall into two classes: The practical statisticians who actually make such comparisons and the theorists who prove conclusively that it is meaningless to try. My experience with digging out the raw numbers needed for international comparisons is much less than that of others from whom you will hear. The easiest thing for me to do, therefore, would be to summarize for you all the traps and pitfalls into which those who need to use such numbers can fall. They are seldom what they seem, partly because the data are inevitably poor, but more important because a close look at the very idea of compariing costs of production, living standards, and rates of economic growth reveals that these are much more elusive and less simple concepts than they seem at first sight. I shall give you some illustrative examples presently.

But while the logical exercise of uncovering all the ambiguities and sources of error in measures of cost of production or income per capita is an essential experience for any student of economics, it is perhaps not the best way to begin a series of congressional hearings on foreign economic policy. We must use such measures in practice, however misleading the professional may feel they are. The degree of precision, either statistical or conceptual, that one needs in such data depends on what one wants to use them for. There are some conclusions which will not be significantly affected by adding or subtracting 20 percent from the numbers on which they are based. Others will be drastically altered by a 1 or 2 percent difference. If we are comparing output per head per year in India with a United States figure of about $2,300, it does not make much difference whether the Indian figure is $60 or $100. But it may be of crucial importance whether this figure, whatever it is, is increasing by 50 cents per year or falling by 50 cents.

I should like to consider briefly three types of international comparisons: (1) Costs of production, (2) levels of output or income per capita, and (3) rates of economic growth. For each type I should first like to suggest an important use to which we might want to put the data if we had it. I shall then illustrate some of the ambiguities and difficulties in finding meaningful numbers. Finally I shall express some judgments as to whether, in the light of these ambiguities, the available data are sufficiently precise and meaningful to be used for the purpose in question. The discussion can, of course, be no more than illustrative since a complete discussion of any one of these measures would occupy a fat volume.

There is one difficulty worth mentioning at the start since it crops up in virtually all attempts at international comparisons. This is the problem of how to translate a figure expressed in one currency into terms of another currency. This is normally done by using an official rate of exchange. Even in a situation where currencies are freely convertible and where the rate of exchange reflects the judgments of a developed exchange market as to the relative values of currencies, there are many purposes for which rates of exchange seriously distort relative values. In such a situation the values of things traded in international commerce will be brought into relation to each other through the foreign exchange market, but the values of wages, rents, goods, and services produced and consumed entirely on the home market, and the like cannot easily be translated from one currency into another by using exchange rates. In the post-World War II world of exchange and price controls, quotas and restrictions, and multiple exchange rates there is first the question frequently of which of a number of different rates of exchange to use and second of whether any of the rates available translate values from one currency into another with accuracy for the purpose in hand. The range of variation possible is not usually a matter of 1 or 2 percent but rather of 20, 50, 100, or more percent.

This leads to a conclusion of great importance for many kinds of international comparisons. Wherever it is possible to make a comparison which avoids the necessity of translating values from one currency into another we can be very much more sure of our conclusions than where we are forced to make such a conversion. Examples of ways in which this can be done will emerge in what follows.

Let us now turn to a consideration of international comparisons of costs of production. A prime reason why we are interested in such comparisons is that we hope they will throw light on the probable consequences for us and for other nations of altering our tariff policy. Are costs in other countries such that if we adopt a more liberal trade policy many American manufacturers will be subject to intense competition? Are they such that if other countries liberalize their tariffs American exporters will have important competitive opportunities now denied them? This will be considered at length in other sessions of these hearings and it is not my purpose to enter at this point into any detailed discussion of these issues. I should merely like to suggest for illustration certain uses and abuses of the available data in our attempt to throw light on the question.

There is one superficially appealing kind of cost of production comparison which I believe can be shown to be meaningless. One sometimes hears discussions which imply that there is some sort of average of costs of production for all kinds of output in a country which can be compared with a similar average for other countries, so that one can say that country X is a high-cost or a low-cost country relative to country Y. This frequently springs from the observation that there are very great differences in average wage levels between countries. Since wages are in many lines of activity the largest component of cost, a country where wages are high is thought of as a high-cost country which must somehow protect itself against countries with lower wage levels. In fact, of course, labor cost depends not only on average wages but also on productivity or output per man-hour. Broadly speaking, in those economies like the United States where average wages are high, output per man-hour is also high. Indeed, the high wages are a result of and are made possible by the high productivity of labor. Particular industries in a country may, of course, have a competitive advantage over similar industries in other countries because they have achieved lower labor costs but I would suggest that it is not fruitful to speak of a country as a whole as having lower labor costs than another country.

Some meaning can be given to this concept. A country whose population is large relative to its other resources can afford to use more labor and less of other inputs in many of its economic activities. But while such a country will often have low-wage levels because its per capita product is low, its labor costs translated at ruling rates of exchange will frequently be as high as or higher than those of less populous areas. In the event that labor costs, if one could measure them, should turn out to be lower on the average in one country than another this would be because other input costs are relatively higher. There is a sense, of course, in which a country can secure a general competitive advantage in international competition by depressing the external value of its currency. No useful purpose seems to me to be served by describing the resulting situation as one in which average costs of production are in some sense lower in the country in question. The data required to recognize this problem and formulate measures to deal with it are principally monetary and balance of payment data of a kind that will presumably be discussed later in these hearings.

While the concept of average costs of production for an economy as a whole does not seem to be one that it is worth pursuing, there is, of course, great policy interest in international comparisons of costs in particular industries, for the light they might throw on the consequences of various tariff policies. Unfortunately when we try to look at a particular industry in isolation and compare its costs of production in a variety of different countries we run into analytic difficulties that make clear-cut conclusions very difficult to arrive at. At any moment of time one can, of course, get information on the prices at which commodities produced in various countries are selling on the international market. But these prices are influenced powerfully by a large number of factors other than those which determine long-run costs of production. Exchange rates applicable to particular kinds of products are frequently artificially set, sellers are subject to a wide variety of rules and regulations concerning what they can do with the foreign exchange proceeds of any sale they make, governments frequently appear directly as buyers or sellers or indirectly as subsidizers or taxers, applying criteria other than strictly economic ones, competition among private firms is seldom of a kind to insure a correspondence between sales price and cost, etc.

Further, the modification of existing barriers to trade would lead to a variety of changes which could be expected to modify relative costs in various ways. Costs will be affected by the volume of business which various firms are able to achieve, by the kinds of investment which may be stimulated by the opening of a new market, by the changes in monopolistic market control which may result from opening a market to new competitors, and by many other factors. When we turn to products not now traded internationally which might enter international commerce if barriers were substantially lower, the complications of estimating relative international costs become even more formidable.

All this would not lead me to conclude that comparisons of costs in a particular industry in different countries are wholly impossible, but I would hazard the guess that we cannot rely on such comparisons as an aid to policy except in rather rare cases where the magnitudes are such as to make errors and ambiguities of little importance. For broad policy purposes there is a kind of cost comparison which may have some utility, and which should, in my opinion, be attempted on a wider scale. This is the comparison of relative costs as between industries in one country with similar relations in another country. This kind of comparison has the very great virtue of not requiring that figures expressed in one currency be translated into another. To compare the ratio between the cost of steel and the cost of aluminum in the United States with a similar ratio for England it is not necessary to convert costs in either country into the currency of the other. By this process a series of patterns of relative costs can be developed for each of a number of countries and compared with each other.

What does this tell us? It gives us an indication of the industries in which a country has a relative rather than an absolute cost advantage. Economists are, I think, agreed that in the long run it is this relative advntage which determines the pattern of trade in a free system. Absolute advantage computed by applying a current exchange rate can and will change as exchange rates fluctuate. Indeed, any country which apepars to have a general absolute advantage across the board will inevitably lose it because it will be unable to maintain the exchange rate of which it is a reflection. But relative advantage springs from much more fundamental characteristics of a nation's economy such as its distribution of resources, the pattern of skills it has developed over the years, and the like. These will determine the pattern of trade which will be to its advantage and which it can maintain in the absence of barriers to free international interchange.

There are many conceptual and statistical problems in the determination of even these relative cost patterns. Some economists would hold that these problems are too formidable to permit the use even of this limited statistical tool of comparison. I would agree that broadly we cannot base a tariff policy primarily on international cost comparisons. This would be wrong in principle as well as imposible in practice. We must rather rely on our conception of the way a free market operates, and if we conclude from this reasoning that our welfare would be increased by tariff reduction, take the plunge with faith in our conviction that whatever adjustments occur the end result is likely to be an improvement. I do believe that statistical investigation can give us hints as to the kinds of adjustments we are likely to have to face and can make it possible for us to prepare more intelligently to face those adjustments.

I would like now to turn to the second area of international comparison, the comparison of living standards. To judge how useful the available data are we must once again consider what policy purposes this kind of data can serve in order to pass judgment on whether the data is or can be accurate and definable enough to serve those purposes. I must here step out of my terms of reference briefly in order to identify what seems to me to be one of the most critical objectives of foreign economic policy today. We are in the midst of a revolution in the hopes and expectations of peoples everywhere which is without parallel in the world's history. The vast bulk of the world's population has until remarkably recently lived as its fathers and grandfathers and great-grandfathers lived without suspecting that any different kind of life was possible. Two World Wars, combined with a phenomenally rapid spread of communication to the remotest parts of the world, have profoundly shaken the stability of these traditional patterns of life and outlook. While this is most dramatically apparent in the so-called underdeveloped areas of Asia, Africa, and Latin America, there are important segments of the populations of the more advanced countries of Western Europe whose aspirations have outgrown their present ability to satisfy them. This climate of instability and awakened hopes is one in which extremist movements advocating change by violence flourish. Specifically at the moment communism is making vigorous and in places all too effective efforts to exploit these awakened aspirations to extend its power and influence. To the degree that it is successful, American security is directly threatened.

The success of extremist movements will depend on the degree to which the newly aroused peoples of the world feel that existing institutions are thwarting their aspirations for change and self-improvement. If they are able to make some headway in solving their problems, if they become absorbed in the details of constructive activity to improve their own lot and are encouraged by a sense of movement to believe that further progress is possible, they will be resistant to appeals to join movements of protest. If progress in the present context appears hopeless, spreading the gap between their aspirations and the performance of their societies may well push them into violence.

What is the relevance of this for United States foreign economic policy? We have emerged in the past 20 or 30 years into a position in which we are the dominant influence on world economic developments. Almost everything we do has an influence on the opportunities people elsewhere have to meet their own economic problems successfully. Our monetary policy, our foreign trade policy, our policy with respect to capital movements, our policy on agricultural surplus disposal, our technical assistance effort, our atomic energy program, our military programs, and many other aspects of our behavior will affect the progress made by people everywhere toward the new goals that many millions are adopting, and will thus affect profoundly our international, political, and security objectives. I believe it must be one of our dominant objectives to frame our foreign economic policies in such a way as to promote the development abroad of democratic, stable societies capable of meeting the aspirations of the broad masses of their members for progress.

It is not my function to elaborate on how we should do this. The relevance of this objective to our need for international comparisons of living standards and also of economic growth is, of course, that we need some measures or indexes of our success. The problem, of course, is to compare the growth of aspirations with the growth of capability to satisfy them. The first half of this is a problem not in economic but in attitudinal and political measurement. But the economic component is vital.

What can we learn from international comparisons of living standards which will throw light on this problem? There are several ways we can approach the measurement of living standards. The two most important are budget studies and per capita national income or product estimates. Budget studies are direct examinations of levels and patterns of consumption of sample groups of families. Their purpose is to tell us how such groups of families, usually selected so as to be representative of some segment of a population such as small farmers, urban workers in large cities, and the like, spend their incomes. For economies in which a good deal of economic activity is conducted within the household without money payments—the growing of food consumed on the farm, the household's manufacture of its own clothes, and the like—an attempt is often made to estimate and place a value on what is called nonmonetized production and consumption.

There are many problems and difficulties, both conceptual and statistical, in conducting and interpreting such studies. But the main objection to placing primary reliance on them as index of living standards all over the world is that they are so expensive to conduct that it is unlikely that more than a small fraction of the kinds of foreign families in which we are interested could be covered by such studies at a practical cost. There are other problems. In many foreign countries an important fraction of the things that go to make up the welfare of the average citizen is supplied through collective effort. A study of family expenditure or even of family consumption cannot easily be made to reflect benefits received in education, public health, transportation, water supply, group recreation, and the like. Adjustments indicating orders of magnitude could perhaps be made for these, but in view of the cost it is too much to hope that for some time to come the evidence from such studies will be more than spotty. They can be used, of course, as a very useful check on the meaning and significance of the other measure of living standards, namely, per capita national income or product.

This is a measure which is derived by estimating the value of all the economic output of a country and dividing by its population. The resulting figure can then be compared with similar figures for the United States and other countries to get an indication of the average economic status of the people of different countries. There are a great many reasons why such estimates cannot be taken as any but the roughest sort of indication of an order of magnitude. Some of these reasons relate to problems of collection and classification of data which are in principle capable of being improved. Others, however, are so deep in the very concepts being employed that statistical refinement cannot remove them. I shall try to indicate why, in spite of all these difficulties, the figures are nonetheless of considerable utility for policy.

The first problem is, of course, that averages for a whole population tell us nothing about the distribution of income within the population. A country might well have an impressive national income per capita, but if a substantial fraction of that income went into extremely luxurious consumption by a very small elite at the top, it might have more political dynamite than a situation in which the total was smaller but was spread more evenly. We badly need more evidence on income distribution in foreign countries to supplement our national product data. In fact this is a less serious limitation than it appears at first sight. The very poor countries of the world are so poor that unless income were fairly evenly spread there would be mass starvation. There are, of course, individuals who by individual standards are very wealthy, but the total incomes of such individuals are so small a fraction of the national income that spreading them equally over the population would not significantly affect the average. Most of the countries of Asia and Africa are in this class. At the other end of the scale, income distribution in the more developed countries is sufficiently similar, as we know from spot investigations, so that the broad conclusions as to living levels drawn from per capita national income data are not seriously suspect. An exception probably has to be made here for the U. S. S. R., whose national product has a composition and a distribution so different from that of Western societies as to make any conclusions about welfare from national aggregates highly suspect.

The second problem arises from the fact that different things are included in what is regarded as economic activity in different cultures. It has already been noted that in primitive societies many of the things that would be bought and sold in America are produced and consumed at home. Efforts are made to value and include some of these, like agricultural production, but others, like personal services, are virtually impossible to estimate. This is not, of course, a problem limited to primitive societies. A favorite textbook problem is to inquire what happens to the national income of a country when a man marries his housekeeper. In the United States a substantial volume of what used to be regarded as economic activities because they were paid for have now dropped out of national income because the services in question are now performed by husbands in the leisure time made available by the shorter workweek. One of my female European acquaintances has quipped that of all the labor-saving devices in the American home the most important is the American husband. Nonetheless it is probably a safe generalization that the national income of the underdeveloped countries is consistently understated relative to the developed countries because so many activities that should be included are left out.

A third problem arises from the fact that national income estimates make no allowance for the amount of input of effort required to produce the national product. Since in the less developed countries hours of work tend to be longer (though not universally), again the tendency is to overstate the differences between developed and underdeveloped. Another difficulty relates to how we draw the line between consumption and intermediate products that are really to be considered as stages in the production of something else. In the United States we count commuter fares and gasoline used in driving to and from work as part of the value of consumers' incomes. Perhaps they should be regarded as costs of production and excluded from the value of things available for enjoyment.

A serious problem arises from the fact that people in different cultures place different values on different kinds of output. A bumper crop of wet brussels sprouts would be a bonanza in England, but I can think of places where it would be regarded as a national disaster. In a dispute in Boston just after the outbreak of World War II in Europe over a cost-of-living wage increase a worker of Italian extraction refused to accept the Bureau of Labor Statistics estimates showing moderate increases on the ground that olive oil had doubled in price because supplies from the Mediterranean were shut off. There was justice in the claim that for him the cost of living had nearly doubled.

How much difference do these considerations make? They raise questions sufficiently disturbing to suggest that no weight whatsoever should be placed on minor differences revealed by international comparisons. But whatever adjustments one makes in the figures to correct for considerations like the above, international differences are so large that certain broad conclusions of importance for policy remain. One of my colleagues has tried to adjust the per capita national income figures for 1950 for some of the Asian nations to allow for some of these difficulties. Against a figure for the United States of about $1,550,[1] his adjustments raise the figure for Asia as a whole excluding the Middle East from $58 to $185 and for Africa (excluding Egypt) from $48 to $177. In each case the figure for the underdeveloped area is more than tripled. The superiority of the United States is reduced by this process from thirtyfold to under tenfold. Nevertheless the picture remains one of an extraordinary contrast between a wealthy country and two areas of extreme poverty.

An interesting study was recently published by Milton Gilbert and Irving B. Kravis which computes the national products of five countries for 1950, the United States, the United Kingdom, France, Germany, and Italy by two alternative methods, one using United States prices, and the other using European prices as weights. The results were as follows:

Per capita gross national product as a percent of that of United States

	In United States prices	In European prices
Italy	30	22
Germany	43	33
France	53	42
United Kingdom	63	53

The absolute differences in the values for any country run as high as 30 percent, but the broad picture is not radically changed. Here is a group of countries which, by contrast with the Asian and African group, are not one-thirtieth to one-tenth as well off as the United States but rather one-fifth to one-half as well off. You will note also that the relative positions of the various countries has not changed.

We can conclude from data of this kind, whatever its limitations, that there are major differences in living standards in various parts of the world, that there is a group of countries at the bottom of the scale represented by the Asian and African Continents, another group further up including many of the Latin American States, another group with a substantial internal range but all closer to us in Western Europe, and some somewhat doubtful cases like the U. S. S. R. A further negative policy conclusion can easily be supported by this data. The magnitudes of capital, effort, and resources required to raise most of these countries to levels approximating ours are clearly so great that to adopt this as our objective in the short run would be ridiculous, whatever its desirability. It is clear that for some decades to come the underdeveloped areas of the world are going to remain relatively poor and that great international differences in living standards are going to persist.

Turning to our third measure of economic progress, one could easily draw from this picture a pessimistic conclusion with respect both to the possibility of measuring it and the feasibility of encouraging it. In my view both conclusions would be quite wrong. Only an incorrect statement of our objective would make the above conclusions pessimistic. To achieve the political and psychological and even the economic results emphasized above as important to us it is neither necessary nor desirable to try to raise the rest of the world in one fell swoop up to our level. What is required is that there should develop in the newly aroused areas of the world a sense of progress and movement and a growing confidence that by their own efforts they can move forward. The rate of change does not have to be great in absolute terms. One or two percent per capita per year can have a profound influence in improving both attitudes and political performance. On the other hand, a change of zero, or worse, a decline of 1 or 2 percent per year per capita sustained for several years can start a spiral of political and social as well as economic deterioration which in the end is bound to leave the society in chaos or in the grip of a totalitarian philosophy. Since in many of the less developed areas of the world, population is growing at a rate between 1½ percent and 2 per-

[1] This figure is lower than the $2,300 given earlier partly because this is for 1950 rather than 1953 and partly because this is national income rather than gross national product.

ent per year, a static national product such as has characterized many of these economies for 50-year periods in recent history can mean declining welfare for he average man. A feudal society with limited horizons could tolerate this levelopment. The new fluid societies where awareness is flowering almost ertainly cannot.

The small margin of difference between success and failure should encourage is to recognize the importance of our actions. If they can influence that small nargin by an even smaller margin they may yet be decisive. In terms of our mmediate concern with data and measurement, what are the possibilities open o us of knowing whether there is progress or not? If we cannot tell whether Asian income per capita is $58 or $185, how can we possibly tell whether it is ncreasing by 50 cents a year or declining by a similarly insignificant amount? Actually we can define change in a given country with enormously greater precision than we can define differences between countries, and we can define change rom year to year with more confidence than the same magnitude of change from lecade to decade or century to century. The problems of defining international lifferences almost all arise from the fact that we are trying to compare things hat in a great many different ways are incomparable. This finds its statistical expression in the fact that we find it very difficult to decide at what rate to convert estimates in one currency into another currency. When we are measuring hange within a country this difficulty disappears, and with it most of the variation of our per capita income estimates. Much of what remains rests on decisions s to whether to include or exclude certain items and as to the principles to be ised in valuing them. So long as we keep our ground rules constant we have very reason to believe that we can detect, at least over several years, rates of hange as small as 1 or 2 percent.

We must, of course, be on our guard about the ground rules. One particular langer is that as the coverage of national statistical reporting improves in various ountries, we will mistake greater coverage for higher output. This is especially ikely where, as in the case of most of the underdeveloped countries, an increasing hare of economic activity is being brought within the monetized, exchange sector f the economy. The temptation of national statistical authorities will, of course, lways be, when in doubt, to adopt the practice that is most likely to show growth. We should not be too contemptuous of this tendency, since progress is partly real nd partly symbolic, and the symbols, if they are believed in, are as important o our ends as the reality. Nevertheless, it is clearly to our interest to encourge the maximum understanding of and uniformity in reporting among the various nations of the world so that we will all be able to agree on whether and to what extent the progress so important to our selfish interest is in fact taking lace. Dr. Rice is much better equipped than I to discuss this aspect of the roblem.

Mr. BOLLING. Thank you very much.

Our next participant is Dr. Stuart A. Rice. His has been a disinguished career in academic and Government life, and now he is an conomic consultant with world-ranging assignments. His posts in Government have included service as Assistant Director of the Bureau of the Census, Chairman of the Central Statistical Board, and more ecently Assistant Director of the Bureau of the Budget for Statistical Standards. He has been president of the International Statistical Institute, an official of the Inter-American Statistical Institute, and president of the American Statistical Society. He has served as the United States representative on the United Nations Statistical Commission. It is particularly fitting that he come to us today to speak on the topic, Progress To Date in Achieving Uniform Reporting of Data of International Concern and Needs for the Future.

Dr. Rice.

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STATEMENT OF DR. STUART A. RICE, OF STUART RICE ASSOCIATES, WASHINGTON, D. C., ACCOMPANIED BY HARRY VENNEMAN, OFFICE OF STATISTICAL STANDARDS, BUREAU OF THE BUDGET

Dr. RICE. Thank you, Mr. Chairman.

I have a prepared statement which is much longer than you would want me to read at this hour. I shall try to tell you what is in it and submit the statement itself for your record.

Mr. BOLLING. It will be included in the record.

(The statement of Dr. Rice is as follows:)

PROGRESS TO DATE IN ACHIEVING UNIFORM REPORTING OF DATA OF INTERNATIONAL CONCERN AND NEEDS FOR THE FUTURE

Statement submitted to the Subcommittee on Foreign Economic Policy of the Joint Committee on the Economic Report at its hearings on Wednesday, November 9, 1955, by Stuart A. Rice, Stuart Rice Associates, Washington D. C.

I. INTRODUCTION

Efforts to achieve international comparability of the statistical data needed as a basis for international economic policy have had a long history; but the results of these efforts have begun to be realized to any great extent only in relatively recent years. For the purposes for which these hearings have been arranged, it will suffice to limit a review of the progress to date to the period since World War II. This review begins, therefore, with the establishment of the United Nations as the foundation for the present structure of international statistical organization, and refers only incidentally to accomplishments in this field prior to that date.

In order to appreciate the state of progress attained in this field, some understanding is needed of the organizational structure and the mechanisms that have been developed for international cooperation in the establishment of statistical standards and the compilation and improvement of statistical data. Section II of this statement, therefore, presents a brief description of the structural framework of international organizations and agencies involved in work in this field. This description is by no means comprehensive, but attempts merely to identify the principal elements of the structure, their functions, and their interrelationships.

In section III an attempt is made to illustrate what may be called the product of our machinery for international statistical cooperation by an examination of a few of the more important compilations of general-purpose statistics that are currently being made available through publications of the United Nations and other agencies. To supplement the picture provided by the few general compilations selected for illustration, a comprehensive list of the statistical series compiled by international organizations is presented as an exhibit to the statement.

Section IV comprises a more detailed examination of the status of progress to date in the development of international comparability of data on a number of subjects considered to be particularly relevant to questions of international economic policy. For each subject an effort is made to indicate the stage that has been reached in the development of international standards, to describe the scope of the data being made available currently, and to note aspects on which further work is being done or should be undertaken. No attempt is made in this section or elsewhere in this statement to appraise the quality of individual statistical series, or to determine precisely the degree of comparability of data from different countries.

A few general observations and conclusions on the state of progress in the development of a world statistical system are presented in the final section of this statement, with particular emphasis on outstanding problems and unmet needs to which continuing or intensified work should be devoted in the future. These observations reflect mainly my own judgment of what is desirable and practical in the direction of future work in this field. They do not in any sense constitute a synthesis or conspectus of the many different and perhaps conflicting views to be presented to this subcommittee in the statements prepared by various Federal agencies and in the testimony of others scheduled to participate in the hearings.

II. The Organizational Structure for International Statistics

Within the framework of the structure created pursuant to the Charter of the United Nations and related instruments of international cooperation during the postwar period provision was wisely made for performance of statistical functions which were recognized at the outset as an essential element of world peace and economic and social advancement. Needs were anticipated for three different but closely related types of activity in the field of statistics. First, it was anticipated that there would be a continuing and perhaps greatly accelerated increase in the demands for statistical information to serve not only the new needs of international agencies but also newly emerging national needs resulting, from progress in the understanding of economic and social forces; second, it was apparent that effective means would have to be devised for great improvement in the comparability of the statistics available from different countries; and, finally, it was recognized that existing facilities to produce needed statistical data were grossly inadequate or altogether nonexistent in many parts of the world, and measures to develop and strengthen national statistical services would have to be promoted.

The pattern of organization developed to perform these functions was visualized as centering around the United Nations and the specialized agencies brought into relationship with the United Nations under the terms of the charter. Within the United Nations itself provision was made for two functional statistical organs: (1) A Statistical Commission was established as one of the so-called functional commissions of the Economic and Social Council, to be composed of representatives of member governments with expert knowledge and experience in statistical work, to assist the Council in (*a*) promoting the development of national statistics and the improvement of their comparability; (*b*) coordination of the statistical work of the specialized agencies; (*c*) development of the central statistical services of the Secretariat; (*d*) advising organs of the United Nations on general questions relating to the collection, interpretation, and dissemination of statistical information; and (*e*) promoting the improvement of statistics and statistical methods generally; (2) a statistical office was created as part of the Secretariat to perform central statistical functions for the organs of the United Nations as a whole, including the compilation and publication of statistics from member governments, specialized agencies, and other sources, and to provide Secretariat services to the Statistical Commission.

COLLECTION, ANALYSIS, AND PUBLICATION OF STATISTICS

Implicit in the creation of these two statistical organs within the United Nations was the recognition of the United Nations itself as the central agency for the collection, analysis, publication, standardization, and improvement of statistics serving the general purposes of international organizations. It was also recognized that other organizations, more particularly the autonomous international organizations brought into relationship with the United Nations as specialized agencies,[1] would have statistical needs and interests within their fields of responsibility that would require separate organizational units outside the central agency. Each of the specialized agencies has signed a formal agreement with the United Nations governing their interrelationships, and each of these agreements includes an article dealing with statistical services in which each agency recognizes the interests of the others in their respective special field or fields. Thus, in practice the ILO, for example, is responsible for such statistics as those on employment, wages and hours, cost of living, and industrial accidents; and the responsibility of the United Nations is recognized for statistics of external and internal trade, nonagricultural production, wholesale prices, transport (except air transport, which is the responsibility of ICAO), national income, population and vital events, certain subjects in the general social field,

[1] The 10 specialized agencies that have been brought into relationship with the United Nations are: The International Labor Organization (ILO), the Food and Agriculture Organization of the United Nations (FAO), the United Nations Educational, Scientific, and Cultural Organization (UNESCO), the International Civil Aviation Organization (ICAO), the World Health Organization (WHO), the International Bank for Reconstruction and Development (IBRD), the International Monetary Fund (IMF), the Universal Postal Union (UPU), the International Telecommunications Union (ITU), and the World Meteorological Organization (WMO).

and any statistics required for international purposes which are not otherwise provided.

The allocation of responsibility for statistics in different subject fields that has been agreed to by the United Nations and the several specialized agencies is shown in very summary form in a chart (chart I accompanying this text), which was prepared by the Statistical Office of the United Nations as a graphic device to describe the international circulation of national statistics. This chart, it should be noted, deals with only 1 of the 3 types of statistical activity referred to above as functions of the international statistical system—i. e., the compilation and publication of statistics—and with that only in terms of organizational relationships. Details on the results, or end product, of this statistical function of the international organizations are presented in section III, below. First, however, something should be said of the other two types of activity, and the contributions of other elements of the international statistical system should be mentioned.

DEVELOPMENT OF INTERNATIONAL STANDARDS

In the performance of the second type of activity mentioned above—the development of international statistical standards and the improvement of comparability of statistics—responsibility is also shared by various organs. Chart II shows in very summary fashion the procedure that is normally followed. The Statistical Commission typically initiates action looking toward the development of standards on a particular subject by requesting the Statistical Office to prepare a study or draft proposal. The draft is circulated to national governments and to interested specialized agencies and other international organizations. Expert advice may be obtained by convening working group meetings or through correspondence. Arrangements may be made for consultation or discussion of the subject on a regional basis through one or more of the regional agencies or organizations (see below). A revised draft taking account of the views and comments received is prepared for consideration by the Statistical Commission, which may accept, reject, or modify the proposal or request further study and consultation. The whole procedure may require several years if, as in the case of the Standard International Trade Classification (SITC), for example, consideration by the Statistical Commission must be spread over 2 or 3 sessions and subsequently submitted to the Economic and Social Council for approval. Ultimately the proposal will emerge, if accepted, as a recommendation to national governments that they adopt the standard directly in the compilation of their national statistics or provide supplementary tabulations of their data in accordance with the standard for purposes of international comparisons.

Somewhat similar procedures are followed in the development of standards on subjects within the responsibility of a specialized agency. In the ILO, for example, recommendations are agreed upon by the Conference of Labor Statisticians and submitted to the governing body of the organization for approval. The WHO works largely through expert committees, the proposals of such committees being reviewed by the WHO executive council and then by the World Health Assembly. In each case, however, the views and interests of national governments and other international organizations are taken into account at various stages in the development of standards and recommendations.

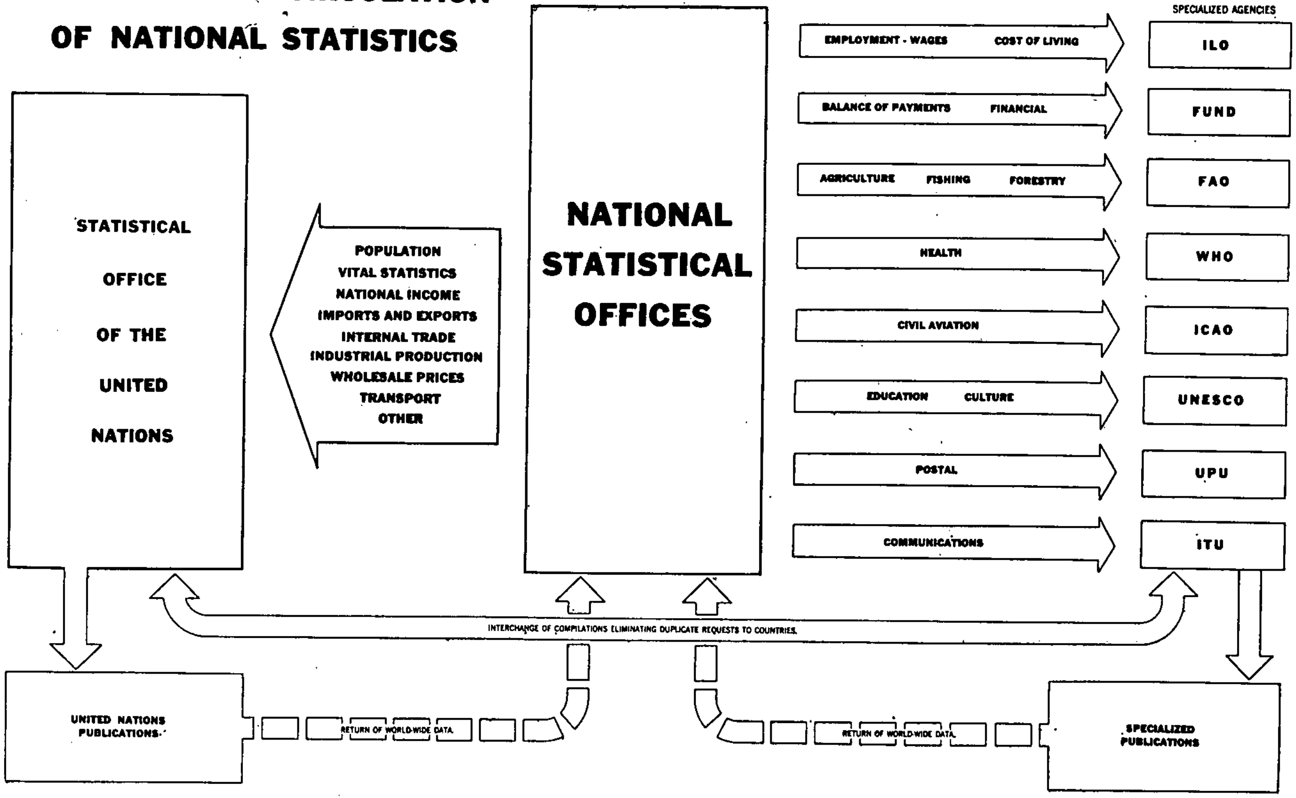
A comprehensive list of the statistical concepts, definitions, methods and classifications that have been established by international conventions, or by regulations and recommendations adopted by competent organs of international organizations, is presented in a publication of the Statistical Office of the United Nations entitled "Directory of International Standards for Statistics" (Statistical Papers, Series M, No. 22, January 1955), a copy of which is available to the subcommittee as exhibit B.

IMPROVEMENT OF NATIONAL STATISTICS

The third type of statistical activity mentioned above—the development and improvement of national statistical services—is likewise carried on by cooperation among the organs of the United Nations and the specialized agencies, and with the collaboration of national governments, other intergovernmental organizations (including regional organizations), and nongovernmental organizations and agencies, both national and international. This type of activity, which compromises the provision of consultant services to governments on statistical problems, statistical training and fellowship programs, preparation of technical manuals and other statistical aids, correspondence with national offices on

CHART I

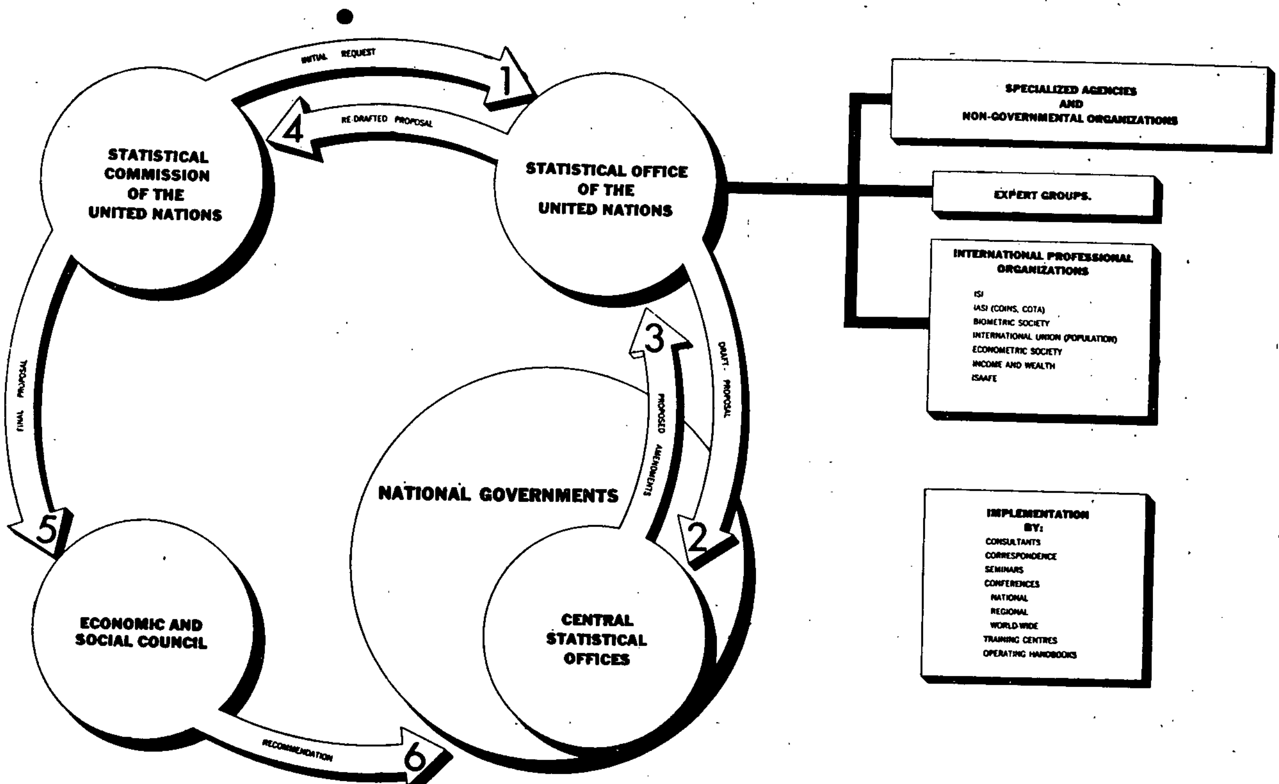
INTERNATIONAL CIRCULATION OF NATIONAL STATISTICS



SOURCE: STATISTICAL OFFICE OF THE UNITED NATIONS (1955)

CHART II

DEVELOPMENT OF COMPARABILITY



technical statistical questions and the like, is carried on both as a part of the regular operations of the participating agencies and as supplementary services provided under various programs of technical assistance. Effective performance of such functions is perhaps the most basic element in efforts to improve the adequacy and comparability of the statistics available for the world as a whole.

OTHER AGENCIES AND ORGANIZATIONS

This brief review of the organization and functions of the main components of our international statistical system would be incomplete if it failed to mention the important functions performed by regional organs of the United Nations and by agencies and organizations outside the framework of the United Nations and the specialized agencies. They will be mentioned only briefly here, however, without any attempt to describe their functions or interrelationships in detail, as a comprehensive treatment would range far beyond the purposes of these hearings.

Perhaps of the greatest revelance for the purposes of these hearings are the statistical activities of 5 regional agencies or organizations, 3 of which are United Nations organs. The latter are the three regional economic commissions of the United Nations Economic and Social Council: the Economic Commission for Europe (ECE), the Economic Commission for Asia and the Far East (ECAFE), and the Economic Commission for Latin America (ECLA). These commissions report to the Council, and each serves as a regional arm of the United Nations organization in dealing with problems of particular interest to countries within its region. They have their own secretariats and offices, and programs of work which are coordinated with the work at U. N. headquarters and in other regions as well as with that of the specialized agencies. This means that in statistics, for example, they assist in the development and application of international statistical standards within the region, so far as these fall within their spheres of interest, conduct special regional studies, and compile statistics of importance to the solution of regional problems. Statistics on particular commodities or industries are likely to be the subject of more intensive work at the regional level than globally. In the case of ECE, for example, special working parties or standing committees have done intensive work on statistics on a number of subjects on which work has not progressed very far on a world basis, including statistics of steel production and consumption, coal, timber, electric power, housing and building, and inland transport.

The two principal regional organizations with important statistical functions that are not integral parts of the United Nations system are the Organization for European Economic Cooperation (OEEC) and the Inter-American Statistical Institute (IASI). The statistical activities of OEEC stem from its operating functions in such fields as trade, industry, agriculture, manpower and migration, and productivity. Although primarily concerned with statistics as a user of data supplied by governments or compiled by other international organizations, OEEC is drawn on occasion into the task of development of standards and improvement of national statistical services, and it also publishes monthly bulletins and annual handbooks containing extensive compilations of data on industrial and agricultural production, internal and external trade, national accounts, prices, and related subjects. The statistical work of the OEEC is coordinated with that of the United Nations and specialized agencies by means of informal but close and effective working relationships at the secretariat level.

In the Western Hemisphere, the Inter-American Statistical Institute (IASI) performs important statistical functions in close collaboration with the United Nations and the specialized agencies, as well as with the organs of the Organization of American States, by agreement with which its Secretariat serves as the Division of Statistics of the Pan American Union. Its purposes are to stimulate improved methodology in the collection, tabulation, analysis, and publication of statistics in the American nations, to encourage measures designed to improve international comparability of statistics in the region; to provide a medium for professional collaboration among American statisticians; and to cooperate with national and international organizations in advancing the science and administration of statistics. It provides technical advisory services to governments on statistical problems, sponsors inter-American statistical conferences and related technical meetings, sponsors and participates in operation of statistical training centers and programs, and performs many other services related to its objectives.

Several international organizations of a nongovernmental character also constitute important elements of the world statistical system. Most notable among these are the international professional associations that are concerned with the science and adminisration of statistics generally or with specialized fields of statistics, including the International Statistical Institute, the International Union for the Scientific Study of Population, the Biometric Society, the International Association for Research in Income and Wealth, and the Econometric Society. Many other international, regional, and national associations and organizations in the field of statistics have made and are making valuble contributions to the development and improvement of statistics, but, as indicated above, a completely comprehensive listing would be beyond the scope of this statement.

III. Statistics Compiled by International Organizations

What may be called the product or end result of the structure of international statistical organization described briefly in the preceding section is a very impressive volume of statistical data on a wide range of subjects from a substantial proportion of the countries of the world that are made available regularly in monthly, quarterly, and annual publications and special reports of the United Nations and other international organizations. A comprehensive catalog of the statistical series included in these publications has been issued by the Statistical Office of the United Nations in its List of Statistical Series Collected by International Organizations (Statistical Papers, Series M, No. 11, Revised 1, February 1955).[2] An indication of the magnitude of the output of our international statistical system may be inferred from the fact that the list of series itself, with no descriptive text or analysis of scope or coverage, fills some 78 pages.

Because of the large volume of data involved, it would be obviously impossible in such a brief statement as this to present a comprehensive description or appraisal of the statistics compiled by international organizations. This review, therefore, will deal fairly briefly with only a few of the more important general-purpose compilations that are currently made available. Information on more specialized compilations of data in particular fields is presented in section IV.

Monthly Bulletin of Statistics.—Perhaps the most valuable and widely used publication among the many issued periodically by international statistical agencies is this monthly compilation prepared by the Statistical Office of the United Nations with the cooperation of statistical units of ILO, FAO, IMF, ICAO, and other intergovernmental bodies and national statistical offices. Few issues of the Bulletin are without information which, when it appears, is cited as news in the pages of metropolitan newspapers. The 57 regular tables appearing each month, and special tables on selected topics featured in every issue, contain the most recent figures available on a wide range of subjects, covering a very substantial proportion of the countries of the world. With a few exceptions—such as data on rubber and tin production, which are supplied by the International Rubber Study Group and the International Tin Study Group, respectively—the figures are obtained from official sources in the various countries.

Tables appearing regularly in the Bulletin present statistics for individual countries on a variety of subjects in the fields of population, manpower, industrial production, mining, manufacturing, electricity and gas, construction, transport, internal and external trade, wages and prices, national income, and finance. Figures relating to the world as a whole (excluding the U. S. S. R.) are also presented in a regular 2-page table of data on population, agriculture and forestry, industrial production, transport, external trade, and finance. Figures for individual countries in most tables relate to whole years from 1938 to date and to months for the current and preceding year. Many of the series are remarkably current. Thus the Bulletin for October 1955 includes figures for July and August on the international trade of a substantial number of countries.

Figures are not available from all countries on all subjects; and in fact some of the series (tin and rubber production, for example) are obviously inapplicable to large numbers of countries. In general, however, the geographic coverage of the tables, especially for the more basic series, is outstanding for a monthly publication of this type. In the October 1955 issue, for example, the number of countries for which data were included in representative tables was as follows: indexes of industrial production, 24 (with June or July figures for 18 countries

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[2] The list also includes a number of series that are collected but not regularly published. A copy of the list is attached as exhibit A to the record copy of this statement.

including most of those of major importance); crude petroleum production, 33; woven cotton fabrics, 23; cement production, 53; crude steel production, 25; production of electric energy, 57; construction, 36; railway freight traffic, 61; civil aviation traffic, 35; value of imports and exports, 84; money supply, 57; gold and foreign exchange holdings, 51; yields of long-term Government bonds, 23; and market prices of industrial shares, 27.

The special features presented in the Bulletin usually consist of analyses or tabulations of data on particular topics and selected series of world statistics. The October 1955 issue, for example, included a special article on world industrial production in the first half of 1955 and a table of world production indexes; special tables of statistics on world production of certain raw materials and electricity, infant mortality rates, and capital formation; and index numbers of wholesale prices of building materials and cost of residential building materials. A noteworthy feature of another recent issue was a table of annual data on private consumption expenditure in a number of countries for 1938 and 1948–53, showing the volume of consumer expenditures in the aggregate and for such items as food, rent, clothing, tobacco, and alcoholic beverages, etc. The same issue included a table of retail price comparisons in selected cities, based on surveys conducted for purposes of determining salary differentials in various countries as compared with New York.

Inasmuch as the usefulness of any statistical information depends largely upon the definitions and explanatory statements that accompany it, especially when far removed from its source, the United Nations exhibits care in the annotation of its tables. At biennial intervals, beginning in 1948, it has compiled and published a Supplement to the Monthly Bulletin of Statistics containing technical notes upon the tabular material in the Monthly Bulletin. The third of these supplements, issued in 1954, contained 196 quarto pages of detailed expositions of the origins, definitions, methods of computation, etc., which enable the user of U. N. data on any subject from any country both to understand their meanings and to appraise their value for his purposes.

United Nations yearbooks.—More detailed statistics than could easily be assembled and published monthly are contained in three annual publications of the United Nations: the Statistical Yearbook, the Demographic Yearbook, and the Yearbook of International Trade Statistics. The last of these, to which further reference will be made later in this paper, shows, for each country which reports its trade data in accordance with the standard international trade classification, figures for trade by sections, groups, and, where possible, principal items of that classification.

All of the three publications provide geographical breakdowns in considerable detail. The Statistical Yearbook is the most comprehensive of the three. In the 1954 edition, some figures are given for each of 233 countries or areas. It contains 179 tables in the space of 594 quarto pages. The broad topics included are in general the same as those in the Monthly Bulletin but the detailed tables include, for example, data on the annual production of many commodities for which data at shorter intervals are not available.

Publication of the Statistical Yearbook of the League of Nations ceased in 1945, and there was a lapse of about 4 years before the first issue (1948) of the United Nations Statistical Yearbook appeared in 1949. Although the 1948 yearbook was somewhat broader in scope than the volumes previously published by the League, it was far from comprehensive and the geographic coverage of the tables left much to be desired. Successive issues have shown steady improvement in territorial coverage, amount of detail, and quality of the data. New tables have been introduced each year; the latest (1954) issue, for example, included for the first time a table showing the number of television receivers licensed or in use during the first half of 1954 in most of the countries in which regular television broadcasts are made.

Prior to 1945, the League of Nations and its Health Organization had included fairly extensive tabulations of population data and vital statistics in their annual publications and special reports, and the International Statistical Institute had published a series of summaries of international demographic statistics between 1916 and 1939; but the first (1948) issue of the United Nations Demographic Yearbook, published in 1949, was without precedent in the scope and coverage of the demographic data assembled in its covers. As in the case of the Statistical Yearbook, the territorial coverage, subject-matter scope, and quality of the data provided in successive issues have undergone steady improvement. The latest issue (1954), which presents some data for each of 258 different geographic areas, contains 43 tables on such subjects as population size and characteristics, births, reproduction rates, stillbirths, deaths, marriages, divorces, life tables, and international population movements. More than 10th of the total of 719 pages is devoted to technical notes (in English and French) describing the tables and presenting information on the accuracy and comparability of the data.

In order to maximize the amount of information on demographic subjects that can be included in an annual publication, a systematic plan for rotation of tables in successive issues of the Demographic Yearbook has been worked out. Thus, for example, the 1954 issue featured special tables on natality; and the 1952 issue presented special charts, tables, and analytical text on urban trends and characteristics.

Of particular interest in both the Statistical Yearbook and the Demographic Yearbook are indexes to the data appearing for every country included. This facilitates comparisons of the volume and variety of information available for specific countries. For example, data for the Soviet Union appear in 42 tables in the 1954 Statistical Yearbook, although a small and relatively underdeveloped nation like Thailand has contributed data to 55 tables. United States data appear in 166.

The paucity of information hitherto supplied by the Soviet Union to intergovernmental organizations of which it is a member is even more conspicuous in the 1954 Demographic Yearbook. Only 3 tables in that publication contain any data whatsoever for the U. S. S. R. as compared with 39 for neighboring Finland and 40 for the United States.

The absence from international statistical tables of data for a particular nation may indicate either its lack of information on the subject in question or its unwillingness to supply such information. In the case of the U. S. S. R., its scanty contribution of demographic data must presumably be assigned to purpose rather than to statistical impotence. I am very glad to note, however, that in the November 1955 issue of the Monthly Bulletin of Statistics, which has just come off the press, some indication of change in this picture is afforded by the inclusion, for the first time, of figures supplied directly to the United Nations by the Soviet Government in the form specified in the questionnaires used by the Statistical Office to obtain data for its publications.

Other international statistical publications.—The amount of international statistical information that has become available in recent years is imposing. As already noted, the United Nations' List of Statistical Series Collected by International Organizations extends to 78 pages; and it identifies some 2,300 or more individual series. A large proportion of these pertain to production and trade of individual commodities.

Most of the specialized agencies of the United Nations issue periodic statistical publications. Among these, for example, are the ILO Yearbook of Labour Statistics and the monthly International Labour Review; four FAO yearbooks dealing respectively with production and with trade in agricultural commodities, with fisheries and with forest products; a biennial compilation entitled "Current School Enrollment Statistics," just launched by UNESCO, to supplement its less-frequent summations of educational facts and figures throughout the world; a monthly International Financial Statistics and a Balance of Payments Yearbook by International Monetary Fund; and numerous others.

Intergovernmental bodies outside the organization of the United Nations which periodically publish statistics relating to their special fields include the Organization for European Economic Cooperation (to which reference is made elsewhere in this statement), the Committee for Whaling Statistics, the International Cotton Advisory Committee, the International Rubber Study Group, the International Sugar Council, the International Tea Committtee, the International Tin Study Group, and the International Union of Official Travel Organizations.

The leading international organization of professional statisticians, the International Statistical Institute, in cooperation with a group of European officials, has issued the first of a projected series of compilations of municipal data, entitled "Population and Vital Statistics of Large Towns."

IV. Statistics of Special Relevance to Foreign Economic Policy

The foregoing sections have dealt rather generally with our international statistical system and the output of this system considered as a whole. For the purposes of these hearings, it is desirable to consider certain aspects of international statistics that are particularly relevant to foreign economic policy in somewhat greater detail. This section, therefore, deals more specifically with the status of work on statistics in several special fields, considering each in terms of progress in the development of international standards and comparability, the scope and coverage of data currently being made available, and the directions of future work.

STATISTICS OF INTERNATIONAL TRADE

Of central importance to nearly all issues involved in questions of foreign economic policy are data on the international movement of goods, commonly referred to as international or external trade statistics. Because of the great importance of such data in many types of economic analysis, the United Nations from its inception has devoted fairly intensive effort to work on this subject. Before the establishment of the United Nations, pioneer work in this field had been carried on under the auspices of the League of Nations; and the International Convention Relating to Economic Statistics (1928) included provisions under which countries subscribing to the convention agreed to compile and publish statistics of their external trade in accordance with definitions and specifications contained in an annex to the convention. In 1938 the Committtee of Statistical Experts of the League had issued the Minimum List of Commodities for International Trade Statistics which specified the particular items or groups of commodities on which statistics of imports and exports were to be compiled and published. Although these measures represented important steps toward the development of comparable data on external trade for a significant proportion of total world trade, the results fell far short of meeting the needs for information about world trade in the period following World War II. It was necessary, in order to obtain detailed figures on the volume and direction of trade in important commodities, to search laboriously through national statistical publications, with little assurance as to the validity of the results. The language barrier alone was too much of an obstacle to many analysts.

Through its Statistical Commission the United Nations at an early stage undertook the formidable task of improving the national usefulness and international comparability of data in this field. To date the Commission has dealt with the following aspects of the problem of improving statistics of international trade:

1. The modernization of commodity classification by formulation and adoption of the Standard International Trade Classification to replace the minimum list of the League of Nations.
2. The establishment of rules for coverage of trade statistics, specifying the transactions that should and should not be included.
3. The standardization of methods of attributing imports to countries of provenance and exports to countries of destination.
4. The improvement of methods of determining the value, for statistical purposes, of goods moving in international trade.
5. Increasing the usefulness of indexes of the volume and price of imports and exports.

Following the recommendation of the Economic and Social Council, more than 60 countries, including nearly all the important trading nations, now regularly compile statistics of their imports and exports in accordance with the Standard International Trade Classification (SITC). This means that the statistical office of the United Nations is able to publish quarterly figures covering 80 to 85 percent of total world trade in sufficient detail to show value and quantity of imports and exports for about 150 uniformly defined commodity groups, analyzed by countries of origin and destination. These data are made available in a quarterly publication entitled "Commodity Trade Statistics" (Statistical Papers, Series D) at only $1 per copy or $4 for a 1-year subscription. Each issue presents figures for the period ending approximately 6 months prior to the publication date.

In addition to the detailed figures presented in its Commodity Trade Statistics, the United Nations publishes a large number of valuable trade statistics series, generally covering longer periods, in the Monthly Bulletin of Statistics, Statistical Yearbook, Yearbook of International Trade Statistics, and a monthly publication issued jointly by the United Nations, IMF and IBRD, entitled "Direction of International Trade." These series include monthly data on total value of imports and exports, by country; index numbers of quantum and unit value; tonnages of goods loaded and unloaded in external trade at principal seaports (monthly figures); value of merchandise and gold imports and exports in national currencies; and many others.

No precise measure can be given of the extent to which data on external trade compiled by different countries conform to the several standard definitions and specifications recommended by the Statistical Commission. The international publications in this field, however, provide detailed annotations to the tables indicating known deviations in the figures from the recommended standards; and for any particular series it is possible to obtain at least a sound approximation of the degree of comparability. It is known that some countries have not been able to conform to all the recommended definitions in all respects. With respect to the recommended definition of valuation, for example, the United States has not been able to provide data in terms of the agreed concept of "transaction value," which prescribes a c. i. f. valuation for imports, because the basis of value prescribed by our tariff laws is substantially equivalent to an f. o. b. valuation; and funds have not been provided for the special sample studies that would be needed to calculate the values of a c. i. f. basis. Such deviations from the recommended standards, of course, affect the international comparability of the data, but in the aggregate their effects are relatively unimportant; and continued progress is being made toward their elimination as more and more countries are able to improve their national statistics on their foreign trade.

Although great strides have been made in improving the international comparability of external trade statistics in the postwar period, there remains a substantial amount of work still to be done in this field. At its ninth session, scheduled to be held early in 1956, the Statistical Commission is expected to study two aspects of the problems remaining in this area: (1) means of improving the figures on value of imports and exports for countries with multiple exchange rates (this problem is particularly serious in some of the Latin American countries which are important trading partners of the United States; but in terms of total world trade, it affects probably less than 5 percent of the aggregate value of imports and exports); and (2) methods of improving the adequacy of indexes of quantum and unit value in countries whose external trade is concentrated in only a few principal commodities (i. e., countries exporting mainly raw materials or agricultural products that tend to fluctuate widely in price and therefore to distort indexes with weights based on periods with different price levels). Generally speaking, however, it may be said that the problems of international comparability in this field of statistics are insignificant in comparison to the situation that existed before the United Nations organization was established.

BALANCE-OF-PAYMENTS STATISTICS

The need for accurate, comprehensive and current data on the international transactions and balance-of-payments position of individual countries as a basis for almost any kind of international economic analysis is too obvious to require statement. The foundations of international coordination in the field of balance-of-payments statistics were laid by the League of Nations, whose Economic Intelligence Service was responsible during the period before World War II for assembling in conveniently standardized form the growing mass of statistical data on balance of payments compiled by individual countries in the process of formulating their increasingly intricate foreign economic policies. The League, however, had no operating responsibilities comparable to those subsequently given to the International Monetary Fund, and its needs for data were relatively limited in scope and comparatively simple in form. No need was felt to adapt its standard reporting form to the requirements of particular countries in different stages of economic development, and it was not found necessary to effect any detailed reconciliation of estimates submitted by countries with data from other sources.

With the establishment of the International Monetary Fund after World War II, new needs and new responsibilities of both an operational and statistical character emerged in the field of international monetary relations; and new instruments were created for more intensive and extensive work on improving the data. Using the work of the League as a starting point, the fund undertook the preparation of a comprehensive Balance of Payments Manual, which was first issued in 1948, revised in minor particulars in 1950, and now being further revised in the light of experience to date, and to bring it more completely into harmony with the United Nations system of national accounts. This manual serves as the basis for detailed reporting to the fund by member governments on their international transactions. From these reports the fund compiles its

Balance of Payments Yearbook (issued in loose-leaf form to make data available promptly as reports of individual countries are received), containing detailed tabulations and analytic presentations of data on a more systematic basis and with much more extensive coverage of countries than the League found necessary or possible. Summary tabulations of the data are also published in the fund's monthly International Financial Statistics.

The annual volumes in this field issued by the League of Nations generally covered 25 to 30 countries. The first Balance of Payments Yearbook published by the fund covered 51 countries and the number has increased with each successive issue, to a total of nearly 70 at present (including virtually all major countries of the free world). The range, accuracy and international comparability of the data have also been greatly increased, and progress is still being made. Regional classifications, not generally compiled before the war, are now available for a substantial number of countries. Finally, the fund is finding it possible to obtain balance-of-payments statements for half-yearly or quarterly periods from an increasing number of countries, in addition to the annual reports.

Future work in the field of balance-of-payments statistics probably will be devoted largely, at least within the next few years, to further refinement and modification of existing standards; the preparation of additional aids in the compilation of better data (including the publication of a Balance of Payments Textbook now used in training programs); and further steps to promote improvement in the quality of data available from less well developed countries.

PRODUCTION AND DISTRIBUTION STATISTICS

Among the various types of data that are essential to analysis of foreign economic policy questions, few are more basic than statistics on the output and distribution of manufacturing, agriculture and mineral industries. In this field as in the field of external trade, considerable work had been done before World War II under the auspices of the League of Nations, and the 1928 International Convention included provisions aimed at improving comparability and adequacy of data compiled by national governments. Progress was slow, however, and the Statistical Commission of the United Nations considered that a high priority should be given to urgently needed measures in the field.

As a first step the Statistical Commission undertook the development of a new and improved system of classification of economic activities by means of which the basic statistics of production and distribution compiled by different countries could be arranged in significant and comparable groupings. The international standard industrial classification which was adopted by the Commission and approved by the Economic and Social Council in 1948 has now been widely adopted for use in the compilation of data on production and distribution for purposes of international comparison, and many countries have even adopted it as the basis for their national classifications. The Statistical Commission and the Statistical Office of the United Nations also undertook the preparation of a comprehensive revision of the recommendations of the League of Nations' Committee of Statistical Experts on indexes of industrial production; formulated up-to-date standards which were approved by the Economic and Social Council as recommendations to countries for the preparation of basic industrial statistics (including censuses); undertook the preparation of a comprehensive technical manual of procedures for the taking of censuses of industrial production, with particular reference to the problems of underdeveloped countries; and took many other steps toward the development and improvement of comparable measures of basic economic activity.

In the field of agricultural production statistics, intensive work has been done by FAO, particularly in the promotion of agricultural census programs throughout the world, assistance to national governments in the establishment and improvement of their statistical services, and the development and improvement of standards and statistical methods applicable to agricultural statistics programs, including the use of sampling.

Extensive preliminary work has also been done by the United Nations and other international organizations looking toward improvements in adequacy and international comparability of basic distribution statistics, including current measures of wholesale and retail trade as well as comprehensive distribution censuses. Some aspects of this work are expected to culminate in approval of formal recommendations at the 1956 session of the Statistical Commission.

Because of the importance attached to improved measures of production and distribution in various connections, work on problems in this field has been undertaken by many different agencies and organizations. As noted above, several subordinate organs of ECE have done intensive work on statistics of particular industries, notably steel, coal, and electric power. The Conference of European Statisticians, under the sponsorship of the Statistical Commission and ECE, has studied problems of wholesale- and retail-trade statistics, needed improvements of data on stocks and work in progress, construction and use of input-output tables, and a number of other subjects. ILO and OEEC have done pioneer work on measures of labor and industrial productivity. Valuable contributions have been made by ECAFE, particularly to the development of measures of economic activity of household and handicraft industries. IASI has furnished invaluable initiative and assistance in promoting improvement of industrial statistics in the Western Hemisphere. The International Chamber of Commerce has contributed substantially to progress in the development of improved measures of distribution. Many other agencies have done original work or collaborated in United Nations activities in this field.

The results of all this work, in terms of availability of good basic benchmark and current data on industrial production and distribution, can be dealt with only in very summary fashion in this brief review. In the period since 1946 nearly 50 countries, including most of the important industrial countries of the world, have taken censuses of industrial production, conforming by and large with existing international standards and recommendations. The number of countries and territories that have taken agricultural censuses within the framework of the 1950 World Census of Agriculture now stands at 95 and still additional countries are planning such censuses. About 30 countries have taken censuses of distribution within the last decade. Current programs of basic industrial, agricultural, and distribution statistics have advanced to such an extent that the Statistical Office of the United Nations finds it possible to compute a "world index of industrial production" (excluding Eastern Europe and Communist China) on a quarterly basis; and, as exhibit A reveals, literally hundreds of monthly, quarterly, and annual series on production, stocks, and distribution of important commodities are made available currently in publications of international organizations, many covering substantially the total world output.

Despite the substantial progress that has been made, much work lies ahead in the general field of improvement in the adequacy and international comparability of basic and current measures of production and distribution. International standards for statistics of distribution are still largely in the formative stages. Standards for minimum programs of tabulation of industrial census data have yet to be developed. A general review of the status of progress in the application of standards previously recommended, and of needs for the future in this area, is badly needed. Work on development of measures of industrial productivity has not proceeded beyond the stage of preliminary exploration, except in limited areas. Consideration must be given in the near future to needed revisions in the International Standard Industrial Classification; and the need is still urgent for coding guides or manuals to assist in the uniform application of the classification to national statistics. Work on some of these problems has been scheduled in the programs of various agencies and organizations during 1956, and continued progress can be expected. It will be many years, however, before any real relaxation can be afforded in concerted efforts to improve the adequacy of world statistics in this field.

NATIONAL INCOME AND RELATED MEASURES

Although estimates of national income and gross national product, and the more recent development of comprehensive systems of national accounts, largely have their origins in rather recent years, such measures have become firmly established among the basic instruments for economic analysis on both national and international levels. The development of the concepts of national income and social accounting in its modern form commenced during the 1930's, when a small number of economists and statisticians began to study the conceptual problems involved in this work and to prepare private or semiofficial estimates for the United States, United Kingdom, and certain other countries. During World War II preparation of these estimates became more urgent, but by 1945–46 the number of countries having official national income estimates still barely exceeded 20. At that time there was only limited comparability between countries in the accounting terminology and statistical forms adopted.

The role of the United Nations in developing national-accounting practices began early in the postwar period. An extensive study dealing with concepts and statistical methods, entitled "Measurement of National Income and the Construction of Social Accounts,"[3] was published by the United Nations in 1947. In following years a number of studies concerned with both the concepts and the methods of national accounting have been published for the guidance of statisticians by the United Nations Statistical Office. In addition, conferences, direct advice and assistance in actual computation have been employed to encourage countries in the preparation of national estimates. Initial studies in social accounting were concerned mainly with the estimation of a national income aggregate. Subsequently, breakdowns showing the distribution of national income (wages, rent, profits, etc.), the industrial origin of domestic product, and the detailed categories of expenditure on domestic product, were undertaken. At a later stage of development, additional detail was added to the accounts and a comprehensive system of social accounts was drawn up. Initially, progress in these various phases of social accounting was largely restricted to estimates presented in current prices, but in recent years there has been a sharp increase in the number of countries producing estimates in constant prices, and it would seem that further progress in this direction must be expected in the next few years.

The expansion of social-accounting techniques and improvements in methods of estimating were considerably advanced when the Statistical Commission adopted in 1953 A System of National Accounts and Supporting Tables. In 1955, the Statistical Office published an operating handbook on methods of national-income estimation which summarized technical methods for the compilation of income and expenditure flows and the industrial origin of the gross domestic product.

The results of these developments in national accounting, which reflect the efforts of various national and international agencies in this field, may be expressed by statistics showing the rapid increase between 1938 and the present time in the number of countries publishing official estimates of national income. These statistics are set out in an accompanying table which relates to the years 1940, 1948, 1952, and 1955. The developments revealed by this table are described below, but these figures fail to reveal the equally important fact that there have also been marked gains in the scope, accuracy, and comparability of these studies.

National-income aggregates.—In 1955 official income estimates for a number of recent years were available for between 60 and 65 countries. In addition, single-year estimates for some year within the last decade were available for another 25 countries. In 1952, these figures were 50 and 22, respectively, while in 1948 current and official income series were produced by only 28 countries and single-year estimates by 23 countries. In 1940 fewer than 20 countries could show any sort of income estimate, and of those available many were the results of unofficial study. Consideration of the increases over the last decade in the numbers of estimates in constant prices indicates that progress in this field in the last decade has been even more rapid. In 1948 constant-price estimates existed for only 10 countries against the 45 countries which now produce estimates of this order. Historical series of national income relating to al lor part of the period 1919–40 numbered 32 in 1948 and 37 in 1955.

Industrial origin of national product.—For many purposes of analysis detailed breakdowns of the income aggregates are required, including studies concerned with economic development which are sometimes based upon industrial breakdowns of the national product. In 1948 such estimates were available for 26 countries against the 62 countries now engaged in this work. Similarly, constant-price studies which assist the carrying out of additional types of analysis have increased in number since 1948 from 1 to 11.

Distribution of national income.—In 1945 fewer than a dozen countries presented breakdowns of the national income by distributive shares despite the fact that income tax and related data commonly available assisted the early development of this branch of the study. By 1948, 19 countries had produced such estimates and in 1955 this number had increased to 41. Constant-price estimates of the distributive shares are not technically feasible.

[3] Report of the Subcommittee on National Income Statistics of the League of Nations Committee of Statistical Experts.

Final expenditures.—Again the number of countries presenting detailed expenditure estimates in 1945 was less than a dozen. In 1948 the number had grown to 18 and in 1955 to 50. Official constant-price estimates of the final expenditure flows were provided for only 2 countries in 1948, while at the present time (1955) such estimates exist for 13 countries.

The few statistics quoted above do not bring out the fact that for between 15 and 20 countries detailed systems of social accounts are now available which measure economic activity in the fields of production, distribution, capital formation, households, government, and the rest of the world, and present these measures within a coordinated system of accounts. These studies usually provide time series covering a number of recent years and are in some cases supplemented by extensive constant-price estimates and by input-output and other studies. Partial systems of national accounts are available for another group of countries, which in the main are making considerable year-to-year progress toward the development of fully articulated social-accounting systems. Progress is being made not only in widening the scope but in improving the quality of these estimates.

Apart from the various forms of technical aid provided by the Statistical Office of the United Nations and other international agencies in the direct encouragement of this work, considerable impetus to the long-term development of national income estimates has been provided by the improvement of basic statistics relating to trade, balance of payments, government, industrial and agricultural production and other subjects. The Statistical Office has endeavored to coordinate the presentation of statistics in all of these fields to permit their ready assimilation into a comprehensive and internationally comparable national accounting system.

Availability of national income aggregates and components, 1940, 1948, 1952, 1955

	Number of countries for which these estimates existed in—			
	1940 [1]	1948	1952 [2]	1955 [2]
1. National income aggregates for a number of recent years:				
(a) Current prices	12	28	(2) 50	(7) 65
(b) Constant prices	2	10	26	45
2. Estimate for a single year	----------	23	22	25
3. Historical national income series within period 1919 to 1938	----------	32	34	37
4. Details of the industrial origin of national product:				
(a) Current prices	----------	26	(13) 37	(9) 62
(b) Constant prices	----------	1	2	11
5. Details of the distribution of national income by income shares	----------	19	(6) 28	(5) 41
6. Details of the final expenditures on domestic product:				
(a) Current prices	----------	18	(5) 32	(4) 50
(b) Constant prices	----------	2	5	13

[1] Approximate only.
[2] A number of the studies, shown in parentheses, are obsolete or tending to become obsolete but are retained in the table to indicate the number of countries engaging consistently or intermittently in national income estimation.

STATISTICS OF WHOLESALE PRICES

Current wholesale price indexes and data on actual levels of wholesale prices of particular commodities are among the more sensitive indicators of economic change that are useful for many purposes of economic analysis, both nationally and internationally; and efforts to improve the adequacy and comparability of such data have occupied attention of international organizations for many years. When the United Nations took up the work that had been carried on by the League of Nations in this field, it was found that most of the 25 countries that had agreed to follow the recommendations on this subject contained in the 1928 International Convention Relating to Economic Statistics were actually endeavoring to carry out the provisions of the Convention in compiling data on wholesale prices. The Statistical Commission considered, however, that the 1928 recommendations required reexamination and that further steps should be taken to extend the area of international agreement and to improve the adequacy of available data on this subject.

At its sixth and seventh sessions, in 1951 and 1953, the Statistical Commission considered a number of rather comprehensive proposals with respect to wholesale prices that were based on a technical report prepared by the Statistical Office with the aid of expert consultants. The proposals would have provided, among other things, for a standard system of grouping commodity price quotations in an arrangement of index numbers corresponding to value flows between important sectors of the economy, in contrast to the traditional commodity group arrangements used in the United States and a number of other countries. The Commission concluded that the time was not ripe for international agreement or recommendations on a standard system of index numbers of wholesale prices of the sector type. It decided, however, to adopt a series of recommendations dealing with the desirability of establishing an adequate system for collection and publication of wholesale price data, the need for indexes for individual commodities, methods of weighting, the formula, the base period, and the frequency of review and revision of weight bases. The recommendations have served as part of the basis for continuing work on the subject by the Statistical Office, including work on a manual dealing with concepts and methods for the collection of wholesale price statistics that is now in preparation; and have also been the subject of extensive discussion and consideration, along with other aspects of wholesale price statistics, at meetings of a number of regional groups.

An impressive volume of current wholesale price data is now regularly made available in periodic publications of the United Nations, FAO, IMF, OEEC, and other organizations. The United Nations Monthly Bulletin of Statistics, for example, contains approximately 200 national wholesale price series for 52 commodities selected for their importance in international trade, including specific food and tobacco products, crude materials, mineral fuels, oils and fats, chemicals, textiles, metals, and newsprint. Prices are shown in national currencies rather than as index numbers, with an average timelag of only about 2 months from the reference date of the figures to the date of publication.

Further work in this field probably will deal principally with measures to promote still wider application of existing recommendations, and with the development of new proposals looking toward the possibility of agreement on a standard system of index numbers.

STATISTICS ON EMPLOYMENT, WAGES, AND COST OF LIVING

Analysis of many fundamental issues of international economic policy is vitally dependent on reliable current data on wages and earnings, employment and unemployment, consumer prices, and other subjects commonly grouped under the heading of labor statistics. On the international level such data are the particular responsibility of the International Labor Organization and its permanent secretariat, the International Labor Office. From its inception in 1919, the ILO has worked for the development and improvement of labor statistics and has compiled and published data on labor and social conditions. Its major fields of statistical activity have been labor force and employment, unemployment, wages, consumer prices, and family living studies, but it has also carried on work on statistics of hours of work, labor turnover, and absenteeism, labor productivity, labor income, social security, industrial injuries, industrial disputes, collective agreements, trade-union membership, and migration.

Various methods are employed by ILO in its efforts to improve the adequacy and comparability of labor statistics. One field of labor statistics has been the subject of an international convention—ILO Convention No. 63, adopted in 1938, which prescribes a minimum program of statistics of wages and hours of work to be compiled by countries adhering to the convention. International standards and recommendations are formulated principally through meetings of the International Conference of Labor Statisticians, eight of which have been convened since ILO was established ILO has also convened meetings of a number of expert groups to study particular labor statistics problems and has participated actively in the meetings and programs of other organizations on matters related to its fields of interest. The large body of international standards and recommendations on labor statistics subjects that had been adopted up to that time were brought together by ILO in a single volume issued in 1943.[4] A revised

[4] International Labor Office. The International Standardization of Labor Statistics. Montreal, 1943 (series N, No. 25; 169 pages).

edition of this volume is now in preparation. (See exhibit B for a list of the international standards in this field.) ILO also seeks to promote the development and improvement of labor statistics by various types of technical assistance, including direct aid to countries in establishing or strengthening their statistical services in this field, seminars in labor statistics and other types of statistical training, special studies of labor-statistics problems, and in other ways.

As a partial indication of the extent to which national and international efforts to develop and improve statistics in this field have produced useful results, reference may be made to the broad scope and extensive geographic coverage of compilations of labor statistics regularly published in the ILO's International Labor Review and Yearbook of Labor Statistics, and the Monthly Bulletin of Statistics and Statistical Yearbook of the United Nations. These publications now present monthly and annually cost-of-living indexes supplied on a current basis by nearly all countries of the free world; the October 1955 issue of the Monthly Bulletin of Statistics, for example, presents such data for 83 countries or geographic areas, and figures for July or August 1955 are shown for more than half of these. Current statistics on employment and unemployment, wages, earnings, and hours of work are available for only a much smaller number of countries. The 1954 issue of the Yearbook of Labor Statistics, for example, includes relatively recent figures on wages for fewer than 50 countries. Current series on hourly, daily, weekly, or monthly earnings in manufacturing are available from only about a score of countries; current indexes of employment in manufacturing from only 26; recent monthly data on hours worked per week in manufacturing from only a dozen countries; and monthly statistics of unemployment from only about 30 countries.

Although the geographic coverage of available current labor statistics, as these few examples indicate, is very far from meeting present-day needs for international economic policy purposes, it should be noted that the situation now is vastly better than in the prewar period (roughly only half the number of countries indicated above as supplying current data at present were able to do so in 1938), and the rate of progress that has been attained during the past decade can be expected to continue under the impetus of economic development and technical assistance programs.

The development of adequate programs of labor statistics and the improvement of international comparability of data in this field constitute a long and laborious task. The most notable progress to date has been in the fields of consumer-price indexes (which are not only considerably more numerous now than in the prewar period, but are more representative of actual price movements and much more nearly comparable from country to country), and statistics of the labor force, employment, and unemployment (which have been greatly improved as to coverage, adequacy, and comparability, particularly as regards the adoption of standard definitions and classifications). But much remains to be done, particularly with respect to development and improvement of data on wages and earnings, before the available data in this field can be said to be reasonably adequate for present needs.

POPULATION AND VITAL STATISTICS

Facts about the size, characteristics, distribution, and movement of population and the factors underlying population changes are essential to virtually all types of analysis of economic and social problems, both national and international. In the prewar period, leadership in international efforts to improve population statistics was provided mainly by the International Statistical Institute. As early as 1872, ISI took the initiative in establishment of international standards for population censuses, and the idea of a world population census program originated in proposals presented at one of its early sessions. When the United Nations was established this subject was one of the first to occupy the attention of its Statistical Commission and Population Commission. At their first sessions, the two Commissions considered reports on work being done under the auspices of the Inter-American Statistical Institute on plans for the 1950 census of the Americas, and took steps promptly to promote parallel programs in other parts of the world.

The variety and scope of cooperative international activities in this field since 1946 are too extensive even to summarize here. International standards and recommendations relating to methods of collecting, classifying, and tabulating census and current data on economic activities that were formulated up to the end of 1950 were brought together in convenient form in a volume entitled "Application of International Standards to Census Data on the Economically Active Population" which was published by the United Nations in 1951 (ST/SOA/Series A. Population Studies, No. 9; 139 pages). An up-to-date compilation of international recommendations relating to national censuses was also included in a Handbook of Population Census Methods published by the Statistical Office of the United Nations in 1954 (Studies in Methods, Series F, No. 5; 143 pages), together with summaries of the studies of census methods upon which these recommendations were based. This volume was designed primarily to assist countries in applying the international standards and improving their statistics on population. A wealth of other material in this field has been made available by the United Nations and the many other organizations that have collaborated in efforts to improve available data on population and related subjects. WHO in the fields of vital and health statistics; ILO in current labor force and migration statistics and occupational classification; FAO on development and improvement of census methods; UNESCO on advancement of statistical education and training; the International Union for the Scientific Study of Population Problems and the International Statistical Institute in the development of scientific methodology in demographic studies and sponsorship of international conferences and training activities; IASI and other regional agencies in the promotion of programs for improvement of population statistics within their areas; and many other agencies have made valuable contributions to the progress that has been accomplished in this general field within the last decade.

The results of all this international cooperative effort are reflected in the scope and quality of the data now made available on population and related subjects in the publications of the United Nations and other international organizations. Some of these, notably the United Nations Demographic Yearbook, have been mentioned in the preceding section of this statement, and a complete list of the demographic series currently compiled by international organizations will be found in exhibit A. Perhaps the practical purposes of these hearings will be adequately served if this review of the subject is confined to a reference to one further publication in this field, to illustrate the scope of available data. The quarterly publication issued by the Statistical Office of the United Nations under the title "Population and Vital Statistics Reports" (Statistical Papers, Series A) presents currently, for each of some 220 geographic areas of the world, the total population as shown by the most recent census of population, the latest official estimate of total population, and estimated population as of midyear for a recent year (1954 in the most recent issue). The latest available statistics of live births, deaths, and infant deaths, expressed in terms of numbers and rates, are shown for countries containing about half the total population of the world, and the most recent estimates of total population of the world by continents, are presented. Each table includes a column providing information on the quality of individual statistical series included. In this single publication—which is made readily available to users at only 30 cents per copy (or the equivalent in other national currencies) through sales agents for United Nations publications in more than 60 countries scattered over the world—the most essential population statistics required for international economic policy analysis are presented in convenient form. They meet standards of coverage and reliability that scarcely existed even on paper less than a generation ago.

Vastly improved as they have been during the last decade, existing demographic data for many countries leave much to be desired in terms of quality and international comparability. Even fairly inexpert scrutiny of international publications in this field discloses deficiencies and inadequacies. Known defects in the figures presented are pointed out in descriptions of the series and annotations to the tables, but such devices can only serve to caution the user and cannot fill gaps in the information or compensate for inferior quality. Concerted effort in this field must be continued on a fairly large scale, and there is every reason to expect that it will be. For the immediate future, in fact, greatly intensified activity may be anticipated in connection with preparations for the so-called world population census program of 1960, on which international, regional, and national agencies have already begun their work under systematic and well-coordinated arrangements.

V. Needs for the Future

In discussing future needs in the field of international statistics there is danger of diverting attention from past progress and thus of belittling what has already been accomplished. There are deficiencies in the organization of the growing international statistical system and there are gaps in the data that it makes available. Criticism, however, is unrealistic unless based upon a recognition of the tremendous advances of the past few years and the promise they hold of further improvement if allowed to develop along the lines already followed. The foundations of the system are solidly based and the most general need for international statistical improvement is for continued growth in the directions already taken. I will indicate several of the principal needs, viewed in this sense, as I see them.

1. Most conspicuous is the need for the further development of national statistics in underdeveloped countries. International statistics can rise no higher than the national data to be assembled and made comparable. Many countries have made great strides from a state of almost complete statistical illiteracy a very few years ago; however, the science of statistics and the tools in its possession have developed with greater rapidity than they can be completely assimilated, even in a country like ours which is accustomed to rapid technological change. It is not surprising to find some other parts of the world lagging behind, or attempting to utilize advanced machine equipment before the elementals of statistical procedure have been mastered.

The need for national statistical development in many countries is being met not only by the multilateral-aid programs of the United Nations and its specialized agencies but also by the bilateral programs of technical assistance of the United States. It is noteworthy that statistical leadership in many parts of the world and particularly in the Western Hemisphere is increasingly being exercised by young men and women who have received training in technical agencies of the Federal Government of this country.

2. A second need somewhat like the first but for different reasons is for a penetration of statistical light behind the Iron Curtain. As indicated in previous paragraphs, the statistical information about the Soviet Union in international statistical publications is minimal. What is known about Communist China has much the same quality of seeming remoteness, of blended myth and fact, as the tales of Marco Polo. The statistical blackout over the U. S. S. R. is presumably due less to an absence of data than to the secretiveness of its Government. The disclosure of data of types which are freely disseminated in most modern nations has, until recently at least, been a major crime in the Soviet Union, subject to horrendous penalties. Fortunately there are evidences that official attitudes toward statistics in that country are becoming more liberal. But even the existence of common types of statistical information in Communist China is a subject of uncertainty and dispute among statisticians in the free world.

3. A third major need of international statistics, happily in process of some degree of realization, is a world census in or about the year 1960. The cornerstone of most national statistical systems in western countries is a periodic census of population. To it may be added such related inquiries as censuses of housing, agriculture, and economic activity. The numbers and distribution of population by social and economic characteristics (sex, age, education, income, etc.) can provide a foundation for sample studies of more specialized types of wide usefulness to government, business, or other interests, both national and international.

But international statistics can make effective use of national-census data only if the latter present approximate uniformity in timing, in topics covered, in concepts and definitions embodied in the questions, and in the groupings adopted for tabular summarization. The attainment of uniformity in such matters requires a long period of planning and consultation among nations which must to some degree subordinate their national purposes to an overall international program. Thus it is now 30 years since the first project of this order, the world census of agriculture, was launched by the International Institute of Agriculture (Rome) on the initiative of the American agricultural expert, Leon Moyer Estabrook. Five years were then devoted to the preparations for coordinated national censuses that were conducted in 1930–31—approximately the same time that is still available for the consummation of plans already long in preparation by the United Nations and other intergovernmental bodies for a world census in 1960.

4. I place next in order of importance the furtherance of work in all countries on the estimation of national income and gross national product and the development of systems of national accounts. The importance of such work rests in part on the value of the estimates they produce for international comparisons

of national well-being, economic strength, standards of living, etc. It has the further importance that statistical development in many other directions is stimulated in order to supply the necessary raw material for the estimates desired. The information on previous pages indicates the extremely rapid progress already made in this area of technical development.

5. The further development and adoption of standard concepts, definitions, and practices relating to records of trade among nations is also in my opinion of major importance. The Standard International Trade Classification (SITC) was a basic and essential step toward the comparability of international trade data. It seems well on the way toward general adoption for trade reports by all nations. But we have by no means achieved complete uniformity in the methods of valuing imports and exports, in reporting the national origins and destinations of goods, in defining precisely the content of merchandise trade, and in other similar matters. In efforts to conform to international standards in this field the United States, whose record is otherwise good, has far from a perfect score, as has already been suggested above.

6. Numerous other instances in which international data for important purposes are unavailable or inadequate might be mentioned. Two of these, in the public and the private sectors of the economy, respectively, relate to public finance and to distribution of internal trade. Progress in the first is being stimulated and guided by the United Nations and the International Monetary Fund. Initiative respecting the second has for some years been taken by the International Chamber of Commerce. The development of proposals for censuses of distribution, long advocated by that organization, now has high priority on the work programs of the United Nations Statistical Commission and the Statistical Office.

In conclusion I wish to pay tribute to the many able and sincere professional men and women in national statistical offices and in international organizations who are devoting their lives to the perfection of a world statistical system. Our hopes for an orderly, peaceful, and prosperous world depend to no small degree upon the availability of information which their efforts are seeking to supply. I wish also to pay tribute to the breadth of vision of the Joint Economic Committee, its subcommittee and staff in noting the importance of international statistical development to our own country and providing for consideration of the topic on the agenda of these hearings. For the privilege of participating in the discussion I express my thanks.

Dr. Rice. A convenient time to begin a discussion of progress in international statistics is with the creation of the United Nations. Actually, there is a fairly long history extending back of that time, but about the time of the San Francisco Conference, it was well recognized that both international organizations and national governments would need a great deal more information than was customarily obtained in the past. Further, that that information would have to be comparable as between countries, and that that involved a good deal of national statistical development where it had not occurred.

Therefore, there were the beginnings with the U. N. of an international statistical system which is still in process of development.

The core of that system is in the U. N. Statistical Commission, to which you have referred, and the U. N. Statistical Office.

In the agreements that were arrived at by the Economic and Social Council, with all of the so-called specialized agencies of the U. N., there is a clause providing for the allocation of statistical work among them, and that clause recognizes the U. N. as, in effect, the central statistical body internationally speaking.

The actual work of statistics internationally is divided between the U. N., the two organs I mentioned, and the specialized agencies. One of the prime functions of the U. N. and of the specialized agencies in their own respective fields is the development of statistical standards. We have a section on that subject in this paper.

I might mention that the magnitude of data that are collected and the data that have been collected in accordance with standards that have been developed by intergovernmental organizations is much larger than is usually appreciated. The United Nations has published a directory of international standards for statistics. It has also published a list of the statistical series collected by international organizations. This runs to 78 pages as a mere list of some 2,300 separate series. Many of these deal with individual commodities.

Help in the development and improvement of national statistics is given by the international organizations, centering around the U. N., and also by the United States Government through its bilateral program of technical assistance.

There are other organizations which contribute to this conception of a growing international statistical system. There are 3 regional bodies of the U. N. concerned with statistics—1 in Europe, 1 in Latin America, 1 in Asia and the Far East. Their statistical functions are very largely those of applying the international standards developed by the U. N., the ILO, FAO, and so forth, to the particular regions in which they operate.

There are also such professional bodies as the International Statistical Institute, the International Association for Research in Income and Wealth, which has grappled with many of the problems with which Professor Millikan dealt in his paper; the International Union for the Scientific Study of Population; and others.

In the Western Hemisphere we have an organization which is partly professional and partly official, the Inter-American Statistical Institute, which has done much to apply international standards in this hemisphere. In Europe, in addition to the Economic Commission for Europe of the U. N., there is also the OEEC, or Organization for European Economic Cooperation, which conducts statistical work in connection with the effort to develop trade relations among its members.

It seemed to me, Mr. Chairman, that this brief account of the structure of the international mechanisms for collecting statistics was necessary for a better understanding of the information that is available.

The third part of my paper deals with the statistics that are compiled by international organizations.

The most widely used international statistical publication is the Monthly Bulletin of Statistics of the U. N. There is scarcely an issue which, when it reaches the public, does not contain something that is seized upon as front page news in our metropolitan dailies. There are 57 regular tables each month. The data in these tables are contributed by the statistical units of all the principal U. N. agencies, such as the ILO, the International Monetary Fund, the Food and Agricultural Organization, and others.

The regular tables deal with such subjects as population, manpower, industrial production, mining, manufacturing, electricity and gas, construction, transport, internal and external trade, wages and prices, national income, and finance. That is to say, in respect to each of those subjects, data are assembled in a number of tables from as many countries as are able to supply the information called for on the questionnaires of the U. N. or one of the specialized agencies.

In addition to the regular tables, special information appears in each issue on selected topics which are not covered each month. For example, in last May's issue there was for the first time an assemblage from some 16 or 20 different countries, as I recall, of information pertaining to consumption by individuals and families in different countries, something on which there had previously been nothing available to our marketing people and in which they are very interested.

In addition to the Monthly Bulletin of Statistics, there are three very important annual publications of the U. N.: The Statistical Yearbook, the Demographic Yearbook, and the Yearbook of International Trade Statistics. These are voluminous in the data they contain, and extraordinarily wide in their coverage, considering the short space of time in which they have been published, since the Second World War.

The Statistical Yearbook, for example, contains 179 tables in 594 quarto pages. The topics are in general the same as those in the Monthly Bulletin, but are, of course, expanded and more detailed.

The Demographic Yearbook is of about the same magnitude, and represents even greater development in its field. Of course, it is less comprehensive in the coverage that is included.

It is interesting to me to study in these two books what nations provide what information. Some small countries cannot provide the information that is called for. Some other countries do not provide the information—I will not say for what reasons. For example, in the Demographic Yearbook for 1954, there are only 3 tables which contain data for the U. S. S. R., as compared with 39 for Finland and 40 for the United States. This seems to indicate an unwillingness of the U. S. S. R. to supply data to the United Nations, although I am very happy to note that in the November 1955, Monthly Bulletin of Statistics, which has just appeared, there is evidence that for the first time the Soviet Union is supplying information requested by the U. N. Statistical Office and not previously supplied.

I will refer again to the question of international trade, which is the subject of the third U. N. Yearbook.

The other U. N. agencies—the so-called specialized agencies, prepare yearbooks which are very important in their own fields. The ILO has the Yearbook of Labor Statistics, in addition to its Labor Review, which is monthly. The UNESCO has just issued the first number of a very interesting publication on current school enrollment statistics throughout the world. The International Monetary Fund issues monthly a publication entitled "International Financial Statistics," as well as a Yearbook on Balances of Payments; and there are various others.

These, Mr. Chairman, are illustrations rather than listings. You will find a listing in one of the documents to which I have previously referred, and which is presented as an annex to this paper.

(The documents referred to, a list of Statistical Series collected by International Organizations (United Nations Statistical Papers, series M, No. 11, rev. 1) and Directory of International Standards for Statistics (United Nations Statistical Papers, series M, No. 22) are made a part of the record and are in the files of the committee.)

Dr. RICE. In some of the fields of interest from the standpoint of foreign economic policy, I will mention just a few of the highlights. In respect to international trade, the outstanding step forward as a result of several years of effort by the U. N. Statistical Commission was the development and general adoption by governments of the Standard International Trade Classification, known as the SITC around the world.

In other words, for the first time commodities in international trade are classified by most countries according to a uniform pattern and, therefore, become comparable insofar as the nomenclature in use is concerned. There is still a great deal of work to be done in respect to standardizing such things as the method of valuing the trade between any two countries. For example, should figures on the value of imports include the freight charges, the insurance and other costs of getting the commodities to the point of importation; or should the valuation relate to the original purchase price of the commodity? As still another possibility, should it refer to market value in the importing country? Questions of that sort are being worked on, and solutions are emerging.

In respect to Balance of Payment Statistics, the International Monetary Fund, as I said, is the central source, and it issues annually a balance of payments yearbook which is looseleaf to make the data available as promptly as possible.

In respect to production and distribution statistics, a very important advance was the development of the International Standard Industrial Classification of All Economic Activities, a result of the work of the Statistical Commission and the Statistical Office.

I might say that the process of developing and gaining acceptance for aything like these standard classifications, is prolonged and arduous. There are graphic charts in my statement which indicate the process. It involves repeated negotiations with the national governments and taking into account their suggestions, as a result of which renewed consideration by the Statistical Commission and the Statistical Office must follow. Eventually a recommendation is made to the Economic and Social Council, which in turn may recommend the adoption of the standard to member governments. The general adoption within the scant period of 10 years of the Standard International Trade Classification and the Standard International Industrial Classification, permitting comparisons of production in different countries and of trade between them, is really a very remarkable achievement in my opinion.

As to national income estimates, I think Professor Millikan has very lucidly and eloquently described some of the major problems. I think there has been real progress and that the table appearing on page 41 of my statement demonstrates that progress.

In 1945, there were only 12 countries able to report national income aggregates at current prices. In 1955, there were 65. Throughout the table you will see other extensions of work on the estimation of national income and its components. Thus, the development of estimates in current prices has been followed by efforts to develop estimates at constant prices. The number of countries in 1945 that reported on that basis was only 2, and in 1955 was 45.

In respect to data on wholesale prices, a great deal of information is obtained through a number of the organizations that I have mentioned. The Monthly Bulletin of Statistics contains some 200 series on wholesale prices for some 52 commodities.

In respect to statistics of employment, wages, and costs of living, the International Labor Organization is the responsible agency. Its work, of course, dates back beyond the U. N. in time. There are periodic conferences of labor statisticians who examine the issues which arise. One of the most difficult of those—I think it is not mentioned in my paper here—is the attempt to standardize occupational classifications, so that it will be possible to some degree, never in very much detail, I fear, to compare the distribution of workers by occupations in different countries of the world.

As to population and vital statistics, as I said, there has been a great deal of progress. The Inter-American Statistical Institute, taking the initiative early in the last decade, carried through a population census of the Americas at the end of the decade, with only two countries missing. That is to say, through international committees in the Western Hemisphere, it developed a high degree of uniformity in definitions, classifications, conceptions, which were employed in population censuses then taken by each of the national governments concerned. The outcome was a set of reasonably comparable data for the countries of this hemisphere.

Since the early part of this decade the United Nations has been preparing for a uniform world census of population in or around 1960.

In discussing needs for the future, I feel it important to keep in mind that great progress has already been made. The foundations of the system which we now have are solidly based and the most general need for international statistical improvement is for continued growth in directions already taken.

In my opinion, the most conspicuous of the needs for the future is the further development of national statistics in underdeveloped countries. International statistics can rise no higher than the national data to be assembled and made comparable. It is hardly surprising, in view of the fact that many nations were almost completely illiterate statistically just a few years ago, to find that some still lag behind, despite the progress made.

A second need seems to me to be for a penetration of statistical light behind the Iron Curtain. As I have indicated before, the statistical information about the Soviet Union in international statistical publications is minimal. What is known about Communist China has much the same quality of seeming remoteness as the tales of Marco Polo. The statistical blackout over the U. S. S. R. is presumably due less to an absence of data than to the secretiveness of its Government. The disclosure of data of types which are freely disseminated in most modern nations has, until recently at least, been a major crime in the Soviet Union, punishable by very severe penalties, even including death.

Fortunately, there are evidences that official attitudes toward statistics in the U. S. S. R. are becoming more liberal; but even the existence of common types of statistical information in Communist China is a matter of debate among western statisticians.

A third major need of international statistics is for a world census in or around 1960. I cite that as a need, although preparations are actively in process for it. The cornerstone of most national statistical systems is a periodic census of population, and around such a census may be added such related inquiries as censuses of housing, agriculture, and economic activity. Increasingly in the Western World the use of sampling techniques is developing; they are less expensive, more prompt in the appearance of information, and even more reliable; but such sample inquiries depend almost completely upon a firm basis of population information to be obtained in a census.

Fourth in importance I would place the need for furtherance of work in all countries on estimates of national income, gross national product, and development of systems of national accounts—in other words, for work on attempts to meet and solve in some satisfactory way the difficult problems to which Professor Millikan has referred.

Finally, and selecting from many candidates for inclusion in a minimum list of needs, I place the further development and adoption of standard concepts, definitions, and practices relating to records of international trade. I have already referred to that. I also include the development of information on public finance and on distribution or internal trade.

There are active efforts underway within the U. N., the International Monetary Fund, and in some private organizations in respect of the matters last named. With regard to distribution data, the International Chamber of Commerce and the International Statistical Institute have given the subject pioneer attention.

In conclusion, I wish to pay tribute to the many able and sincere professional men and women in national statistical offices and in international organizations who are devoting their lives to the perfection of a world statistical system. Our hopes for an orderly, peaceful, and prosperous world depend to no small degree upon the availability of information which their efforts are seeking to supply. I wish also, Mr. Chairman, to pay tribute to the breadth of vision of the Joint Economic Committee, its subcommittee and staff in noting the importance of international statistical development to our own country and providing for consideration of the topic on the agenda of these hearings.

Mr. Bolling. Thank you. Will you identify, please, the gentleman accompanying you?

Dr. Rice. I am sorry. I intended to do that. Mr. Harry Venneman, of the Bureau of the Budget, who has held a very important role in representing his Government in various international statistical connections.

Mr. Bolling. Thank you.

We have had these very fine reports from Professor Millikan and Dr. Rice, covering the concrete problems of making international comparisons so essential to definitive opinion in this field of foreign economic policy. Dr. Rice, as you know, was formerly the coordinator of statistical matters among the many Federal agencies during his service with the Bureau of the Budget. We asked him to review in the light of his experience a report prepared by the Bureau of the Budget specifically for these hearings. He has done that, and his comments this morning have taken into account his review of this special report.

I am going to place in the record a copy of our letter of request to the Bureau of the Budget, Office of Statistical Standards. This request asked the assistance of OSS in coordinating the replies as made by a large number of Federal agencies to our general query on this subject of adequacy of statistics for making international comparisons.

I want to take this opportunity to express our appreciation for the splendid cooperation of the Office of Statistical Standards in analyzing our needs, interpreting these needs to the many departments of government, and in assembling the resulting reports. Mr. Raymond T. Bowman, Mr. Donald C. Riley, Mr. Edward T. Crowder, and Mr. Harry Venneman all deserve special commendation.

The materials received in response to our letter of request will be included in the record.

(The letters referred to are as follows:)

SEPTEMBER 20, 1955.

Mr. RAYMOND T. BOWMAN,
Assistant Director, Office of Statistical Standards,
Bureau of the Budget, Executive Office Building,
Washington, D. C.

DEAR MR. BOWMAN: The Subcommittee on Foreign Economic Policy, together with the Subcommittee on Economic Statistics, are concerned with the progress being made in the field of statistical reporting of worldwide economic data. This concern is twofold. First, as a part of our continuing responsibility to the Congress to keep abreast of needs in the field of economic statistics, we wish to bring up to date the previous reports of the executive branch of the Government to this committee. Secondly, we are engaged in a review of foreign economic policy which requires a consideration of the availability of data needed to make analyses of comparative economic conditions from country to country.

The Subcommittee on Foreign Economic Policy is holding hearings in November of this year which seek to relate guiding economic principles to the specific political and business needs of the country. Such a linkage can lead to fruitful results only on the basis of reliable statistical facts. We are studying the nature of the comparative advantages enjoyed by the major participants in world trade. We are concerned with assessing the competitive position of American business, labor, and agriculture in world markets, and with the potential effects which foreign production may have upon our own markets. This concern extends to individual commodity reviews of costs and prices, and also the aggregative effects upon levels of national income of shifts in the volume of trade. Our concern with foreign economic policy extends to the drive to develop the so-called backward areas, and to the economic rivalries between the countries in the two major ideological camps.

Therefore, it seems to us that the following categories of data are of particular significance to these investigations:

(1) Adequate reporting of import and export statistics of all countries of the world in common terms of commodity classification, units of net and gross measure, comparable valuations, comparable definitions of origin and destination.

(2) Identification and classification of production data within all significant countries of the world to trace important changes of output in comparable terms, and sufficient analysis of costs of production and of selling prices.

(3) Data on gross national product and national income in comparable terms.

(4) Data on the distribution of product and income by functional categories, income recipients and industries.

(5) Data on shifts in the terms of trade in international commerce.

(6) Data on the balance of payments positions of all countries of the world, giving recognition not only to total figures but also holdings of hard and soft currencies, and relations with dependent areas.

(7) Other pertinent economic and financial data, including money supply, banking figures, gold reserves, and Government fiscal information.

We recognize that some of these data can be readily collected or prepared by branches of our own Government, while others become available only as other governments make them available on a cooperative basis. We further recognize that international agencies such as the United Nations, the International Monetary Fund, the World Bank, and regional groups like ECAFE have had to take the lead in establishing common definitions and collection efforts in many of these areas of compilation. We should appreciate the help of your office in identifying and collecting from those parts of the Federal Government which are principal compilers and principal users of the types of international data referred to above. We suppose that the principal agencies concerned would include the Department of Commerce, the Department of State, the Department of Agriculture, the Department of Labor, the Department of the Treasury, the Tariff Commission, the Federal Reserve Bank, and the intelligence community.

By these agencies and any other important ones we may have overlooked, we should like to have reports prepared which do not duplicate previous submissions to the joint committee. The purpose of these reports as suggested above is really twofold. In the first place, they should represent an appraisal by the agency concerned of its particular needs for better reporting, with recommendations as to whether changes within that agency could accomplish this need, or whether improvements are needed elsewhere to this end. We would think of these reports, when coordinated by the Office of Statistical Standards, as a bringing up to date the review of Federal statistical requirements in the international field. The report then might help these agencies to appraise their own position, and also serve as a basis for the joint committee to recommend statistical changes and improvements in its report to the Congress. In the second place, we wish a section of each report to address itself specifically to the needs of the Subcommittee on Foreign Economic Policy. This section should answer, from the viewpoint of the agency concerned, "How well equipped are we to make the kind of meaningful comparisons among nations required if the Congress is to frame intelligent legislation in the field of economic policy which has international significance or repercussions?"

The reports prepared should take advantage of existing studies, and their length should be tailored to the circumstances of the agency. There is no reason to resubmit previous findings, unless they are in summary form, or necessary to the interpretation of the current report. They should be forwarded to the Office of Statistical Standards for further transmission to the Subcommittee on Foreign Economic Policy by November 1, 1955. Any reports ready before that date would be useful to have when available.

Very truly yours,

RICHARD BOLLING, M. C.,
Chairman, Subcommittee on Foreign Economic Policy.

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington 25, D. C., November 9, 1955.

Hon. RICHARD BOLLING,
Chairman, Subcommittee on Foreign Economic Policy,
Joint Committee on the Economic Report,
House of Representatives, Washington 25, D. C.

MY DEAR MR. CHAIRMAN: In your letter to me of September 20, 1955, you requested the cooperation of this Office in bringing together the views of the interested Federal agencies as to the adequacy of available economic statistics for analysis of problems of foreign economic policy, with special attention to the problem of international comparability of data.

In my absence, Mr. Riley replied to you on September 28 indicating that we would be glad to comply with this request. Accordingly we wrote the various agencies whose views seemed most likely to be helpful, enclosing a copy of your letter and requesting that statements be sent to us for transmittal to the Subcommittee on Foreign Economic Policy. The attached copy of a letter of September 28, 1955, from Mr. Riley to Chairman Martin, of the Board of Governors of the Federal Reserve System (appendix A), is typical of the letters which we sent, with appropriate adaptations, to the several agencies.

I am writing now to transmit to you the statements which we have received. They include statements from the Departments of Agriculture, Commerce, Labor, State, and Treasury, the Board of Governors of the Federal Reserve System, the Council of Economic Advisers, the International Cooperation Administration, the United States Tariff Commission, and the intelligence agencies. These are attached as appendixes. We expect also to receive a statement within a few days from the Department of the Interior, which we will forward to you.

Although these statements require no commentary, it may be useful to indicate briefly how they relate to the seven categories of statistics which you indicated in your letter would be of particular interest to the subcommittee. The categories as listed in your letter may be identified briefly as follows: (1) Imports and exports; (2) production, costs, and prices; (3) gross national product and national income; (4) distribution of income and product data by functional categories, income recipients, and industries; (5) terms of trade; (6) balance of payments; (7) money, banking, and other economic and financial data.

The Department of Commerce statement (appendix B), comprising 5 separate papers, deals directly with 6 of the 7 listed categories. It includes statements by the Bureau of Foreign Commerce on foreign trade statistics (appendix B–1) and on terms of trade (appendix B–2); a statement by the Bureau of the Census on foreign-trade statistics and production statistics (appendix B–3); and statements by the Office of Business Economics on national income and product and related data (appendix B–4) and on the balance of payments (appendix B–5). You will note that the statements of the Bureau of Foreign Commerce and of Census on foreign-trade statistics cover some of the same ground but with some difference in viewpoint and emphasis. The Bureau of Foreign Commerce has a leading responsibility for assembling and interpreting foreign data in this field, while the Bureau of the Census, as the agency responsible for collecting United States export and import data, is most directly involved in United States efforts to conform to international standards of comparability.

The statement of the Department of Labor (appendix C) discusses the needs of the Department for data bearing on foreign economic policy, and deals with both the Department's own statistical programs covering prices, employment, earnings, and related data (relating most directly to categories (2) and (4) in your letter) and its requirements for foreign trade and other statistics.

The statement of the Department of Agriculture (appendix D) cites as still appropriate the data presented for the 1954 hearings of the Subcommittee on Economic Statistics dealing with your category of production, cost, and price data, and offers a brief addendum on foreign agricultural production statistics.

The statement of the Treasury Department (appendix E) deals with the Department's program of international financial statistics, and also discusses more generally data for foreign economic policy analysis.

The statement of the Board of Governors of the Federal Reserve System (appendix F) similarly deals with the program of the System with respect to financial data; and more broadly with the needs of the Board and others for data in the various fields.

The statement of the Department of State (appendix G) reflects the experience of the Department as a user and collector of foreign economic data generally. A separate extensive statement is filed by the International Cooperation Administration (appendix H) also covering the range of data under discussion, and reflecting the experience of the International Cooperation Administration and its predecessor agencies in obtaining and using data covering foreign aid recipients.

The statement of the Council of Economic Advisers (appendix I) deals generally with data needed for analysis of international economic relations, with special emphasis on foreign trade and balance of payments data.

The statement of the Tariff Commission (appendix J) explains the data requirements of the Commission in connection with its various types of investigation, and includes a discussion of the Commission's experience with comparative cost determination.

Finally the statement submitted by the intelligence agencies (appendix K) deals with economic statistics published by countries of the Sino-Soviet bloc.

These statements cover a wide variety of issues and reflect a diversity of experience, and in the short time that they have been in our hands it has not been practicable to prepare a definitive summary. However, a reading of the materials does suggest a few general comments. Thus there is recurrent testimony as to postwar progress toward the development of an internationally comparable body of world economic data, and there is recognition of the role played by the United Nations and other international agencies and of the leadership of this country, including its technical-assistance activities. There is also some reference to the point that the degree of United States compliance with internationally accepted standards may affect the disposition of other nations to comply. There is no lack of testimony as to unsolved problems involving availability, quality, and comparability of foreign data, with particular emphasis on the shortcomings of data for underdeveloped countries as well as for the Sino-Soviet bloc. A substantial amount of attention is given to United States data used in the analysis of our international economic problems, and the need for further improvement, with some testimony as to recent retrogression. The extent to which remaining problems are viewed as serious appears to vary in terms of the problems and the data involved. Recommendations, express or implied, include continued support of the activities of the international agencies and of the United States technical assistance program as they relate to statistics, fuller staffing of overseas missions for collecting foreign statistics, and the application of greater resources to the United States statistical program.

We are happy to have had the opportunity of participating with your subcommittee in this inquiry. The statements submitted deal with problems of importance to the Office of Statistical Standards, and we expect to study them with profit.

Sincerely yours,

RAYMOND T. BOWMAN,
Assistant Director for Statistical Standards.

APPENDIX A

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington 25, D. C., September 28, 1955.

Hon. WILLIAM McC. MARTIN, Jr.,
Chairman, Board of Governors of the Federal Reserve System,
Washington, D. C.

MY DEAR MR. MARTIN: I am enclosing a copy of a letter from Representative Bolling, chairman of the Subcommittee on Foreign Economic Policy of the Joint Committee on the Economic Report. This letter asks for an appraisal of available economic statistics from the point of view of the determination of foreign economic policy, with special attention to the problem of international comparability of data, and requests the Office of Statistical Standards to bring together the views of the Federal agencies most concerned.

I am accordingly requesting that selected agencies, including the Board of Governors of the Federal Reserve System, prepare appropriate statements responsive to the Bolling letter. These statements should cover postwar progress in developing United States statistics for the stated purposes as well as progress toward the availability of comparable foreign data. They should indicate important needs and recommendations both for improving our own data and for appropriate United States action to encourage improvement in foreign data. We look to each agency to discuss the data in those fields listed in the Bolling letter in which it has a primary responsibility for collection or compilation; and we are also interested in its appraisal and recommendations with respect to statistical data regardless of source, reflecting its experience as a user of data and as a participant in the formulation of United States policy.

The statements may overlap to some extent the materials presented for the 1954 hearings of the Subcommittee on Economic Statistics of the joint committee, particularly as they relate to United States data. Each responding agency should feel free to exercise its own judgment as to whether the purposes of the present inquiry would be best served by further elaborating, repeating, or merely citing such earlier materials.

In order that there will be time for such collation and summarization as may be called for prior to the subcommittee hearings scheduled for November 9, I hope that you will be able to give us your reply by November 1, 1955. We are asking Mr. Edward T. Crowder of this Office to make himself available for answering particular questions that may arise in your staff regarding this matter.

Sincerely yours,

DONALD C. RILEY,
Acting Chief, Office of Statistical Standards.

Enclosure.

APPENDIX B

DEPARTMENT OF COMMERCE,
OFFICE OF THE ASSISTANT SECRETARY,
Washington, November 8, 1955.

Mr. DONALD C. RILEY,
Acting Chief, Office of Statistical Standards,
Bureau of the Budget, Washington, D. C.

DEAR MR. RILEY: The attached information is in further reply to your letter of September 28, 1955, in which you requested selected bureaus in the Department of Commerce to prepare statements responsive to a letter addressed to you by Congressman Bolling. We understand this information will be made available to a subcommittee of which Congressman Bolling is chairman, which subcommittee will begin hearings on November 9, 1955.

Sincerely yours,

OSCAR H. NEILSON,
Director, Office of Budget and Management.

Enclosures.

APPENDIX B-1

STATEMENT BY BUREAU OF FOREIGN COMMERCE ON ADEQUACY OF FOREIGN TRADE STATISTICS

Foreign trade data of the countries of the world are compiled from the point of view of each country's own needs, influenced by tariff laws, administration of import or export controls, the composition of trade, the importance of foreign trade to the country, statistical budgets, historical accidents, and numerous other factors. About 135 countries publish some kind of trade data, varying from nothing more than estimated totals of the value of annual trade to detailed commodity-by-country listings showing the quantity, value, and destination or origin of each of several thousand items.

It is often impossible, because of the wide differences in bases of data collection and methods or concepts of compilation and reporting, to combine or compare with exactitude data on the total value, or on geographic or commodity categories, of the trade of various countries. The United Nations, however, has in the postwar years made a major contribution toward increasing the international comparability of foreign trade statistics. Through its Statistical Commission, it has pressed for the adoption of standard terminology and statistical practices in relation to all important phases of world trade. As is indicated in the following pages, many steps toward uniformity have already been taken. Many more are expected in the near future.

Because of the special requirements in individual countries, however, there still exist, and will probably continue to exist, many areas of international incomparability in the national foreign trade statistics. These are briefly discussed, together with steps being taken by the United Nations to achieve a closer approach to uniformity, under the following headings:

1. Systems or concepts of trade
2. Commodity classification
3. Country nomenclature and bases for classification by destination or origin
4. Coverage
5. Valuation
6. Availability, timeliness, and continuity

Two principal "systems" of trade statistics, or concepts of trade, are used in recording foreign trade transactions, with consequent differences in coverage and comparability: the "general" system (exports, including reexports; and imports, including all arrivals other than direct transit and transshipment trade) and the "special" system (imports for domestic consumption, improvement or repair; and exports of domestic produce and of foreign goods after customs clearance for import or after transformation). Somewhat more than half the countries of the world—principally the continental European countries and their dependencies—use the special trade system. A few use a system for exports different from that for imports, or various mixed systems. Some special-trade countries also report supplemental information such as direct and indirect transit trade, but these are in the minority. In addition to these major differences in systems of recording trade, the practices of individual countries vary widely in actual application of the systems, so that difficulties of interpretation which lead to inaccurate comparisons are frequent.

The differences described above are responsible in large measure for many of the serious discrepancies observed in the records of trading partners regarding movements of goods between them. Moreover, some of the systems in common use provide records which omit significant foreign trading activities of the country's residents.

The United Nations has recommended that countries record transactions according to both systems. Only a few countries, however, of which the principal one is the United States, record imports on both the general and special trade systems. Even the United States publishes commodity detail only on the special-trade basis, the alternative record being unavailable except in unpublished form.

Commodity classification

The many different commodity classifications which have been developed out of the diversity of national trade and administrative requirements, and which are still in use, present serious problems of international comparability. Widespread adoption of a standard classification of commodities entering international trade would greatly facilitate comparisons between common or related commodity categories for all countries or selected countries.

The most hopeful development in the commodity classification field is the provision by the United Nations of commodity indexes which group about 20,000 individual commodities into 570 basic items of a Standard International Trade Classification (SITC) under which the millions of individual transactions comprising international trade can be reported. The 570 basic items, in turn, are grouped into successively broader categories for summary comparisons.

The use of this SITC was recommended to the member countries by the Economic and Social Council of the United Nations in 1950 after several years of preliminary work by the U. N. Statistical Commission. Since that time, 19 countries have adopted it as their national classification (sometimes with modifications); 23 other countries make available their commodity data in this form on a supplementary basis, even though they have not changed their national classifications. A substantial number of the countries which have shifted to the SITC outright have done so very recently, either in January 1954 or 1955.

A further refinement of the SITC has been incorporated in the new Central American Tariff Nomenclature, based on the SITC terminology. It includes a total of 1,280 subitems, with a proposed accompanying index manual which will group about 100,000 individual commodities under the appropriate subitems. This has been adopted by Costa Rica and Jamaica to serve as both a tariff and a trade classification. When put into effect by all Central American countries, it will enormously simplify the comparison of trade statistics in that area of the world.

The best recent example of a comprehensive presentation of data on international commodity movements is the 1954 annual Commodity Trade Statistics published in August by the United Nations. Commodity-by-country detail of exports and imports is published by the United Nations in terms of the 150 groups of the SITC for 23 of the principal countries in complete form and for 11 others in partial form. These statistics cover approximately 75 percent of world exports and 65 percent of world imports. Partly because the exact limits of each SITC class have not always been clearly recognized and partly because individual classifications of the established national systems overlap SITC classes in a number of cases, the contents of some of the SITC categories shown classes not strictly homogeneous for every country.

In cases of countries whose trade statistics are deficient in commodity details or in other respects, various expedients may sometimes be used to compensate for the lack of direct reporting. Among the more common of these expedients are estimation on the basis of residuals, when a country's data are incompletely detailed, and derivation of missing details or even totals from records of trading-partner countries when a country's official data are not available. The latter techniques, however, is complicated and clouded by differences in valuations, time lags between the recording of an export shipment and its arrival in the partner country, and possible duplication or omission of data because of transshipments or other factors. Reasonably reliable tabulations of this type are difficult, and the expenditure of time and effort on such methods may only be justified in exceptional cases.

This is the situation regarding trade with the Soviet-bloc countries, which publish no usable statistical data of their own. Because of the interest of the United States Government in their trade, and because of the absence of any alternative, estimates of Soviet bloc countries' trade with the free world are laboriously built up in the Department of Commerce from the detailed country-by-commodity data reported by their free-world trading partners.

A few countries employ, in addition to their basic commodity groupings, supplementary classifications to present summary commodity trade information by economic classes, origin of materials, tariff status, or purposes served by the transactions. These are often highly useful, but are not at all uniformly available.

It is unfortunate that breaks in national continuity of trade data have been unavoidable at the time of each changeover in a country's classification. Conversion indexes are often available to aid in linking the new and old classifications, but this is at best a slow and tedious task, and the results are usually replete with unavoidable inaccuracies in the finer details.

Country nomenclature and bases for classification by destination or origin

The definition of "country" nomenclature for geographic classification of external trade statistics is the major basic aspect of such statistics on which international agreement has not yet been reached. The consequent difficulties in trade comparisons can be readily understood. There are many changes in boundaries over periods of time, and the effective dates on which such boundary changes are reflected in statistics of the countries involved and in those of their trading partners vary widely.

Official figures showing the prewar and postwar trade of Japan, for example, are not at all comparable. For approximate comparability, the trade of Taiwan, Korea, and other former territories of Japan must be excluded from Japan's prewar foreign trade totals, and her trade with them must be added to those totals. Some of Japan's trading partners have not yet adjusted their definitions to Japan's present-day territory. More often than not, the data necessary for adjustment of either historical figures or current figures to a comparable basis are lacking because one or more of the areas involved was in one or both periods an integral part of some other national jurisdiction, so that nothing in the nature of a foreign trade record has been compiled. The postwar division of prewar Germany and India are a leading example of this type.

Differences arise in regard to the treatment of areas within the political control of a country which are not part of its customs area, as in the case of the Channel Islands, which are part of the political, but not the customs, area of the United Kingdom. Similarly, the French include the Saar in their customs area, but most of the Saar's trading partners show transactions with that area separately. Although mainland China is now frequently shown as a separate country, many countries continue, in their statistics on trade with China, to include or exclude variously Taiwan, Tibet, Manchuria, Mongolia, Hong Kong, Macao and/or a few other areas. Alaska, Hawaii, and Puerto Rico are included in the United States customs area (and are treated as part of the United States in its own trade statistics), but are shown separately or in a general all other countries group in the statistics of many foreign countries. In line with the recommendations of the United Nations Statistical Commission, some countries have drafted official descriptions of their customs areas for use in compiling a generally accepted list of country designations. However, for many reasons—political or statistical—this list is not yet uniformly adhered to.

There are three principal bases in general use for classifying trade movements according to countries from which imports are received or to which exports are sent: country of consignment; country of origin or consumption; and country of purchase or sale. The basis recommended by the United Nations Statistical Commission, though not now widely in use, is that of country of consignment because it lends itself to clearer definition and more accurate implementation than the other criteria. In practice, it is the simplest and often the only criterion the importer or exporter can follow in furnishing information at the time the goods cross the border.

The practice of recording country of origin or consumption, which is most commonly used throughout the world, is preferred by many countries because it has advantages in the administration of commercial policy and is believed to afford information on the interdependence of producing and consuming countries. The precise formulation of the concepts of countries of origin and of consumption for practical application is extremely difficult, however, and it is correspondingly burdensome to obtain the necessary documentation and accurate information from the importers and exporters. In fact, many transactions of countries following the origin or consumption criterion in principle are known to be recorded in practice according to one of the other criteria. This usually stems from lack of full knowledge by traders or customs officials of the past or prospective history of the merchandise.

Statistics by country of purchase or sale are usually provided as supplements to geographic classifications on other bases, but at least two countries—Denmark and Colombia—use this as their primary basis for recording detailed country data.

Each of the bases mentioned has unique advantages, but with three diverse approaches in use, each subject to inconsistencies in practical application, it is difficult to analyze flows of trade from source to ultimate destination, or to reconcile disparities between the statistics of partner countries.

Coverage

The coverage of goods included in the various national reports of foreign trade statistics differs for many reasons. Among the most important are varying treatment of certain kinds of goods, administrative difficulties in recording statistics on some types of transactions, and reluctance to reveal information of a commercially or militarily confidential character.

Gold, silver, fishery products, ships, and ships' stores are examples of goods which are treated differently by various countries. Many include some forms of gold in their foreign trade statistics, although the United Nations recommends that all gold (except certain manufactures) be excluded as international gold purchases and sales are primarily monetary transactions. Conversely, some countries (including the United States) exclude silver from their basic compilations, although the U. N. recommends its inclusion.

Some countries (e. g., Norway and Japan) exclude fish and fishery products landed abroad directly from the high seas by domestic vessels. The recording of purchases and sales of ships differs among the foreign trade reports of the various countries. For example, the majority of countries includes all purchases and sales of ships, but the United Kingdom, which includes purchases and sales of new ships, excludes old ships. Statistics on trade in bunkers and other ships' stores are excluded from most foreign trade statistics, but some include them.

Foreign oil companies' exports of crude petroleum are excluded from Iraqi export statistics, although they constitute probably 85 percent or more of exports from that country. Export values can only be estimated from reported tonnages. Although Israel imports substantial amounts of crude petroleum, these no longer appear in the published statistics. Innumerable other examples could be cited.

Foreign trade statistics are often incomplete and incomparable from one country to another simply because of difficulties involved in obtaining statistics. This is true, for example, of trade across some land frontiers such as Indian trade with Tibet, Nepal, Bhutan, and Sikkim; Egyptian trade with Sudan; Afghanistan trade with U. S. S. R.; and the Federal Republic of Germany's trade with the Soviet Zone (although the latter is published separately in limited detail). Small-value transactions, gifts, parcel post, tourist baggage, and other fringe items are commonly either omitted or reported without detail because the cost of collection would be disproportionate to the informational value of such data.

Protection of national interests is the ground for the common—though not universal—practice of excluding from published foreign-trade statistics transfers of military goods. Similarly, trade in fissionable materials has generally been excluded in recent years.

In order to prevent revelation of transactions regarded as confidential by a domestic industry or a single major firm, certain detailed trade statistics are often withheld or combined in broader totals. For example, trade in diamonds is excluded by the United Kingdom and by the Netherlands, although separate totals for Dutch purchases and sales of diamonds are available.

Detailed statistics on transit trade, although valuable in analyzing the flow of foreign commerce, are seldom available. The Netherlands and Belgium-Luxembourg are among the few countries for which such data are reported. Belgium, however, reports only country and commodity totals, with no country-by-commodity or commodity-by-country detail.

Foreign-trade statistics by means of transport are useful tools for some types of economic analysis, but are not widely available. A recent investigation of statistics of Western European countries revealed that there are only three countries which now classify them by means of transport by country. Of these, only French statistics are available in country-by-commodity detail by means of transport.

Valuation

According to United Nations recommendations, the valuation of foreign-trade statistics should reflect the actual transaction values of imports and exports. This valuation is widely used, but there are many exceptions. Exports of bananas from certain Latin American countries, for example, are almost always recorded at arbitrary values, as transaction values are usually not known.

Trade between Iran and the U. S. S. R., which moves under a barter arrangement, is considered to be valued at nominal amounts. In some countries, customs or foreign-exchange regulations give rise to declarations of values on some basis other than actual prices underlying the transactions.

Exports are generally valued f. o. b. (free on board), port of shipment, with minor exceptions. The valuation of imports, however, varies more widely. The general practice is to value imports on a c. i. f. (cost, insurance, and freight) basis at the frontier of the importing country. Nevertheless, 15 countries, many of them major trading countries, value their imports f. o. b. foreign port of exportation. In order to compile internationally comparable data, appropriate adjustments are in order, but can be made only on the basis of rough estimates.

Foreign trade statistics are, of course, ordinarily recorded in the national currencies. The publication by the International Monetary Fund of conversion factors for foreign trade statistics and of dollar values of trade of foreign countries, has done much to standardize dollar conversion factors for trade statistics. Nevertheless, for some countries, the conversions to United States dollar values are mere approximations. In Argentina, for example, where a multiple exchange rate system remains in effect, dollar equivalents of peso values, computed at a uniform exchange rate, may differ substantially from dollar equivalents based on the varying effective rates for individual commodities. Special care must be exercised in interpreting data from countries in which such situations exist.

Availability, timeliness and continuity

The primary sources of official international trade information are the national reports showing direction and composition of merchandise movements. Trade data of dependent areas are published either by the areas themselves or by the mother country, and sometimes by both. These foreign publications are available in complete sets (more or less) in the Department of Commerce, the Library of Congress, and the International Monetary Fund in Washington, perhaps at a few principal public and university libraries, and at the United Nations headquarters in New York. Otherwise, such data are not readily available in the United States. Problems of language, valuation, and interpretation of data present serious impediments to their proper use by most United States citizens.

As indicated earlier, external trade data of some kind are being published at present for about 135 countries. These variously comprise annual, monthly, and other periodic reports of trade by countries, trade by commodities, and country-by-commodity or commodity-by-country trade. The degree of detail which is made available varies widely, from the simple listing of totals or of a few principal trading partners and a few principal export commodities to the very extensive listing of nearly 5,000 export and import items, showing complete distributions of commodities by country of origin or destination. A few important countries of the world trading community, as well as a number of minor ones, publish no data. Among the free-world countries, the most noticeable lack is that of data from certain petroleum exporting areas of the Middle East, such as Saudi Arabia and Kuwait. The major gap in reporting of trade data today, however, is the absence of statistics from the countries of the Soviet bloc. In the past year, a few data have been made available, but for practical purposes a picture of the trade of the free world with the bloc must be laboriously built up by compiling the data of each free-world trading partner on trade with each bloc country. There are no usable data available regarding intrabloc trade.

In addition to the official records, published in the originating country, several excellent up-to-date compilations on a monthly, quarterly, and annual basis are available from international and regional organizations, based on official reports submitted to them by cooperating countries. These publications provide data, for the most part, converted to United States dollars.

It is never possible to secure detailed trade data on a literally up-to-date basis, for there is inevitably a lag in recording and publishing trade data. For some of the larger countries, hundreds of thousands of customs documents must be processed each month, and while the volume of raw data is lower in smaller countries, their resources for handling it are typically more than proportionately smaller. Moreover, the assembly of many countries' reports at any central point requires further time. As of October, most large trading countries have published fairly detailed information regarding their trade by country and commodity through the first 6 months of 1955, and some of them through July or August. A number of these countries release data on total trade values several days or weeks before the more detailed reports can be published. On the other hand, there are still a number of important countries which have not yet published detailed information showing origins and destinations of commodities traded in 1954.

Some countries publish detailed data so late as to be of little value for any except historical purposes. Many publish brief statistical accounts of trade on a more or less current basis, but with a time lag of some years before information in any significant detail is available (e. g., South Africa and Venezuela). Some, but by no means all, of the gaps can be filled by countries' submissions regarding the direction of their commodity trade to the OEEC and the United Nations.

The question of continuity of data has been mentioned in other sections relating to classification and country nomenclature, but it needs to be stressed that this is a very real problem in adequately presenting data on a comparable basis over a period of years. The postwar period has generally been one of great change in improvement in the compilation of trade statistics. But very few countries which have changed their classifications or coverage have found it possible to retabulate data for earlier years on comparable bases. When new definitions are adopted, (e. g., to include silver and exclude gold in statistics of total trade, as recommended by the United Nations), current data are thereafter compiled in a different form from those of earlier years. Often, details from the earlier period are not available for construction of comparable series; and even if they are, the task is sometimes beyond the resources of most users of the data.

Appendix B, 2

Statement by Bureau of Foreign Commerce on Adequacy of Data on Shifts in the Terms of Trade in International Commerce

Terms of trade statistics, together with the export and import price indexes on which they are based and the related indexes of the volume of foreign trade, serve a number of purposes within the United States Government. They are essential, for example, to even elementary analysis of current developments and historical trends in any country's exports and imports. They help to clarify balance-of-payments developments and to identify causes of foreign exchange difficulties. They shed much light on the relationship of foreign trade to domestic economic activity and changes in real incomes, especially in underdeveloped countries. In short, terms-of-trade and related data are necessary for sound technical understanding of most countries' business conditions and prospects.

Analyses in the above fields, in turn, often play important rules in determining United States policies with respect to such issues as the allocation of foreign-aid funds, the making of international loans, or the decisions taken in the administration of the General Agreement on Tariffs and Trade or of the activities of the International Monetary Fund. Terms of trade statistics have also been widely used in various international forums in connection with debates regarding proposed international commodity agreements, schemes for stabilization of primary product prices, etc.

The standard of reference in judging adequacy of available terms of trade data necessarily varies with the analytical purpose at hand. For some of the typical uses suggested above, few details are needed, and rough approximations may suffice. For others, details for various commodity classifications or geographic areas, or both, may be required, and a high degree of precision may be desirable. The following comments outline in general terms the situation as to the adequacy of terms of trade and closely related figures, with respect to the following aspects:

1. Their availability, country by country.
2. The continuity and timeliness of available terms of trade series.
3. Technical comparability of the calculations from country to country with respect to degree of commodity coverage and the methods of calculation employed.
4. Availability of country indices by commodity groups and by monetary areas.
5. Availability of global and regional measures.
6. The situation with regard specifically to United States terms of trade statistics.

Briefly summarized, the situation is as follows:

1. A number of countries do not calculate the unit value indexes of exports and imports requisite for computing their terms of trade.

2. In many cases the limited historical extent and continuity of the calculations, or the lack of timeliness in the calculation for the latest periods, impair seriously the usefulness of computations to describe the terms of trade.

3. Limitations on the technical quality of the index number calculations and their comparability from country to country, varying from minor to substantial in degree, necessitate corresponding reservations with respect to the accuracy of description of the terms of trade of particular countries and the validity of comparisons among countries. These limitations become more serious with the increasing span of time to which descriptions or comparisons apply.

4. Although many countries furnish index numbers for breakdowns of their foreign trade by commodity groups and/or countries or areas with which they trade, much further detail along these lines would facilitate analysis of trade developments.

5. The United Nations Statistical Office, the staffs of the United Nations regional economic commissions, and the OEEC headquarters have done very valuable work in compiling consolidated weighted averages of terms of trade indexes, the underlying export and import price indexes, and related quantum indexes for regional or monetary groupings of countries, as well as on a global basis. These provide a most helpful standard of comparison for individual country indexes.

6. The United States terms of trade and related foreign trade indexes are adequate in terms of frequency, and are fairly satisfactory from the standpoint of timeliness, and commodity-group breakdowns. On the latter point, however, further distinction between consumer and capital goods, and between durable and nondurable goods, would be desirable. The United States data are more seriously deficient as regards breakdowns by regional or monetary groupings of trading partners. Apart from special indexes of United States trade with the Latin American Republics, nothing is now being done in this field.

As regards methodology, the United States indexes are believed to be in need of review and revision aimed at improving the sampling coverage of items figuring directly in the index computations, and at better stratification of the weighting system. While the Bureau of Foreign Commerce is in the process of conducting such a review, it has not been a high-priority project, and much work remains to be completed. The nominal, or publication base of the series is also in need of updating.

All of these improvements would require allocation of staff resources which are not available at present for such extensive work on foreign trade indexes.

Availability of country calculations

Actual terms of trade indexes or the index numbers requisite for computing the terms of trade are now available in readily accessible published sources for 56 countries. The International Monetary Fund publishes in its monthly International Financial Statistics annual indexes of terms of trade for 1937, 1938, and 1948 and subsequent years for 35 countries.

Although not publishing actual terms of trade figures, the United Nations publishes index numbers of either volume or price for 45 countries of the eighty-odd countries for which it regularly reports aggregate values of exports and imports. Of the 45 countries, 18 are not represented in the IMF publication.

The terms of trade figures computed by the IMF vary considerably in quality from country to country. For some countries the figures are based, not on unit value index numbers calculated directly from the actual prices involved in export and import transactions, but rather from index numbers based merely on prices quoted in commodity markets for commodities entering into foreign trade.

In the cases of those countries for which the United Nations publishes only an index of volume, the terms of trade can be calculated by deriving implicit-price indexes. These indexes vary considerably in closeness of approximation to suitable unit value indexes, depending, of course, on the accuracy of the volume index utilized.

Continuity and timeliness of data

The construction for most countries of indexes essential for calculating the terms of trade is, historically speaking, fairly new. A number of countries which now construct such indexes introduced their series only in recent years. Available series, therefore, often do not extend over a long period of time. Moreover, in many cases their continuity is interrupted by changes in the method of construction where index numbers for earlier years have not been recalculated according to the new method. With continuity broken, data on a country's terms of trade lack comparability over time.

The value of terms of trade calculations and their underlying index numbers for economic research and foreign policy formulation would be measurably increased if the calculations were carried back further and if the statistical measures for periods prior to changes in methods of calculation were recomputed on the new basis to attain greater comparability over time.

Timeliness of terms-of-trade figures as well as historical continuity and comparability is of very considerable importance if they are to be of maximum value for United States governmental purposes. Much has been accomplished recently to secure timely availability of international trade index numbers, although for many countries their release is still unduly delayed.

Studies of shifts in terms of trade on a current basis are not possible unless the requisite index numbers are kept up to date. Many countries have recognize the value of timeliness and now publish their index numbers not only annually, but also quarterly, and even monthly with only small timelags. Moreover international organizations have done a noteworthy job in coordinating, preparing, and consolidating country index number data and in publishing the figures promptly. Indeed, as of September, numerous countries had already reported for the first half of 1955 through the medium of the United Nation's Monthly Bulletin of Statistics. Terms of trade figures and underlying index numbers for all countries would be increasingly useful if those for the lagging countries could be made current with those which are now available promptly.

Publication of figures for relatively short periods—quarterly or monthly—is a necessary (though certainly not a sufficient) condition for achieving the maximum timeliness of information and contributes to comparability and the fineness of economic analysis. Of the 45 countries with foreign trade index numbers in the United Nations Monthly Bulletin, only 27 are represented by monthly index figures. Calculation of monthly figures by the remaining 18 would augment the value of the figures in these respects.

Commodity coverage

Problems of comparability between index numbers of export and import unit values and quantities arise by reason of the usual technical factors in index number construction. Problems of commodity coverage and of method of computation deserve close attention in this field, where widely varying economic characteristics of trade, combined with differing practices in collecting and classifying data and in calculating index numbers, give rise to many reservations concerning the comparability of country index numbers.

Unit value and volume indexes for individual countries are rarely calculated from price and quantity data for every commodity that enters into their export or import trade. For the majority of countries, a higher percentage of commodities is directly included in the calculation of index numbers for exports than is the case for imports.

Data for certain commodities do not enter the calculations for several reasons. The most important is that homogeneous export or import price series are not available within some commodity classifications because the physical unit is not homogeneous or is not reported. This is especially true where "basket classes" are involved. Where fixed weights are used, products appearing in trade subsequent to the base period are especially likely to lack accurate representation. In any event, manipulation of complete detail is neither practicable nor necessary for most countries.

Of the 45 countries which publish indexes of volume and price, only 9 countries regularly include 100 percent both of exports and imports in volume index construction, and fewer still are similarly inclusive in unit value index construction. Most countries, however, are now striving to reflect directly a fairly high percentage of commodities in their index numbers.

Nevertheless, considerable room remains for improvement of commodity coverage. In the case of unit value indexes, the direct coverage of fewer than 70 percent of their imports is reported by 11 countries and of their exports by 6 countries, while in the case of volume indexes, less than 70 percent coverage is reported by 10 countries for imports and 4 countries for exports. Improvement in commodity coverage in index numbers constructed by these countries may be appropriate if price changes of the commodities not as yet covered are to be reliably reflected.

The problem of adequacy of commodity coverage arises sooner or later for most index numbers. The percentage of coverage usually decreases as an index number moves away from its base period. This point is even more applicable if successive years are compared not with the base year of an index number as presently calculated but with the year in which the index number was originally introduced. Declining coverage, which is often rather rapid, is one sign of aging of the series.

Correction of deterioration in commodity coverage appears due in a good many instances. At the end of 1954 almost one-third of the 45 countries were still using the commodity weights of prewar base periods. Certain western European countries, some still using prewar base periods, have indicated their intention of bringing their base periods more up to date.

Methods of calculation

One of the more serious problems of comparability among index numbers arises from the variety of methods employed in their computation. In particular, a number of formulas are employed which embody differences in weighting schemes and in some cases even in the basic method of averaging. Among the leading formulas in use are those of Laspeyres and Paasche and the Fisher formula.

Of 35 countries for which both unit value and volume indexes for exports and imports are available in the Monthly Bulletin of Statistics published by the Statistical Office of the United Nations, 19 countries have adopted the method of calculating a simple volume index of the base-weighted Laspeyres type with a derivative unit value index of the Paasche type. Only 6 countries calculate their indexes in the reverse fashion, i. e., a unit value index of the Laspeyres type with a derivative volume index of the Paasche type. Only four countries, and this includes the United States, are currently using the cross-weighted Fisher formula. Five other countries construct both unit value and volume indexes according to the Laspeyres formula; accordingly, they must calculate each index separately since neither one can be derived from the other (by division into the value index), and the resultant series are not mutually compatible with the value index.

Increasing uniformity in the method of constructing index number on foreign trade seems in prospect. According to a survey of western European countries reported in the May 1955 issue of the quarterly United Nations Economic Bulletin for Europe, most of the few European countries not now using Laspeyres for volume and Paasche for unit value indexes have signified their intention of adopting this combination in the near future.

The trend toward greater uniformity of method will make for greater consistency and comparability of international series such as those published by international organizations. Moreover it will reduce the need imposed by the present still considerable diversity in methods of calculation to recompute country index numbers in order to make them consistent in nature for the proper computation of world and regional indexes.

Index numbers by commodity groups and by monetary areas

Many countries publish, in addition to unit value and volume indexes for exports and imports in their entirety, group indexes that measure average unit value and quantity behavior of trade within particular commodity groupings or with particular areas of the world. Commodity group indexes permit the study of shifts in the terms of trade as they apply to particular commodities either in comparison with the aggregate of all commodities or in comparison with one another. Area indexes facilitate analysis of a country's trade with particular parts of the world which are of special interest by reason of their importance in trade, their economic homogeneity (e. g., industrial countries from which manufacturers are imported, the foreign-exchange characteristics of their currency units), or the unity of their political control.

The countries in undertaking the construction of group indexes have followed recommendations first made by the Committee of Statistical Experts of the League of Nations in 1939 and reiterated by various sessions of the Statistical Commission of the United Nations during the postwar period.

The eighth session of the Commission in April 1954 recommended that commodity group indexes should be calculated on the basis of the Standard International Commodity Classification (SITC), which more and more countries have been adopting. Countries were urged to calculate separate indexes according to sections of the SITC with a possible subsequent regrouping into the following four classes:

1. Food, beverages, and tobacco (secs. 0 and 1 of the SITC);
2. Other manufactured goods (secs. 5, 6, 7, and 8);
3. Raw materials other than fuel (secs. 2 and 4); and
4. Fuels (sec. 3).

It was suggested further that indexes be calculated for each of two subclasses, the class of "other manufactured goods" to be broken down into two subclasses, consumer goods and producer goods.

The SITC and the above classes and subclasses are already followed by six countries in elaborating their foreign-trade index numbers by groups of commodities. A number of countries which have not yet based their index numbers on the nine sections of the SITC classifications have, nevertheless, followed the economic class concepts underlying the above groupings and earlier recommended by the U. N.

Many other countries produce a varying number of group indexes according to their own schemes of classification, which reflect the commodity composition of their trade.

Comparability among the commodity group indexes computed by various countries is as yet rather limited, as the above summary suggests. Even among the industrial countries, for which it is relatively more important that appropriate economic classes be used, not all countries employ either the grouping of SITC sections or the underlying economic class concepts.

Reservations may be entertained regarding the adequacy of the above groupings of the SITC. The most serious relates to the inclusion in the manufactures group of many processed or partly processed materials of economic significance primarily as raw materials in remand for later stages of processing and fabrication.

Indexes of unit value and volume in trade with particular groups of countries are at present largely confined to currency area groupings. The principal instances are the dependent overseas territories of European metropolitan countries.

The United Nations Statistical Commission has made the far-reaching recommendation that separate volume indexes be computed for commercial trade with each of a country's principal suppliers or customers. The availability of indexes by principal trading partners would permit corresponding terms of trade calculations. This recommendation, however, has not yet been adopted by any country.

Global and regional indexes

Despite the gaps in index number statistics and the defects and limited comparability of the available figures, international organizations are now constructing indexes of the terms of trade for certain world regions, and unit value or price index numbers on both global and regional bases.

The OEEC publishes monthly indexes of export and import unit values and volumes for the total of all trade among OEEC countries and for trade between OEEC countries and the rest of the free world. It also publishes terms of trade figures calculated from these indexes. The International Monetary Fund provides monthly indexes on terms of trade, based partly on quoted prices of export and imports, for Latin America, the continental EPU countries (countries participating in the European Payments Union), the United Kingdom dependencies, and the self-governing countries of the British Commonwealth. The Economic Commission for Europe, as part of its yearly economic survey of the area, prepares and publishes annual regional figures similar to those reported monthly by the OEEC.

Other useful tools for global and regional analysis are provided by the United Nations at quarterly intervals. One of these is a set of export unit value and volume indexes for the world and the major regions grouped along geographical or monetary lines. The regions include northern North America, Latin America, continental Western Europe, the sterling area (with certain subdivisions), the Middle Eastern and Far Eastern countries outside the sterling area. The global and regional groupings omit trade of the Soviet bloc countries.

Another set of global indexes released quarterly by the United Nations is comprised of a global export unit value index for all commodities, a similar index for manufactured goods, and world price indexes for raw materials. In the raw material indexes about one-half of the weight is assigned to import prices, c. i. f., and one-half to export prices, f. o. b. The raw materials price indexes include a total index for all raw materials, separate indexes for food and nonfood commodities, and special group indexes for agricultural and mineral commodities.

For Western Europe as a whole, the OEEC has worked out a price index for foodstuffs imported by OEEC countries from outside their area, and a similar index for industrial raw materials.

Index number statistics on global and regional bases are spotty in coverage, both as to geography and as to content in other respects. Moreover, under present circumstances of limited and often poor basic country index number data, their quality leaves much to be desired.

United States terms-of-trade and related indexes

In the United States, balance-of-payments and foreign exchange reserve problems scarcely exist in the sense so crucial for many foreign countries in recent years. Accordingly, interest in the terms-of-trade ratio as such is perhaps a good deal less urgent than in most other countries. The component export and import price indexes and the related volume indexes, however, are highly valuable and indeed indispensable analytical tools.

The attached explanation of index numbers of United States exports and imports describes in summary manner the technical characteristics and commodity breakdowns of the United States indexes. They are computed and published on a monthly basis, as well as annually and for intermediate periods. Annual data are available for 1913 and in a continuous series from 1919 to date. Quarterly figures cover all years from 1929 to date, and a monthly series is available from July 1933 to date.

The commodity categories for which United States indexes are computed are the five standard economic classes into which commodity details have been grouped for many decades by the Bureau of the Census, the compiling agency for United States foreign trade statistics. In terms of current analytical techniques, there is a need for breakdowns which would also, or alternatively, distinguish between consumer and capital goods, as well as between durables and nondurables. This would require provision of compilations for such categories in the basic machine tabulations of the foreign trade statistics.

There is also a deficiency of breakdowns of the United States indexes by regional or monetary groups of countries of origin and destination of United States trade. Except for limited special indexes, annual and quarterly for recent years, of export and import prices, volume, and terms of trade in merchandise transactions with the Latin American Republic, neither the Bureau of Foreign Commerce nor any other Government agency has been able to provide regular indexes of United States trade with particular regions or individual countries.

The Bureau of Foreign Commerce has under consideration the problem of reviewing and revising the methodology utilized in calculation of the United States indexes. Improvement of direct commodity coverage in the index samples and better stratification in the weighting system are thought to be the greatest needs from the standpoint of technical revision to increase the reliability of the data. It would also be desirable to update the nominal base year on which routine publication of the series is now based. While this is a relatively simple operation, it will require a considerable expenditure of clerical man-hours. It has been postponed chiefly in hopes of incorporating simultaneously the substantive revisions of methodology mentioned above.

In connection with both the review and revision and the current maintenance of the series, considerable time is required to obtain unit value data from the quantity and value records for individual commodities. This work is now done on manual calculators. With the prospective utilization of the Univac for foreign trade statistical tabulations, the possibility of routine Univac calculation of unit values should be explored. The exercise of judgment in construction and modification of the index samples would be greatly facilitated if detailed unit value data were readily available monthly and annually for items both within and outside of the present samples.

Most of the possible improvements suggested above would require the allocation to such projects of technical manpower not now assigned, and generally not available for assignment, to work on foreign trade indexes.

EXPLANATION OF INDEX NUMBERS OF UNITED STATES EXPORTS AND IMPORTS

Quantity, unit value, and value indexes are calculated for the totals and for each of five broad commodity categories of United States exports and imports, namely, crude materials, crude foods, manufactured foods, semimanufactures, and finished manufactures. The value indexes are based on direct ratios of current values to corresponding average values in the nominal base period. The indexes of quantity and unit value are constructed according to Fisher's "ideal" formulas,[1] using weights from both the current period and the preceding calendar year. The resultant indexes are then chained into a series with a common base.

Basic data for the index calculations are export and import commodity statistics compiled by the Bureau of the Census from data on export declarations and import entries filed at United States ports. The commodity prices used in the computations are average unit values derived from the summarized value and quantity figures published in Bureau of the Census reports No. FT 110 for imports and FT 410 for exports.

Quantity and unit value indexes are based essentially on data for selected commodities in each of the five broad economic classes of merchandise. Other commodities are included in the calculations on the basis of certain assumptions, described below, regarding their average price movements.

The selected samples generally include the leading individual products in the trade and a variety of smaller typical items. The selections, especially for manufactured goods, however, are limited somewhat by lack of homogeneity in the statistical classifications for many commodities and by the fact that the basic data do not provide quantity measures for all items. The samples are modified as improved data become available or new products enter the trade, and as items are deleted when they fall to relatively insignificant positions in the trade. Changes in the samples are made at the beginning of a calendar year—at the time the base weights for the indexes are moved forward. Ordinarily, the changes have little immediate effect on the relative coverage of total exports and imports or on the comparability of the samples from year to year. Variations in the percentage of the trade directly covered are explained, for the most part, by changes in the volume of trade in certain products.

In recent years, commodity data directly entering the index calculations have covered 68 to 73 percent of the total value of imports for consumption and 35 to 50 percent of total domestic exports (roughtly 45 to 50 percent of nonmilitary exports). Seventy percent or more of imports have been directly covered in each economic class except finished manufactures, in which the percentage has been 40 to 45. Commodities directly entering the export indexes have accounted for 90 percent of crude materials and of crude foodstuffs, 68 to 75 percent of manufactured foodstuffs, about 55 percent of semimanufactures, and 20 percent of total finished manufactures. Ordinarily the index sample has covered about 30 percent of nonmilitary exports in the latter class.

Adjustments for the incompleteness of the sample coverage are made in the data for each economic class of exports and imports by assuming that the average relative price change for commodities not directly covered corresponds to the weighted average for selected items in the same economic class. In some instances the parallel is assumed with respect to the entire sample, while in other cases, it is assumed only with respect to some given segment of the selected sample. In an instance of the former type, the final unit value index for the class remains the same as that computed from the selected sample, but weight is given in the final quantity index to the estimated change in the volume of goods not covered by the sample. In a case of the second type, the unit value index as well as the quantity index for the economic class may be influenced by the adjustment.

In mechanical terms, the result of the above assumptions is the derivation of estimated cross-product values (for the base-period volume at current-period

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[1] The formulas, in conventiaľnotation are:

$$\text{Unit value index} = 100 \sqrt{\frac{\Sigma p_1 q_0}{\Sigma p_0 q_0} \times \frac{\Sigma p_1 q_1}{\Sigma p_0 q_1}}$$

$$\text{Quantity index} = 100 \sqrt{\frac{\Sigma p_0 q_1}{\Sigma p_0 q_0} \times \frac{\Sigma p_1 q_1}{\Sigma p_1 q_0}}$$

prices and for the current-period volume at base-period prices) for the group of items in each economic class which are not incorporated in the sample. The actual base- and current-period values for each such group of items are obtained, of course, as residuals from comprehensive economic-class totals provided in the basic data (Bureau of the Census Report FT 930) and the totals for the respective samples. These base-period, curent-period, and cross-product values are added to the corresponding values calculated in detail for the sample commodities to provide the four sums required for final calculation of Fisher indexes[1] for each class. Indexes for total exports and for total imports, in turn, are computed from aggregates of exports and for total imports, in turn, are computed from aggregates of these 4 adjusted values (2 actual and 2 hypothetical) for each of the 5 economic classes.

APPENDIX B–3

STATEMENT OF THE BUREAU OF THE CENSUS IN REGARD TO AVAILABLE INTERNATIONAL ECONOMIC STATISTICS

The Bureau of the Census is responsible for the compilation of United States import and export statistics and statistics on United States production of manufactured goods. It has participated in efforts to improve international comparabiliy in these statistical fields. This statement is limited to items 1 and 2 of the statistical areas outlined in the letter from Congressman Bolling to Raymond T. Bowman of the Bureau of the Budget dated September 20 although the appraisal also has indirect application to items 3, 4, 5, and 6 of the letter which cover fields primarily the responsibility of agencies other than the Bureau of the Census.

IMPORT AND EXPORT STATISTICS

It is generally recognized that there is a substantial need for improvement in comparability of the import and export statistics of all the countries of the world if the needs of both the Congress and the executive agencies are to be met for the purposes outlined in Mr. Bolling's and Mr. Riley's letters, that is—

(1) The nature of the comparative advantages enjoyed by the major participants in world trade;

(2) The competitive position of American business, labor, and agriculture in world markets;

(3) The potential effects which foreign production may have on our own markets;

(4) The drive to develop the so-called backward areas;

(5) The economic rivalries between the countries in the two major ideological camps.

The use of other countries' import and export statistics for each of these relatively diverse purposes presents different problems in regard to the extent to which information on the imports and exports of the countries should be on a comparable basis. All of these objectives would be served at least in part if substantially comparable statistics on exports and imports of all countries were available in terms of summary commodity groupings of the data. Some of the objectives would only be served by the availability of relatively detailed information. In this context we are taking summary statistics to mean information on imports and exports for all countries in terms of a few hundred broad commodity groupings, at most no more than about 500. For these summary groupings of commodities the objective would be to obtain comparable information on each country's exports and imports to each other country in the world. Detailed import and export statistics on the other hand would consist of statistics on the imports and exports of each country showing the trade with each other country in terms of substantially greater commodity detail, say in terms of thousands of commodity classifications rather than a few hundred.

The use of export and import statistics by both Congress and the executive agencies in connection with problems of the economic rivalry between the countries in the two major ideological camps or the use of the statistics to determine the potential effects which foreign production may have on United States markets or the use of the statistics to provide information on the competitive position of American business, labor, and agriculture in world markets would tend to require greater commodity detail than that needed for such matters as the drive to develop the so-called backward areas. However, United States Government interests would in general be most adequately served if comparability were achieved at a detailed commodity level rather than at merely the level of a few hundred commodity groupings.

There is nevertheless another side to this; namely, the problem of adjusting our sights to what is reasonably attainable. It is here that there appears to be a substantial need for the United States Government to establish reasonable and consistent policies as to what it will attempt to achieve. There are at least three considerations in addition to cost which counsel a policy of not attempting to achieve comparability in terms of too great commodity detail:

(1) Countries which are heavily engaged in foreign trade and which depend for a very high proportion of their national income on merchanting transactions may look upon too detailed statistics on their buying and selling operations in international trade as essentially economic intelligence which they feel it is in their national interest to supply to their own traders but which it would be contrary to national interest to supply to other countries.

(2) Countries which are involved in the economic rivalry between the countries in the two major ideological camps are very likely to interpret an interest by the United States Government in detailed commodity information as an attempt by the United States Government to use the statistics for administrative policing of such United States statutes as the Battle Act. There is a real hesitancy on the part of foreign countries to provide information which would be likely to be used, for example, by a congressional committee, to accuse the country of "trading with the enemy." It might be pointed out in this connection that attempt to use the statisics for such primarily administrative purposes will, in fact, result in the statistics becoming useless for this purpose. The use of statistics for policing purposes would indeed be in violation of a principle followed in the collection of statistics on the United States domestic economy, namely, that statistical reports should not be used to determine whether the person or organization who supplies the information is "in violation of a regulation or to induce a violator to attest to his own violation." (Statement made in 1951 by the Bureau of the Budget based on a statement by the Advisory Council on Federal Reports, an organization of representatives of business and industry established to advise the Bureau of the Budget on statistical and other reporting requirements of the Federal Government.)

(3) Foreign countries exporting to a third country are very likely to look upon the release of information on the detailed commodity composition of this trade as giving rival exporting countries such as the United States vital information which it could use in negotiating trade agreements with the third country in such a fashion as to favor United States exports of particular products to the third country. Even if this information is not used for trade-agreement negotiations, the release of the information on exports to third countries may provide American business with information on markets for such products which they could then exploit by themselves promoting the exports of American products to these markets.

The existence of these considerations, as well as other similar ones, argues strongly for limiting the objective of comparability of import and export statistics of the countries of the world to the level of summary rather than detailed commodity classification. There is a great deal to be done even before reasonable comparability can be achieved at such a summary level and certainly it is true that, before any attempt is made to increase commodity detail, adequate comparability in terms of summary groupings of commodities should first be attained. At any rate attempts at achieving more adequately comparable import and export statistics have so far been primarily directed to the summary level of the commodity information and the following discussion will therefore be addressed to this problem only.

Progress toward the availability of comparable import and export statistics for the countries of the world

Creating adequately comparable import and export statistics for the countries of the world has been the objective of many international endeavors over the past hundred years. Until World War II the progress in this direction was modest. The progress since World War II has been relatively much more rapid. Shortly after the end of World Mar II efforts were started to set up a standard international trade commodity classification which could be adopted by the nations of the world to increase comparability. These efforts culminated in the adoption by the United Nations in 1950 of the SITC (Standard International Trade Classification). Since 1950 some 38 countries handling 70 percent of total world trade have adhered in whole or in part to the recommendation of the United Nations that they present data on a quarterly cumulative and annual basis in terms of the SITC, in general in terms of 150 groupings of commodities. The reports of these countries on a common commodity classification basis are published in the United Nations series D quarterly and annual publication series and this information has proved of important usefulness to United States Government agencies. American business has also found the information useful even though it is in terms of summarized commodity groupings. This acceptance of the recommendation of the United Nations for a common international commodity classification system has been an outstanding record and one which reflects the high importance which countries give to this participation in a common effort for the mutual advantage of all countries.

This is not to say that these data are wholly satisfactory. In one important respect they are still unsatisfactory, namely, the lack of a common valuation definition followed by all countries in reporting in terms of the SITC. This matter is one which has also received substantial attention by the United Nations, and this resulted, in February 1953, in a recommendation by the United Nations that all countries should report in terms of the common valuation definition which had been agreed upon. As yet there has been no great effort by countries to follow this definition.

Even with a common commodity classification and a common valuation definition the data on the imports and exports of all the countries of the world would not be satisfactory from a comparability point of view unless further steps were taken by the United Nations to make certain that there was comparability in terms of coverage (i. e., the types of transactions included in the statistics) and in terms of the definitions of the countries to which the import and export trade of each country is credited. The lack of a common country definition is perhaps the greatest reason for the lack of comparability among the countries in their reports on the common SITC commodity classification. Considerable attention has been given to the problem of arriving at an acceptable definition as to how trade is to be credited by country. Getting such definition worked out and adopted by the important trading countries of the world is, therefore, an important current project of the United Nations. While, until this is done, the reporting in terms of the SITC is limited in usefulness, the fact that there is substantial uniformity in commodity reporting does offer substantial assistance to the United States Government.

Postwar progress in developing United States statistics for the purposes being appraised

Except for about the past 2 years, the United States may indeed be proud of its participation in the efforts which have been made since World War II to increase the comparability of the import and export statistics of the countries of the world. Contrary to the situation before World War II, the United States soon after World War II took the lead in pressing for efforts toward increased comparability of trade statistics. The contribution of the United States as a result of these efforts undoubtedly went a long way toward achieving the success attained thus far. The United States was one of the first countries to begin reporting in terms of the United Nations recommended SITC. It should, of course, be admitted that in conforming to the United Nations recommendation on the SITC the United States in contrast to a number of other countries took the easier of two alternatives which were permitted under the United Nations recommendation. That is, the United States has been preparing supplementary quarterly and annual tabulations in which it has rearranged the commodity classifications in its regular import and export statistics into the classifications of the SITC rather than adopting the alternative more strongly recommended by the United Nations which calls for countries to use the SITC as the classification for their regular statistics. To a certain extent the fact that the United States chose the easier of two alternatives is taken by some countries as an indication of a lack of wholehearted support of the effort toward comparability of trade statistics. These countries are, however, aware of the fact that for the United States to conform under the more difficult alternative basis would require the expenditure of several hundred thousand of dollars and that the United States would then face increased difficulties in keeping comparability between its trade statistics and statistics on its internal domestic economic activities. Other countries are aware of the substantial cost of a full conversion and the conflict of interest between the need for conforming import and export statistics internationally and on a domestic basis and the United States position on the whole is, therefore, viewed sympathetically. On balance then it does not appear that there is any pressing need for the United States to undertake a more difficult conversion to the SITC.

In contrast the United States record in conforming to the February 1953 United Nations recommendation on valuation, which it took the lead in sponsoring, is not satisfactory. Here, as a result of the United Nations recommendation, the United States finds itself with a group of other countries which has to go to some effort to adhere to the United Nations recommendation. Due to a lack of resources for this work the United States has not as yet taken any action leading toward adherence to the United Nations recommendation and this uninspiring example has undoubtedly influenced the attitude of other countries toward the recommendation. The United States finds itself for the first time in the position of facing difficulties in adhering to international recommendations for comparability. In other fields of statistical activity the United States is preeminently in the forefront of countries having satisfactory statistics from the point of view of comparability. In the case of trade statistics, however, the United States, due to certain peculiarities of its tariff act, finds itself faced with a substantial problem. The lack of action by the United States when it has to go to some trouble to conform to international standards has had the unfortunate consequence of tending to convince other countries that the United States is not really wholeheartedly in support of efforts toward international comparability. To these countries this looks like a reasonable conclusion since the United States took little part in the efforts toward comparability taken prior to World War II. It is, of course, not too late for the United States to prevent this interpretation becoming too strongly entrenched with consequent considerable damage to the whole attempt at comparability both in trade statistics and in other statistical fields. To accomplish this will, however, require that Government agencies whose responsibility it is to work toward international comparability be supplied with funds necessary for this effort. Even though funds are provided, it would appear prudent in addition to have some overall statement of policy to help assure continuity in United States participation in efforts at international comparability, or at least to provide some broad assurance to other countries of the United States intentions.

The undesirable but not surprising interpretation by other countries of the United States attitude as one of lack of interest has unfortunately been reinforced by the slowdown over the past few years in United States participation in the effort to increase comparability by adopting common definitions for coverage and for the manner in which imports and exports are credited by country. Determining definitions for all countries to adopt in these areas requires a considerable amount of investigation and other active participation by interested countries in arriving at definitions which will be practical, mutually acceptable, and which will be likely to achieve the objective of comparability to some reasonable degree. Unfortunately the United States has not participated actively in this investigation work over the past several years, and this has tended to reinforce the interpretation that the United States cannot be relied upon to have a continued, sustained interest in comparability problems.

PRODUCTION DATA

In regard to the manufactures segment of the United States economy, the statistics for determining foreign economic policy are as advanced as in any part of the world and more advanced than in most. Labor and total materials cost figures are available for each of 450 individual industries on a quinquennial census basis as well as detailed production data on both quantity and value for approximately 7,000 individual commodities. Quantity and cost of consumption of several hundred key materials are also available from the quinquennial censuses. Further, there are available on an annual basis, similar labor and materials cost figures by industry and value of production data for all products grouped into approximately 1,000 product classes. These product class totals are supplemented by annual data on quantity and value of production for several hundred of the most significant commodity areas of industrial output. Coverage of these data in quinquennial censuses is complete, while in interim years the annual figures either represent completely covered activities or are highly accurate estimates developed from scientifically drawn samples.

International comparisons of industrial costs and production data suffer primarily because of the lack of such data in most foreign countries.

In a recent survey conducted by the European office of the United Nations regarding data collection practices of the United States as compared with the basic industrial statistics program recommended by the Statistical Office of the United Nations, our reply to the questionnaire indicated that our Government was fully covering all the specified significant measures of industrial activity. A review of the data collection practices of other countries, however, would indicate that with the exception of the Scandinavian nations, Canada, the United Kingdom, the Netherlands, and Australia, the collection of basic industrial statistics which could be used for international comparison purposes are sadly deficient in regard to completeness of coverage of the producing establishments in these countries, as well as the amount of statistical detail collected from establishments covered by such industrial surveys or censuses.

Substantial strides have been made in the last 5 years through the Statistical Office of the United Nations and regional international organizations to develop standard methods in conducting industrial censuses and surveys throughout the world. The Bureau of the Census has cooperated in the preparation of international standards and methods manuals. It has provided visiting groups of foreign economic statisticians with formal training courses at the Bureau, in addition to demonstrating "laboratory" fashion the actual techniques used by the Census Bureau in data collection and processing.

With the increased use of international standards, gradual improvements in statistical collection practices of other significant industrial producers of the West should be discerned in the future.

Appendix B-4

Statement by Office of Business Economics on International Data in Categories 3 and 4

Category 3: Data on gross national product and national income in comparable terms.

Category 4: Data on the distribution of product and income by functional categories, income recipients, and industries.

Because of its role in the development of national income and product analysis, the Office of Business Economics has been called upon during the past decade to assist in improving the statistics of foreign countries. As explained later, it has done so mainly by promoting the international comparability of national-income statistics through the formulation and support of uniform-reporting systems, and through the technical training of foreign personnel in national-income estimation and analysis.

Present coverage of United States data needs

The uses of foreign national income and product data for the subcommittee's purposes may be classified under three distinct headings: (1) appraisal of basic economic trends in foreign countries important to the United States; (2) intercountry comparisons as to structure of national economy—e. g., as to relative importance of various industries or of segments of the national market; and (3) intercountry comparisons of levels of living and production potential. The following comments may be made on the statistics available for each purpose:

(1) Progress in income research needed for appraisal of foreign economic trends has been rapid in the past decade. The most essential of the income and product statistics have been developed for nearly all the highly industrialized nations and for a considerable number of the so-called underdeveloped countries as well. However, the reliability and currency of the figures vary widely from country to country; there are certain troublesome disparities in concepts, and these conditions make difficult the interpretation of the data with the personnel available for the purpose. Tables I and II below, which indicate broadly the scope of the data now tabulated in the most comprehensive international summaries, in general do not reflect these difficulties.

As can be seen from the tables, more than 70 countries have prepared estimates of either national income or national product. Annual series of varying length are available for 60 countries. Two-thirds of the latter have attempted also to correct the movement of the totals for price changes.

Around 40 countries publishing current-dollar series present some breakdown by industrial origin, and a large minority provide details by form or type of income. Over a dozen have attempted the presentation of their national income statistics in an accounting framework so as to relate income to expenditure for individual segments of the national market; such "economic accounting" data are of critical importance for an understanding of the working of the economy. Comprehensive basic data on income by size classes are also available in one form or another for around a dozen countries.

The time periods spanned by annual data on the major aggregates vary considerably from country to country. This point is relevant to the subcommittee's purposes because it is hard to interpret current data without a basis in experience by which to appraise them. The table shows 26 countries with back figures for 10 years or more, while 20 have series covering periods of 5 to 10 years in length.

The most comprehensive statistics on a country naturally tend to be delayed until a fairly broad range of data sources become available for the given year. From the standpoint of current economic analysis this situation poses a major problem. By October 1955, estimates of national income or product for 1954 had been published for 22 countries, while 19 had carried their series only through 1953, and the latest estimates for the others were still older.

It will be noted that the information available to us on the income and product of the Iron Curtain countries is conspicuously inadequate in nearly all the foregoing respects. A good deal of work has been done in the United States by way of piecing together the fragmentary data which have been published, but the results have had to depend heavily on assumptions of various sorts.

(2) Foreign national income and product statistics may suffice for direct economic analysis of the countries concerned without being at all satisfactory for purposes of international comparisons. The latter in general requires at least a very close approach to uniformity of definitions, and the necessary degree of uniformity has been difficult to achieve in a field where each country is impelled by its own needs, principles, and pattern of source data to develop its own special system. However, here again a great deal of progress has been made, as a result of League of Nations, United Nations, and OEEC efforts in which technical representatives of this country have participated.

Postwar work aimed at improving the international comparability of national income and product data was initiated by the Office of Business Economics in 1944, when a series of conferences with representatives of the United Kingdom and Canada resulted in a tripartite agreement that significantly advance definitional uniformity. This initial step was of special importance inasmuch as many of the foreign statistics that were developed in the following years were patterned after either the United States or the United Kingdom data. The next major step toward international standardization of national-income accounts was a conference held under the auspices of the United Nations in Princeton, N. J., in 1945, which resulted in an initial version of a uniform system: Measurement of National Income and the Construction of Social Accounts (Geneva: United Nations, 1947). This system was considerably simplified, so as to make it more adapted to the practical possibilities of reporting countries, at a conference of OEEC countries held in Paris in 1951. Results appeared in A Standardized System of National Accounts (Paris: OEEC, 1952).

Finally, an international group of experts, working under the auspices of the United Nations in New York in the summer of 1952, developed a system that was to be applicable to all countries reporting to the Statistical Office of the United Nations, including not only Western industrialized countries, but "underdeveloped" countries as well. The report is entitled "A System of National Accounts and Supporting Tables" (New York: United Nations, 1953).

The Office of Business Economics participated actively in each of these projects.

As a result of these efforts, and the widespread work of other organizations and individual estimators, a wide variety of valid and important conclusions can be drawn from comparisons of the available statistics. Two cautions are still in order. First, no such comparison should be made without careful study of the definitions used in the countries concerned, since there still exist variations not reflected in the titles of the statistics themselves. Secondly, even if definitional uniformity has been achieved, institutional differences have to be taken into account in comparing the series. For example, the greater dependence of some countries upon factories and of others upon home handicraft must be considered in interpreting the reported proportions of national income originating in "manufacturing."

(3) The great disadvantage of national income and product statistics for international comparisons of living standards or productive power lies in the comprehensiveness of these statistics, which are designed as summaries covering substantially all forms of economic activity with proper weighting for each. Intensive efforts have been made to overcome the statistical problems involved so that this advantage may be fully exploited. However, progress has been relatively limited, and comparisons are subject to a wide margin of error.

The usual approach is to establish dollar equivalents of the various foreign currencies by means of foreign exchange rates. In general these rates are not fully satisfactory for the purpose. First, they are very often maintained as a matter of national policy at levels other than would be established in a free market. Furthermore, even at best they would tend to indicate the relative purchasing power of the various currencies in buying the sorts of goods and services internationally traded, rather than in buying all the items which enter into the national standard of living or the overall national product. It is a "purchasing power parity" based on these latter values which is required, of course, to translate foreign currency gross national product figures into the United States dollar equivalents. The OEEC last year published comparative figures, so converted, for the United Kingdom, France, Italy, Germany, and the United States. We know of no such studies covering other countries in recent years, and the results of this one are such as to suggest that only the broadest sorts of comparisons of real levels of output can be made from the presently available figures for other countries.

But even refined analyses of the OEEC type are inadequate to overcome the difficulties that arise when countries of widely different tastes, institutions, technologies, and natural gifts are to be compared. Little headway has been made, for instance, in developing a common standard by which to measure the comparative levels of living in industrialized and in underdeveloped countries.

Improvements needed

What is needed for the improvement of income and product statistics to serve better in the types of international uses outlined above may be summarized as follows.

First, there is continuing need for the development of greater international uniformity of concepts and definitions. Complete standardization is not a practicable goal, since diversity in national conditions calls for appropriate variation in the framework of national economic analysis. The resulting limitations on comparability can be overcome in considerable part, however, if the countries concerned prepare special estimates of the adjustments required to convert their summary statistics to an international standard. The reporting requirements of the U. N. and the International Bank and Monetary Fund have encouraged this practice, as have occasional meetings of technicians from various countries. Technical conferences have also helped greatly to discourage variations of a merely accidental nature. Continuation of these steps to improvement under the aegis of the international agencies seems likely to result in satisfactory progress toward uniformity as time passes.

Of even greater importance, there is a prime need for more—and more scientific—collection of data by the foreign governments themselves. The requisite basic statistics cover a very broad range of topics, including production, consumption, income, prices, population, and the labor force. In many of the countries concerned there is a shortage of personnel trained to do this work, coupled with an inadequate recognition of the practical value of such statistics. The two difficulties are of course linked together. The international technical assistance programs of the U. N. and the United States and other technically advanced governments have attacked the problem at both ends, augmenting the countries' ability to develop their basic data sources and also to utilize the results to advantage.

OBE's own activities in the field of technical assistance have consisted mainly of an annual training course given since 1947 to foreign government and central bank employees engaged in national income and balance of payments work. In all, nearly 150 technicians from more than 40 countries have received such training. OBE also aided in the organization and work of the 1953 Inter-American

Seminar on national income, at which nearly all the American nations were represented.

TABLE I.—*Content of income and product estimates, by country*

Countries	Periodic grand totals			Income by—			Product by—		Income and expenditure accounts
	National income	National product	Either series corrected for price changes	Distributive shares	Industrial origin	Size	Expenditure category	Industrial origin	
Argentina	-----	X	X	-----	-----	-----	-----	-----	-----
Australia	X	X	-----	X	-----	X	X	-----	X
Austria	X	X	X	X	-----	-----	X	X	-----
Belgian Congo	X	X	-----	X	X	-----	X	-----	-----
Belgium	X	-----	X	X	X	-----	-----	-----	-----
Brazil	X	-----	X	X	X	-----	-----	-----	-----
British Guiana	X	-----	X	-----	X	-----	-----	-----	-----
British Honduras	X	-----	-----	X	X	-----	-----	-----	-----
British West Indies	X	X	-----	-----	-----	-----	X	-----	-----
Bulgaria	-----	-----	[1] X	-----	-----	-----	-----	-----	-----
Burma	X	X	X	-----	-----	-----	X	-----	X
Canada	X	X	X	X	X	-----	X	-----	X
Ceylon	X	X	-----	-----	-----	-----	X	-----	-----
Chile	X	X	-----	X	X	-----	X	-----	X
Colombia	X	X	X	X	X	-----	X	-----	-----
Cuba	X	-----	X	X	-----	-----	-----	-----	-----
Cyprus	X	X	-----	X	X	-----	X	-----	-----
Czechoslovakia	-----	[1] X	[1] X	-----	-----	-----	-----	-----	-----
Denmark	X	X	X	-----	X	X	X	-----	X
Dominican Republic	-----	X	-----	-----	-----	-----	X	-----	-----
Egypt	X	-----	-----	-----	-----	-----	-----	-----	-----
El Salvador	-----	X	-----	-----	-----	-----	X	X	-----
Finland	X	X	X	X	-----	X	-----	-----	-----
France	X	X	X	X	-----	X	-----	-----	X
Gambia	X	-----	-----	-----	-----	-----	-----	-----	-----
Germany (Eastern)	-----	-----	[1] X	-----	-----	-----	-----	-----	-----
Germany (Western)	X	X	X	-----	X	X	X	-----	-----
Gold Coast	X	X	-----	X	-----	-----	X	X	-----
Greece	X	X	X	-----	X	-----	X	-----	-----
Guatemala	-----	X	X	-----	-----	-----	X	X	-----
Haiti	X	-----	-----	-----	X	-----	-----	-----	-----
Honduras	X	X	X	X	X	-----	X	-----	-----
Hong Kong	X	-----	-----	X	-----	-----	-----	-----	-----
Hungary	-----	-----	[1] X	-----	-----	-----	-----	-----	-----
Iceland	X	-----	-----	-----	-----	-----	-----	-----	-----
India	X	-----	X	-----	X	-----	-----	-----	-----
Indonesia	X	X	X	-----	X	-----	X	-----	X
Ireland	X	X	[2] X	X	X	-----	X	-----	-----
Israel	X	-----	X	-----	X	-----	-----	-----	-----
Italy	X	X	-----	-----	X	X	X	-----	-----
Jamaica	X	-----	-----	-----	-----	-----	-----	-----	-----
Japan	X	X	X	X	X	-----	X	-----	X
Kenya	X	-----	-----	X	X	-----	-----	-----	-----
Korea, Republic of	-----	X	-----	-----	-----	-----	-----	X	-----
Luxembourg	-----	X	-----	-----	-----	-----	-----	-----	-----
Malaya	X	-----	-----	-----	-----	-----	-----	-----	-----
Mexico	X	X	X	X	X	-----	X	-----	-----
Netherlands	X	X	X	X	X	-----	X	-----	X
New Zealand	X	X	-----	X	X	X	X	-----	X
Nicaragua	-----	X	-----	-----	-----	-----	-----	X	-----
Nigeria	X	X	-----	X	X	-----	X	-----	-----
Northern Rhodesia	X	X	-----	X	X	-----	[3] X	-----	-----
Norway	X	X	X	X	X	-----	X	-----	X
Nyasaland	X	-----	-----	-----	X	-----	-----	-----	-----
Pakistan	X	-----	-----	-----	-----	-----	-----	-----	-----
Panama	X	X	-----	X	X	-----	X	-----	-----
Paraguay	X	X	X	-----	-----	-----	-----	X	-----
Peru	X	X	X	X	X	-----	X	-----	-----
Philippines	X	X	-----	X	X	-----	X	-----	-----
Poland	-----	-----	[1] X	-----	-----	-----	-----	-----	-----
Portugal	X	-----	-----	-----	X	-----	-----	-----	-----
Puerto Rico	X	X	X	X	X	X	X	-----	-----
Southern Rhodesia	X	X	X	X	X	-----	[3] X	-----	-----
Spain	X	-----	X	-----	-----	-----	-----	-----	-----
Surinam	X	-----	-----	-----	-----	-----	-----	-----	X
Sweden	X	X	X	-----	-----	X	X	-----	X
Switzerland	X	-----	X	X	-----	X	-----	-----	-----
Taiwan	X	-----	X	-----	-----	-----	-----	-----	-----

See footnotes at end of table.

TABLE I.—*Content of income and product estimates, by country*—Continued

Countries	Periodic grand totals			Income by—			Product by—		Income and expenditure accounts
	National income	National product	Either series corrected for price changes	Distributive shares	Industrial origin	Size	Expenditure category	Industrial origin	
Thailand	X		X		X				
Turkey	X		X		X				
Uganda	X			X	X				
Union of South Africa	X		X		X				
United Kingdom	X	X	X	X	X	X	X		X
United States	X	X	X	X	X	X	X	X	X
Uruguay	X								
U. S. S. R.			[1] X						
Venezuela	X								
Yugoslavia	X								

[1] Index of material product at market prices (excludes certain services and government) less depreciation.
[2] Private consumption expenditure only.
[3] National product at market prices less depreciation.

Sources: United Nations. Statistics of National Income and Expenditure (Statistical Papers Series H, No. 7), U. N., New York, March 1955; United Nations. National Income and Its Distribution in Underdeveloped Countries (Statistical Papers, Series E, No. 3), U. N., New York, 1951; National Income Statistics, 1938–48, United Nations, New York, 1950. International Monetary Fund: International Financial Statistics, October 1955. International Association for Research in Income and Wealth: International Bibliography on Income and Wealth, vols. I–VIII. (Mimeographed document.)

TABLE II.—*Characteristics of grand totals, by country* [1]

Countries	Annual data cover—					Latest year covered as of October 1955			
	More than 15 years	10 to 15 years	5 to 9 years	2 to 4 years	1 year	1954	1953	1952	1951 or earlier year
Argentina		X				X			
Australia	X					X			
Austria			X			X			
Belgian Congo				X			X		
Belgium			X					X	
Brazil			X				X		
British Guiana				X					X
British Honduras					X				X
British West Indies					X				X
Bulgaria									
Burma			X				X		
Canada	X						X		
Ceylon			X				X		
Chile		X				X			
Colombia		X						X	
Cuba	X					X			
Cyprus					X				X
Czechoslovakia				[2] X					X
Denmark	X					X			
Dominican Republic				X		X			
Egypt				[2] X			X		
El Salvador				[2] X					X
Finland	X					X			
France			X			X			
Gambia					X				X
Germany (Eastern)									
Germany (Western)		X				X			
Gold Coast				X [3]					X
Greece			X				X		
Guatemala	X						X		
Haiti					X				X
Honduras	X							X	
Hong Kong				X					X

See footnotes at end of table.

TABLE II.—*Characteristics of grand totals, by country* [1]—Continued

Countries	Annual data cover—					Latest year covered as of October 1955			
	More than 15 years	10 to 15 years	5 to 9 years	2 to 4 years	1 year	1954	1953	1952	1951 or earlier year
Hungary									
Iceland				X				X	
India				X				X	
Indonesia				X				X	
Ireland	X					X			
Israel				X			X		
Italy			X			X			
Jamaica				[2] X					X
Japan	X					X			
Kenya			X					X	
Korea, Republic of				X					X
Luxembourg			X				X		
Malaya				X					X
Mexico		X					X		
Netherlands	X					X			
New Zealand	X					X			
Nicaragua					X				X
Nigeria					X				X
Northern Rhodesia			X				X		
Norway		X				X			
Nyasaland			X				X		
Pakistan				X				X	
Panama		X						X	
Paraguay			X				X		
Peru		X						X	
Philippines			X				X		
Poland									
Portugal			X			X			
Puerto Rico	X					X			
Southern Rhodesia	X						X		
Spain		X					X		
Surinam				X					X
Sweden			X				X		
Switzerland	X					X			
Taiwan			X				X		
Thailand			X					X	
Turkey			X					X	
Uganda				X					X
Union of South Africa	X					X			
United Kingdom	X					X			
United States	X					X			
Uruguay				[2] X					X
U. S. S. R.									
Venezuela			X					X	
Yugoslavia					X			X	

[1] As reported in latest international summaries; see general sources below.
[2] Intermittent series.

Sources: United Nations: Statistics of National Income and Expenditure (Statistical Papers Series H, No. 7), U. N., New York, March 1955; National Income Statistics, 1938–48, United Nations, New York 1950. International Monetary Fund: International Financial Statistics, October 1955.

APPENDIX B–5

STATEMENT BY OFFICE OF BUSINESS ECONOMICS ON CATEGORY 6: DATA ON THE BALANCE OF PAYMENTS POSITIONS OF ALL COUNTRIES OF THE WORLD, GIVING RECOGNITION NOT ONLY TO TOTAL FIGURES BUT ALSO HOLDINGS OF HARD AND SOFT CURRENCIES, AND RELATIONS WITH DEPENDENT AREAS

Balance of payments statements are currently prepared and published by nearly all countries. In fact, this is a requirement for all members of the International Monetary Fund and other international organizations, such as the OEEC. These statements have to be submitted to the IMF at least annually in a uniform pattern, which has been set up by the staff of the IMF in consultation with representatives of some of the major member countries, including the United States. A special manual includes the definitions of each of the items which enter into the balance of payments, and shows how these items should be combined and entered into the composite tables. The prescribed tables also require an area breakdown of the estimates. Soon after the data become available they are published by the IMF in a looseleaf Balance of Payments Yearbook. In addition, the Monetary Fund publishes in the monthly International Financial Statistics abbreviated and preliminary balance of payments statements prepared by the various countries for their own purposes.

Member countries are also obliged to furnish to the International Monetary Fund data of their position on given dates with respect to holdings of gold and foreign exchange (broken down by major currencies) by official agencies, such as the governments and central banks as well as by private banks and financial institutions. These data are usually confidential, however, and are not published by the fund in detail. Summary tables on gold and total foreign-exchange holdings are published in the monthly International Financial Statistics in a table showing the holdings for each country. Additional details appear in the individual country sections.

In order to help foreign countries to set up balance of payments statistics, this Office has conducted training courses in balance of payments techniques for foreign officials for approximately 8 years. During the last few years these courses have been given jointly with the International Monetary Fund. Most of the trainees were from relatively underdeveloped countries, but some were also from more advanced countries, such as France, Italy, Germany, and Sweden.

The balance of payments division of OBE is also in regular contact with several foreign countries to exchange data or other information which is helpful in improving the statistics both here and abroad.

The Monetary Fund also sends members of its balance of payments staff to foreign countries to initiate or improve the work in these statistics. There can be little doubt that these efforts have resulted in continuing improvements in balance of payments data. The number of countries preparing such statistics has increased, the data furnished have become more reliable, and separate estimates are made for a larger number of items in the balance of payments.

Although balance of payments data are available for nearly all countries, there is no satisfactory method to evaluate their validity. A large part of the statistical data used in balance of payments computations throughout the world is collected for various administrative purposes and does not necessarily fit the concepts and requirements of balance of payments computations. An example which applies also to the United States may be import statistics which show valuations required by customs regulations rather than actual foreign payments. For some countries the differences can be substantial. In most foreign countries exchange control records are used to prepare balance of payments statistics, and these records usually do not cover all transactions, and they do not always provide the detail required. Adjustments to the balance of payments concepts of data collected for other purposes are usually difficult and expensive. The result is that such adjustments can be attempted in only few instances.

Because of different reporting systems, and sometimes the large magnitude of borderline cases, the classification of individual transactions between the different categories, such as merchandise, services, unilateral transfers, and capital movements may differ from country to country.

Likewise methods used in the geographical allocation of individual transactions may vary substantially from country to country, particularly between those using exchange control data and those using other sources of information.

As long as each country uses consistent methods and criteria in computing and compiling balance of payments data over a period of time they can provide the starting point for an analytical appraisal of the country's development in relation to the rest of the world. At this moment it would be very difficult, however, to compare balance of payments statistics of different countries, either by assuming that the totals for the same categories, such as merchandise trade, the various services, etc., are strictly comparable, or that the same transactions between two countries can be found in the corresponding positions in the statements of these countries for the same time period. The National Bureau for Economic Research is at present engaged in preparing a matrix of international transactions for 1951. After extensive work for about 2 years, there are still many data which have not yet been reconciled.

Balance of payments statistics of the United States have been substantially improved since the end of the war. For many accounts superior methods of estimate have been developed, the number of transactions for which estimates are made has increased, the frequency of estimates was raised from annual to quarterly, the lags in publication of the data has been reduced from 6 or 7 months after the end of the period to about 2 months. All of the data are now shown in a breakdown by 11 areas or countries. Yet, in order to meet the requirements of both business and the Government, further improvements are urgently needed.

One of the most significant gaps in the information now available from United States and foreign sources is the lack of tables showing the balance of payments of the United States with individual countries. Neither is it possible to obtain complete or convenient tabulations showing for individual countries all of their liabilities to and assets in the United States. For many types of transactions such data are available for some individual countries and could be published with a relatively small amount of additional work if the publication space were available. To augment the types of transactions for which country breakdowns are provided and to increase the number of countries for which such data are shown separately the present staff would have to be raised.

Less obvious than the availability or lack of certain figures are the changes in the quality of those figures which are currently presented. In order to reduce the workload for the general public providing the basic data and to reduce the costs to the Government various changes had to be made in the collection of basic data. The number of reporters was lowered by changing reporting requirements as for instance in the monthly reports on foreign short-term liabilities and claims; samples were substituted for complete enumerations as in some parts of trade statistics. Where samples are used, they have had to be limited to a size which is not always sufficient to meet reporting requirements, as in travel. In some instances, as in international investments, extrapolations have to be made from benchmarks which have become obsolete and which should be renewed at more frequent intervals. The last complete count on United States direct investments abroad was for the end of 1950 but the benchmark for United States holdings of foreign securities dates back to 1943 and even earlier for some countries. Foreign direct investments in the United States have not been enumerated since 1941. Continuous efforts are made through inquiries to business to keep the basic information current. Nevertheless, the lack of more recent complete date affects the estimates of the current creditor-debtor position of the United States and of individual foreign countries with the United States as well as the estimates of income receipts and payments in the balance of payments statements,

Another factor which affects the usefulness of United States balance of payments for Government and business needs is the declining timeliness of the availability of basic information from which balance of payments statements are computed. Since the early postwar period preliminary estimates are published about 2½ months after the end of the period and revised 3 months later. Although this publication schedule is still adhered to, in many instances rough estimates have to be used at the time of the first publication where formerly reasonably firm figures were available. This is not only less satisfactory from the point of view of the user of the data but it involves also additional work in preparing estimates which are later displaced. Problems of that type are encountered particularly in the case of certain United States Government transactions. The retardation in the flow of basic and detailed information of these and of merchandise trade data affects, of course, also the analysis of the international transactions and their changes, which cannot always be made satisfactorily on the basis of summary data alone.

The measurement of United States assets in and liabilities to foreign countries is not only affected by the progressive obsolescence of benchmark data but also by difficulties encountered in assuring that reports are filed and in evaluating those which are received. One illustration of the difficulties encountered in collecting data on international transactions and the net dollar position of foreign countries is the recommendation by the Subcommittee on Paper Work Management of the Commission on Organization of the Executive Branch of the Government to reexamine the need for continuing Form BE–578 and Treasury Form C½. Form BE–578 is the questionnaire on the operations of foreign branches of United States corporations and thus 1 of the 2 forms (the other applies to foreign subsidiaries of United States corporations) through which nearly all data on United States direct investments abroad are obtained. Without this form, information on United States direct investments abroad would be very fragmentary and the computation of the United States balance of payments would have very serious gaps. Form C½ is a compulsory reporting form on which private business concerns other than banks, securities dealers, and other financial organizations report their claims on, and liabilities to nonaffiliated foreigners.

This form is the source of data on foreign commerical credits by private concerns and provides very essential information required in evaluating the competitive position of United States industry on foreign markets, and the indebtedness of foreign countries. At those times when foreign reserves show major fluctuations it is most important to have data on private credits and liabilities in order to analyze the factors contributing to such fluctuations. To improve the factual basis on which economic decisions by business and Government have to be made every effort should be exerted to improve these statistics by widening their coverage and by frequent evaluations and checks.

Appendix C

Department of Labor,
Bureau of Labor Statistics,
Washington, D. C., October 31, 1955.

Mr. Donald C. Riley,
Acting Chief, Office of Statistical Standards,
Bureau of the Budget, Washington, D. C.

Dear Mr. Riley: Secretary Mitchell has referred to this Bureau your letter concerning Representative Bolling's request for an appraisal of available economic statistics in relation to economic foreign policy determination.

The Bureau of Labor Statistics analyzes data on prices, imports, exports, and production of commodities, as well as on employment and earnings in the industries producing these commodities, for the use of the Secretary and the departmental representative on the Trade Agreements Committee in connection with determination of policy with respect to trade agreements, negotiations, or legislative proposals. For this purpose, we need comparable statistics on the international commodity trade of all the principal trading countries, and comparability among various domestic series.

Our data on trends and levels of employment and wages in manufacturing and mining, and wholesale and retail prices are extensively used in analyzing the effect of changes in foreign trade on the United States economy. For some 16 separate industries, we have indexes of changes in output per man-hour over a relatively long period and these are also important in such analyses.

In their present form, our data on employment by industry are very useful for the study of foreign trade impacts (both as regards exports and imports), but they would be more valuable if the current series were improved, according to present plans, and we had additional information:

1. *Interindustry relations.*—Since the termination of our studies of interindustry relations, we are not able to follow the effects of changes in foreign trade back through the production process. For example, if exports of automobiles should fall off, we could gage the effect of the decline on employment in the automobile industry itself, but we do not have the proper tools to trace the consequences of this decline back through employment in all the other industries which supply automobile producers with materials. The interindustry relations data which were calculated in our extensive 1947 study in this field are now out of date because of changes in the postwar period in production processes and even in types of materials used. When the results of the censuses for the year 1954 become available, it would be highly desirable to repeat the 1947 study for use in this and other connections.

2. *Employment data by industry in detail.*—At the present time, our employment data are not collected in such a way as to make possible computations of industry series in the fine detail which is frequently needed for analysis of employment in relation to foreign trade. Beginning in 1957, we expect to be able to provide regularly series on employment by industry in more detail than at present. Data obtained from the expanded coverage of the social-security system will provide new benchmarks for the individual-industry series in 1956. When this revision is completed, these series will be more useful for comparative studies than they have been hitherto.

3. *Comparisons of employment and foreign-trade data.*—An even more difficult problem is encountered in connection with industries in which many establishments produce a considerable variety of products. Some of the products made in one plant may be affected quite differently by foreign competition than others. We have not asked the establishments which report to us monthly to separate employment, hours, and earnings by product, nor do we regard it as practicable

to do so, although we do ask the establishments in our sample to send us information annually about the products they make. The Standard Industrial Classification Code anticipates this difficulty and we classify the establishments in this sample in accordance with that code.

In order to estimate the effects of foreign trade on fluctuations in employment in manufacturing, it would be useful to have statistics on imports and exports of manufactured commodities summarized in groups which would be as comparable as possible with the industrial groups used in summarizing our employment data as currently collected. However, when acute competitive problems arise affecting particular commodities, more detailed figures would be required from establishments producing different products.

As you know, Walt Simmons of this Bureau is working on the interdepartmental committee preparing a revision of the Standard Industrial Classification. I have asked him to keep this problem in mind in the process of this revision.

For the purpose of comparing labor costs between or among countries, more information is needed on employers' fringe-benefit costs in this country. The importance of fringe benefits in labor costs has increased considerably in the postwar period. The Bureau of Labor Statistics did a pilot study in this field last year but has no appropriation for current collection of data on fringe benefits.

Even more important in this connection are relative figures on output per man-hour by industry. In this field, we would require extensive cooperation from other countries in order to produce meaningful comparisons.

We should welcome more frequent full-scale censuses, particularly of manufacturing and mining, with collection of full details for secondary as well as primary products of each SIC industry.

The Bureau fully endorses the recommendations made by the Intensive Review Committee to the Secretary of Commerce on foreign-trade statistics, as reported at the hearings of the Subcommittee on Economic Statistics in July 1954 (p. 58 of hearings); particularly the recommendations for larger print, more comparability with United Nations Statistics, and resumption of publication of the annual Foreign Commerce and Navigation of the United States. We also endorse the recommendation for a monthly, instead of a quarterly summary of foreign commerce, with the proviso that finer breaks are needed; the present aggregates of the summary are in many cases too large, particularly when commodities at various stages of manufacture are combined.

In view of the fact that the United Nations publishes import and export data for 25 countries using a common code (the Standard International Trade Classification) it would be helpful to us if our own publications of foreign-trade data were in this form. United States foreign trade statistics are now retabulated by the census according to the SITC for publication in summary form by the U. N. The SITC provides a very detailed classification system, of which only the 3-digit groups were used in the U. N. publication. If our Census Bureau were to adopt the SITC, it could use the finer breaks so that the aggregates would be readily comparable with those published by the U. N.

The data now published on duties paid on imports are summarized in 16 broad classifications corresponding to tariff schedules. Products of a given industry may be classified under the appropriate commodity classification and in the very large miscellaneous list, or in the free list. This summary is, therefore, not useful for many types of economic analysis.

As you know, considerable progress has been made since the end of World War II in improving the comparability of economic statistics from country to country. This progress has been due in large part to United States leadership effected through its bilateral technical assistance programs, through the Statistical Office of the United Nations and its specialized agencies, and through international technical statistical conferences. There is still much to be accomplished, however, if the statistics required for economic foreign policy determination are to become available. It therefore seems to me of extreme importance that technical assistance in statistics be continued.

Very truly yours,

EWAN CLAGUE,
Commissioner of Labor Statistics.

APPENDIX D

DEPARTMENT OF AGRICULTURE,
Washington 25, D. C., November 4, 1955.

RAYMOND T. BOWMAN,
Chief, Office of Statistical Standards,
Executive Office of the President,
Bureau of the Budget, Washington 25, D. C.

DEAR MR. BOWMAN: This is in further reply to Mr. Riley's letter of September 29, relating to the request of Congressman Richard Bolling, chairman of the Subcommittee on Foreign Economic Policy. Mr. Bolling requested that the committee be brought up to date concerning seven categories of statistical data, including as item 3 the "identification and classification of production data within all significant countries of the world to trace important changes of output in comparable terms, and sufficient analysis of costs of production and of selling prices."

The statements on this subject presented for the 1954 hearings of the Subcommittee on Economic Statistics have been reviewed and found to be a satisfactory description of the present situation. However, we should like to amplify these statements to indicate in general terms a few significant changes in the quality of the production statistics obtained from Government sources in other countries. These appraisals are contained in the attached statement. We trust they will be of value to the committee.

Sincerely yours,

EARL L. BUTZ,
Assistant Secretary.

STATISTICS OF AGRICULTURAL PRODUCTION RECENT DEVELOPMENTS [1]

1. The Soviet Union

The Government has changed the basis of its field estimates from the biological outturn to realized production but as yet has not released any statistics on the new basis. On the other hand some additional information of acreage has proven helpful in assessing the probable actual outturn. Also increased opportunities for travel within Russia has been helpful.

2. Other eastern European countries

In general the level of production in terms of prewar is still uncertain. Information probably is less definitive than in the Soviet Union.

3. Communist China

More information made available by Communist government. Considered to be overstatement of actual outturn but degree is uncertain.

4. Southeast Asia

Political unrest in this area has further delayed improvement in the statistical information for this area.

5. Western Europe

Increased reliability and comparability of estimates, particularly in Western Germany, continues in this area. Important exception is Spain where the program is minimal and staff inadequate to provide satisfactory estimates.

APPENDIX E

TREASURY DEPARTMENT,
Washington, D. C., November 4, 1955.

MR. DONALD C. RILEY,
Acting Chief, Office of Statistical Standards,
Executive Office of the President, Bureau of the Budget,
Washington 25, D. C.

DEAR MR. RILEY: This is in reply to your letter of September 28, 1955, addressed to Secretary Humphrey, with which you enclosed a copy of a letter from Representative Bolling, chairman of the Subcommittee on Foreign Economic Policy of

[1] A statement in general terms of changes in 1954–55 in quality of crop production statistics in foreign countries as these appear to the staff of USDA.

the Joint Committee on the Economic Report. In his letter Representative Bolling requested an appraisal of available economic statistics from the point of view of the determination of foreign economic policy.

The Treasury Department has certan responsibilities for compiling statistical data on capital movements between the United States and foreign countries and on estimated gold and dollar holdings of foreign countries. The Treasury is also a user of data pertaining to a wide range of matters in the international monetary and financial field. There is enclosed a statement describing Treasury Department responsibilities for collecting and compiling certain international financial statistics, and appraising the adequacy of available international statistics for its purposes.

I trust that this information will be helpful.

Sincerely yours,

A. N. Overby,
Assistant Secretary of the Treasury.

Treasury Department Responsibilities for Collection and Compilation of International Financial Statistics

The Treasury Department is responsible for the operation of a foreign exchange reporting system which is the only source of comprehensive and reliable information on dollar bank deposits and other short-term assets held by banks and business firms in the United States for the account of foreigners, on private American claims on foreigners, and on transactions in securities with foreigners. Reports are submitted to the Federal Reserve banks which in turn forward consolidated data from their districts to the Treasury Department. The data are collected pursuant to legislative authority under section 5 (b) of the Trading With the Enemy Act and section 8 of the Bretton Woods Agreements Act.

Information obtained from the Treasury reports is used in the formulation of United States Government financial and economic policies in many ways including (1) determining the short-term liabilities of the United States to foreign countries in relation to the United States gold reserve; (2) assessing the influence of capital movements on the reserve position of United States banks; (3) appraising the requests of foreign countries for loans and grants; (4) implementing controls on foreign assets; (5) determining the flow by country of United States private portfolio investment abroad; (6) assessing proposed policy decisions and credits by the International Bank and the International Monetary Fund and furnishing appropriate information to the International Monetary Fund, as required by the charter of that organization; and (7) furnishing data necessary for the preparation by the Department of Commerce of the United States balance of payments, which provides basic information for the formulation of foreign economic policy. In addition to these governmental uses, the Treasury statistics are published in the Treasury Bulletin for use by the banking and business communities and the general public.

The Treasury Department has its reporting system under continuous review in order to improve its operations and the accuracy of the statistics and to reduce the reporting burden on banks and busines concerns without impairing the validity of the statistics. Major revisions have been undertaken during the postwar period. The last major revision of the system was made effective on March 31, 1954.

Data on the dollar balances of foreign countries compiled on the Treasury foreign exchange forms are an important component of the statistical series on foreign gold and dollar holdings compiled by the Treasury Department and the Board of Governors of the Federal Reserve System. Data on the gold holdings of foreign countries are prepared on the basis of reports from State and Treasury Department representatives abroad, foreign central bank statements, and special reports from foreign governments and central banks. Where published or reported data are not available, estimates are made. Because of lack of information, no estimates are made for the gold holdings of the U. S. S. R. Estimates are necessary for the holdings of the United Kingdom and several other countries which do not release information on their gold holdings. Efforts have been made continually and successfully during recent years to get more rapid reporting, and to obtain data on unpublished gold holdings of many countries. The Treasury-Federal Reserve series on foreign gold and dollar holdings are made available to Government agencies for internal analyses associated with the development and implementation of United States foreign economic policy, and are published quarterly in less detailed form in the Treasury and Federal Reserve Bulletins.

Since the monetary reserves of foreign countries are held largely in the form of gold and dollars, it is vital for the United States Government to obtain information on the size and distribution of such holdings. These data have made it possible to gage the impact of United States Government aid programs and the developing patterns of world trade, as well as to analyze closely the economic situations of individual foreign countries and areas.

Because the compilation of these series involves dealing with private United States banking and business firms and with foreign governments, it has been necessary to be reasonable and diplomatic in our requests for information. While the reporting procedures consequently leave some gaps in our information, the overall results are considered to be satisfactory. We believe that the data in this field are on the whole adequate to provide the kind of meaningful international comparisons required for intelligent legislation by the Congress in the field of economic policy.

APPRAISAL OF THE ADEQUACY OF INTERNATIONAL ECONOMIC STATISTICS

The Treasury Department's interest in international economic statistics arises from its responsibilities for the formulation and execution of international monetary and financial policies, its activities in connection with the National Advisory Council on International Monetary and Financial Problems, of which the Secretary of the Treasury is chairman, and its statutory responsibilities with respect to countervailing and antidumping duties.

In dealing with problems in these areas, consideration must be given to the economic and financial relations of the United States with foreign countries and to the economic and financial conditions prevailing in these countries. This involves, among other things, examination and comparison of available statistical indicators of foreign economic and financial conditions. The Treasury has particular need for data on gold and foreign exchange reserves, balances of payments, exchange rates, money supply, prices, foreign debt, public finance, and the value and terms of foreign trade. For some problems, it is also desirable to have information on the amount and distribution of gross national product and national income and on production levels.

While a considerable amount of useful statistical information is available on these matters, the Treasury's work would be facilitated by earlier availability of statistical data and by improvements in their coverage and reliability. Prompt availability of data, particularly on the levels of monetary reserves and on developments in the payments positions of foreign countries is of great importance in dealing with current problems in the international financial field. It would often be helpful to obtain preliminary data even if subject to later revision.

Inadequacies of various degrees exist in the quality and coverage of available statistics. Although statistical data are available on most matters of particular interest to the Treasury, reliance cannot always be placed on the completeness of coverage and accuracy of the data. The adequacy of foreign economic and financial statistics varies, of course, from country to country. Deficiencies are particularly apparent in the data pertaining to the less developed countries and areas of the world.

Improvement in the timeliness, quality, and coverage of foreign statistics would appear to depend primarily upon the efforts of the individual countries concerned. The statistical work undertaken by a number of international organizations since the war has been of considerable significance in furthering progress along these lines and, in addition, has advanced the development of international comparability of statistics. Of particular interest to the Treasury in this regard are the International Monetary Fund publications, International Financial Statistics and the Balance of Payments Yearbook. The various statistical publications of the United Nations and other international agencies are also helpful.

In dealing with problems in the international monetary and financial field, the Treasury Department has not found it necessary to rely solely or principally on statistical data. Available published statistical data are supplemented with other kinds of information, such as dispatches and reports from United States embassies and consulates abroad, and published documents, including those issued by foreign governments. These sources of information, for practical purposes, compensate to a large degree for the deficiencies of the statistics. Thus, while the Treasury's work in this field would be facilitated by improvements in available statistics along the lines indicated, it is not seriously hampered by existing statistical deficiencies.

EXHIBIT F

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, D. C., November 2, 1955.

Mr. DONALD C. RILEY,
Acting Chief, Office of Statistical Standards,
Bureau of the Budget, Executive Office of the President,
Washington, D. C.

DEAR MR. RILEY: This is in response to your letter of September 28 to Chairman Martin, enclosing a copy of a letter from Representative Bolling, chairman of the Subcommittee on Foreign Economic Policy of the Joint Committee on the Economic Report. Representative Bolling asked that there be prepared by agencies of the Federal Government which compile or use international economic data reports dealing with outstanding needs and possible improvements in this field. In reply I am enclosing a statement prepared by the Board's staff on this subject.

The first part of the statement deals with statistics for which the Federal Reserve System has some responsibility for collection and compilation. The second part deals with statistics that are of special interest to the Board of Governors of the Federal Reserve System as a user of data. The third part deals with Representative Bolling's specific question as to evaluation of the available statistics for use in framing "intelligent legislation in the field of economic policy which has international significance or repercussions."

Sncerely yours,

S. R. CARPENTER, *Secretary.*

Enclosure.

COMMENTS ON INTERNATIONAL ECONOMIC STATISTICS

I. STATISTICS COLLECTED OR COMPILED BY THE FEDERAL RESERVE SYSTEM

The Federal Reserve System shares with other agencies—specifically the Treasury Department and the Department of Commerce—certain responsibilities for collection and compilation of data on foreign assets in the United States and United States assets abroad. Through the Federal Reserve banks, monthly or quarterly reports are obtained from banks, brokers, and business firms on dollar deposits and other short-term assets held for the account of foreigners, on private United States claims on foreigners, and on transactions for foreigners in domestic and foreign securities. Compilations from these data are forwarded to the Treasury, and are made available by the Treasury to the Balance of Payments Division of the Department of Commerce and the International Monetary Fund.

The principal responsibility for the collection of these data rests with the Federal Reserve banks, each of which collects from respondents in its district the reports on foreign assets, liabilities, and securities transactions, required under Treasury regulations. Consolidated reports for each Federal Reserve district are forwarded to the Board of Governors and to the Treasury Department; the latter agency, in turn, compiles countrywide consolidations of these data together with data on certain United States Government foreign assets and liabilities of a comparable nature.

The Board of Governors publishes monthly in the Federal Reserve Bulletin several tables based on these data, and tables with somewhat different breakdowns providing additional information are published monthly by the Treasury Department in the Treasury Bulletin. The tables dealing with short-term liabilities to foreigners and short-term claims on foreigners reported by banks in the United States, by countries, are particularly important for the work of the System and for the information of Government agencies, private business, and individuals interested in international financial problems.

The Board of Governors also compiles and publishes, on the basis of information received from foreign central banks or other sources, data on the assets and liabilities of central banks throughout the world, as well as on the gold reserves of central banks and governments.

Some of the principal elements of the data described in the preceding paragraphs, with other related data, are presented in combined form in the Federal Reserve Bulletin table on estimated gold reserves and dollar holdings of foreign countries and international institutions. This table has been and is being revised, as more information becomes available, so as to provide an increasingly better measure of changes in foreign gold reserves and liquid dollar assets.

The selection of material for presentation in the Bulletin and the form and coverage of the reports required under Treasury regulations are continuously under review, for the purpose of maintaining the quality and a broad coverage of the data, while minimizing the burden for the respondent banks and others.

Another type of data compiled by the Federal Reserve System relates to current developments in foreign exchange markets in the United States and abroad. Such information is collected primarily by the Federal Reserve Bank of New York. The Federal Reserve Bank of New York certifies to the Treasury, for use in assessment of import duties, daily exchange rates in New York for foreign currencies; these rates are released weekly to the public and also appear in the Federal Reserve Bulletin.

II. INTERNATIONAL STATISTICS OF INTEREST TO THE BOARD OF GOVERNORS AS A USER OF DATA

The Board's interest in foreign data and in United States data on international transactions derives from the need for current information on foreign financial and economic developments for use (*a*) in the formulation of United States monetary and credit policy by the Board of Governors and the Federal Open Market Committee; (*b*) in the supervision by the Board of Governors of foreign operations of the Federal Reserve banks and the international activities of member banks; (*c*) in carrying out responsibilities related to the Chairman's membership in the National Advisory Council on International Monetary and Financial Problems; and (*d*) in the cooperation given from time to time through the Board's staff to other United States Government agencies concerned with problems of foreign economic policy.

In determining United States monetary and credit policy it is necessary to take into account the interactions of financial and economic developments here and abroad and the flow of funds in international money and capital markets, so as to assess the influence of foreign developments upon production and prices, financial markets, and monetary reserves in the United States. Statistics collected by the Federal Reserve System as described in the preceding section, as well as information obtained by the Federal Reserve Bank of New York from abroad and through its day-to-day contacts with financial markets in New York, provide part of the data needed to assess the impacts of foreign developments upon financial markets in the United States and upon the reserve positions of member banks and of the Federal Reserve banks. Such information, including foreign statistics on exchange rates, interest rates, and central bank credit and liabilities, is available fairly quickly, at least from those countries which have the greatest influence on world trade and finance.

Other foreign statistical information is also needed, especially with respect to the domestic and international trade developments abroad which underlie our balance of international payments and which help to explain changes in world commodity prices, in foreign exchange rates, and in interest rates in foreign money markets. In this field of foreign economic statistics there is an acute and persistent problem of obtaining fully current and up-to-date data. In the case of foreign trade, for example, there may be considerable lag between the event and the publication of processed statistics. Delays in obtaining data for use in Washington are still longer if ordinary surface mail facilities are used. The problem of obtaining current information is often still greater for statistics of foreign bank deposits, loans, etc.; for statistics of foreign domestic production, sales, etc.; and especially for data in the form of index numbers, such as those of production and of prices.

Although the problem of time lags in publication abroad remains, the International Monetary Fund has made a useful contribution to the compilation and rapid dissemination of available data through its monthly publication, in Washington, of International Financial Statistics. The economic reporting received by the Department of State from its Foreign Service posts helps to provide timely information for the use of United States Government agencies in Washington. The United Nations Statistical Office and the Organization for European Economic Cooperation publish, on a fairly current basis, useful compilations and indexes covering groups of countries. For gackground information relating to earlier years, valuable work has been done in compilation and publication of data by the International Monetary Fund, the United Nations Statistical Office, the regional commissioners of the United Nations, and the OEEC.

Closely related to the need for prompt availability is the need, in connection with many types of data, for seasonal adjustment of the figures to facilitate accurate interpretation of the significance of movements shown by the latest available data in a series. Progress abroad in solving the difficult problems of seasonal adjustment has been very slow compared with the work done in the United States, but signs of interest in this problem are beginning to appear.

Viewed beside these acute problems of prompt availability and seasonal significance of current foreign data, other problems such as those of international comparability, or even of gaps in the structure of foreign statistics, appear less important from the point of view of appraising foreign economic and financial developments in connection with the formulation of United States monetary policies. Partly this is so because of the availability—also with lags—of nonstatistical kinds of information and interpretative material, to supplement the statistical information. It should be noted, too, that the quality of available information, both statistical and nonstatistical, relating to some of the more important foreign countries, including the United Kingdom, is greatly superior to that of the information available from many smaller or less developed countries.

In summary, data needed by the Federal Reserve System for assessing foreign developments in connection with the formulation of United States monetary policies are available, to a reasonably adequate degree, from a variety of nonstatistical and statistical sources, including the statistical compilations made by the system itself. However, further progress in the improvement and timely publication of economic statistics by foreign countries is of great importance to the Federal Reserve System for improving its assessment of foreign developments.

III. ADEQUACY OF STATISTICS FOR FORMULATION OF FOREIGN ECONOMIC POLICY

Apart from problems that principally concern the Federal Reserve System, the adequacy of international economic statistics in the formulation of foreign economic policy is discussed in this section. Some of the comments in the preceding section apply also to the general question of adequacy and availability of information for use by the Executive or the Congress in formulating economic policy or legislation having international significance.

It is our experience that currently available statistics and nonstatistical information are in many cases reasonably satisfactory for dealing with problems in this field. There has been gradual but steady progress in many countries in developing new types of statistical information and in improving existing data.

There is, however, much room for improvement of statistical data in many countries, especially among the underdeveloped countries. This comment applies to financial statistics; to statistics of production, foreign trade, and prices; and in some cases even to statistics of population. Problems often arise from inadequate coverage and from unrepresentative sampling or weighting. In a surprisingly large number of countries the delays in compilation and publication of foreign-trade statistics exceed 6 months.

The problem of international comparability is of course very great for certain types of data—such, for example, as per capita national income. Existing techniques should lead to great improvement in such data, but the question will remain whether any techniques can enable statisticians to give, through a single statistical measure, fully accurate and meaningful comparisons from country to country of the levels of well-being or of overall productivity.

For other types of data there are problems of comparability and of filling in the gaps, toward the solution of which foreign countries and international institutions have been making some progress.

Fortunately, in the formulation of foreign economic policy it should generally be possible to rely on the statistical and nonstatistical information now available, and on the application of economic principles to the solution of problems that arise. Perhaps we shall never be in the position of being able to say with precise statistical accuracy, for example, that country A has a comparative advantage over country B in the production of commodity X as compared with commodity Y. Perhaps we shall always have to use statistical and other information that will fall short of what might be desired. Nevertheless, we should be able to expect a continuation of the real progress already made in the postwar period toward improvement of statistics in the international field.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
DIVISION OF INTERNATIONAL FINANCE.

APPENDIX G

DEPARTMENT OF STATE,
Washington, D. C., October 31, 1955.

Hon. ROWLAND R. HUGHES,
Director, Bureau of the Budget.

DEAR MR. HUGHES: I refer to Mr. Riley's letter of September 28, 1955, requesting the views of the Department of State on the adequacy of available foreign economic statistics for the determination of United States foreign economic policy. As a major user and collector of foreign economic data we welcome the opportunity to comment on this subject.

Available foreign economic statistics are generally adequate for the formulation of the broad outlines of United States foreign economic policies—promotion of free world economic growth, the reduction of barriers to trade, economic and military assistance to free nations. However, the implementation of these policies in particular countries undoubtedly has been hampered by inadequate economic data. Such deficiencies also have been a handicap in evaluating the effects of our foreign economic policies.

The inadequacy of foreign economic statistics is to only a limited extent the result of inadequate United States collection efforts. Fuller staffing of overseas missions could correct existing shortcomings in this respect. In the main, however, the problem is that satisfactory economic statistics are just not available in many countries.

Since the war much progress has been made in improving the quality and quantity of economic data on free world countries. Direct United States efforts have contributed to this progress, but more important have been the activities of the United Nations and its specialized agencies, the International Monetary Fund, the World Bank, and the regional economic commissions. These agencies are probably the best vehicles for promoting further advances in the quality of foreign economic reporting.

The quality and comprehensiveness of foreign economic statistics vary widely from country to country. In general only industrialized Western Europe and countries like Japan and Canada publish what might be considered adequate economic statistics, and even as between these countries there are wide differences in the quality of statistical reporting. At the other extreme are the Communist bloc countries, where published economic data are notoriously deficient. In between are the non-Communist underdeveloped countries where large deficiencies exist despite the significant gains of recent years.

Developed countries

The economic statistics of the developed countries of the world (Japan, Canada, and Western Europe except for Spain and Portugal) are generally quite satisfactory. Data on national accounts, production, employment, prices, wages, and government financial operations, while not uniform in quality are generally available and fairly reliable.

Shortcomings are largely matters of detail. Most countries are 3 or 4 months behind in reporting data on domestic economic conditions, so that it is difficult to appraise accurately the current economic situation. Foreign trade statistics lack sufficient detail to permit determination of the effects of changes in our security controls on East-West trade. Statistics on capital movements are usually poor. Almost all countries are deficient in inventory statistics. As a result it is usually hard to explain short-run changes in a given country's balance of payments.

Other deficiencies in Western European economic statistics, but by no means a comprehensive listing, include the following: Italy provides little data on the financial operations of quasi-governmental organizations which represent an important segment of the entire economy. Gross national product data are not available from the income payment side for Italy. In Belgium national accounts statistics from official sources are only fair and are inferior to those compiled unofficially. The situation is similar with respect to data on industrial output. Data on productivity is poor for almost all countries.

Underdeveloped countries

Economic statistics for the underdeveloped countries are seriously deficient in terms both of coverage and reliability. Here again one finds wide differences from country to country. Parts of Latin America and south and southeast Asia are gradually providing more usable economic statistics. By contrast the Middle

East provides almost no statistical reporting. Gaps in economic statistics for most underdeveloped countries generally make it difficult to measure overall trends in economic activity and to determine the factors contributing to these trends.

Only a few underdeveloped countries make regular estimates of gross national product. Since much economic activity occurs outside the money economy, measurement of total output involves a large element of guesswork, and such measures are subject to a wide margin of error. For the same reason it is difficult to tell what is happening to real consumption. Statistics on the labor force and employment are poor. Industrial output figures are incomplete, largely because of lack of information on handicrafts. Analysis of government operations and in particular of semiautonomous agencies is seriously handicapped by the lack of satisfactory fiscal information. Investment data except for the government sector are very deficient. We lack the information required to make good estimates of the contribution which United States private and public investments has made or might make to economic growth in specific foreign countries.

Satisfactory economic data are largely limited to statistics of foreign trade and production of the principal primary products. But even here one finds numerous shortcomings. Trade statistics are often lacking in detail. The use of multiple and frequently artificial exchange rates makes it hard to arrive at reliable international comparisons of the value of trade. Nontrade items in the balance of payments, especially capital items, are almost uniformly poor. Agricultural production figures often are based on inadequate sampling techniques and tend to err on the low side.

The chief reason for the inadequacy of the economic statistics of the underdeveloped areas is the failure of these countries to give sufficient attention to the collection of basic economic data. The remedy lies in much more extensive use of comprehensive census surveys rather than present unsatisfactory sampling techniques. External assistance could play a useful role in this field by providing skilled advisers to help in planning the census and in training census takers and statisticians to collect and process the raw data.

Communist countries

Communist bloc data on most of the major economic indicators are unavailable, incomplete, or so misleading as to be unusable. We are thus greatly handicapped in our knowledge of bloc economic capabilities and growth rates. Such data as are available usually require major adjustments to take account of changes in concepts, shifts in geographic boundaries, and the use of misleading base years. The lack of economic statistics on the bloc is primarily a result of Communist security controls. But it is also a result of the deficiencies in Soviet economic theory.

Specifically for the U. S. S. R. data on gross national product and its distribution are not published and must be laboriously reconstructed from fragmentary information which is available only for certain years. Official pronouncements provide figures on industrial output of a number of important products. However, there are large gaps in our information on industrial capacity and on production of major industries such as mining and chemicals. No reliable data on gross and net agricultural production have been published by the Soviet Union since the late 1920's. A highly artificial exchange rate makes it very difficult to make meaningful international comparisons with Soviet value data. The last complete population census was published in the 1920's and only the broad outlines of the most recent (1939) census are available. The situation with respect to published economic statistics on domestic economic conditions for the European satellites and Communist China is no better than for the U. S. S. R.

Bloc trade data are limited to broad aggregates and are not published at regular intervals. While data on trade with the free world is available from western statistics, information on intrabloc trade by country and commodity and on U. S. S. R. satellite economic ties are not available. Data on nontrade items in the balance of payments are even scantier than for merchandise trade. No statistics are published on gold and foreign exchange reserves.

The above remarks are by no means intended to be exhaustive. If necessary the Department can provide much more detailed information on a country-by-country basis.

Sincerely yours,

FLORENCE KIRLIN,
Acting Assistant Secretary
(For the Acting Secretary of State).

APPENDIX H

INTERNATIONAL COOPERATION ADMINISTRATION,
Washington 25, D. C., November 4, 1955.

Mr. DONALD C. RILEY,
Acting Chief, Office of Statistical Standards,
Bureau of the Budget, Washington 25, D. C.

DEAR MR. RILEY: The attached report is in response to your letter of September 28, requesting special treatment of the experience of the International Cooperation Administration in collecting foreign economic statistics in specific fields. It is intended for use in meeting the request of Congressman Bolling.

As indicated by the table of contents, the submission is organized along two main lines, one depicting the postwar efforts of ICA to improve the adequacy of foreign economic statistics required for ICA programing purposes, the other indicating major deficiencies still remaining.

Sincerely yours,

W. J. SHEPPARD,
(*For W. K. Scott, Deputy Director for Management*).

ICA ROLE IN DEVELOPMENT AND USE OF FOREIGN ECONOMIC STATISTICS

Prepared by Office of Research, Statistics and Reports

I. POSTWAR EFFORTS TO IMPROVE REQUIRED STATISTICS

The development or improvement, quantitatively and qualitatively, in the statistics of countries receiving aid from the United States has been vital to the effective conduct of the mutual-security program. It was soon realized that deficiencies in the statistics of participating countries put serious obstacles in the way of definitive military and economic aid programing. This was true of many of the industrialized countries of Western Europe as well as the underdeveloped areas of the world. It was obvious, therefore, that ICA[1] had to take the initiative in working with other countries to develop and improve the data needed to determine such factors as (*a*) the specific objectives to be met in achieving the overall goals of the program (e. g., required increases in agricultural production, industrial production, transportation facilities, etc.), (*b*) the capabilities of the recipient country for meeting these objectives, (*c*) the gap between objectives and capabilities as an indication of the external assistance required, and (*d*) the progress being made under the program.

Such measures were especially important for countries in which ICA was engaged in direct military assistance, economic support of a military program, or economic development assistance. They were less important for countries in which ICA was concerned only with technical cooperation.

A. Europe

Inasmuch as the earliest aid programs of appreciable magnitude began in Europe, the initial efforts of ICA to improve statistics were concentrated there.

1. *The European-recovery-program period.*—To a considerable degree, the European-recovery program was focused on the problem of remedying the dollar shortage of the European countries. The issues involved required comprehensive and comparable statistics on the foreign trade and balance of payments of the participating countries as a basis for determining commodities most urgently needed and for evaluating recovery progress. In 1948 and early 1949, foreign-trade reports of most Western European countries lagged badly, were inadequate in commodity and country detail, and frequently not comparable as between countries.

To meet these deficiencies which hampered programing, three questionnaires were initiated by ICA. The first was a monthly questionnaire calling for total exports and total imports, and breakdowns of each by selected individual countries. The second questionnaire related to commodity breakdowns of exports and imports by country or area of destination and origin. The information from the latter questionnaire was used by ICA as a basis for projecting country program requirements by individual commodity. A quarterly report also was developed by ICA to cover actual and projected payments and receipts for various

[1] The designation ICA covers the International Cooperation Administration and its predecessor agencies: ECA, TCA, MSA, and FOA.

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invisible transactions such as shipping charges, insurance, tourism, etc., and capital movements, as well as for exports and imports. ICA Mission personnel prepared this report and, where necessary, assisted the governments in the preparation of the other two reports.

As a result of such reporting programs, the adequacy and timeliness of trade statistics for western European countries were vastly improved and the subsequent development of detail reporting systems by such international agencies as OEEC and the United Nations was greatly facilitated. At the present time OEEC collects and publishes the data reported in the first two questionnaires. Although reports are somewhat less prompt than formerly, the data are adequate for present needs.

2. *Military assistance period.*—With the outbreak of hostilities in Korea in 1950, emphasis of the United States aid program in Europe shifted from economic assistance to military assistance and the establishment of force goals for the NATO countries. In this framework of activity it was imperative to have appropriate standards by which to measure the progress of the NATO members toward stipulated targets, especially with regard to defense expenditures.

At this juncture it was necessary to decide whether the United States should attempt to collect country defense expenditure data on its own or whether it should utilize the material that could be collected by NATO. The United States felt that it could not afford to be wholly dependent on an international organization for basic information vital to its own foreign aid operations; yet it appeared unwise to burden member countries of NATO with dual submissions of material that were likely to be substantially overlapping. Moreover, there were psychological and mechanical advantages in having the needed information come through NATO. The problem was resolved by utilizing NATO as an instrumentality for collecting the data on defense expenditures. The United States, however, was able to exert strong influence in gaining acceptance of a comprehensive NATO questionnaire which essentially covered the United States requirements as well as those of NATO. Largely at United States insistence, the NATO reports were designed to reveal in addition to total expenditures the composition of individual defense outlays by such major categories as military personnel, construction, and materiel, as well as by detail on a number of subcategories. It was important to achieve comparable data not only with respect to the breakdown of the various categories but also by way of providing a common yardstick to measure the efforts and achievements of individual countries.

The early submissions of statistical material by the member countries of NATO were inadequate, mainly because differing fiscal systems did not readily permit compilation of data into NATO categories and because some countries lacked experience in developing the kind of data requested. There were countries which felt that they simply could not submit the data on the basis requested. To overcome these difficulties, personnel from the ICA regional office were sent to a number of countries to explain on a person-to-person basis what was needed and why. In addition ICA country missions, in cooperation with the MAAG's, worked closely with the respective participating European governments and provided guidance in establishing appropriate internal reporting systems and submission of the proper data to NATO. The NATO International Staff was convinced that in a current reporting system the adequacy of the followup very largely determined the adequacy of the data reported; therefore, they welcomed the initiative and support of the United States.

For United States needs an internal ICA report was devised to provide, supplementary to the material submitted by each country to NATO, an analysis and appraisal by the ICA missions of the information submitted by the respective countries. Thus the needs of both the United States and NATO were served by coordination of data requests, and we strengthened the NATO statistical work by assisting them and not competing with them. This internal report proved particularly useful in the early periods when country submissions were in a raw state and contained numerous gaps. As these submissions improved, the need for the internal report was reduced, and it was consequently discontinued.

Defense expenditure reports by the NATO countries are now considered reasonably accurate and on a comparable basis. Even in the less advanced countries of Greece and Turkey the current reports demonstrate the value of the combined efforts of NATO and the United States. After starting with a complete absence of such statistics, these countries now provide acceptable data, although, of course, there is still room for improvement.

The NATO defense expenditures data have proved exceedingly valuable in planning the mutual security program, both the military portion and the economic portion supporting it. They have provided a fairly reliable measure of the absolute and relative defense efforts of the NATO countries. For example, total figures and the breakdowns provided have revealed the progress and extent to which budgets and production plans have been translated into construction and production of military "hardware." In short, these data have permitted comparable measurements of defense burdens, progress of the defense buildups, and gaps between country capabilities and requirements.

The United States sets an example for other countries by filing carefully prepared replies to the NATO questionnaires. For policy reasons the United States does not provide forecasts beyond the current fiscal year. It should be pointed out, however, that the timing of the United States submission for the regular NATO Annual Review could be improved.

Another channel of ICA relations with European countries has been the Organization for European Economic Cooperation. The United States, through its associate membership, encouraged the OEEC to compile monthly data for a number of economic indicators, such as industrial production, exports and imports, etc. Moreover, the United States was a leading proponent of adoption by OEEC of standardized statistical questionnaires designed to insure comparability of data among reporting countries. By setting an example of a high level of compliance for itself, the United States has sought to encourage other countries to complete the questionnaires as fully and as accurately as possible. This action was motivated by our need for data essential to the successful conduct of our overseas programs.

One of the more important statistical documents compiled by OEEC is its Annual Economic Review. The questionnaires from which this document is compiled call for a wide variety of data on national accounts, industrial and agricultural production, government finances, and the balance of payments. The questionnaire prescribes the use of standard forms and definitions to insure comparability among the reporting countries. The United States has been able to complete the OEEC questionnaire quite fully and substantially in accordance with the OEEC definitions. As the agency with primary interest in cooperating with OEEC, the ICA has made strong efforts to insure a complete and accurate United States reply to the questionnaire and has worked with other United States Government agencies in resolving technical difficulties.

While the military strength of the Western European countries was being built up, it was necessary to have a clearer picture of their national accounts and government finances in order to appraise their respective capacities to support the desired military programs. Such information was not available in suitable volume or form.

ICA, therefore, assisted in the development of improved and more comparable statistics on national accounts for OEEC countries. Initial ICA efforts were taken over by a special project of OEEC which ultimately resulted in a "standardized system of national accounts" which greatly improved the quality, coverage, and comparability of such statistics. This standardized system has been in acceptance since 1952 and is used in published national accounts statistics of the OEEC and U. N. Wider adoption of uniform concepts, definitions, and methodology extended the benefits of this work to countries outside Europe in their reporting to the U. N. Present OEEC studies are designed to improve international comparability through adjustments for purchasing power differentials. For Western European countries other than Spain and Yugoslavia, national account statistics are adequate for United States foreign economic policy formulation and implementation and for detailed evaluation of our policies and actions.

Besides these efforts toward basic improvement in national accounts data for OEEC countries, ICA has endeavored to provide, for planning and programing purposes, current estimates and projections from most up-to-date OEEC benchmark data on national accounts. Adjustments have been for the purpose of improving comparability and for purchasing power differentials.

In the field of government finance, ICA has collected, compiled, and adjusted the published data of OEEC and other program countries—primarily on central government finances but to some extent (e. g. tax levies) on subordinate levels of government. To obtain international comparability and more adequate coverage of the government finance sector of aid-receiving countries, ICA developed a basic classification and definitional scheme which was implemented by a standard questionnaire submitted to the Washington office by the ICA field missions. Although developed especially for OEEC countries, this questionnaire and basic classification have been utilized for selected program countries outside Europe. The efforts of ICA in this field have been necessary because of the limited coverage and lack of comparability in the government finance data compiled either by the countries themselves or by international agencies such as U. N. and IBRD.

B. The underdeveloped countries

ICA has had to blaze new trails in the measurement of economic developments in the underdeveloped areas of the world in order to provide even a minimum basis for planning the appropriate nature and magnitude of the mutual security programs for those areas. The need was particularly pronounced in such countries as Korea, where a large military and economic program was essential to even the short-run survival of the nation. In similar, but less precise, degree in comparison with the European countries, estimates of what was entailed in reaching the desired goals involve measurement of specific objectives to be met, the nation's capabilities for meeting those objectives, and the differences between objectives and capabilities.

The information initially available for making these determinations was exceedingly fragmentary and much of it was of questionable reliability. Established techniques did not show how to fill such a void of economic information on short notice. It has been necessary, therefore, to pioneer new avenues for formulating estimates and cross-checks that would provide a reasonably accurate picture in depth of the status of the nation's economy. Moreover, for the process of annual programming, it has been necessary to devise measures of country economic progress which had been essentially nonexistent.

This procedure of constructing estimates and measurements in Korea is a continuing one. There is still much to be done to fill important gaps in data and to improve the accuracy of existing data; but some progress has been made in providing at least the basic essentials.

Underdeveloped countries other than Korea present essentially the same problem in greater or lesser degree. For example, Afghanistan has never taken a census of population. Afghan statistics on production, trade, finance, and prices are virtually nonexistent. Moreover, no statistical data are regularly compiled and released by the Afghan Government.

Indicative of what has been done in an overall sense to bridge the statistical gap, ICA has prepared estimates of the balance of payments positions of countries which do not submit reports to the international Monetary Fund. To meet needs for current balance of payments data, ICA has made its own estimates for countries from which official data are not forthcoming until too late to be of current use. In a one-time study, ICA assembled all available data bearing on the programing and accomplishments of the development programs in the Far East, applying dollar values wherever possible. As another instance, comparative analyses have been made to resolve discrepancies between the amounts of trade reported by exporting countries and their corresponding importaing countries.

In the field of national accounts in non-European countries, ICA has collected, compiled, adjusted, and projected such national accounts data as have been available in U. N. and other publications. In public finance, the questionnaire and basic classification scheme developed initially for OEEC countries was used also for selected program countries outside Europe.

C. Technical assistance in statistics

In addition to its efforts to improve the statistics of other countries to meet the current needs of programing, ICA, through its technical cooperation program, has instituted a long-range approach to the fundamental problem of generating more adequate data at the source. In cooperation with the International Division of the Census Bureau, ICA has been providing technical assistance to foreign governments in the development of their economic and demographic statistics. This has taken the form of providing United States technicians and consultants, and undertaking programs of training and observation in the United States for foreign statistical technicians.

A widely expanded program among European countries was aimed primarily at the improvement of economic statistics and statistical processes as part of the European recoverey program and the productivity drive. Substantial impetus was given to statistical quality control and interindustry statistical analyses.

The Latin American countries, in expanding their efforts to compile basic population and economic statistics, have sought substantially increased technical assistance through the United States technical cooperation program. The

Near East and African and the Far Eastern countries likewise have been encouraged to improve their statistics and statistical administration through the use of United States consultants and participant training programs. As an integral part of its technical cooperation program, ICA has employed American universities to conduct training programs in a number of countries. In all instances, these improvements in statistics have been motivated to meet specific needs in a given country; for example, census surveys, vital statistics, customs statistics, national income statistics, labor and economic statistical reporting.

D. ICA coordination with foreign service reporting

Through the development of the comprehensive economic reporting program (CERP) by the Department of State for all foreign posts, it has been possible to organize the use of resources for economic reporting and analysis to the mutual advantage of the Department of State and other interested agencies of the United States Government. ICA is not a reporting agency, but improved economic reporting and analysis are a byproduct of its operations in many countries.

At the Washington end, ICA and the Department of State have worked together to keep duplication to a minimum and to develop reporting arrangements that will meet the needs of the several agencies with the same kinds of interests. Of note in this connection is the current effort to develop guidelines for more uniform and comparable foreign reporting in the field of public finance.

II. THE PRESENT NEEDS

The European countries with which ICA has been concerned are in a different class from the underdeveloped countries of the world in terms of the scope and level of their statistical data. Accordingly, there is some advantage in treating the remaining statistical deficiencies of Europe separately from those of the underdeveloped countries.

A. Remaining deficiences in European statistics

In the past 7 years there has been great improvement in European economic statistics. Nevertheless, specific inadequacies remain which handicap the formulation of ICA policy. This is especially true of short-term economic indicators; less so for annual and longer run data.

An example of erroneous conclusions formed because of lack of data occurred in late 1952 and 1953 when OEEC, and to a lesser degree the ICA regional office, was concerned about economic stagnation when, as became evident later, Europe was simply passing through the contraction phase of a business cycle. Thus the OEEC fifth report was originally planned around the stagnation theme. It is not likely that this mistake would have been made if there had been adequate quarterly data on changes in inventories, consumer expenditures, capital formation, etc.

Balance of payments statistics and projections of most European countries are not sufficiently up to date and do not provide adequate data on changes in payables and receivables and other changes in short-term balances. As a result, we do not know at present whether less than half or nearly all of the United Kingdom's loss in gold and dollars during the third quarter of 1955 was due to scare stories about the devaluation of the pound.

A physical index of munitions production in the NATO countries would be useful. Through stimulation by the ICA, the Director of Statistics of NATO agreed in the summer of 1954 that his organization would attempt to develop one. There is also need for seasonally adjusted monthly industrial production indexes in the European countries. OEEC has been working on this. There is need for coordination on the detailed treatment of export and import statistics from a security standpoint. Indexes of agricultural production computed by the OEEC have not been considered sufficiently reliable for ICA purposes; accordingly, arrangements were made for the United States Department of Agriculture to develop independent indexes for OEEC countries, although USDA efforts along these lines are now directed more to the economically underdeveloped areas.

National account statistics for developed countries in Western Europe are probably adequate for formulation and execution of United States foreign economic policy and for the specific needs of ICA. Deficiencies are in measurement and adjustment for purchasing power differentials and in available detail for some countries, e. g. GNP by industrial origin for France, and national income by factor shares for Germany. Basic benchmark data could also be more adequate. Data for the less developed European countries—Greece, Spain, Yugoslavia—are not now adequate for ICA needs, particularly in the investment and government sectors.

Data on government finances for the developed countries of Western Europe, as now compiled by ICA, are probably adequate for planning and executing United States foreign economic policy and aid programs. As published by the U. N. and in the national budget documents, however, these statistics are not suitable for international comparisons of defense expenditures, government investment or national deficits. General adoption by each country of the new standard classification scheme being developed by the U. N. would probably fill this serious gap in published government finance statistics. Data published or compiled by ICA for Spain are not fully adequate for planning and administering United States aid programs, due to uncertainty in coverage of extrabudgetary accounts and the large number of autonomous agencies carrying on governmental functions. Data for Yugoslavia also are inadequate.

B. Major deficiencies in statistics of underdeveloped countries

Although there is a wide range in the statistical competence found in the underdeveloped areas of the world, for the most part such countries are still at the rudimentary stage in developing their statistical output. Some have a reasonable supply of statistical technicians, but they do not fully comprehend the importance and methods of collecting adequate and reliable masses of raw data. Consequently, there is a tendency to publish statistical indexes with a facade of sophistication that conceals their shaky underpinning.

Generally speaking, foreign trade statistics of the underdeveloped countries continue to be inadequate in detail, too late to be fully useful, and lacking in comparability with the data of other countries. For some countries, even the total dollar values of exports and imports are dubious because of the difficulty of determining an appropriate exchange rate for conversion, especially where inflation is rampant or multiple exchange rates are applied to exports. In light of these deficiencies, it would not be feasible, for example, to make an up-to-date study of intra-Asian trade or of intra-Latin American trade comparable to the studies currently made of the trade of Western Europe. There is an acute need for applying standard definitions to the concept of a country and a commodity. In general, trade statistics would be satisfactory if the conutries could meet the requirements stipulated by the United Nations.

There are still many countries for which balance of payments statements are in a fragmentary stage because of inadequate information or are as much as 2 years late when released. Moreover, changes in the balance of payments should be finally reflected in changes in gold and foreign exchange reserves over the same period. In many countries, wide discrepancies are currently noted.

An important criterion of the condition of a nation's foreign trade is its terms of trade. This is especially pertinent to countries which rely largely on exports as a prime source of revenue. Such data are available only for a limited number of countries. Others should be encouraged to develop statistics on prices or unit values of exports and imports so that the terms of trade could be computed.

National account statistics for underdeveloped countries in general are inadequate for United States foreign economic policy formulation; for some countries they are grossly deficient. Such statistics are unsuitable for policy execution, and for planning and evaluating specific United States foreign aid programs. In many underdeveloped countries there have been no adequate censuses of population, industrial production, or agriculture, which are essential to building national account statistics. Also in these countries the large nonmarket sector of the economy adds to the difficulty of developing national account data. Lack of price data and government control over foreign exchange markets in some of these countries are formidable obstacles to measurement and adjustments of international purchasing power differentials.

Government finance data published by the governments of underdeveloped countries are generally not adequate for proper planning and evaluation of United States aid programs. Country documents and U. N. publications seldom cover the entire government finance sector and do not have systems of classification or uniform treatment of various types of transactions to permit either country-to-country comparisons or a determination of the actual country deficit or surplus positions. ICA is endeavoring to improve its own compilations of these statistics, but major difficulties arise from lack of a standard international classification and reporting system. Efforts of the U. N. and its regional organizations such as ECAFE and ECLA in this field may bring improvement in the future.

Other important gaps remaining in terms of the needs of ICA include: (*a*) Systematic formulation of development goals and reporting of progress in reaching them; (*b*) calculation of purchasing power of currencies to permit more realistic conversion to dollars of data expressed in local currencies; and (*c*) for some countries calculation of comprehensive indexes of agricultural and industrial production. Within the framework of industrial production there is need also for the type of data which reveals more information on output of significant commodities and magnitudes of cost factors.

In the nature of things, progress in improving the statistical performance of underdeveloped countries tends to be slow. Furthermore, efforts to conduct a full-scale attack on the problem have been hampered by a lack of sufficient funds to finance needed basic censuses, training of technicians, and other elements of such a program. As an encouraging factor in this picture, however, it should be noted that there is a growing recognition on the part of the governments of underdeveloped countries of the fundamental value of reliable statistical procedures in advancing their development programs.

APPENDIX I

THE CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS,
Washington, November 1, 1955.

Mr. DONALD C. RILEY,
Office of Statistical Standards,
Bureau of the Budget, Washington 25, D. C.

DEAR MR. RILEY: I am writing in reply to your letter of September 29, 1955, requesting a statement in response to Representative Bolling's letter regarding an appraisal of economic statistics from the point of view of foreign economic policy determination.

The Council's primary interest in international economic statistics stems from the necessity of determining the impact of United States transactions with the rest of the world and of world economic developments generally on the United States economy. We must also be alert to the impact of United States economic activities and policies on the economies of other countries. Hence, it is important for the Council to have accurate information on economic conditions and trends abroad on a current basis as well as detailed information on the foreign economic transactions of the United States.

The international organizations, including the International Monetary Fund, the OEEC, the FAO, and the U. N. and its regional economic commissions, have in general done a good job in gathering and presenting on a comparable basis statistics on trade, balance of payments, and economic conditions abroad. The gaps and weaknesses stem largely from the lack of adequate statistical services in many of the foreign countries. Improvement of foreign statistics requires education and technical assistance by the United States and international institutions.

With respect to United States foreign trade and balance of payments statistics, there is a need for greater improvement along two general lines. First, there is need for additional processing of the various data by the agencies compiling the data. For example, monthly and quarterly export and import trade statistics should be adjusted for seasonal variations. We should also have a properly weighted index of export and import prices by principal categories.

A second general area for improvement is in relating the data on international transactions to the various components of the gross national product and other domestic economic indicators. The net foreign investment component of gross national product does not enable one to assess the contribution of foreign transactions to our gross product. Supplementary information showing exports and imports broken down according to the standard industrial classification currently employed in the presentation of certain components of gross national product is needed in analyzing foreign transactions in relation to United States economic activity. A breakdown of inventories and changes in inventories between domestically produced and imported commodities would also be of value.

For various purposes additional information on transactions between domestic concerns and their foreign branches and subsidiaries would be helpful. For example, how much do we import from American-owned concerns abroad and how much is being exported by American concerns to their foreign subsidiaries? Our information on capital transactions between American concerns and their foreign subsidiaries and on taxes paid by foreign subsidiaries is also inadequate.

There is considerable room for improvement in the quality of our balance of payments statistics, especially in the services and direct investment fields. Finally, the quarterly balance of payments would be a far more useful tool for analyzing current developments if it were to become available earlier than it does now, about 2½ months after the end of the quarter. The timing is largely a matter of the receipt of data by the Balance of Payments Division of Commerce from the original compiling agencies. Ways should be found to speed up this reporting.

Sincerely yours,

ARTHUR F. BURNS.

APPENDIX J

UNITED STATES TARIFF COMMISSION,
OFFICE OF THE CHAIRMAN,
Washington, D. C., October 19, 1955.

Mr. DONALD C. RILEY,
Acting Chief, Office of Statistical Standards,
Bureau of the Budget, Washington, D. C.

DEAR MR. RILEY: I have your letter of September 28 relating to the request of Representative Bolling, chairman of the Subcommittee on Foreign Economic Policy of the Joint Committee on the Economic Report. You asked specifically about our experience in our current investigations and past attempts at cost determination.

The activities of the Tariff Commission in recent years have not required extensive use of the categories of statistical data on foreign countries outlined in Representative Bolling's letter. The Commission has done only a limited amount of general research relating to economic developments in the major trading countries of the world. At present the principal sources of material for such research are the Foreign Service reports of the United States, data compiled by the various executive branches of the United States Government, and data published by the United Nations. In the circumstances the Commission is not sufficiently acquainted with the limitations of the foreign statistical data or the problems that would be encountered in improving them, to offer criticisms that would be useful to the Bureau of Statistical Standards.

In regard to data of interest to the Tariff Commission on domestic industries, I very much doubt that any Government agency would be justified in collecting them on a continuing basis. Most of the Tariff Commission's investigations, and virtually all of the most troublesome ones, relate to narrower categories of commodities than are of continuing interest to most Government agencies. The work and expense that would be involved in collecting and compiling statistical information on a large number of narrow categories of commodities would, of course, be considerable.

A major portion of the activities of the Tariff Commission have consisted of studies relating to individual articles, most of which are made by concerns and industries that make a variety of other articles as well. This is true of most of the investigations under the peril-point provision and under the escape clause of the Trade Agreements Act, as well as under the various investigations conducted under sections 332, 336, and 337 of the Tariff Act of 1930. In such investigations the Commission cannot obtain most of the required data from published sources and must, therefore, resort to the use of written questionnaires and interviews by members of its staff sent into the field. Data are also obtained at the public hearings that are held in connection with the investigations. Some of the commodities studied are of such character that not even official United States import statistics have been gathered for them. In such instances the Commission must analyze importers' invoices filed with the Customs Bureau to determine the volume of imports.

In its peril-point investigations the Tariff Commission is required to make certain findings in regard to a list of commodities that may be considered for tariff concessions in negotiations with other countries. The Commission must determine (1) the maximum decreases in duty, if any, that can be made on each listed commodity without causing or threatening serious injury to the domestic industry producing like or directly competitive products, or (2) the minimum increases in the duty or additional import restrictions that may be necessary on any of the listed products in order to avoid causing or threatening serious injury to such domestic industry. The data required for such determinations are obtained from published production and trade statistics, if available, and from information in the Commission's files of unpublished data and information submitted at the public hearings.

In its escape-clause investigations the Tariff Commission is required to determine whether any product on which a trade-agreement concession has been granted is, as a result, in whole or in part, of the duty or other customs treatment reflecting such concession, being imported into the United States in such increased quantities, either actual or relative, as to cause or threaten serious injury to the domestic industry producing like or directly competitive products. In making its determination the Commission is required to consider the following factors (without excluding other factors): Trend of production, employment, prices, profits, and wages in the domestic industry concerned; trend of inventory, sales, and imports of the product under investigation; and trend of the proportion of the domestic market supplied by imports.

In its investigations under section 336 of the Tariff Act of 1930, the Tariff Commission is required to determine for the article subject to investigation the differences between the cost of production in the United States and in the principal competing foreign country. The possible scope of investigation under the provisions of section 336 has been progressively reduced in recent years as the United States has extended the coverage of trade-agreement concessions negotiated under the Trade Agreements Act. The Trade Agreements Act makes the provisions of section 336 inapplicable to any commodity on which a tariff concession is in effect. Since a class of articles which may be subject to section 336 investigation—like a class which may be subject to escape-clause investigation—frequently consists of only one of several types of products made by the domestic producing organization, the Commission encounters considerable difficulty in obtaining cost data for the domestic products as well as the competing foreign products. In many investigations the Commission found that cost records of individual companies were not kept in a form that was readily usable. The Commission's accountants had the time-consuming task of analyzing the available information, working out cost statements, and segregating or allocating the cost data for the particular product under investigation. Investigation of the costs of production of farm products involves additional problems inasmuch as cost records are not ordinarily available and many elements of cost, such as the labor of the farmer and his family, the value of some feeds, and interest charges, must be imputed or estimated. These obstacles to obtaining costs-of-production data apply to both domestic and foreign industries, but they are multiplied when costs are to be obtained in foreign countries, where accounting and other practices are generally quite different from those in the United States, and when meaningful currency equivalents cannot always be readily made.

Section 337 of the Tariff Act of 1930 authorizes the Commission to investigate alleged unfair methods of competition and unfair acts in the importation of articles or the sale of imported articles in the United States. The information required for section 337 investigations, like that for the other types of investigations listed above, is not generally available in published data and must be obtained directly by the Commission from the domestic producing and importing concerns.

Section 332 of the Tariff Act directs the Commission to make such investigations and reports as may be requested by the President, the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, or by either House of Congress. Under the provisions of section 332, the Commission used to make detailed studies relating to the trade problems of individual countries. For such reports the staff made extensive use of the type of statistical data referred to in Representative Bolling's letter. The latest reports of this kind, however, were those on trade problems of the Latin American Republics, most of which contain statistical data now 10 years old.

Section 22 of the Agricultural Adjustment Act directs the Tariff Commission, upon request of the President, to determine whether an article is being or is practically certain to be imported into the United States under such conditions and in such quantities as to render or tend to render ineffective, or materially interfere with, programs or operations undertaken by the Department of Agriculture. In such investigations, which relate to agricultural products, the Commission relies primarily on published and unpublished data compiled by the Department of Agriculture, information submitted at the public hearings by interested parties and that obtained in the field by the Commission's staff, and data contined in Foreign Service reports.

I trust that you will find the above information helpful to you in responding to Representative Bolling.

Sincerely yours,

EDGAR B. BROSSARD, *Chairman.*

APPENDIX K

ASSESSMENT OF ECONOMIC STATISTICS PUBLISHED BY SINO-SOVIET BLOC COUNTRIES [1]

Historically the trend of statistical issuance by the bloc countries is one of progressive shrinkage, with some slight expansion in the last 2 years. This trend began in the U. S. S. R. in the late 1930's and continued until 1953. In the European satellites it began with full Communist control after 1948. In China it coincided with the transfer of power to the Communists. The present restrictive policy of statistical publication by the bloc countries sets a limit on the data from these sources. There is little likelihood of expanded statistical reporting so long as the present secretive policy continues.

Bloc area economic statistics are generally less comprehensive than those published by nonbloc countries, and far less comprehensive than those of the major free-world countries. Furthermore, they are often based on different methodological approaches. However, by synthesis of important omitted magnitudes from indirect sources, and by changes in the aggregation of available physical and monetary data it frequently becomes possible to obtain meaningful statistical measures.

The governments of the European satellites and Communist China have tended to emulate Soviet practice in statistical reporting procedures. The lower stage of economic development in Communist China and the Balkan satellites, however, is reflected in a smaller volume and poorer quality of the statistics issued by these countries. As a generalization, it can be stated that both the volume and degree of sophistication of economic statistics published by Poland, East Germany, and Czechoslovakia compare favorably with those from the U. S. S. R. Those coming from official sources in Communist China and Hungary and, in even greater degree, from the governments of Rumania, Bulgaria, and Albania, are inferior in both quantity and quality. For the sake of brevity, this assessment will refer to the Sino-Soviet bloc as a whole. The observations noted are chiefly applicable to the U. S. S. R., but with the qualifications indicated are generally applicable to the bloc as a whole.

Production data

Bloc physical production statistics are spotty in their coverage of the economy and vary in the degree of inclusiveness from one year to the next. Frequently percentage increases rather than absolute values are furnished, but usually some related absolute base can be found. In terms of the proportion of the economy covered, bloc production statistics relate to a predominant share of the nonmilitary sectors. It is difficult to find criteria by which to evaluate the accuracy of official production statistics. In the case of the U. S. S. R. one such standard is available in the form of the captured Soviet-classified version of the 1941 economic plan. Comparison between this 1941 plan and official statements discloses almost complete identity.

Aggregative sector production indexes are more open to question. Official bloc-country indexes tend to display different rates of growth of output than do like indexes which western scholars have constructed from substantially the same official bloc-country physical production data. Even though bloc aggregate indexes may be unreliable, some measures of aggregate output can be constructed from published physical production data.

Up to the present there have been no comprehensive analyses of cost and price relationships in the bloc countries. Price information is forthcoming from official producer goods catalogs and from observation of consumer goods prices in the stores and markets. Cost data are not released in comprehensive form, but appear for specific sectors in discussions of their activities. Extensive use of indirect taxes and high profits in the least efficient sectors of industry imply varied relationships between selling prices and costs of production.

[1] Summary statements of an excellent comprehensive discussion on deficiencies of U. S. S. R. statistics are given in Journal of the American Statistical Association, vol. 48, No. 263, September 1953, pp. 629–630.

Gross national product (GNP)

None of the bloc countries has published GNP estimates in recent years. They provide only indexes of GNP. Since GNP indexes represent combinations of sector production indexes they suffer from the limitations of questionable weighting. Furthermore, the conceptual framework for constructing absolute GNP estimates has been conditioned by Marxist precepts and must be reformulated to fit Western definitions if intercountry comparisons are to be ventured. Data on the major monetary magnitudes comprising GNP are readily available, thus providing the essential ingredients for GNP estimates.[2] The resulting estimates can subsequently be converted to dollar terms by application of United States dollar-bloc currency conversion ratios developed from extensive samples of price quotations.

Bloc statistics on the distribution and origin of GNP are subject to the deficiencies of the aggregate estimates. The distorting effects of questionable weighting are even more pronounced than for GNP as a whole. By the aggregation of available official monetary magnitudes into a conventional western conceptual framework, breakdowns of bloc country gross national products can be estimated.

It should be noted that intercountry comparisons of an aggressive nature should be made only with great caution. The less the similarity between two economies, the more difficult it is to find like activities to compare. The very different scale of economic values prevailing in the Sino-Soviet bloc countries compared to that of the West makes comparison between these two areas particularly equivocal.

Monetary and fiscal data

The bloc countries have published almost no statistics on money supply. Isolated figures on bank loans and deposits are presented at rare intervals. There is no publication of bank balance sheets. The national budgets are the most useful sources of aggregative data of a monetary-fiscal nature. Although bloc budgets do not contain the degree of detail disclosed in western country budgets, enough breakdown is furnished to provide a broad insight into the distribution of available resources. Because of the high degree of socialization in the bloc economies their national budgets cover a larger proportion of total economic activity than is the case in a market economy, thus making their budgets a useful tool of analysis in an area of relative statistical scarcity.

Commodity trade data

The Sino-Soviet bloc countries do not regularly report the details of their foreign trade, either with other members of the bloc, or with western countries. In fact, only public addresses by State leaders and scattered references in official publications contain such information on the total volume of trade and its components as is made public. These statements usually refer to broad aggregates (for example, total trade turnover) stated as a percentage of some previous (base) year. Occasionally reference is made to trade in certain commodity groups, as for example, the typically ambiguous statement of Mikoyan in March 1954, "Our supplies of machinery and equipment for undertakings built in the democratic countries to Soviet design are estimated at nearly 800 (million) rubles for 1953 alone." Such reporting is not very helpful.

Existing data pertaining to the volume, value, and composition of total commodity trade between members of the Soviet bloc and countries of the free world are derived from the reports of the western trading partners. The U. N. and the United States Department of Commerce are working to improve the comparability of these data in terms of commodity categories, value, and volume units, both in the records which already exist and in future reporting.

In 1954 for the first time, the U. S. S. R. submitted to the U. N. selected data relating to trade between the U. S. S. R. and countries of the free world in certain broad commodity groups, for 1953 and the first half of 1954. This was followed in 1955 by similar submissions for 1954 and the first half of 1955 by Poland, Czechoslovakia, and the U. S. S. R. These are the only known instances to date of economic reporting by bloc members to an international organization.

Terms of trade data

Members of the Soviet bloc do not report the prices at which their foreign trade is conducted, except to say that they trade "at world prices." Since

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[2] See Abram Bergson and Hans Haymann, Soviet National Income and Product, 1940–48, Columbia University Press, New York, 1954.

"world prices" are not defined, it is impossible to judge the terms of trade of the Soviet bloc from their published data.

Balance of payments data

Bloc countries do not report the volume of their international transactions other than certain commodity trade, nor the volume of their reserves of gold or foreign exchange. Thus, it is not possible to construct a balance of payments for the bloc from their published data.

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington 25, D. C., November 15, 1955.

Hon. RICHARD BOLLING,
Chairman, Subcommittee on Foreign Economic Policy,
Joint Committee on the Economic Report,
House of Representatives, Washington 25, D. C.

MY DEAR MR. CHAIRMAN: I am enclosing a statement from the Department of the Interior on economic statistics for analysis of problems of foreign economic policy. This may be added to the other agency statements which I forwarded to you with my letter of November 9, 1955.

All of the agencies which we invited to submit comments have now responded.

Sincerely yours,

RAYMOND T. BOWMAN,
Assistant Director for Statistical Standards.

Enclosure.

DEPARTMENT OF THE INTERIOR,
OFFICE OF THE SECRETARY,
Washington 25, D. C., November 14, 1955.

Hon. RAYMOND T. BOWMAN,
Assistant Director for Statistical Standards,
Bureau of the Budget, Washington 25, D. C.

MY DEAR MR. BOWMAN: This is in reply to the September 28 letter of Mr. Donald C. Riley, Acting Chief, Office of Statistical Standards, requesting that the Department prepare an appraisal of the availability of economic statistics from the point of view of the determination of foreign economic policy.

The only bureaus of the Department of the Interior which utilize economic statistics to a significant degree for this purpose are the Bureau of Mines and the Fish and Wildlife Service. I am attaching copies of the views of these agencies as representing the views of the Department on this subject.

The opportunity to present our views is appreciated.

Sincerely yours,

DOUGLAS MCKAY,
Secretary of the Interior.

Enclosures, 2.

DEPARTMENT OF THE INTERIOR,
FISH AND WILDLIFE SERVICE,
Washington 25, D. C., October 24, 1955.

Memorandum

To: Director, Technical Review Staff.
From: Acting Director.
Subject: Appraisal of available economic statistics re foreign economic policy.

This is in reply to your memorandum of October 7, 1955, to the Chief, Branch of Commercial Fisheries, requesting an appraisal of available economic statistics for use in determining foreign economic policy.

A. NEEDS OF THE FISH AND WILDLIFE SERVICE FOR FOREIGN FISHERY STATISTICS

In determining foreign economic policy, the Service requires considerable domestic and foreign statistical information. Our experiences show that coverage of the domestic fisheries is adequate. The Service has a well-established statistical system which has recently been expanded to provide necessary coverage of all phases of the domestic industry. Difficulties exist, however, in obtaining comparable evaluated data from foreign sources. Gaps in our knowledge of foreign fisheries presently make it difficult, and, in some cases, impossible for the Fish and Wildlife Service to conduct authorized projects. The principal functions of the Service in regard to foreign fisheries are:

1. To supply the United States fishing industry and Government agencies with current marketing information on foreign fisheries as required for the orderly distribution of domestic fishery products.
2. To aid the United States fishing industry in meeting competition resulting from imports of such competitive products as frozen groundfish, canned and frozen tuna, canned sardines, and frozen shrimp.
3. To foster foreign markets for American fishery products.
4. To conduct economic research and studies on fishery products where international matters are involved.
5. To analyze foreign fishery production, marketing, consumption, import, and export data for determining Interior's position on tariffs, trade, and other international matters.
6. To prepare intelligence reports on the commercial fisheries of foreign countries.
7. To secure foreign technological information required or requested by the American fishing industry and by Government agencies.
8. To advise international organizations, such as FAO, and render technical assistance as requested.

To carry out these authorized projects in the foreign fishery field, the Service requires detailed statistical information from countries where well-established modern fishery industries are conducted, and from countries where undeveloped fisheries show potentials for expanding production of fishery products.

In recent years the need for obtaining foreign fishery data has become critical. Since World War II, the United States has become the world's largest importer of fishery products. In 1953, about one-third of the fishery products consumed in the United States were imported. Three of the four most valuable United States fisheries face serious competition from imports; in 1953 about 40 percent of the canned tuna, 45 percent of the groundfish fillets, and 25 percent of the shrimp were imported. Although United States exports of fish oils increased significantly in 1953 and 1954, exports of other products decreased; American fish oils, however, are facing new competition abroad.

With increasing imports and increasing competition here and abroad, the Service's and industry's requirements for information have increased. Orderly marketing is essential to the welfare of the fishing industry, and orderly marketing is impossible without precise knowledge of production and export trends in countries which are major producers and exporters of fishery products. Foreign catch statistics alone are not sufficient. The competitive position of a foreign fishery product in the United States or abroad is the result of many factors, for example, catch, wage scales, technological developments, government aid in the producing country, and prices of fishery products. For the United States industry to prosper it must have current statistics and knowledge of these factors.

B. CHANGES NEEDED TO PROVIDE ADEQUATE FOREIGN FISHERY INFORMATION

The Service presently relies upon the reporting services of the Department of State for the collection and transmittal of foreign statistical information. Reporting, however, is done by officers who generally lack the specialized knowledge necessary for adequate reporting in the field of fisheries. In some instances statistical reporting from northern European countries has been voluminous, but this has not met the needs of the Service, for the reporters have been unqualified to evaluate the statistical information and correlate it with trends and developments in production and in technology. Moreover, the reporters have not been alert to the need for spot reporting on special developments and this has hampered the Service in conducting urgent and effective action on problems of vital importance to the American fishing industry. Statistical reporting from other areas of the world, mainly where there are developing fisheries, has been fragmentary, and in exceedingly few instances has the Service had the comprehensive reporting necessary to insure effective action by United States Government agencies. The situation with regard to reporting on Japanese fisheries is a particularly good example of ineffective reporting. Almost no useful information has been received from Tokyo since the termination of the United States attaché post in 1953.

The Service has worked closely with the Department of State to improve reporting. Working relationships have been good, and during the past 2 years there has been a slight improvement in the quality and quantity of fishery reporting. Statistical and other economic information, however, remains inadequate and the Service believes that improvement which will meet its needs adequately cannot be expected until competent trained fishery attachés are available, with experience in the technological, biological, and economic aspects of fisheries.

For the past several years the Service has studied the various methods by which needed foreign fishery information could be obtained within the framework of the present reporting system. It has determined that fishery attaché posts should be established in each of the major fishing areas of the world. Six posts are the minimum which would provide adequate economic reporting. The establishment of posts at Tokyo, London, Oslo, Mexico City, Lisbon, and Singapore has been proposed to the Office of the Secretary of the Interior. Approval has been given to consult the Department of State and determine what means should be taken to implement the program.

The fishery attaché program would serve an important function in rounding out the expanded program of assistance provided by the Fish and Wildlife Service to the American fishing industry—important segments of which show declining trends largely because of competition from foreign fisheries. Statistical and other information provided by the attaché program would enable the Service to conduct its authorized functions in the foreign field and to assist the domestic fishing industry in meeting competition from abroad or in disposing of products in foreign markets. The Service and the American fishing industry are presently operating under severe disadvantages. Our Government produces comprehensive statistical information on the American fishing industry and this is available to all nations, whereas information from foreign sources, needed for determining our economic policy, is fragmentary and unevaluated.

If the Federal Government is to aid the fishing industry in meeting competition, assist it in developing foreign markets, and act intelligently with regard to tariffs and trade agreements, the Government must have a knowledge of foreign fishery production, imports, exports, marketing, consumption, technological developments, and Government polices and attitudes. The preparation of intelligence reports also requires a broad knowledge of these factors. Finally, with the rapid development of fishing industries throughout the world, United States fishermen come more into contact and conflict with foreign fishermen, and the need for international cooperation on a governmental level becomes greater. A knowledge of foreign fishing industries is essential to this cooperation.

O. LLOYD MEEHEAN,
Acting Director.

UNITED STATES DEPARTMENT OF THE INTERIOR,
BUREAU OF MINES,
Washington 25, D. C., October 26, 1955.

Memorandum:

To: Director, Technical Review Staff, Office of the Secretary (through Assistant Secretary, Mineral Resources).

From: Director, Bureau of Mines.

Subject: Appraisal of available economic statistics re foreign economic policy.

This is in reply to your memorandum of October 7, 1955, addressed to the chief statistician.

Two questions have been raised by the Joint Committee on the Economic Report:

A. "An appraisal by the agency concerned of its particular needs for better reporting, with recommendations as to whether changes within that agency could accomplish this need, or whether improvements are needed elsewhere to this end."

B. "How well equipped are we to make the kind of meaningful comparisons among nations required if the Congress is to frame intelligent legislation in the field of economic policy which has international significance or repercussions?"

A. APPRAISAL OF REPORTING

The Bureau of Mines finds that a major improvement is needed in the timeliness of the foreign trade statistics now compiled by the Department of Commerce. To a very major extent, minerals are international commodities and the timeliness of the foreign trade data is of great concern. Although the detail by which the import and export data are now classified is large, there are several areas in which the detail should be expanded. The Bureau of Mines has attempted to overcome part of this deficiency by obtaining export or import data on certain commodities in more detail than is now published by the Department of Commerce.

Considerably more remains to be done by the agencies concerned in making available from the free-world countries important data on minerals. One of the areas of deficiency is in the statistics of consumption of minerals in foreign countries for which adequate coverage generally is not available. (See statement of Chief, Division of Minerals, attached.) Other deficiencies of this sort and in respect to comparability are spelled out in detail in the statements of the Chief, Division of Foreign Activities, Chief, Branch of Bituminous Coal Economics and Statistics, and chief economist, copies of which are attached.

It is the consensus in the Bureau that the mineral attaché staff of the Foreign Service is grossly inadequate to perform the kind of reporting required for intelligent foreign economic policy formulation and implementation. The country is thus also deprived of valuable economic and technical background information as well as essential statistical information that industry could use to its great advantage.

To improve the economic, technical, and statistical knowledge required for the resolution of international problems, data should be collected more quickly and in more detail for many minerals. This will necessitate an increase in the facilities of both foreign and domestic services.

With the increasing dependence of the United States upon outside sources of minerals supply as our own resources are depleted, complete and reliable knowledge of developments in other areas becomes increasingly essential if the Government is to deal effectively with the various problems on minerals policy, programing, and conservation which arise. Expansions in this field are required both for the Bureau of Mines and for the other Federal agencies. Only a small portion of the total Federal expenditures for economic, statistical, and technical information is devoted to the foreign field. The United States is fortunate in having available such a wealth of information on domestic progress and well-being. This effort is expensive. In the field of minerals, where developments outside the continental shores are quite significant, it is important to make up for deficiencies in available knowledge. Some of these deficiencies arise from the fact that other countries are not able to afford the cost of such activities. Therefore, the United States perhaps should make provision to bridge the gap in self-interest and as a consequence of its position of world importance.

The means of doing so are through expansions of our knowledge of foreign information by efforts of various arms of the Federal Government both at home and abroad. For relatively small expenditures compared with the budgets for domestic information, extremely valuable additions could be made to our information. The Bureau of Mines could make effective use of funds earmarked for increases in the collection and interpretation of information from the foreign field.

B. MAKING OF MEANINGFUL COMPARISONS

It is apparent from the above that the Bureau of Mines regards the availability of necessary data on the foreign aspects of minerals as deficient. It is obvious that the various agencies of the Federal Government, therefore, do not have all the data that should be at hand to make the evaluations necessary to aid the Congress in the field of international economic policy.

This question raised by the subcomittee has particular relevance with respect to minerals because of the importance of international developments on our minerals supply. Since the domestic implications of proposed legislation can be discussed with the full benefit of hearings among interested parties at congressional hearings, it is only through the knowledge derived from the accumulation of collected information that the Members of Congress and the Federal agencies can assess most completely the possible effects of the bill on foreign areas. This makes it all the more pressing for adequate information to be at hand. Since the implications of our legislation can seriously affect relationships with other governments, the United States as a world power should have available the knowledge it needs to assess the results of proposed or actual legislation.

The field of minerals has several important questions which arise continuously and have international significance. To mention only a few, there are such problems as our purchase programs for stockpiling, tariffs, evaluation of foreign markets for domestic mineral products, mining equipment, and mining supplies, the use of United States capital to finance the development of mineral resources abroad, the relative merits of stimulating domestic production versus the increased dependence upon foreign supplies, and the importation of minerals where the United States must rely upon foreign sources.

It is hoped that the current study by the Subcommittee on Foreign Economic Policy of the Joint Committee on the Economic Report will result in increased support of activities to remove some of the gaps in our foreign information.

J. J. FORBES,
Director.

Attachments 4.

STATEMENT ON THE INADEQUACY OF AVAILABLE FOREIGN ECONOMIC STATISTICS ON MINERALS FOR DETERMINATION AND IMPLEMENTATION OF FOREIGN ECONOMIC POLICY

Prepared by Staff, United States Bureau of Mines

From the viewpoint of foreign economic policy, statistics and other technical and economic data on foreign minerals are important for the following reasons:

1. The United States is dependent on foreign sources for approximately one-third of its strategic mineral requirements. Continued availability of these raw materials in peacetime and during emergencies is, therefore, a major objective of foreign economic policy.
2. Determination of stockpile objectives requires detailed and reliable information on resource potentialities and current rates of foreign production and consumption.
3. Minerals comprise a large proportion of United States and world trade. Details of trade are, therefore, essential in formulating international trade policy.
4. The United States is becoming increasingly dependent on foreign sources of supply. In the face of rapidly mounting demand, it is imperative that American mining capital and know-how be stimulated to develop foreign as well as domestic mineral production.
5. Mineral development plays an important role in the Government's technical assistance program now a vital part of foreign economic policy.
6. Foreign countries are important consumers of United States mineral products and mining supplies and equipment. Appraisal of these markets and the factors noted in items 4 and 5, requires comprehensive knowledge of the mineral economy of foreign areas.
7. Determination of international economic and military strategy necessitates evaluation of the present and potential industrial capacity of foreign nations. Because mineral raw materials provide the foundation on which industry is built, dependable knowledge of the mineral resources and industries abroad is essential for such evaluation.

Foreign statistics and other economic and technical information are grossly inadequate to perform the functions noted above.

Iron Curtain statistics.—Reliable information on mineral developments within the Iron Curtain bloc is almost nonexistent. This entails resort to estimation based on little or no basic data. Consequently evaluation of the present and potential strength of these areas involves much guesswork. Whether or not the new Russian pretense of a more harmonious coexistence means that details of the industries of the Iron Curtain countries will be published remains to be seen. Meanwhile assignment of mineral technicians to foreign areas adjacent to the Iron Curtain would place competent observers and analysts closer to the scene who could provide much more reliable judgments than those now available on what is going on behind the curtain.

Free world.—There is also a serious deficiency in information on mineral activities in the free world countries. Many nations of the free world do not compile mineral statistics and other economic data pertaining to minerals on as broad a scale as does the United States. The Foreign Service of the United States obtains most of the published statistics in free world countries. A better job could be done if the economic staff of the Foreign Service were increased to assure proper evaluation of the authenticity of published data and that all available statistics are obtained. The most important need, however, is for technical observers in the Foreign Service who periodically will visit the centers of mineral production and consumption to observe and report on technologic and economic developments firsthand. They also will be able to obtain additional valuable unpublished information from members of the mineral professions in the areas in which they operate. The Bureau of Mines is preparing recommendations requesting a modest expansion of the present mineral attaché staff of the Foreign Service to meet this need.

International trade.—Statistics on international trade in minerals and mineral products are available from most of the free world nations. There are, however, significant deficiencies. Many nations fail to report separately commodities which do not represent large monetary value although they may be of high strategic importance. Details as to countries of origin and destination frequently are lacking and often are reported on the basis of paper transactions rather than on the physical movement of goods. For example, available data are inadequate to reconcile a major disparity between official reports on Canadian imports of chromite from the United States and United States exports of this strategic commodity to Canada.

Production data.—Statistics on mineral production are generally available. A few countries publish no information on this subject and many nations do not report production of the low-unit value construction materials such as sand, gravel, and building stone. While these commodities do not enter into international trade to any great extent, the industries producing them do provide markets for United States manufacturers of mining supplies and equipment in the appraisal of which quantitative statistics are required. Also lack of information in this field causes uncertainties in judgments on the overall mineral potential of an area. Another serious deficiency in production data is the widespread lack of statistics on the recovery of secondary metals from scrap.

Consumption and stock data.—Perhaps the most serious deficiency in international mineral statistics is the lack of data on consumption, end uses, and stocks. Since World War II consumption data have become more readily available in Europe although there are still major gaps. Very little data on end uses and industry stocks are published abroad.

Petroleum.—Statistical information on foreign petroleum operations is fairly abundant but there are important deficiencies that could be bridged by more comprehensive reporting. Serious weak spots are insufficient repetitive statistical data on consumption of petroleum products and year-end stocks of such products. In some countries a significant growth of crude production and refining capacity is not receiving current statistical and analytical treatment to a degree commensurate with this growth. From the economic and military standpoint the foreign petroleum industry, considering its remarkable rate of growth and the essentiality of petroleum products, is so important to the interests of the United States and friendly nations that it should receive full statistical treatment.

Solid fuels.—A similar situation exists in solid fuels statistics. Major deficiencies are lack of data on consumption by type of fuel and end uses; production of crude versus marketable products; production of metallurgical and nonmetallurgical coke; prices of coal and coke; and on "noncommercial" fuels such as peat, fuel wood, charcoal, and animal and agricultural waste products; the latter are important sources of energy in many strategic areas of the world. Because of these gaps uncertainties exist in present evaluations of the energy resources and industrial potentials of friendly and hostile countries.

Production costs.—Lack of data on foreign costs of production is a serious handicap in formulating and implementing foreign economic policy. For most of the minerals virtually no cost data are available, and since comparisons of domestic and foreign costs enter into so many foreign policy considerations there is urgent need for remedying this situation. To obtain basic information from which cost estimates can be derived requires on-the-spot study by competent technicians. This is another reason why the Bureau of Mines is urging an expansion of the Mineral Attaché Service.

Reserves and resources.—There is a great lack of quantitative information on foreign mineral reserves and resources, information that is indispensable in analyzing the Nation's mineral supply problems. Such data are not available in most areas but reliable judgments could be formed by technical experts stationed abroad with the Foreign Service.

Technology.—Technologic progress is not an exclusive accomplishment of the United States and this Nation has much to learn from attainments in other parts of the world. International exchange of technical and scientific information is fairly well organized but there is an urgent need for closer liaison with foreign research organizations. An expanded Mineral Attaché Service could obtain important information from these sources supplementing that available through international meetings and publications of technical and scientific institutions.

Comparability.—It is a well-known fact that for any commodity import statistics of importing countries are usually on a different basis than the export statistics of the exporting country. Most countries of the world use "f. o. b. exporting country" to value their exports, and a majority use "c. i. f. in the importing country" to value their imports. This office has recently had to struggle with a case of serious noncomparability between the statistics of the importing country and those of the exporting country which is evidently not due to this well-known cause. The Office was concerned with preparing data and analyses of data on coal trade with Canada for use in the multilateral trade negotiations under the Trade Agreements Extension Act of 1955. Canada values her imports on a "f. o. b. exporting country" basis, and the United States values its exports on a "f. a. s." basis.[1] Normally, f. a. s. (free alongside ship) value should be less than f. o. b. (free on board) value at the same port by the loading costs involved. For 1954, however, Canadian statistics show imports from the United States of bituminous coal to be 15,564,000 tons, valued at 70,445,000 Canadian dollars, while United States exports of bituminous coal to Canada were reported by the Bureau of the Census to be 15,878,612 tons, valued at $125,049,642. The difference in the tonnage reported was only 314,612 tons (less than 2 percent of the United States export figure), but the difference in the value figures is over $52 million (42 percent of the United States export value).[2] Since Canada "f. o. b. exporting country" and the United States "f. a. s." should refer to the same physical point, there is no readily apparent explanation for the noncomparability of these data. In contrast, a known noncomparability exists as between Canadian export statistics and our United States import statistics in that Canada values her exports at point of origin in Canada, thereby excluding transportation to her frontier,[3] and the United States values its imports f. o. b. exporting country.

Availability.—The problems of availability of data are worst in respect to the lack of adequate price (and inventory) series for mineral commodities in most countries. Such data published by the various international agencies often lack comparability for more than a very few years. As an illustration, the Monthly Bulletin of Statistics, Statistical Office of the United Nations, publishes wholesale coal prices for a group of countries. The basis for the series seems to be constantly changing over time—Western Germany, for example, being reported in the earlier years on a basis of "Hard, bituminous, Rhine-Westphalia, ex mine,"[4] and recently on the basis of "Hard, fine, bituminous, 0–10 MM, ex mine, Ruhr, Aachen."[5] There no doubt exist necessary reasons for the change, but it makes time series of wholesale prices difficult to use unless conversion factors or adequate explanations are also provided.

Indexes of wholesale prices covering more than 10 years, inclusively, are very scarce for many raw material producing areas of the world. The absence of such data makes the calculation of supply relationships based upon real prices exceedingly precarious. Series giving reported consumption of major raw material in major industrial countries is also generally lacking, forcing the use of very unreliable computed apparent consumption statistics in analysis of demands.

Reliability.—A major problem of reliability of international trade statistics is the value reported for United States imports of goods with a specific duty or on the free-of-duty list. The Bureau of the Census states in report F110, 1954, page 5, "Transportation costs to the United States may inadvertently be included in the case of merchandise which is not subject to an import duty based upon value." This generally affects most mineral commodities, and makes analysis based upon import data suspect, although otherwise such data provide one of the very best and most current compilations of value data available.[6]

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[1] Ely et al., International Trade Statistics, John Wiley & Sons, 1953, p. 87.

[2] The exchange rate for 1954 was 102.7 Canadian dollars per United States dollar, which means that the 70 million Canadian dollar figure represents about 72 million American dollars.

[3] Ibid., p. 86.

[4] November 1951 issue.

[5] August 1955 issue.

[6] It is recognized that the Bureau of the Census takes steps to keep the intrusion of transportation costs to a minimum, but they evidently are not wholly successful in this endeavor.

Some of the above problems can only be solved by mutual international action; i. e., comparability of foreign import data with United States export data, and procedure of the U. N. price series compilations, but others arise from the collection procedures of United States Government agencies. These latter problems especially should be solvable, and we would strongly recommend whatever reasonable steps necessary for their correction be taken.

Mr. BOLLING. I would inquire if either of your questions have aroused questions in the mind of the other?

Dr. RICE. Well, Mr. Chairman, I was extremely interested in the discussion by Professor Millikan of the possibility of getting comparable measurements of standards of living. May I ask him to summarize his viewpoint; is he a pessimist or is he an optimist? Does he think these problems that he has raised are insuperable or would he agree with me that they are on the way to solution, even though the solution is very difficult? It is a question of his attitude that I am seeking an answer to.

Dr. MILLIKAN. I think, Dr. Rice, and Mr. Chairman, that my attitude is definitely optimistic rather than pessimistic, but I do feel that this question cannot be asked in the abstract, that you have to ask about the adequacy of a set of statistical data or statistical information, for the purposes for which you want to use it.

Now, I do feel myself that of the three types of data that I discussed, cost-of-production comparisons, standard-of-living comparisons as between countries in the absolute, and rates of changes, rates of economic growth, that these are in increasing order of possibility of becoming fairly definite. I feel myself that we certainly have almost today, and can develop easily in the near future, information that is adequate to provide us with a pretty good indication of rates of economic change overall in foreign countries. I think that as far as the problem of comparison of standards of living is concerned, I am less clear that this matters. It does matter in terms of these very broad overall—this very broad overall picture that I have painted. It is an important conclusion, it seems to me, to arrive at, that levels of output and income in Asia are somewhere between a tenth and a thirty-fifth of what they are in this country. I am not awfully hopeful about narrowing the difference. I think this Gilbert and Cravis study is about as thorough a study as you could have and the difficulties that Gilbert and Cravis have in arriving at a single figure for, let's say, the national income of Great Britain as a percentage of the national income of the United States, are not difficulties in getting hold of enough data, nor are they difficulties really in getting some standard materials in which you put the data. They are almost metaphysical difficulties, which of these sets of definitions is more meaningful than another set, and I don't see much in the way of progress here, because I think it is inherent in the nature of the problem.

Nonetheless, for purposes, for most policy purposes, most foreign economic policy purposes that I can think of, on balance, I am optimistic.

I do have a comment on your paper, if I may, in terms of some areas that are so far neglected. I do feel possibly this is an impossible thing to do, but I do feel in terms of our political objectives as well as our economic objectives that more information on the income distribution by income size class in the foreign countries is a very important thing.

To my knowledge, we have almost no information of this kind, except a very few sorts of spot checks, and this is the biggest gap in interpreting what a change in aggregate economic output in a country means.

Does it mean that the population of the country at large is beginning to feel a sense of growth and progress, or does it mean as, for example, would be the case in Saudi Arabia and certainly the Middle Eastern oil countries, a change in the price of oil could significantly influence the national income of the country in question, but the addition to the national income might go entirely into the pockets of a very small number of people, so that this is one direction in which I at least would like to see considerable expansion of effort.

Another direction which is related to this, and which it seems to me is important to see an expansion of effort, is an increase in the number of breakdowns of national income and product in foreign countries by regions and along certain other lines. If you look at the overall national income figures for Italy, for example, these do not convey any sense of standard of living in southern Italy, because the very high or relatively high by standards, European-wise, the relatively high level of standard of income and output in nothern Italy is balanced by a level in parts of southern Italy that is almost as low as that in Asia, perhaps not quite.

A further breakdown by regions and areas would be again useful in giving us some hints about how these national income aggregates are distributed. A breakdown between urban and rural areas—this is in part supplied in some degree in national income statistics as they now are supplied, although more can be done in this respect.

Dr. RICE. Mr. Chairman, I can only express agreement with Professor Millikan's comments.

The table on page 41 of my statement shows that in 1948 there was some data from 19 countries on the details of the distribution of national income by income shares. That had grown to 28 countries in 1952, and to 41 countries in 1955, although the tables for some of those countries were rapidly becoming obsolete. There is further data on the distribution of the national income in the U. N. publication Statistics of National Income and Expenditures, September 1955, a very recent issue of this publication, pages 58 and following.

There is a general explanatory note accompanying table 4 which follows for several pages.

Now, the point that Professor Millikan has made on the need for information on income distribution seems to me to be very obvious. If I remember correctly, for example, the estimated national income of Iran fell very sharply after the contract with the Anglo-Iranian Oil Co. was broken by the Mossadegh government. What did that mean in terms of the well-being of the people? You would have expected widespread increase in poverty if the income that was lost had been evenly spread. Presumably it wasn't. I doubt if the peasant in Iran felt the decline in national income very much.

I was interested in another point he made, respecting the underestimate of per capita income in Asia. In certain national income estimates used for official purposes, the per capita national income of China was for several years placed at $27 per year. How could that be? How would it be possible for a people to live on an average of $27 a year income, regardless of the exchange-value factors?

I am impressed with the importance of Professor Millikan's information that there has been a threefold increase in national income estimates for Asiatic countries by some of his colleagues.

Mr. BOLLING. Could I interject something here? I am curious as to not only the increase in number, of countries reporting distribution of national income as shown in Dr. Rice's table. I wondered if it is reasonable to assume that the countries now reporting are the ones whose data are necessarily of greatest significance to us in terms of policy decisions. Certainly, obviously, there are certain areas where it is more important to us to have this information than in the case of other areas. I was wondering about the spread, the kind of countries that were included in this list.

Dr. RICE. I think it might be well on this question of distribution, Mr. Chairman, to run through the countries which have reported data to the U. N. on income distribution. They include Australia, Austria, Belgian Congo, Belgium, Brazil, British Honduras, Canada, Chile, Colombia, Cuba, Cyprus, Ecuador, Finland, France, Gold Coast, Honduras, Hong Kong, Ireland, Japan, Kenya, Luxembourg, Mexico, Netherlands, New Zealand, Nigeria, Northern Rhodesia, Norway, Panama, Peru, Philippines, Puerto Rico, Southern Rhodesia, Switzerland, Uganda, United Kingdom, and United States.

I don't see any particular pattern among those areas. Perhaps these should be called areas rather than countries. There are something more than 200 different areas apearing in U. N. tables, and of course, there are not that many independent sovereignties; but I don't see among them a pattern along the lines of your question.

Dr. MILLIKAN. Mr. Chairman, could I make a comment? I think we are in danger of getting a misapprehension about the availability of the kinds of data I am talking about, because of ambiguities in the meaning of the word "distribution." There are several different senses in which this term is used. In the first place, the word "distribution" is used sometimes to refer to the distribution of commodities. That is, transportation and distribution in this sense, and there is a good deal of information on this.

In the second place, what "distribution" means in these national income estimates, the conception of distribution here implied is a so-called distribution by functional share. That is, the division of national income that you get is a division into compensation of employees, income from unincorporated enterprises, rent and interest, dividends, saving of corporations, direct taxes on corporations, general government income.

Now, these are categories that have some uses, but they are, I would suggest, almost totally useless for the purpose that I have in mind, which is the question of national-income distribution by income-size class. Although very frequently this kind of data is misused, to try to give some implication; that is, when there is an increase in the official figure of compensation of employees, as a percentage of national income, people are inclined to say labor is getting more than it did before, but it may very well be that all that has happened is that some previously unincorporated enterprises have incorporated and begun to pay themselves wages, whereas before all they did was receive income in profit form. This kind of ambiguity runs so very much throughout this particular concept of distribution, that my feeling is that unhappily, I wish we could take this increase from 19 to 41 in the number of countries reporting this kind of information as something of an answer to the problem I have stated, but I am afraid it is not an answer.

Mr. Bolling. You are saying in effect that you do not feel that we have the information on which to judge in any way objectively, what you might call the social progress?

Dr. Millikan. Exactly. That is just what I am saying.

Mr. Bolling. Do you have anything further, Dr. Rice?

Dr. Rice. All I would say to that, Mr. Chairman, is that we have made remarkable progress, and as I pointed out any talk of needs for the future implies a dissatisfaction with the past. We can feel dissatisfaction with what we have, but we must take great satisfaction over the advances we have already made.

Mr. Bolling. I am sure we would all agree with that.

Mr. Balivet. I would like to ask Dr. Millikan first a question on behalf of Senator Flanders concerning your statement about the two World Wars profoundly shaking stability of traditional patterns of life and outlook. Senator Flanders is concerned about the recurrent argument made out of traditional trade patterns. You made a statement which might apply to that, it suggests that these traditional trade patterns also have been shaken and shaken rather hard.

I wonder whether you would want to comment on that.

Dr. Millikan. I certainly would agree that traditional trade patterns have been shaken and shaken very hard. I think that these patterns are going to be modified even more in the future, perhaps modified more by economic development in some of these countries than they had been modified in the past by the dislocations of wars and depressions, great as those modifications have been.

It is very easy, I think, to become obsessed with the particular factors which have been upsetting in recent years, and to believe that if only we could return to an era of free multilateral trade we would have patterns very similar to those that we had before. I think that increasingly the growth in the national incomes and products of many of these countries which have been static, and which I would predict will develop quite rapidly in the future, are going to produce very substantial modifications in international trade patterns, some of them desirable, some of them perhaps not. I think this is something that certainly we have to keep an eye on.

Mr. Balivet. It leaves the argument of the traditional trade patterns at least at a fairly heavy discount, given the dynamics of the present climate.

Dr. Millikan. I would think so. For example, the countries which have been primarily raw material producers, single commodity or small number of commodity export countries, like Malaya, Indonesia, with rubber and tin, are certainly going to change the structure of their economies over the next 50 years. They may continue to be prime sources of these commodities, but there are going to be a lot of other things as well that are going to gradually reduce, I would suggest, the importance, whatever international policy is, of certainly these items in their international account.

Mr. Balivet. Dr. Rice, may I ask you whether you would say the pursuit of meaningful international statistical reporting standards for the purposes of international trade is a primary and necessary step toward expanded international trade?

Dr. RICE. No, sir. I wouldn't care to say that it was a necessary and essential step to the expansion of international trade. It is a necessary and essential step to knowing what is taking place with respect to changes in international trade.

Mr. BALIVET. Then the question is one of whether the United States can do more in aiding other nations to do fuller and a more meaningful economic reporting. Are there any specifics that you have in mind?

Dr. RICE. The United States with respect to international trade data is in the unfortunate and difficult position of being a laggard in its adoption of international standards. The reason is that the commodities specified in our tariff laws tend to pin down, fix, the designation of a commodity and a class of commodities in our trade statistics. Our trade data are not subject to the alteration that some other countries find possible, in order to fit a standard international classification.

We have, therefore, not fully adopted the Standard International Trade Classification and other related international standards that have been recommended by the U. N.

Of course, we are not going to abandon our tariff laws for the sake of statistics. The method we should employ in order to conform to the international standards would be to draw each quarter a sample of our international trade data, reclassify them according to the U. N. recommendations, and report the estimated totals in our periodic statistical reports to U. N. That has not been done by the Department of Commerce up to the present for lack of funds.

Mr. BOLLING. Dr. Sheldon?

Dr. SHELDON. I have brief comments to make on each of the papers.

The material which Professor Millikan has presented to us covered a very wide range of important points which we are going to be examining in successive sessions. If we had been able to absorb them all this morning, perhaps some of our later sessions would be less necessary. I do think we are off to an excellent start. But it will take a little time to analyze all these points which have been made.

In regard to the report which Dr. Rice has presented, I think it is most important to bring to public attention that so much has been done. I certainly share his hopes for further improvement in these figures.

I do feel that as one gets closer and closer to the working level, that the great problems to be overcome are much more apparent than perhaps they would be to the outsider.

During some of the period of the American occupation of Japan, I was in charge of the preparation of all trade statistics for that country. Working with my good friends in the Japanese Ministry of Finance, I had some experiences of trying to arrive at standard meanings and definitions for trade terms. It was during this period in Japan that we received the first standard commodity classification from the U. N. and tried to reconcile it with some five different sets of American and Japanese commodity codes with which we were struggling in Japan. I feel that progress can be made, but I hope that everyone understands that there is a lot of hard work involved in bringing about these changes.

Most of the specific questions which I had prepared in advance for Professor Millikan I heard him answer as he delivered his report. I am very pleased in that respect.

Some of the things which he raises undoubtedly are going to come up in the discussions which follow. He has shown us the dangers of making statistical comparisons which often are not valid. Here is one question which undoubtedly will come up later: How can we judge when foreign labor is being exploited? This is frequently raised in connection with protection against imports from abroad. Can we answer that kind of a question?

Dr. MILLIKAN. I think it is extremely difficult to answer that kind of a question, because I think that an American business firm that is feeling competition from abroad, will regard as exploitation the payment in a foreign country of a wage below what he has to pay.

Now, this perfectly clearly in any kind of proper economic theory could not be regarded as exploitation; the difference in these wage levels is due to a difference basically in productivity. You can ask the question as to whether certain costs in a foreign country are being held below by monopolistic action or, by governmental subsidy, are being held below what those costs would be in that country if there were in that country a completely free set of market forces at work. On the other hand, whereas this is a perfectly good theoretical question, it is an extraordinarily thorny statistical question.

Once again, I would suggest that there are certain broad obvious areas where the magnitudes involved are so great that the answer clearly is qualitatively at least achievable. If there is a large government subsidy, which makes competition possible by a producer in one country, you can usually identify this and you can get some sort of rough idea as to whether, if the subsidy were withdrawn, the producer would still be able to compete; but when you come to questions of levels of wages in foreign countries, you may be able to identify again some extreme sweatshop conditions, sweatshop not in terms of our standards but in terms of the average standards of that country, which is what the critical question is.

You may be able to identify extremes there, but my general guess would be, in view of the very rapid progress of social legislation and the degree to which the governments of a lot of these foreign countries are focusing their attention on protecting the working-class groups, my guess would be that your really systematic investigation would suggest that in many of the areas where there is competition, labor in the foreign country is not being exploited, but quite the reverse. I am sure that wage scales in a number of Indian industries, for example, are above what any proportion of average income to the factory-production laborer in India would suggest.

Dr. SHELDON. Thank you very much.

I have a specific question for you, Dr. Rice. With the progress that is being made in arriving at international standards and definitions in statistics, we are going to have many more of them available for use. My question is this: Is it going to be possible for us to pick up a foreign report prepared in accordance with the standard definitions and use it with confidence, or must we first of all have a thorough understanding of the wide range of institutional factors connected with that foreign country before we can really use their figures?

Dr. Rice. I am grateful to you for that question, Dr. Sheldon, because I neglected to mention a U. N. publication to which reference is made in my written statement. A supplement to the Monthly Bulletin of Statistics is issued every 2 years by the Statistical Office. It goes into a great deal of detail concerning the sources of the national data in the monthly bulletin. This critical examination of data sources helps the user to appraise their reliability. Any figures, domestic or foreign, have varying degrees of reliability. One should not use incautiously figures which are derived close at hand, from your neighbors. You need to know something about how they were put together, what pitfalls were encountered and how they were surmounted, if at all, or sidestepped; before you can know how far you may rely on them. That is even more true of data from other countries.

Dr. Sheldon. Thank you.

Mr. Bolling. Dr. Ensley?

Dr. Ensley. Just one brief question: I am sure we are all impressed with the progress being made to provide a greater variety and to improve the accuracy of wide range economic and social statistics. We are acquainted, of course, with some of the statistical needs of private business and of Government. Are we relating the needs for policymaking, both public and private, to the additional statistics that we are gathering?

Dr. Millikan mentioned the very important need for statistics on the distribution of income, and regional statistics. Are we likely to make progress in those areas under our present institutional arrangements, and present motivation, or will we be getting just miscellaneous statistics which are interesting but of less importance in policymaking?

Dr. Rice. Mr. Chairman, I think there is a relationship between statistical planning and policymaking. As you have indicated, I am now in business, after a long period of Government service. In both connections I have encountered an interest by business organizations in obtaining statistical data on other countries which they look upon as actual or potential markets. They may contemplate the possibility of going into an area with some sort of program and they depend upon statistics for that area to guide them as to whether or not their venture would be profitable.

The Government's use of international data is also extending. Government agencies, with responsibilities abroad, are continually more aware of their need for sound, factual information about other countries.

Dr. Ensley. You believe, I gather, that the developments which are taking place are in those areas of real need for policymaking rather than in areas which are perhaps of interest, but not of vital concern, to policymaking?

Dr. Rice. Yes; I think so. Take this matter of national-income estimation. The strength and potentialities of another country—politically, economically, in the mosaic of international relationships—are summarized by its national income. Also—I would agree with Professor Millikan—by its national-income distribution.

Dr. Ensley. Thank you.

Mr. Bolling. Thank you.

I have but one question which I suppose is perhaps too speculative even to ask, but despite all the difficulties and deficiencies, and needs for the future, and so forth, and taking into account the progress made to date, is it the opinion of you gentlemen that there exists now a sufficient body of information in these areas that we have been discussing for the people that have to make the policy decisions at the governmental level to make sound policy decisions?

Dr. MILLIKAN. Well, my feeling, it would certainly be rash to answer that question wholly unqualifiedly in the affirmative. There are certainly areas. There are many countries where we, for example, may be considering or are now considering technical assistance or other programs where we don't even have yet anything that could be regarded as a decent estimate of national income.

We have been working at our Center for International Studies in Cambridge on Indonesia, for example. We have been trying to develop estimates of national income there, and above all we have been trying to develop estimates of what level of capital formation is in fact going on in this country at the present time, and knowledgable people who have looked into this will vary in their estimates of how much the Indonesians are actually investing in the development of their economy currently, which range may differ as much as 100 percent.

This area, going back to Dr. Ensley's questions, of levels of capital formation and levels of capital requirements for varying levels of change of national income, is one of the areas where I feel we are most in need of expansion of our information and data. Nonetheless, I think I would still answer your question by saying that many of the pressing policy needs and requirements facing the United States are so clear on the basis of existing data that nobody ought to hide behind inadequacies in data as an excuse for failing to act in some of these areas. I think we have enough information to know in what general directions we ought to move.

Mr. BOLLING. Thank you. Dr. Rice?

Dr. RICE. I would say in general that the international agencies responsible for the information we are talking about have set their programs in accordance with the expressions of need which have come to them. In other words, all of them have tried to be realistic and have been realistic in terms of what the demand has called for.

Now, no one ever has enough information to serve his particular purpose. The useless statistics are the statistics you don't yourself use.

I think, however, there is a close relationship between the international data now provided and the major demands for data.

Of course there are areas of statistical scarcity in our domestic scene. For example, we have never tried sufficiently to measure the results of our technical assistance programs. We send someone to another country to advise and this is followed by evidence of improvement. How much of the improvement is due to our technical assistance we usually have no clear means of measuring. An answer may be difficult—perhaps impossible—but we need more attention to measuring the accomplishments of our efforts overseas.

Mr. Venneman calls my attention to the fact that the Statistical Commission at its next session in April will have on its agenda a discussion of improving distribution of income statistics.

Mr. BOLLING. Thank you. The reason for my question, the obvious reason, I didn't want this very constructive discussion to be used as a refuge for anybody who wanted to evade a decision.

I would like to thank you on behalf of myself and members of the staff and the other members, the absent members of the committee, for getting us off to an excellent start. We are very grateful to you for your efforts and your contribution and I know for myself I have learned a great deal this morning. We thank you both.

The committee will now adjourn until 2 o'clock, when the subject will be International Costs and Prices. The hearing will be held in this same room.

(Whereupon, at 12:18 p. m., the subcommittee recessed until 2 p. m., the same day.)

AFTERNOON SESSION

The subcommittee met at 2 p. m., the Honorable Richard Bolling, chairman of the subcommitee, presiding.

Also present: Grover W. Ensley, staff director; Charles S. Sheldon II, staff economist; and Henry P. Balivet, Jr., administrative assistance to Senator Flanders.

Mr. BOLLING. The subcommittee will be in order.

In the morning session today we reviewed problems of making international comparisons, both from the conceptual point of view and from the practical side of statistical availability. This treatment in effect served as a bridge from the statistical activities of the Subcommittee on Economic Statistics, and of this Subcommittee on Foreign Economic Policy.

This afternon we are going to turn to some of the basic principles of trade and international economic relations. We hope that the discussion will develop useful concepts which can be applied in the meetings to come on following days in these hearings.

Prof. Frank W. Fetter, of Northwestern University, is our next speaker. Dr. Fetter has had a career both in academic work and in Government service. During World War II he served with the Lend-Lease Administration and with the Department of State. He was also a member of the American Commission of Financial Advisors to Foreign Governments. He is the author of several books and articles relating to international trade. Because of his long experience in this field we have invited him to discuss the principles of comparative advantage, the doctrine which explains how trade among countries with diverse living standards and costs can be carried on.

Professor Fetter.

STATEMENT OF DR. FRANK W. FETTER, PROFESSOR OF ECONOMICS, NORTHWESTERN UNIVERSITY

Dr. FETTER. Mr. Chairman, it might be well first to have a picture of the dimensions of the problem that we are talking about.

At the present time the international trade of the world is over $75 billion a year. Of this total, around 20 percent is represented by exports from the United States. The United States, Canada, and Western Europe between them account for about 65 percent of this total. If we add to the American exports of $15 billion the $10 billion of goods we import, we have a total of $25 billion, or about one-third of the total international trade of the world, that either goes out of the United States or comes in.

I think there is a tendency to draw too great a distinction between international trade and domestic trade. The reason why these $75 billion of goods move isn't essentially different from the reason why some goods go from New York to Illinois, and others go from Florida to Indiana, or why goods go from the south of France to the north of France, or from England to Scotland.

Perhaps I can make that clear by a hypothetical illustration. If the United States were to be split into five countries, much of what is now domestic trade would become international trade. If two or more European countries should unite politically much trade that is picked up statistically as international trade would no longer appear in the international trade statistics. But both here and in Europe the same goods would probably be moving, the same people would probably be doing the trading, and the explanation as to why they did it would be essentially the same as before.

If you were to turn to a businessman or to a consumer in this new united Europe and ask him why he bought domestic goods that previously had been imported, he probably would explain it in the same terms as he had before: He could get a better product or a cheaper product or one that was better suited to his needs. And presumably this Illinois businessman or consumer in this hypothetical divided United States, if he was asked why he now bought "foreign" goods from New York or Florida, would give much the same answer. The problem is to find out why people in particular areas are satisfied to buy many local products, and why in other cases they go far afield, either abroad or within their own country, to get what they want, or to sell their products.

The explanation that the buyer thinks that the goods are cheaper or better is true as far as it goes, but it leaves unanswered the question why some goods are cheaper elsewhere and why other goods are cheaper near to home.

The idea that in some countries all prices are higher or lower than in other countries is often expressed and is at the basis of some misunderstanding about international trade. Professor Millikan made some comments this morning on that matter. Our appearances are completely unrehearsed, but what he said ties in closely with my own remarks.

The American tourist is likely to report how low prices are in some countries, and how high they are in others, basing his conclusions upon what he paid for a haircut, cup of coffee, hotel room, nylon shirt, or camera film. But his report may be completely out of line with what a careful study of the total price situation, or a study of the export and import of goods, would show. The American producer who is facing European competition quite understandably feels that the trouble is that European prices are lower than prices in the United States. Yet at the same time you will find that the European manufacturers are complaining about the competition of low-priced American goods, and you will find many European farmers protesting their inability to compete with cheap American wheat.

If you look at the trade picture, instead of finding countries where all prices are high, and countries where all prices are low, you will find great diversity in price relationships. There are three main reasons for these international price relations. First, some of the factors of production are relatively more abundant in one country than in some other country. Secondly, it is necessary to use factors of different proportions in producing various articles. You don't make automobiles using the same combination of factors as in producing cameras, clothespins, or wheat. Thirdly, in some countries it is possible to use large-scale production methods that cannot be used elsewhere.

No product is made by using just one factor of production. To some degree human labor, natural resources, manmade machinery, and organizing and business ability are back of everything that is turned out, whether it be in Finland, in Austria, in Italy, in New York State, or in Indiana. In practice, you find different types of labor, different kinds of resources, and different amounts of machinery that are needed for different products. In some lines, cheap power may be very important; in other cases, it is irrelevant.

If one factor of production is relatively cheap in an area, that makes it likely that any product that uses a lot of that cheap factor, whether it be land or labor or machine tools, is likely to be cheaper there is relation to the products that use a lot of more expensive factors, than will be true some other place. If in one country there is a large domestic market, whether the result of cheap local transport or high living standards, that encourages large-scale production, one would expect to find articles, in which large-scale production methods can be used, cheaper there in relation to the articles produced by hand labor, than would be the case elsewhere. If the technical requirements for the production of wheat and sugar, and the availability of factors of production in an area, are such that more wheat will trade for a given quantity of sugar than some place else, there is a basis for trading; trading wheat that is relatively cheap for sugar that is relatively cheap some other place, whether that some other place is within the same State, within the same country, or whether it is 10,000 miles away.

The same idea is true of automobiles and machinery. If more automobiles will exchange for a given quantity of some type of machinery here than is in the case in Europe, there is the possibility for trade: Automobiles moving from the United States where they are relatively cheap toward the areas where machinery is relatively cheap. There would be a basis for trade, even if in a country resources were so abundant that in every line its labor was more effective than elsewhere; that a given input of human effort would turn out more automobiles, more wheat, more machines of every kind, more vegetables than you could in some other country. American labor might be able to turn out more sugar, more handicraft articles, more hand-designed textiles, more garden vegetables, than workers could elsewhere, but if the question is whether one makes a living by producing wheat, automobiles, or a particular type of textile, the forces of the market, unless the Govenment interferes, will lead men to produce for export the lines where the comparative cost is less.

The term "comparative cost" is just another way of describing the business principle "use your resources to best advantage," or use the high-powered men and the high-powered machinery for the high-powered job.

Before I develop further some aspects of comparative advantage, I would like to outline the causes of a large foreign trade for a country, because there is a difference between the conditions in the country that make for a large total of trade per capita, and the conditions that make foreign trade important in relation to total trade.

If a country is wealthy, in the sense of being richly endowed per person with a great variety of resources, we would expect it to have a large per capita total trade, foreign and domestic combined, this is just another way of saying that we would expect per capita income to be high and wages to be high, and the standard of living to be high. That is the situation in the United States.

But in such a country the proportion of foreign trade to total trade is likely to be rather small, even if there were no tariffs. The very diversity of its resources makes it unlikely that there will be great differences in the domestic ratios of exchange between products from the ratios we find in other parts of the world. That is also the situation of the United States. We have the largest export trade of any country in the world, but our exports are a smaller proportion of our national income—about 5 percent—than in any other important country of the world.

If a country's per capita wealth is less, but if in some lines the inferiority is relatively smaller than in other lines, we would expect that there would be a smaller per capita total trade, but we might well expect that foreign trade would be more important in relation to total trade, which, of course, would mean that it would be more important in relation to domestic trade than in a country like the United States. That is the situation in Europe, where in most countries exports run 15 to 25 percent of the national economy.

If we look at the trade of the United States, or of the European countries, we find that much of it fits into a pattern that is in line with this comparative cost notion. We may find coffee or cotton moving in international trade, not necessarily from the area that the agricultural expert might say was ideal, but from the place where the soil and climate, in relation to the other uses for the soil, is the best suited. Wool comes in large part from areas of limited rainfall or of low fertility, not because sheep prefer that sort of land, but because land crops and other livestock provide so much competition. They bid up the price of land to a point that pushes the sheep culture into lands that are comparatively, but not absolutely, better suited for raising sheep. It is much the same way with labor. There are some lines of American production, the finer textiles, machinery made to order, almost any article produced in very limited amounts, some vegetables that require a great deal of hand labor, where the American worker may be more efficient than the foreign worker in the absolute sense that he can turn out more of the product than the foreign worker, but less effective in the comparative sense that his ratio of output to that of some other product, say, wheat, fruit, machinery, would be less than abroad. Some American producers find that they can consistently undersell foreign competitors not only in the American market but in third countries. In other lines, the American producer finds that even in the United States, despite the advantage in many cases of a tariff, the foreigner seems to undersell him. The American producer, or his workers, is quite likely to feel and to say the reason why the foreign product provides such severe competition is that the foreign worker is paid lower wages.

If we assume that everything else is equal, then, of course, it follows that if the foreign producer pays lower wages than the American producer the foreign producer is going to produce for less than the American. But other things aren't equal, and it is important to an understanding of why goods move in international trade to see why things aren't equal. Specifically, there are two questions: Why are American workers paid higher wages than foreign workers; and why do so many American producers who pay these high American wages not only manage to undersell the foreign producers in third countries, but frequently create such severe competition in the foreign producer's own country that in Europe many manufacturers who are as alarmed—sometimes more alarmed—about the dangers of the high wage American competition as our own manufacturers are about the competition of low-wage European producers.

The key to this apparent paradox is that a high market price of a factor of production, whether labor, land, or business ability, doesn't come out of thin air. It has to be based on production. In the case of labor we find the answer primarily in the higher per capita productivity of the United States. This is partly the result of our rich natural resources, partly of cheap power, partly of our business genius in organizing industry, partly of the health and vigor of American workers, and partly of the large American market, which has permitted a great outlay in research and machinery. But if as a result of these things wages are high in the United States, these high wages become a cost that every American producer has to meet. The high wages, the high cost of land, or whatever factor it is that makes a producer think that foreign competition is too much for him, doesn't appear as an obstacle to a producer who can use that labor or that land or that capital to the best advantage, because the reason why these are so high-priced is that they have such high productivity.

This isn't a special feature of international trade. We find it, perhaps in a little less striking way, in many lines of domestic trade. The prosperity of manufacturing in many American cities has made life hard for farmers, because it has raised wages in that area. The prosperity of a particular line of American business in some area may make things difficult for some other line of manufacturing, because the prosperity of this business may raise the cost of labor, may raise rents, and may raise the price of important raw materials.

There is little doubt but that the development of the American automobile industry has been an important factor in raising American wages, but it has made foreign competition more difficult for some other American producers whose products are not of the type that permit the methods of the automobile industries, or possibly whose leaders haven't had the imaginative thinking of people in the automobile industry. The improvement of living conditions in the South has contributed to the difficulty of the American cotton producers abroad, because the cotton producer now has to meet a wage situation that is in part the result of the increased prosperity of the South. That is just comparative costs in action.

One of the features of the foreign trade of Europe that stands out, when one examines the figures, is the amount that the industrial countries of Europe sell to each other. The United States also sells machinery and manufactured products in Europe, and we also import machinery and manufacturers from Europe, and our imports would run even higher in some instances were it not for fairly substantial tariffs. Nearly one-half of the exports of the continental EPU countries go to other continental EPU countries, and another 10 percent go to the United Kingdom. Sixty percent of Belgian exports, and 50 percent of Swiss exports go to continental EPU countries. About 70 percent of Swedish imports go to continental EPU countries or to the United Kingdom. Despite all of the restrictions that a shortage of dollars has caused in Europe on the import of goods to the United States, it is worth noting that that highly industrialized area, Western Europe, buys about 20 percent of the machinery exports of the United States.

About 2 months ago I came back from a 14 months' stay in Europe. where I visited a number of industrial plants and talked with their engineers and managers. In our conversation the words "comparative cost" were never used, but repeatedly, as they explained to me the lines in which they could more than hold their own with competition, and, the lines in which American competition was too much for them I recognized the idea. In the catalog product the American frequently provided too stiff competition, with all his high wages, but where the buyer wanted a special design, or where the nature of production required hand work, the European product often sold for less than the American product.

Sometimes the comment is made by persons who urge that American tariffs be reduced, that American producers have nothing to fear from the competition of low-wage countries, either because American labor is so much more efficient, or because American business or American labor, if they tried, could become more efficient. I am all for the idea of American production becoming even more efficient, and I think that there are good reasons for further reductions in some American tariffs. But we are deluding ourselves if we think that an increase in American productive efficiency would put an end to foreign competition. If the increased American efficiency applied unequally in different lines, as almost certainly it would, it would increase labor costs even for producers who are not able to use the new and more efficient methods. You might even get the situation that a general increase in American efficiency would, in many lines of American business make foreign competition more severe than before.

Let us turn to the other side of this coin. In the same spirit it is sometimes suggested by advocates of high tariffs that it would be a fine thing to have low tariffs in this country, or even free trade, if foreigners would only raise their wages to the American level. I think that that argument misses completely the point as to why foreign wages are lower. Foreign wages are lower than American wages primarily because per capita productivity abroad is lower than here, and foreign wages could be raised to the American level only by a great increase in foreign productive efficiency, which in many cases would leave the foreign producer as severe a competitor as he is now, and in some cases would make him an even more severe competitor.

The nub of the problem is this: Whether wages are high or low, and even if we assume that they were the same level throughout the world, there will be some lines in which Americans regularly undersell foreign producers and some lines in which foreign producers will regularly undersell American producers. The real issue in international trade policy is whether to let trade develop the way in which it will if individuals, accepting the relations of costs of various factors, decide to produce, sell, or to buy, or whether on some larger grounds of public policy it is better to have the Government decide how people should use the resources that are at hand.

On grounds of national defense, because one thinks that we should have as little to do politically and economically with the rest of the world as possible, or because one believes in a planned economy, we may decide that we don't want to let that trade take place. That is an important question that Congress must decide, but it is not one that I am discussing here today.

Regardless of what wages are, you are going to have a flow of trade between areas and between countries based upon this difference in ratios of production. Some people like to call this comparative costs. Others may say that it is just the idea of deciding how to use your resources to best advantage. Others may say that it is the well known business principle of deciding what to produce and how to produce in view of the market that you have, and in view of the costs that you are faced with. But whatever you call the idea, the practical issue that it presents to lawmakers is this: No matter what wage levels are, no matter what natural resources are, no matter what climate it may be, there are a lot of products that people will find they can buy more cheaply abroad, and a lot that they find they can produce more cheaply at home.

Given this situation, to what extent do you wish to restrict or prevent that trade? That is the essential foreign trade issue.

Mr. Bolling. Thank you very much, Professor Fetter.

(The prepared statement of Prof. Frank W. Fetter is as follows:)

Statement of Frank W. Fetter, Professor of Economics, Northwestern University

The topic that I have been asked to discuss with the members of this committee, the Role of Comparative Costs in the Determining of Trade Flows, is one that economists have talked about for nearly a century and a half. It involves an analysis vital to an understanding of international trade, and of the effect that changes in productive efficiency in various countries are likely to have on the nature and volume of international trade.

THE AMOUNT AND DISTRIBUTION OF INTERNATIONAL TRADE

At the present time the international trade of the world is running over $75 billion a year. Of this total around 20 percent is represented by exports from the United States; and the United States, Canada, and Western Europe together account for around 60 percent. If we add to our exports of $15 billion the $10 billion of goods exported by other countries that are imported by the United States, we have a total of over $25 billion, or approximately a third of all the goods that cross a national boundary, that either come in or go out of the United States.

THE SIMILARITY OF INTERNATIONAL TRADE AND DOMESTIC TRADE

The reasons why these $75 billion of goods cross national boundaries, and the reason why $25 billion of these goods go out from or come into the United States, are not essentially different from the reasons why some goods move from New York to Illinois, other goods from Florida to Indiana; why goods move between the south of France and the north of France, or between England and Scotland. If the United States were to be split into five countries much of what is now domestic trade would become international trade. If two or more European countries should unite politically much trade that is now international would no longer appear in international trade statistics. But both here and in Europe the same goods might be moving, the same people might be doing the trading, and the explanation as to why they were doing it would be essentially the same as before.

If you were to turn to a businessman, or to a consumer, in this new united Europe and ask him why he bought domestic goods that had formerly been imports, he probably would explain it in the same terms as before; that he could get a better product, or a cheaper product, or one more suited to his needs, whether it was called domestic or imported. And presumably the Illinois businessman or consumer in this hypothetical divided United States, if asked why he bought foreign goods from New York or Florida, would give essentially the same answer. The problem is to find out why people in particular areas are satisfied to buy many local products, but in other cases roam far afield, either abroad or within their own country, to get what they want, or to sell their products.

PRICE DIFFERENCES AS A CAUSE OF TRADE

The explanation that the buyer thinks that the goods are cheaper or better is true as far as it goes, but leaves unanswered the question why some goods are cheaper elsewhere and why other goods are cheaper near to home. The idea that in some countries all prices are higher or lower than in other countries is often expressed, and is at the basis of some misunderstanding about international trade. It is true that there is such a thing as a difference in national price levels, as measured by index numbers and reduced to a common base by using an exchange rate, that can cause exports and imports to get out of line with each other and result in an inflow or outflow of gold or an increase or decrease of holdings of foreign exchange. This situation is often referred to as an undervaluation or overvaluation of currencies. But I have in mind something less complex and less subtle: the tendency that all of us have to judge the international price situation, not by careful regard to all prices, or to purchases and sales of foreign exchange, but by observing the prices of a few things that we are interested in. The American tourist is likely to come back from Europe reporting how low prices are in some countries, and possibly how high they are in others, basing this conclusion on what he paid for a haircut, a cup of coffee, a hotel room, a nylon shirt, or camera film. But his report may be completely out of line with what a careful study of the total price situation, or of the export and import of goods would show. The American producer facing European competition either in the United States, or in South America, quite understandably feels that the trouble is that European prices are lower than prices in the United States. Yet at the same time European manufacturers are complaining about the competition of low-priced American products, and European farmers are protesting their inability to compete with cheap American wheat.

THE REASONS FOR DIFFERENCES IN RELATIVE PRICES

Here the idea of comparative costs gives an answer, or at least brings some order into what otherwise might seem a confused and confusing picture of price differences. When we look at what is back of the production of goods, the fact that the prices of some goods are much lower abroad than in the United States, and that some are much lower in the United States than abroad, instead of being a mystery, fits into a pattern that I think is familiar to any businessman. There are three main reasons for these international differences in price relations:

(1) Some factors of production are relatively more abundant in one country than in another;

(2) Different combinations of factors of production have to be used for different products;

(3) In some countries it is possible to use large-scale production that is not possible in other situations.

No product is made by a single factor of production: to some degree human labor, the resources of nature, man-made machinery, and organizing and business ability are needed in almost every act of production. And in practice different types of labor, different kinds of resources, and different amounts of machinery, are needed for different products. In some lines cheap power is important, in some cases it is almost irrelevant. If some factor is relatively cheap in an area this means that any product that uses a lot of that factor is likely to be cheaper there, in relation to products that require a lot of some other and more expensive factor. If in one country there is a large domestic market—whether the result of cheap local transport, or high living standards—that encourages large-scale production, one would expect articles in which large-scale production methods could be used to be cheaper there in relation to articles to which such methods could not be applied.

If the technical requirements for the production of wheat and sugar, and the relative availability of the factors of production in an area, are such that more wheat will trade for a given quantity of sugar than is the case elsewhere, there is a basis for trade: trading wheat that is relatively cheap there for sugar that is relatively cheap some place else, whether that some place be within the United States or abroad. The same idea is true of automobiles and machinery. If more automobiles will exchange for a given quantity of some type of machinery than is the case in Europe, the possibility of trade exists: automobiles moving from the United States where they are relatively cheap toward the areas where the machinery is relatively cheap. This makes possible, with given resources, a larger production of both wheat and sugar, or automobiles and machines. Although there is no absolute certainty that both parties will have a larger real income, if one has any faith at all in the operations of the market and any belief in free enterprise, there is a strong presumption that there will be mutual gains from the flow of trade arising out of the difference in ratios of exchange.

DIFFERENCE BETWEEN ABSOLUTE COST AND COMPARATIVE COST

There would be a basis for trade even if one country—or one area, if we were thinking of domestic trade—were so well endowed with resources that in every line its labor would be more effective than elsewhere: that a given input of human effort would turn out more automobiles, more wheat, more machines of every type, more vegetables, that would the same effort elsewhere. But unless we assume a permanent state of mass unemployment—something that I think is happily behind us in the United States—then the production of more machines, more sugar, or more of a particular type of textile can take place in substantial amount only by drawing on resources that otherwise could be used to produce the articles whose cost is relatively less. American labor might be able to produce more sugar, more handicraft articles, more hand-designed textiles, more garden vegetables than could workers elsewhere, but if the question is whether one makes a living by doing that or by producing wheat, automobiles, or other types of textiles, the forces of the market, unless government interferes, will bring men into producing for export the lines where the comparative cost is even less. Comparative cost is just another way of describing a rather simple business principle: use your resources to best advantage. It is what every businessman does with what he has: he doesn't consider whether he might do a job better than one of his workers, or whether an expensive machine with a very powerful motor might do a job better than a cheaper low-powered machine, but whether it is better to use the high-powered man and the high-powered machine for high-powered work.

CAUSE OF LARGE FOREIGN TRADE IN RELATION TO TOTAL TRADE

There is a difference between the conditions in a country that make for a large total of trade per capita—both foreign and domestic—and the conditions that make foreign trade important in relation to domestic trade. If a country is wealthy in the sense of being richly endowed per person with a great variety of resources, we would expect it to have a large per capita total trade—foreign and domestic combined—which is another way of saying that we would expect per capita income to be high and wages to be high. That is the situation of the United States, but in such a country the proportion of a foreign trade to total trade probably will be small, even were there no tariffs. The very diversity of its resources makes it unlikely that there will be great difference in its domestic ratios of exchange from those prevailing in the rest of the world. That is also the situation of the United States; with the largest total export trade in the world, our exports are a smaller proportion of national income—about 5 percent—than in any other important country.

If a country's per capita wealth is less, but if in some lines the inferiority is relatively less than in other lines, then we might expect a smaller per capita total trade, but a larger foreign trade in relation to total trade, than in a country like the United States. This is the situation in Europe, where in many countries exports run 15 to 25 percent of national income.

THE EXPORTS OF HIGH-WAGE COUNTRIES

If we look at world trade—whether the total figure of $75 billion, the $15 billion of our exports, the $10 billion of our imports, or the exports or imports of some other country, say Denmark, Switzerland, Sweden, or the United Kingdom—we find that much of that trade fits into a pattern suggested by comparative costs. I do not refer to the more obvious point of tropical products coming from tropical countries, or coal or petroleum coming from areas where there are large deposits of coal or petroleum. I have in mind the question as to which tropical countries export which tropical products, and why one country rather than another with raw materials develops large exports based on that raw material, and the question as to which industrial country exports which types of industrial products to the agricultural areas. And particularly do I have in mind the question as to why the United States and the industrialized countries of Europe trade so many industrial products with each other, even in the face of high tariffs.

We may find coffee, or cotton, moving in international trade, not necessarily from the area that the agricultural expert says is ideal for that product, but from the soil and climate that is, in relation to the other uses for that soil, the best. Wool comes in large part in areas of low rainfall or of low fertility, not because sheep prefer that sort of land, but because land crops and other livestock provide too much competition, and bid up the price of land to a figure that pushes sheep culture onto lands that are comparatively, but not absolutely, better suited to the raising of sheep. It is much the same with labor: there are some lines of American production—the finer textiles, machinery made to order or produced in limited amounts, vegetables which require much hand labor—where the American worker may be more efficient than the foreign producer in the absolute sense that he could turn out more of the product than could the foreign worker, but would be less effective in the comparative sense that his ratio of output of some other product, say wheat, fruit, machinery, would be much more than abroad. Some American producers find that they can consistently undersell foreign competitors, not only in the United States but also in a third country; in other lines the American producer finds that even in the United States, despite the advantage that in many cases he has over his foreign competitor from a tariff, the foreigner is underselling him. The American producer, or his workers, is quite likely to say that the reason why the foreign product provides such severe competition is that the foreign worker is paid lower wages.

If we assume that everything else is equal, then it follows that if the foreign producer pays lower wages than the American, he can produce for less. But other things are not equal, and it is important to know how and why they are not equal. Specifically: (1) Why are American workers paid higher wages than foreign workers and (2) why do so many American producers, who pay these high American wages, not only manage to undersell foreign producers in third countries, but frequently create such severe competition in the foreign producer's own country that some foreign producers are as alarmed—perhaps more alarmed—about the dangers of high American competition as some American producers are alarmed about the dangers of low-wage foreign competition. In many lines where American producers are alarmed over low wage competition the competition is not from the really low-wage countries of the world, but from such countries as Australia, New Zealand, Switzerland, and Sweden, where wages are closer to the American standard. And similarly the countries abroad where the talk of the dangers of American competition is loudest, and where there is the greatest demand that the Government do something about it, are frequently countries where wages are well below American standards.

THE REASONS FOR HIGH AMERICAN WAGES

The key to this apparent paradox is in the fact that a high market price, in real income terms of any factor of production whether labor, land, capital, or return to business ability, does not come out of thin air. It is based on production. In the case of labor it comes from the high per capita productivity in the United States: partly the result of our rich natural resources, partly of our cheap power, partly of our business genius in organizing industry, partly of the health and vigor of American workers, and partly of the large American market, permitting great outlays in research and in machinery. But if wages are high in the United States those high wages are a cost that every American producer has to pay. The high wages, or the high cost of land, or the high cost of whatever factor that seems to the domestic producer facing foreign competition as the reason why foreigners undersell him do not appear as an obstacle to the producer who can use that labor, or that land, or that capital to best advantage, because the high cost of the labor, land, or capital is the result of its great effectiveness in some line of production. This is not a special feature of international trade; it is found in almost every line of business. The prosperity of manufacturing industry in many an American city has made life hard for farmers in the neighboring country because it has raised labor costs to farmers; the prosperity of a particular line of manufacturing may well make things difficult for other manufacturers, because this prosperity raises the price of labor, raises rents, and raises the price of important raw materials. There is little doubt that the development of the American automobile industry has been an important factor in raising American real wages, but it has made foreign competition more difficult for some other American producers whose products are of a type that do not permit the methods of the automobile industry, or whose leaders may have lagged behind the automotive industry in imaginative thinking. The improvement of living conditions in the South has contributed to the difficulties of the American cotton producer in foreign markets, because the cotton producer now has to meet a wage situation that is in part the result of increased productivity in other lines in the South. That is just comparative costs in action: even though methods of growing cotton may have improved, the methods of using labor or land in other lines in the South probably have improved even more, so that costs of growing cotton have risen to a point where profitable opportunities for raising cotton for sale in foreign markets are more limited than before.

One feature of the foreign trade of Europe is the amount that the industrial countries of Europe sell to each other. The United States sells machinery and manufactured products in Europe; we also import machinery and manufactures from Europe and undoubtedly would bring in more were it not for American tariffs. Nearly one half of the exports of the continental EPU countries go to other continental EPU countries, and another 10 percent go to the United Kingdom. Sixty percent of Belgian exports and 50 percent of Swiss exports go to continental EPU countries; 70 percent of Swedish exports go to continental EPU countries or to the United Kingdom. Despite all of the restrictions that a shortage of dollars has caused in Western Europe, that highly industrialized area takes 20 percent of the machinery exports of the United States.

Where raw materials, mass production, and the use of machinery are important, we are likely to find the high wage American producer has the edge; where raw materials are less important, where the designs are changed more frequently to meet the needs of individual customers, where much handicraft work is needed to complete the product, we are likely to find the European producer more than holding his own with the American. This is not just a question of big business versus small business. An American plant with only a hundred workers may use production methods that turn out goods that are sold in every corner of the seven seas in competition with the best that Europe can offer; a European plant with thousands of workers may undersell American producers. It frequently happens in European plants that some of the lines turned out find the American high-wage competition so stiff that even in third countries the American producer does the lion's share of the business. Yet other products from the same European factory undersell the American product in third countries, and even get into the United States over the barrier of transport costs and tariffs.

Two months ago I returned from 14 months in Europe, where I visited a number of industrial plants and talked with their engineers and managers. I doubt if the term "comparative costs" was ever used in our conversations, yet time and again, as they explained to me the lines in which they could more than hold their own with American competition, and the lines in which American competition was too much for them, I recognized the idea. On the catalog product, the American frequently provided too stiff competition, with all his high wages; but where the buyer wanted some special design to meet his special needs, or where the nature of the production required more handwork, or the use of a great variety of small machines, the European product often undersold the American product.

EFFECT OF GENERAL INCREASE IN EFFICIENCY ON FOREIGN COMPETITION

Sometimes the comment is made by persons who urge that American tariffs be reduced, that American producers have nothing to fear from foreign competition from low-wage countries, either because American labor is so much more efficient, or because American business or American labor, if they tried, could become more efficient. I am all for the idea of American production becoming even more efficient, and I believe that there are good reasons for further reductions in many American tariffs. But we are deluding ourselves if we think that an increase in American production efficiency would put an end to foreign competition. If the increased American efficiency applied unequally in different lines—as almost certainly would be the case—it would increase labor costs even for producers who were not able to use the new and more efficient methods. Hence it might well place some American producers in an even more difficult position than before in international competition.

In the same spirit it is sometimes suggested by advocates of high tariffs that low American tariffs or even free trade would be a fine thing, if foreign wages were raised to the level of American wages. Such an argument also misses the point as to why foreign wages are lower. Foreign wages are lower than American wages primarily because per capita productivity abroad is lower than in the United States. Foreign wages could be raised to the American level only by a great increase in foreign productive efficiency, which in many cases would leave the foreign producer as severe a competitor, and in some cases an even more severe competitor, than he is now.

Whether wages are high or low, and even if we assumed that wages throughout the world could be brought to the same level, there would be some lines in which America would regularly undersell foreign producers, and some lines in which foreign producers would regularly undersell American producers. The real issue in international trade policy is whether to let trade develop the way in which it will if individuals, accepting the relation of costs of various factors, decide to produce, to sell, and to buy, or whether on some larger grounds of public policy it is better to have the Government decide how people should use the resources that are at hand. On grounds of national defense, because one thinks that we should have as little as possible to do, politically and economically, with the rest of the world, or because one believes in a planned economy, we may decide that we are not going to let that trade take place. That is an important question, that Congress must decide, but it is not one that I was asked to discuss today.

IMMIGRATION AND THE FLOW OF TRADE

Some factors of production are practically fixed by the forces of nature, in particular mineral deposits, soil, and climate. It is often possible for other factors, in particular capital and labor, to move. Because living standards in the United States are much higher than in most foreign countries, far more people from abroad want to move to this high wage country than Congress had thought it wise to admit. It is sometimes argued that as we attempt to protect American living standards by keeping out the labor from low-wage countries, we should also keep out the products of low-wage countries. This argument involves a confusion between the one-way movement of a factor or production—the migration of people—and the two-way movement of goods.

I would like to make it clear that I am not suggesting to this committee what our immigration policy should be. But in view of the fact that it often has been urged that a policy of high tariffs should go logically with our present policy of immigration restriction, I do wish to make clear my view that we are dealing with quite different situations. A restrictive immigration policy—which is a fact that faces us—is in itself no argument for a restrictive tariff policy, although as I have suggested earlier, there may be other reasons for a restrictive tariff policy. The people who come to the United States add to an American factor of production—labor—and do not set up an international flow in the opposite direction. If they come in too large quantities there is a danger, that by adding to the labor factor unduly in relation to other factors, the return per unit of existing labor will be less. But goods come as part of a two-way international transaction: the goods come in exchange for American goods, which is part of a decision as to how we use the resources that our national good fortune and our national genius have given us.

Some people like to call this comparative costs. Others may say that it is the idea of deciding how to use your resources to best advantage. Others may say that it is the well-known business principle of deciding what to produce and how to produce it in view of your market and your costs. But whatever you call the idea, the practical issue that it presents to lawmakers is this: no matter what the wage levels, no matter what the natural resources, no matter what the climate, there are a lot of products that people will find they can buy more cheaply abroad; and a lot that they find that they produce more cheaply than foreigners. Given this situation, to what extent do you wish to restrict or prevent that trade?

Mr. BOLLING. Prof. Robert Triffin of Yale University is our next speaker. His experience of study and residence abroad, of general economics work in this country, and service with the International Monetary Fund, make him an appropriate choice for the subject he is going to cover for us. Dr. Triffin is the author of several books and articles concerned with international finance. He is going to discuss for us a subject which is complementary to the one covered by Professor Fetter, Adjusting Features in the Mechanism of the Balance of Payments and Exchange Rates.

Professor Triffin.

STATEMENT OF DR. ROBERT TRIFFIN, PROFESSOR OF ECONOMICS, YALE UNIVERSITY

Dr. TRIFFIN. Professors being notoriously long winded, I thought I would guard myself against that danger by preparing a highly condensed summary of the remarks which I have put into the record. It is a three-page summary, and if it is the pleasure of the committee I shall try to keep as close as possible to this summary, even though some points may be too condensed and may appear obscure in this first statement.

I think that necessary explanations can best come out during the question part of the hearings.

Mr. BOLLING. Proceed just as you wish, sir.

Dr. TRIFFIN. Thank you very much.

The first point I would like to make is there are adjusting features in the mechanism of the balance of payments and it must be so because, after all, it is impossible for a country to incur deficits in excess of the means of external financing available to that country to cover the deficit. That is to say, a country cannot cover a deficit which is larger than the foreign exchange which it has at its disposal, either through its own reserves or investments abroad, or through the loans or grants which it may obtain from abroad. These resources place a definite limit on the size of the deficit which a country may incur, no mater how wise or foolish that country's policies may be, and, therefore, the real question, I think, is not whether this adjustment will take place, but, rather, how it will take place.

In this connection, people often discuss the various alternative methods of adjustment which may help correct a deficit. Broadly speaking, these methods may be summarized under three headings: Deflation, devaluation, or various forms of tariff and trade exchange restrictions or controls.

The question is very often put and debated, which 1 of these 3 methods is the best method of curing the balance of payments deficit.

You might, I think, just as well run to your doctor if you have a high fever and ask him what is the best cure for fever, without letting the doctor diagnose what is the basic trouble of which this fever may be a reflection or manifestation.

The same thing is true in economics as in medicine in this case. There are very many different causes creating balance of payments deficit, along with other signs of disequilibrium in a country's economy. Those causes being very different, the remedies also must be different, and, therefore, the question as to what is the best cure-all for balance of payments deficit is obviously, to my mind, a nonsensical question.

Now, we greatly overemphasized, a few years ago at the time of Bretton Woods the advantages of exchange stability. We have now gone to the opposite extreme of emphasizing excessively, I think, the advantages to be derived from flexible exchange rates, or from exchange rates adjustments to realistic levels.

One reason why this theory finds so much favor today is that it fits particularly well one type of balance of payments deficits which has been discussed ad nauseum by all classical economists. That is the case where balance of payments deficits derive from the fact that deficit countries' prices and costs have become uncompetitive. The country cannot meet foreign competition because of high prices and costs. These tend to increase imports unduly, to discourage exports and therefore to produce a deficit in its external transactions.

I think that when this is the case there is often a good justification for exchange-rate adjustments, at least when those disparities are very large. Costs and prices have become very rigid, and very often it will take a prolonged period of unemployment or deflation in order to bring them down to a competitive level, and, therefore, you may take a shortcut, in that case, by devaluing the currency instead and becoming competitive, not because your prices have been reduced but because the cost of your own currency has been reduced. But this is by no means the sole cause of balance of payments deficits, and if we look at the record of the last 25 years I think that we find many cases which do not fit at all this kind of situation.

For instance, in the postwar years balance of payments deficits have often arisen not so much from the fact that prices of foreign countries were uncompetitive, but from the fact that there existed persistent financing by bank credit, by monetary expansion, of a level of overall demand in these countries, which was in excess not only of their production but even of their maximum productive capacity at the time. This is the most typical case of continuing inflation. You can see that as long as this is going on you may depreciate the currency, and this may help for a while, but you would have to depreciate the currency constantly more and more, month after month, year after year, in order to allow you to continue with such inflationary policies. The end result of such a process would obviously lie in a complete currency collapse, such as Germany experienced after the First World War, and, therefore, in this case, there is really no other remedy in the long run but to stop your inflation, and to modify, therefore, your monetary, banking, and fiscal policies.

There is a second case which has been very typical also in the postwar, and it is the case where the current bank, credit, and monetary expansion had been arrested, but had left individuals with very large liquidities, with very large claims on the banking system. This is often called latent inflation. These excess liquid claims have not been curtailed by price rises because prices had been kept relatively stable, or had been kept from rising, by price controls, by rationing, by various methods of this sort, but individuals were left with large cash balances which they could use to buy an amount of goods again which was in excess of the current production in the country. I think that many of the balance of payments difficulties of Britain or the Scandinavian countries after 1950 can be analyzed only in those terms; certainly after the devaluations of 1949 the prices of these countries were highly competitive by any kind of standard you can apply. Their currency was undervalued, not overvalued, and yet they ran into balance of payment difficulties. Why? Not because they could not export at these prices, not because there did not exist an export demand at these prices, but simply because they did not develop a sufficient export supply at those prices, and the reason was the very high state of liquidity in the market, people having plenty of money, the home market would absorb resources which could not, therefore, go into exports. I think that from this point of view the devaluations of 1949 were probably either excessive or at least premature.

The only way in which this situation of excess liquidity could have been cured would have been by a monetary purge—which was done in Germany, Belgium, or the Netherlands—or a slow disinflation—which was attempted elsewhere but did not proceed very far—or finally by price increases. By letting prices increase, the real purchasing power of those excess liquidities would be curtailed, and you would get back into some sort of an equilibrium. After the prices had increased then you might come back to this classical case I was discussing at the beginning of my statement. That is to say prices would then become uncompetitive and devaluation would become unnecessary, but trying to hold prices down while devaluing the currency to that extent clearly served only one purpose, which was to deteriorate the terms of trade of those countries without really curing the basic factor of disequilibrium.

Finally, I would like to mention a third type of balance-of-payments deficit, the one which was characteristic of the thirties, in which again the situation could not be analyzed in terms of international price distortions.

If the deficits of these countries in the thirties had been due to the fact that their prices were uncompetitive, then you would expect, in accordance with all classical analysis, that their exports would have gone done, yes, but that their imports would have gone up. As you all know, the characteristic situation in the thirties is that both exports and imports were going down constantly all around and, therefore, the situation could not be due basically to uncompetitiveness of prices in some country, in comparison with others. It was very clearly due to a general wave of deflation and unemployment, so that countries lost economic activity not only at home but also in their export markets.

In such a situation if a country devalues to make up its deficit it is very likely that other countries will also have to devalue because this would aggravate the position of the others.

This is what is usually referred to in economic discussions as the "competitive devaluations" of the thirties. I think it is really a poor term. The devaluations were not competitive. Countries were forced into them. Even after those devaluations they did not accumulate large surpluses, which showed that this was not really a systematic policy of competitive devaluation. It remains, however, that devaluation was not the remedy. The only sensible remedy in such a situation would have been for the various countries, and especially for the surplus countries, to follow expansionary policies and try to restore full employment at home.

Now, I think that it is possible, in connection with this third kind of problem, of foreign deflation—and also with the problem of foreign restrictions on trade—that policies of trade restrictions or controls may conceivably become justified for a deficit country. That is to say, if their export markets are extremely unstable either because the economy of the buying countries is very unstable, or if their export markets are very unstable because there is a constant change in the level of restrictions applied against their exports by the foreign countries, it may be the better part of valor for the country to try and become less dependent on foreign trade. This would be true on the most rational economic criteria because if you can sell in that market only 1 year out of 2 and have to suffer heavy unemployment 1 year out of 2, it is far better probably to turn to some other line of activity. Fortunately, I think the postwar record in that respect is much brighter than the record of the thirties, and that particularly in this country we have followed consistently policies which have maintained employment at very high levels. We have followed also on the whole even though with some blemishes, liberal trade policies. This has created a climate in which more liberal and more reasonable economic policies become much more possible everywhere than would have been true in the thirties.

Now, we still have to face a lot of problems in the way in which this is organized. The fact that a country may as of today find little obstacle to its exports is certainly a favorable factor, but still that country may not be able to base its policies on the maintenance of those favorable conditions in the absence of some international agreements which will give it confidence that those conditions may not change again from one day to the next.

I think it is here that we face one of the most difficult problems, which is the way in which these mutual commitments among the various countries to establish a more stable framework for international trade can be implemented in practice.

Thank you.

Mr. BOLLING. Thank you very much.

(Dr. Triffin's prepared statement follows:)

ADJUSTING FEATURES IN THE MECHANISM OF THE BALANCE OF PAYMENTS AND EXCHANGE RATES

(By Robert Triffin, professor of economics, Yale University)

I

Professors of international trade like to shock their students by denying the existence of any balance-of-payments problem. All balances of payments are always adjusted, in all countries and at all times, irrespective of the state of the economy and of the policies followed by the country concerned or by its trade partners.

Paradoxical as it may sound, this statement is, of course, perfectly correct. It does not, and indeed could not, deny the existence of possible deficits or surpluses on current account, i. e., of a possible imbalance between a country's foreign income and its expenditures abroad on goods and services. It asserts merely the obvious fact that any current account deficit must necessarily be offset by the liquidation of international reserves or other foreign assets, or by foreign loans or gifts—including the involuntary gifts resulting from permanent defaults on the part of the debtor country. Similarly, current account surpluses are inseparable from an equivalent accumulation of international reserves and investments or foreign grants by the creditor country.

This universal, and inescapable, type of international balance has no more virtue, however, than the accounting balance implicit in all double-entry bookkeeping procedures. Yet it may be used as a point of departure for a second observation which has a real bearing on the problem of balance-of-payments adjustments. Come hell or high water, a country's foreign deficits on current account cannot possibly exceed the external means of financing available to cover them, i. e. the amount of international reserves and foreign investments on which the country is able and willing to draw, plus the amount of foreign grants and capital it is able to attract and willing to accept. The maximum deficit which can be incurred will inescapably be limited to this sum, irrespective of the wisdom or folly of the country's policies.

Some people may delight in pointing out that one of the implications of this statement is that the deficits of foreign countries in the postwar era would have been adjusted and corrected far more speedily than they were in fact if we had not made their continuation possible by our own foreign-aid programs. This is true, but tells us nothing about the levels of trade, production, consumption, and investment at which equilibrium would have been attained nor about the political consequences which might have ensued, nationally and internationally.

Current account equilibrium in a country's balance of payments is neither the sole nor the best form of adjustment in all cases. It may be perfectly rational and legitimate for a country to regard as desirable a current account deficit which can be financed through capital imports and which will permit a faster rate of reconstruction, investment, and economic growth than could be attained on the basis of its domestic savings alone. International investment certainly played a significant part in our own economic growth as well as in that of other countries in the 19th century.[1]

An important objective of national and international economic policy should be to recreate conditions which will stimulate once more an adequate flow of international development capital, and facilitate, therefore, the financing, rather than the elimination, of desirable balance-of-payments deficits.

Yet there are limits to the amount of indebtedness which a country is, or should be, prepared to incur in this manner, and there are further external limitations on the amounts it will be able to borrow abroad or to procure from previously accumulated reserves and foreign assets. The deficit on current account may be smaller, but cannot possibly be larger, than this. In some manner or fashion, foreign earnings and foreign expenditures will have to adjust to a level equal to, or smaller than, the maximum deficit which can be financed from available foreign assets, borrowings, and grants. The real question is not whether this adjustment will take place, but how it will take place. I take it that your committee's purpose in calling for this discussion today was to compare the various alternative ways in which this inescapable adjustment may come about, either through market forces or through Government policies.

II

Broadly speaking, adjustment may be reached in three different ways: through deflation, through devaluation, or through various types of trade and exchange controls. And the question that immediately comes to mind is, Which of these three adjustments is the most desirable either from the international point of

[1] It might be observed in passing that British capital exports alone are estimated to have averaged 4 percent of national income in the years 1870–1913. At current rates of national income in the United States, this would correspond to net capital exports of more than $10 billion a year.

view or from the point of view of the country concerned? Although it is often debated in economic textbooks as well as in more popular writings, this is, I think, a nonsensical question. You might as well try and get from your doctor the best prescription to cure a fever, without letting him first diagnose what may be the cause of that fever. A balance-of-payments deficit is only one of the most easily perceived symptoms and results of more basic maladjustments which may differ widely from one case or another. The cure must be fitted to the disease, in economics as well as in medicine, and there is no universal and ideal panacea for all balance-of-payments maladjustments.

I shall limit myself here to a brief, and necessarily highly simplified, discussion of four major types of balance-of-payments deficits.

1. First of all, the deficit may be due to the fact that price and cost levels in the country concerned have risen excessively in relation to price and cost levels in the rest of the world. This will both stimulate imports and discourage exports and will result in balance of payments deficits, accompanied by a contraction in economic activity and employment.

This type of case is the one which has been most extensively investigated by economists and which underlies most of their prescriptions for balance of payments readjustments.[2] Let us see how the three corrective mechanisms mentioned above—deflation, devaluation and controls—compare with one another in this kind of situation.

The traditional remedy was to let prices and wages be forced down under the market impact of foreign competition, external deficits, and the ensuing contraction in employment, incomes, and money. This readjustment could be accelerated, if need be, by additional deflationary monetary and fiscal measures curtailing the volume of outstanding bank credit and disposable incomes.

While effective from the balance of payments viewpoint—at least under the famous ceteris paribus assumption—this kind of readjustment also tends to contract economic activity and employment, and therefore to elicit social and political resistance to it, as long as the process has not been fully completed. Moreover, under modern economic conditions, wage rigidities may offer nearly insuperable obstacles to full adaptation, with the result that balance of payments equilibrium may only be reached through the impact of permanent unemployment on incomes and import demand. The bulk of economic opinion has therefore come more and more to reject deflation as the best method of balance of payments adjustment whenever it requires drastic cost reductions, is likely to drag on over a long period of time or—worse still—to remain incomplete and perpetuate unemployment as a balancing factor in the country's international transactions.

The method of readjustment which now finds most support among liberal economists in such a case is that of exchange rate readjustments. A devaluation of the currency will tend to stimulate exports and reduce imports, while releasing at the same time expansionary—rather than contractionist—forces in home demand for domestically produced goods.

Both deflation and devaluation, however, have met with strong objections among less orthodox circles which see a third, and better, way out in trade or exchange restrictions. Their objections to devaluation are bolstered both by a controversial analysis of its probable effects on the devaluing country's terms of trade[3] and by the fact that repeated currency devaluations will shake confidence in the currency, discourage domestic savings, stimulate capital flights and may, in the end, bring about a total collapse of the monetary system.

If imports—and other foreign exchange expenditures—can be reduced directly by tariffs, trade, or exchange controls, the country will be able to close its balance of payments gap with a smaller volume of exports. Export prices, therefore, expressed in foreign currencies, will not have to be forced down as much as they would under the alternative policies of price deflation or exchange-rate devaluation. This "terms of trade" advantage, however, must be weighed against its disadvantages. The contraction in export activities—accepted and even advocated by the proponents of trade restrictions—may involve very costly and difficult readjustments in the country's trade and production pattern. This first disadvantage will be particularly felt by small countries, in which important sectors are heavily dependent on foreign markets for the bulk of their pro-

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[2] This overemphasis has been unfortunate for the analysis of postwar developments, where deficits were accompanied by full or overfull employment and could not be explained in terms of price disparities alone.

[3] Although generally raised against devaluation, the same objection would also hold to a considerable extent against policies aiming at a reduction of domestic prices.

duction.[4] Specialized export resources may not be quickly and easily shifted into the lines of production previously satisfied by imports. Moreover, insofar as it does in fact take place, this substitution of domestically produced goods for the formerly imported goods—and of domestic markets for foreign markets—may involve heavy sacrifices in terms of long-run productivity and living standards.[5]

As for the objections which can legitimately be raised against repeated currency devaluations, they would also tend to apply against a continuous tightening of trade and exchange controls. If devaluation—or controls—must be resorted to over and over again to maintain balance of payments equilibrium, the root source of the trouble is not in the current level of price and cost disparities but in the reasons underlying the continuing tendency of domestic prices and costs to rise further and further above price and cost levels in foreign countries.

2. This brings us to a second possible diagnosis of the balance of payments deficit, which fits far better than the first the characteristic features of the postwar years. Foreign deficits in this period have most often been accompanied not by unemployment but by full or overfull employment. Effective demand for consumption and investment was in excess of the maximum amount of production which could be obtained from full employment of the deficit country's resources. Under such conditions, the pressure of excess demand was bound to find an outlet either in foreign deficits or in inflationary price rises at home, or both, irrespective of whether or not domestic prices were competitive with foreign prices. As long as excess demand persisted any measures which successfully eliminated the foreign deficit would also aggravate domestic inflationary pressures, and any measures which successfully suppressed domestic inflationary pressures would aggravate the foreign deficit. Only the removal of the excess demand itself could provide a valid answer to both problems.[6]

It is here that the crucial role of internal monetary mechanism and policies emerges most clearly, for an excess of expenditures over current production income can only be financed, in the end, through the monetary system itself. Individuals or firms can, of course, obtain such financing from one another through the capital market or the sale of real assets. For the community as a whole, however, such transactions necessarily wash out, and an overall excess of expenditures over production incomes can only be financed either (*a*) from foreign disinvestment or borrowings; or (*b*) from borrowings from the banking system; or (*c*) from a drawing down of cash and other liquid assets held on the banks.

The excess demand of firms or individuals, however, can result in an actual excess of overall spending over production incomes only if the net sum of these three methods of financing allows the community as a whole to satisfy the excess demand through an excess of imports over exports. Alternatively, the excess demand may be thwarted by internal price rises which restore balance between expenditures and incomes through nominal rises in the latter. In this event, the price increases reflect the fact that the pressure of excess demand has been directed toward the home market itself, and that the resources procured by some individuals to finance their own excess expenditures have not been paid out abroad but absorbed within the community itself. For instance, individual cash disinvestments, spent domestically, have merely resulted in a reshuffling of total cash holdings rather than in an overall contraction for the community as a whole. Finally, the excess demand may also be thwarted by comprehensive trade or exchange restrictions, price controls and rationing, which also restore balance between actual expenditures and production, but perpetuate latent inflationary pressures in the form of a forced accumulation of inactive cash balances.

Let us now consider in turn these three methods of financing, their impact on the balance of payments and the alternative ways in which the deficit may be adjusted to the available means of external financing.

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[4] A recent study estimates that production for exports accounts for as much as 40 percent of total industrial production and employment in Belgium, and more than 80 percent of production and employment in the basic iron and steel industries. See La Place du Commerce Extérieur dans l'Economie Belge, Bulletin d'Information et de Documentation, Banque Nationale de Belgique, August 1955, p. 94.

[5] It may also be noted that this whole "terms of trade" argument should have nothing to do with the existence or absence of a trade deficit, and should only bear on the determination of the optimum level of trade under equilibrium conditions.

[6] Let us remember, however, the point made at the outset of this paper: the excess demand—and foreign deficit—need not be entirely eliminated, but only brought down to a level compatible with available and desirable means of financing the external deficit.

(*a*) The liquidation of foreign assets by individuals and direct borrowings abroad by them provide at the same time (1) the means to cover the external deficit on current account without drawing down the international reserves of the banking system, and (2) the means to cover, from foreign sources, the excess internal demand for goods and services without unleashing domestic inflationary pressures. Such transactions may be regarded as desirable or undesirable by the monetary authorities, and various types of controls may be instituted by them over such foreign borrowings or disinvestments. In any case, the process need not involve, as long as it lasts, either balance of payments difficulties or uncontrollable inflationary pressures for the economy.

(*b*) The drawing down of cash balances and other liquid assets previously accumulated on the banking system raises a very different kind of problem.

Such assets may actually be drawn down in order to purchase from the banking system the foreign exchange resources necessary to cover the external deficit arising from the excess of national spending over national production. As long as the international reserves of the system are adequate to cover such withdrawals, the process can continue without involving inflationary pressures and without endangering the external stability and convertibility of the national currency.[7] The very contraction of cash balances will progressively tend to slow down the process and to bring to an end the excess of expenditures over production incomes.

Difficulties may arise, however, long before this stage is reached, if the liquid balances outstanding are in excess of normal requirements and have previously been built up by domestic bank credit rather than by foreign surpluses and the acquisition of equivalent gold and foreign exchange resources by the banking system. Fluctuations in the ratios of liquid assets to national income and to international reserves are worth watching, from this point of view, as a gage of the vulnerability of the monetary system to cash disinvestments by the public.

Let us consider the case when international reserves have clearly become inadequate to satisfy the public demand for conversion of its liquid balances into foreign exchange. How do trade and exchange controls, devaluation, or deflation fit this type of situation?

(1) Trade and exchange controls may, of course, reduce the outflow of foreign exchange for imports and other transactions. If excess liquidities are substantial, however, and the controls have to be maintained indefinitely, the public will be less and less likely to hoard the cash which it is thereby prevented from spending abroad. The controls—particularly on capital flight—may become more and more difficult to enforce. Insofar as overall spending abroad can be effectively controlled, demand will turn toward the home market. This may initially stimulate production but if, or when, a level of high employment has been reached, the shift of demand from imports to home-produced goods will exert upward pressures on prices. Rising prices will both curtail foreign demand for the country's exports and induce producers to sell in the domestic market rather than in foreign markets. Thus, foreign exchange receipts will decline and the controls on imports may have to be tightened further. This spiral will continue until rising prices have curtailed sufficiently the purchasing power of existing cash balances and restored a normal ratio of such assets to national income at the new, and higher, level of prices and costs. Prices may then cease to rise, but the controls will have to be retained indefinitely. We thus come back to a situation where the balance of payments difficulties can be ascribed to international price disparities, and the analysis outlined in the preceding section of this paper (pp. 5–8) becomes relevant.

Price rises may, of course, be more or less effectively controlled by an extensive system of internal price controls and rationing. If this is done, however, the situation of overliquidity will not be reabsorbed, and rationing will also have to be retained indefinitely. The disadvantages of such policies—outside of their administrative difficulties and of the restrictions involved on our traditional concepts of freedom—are the same as those already discussed. They must, of necessity, involve a curtailment of productivity and living standards for the community as a whole.

We must observe, however, that if excess liquidities are of moderate magnitude they may be absorbed in time by the normal growth of production. Moreover, if foreign prices and costs are themselves rising, it will be possible to reabsorb

[7] On the contrary, the danger that may be involved here is one of deflationary pressures and unemployment.

excess liquidities by allowing a parallel rise in domestic prices and costs without endangering the country's competitiveness in international trade. Both of these factors did, indeed, help correct to some extent the overliquidity inherited by European countries from the excessive rate of monetary expansion during the war and early postwar years.

(2) Currency devaluation does not, by itself, readjust the level of liquidity. It may only do so if internal prices are allowed to rise. The readjusting effects of devaluation in this case do not lie in an improvement in the country's competitiveness through a lowering of its prices in relation to foreign prices. On the contrary, if domestic prices are prevented from rising, nothing will be achieved toward the elimination of overliquidity, and the devaluation may then result in a needless and costly deterioration of the country's terms of trade. The justification for the devaluation in this case lies in the fact that it may be necessary to preserve the country's competitiveness in spite of the rise in prices needed to reabsorb excess liquidities.

(3) Finally, both controls and currency devaluation may be avoided by a direct cutdown of excess liquidities through monetary and fiscal policies. The so-called monetary purges of the postwar years, and particularly those of Belgium and Germany, tried to achieve this result overnight by the temporary blocking, long-term funding, or outright cancellation of a large portion of cash holdings and other liquid assets. Slower methods were applied, or at least officially endorsed, in other countries where reliance was placed on budgetary surpluses, a progressive contraction of bank credits, etc. The overall results of these measures, however, are not impressive. Downward liquidity readjustments, like downward price readjustments, are difficult to carry out in practice if large cutdowns are required and can be implemented only in slow fashion over a long period of time. If the readjustments cannot be effected reasonably quickly, price increases and currency devaluation may be preferable to a long-drawn-out process of deflation.

(*c*) The third method of financing excess demand—i. e., the expansion of bank credit—differs radically from the other two in that it is not subject to the same absolute limitations. In the absence of voluntary, legal, or administrative restraints, the process can continue indefinitely and lead in extreme cases to a total collapse of the monetary system.

The reasons for the inefficacy of either trade controls or devaluation to effect a satisfactory adjustment in this case are identical to those which we have just discussed, but are greatly reinforced by the inexhaustible character of such inflationary financing. As long as it continues, trade controls will have to be tightened further and further in order to adjust foreign expenditures to a constantly declining level of foreign exchange receipts, as the diversion of inflationary pressure from imports to the home market accelerates the increase in domestic prices. Repeated currency devaluations will then become unavoidable—in spite of trade controls—to preserve even a trickle of exports. Ultimately, the acceleration of price increases and currency devaluation may lead to a total currency collapse, as happened in Germany and several central European countries after the First World War.

At first view, internal price controls and rationing offer a third, and more attractive, way out. In practice, their efficacy is also likely to break down if a persistent inflation of credit and money forces an ever-increasing tightening of the controls, thus confronting the administrative authorities with greater and greater difficulties of enforcement, and the political authorities with growing opposition on the part of the public. Again, this may lead in the end to another form of currency breakdown such as was experienced by Germany after the Second World War. Official prices had probably been better controlled and enforced in Germany than in any other belligerent country, but ration coupons, cigarettes, nylon stockings, etc., had in fact replaced the reichsmark as an effective currency unit. Transactions increasingly took the form of barter deals, and incentives to produce or sell became nearly nil when payment could only be expected in the form of additions to large, and unusable, cash balances rather than to scarce goods or ration coupons.

Neither devaluation, nor trade controls, nor rationing, can provide valid alternatives to monetary restraints in such a situation. This is not to say, of course, that the whole burden of readjustment should always be placed on sometary policy alone, nor that monetary expansion does not have a role to play in the process of economic growth, and particularly in a fight against depression and unemployment. In the situation of acute scarcities which accompanied and followed the war in many countries, the distribution of scarce resources between consumption and investment, among various types of investment, and among individual consumers, could not be left to market forces, or handled through feasible instruments of monetary and fiscal policy, without running the risk of considerable delays in essential reconstruction and investment needs, and of starvation levels of consumption for many people. The distribution of scarce resources in accordance with socially accepted criteria of essential needs, rather than with individual desires and purchasing power, was the real justifiction for trade restrictions, exchange controls, and rationing during this period. This, however, did not absolve the monetary authorities from all responsibility in the matter. They faced the double task of restraining the overall expansion of credit so as to minimize inflationary pressures and of directing such expansion toward the most urgent and essential needs of the economy.

As production recovered, however, and the harmful effects of direct controls upon productivity and incentives became increasingly felt with the passage of time, public policy gave more and more attention to the restoration of market mechanisms of internal and external adjustment. Unlike many of my colleagues, I incline to think that the delays experienced in that respect were due in many cases—particularly in Britain and the Scandinavian countries—to the slowness of liquidity adaptations rather than of exchange rate adaptations. In dollar terms, British and Norwegian prices, for instance, had risen less than United States prices between 1938 and 1947, but the ratio of money to GNP had grown to about 164 percent of prewar in Britain and 200 percent in Norway. Exports were not held down so much by a lack of foreign demand, due to uncompetitive prices, as by the impact of overliquidity on internal demand.[8] This overliquidity could have been reabsorbed—and was largely reabsorbed later—by domestic price increases curtailing the real purchasing power of liquid balances and restoring a more "normal" ratio of cash to incomes. Currency devaluation might then, but only then, become necessary to restore price competitiveness in world markets. Coming as they did much in advance of price increases, and accompanied as they were by concurrent efforts to prevent them, the devaluations of sterling and the Scandinavian currencies in September 1949 contributed for a time to a needless deterioration of these countries' terms of trade, without correcting the overliquidity which was one of the primary factors of their balance of payments difficulties.

3. Price uncompetitiveness and the financing of excess demand by current monetary expansion or excess liquidity are not the only causes of balance of payments deficits. Foreign deficits may also arise from a contraction of exports resulting from a decline in economic activity and employment abroad, or from the adoption of various measures of trade and exchange restriction by a country's trade partners.

Both of these factors played a major role in the balance of payments difficulties of the 1930's. If these had been due to international price disparities, or to national inflationary policies, we should have witnessed a simultaneous increase in the deficit countries" imports and decrease in their experts. What took place in fact was a simultaneous decrease in both exports and imports—ranging in most countries from 60 to 80 percent between 1929 and 1933—associated with a wave of international deflation and unemployment. United States national income contracted by more than one-half from 1929 to 1933, unemployment rose from 400,000 to nearly 12 million workers, and expenditures abroad on current and long-term capital account declined by about two-thirds. Under such circumstances, national deflationary policies might well bring temporary relief to the balance of payments of a country, but would also contribute to the spread of the depression. On the other hand, national antideflationary measures would tend to aggravate exchange losses and force a country to try and protect its vanishing foreign-exchange reserves through devaluation or restrictions. The effectiveness of these measures on the stimulation of exports would be largely nullified by their tendency to spread from country to country. Individual countries could always control and contract their import levels, but their efforts to expand exports could always be thwarted by other countries' actions. Thus, in practice, the unavoidable redjustments in the balance of payments were primarily effected by a reduction in the volume of trade and the sacrifice of the advantages of international specialization and of an economic allocation of the world's resources.

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[8] In the British case, this overliquidity was also reflected in the size of sterling balances held abroad. These financed "unrequited exports" which similarly absorbed exportable capacity without contributing to the United Kingdom's foreign exchange receipts.

From a purely national point of view, this was a perfectly rational—and largely unavoidable—way to deal with the situation. The benefits of international trade become illusory if the pattern of production which they imply makes a country highly dependent on excessively volatile export markets. Recurrent unemployment in the export industries may involve social and economic costs out of proportion with the advantages derived from international trade in the more prosperous export years.

The maintenance of a high and growing level of economic activity in the United States throughout the postwar era, together with the gradual liberalization of our tariff policies, has greatly contributed to creating, in this respect, an environment totally different from that of the 1930's. Yet full confidence in the benefits of freer trading policies may not be established on the basis of unilateral, and always reversible, action by one or a few countries. Multilateral and reciprocal agreements are necessary to hasten and consolidate progress toward the removal of excessive trade barriers. Experience as well as economic analysis amply demonstrates that regional agreements (of the OEEC–EPU type) and worldwide agreements (of the GATT–IMF type) may both be of great value in this respect. It is with some regret that I must leave aside this aspect of the problem, which will be debated before your committee in later hearings.

III

I have concentrated so far on the readjustment of balance-of-payments deficits rather than of balance-of-payments surpluses. Our own problem, of course, has long been of the latter sort, and we have solved it in a great variety of ways.

In the 1930's, and particularly following the devaluation of the dollar in 1934, we cashed our overall surplus in the form of an unprecedented accumulation of gold reserves—nearly $11 billion in 6 years, of which more than $3 billion was accumulated in 1939 alone. This gold avalanche, however, was linked primarily to an unprecedented inflow of capital to the United States. Our current account surpluses were far smaller in the 1930's than in the previous decade, as foreign countries contracted sharply (by about two-thirds from 1929 to 1933) their expenditures on our goods and services, under the double impact of the world deflation and of their losses of foreign reserves. Certainly, these two forms of adjustment—huge gold flows and a sharp contraction in trade and economic activity—were about the worst possible solution of the problem, for us as well as for foreign nations.

The postwar record contrasts sharply with that of the 1930's. Instead of accumulating surpluses in the form of gold reserves, we financed them overwhelmingly through large-scale Government loans and grants to foreign nations. The major arguments for this policy were certainly political rather than economic, and I don't propose to discuss them here. The fact is that, in spite of current account surpluses totaling nearly $37 billion over the 9 years 1946–54,[9] our gold reserves increased by less than $2 billion, an increase more than offset by a $5 billion growth in our short-term liabilities to foreign countries.

Our financial aid to foreign nations was certainly the main prop in the maintenance of our high export levels—more than twice prewar in volume, and four times prewar in dollar value—in the initial postwar years.[10] It also contributed, however, to the rapid recovery of production and export capacity abroad. Foreign countries' exports to the United States this year have also been running close to twice their 1938 volume, and 5½ times their 1938 dollar value. Ever since the end of 1952, our tapering levels of foreign assistance have been matched by almost equal rises in foreign countries' gold and dollar assets.

This closing of the so-called dollar gap through increased American imports is certainly preferable to the two alternative forms of adjustment, that is—

(*a*) The continued financing of a high level of United States exports by huge grants of foreign aid; or

(*b*) A contraction of United States exports brought about by foreign deflation, devaluation or trade and exchange restrictions.

[9] Exclusive of military transfers under aid programs.

[10] Our $11.6 billion surplus on goods and services in 1947 alone was just about equal to the total gold reserves and official dollar holdings of foreign countries at the end of that year ($12.2 billion).

The rise in our imports is the result of the recovery of production and exportable capacity abroad, of overall monetary recovery and exchange-rate adjustments by foreign countries, of the high and growing levels of economic activity at home and of our trade-liberalization policies. All of these factors are beneficial to us as well as to others. The trade-liberalization policies pursued by our country for the last 20 years are too often defended on altruistic or political grounds, as if they represented a concession by us to our foreign allies. They correspond in truth to our own direct economic interests, particularly in times of high economic activity, verging on inflationary pressures.

A final method of adjustment should be mentioned. This is foreign investment. There is no doubt that American capital can accelerate economic development abroad and bring benefits to our own investors as well. Once more, this question can hardly be discussed without bringing in political considerations alongside of economic considerations. Yet, on economic grounds alone, there is no lack of opportunities for profitable foreign investments on a scale substantially larger than that of recent years. The obstacles to private initiative in this respect are well known. They are gradually being removed today, and the acceleration of this process through various domestic measures as well as through international negotiation, agreements, and institutions, should be regarded as a legitimate and fruitful task of American economic policy.

Mr. BOLLING. Do either of you gentlemen wish to comment on the other's statement, or add to the statement that you have already given in the light of the other's statement?

Dr. FETTER. I have no desire now to comment on Dr. Triffin's statement.

Mr. BOLLING. Well, I will proceed as I did this morning.

Are thre any questions, Dr. Sheldon?

Dr. SHELDON. I think that our two visitors and myself, and probably others in the audience who have taught international trade from time to time in the past, agree with the main points being made today. These presentations have a place in the program by way of background for some of the detailed sessions which are to follow. We are trying to explore such general questions now as give us a framework or point of reference for some of the particulars to be discussed later.

Professor Fetter, here is a question which comes up very often in trade discussions, where comparative costs or comparative advantages are mentioned: Can this doctrine really be applied in the practical world to answer how trade is going to flow? We recognize that these are general principles which are very important. They give us some confidence about trade, but do they answer specific questions?

Dr. FETTER. I am a little puzzled as to whether your question means, does this explain why goods will be exported or imported; or is your question; Is it desirable to let exports and imports take place? The concept of comparative costs has two aspects, which are logically not the same, but which historically and in political discussion have often been closely associated.

One is the question, How explain why this trade takes place? The other question is, Is it desirable to let this trade take place?

In the British tariff controversy of the 19th century, those two things were identified, in the sense that it was felt that once one had shown that trade took place along lines of comparative advantage the conclusion followed that it was desirable to allow that trade to take place.

My feeling is that such an identification involves a complete acceptance of the idea that competition, in the market, is the best regulation of trade. My own view is, that we have to first know why trade takes place, before we can make a judgment as how far we should go in regulating that trade. Then we may say "All right, this trade will take place, but we don't want it to take place because we want to produce all of our own carburetors in the United States," or for some similar reasons. Or "we don't want it to take place because we feel that we don't want trade to be developing with certain areas of the world, for political reasons." We may say that: "We don't want it to take place because we think that it is desirable to maintain handicraft industries here," even though they are costly industries.

This situation isn't a peculiar feature of international trade. We may decide that the civilization which the automobile has produced has some undesirable features, and that therefore we should forbid more than one automobile per family. It is one thing to explain why we have 2 automobiles, or 3 automobiles, or 4 automobiles per family in the United States. It is another thing to say "This is something that we should encourage." We might say "We are just not going to let a family have more than one automobile, no matter what the market might be prepared to do.

There may be another point, Dr. Sheldon, that you had in mind; the question as to whether in international trade, in allowing trade to develop, there are dangers and risks that wouldn's exist in domestic trade.

May I have a moment, Mr. Chairman, to explain this?

Mr. BOLLING. Certainly.

Dr. FETTER. Whenever we have the division of labor we run a risk. The moment a man starts to work with a shovel, rather than work with his hands, and organizes his work on that basis, he runs the risk that he may not always be able to buy shovels. In international trade we aren't dealing with anything that is different in principle from the risk that we run in any domestic trade, unless one says that in the foreign field we are dealing with breakdowns which are beyond our control. One might say that we can control what takes place domestically, through the power of Government, but abroad we are subject to some actions outside our control. However, one could develop that argument so that it would also cut the other way, because foreign markets may be able to offset some of the ups and downs of the domestic market.

I think that this argument isn't very applicable in the present position of the United States and the position that we will be in for some years to come. There is little evidence that foreigners are not using all the dollars they can get hold of. One might argue theoretically, if we admit $2 billion worth of foreign goods, how do we know that the foreigners won't just take the gold and bring on deflation and depression?

We have no absolute proof that they won't, but the attitude in all foreign countries appears to be to use all the dollars they can get hold of. I don't think that for the foreseeable years, let us say the next decade, we need to worry about foreigners not spending the dollars raised from sales in this market.

Dr. SHELDON. I have just one other question that relates to the original one that I put:

In an elementary class in economics most students are exposed to very simple numerical examples of how comparative advantage is supposed to work, and there will nearly always be some bright student in the class who is bothered by the incompleteness of this kind of analysis. What advice do you have to people who feel that the classical explanation of comparative advantage is inadequate? In fact, of course, you have developed this at greater length, but can you in just a few words explain how much we can salvage in modern form for current application of the classical doctrine of comparative advantage?

Dr. FETTER. Dr. Sheldon, I am not a subscriber to what might be called classical views on this matter. The classical theory of international trade started from an assumption of a great difference between domestic trade and international trade. Sometimes when people speak of classical doctrines, they mean a view that separates sharply the explanation of foreign trade and of domestic trade.

My own approach is that our problem isn't to explain international trade. It is to explain trade, and the reason why you have international trade is the same reason that you have domestic trade, with some added complications which are largely of political origin.

My answer, which perhaps is an argument ad hominem in the sense that it doesn't go to the root of the problem, would be to say insofar as one distrusts such an analysis for international trade, one is distrusting the whole process by which trade takes place in the United States. When one attacks international trade, not on the emotional ground but on the logical grounds, it must involve a serious undermining of the idea that in any trade it is proper to let the forces of the market operate.

I have tried to suggest that there may be good reasons why one may feel that international trade should not be permitted to take place. However, I draw in my own mind a distinction between the proposition, let us go out and see why this trade takes place, and the issue of policy, which is whether Congress should say, "Let us permit this trade to take place without restriction," or "Let us tax or forbid this trade on the ground of some larger objective of public policy."

Dr. SHELDON. You would feel, I take it, that comparative advantage, important as it is as an explanation of trade, domestic and international, still will not help the Congress answer a specific complaint of individual industries that feel foreign competition. It doesn't offer us very much help directly in that respect.

Dr. FETTER. Frankly not. As I have indicated, I find myself in disagreement with a theory which I find sometimes held by both free traders and high protectionists, which is, that somehow you have a single level of productivity. The conclusion of such a view appears to be that if American industry will become more productive we won't have foreign competition. I think that is shot through with the same fallacious approach as is the idea that if foreigners will raise their wages we won't have foreign competition.

To answer your question again, I don't think that an analysis of the causes of trade provides an answer to the question of policy. No matter what wages are, there is going to be a lot of trade, and there are going to be a lot of people who will protest and say, "We shouldn't permit that." If it weren't for the provision in the Constitution, which forbids the States from putting on import duties, we would have the same situation within the United States. The fact that we have the same wage levels here does not prevent the Wisconsin manufacturer being very much alarmed over what is happening in manufacturing development in other States. This doesn't prevent the growers of vegetables in one State finding that their market is contracting because of the expansion of the industry in another State. It may be on the basis of lower wages there; it may be on the basis of higher wages.

Dr. SHELDON. Thank you very much.

Professor Triffin, I very much liked the analysis which you gave us of problems of the balance of payments. You have brought out very clearly that there are different situations, that different causes require different remedies. You used at an occasional point in your talks some expressions which probably are not so well known to everyone in the audience. Perhaps we shouldn't go too far into technical matters, but I wonder whether you would explain what is meant by "terms of trade." This is an expression which is used a great deal by economists, but I am not sure that the lay public always knows what we are talking about. What do we mean by the "terms of trade"?

Dr. TRIFFIN. I think this could provide for a very lengthy discussion, undoubtedly, but to put it in a very brief form and in the form in which it is most usually discussed today in connection with these problems, the terms of trade refer simply to the comparative prices of your exports and imports. That is to say, for instance, if the price of coffee goes down, and the price of machinery remains where it is, the terms of trade of Brazil deteriorate. If, on the contrary, coffee prices improve, the terms of trade of Brazil improve. Therefore, what I wanted to point out in connection with this is that when the British devalued the pound by approximately 30 percent they tried at the same time to keep their sterling costs from rising. Insofar as these policies were successful, British exporters could afford to sell abroad, quoting prices which were 30 percent cheaper in dollars, and this brought about a deterioration of the British terms of trade. The same amount of exports brought them fewer dollars, while they still had to pay the same amount of dollars for what they bought, assuming that prices in England did not change. In fact, they did change to a considerable extent.

Dr. SHELDON. One other expression which you used I think perhaps should be made clear. You spoke of "liquidities," another word with which we economists are familiar.

Dr. TRIFFIN. Yes. I would like to develop that point a little more in order to clarify its relevance to this discussion, if you will allow me.

The kind of deficit about which most countries have been worried in the postwar period were deficits which involved considerable loss of gold and dollars by their monetary and banking system. This meant in effect that people in the Netherlands, for instance, were buying from the banking system more foreign exchange to pay for imports than they were selling to the banking system as proceeds from their exports. But when the banks sell more exchange than they buy, something else must happen also.

The simplest thing that may happen is that this exchange is being paid for with cash balances in national currency which have been accumulated in the country and, therefore, the money supply goes down, but obviously, this process cannot go on indefinitely and therefore the process of depletion of foreign exchange reserves by the banking system can go on indefinitely only if the banking system itself recreates new money through bank credits, through bank expansion. Therefore, the two sources out of which difficulties may arise for the banking system are, first, the fact that the banking system is currently creating new liquidities through its lending policies, creating new deposits, new currency or, secondly, the fact that such policies has been pursued in the past and have provided individuals with very large liquidities—that is, essentially currency and deposits, or other claims on the banking system—which they can use to finance their deficits.

Dr. SHELDON. How would you characterize the sterling balances which existed immediately after World War II as a result, say, of British purchases from India and Australia, and so forth?

Dr. TRIFFIN. They were simply part of those excess liquidities which had been created. They were the portion held by foreigners or by people in the Commonwealth. The excess liquidities which endangered the situation of Britain resulted both from the accumulation of sterling liquidities by foreigners, but also from the accumulation of such balances within England itself; both tended really to have the same effect as far as the actual balance of payments of the United Kingdom in terms of hard currencies was concerned.

Dr. SHELDON. Would you explain for us what we mean by "unrequited exports"?

Dr. TRIFFIN. Unrequited exports were exports which would be paid for in sterling balances. That is to say, people who held claims on the Bank of England would simply pay for those exports by surrendering those claims, but the Bank of England would receive no dollars for the exports and therefore there would be a certain amount of resources which would go out of the country, which would undoubtedly help in this sense, that it would reduce the total indebtedness of England, but which in an immediate sense did not bring in any means by which Britain could purchase goods abroad. If those same exports had gone to the United States, they would have brought in dollars.

Dr. SHELDON. One of the points you made toward the end of your statement was that if countries find that fluctuations in trade are very extreme, that perhaps the solution in a few individual cases may be to withdraw to some extent from trade. I suppose that means the policy of autarky. How strong a case do you think can be made for autarky?

Dr. TRIFFIN. I think that depends very much really on the international framework within which trade is taking place, and if you do have a situation—which I would like to insist is not the case today—in which the countries to which you sell a very large part of your production, of your exports, if these countries get into the habit of having very bad depressions, and you find suddenly that your export markets vanish to reappear later on when the boom comes but only to vanish again later, then it may be a bad idea to concentrate the employment of your people on the production of goods which can be sold, as I say, only very irregularly in the market, unless you can stock those goods, of course, which is not always the case.

The second cause of instability would be the case in which the countries to which you sell your exports are maintaining a satisfactory level of employment and economic activity and would normally continue to buy your exports, but in which they change very frequently the level of restrictions applying to your exports, and in which you have no way to prevent them from doing so. Of course, the worst case of all was the situation from which several countries suffered in the postwar, which was the pervasiveness of bilateral trading agreements, where the amount which firms could sell abroad would depend on the successful negotiation of trade and payments agreements which had to be renewed very frequently, from year to year, or even sometimes for a shorter period.

In that case the conditions under which trade will take place are so uncertain that you must really put your efforts into one of two directions: The first, and the preferable one, of course, is to try and reach some international agreements by which some stability will be created, and by which such sudden changes will no longer threaten you, and then you can resume trade on a reasonable basis. I think that the substantial progress achieved by the Organization for European Economic Cooperation was due to the fact that it has created conditions which permit trade to flow more normally over a large part of the member countries' export markets.

On the other hand, if you cannot succeed in doing that, you may have to withdraw into your shell and to try and stress production for the home market, but I would say it is a policy which we might follow possibly more easily than most European countries. For instance, in the postwar years a country like the Netherlands has exported typically from 35 to 50 percent of its gross national product. It has depended on exports for 35 to 50 percent of its economic activity. For some specific industries this would reach 80 or 90 percent. It is not easy to shift back those specialized resources into other employment to satisfy the home market. That is why it is extremely difficult for countries which are heavily dependent on foreign trade to withdraw into their shells.

Dr. Sheldon. Thank you very much.

Mr. Bolling. Dr. Ensley?

Dr. Ensley. Professor Fetter, I would like, if I can, to clarify my thinking as to your position. I gather that from a purely economic standpoint of maximum production and living standards, on the basis of comparative advantage, you would take the position that the free market is the best place to determine whether or not trade should take place. I gather that you would agree that interference in the market could perhaps be justified for military or special interests purposes. Is that right?

Dr. Fetter. I think you have pictured me as a more extreme supporter of the market, come what may, than I am. I have tried to describe what would happen in the market.

To go back to the analogy with domestic trade, there are lots of fields in domestic trade where we don't want the market to operate fully. But before we interfere with the operation of the market we ought to know why you would have certain things developing. We certainly have had subsidization of certain forms of transportation, and I am not one to say that we shouldn't have given any aid to the railroads, or to shipping, or to aviation. Perhaps we gave too much, but that is not the issue.

My approach on this is that we don't have a peculiar and unique problem when we are dealing with international trade. We may say here are certain lines of trade which we think on lines of larger policy interests we don't want to develop. It is possible that the conclusion that you might reach would be, recognizing some of these problems that Dr. Triffin has spoken about here, that we would not have tariffs over a certain amount, assuming that when you went over that figure you were paying too high a price in the quest for stability.

We run a risk in being dependent upon foreign markets, just like the manufacturer in Maine runs a risk depending on markets in Arizona. He doesn't know what will happen. What you have asked me ties in so closely with what Dr. Triffin said that, if I may, Mr. Chairman, I would like to make a remark which I think at the same time bears on what Dr. Triffin says and bears on Dr. Ensley's question.

Mr. BOLLING. Surely.

Dr. FETTER. I have no disagreement in principle with Dr. Triffin's analysis of the dangers of unstable market. It simply becomes a question of fact, in given circumstances, whether that instability is such that you want to run the risk. In the domestic market a businessman often has to say, "Is this a fad, is it worthwhile for me to make an investment for what seems to be the latest bobby-sox fad in clothing, when the kids next year might not buy the product?"

What you face internationally is just that, with something added—in addition to the capriciousness of the consumer, the capriciousness of foreign governments. In trade policy this instability problem as a practical issue is of less significance for the United States than it is abroad, for two reasons: First, the smaller proportion of our production that goes abroad; and, secondly, the present trade situation, which is likely to continue for the next few years, makes the determining factor of the total of our sales abroad what foreigners are able to buy, either out of what they sell here or out of what they get in grants-in-aid of one form or another. Many an American businessman says, "The reason I can't sell in Great Britain is that they have put a quota on my particular product." But the British are not piling up huge balances here. They have simply decided, given their limited dollars, that they are going to buy cotton rather than ballpoint pens, and it isn't so much a case of the British discriminating against the ballpoint-pen manufacturer as saying, "We are going to give the edge to cotton." If they can get hold of extra dollars, somehow or other, I see no evidence that they wouldn't be used.

A number of European countries, with considerable reason, are worried about the instability of the American market. In one Swiss watch factory the manager told me that it was a company policy not to get themselves too much into the grip of the American market, and that they would prefer not to sell over about a third of their watches in the American market; and he looked with some skepticism on the wisdom of some competitors who were selling a much larger percentage of output here.

One consideration that has limited the effectiveness in trade stimulation of some American rates that are fairly low on paper is the feeling of European producers that although the rate may only be 20 percent, any large increase in sales in the American market may result in a tariff of 40 percent.

Dr. ENSLEY. Thank you.

Mr. BOLLING. I have a letter from the chairman of the full committee, Senator Douglas, which I will read in part:

I am sorry that because of a necessary trip to Illinois I cannot be with you for the hearings on tariff and trade policy. I am writing out a series of questions which have long concerned me and upon which I think it is important that we get the best advice possible. I would appreciate it if you would submit these questions to one or more of the sessions and ask for comments and answers. They seem essential to me.

The questions are, with a brief introduction:

The advocates of protection are urging that countries maintain and increase trade barriers because they say that the automatic price adjustments which formerly under the gold standard used to balance trade and settlements between countries are no longer operative now. That most countries are off gold and have more or less successfully insulated their price levels from being affected by the quantities of gold which are within their borders.

This argument is being advanced in both Great Britain and the United States and is one of the strongest forces making for protectionism at the present time.

It raises a series of questions upon which not only I, but the country desire light.

What I am going to do is read through the whole series of questions and then come back and read them in sequence. I am aware that some of these questions have been touched on and the answers already given, but for the sake of the record I would like them to be answered fully as they come up. I will read through all of them first.

1. Under the gold standard the automatic adjustment was that country A with a large excess of imports would export gold. This would curtail the money supply in A and lower its price level. At the same time, the outward flow of gold into the rest of the world B would expand the money supply there and raise the price level. This increase in the price level in B and the fall in A would reduce exports from B into A and increase exports from A to B. This process would go on until the balance of trade or more properly of settlements would be effected.

Can anything like this process take place now with countries off gold and, if so, how?

2. Trace in precise detail what would happen if exchange rates were allowed to fluctuate, if country A found its industries were unable to compete in international trade with those of the rest of the world and its imports therefore rose and its exports either declined or could not equal its imports (other things being equal).

Is there a self-correcting process? If so, through what stages would it operate and what would be some of the consequences?

3. Compare the relative advantages of fluctuating versus fixed exchange rates in terms of (*a*) effect on quantity of world trade, (*b*) trade of country in particular, (*c*) maintenance of rigid price and cartelization policies within a country, and (*d*) effect on wage structure, etc.

4. Does not the use of periodic devaluations of currency to correct trade or settlement deficiencies tend to create additional disadvantages? If so, what are they?

Now we will return to the first question:

Under the gold standard the automatic adjustment was that country A with a large excess of imports would export gold. This would curtail the money supply in A and lower its price level. At the same time, the outward flow of gold into the rest of the world B would expand the money supply there and raise the price level. This increase in the price level in B and the fall in A would reduce exports from B into A and increase exports from A to B. This process would go on until a balance of trade or, more properly, of settlements would be effected.

Can anything like this process take place now with the countries off gold and, if so, how?

Gentlemen, you have it.

Dr. FETTER. I think that is Dr. Triffin's question, but may I say I think this really calls for the appointment of a Douglas committee to investigate the matter for 6 months because everything in the book has been thrown at us here.

Dr. TRIFFIN. I will try to give a very simple answer to it and then to explain that answer more fully.

Taking the question itself, Can anything like this process take place now with the countries off gold and, if so, how: I think that this process can take place now, and does in fact still take place to a considerable extent. At the same time, I think that it does not necessarily take place, and that it did not necessarily take place under the gold standard, either.

Will you allow me to explain that, please?

Mr. BOLLING. Proceed.

Dr. TRIFFIN. We must distinguish two things: First, is the money supply curtailed when a country suffers a foreign deficit, and second, would the curtailment in the money supply act to lower prices? If I may take those two questions in turn, I think you will understand the answer which I gave very briefly above.

First of all, is the money supply curtailed by foreign deficits, and expanded by foreign surpluses? I would say "Yes," and quite irrespective of whether the countries are on gold or not, and the reason why I say "Yes" is the one which I mentioned before, that if the country is losing gold or foreign exchange, it means, in the most usual case today at least, that its banking system is selling more foreign exchange than it is buying. It is selling that foreign exchange, however; it is not giving it away, and it is selling it against what? Against local currency, and therefore the money supply within the country goes down when the importers buy from the banking system more foreign exchange than the exporters sell to the banking system.

Fortunately or unfortunately, other things do not remain equal, and even though the money supply is curtailed by the deficit, it may be simultaneously increased by bank credit, and therefore there is no one-way relationship which applies at all times. In fact, it may very well be that when a country has a surplus, part of the surplus will be applied to reducing the indebtedness of people to the banks, and therefore the money supply would not go up. It may also be that when a country has a deficit, people will borrow money from the banking system in order to settle that deficit, and therefore the money supply will not go down if the banking system is flexible enough to expand its lendings at that time.

I would not deny, of course, that the suspension of the gold standard has made a great deal of difference. It has made a substantial difference, which is that the monetary authorities are not as constantly worried about the maintenance of convertibility at all costs as they were previously. Instead of reducing the money supply when they lose reserves, they may try to defend themselves in other ways, through trade or exchange controls or devaluation. This does make a difference. It is still true, however, that the process described in the question never took place fully under the gold standard, and still does take place today whether you are on gold or not.

The second question is whether changes in the money supply necessarily affect prices, whether if you are in deficit and your money supply goes down, your prices go down and become more competitive and your exports increase, as assumed in the question.

I would say this is not necessarily the case. If you have a very heavy unemployment, for instance, the increase in money supply may help expand employment, rather than push up prices, and this is a justification certainly in this case for expansionary policies.

On the other hand, in the case of a deficit, if prices and wages are very rigid in the country for one reason or another, it may very well be that in spite of a decline in the money supply, prices and wages will not go down, and it may be that instead of correcting your foreign deficit through a change in prices, you adjust it through a change in employment and incomes; that you will buy less abroad, not because your prices have fallen, but because your incomes are smaller.

Finally, I would like to answer the last question, but I think I can refer to my previous remarks: Is the foreign balance, the surplus or deficit, necessarily affected, and exclusively affected, by price changes. I have indicated to you before, and especially in my longer statement, that this is not necessarily the case; that the state of surplus or deficit in your balance of payments may be affected by quite a number of other factors which may work in the same direction or in opposite directions, as the impact of price changes.

The first of those various factors are changes in employment and in income levels, as I just mentioned, which may reduce the total demand for goods irrespective of what happens to prices. The second possibility is changes in bank credit; the third one may be a change in the desire of people to hold cash; and, finally, there may be the effect of rationing controls.

In conclusion, I would say the balance of payments provides for an automatic mechanism of price adjustments, but only under *coeteris paribus* assumptions, assuming other things to remain constant. This is not a very useful assumption to work on. I think what is much more interesting is to see what are the various factors at play, and then to see in a given situation which of those factors are most important, rather than just single out one of them and ignore the others or assume them constant.

Mr. BOLLING. Thank you.

I notice, Professor Fetter, that you were nodding your head. I take it there is no substantial disagreement.

Dr. FETTER. No. May I make a comment?

Mr. BOLLING. Certainly.

Dr. FETTER. I have no substantive disagreement with what Professor Triffin has said, but I think it well to add one thing to the record. When we speak of the automatic adjustment under the gold standard—and I see in the question of Senator Douglas the evidence of the hand of Professor Douglas—it seems to me that there are really two points involved.

The old-gold standard meant that you maintained stable exchange rates, and it also carried with it the implication that you maintained them even though it brought deflation and economic distress. If you do away with the formal gold standard, but maintain stable rates for some time, with little or no deflation, looking forward, you say, "We don't have the gold standard because we have no pledge to redeem or to maintain a stable rate. But looking back you can say, our monetary system has behaved in just the same way or very much the same way as if we had had the gold standard. So when you raise the question, Would adjustments be different with the gold standard, the answer depends in large part on what conditions would be with the gold standard, and these are not always the same. In many situations the difference between being on the gold standard and off the gold standard is much greater in theory than in practice; in other situations the difference may be very great in practice.

If countries are off gold, as would be true with some South American countries, or the British Dominions, but follow the policy of maintaining a stable rate with a major country, whether it be New Zealand mantaining it with Great Britain, or Cuba, or Guatemala maintaining it with the United States, those countries face a problem which is essentially the same that they would face if on gold. That is, they have to pay attention to their gold and external reserves. If these reserves go down seriously, unless they are to break the par rate, they will have to restrict credit.

Dr. TRIFFIN. I agree, as long as those countries try to maintain their reserves and maintain at the same time free and stable exchange rates, but, of course, they can maintain stability in their rates and they can maintain the level of their reserves but use other policies for the purpose, such as exchange controls, and beyond that follow banking policies which would be different from the gold standard.

Mr. BOLLING. Thank you.

The second question is:

> Trace in precise detail—

and "precise detail" is underlined—

> what would happen if exchange rates were allowed to fluctuate if country A found its industries were unable to compete in international trade with those of the rest of the world and its imports therefore rose and its exports either declined or could not equal its imports (other things being equal).

Dr. TRIFFIN. I would answer this in this fashion: Through the devaluation of the currency, imported goods become more expensive than before, and exported goods bring more money than before, and therefore it follows that people will buy less imported goods and more domestic goods instead. At the same time, they will sell more in their export markets and less in the home market. This is fine, but it is obviously impossible if you have full employment and if you don't reduce your total expenditures. If you have full employment you cannot at the same time sell more abroad and buy more domestically. Those are contradictory statements, and therefore for this mechanism of devaluation to function, you must assume 1 or 2 things: Either that you had unemployment before, and that through devaluation you will be able to cure that unemployment by selling more now in the domestic market and also selling more abroad.

If you had full employment, this would not be possible and the effect of the devaluation would depend on its impact upon the total level of expenditures in the country. If, because of devaluation people are not able to spend as much as they did spend before in real terms, to buy as many goods as they did before, then the devaluation may be successful, and specially it may permit both an expansion of exports and a reduction of imports, but again I come back to what I have mentioned before, that all this presupposes that your low exports or high imports were simply due to the fact that as of today your domestic prices were out of line, were uncompetitive with respect to foreign prices.

If your difficulties are due to other reasons, such as those which I have discussed previously, then, of course, the devaluation will not cure your difficulties.

Mr. BOLLING. I would take from that answer that the answer to that next part of the question would be that there is not a self-correcting process.

Dr. TRIFFIN. That is right as far as devaluation is concerned.

Mr. BOLLING (reading):

> If so, through what stages. * * *

We need not go to that if there is not.

> 3. Compare the relative advantages of fluctuating versus fixed exchange rates in terms of (*a*) effect on quantity of world trade, (*b*) trade of country in particular, (*c*) maintenance of rigid price and cartelization policies within a country and (*d*) effect on wage structure, etc.

Dr. TRIFFIN. I think again, I am afraid I am forced to repeat myself to some extent, but if the deficits and surpluses are primarily due to price distortions, undoubtedly deficits and surpluses will be remedied to some extent by devaluation in the countries in which prices are too high, or by an upward revaluation of the currency in the countries where prices are too low.

But that, of course, is putting a very great burden on the theory of flunctuating versus fixed exchange rates. If the deficits are due to inflation at home, inflation must be stopped anyway and you will not get back any corrective tendency through devaluation only.

To trace the effects of fluctuating versus stable exchange rate on the quantity of world trade as a whole would again depend on what are the alternatives to the fluctuating exchange rates, and what monetary policies are being pursued simultaneously in the country.

It is quite clear, I think, that if instead of devaluing you use import restrictions, well, you will cut your imports through the import restrictions, but this may not expand your exports. That would be a difference which would make it, that the world trade might expand with fluctuating rates, but in the circumstances it will expand even more if you don't have any fluctuations in rate, if you succeed in keeping the rates where they are and continuing to overimport; world trade in toto will be larger, but I don't think that this is a tenable situation nor necessarily a desirable situation. The volume of world trade as such is not a final objective of policy. It is the adequacy of world trade that should concern us, that is, the development of trade levels and trade patterns corresponding to the optimum utilization of the world's resources, given the distribution of these resources and of comparative costs among the various countries concerned.

As for the effects of devaluation on the trade of the devaluing country itself, that is easier to answer, but I come back to the first remark I made in my opening statement, that in the end the trade will have to be balanced, given the resources available to the country.

Professor Fetter pointed out that if the British cut down their imports of ball pens, it doesn't mean they cut down the overall level of imports. They cut down the imports of ball pens in order to be able to buy more cotton. This is again a question of reaching overall equilibrium in your balance of payments, and the proper way to do that may depend on the causes of your difficulties.

There was another remark which came to my mind but I seem to forget it at the moment. It probably doesn't matter too much.

As far as maintenance of rigid price and policies are concerned, I am not quite sure what Senator Douglas was aiming at, but it may very well be, for instance, that the difficulties which a country has to maintain exchange rate stability are due to the fact that the country gives excessive protection to certain sectors of its economy. This lowers the productivity and efficiency of the country's economy as a whole. Because of this, the country may have to devalue, because it is losing reserves. In that sense, I think that there is a danger of excessive simplification when we say that you can remedy your cost and price disparities either through devaluation or through a deflation of internal prices. It is a big simplification because it is based on average price and average cost levels within the country.

The disadvantage of the devaluation in this case is that it may do nothing to correct internal price disparities, which should be corrected if the economy is to perform most efficiently.

Finally, as to the effect on the wage structure, I am really not sure again what aspect of this is to be treated, and I don't want to make a long answer, but there is no doubt, I suppose, insofar as you devalue the currency, rather than use trade and exchange controls you would maintain a higher level of exports than otherwise and therefore this might help employment and maybe wage levels in the exporting industries; while opposite policies of import restrictions might be followed by either unemployment or downward wage pressures in the export industries, but stimulate employment and raise wages in the domestic industries which expand as a consequence of the import restrictions.

Dr. FETTER. May I add one thing there?

Mr. BOLLING. Certainly.

Dr. FETTER. I gather that the committee is likely to be interested in this question of fluctuating versus fixed exchanges. If the analysis is to be very fruitful, it should be put, not in the abstract, but with relation to a particular problem.

First, are we discussing a fixed exchange that is deflationary, or are you discussing a fixed exchange which is associated with no substantial deflation or with even inflation?

It was part of traditional argument up to 1914, and to some degree since then, that a fixed exchange encourages international trade. There was an assumption that if people had assurances as to what they would be paid in, this would make for a larger trade, and that fixed exchanges were also an encouragement to international investment, and thus indirectly to an expansion of trade. In the later 1920's and early 1930's fixed exchanges frequently meant severe deflation. This led through legislative action in a number of countries, to very severe restrictions on trade.

In the situation of those years, fixed exchanges probably reduced the total of trade, but to generalize from that experience with fixed exchanges could be a great mistake.

Then, on top of that, there is the question whether the fluctuations are moderate or whether they are very great. Canada has had a fluctuating exchange for a period of some 5 years, with fluctuations rarely outside a range of 5 percent. To try to generalize from Canadian experience about the results of exchange fluctuations of 25 or 50 percent could be quite misleading. If the subcommittee wants to pursue further the problem of fixed and fluctuating exchanges it would be well to keep in mind the basis from which the fluctuations started, and also the size of the fluctuations.

Dr. TRIFFIN. You might add for what reasons does it start.

Dr. FETTER. I really meant to say that, too.

Mr. BOLLING. Thank you very much. I think the fourth question has been answered so thoroughly already that I will not ask for another answer to it.

Do either of you gentlemen have any further comments you wish to make?

If not, I want to express our very definite appreciation to you both for your efforts and your very substantial contribution to our efforts. Thank you.

Dr. TRIFFIN. Thank you very much, sir.

Mr. BOLLING. Those of you who have reviewed the schedule of hearings are aware that next week there will be a series of short reports on Monday. One of these was to have been on the problem of dumping. A change in scheduling has shifted this particular report to today.

This is an appropriate time to consider the problem, even if briefly. It constitutes a practical example of the problems related to international comparisons, for the legislation concerned with dumping requires that international comparisons be made.

Our speaker on this topic is an attorney who has made a very thorough study of the problems associated with dumping over a period of some years. I am going to ask him to make his summary statement now, and to file for the record a more completely developed analysis of the problem. Mr. William J. Barnhard is associated with the firm of Sharp & Bogan.

Mr. Barnhard, we are pleased to have you with us.

STATEMENT OF WILLIAM J. BARNHARD, ATTORNEY, SHARP & BOGAN, WASHINGTON, D. C.

Mr. BARNHARD. Thank you, Mr. Chairman.

I have here numerous copies of the written statement which I would like to file for the record.

(The statement is as follows:)

STATEMENT BY WILLIAM J. BARNHARD, ATTORNEY, SHARP & BOGAN, WASHINGTON, D. C., ON FOREIGN TRADE DUMPING AS AN ILLUSTRATION OF INTERNATIONAL PRICE COMPARISON PROBLEMS

INTRODUCTION

The problem of foreign trade dumping has been the subject of extended discussion for a long period of time. In our own history, the references go back to Alexander Hamilton's Report on Manufactures. The dumping problem reached a height in the decade that included World War I. During the past few decades, however, the problem has been a minor one, principally because of the economic spurs provided by defense preparation and wartime demands. Now suddenly, within the past 2 years, the antidumping policy of the United States has started to achieve a new significance in the Nation's overall foreign economic policy. And only 10 days ago, a decision was handed down which makes this antidumping policy a question of prime importance in the determination of our trade policy and in the maintenance of the national security and free world strength in which the trade program plays so vital a part.

Dumping should be stopped. On this there is almost universal agreement. How to stop it is less clear. Attempts have been made in the United States to make dumping a crime subject to criminal penalty. Although this statute is still on the books (15 U. S. C. 72) it has never been effective. Dumping probably falls within the definition of unfair competition (19 U. S. C. 1337) and could presumably be subject to the restrictive sanctions of that statute, although this too has never been applied. Dumping could be effectively stopped by curtailing all imports. This would be the most effective method of stopping the practice, but would obviously lose to the United States the advantages of the $26 billion of world trade that it now enjoys. This would clearly be a case of penny wise and pound foolish, but it is not far removed from the threat which the recent administration of the United States Antidumping Act raises to our trade policy. The imposition of dumping duties is the most common method used by the nations of the world to prevent dumping, and is the basic form in which the antidumping policy of the United States is expressed.

WHAT IS "DUMPING"?

A definition of "dumping" is essential to any discussion of this international trade practice. But more than that, the problems involved in arriving at a sound definition epitomize the broader problems inherent in the operation of the United States antidumping policy.

The Antidumping Act of 1921 unfortunately contains no definition of the word. It states the tests for the determination of dumping in these terms: Whenever the Secretary of the Treasury finds that an imported commodity "is being, or is likely to be, sold in the United States * * * at less than its fair value" and the Tariff Commission determines that "an industry in the United States is being or is likely to be injured" by such imports, then a finding of dumping will issue.

The act contains no definition of the key words "fair value," "injury," or "industry," nor even any standards by which these factors shall be measured. The definitions and criteria are left exclusively to the discretion of the Secretary and, more recently, the Tariff Commission.

When the finding of dumping has been issued, the act does contain a specific measure of the dumping duty that shall be imposed, generally equal to the difference between the United States purchase price and the foreign market value, both carefully defined. There is no policy problem involved, therefore, in the actual measure of a dumping duty, but only in the preliminary determination whether dumping within the meaning of the statute actually exists.

"Dumping" means many things to many people. Its meaning to the businessman fearful of import competition is quite different from its meaning to students of the law, and both interpretations differ substantially from that of the professional economist. However, since dumping is an economic concept, the definition must start with that employed by the economists.

Prof. Jacob Viner, the foremost authority on dumping, at least in the early days of our antidumping policy, defined the practice as "price discrimination between national markets" (Viner, Dumping: A Problem in International Trade (1923), p. 3). This is almost identical with the definition given to the Tariff Commission recently by Dr. Willard Thorp who described dumping as price discrimination across national boundaries. The Tariff Commission itself, prior to the 1921 act, described it as "the sale of imported merchandise at less than its prevailing market or wholesale price in the country of production" (U. S. Tariff Commission, Dumping and Unfair Foreign Competition, 1919, p. 9).

In his exhaustive analysis of dumping, Professor Viner lists the various forms in which this economic practice occurs—spurious dumping, exchange dumping, freight dumping, concealed dumping, etc. In analyzing the motives for dumping, he notes that sporadic dumping is usually motivated by the need for disposal of a casual overstock, or is sometimes unintentional. Short-run or intermittent dumping usually results from the desire of foreign producers to maintain trade connections in a market where prices have become unfavorable, to develop goodwill in a new market, to eliminate competition, to prevent the development of competition, or to retaliate against dumping. Long-run or continuous dumping is motivated by the desire to maintain full production without cutting domestic prices, to encourage larger-scale production without cutting domestic prices, or purely mercantilistic grounds.

All of these are within the economist's definition of "dumping." The businessman who fears importing competition is not always as meticulous in leveling charges of "dumping." As Professor Viner states:

"If they feel keenly the effects of foreign competition, manufacturers are all too prone to make sweeping charges of foreign dumping or foreign unfair methods of competition without being in a position to substantiate such charges by any evidence. They often exhibit a deplorable tendency to identify any manner of foreign competition with unfair competition. They often use alleged foreign dumping as a pretext for higher import duties where what they really seek is a greater measure of tariff protection against foreign competition in general. In many cases little would remain of the alleged injury from dumping if the complaints were sufficiently discounted for the elements of exaggeration, misrepresentation, inadequate analysis of facts, and even outright lying, which entered into them."

The Tariff Commission, in its 1919 report on dumping, notes similarly that:

"The answers [by domestic companies to the Commission's questions on dumping experiences] evidence a tendency to complain indiscriminately, not only of these methods condemned everywhere as unfair, but also of every form of successful foreign competition. The latter attitude, if given legal sanction, would affect American business usages in the promotion of foreign trade and would invite retaliation by other countries. Ordinary price cutting and underselling are so universal, both in domestic and foreign fields, that it is taken for granted that restrictions are contemplated only when their practice is accompanied by unfair circumstances or by unfortunate public consequences."

The experience of the Treasury Department with antidumping enforcement bears out the conclusions of Professor Viner and the Tariff Commission. On June 22, 1954, Assistant Secretary of the Treasury H. Chapman Rose informed the Ways and Means Committee of the House of Representatives that since January 1934 there had been a total of 136 antidumping complaints received and processed. Of these complaints, 23 were dismissed because the volume of importations was negligible; 26 because there was no basis for a finding of injury; 81 because there were no sales at less than fair value; and only 6 of the 136 complaints resulted in findings of dumping during this period of more than 20 years. Since June 1954, there have been an additional 29 complaints processed, resulting in 2 withdrawals, 25 findings of no dumping, and 2 findings of dumping.

Behind the loose definition of these complaining businessmen and the technical concepts of the professional economists, however, lies the root of the problem—namely, what kind of "dumping" Congress intended to restrict when it passed the Antidumping Act of 1921.

The first United States antidumping legislation was a clause in the Revenue Act of 1916 which imposed penalties for the systematic dumping of goods on the United States market with the intent to destroy an American industry (15 U. S. C. 72). The evil at which this statute was aimed was "predatory dumping" of the type then being threatened by several European cartels. However, the obvious difficulties in proving the intent of the dumpers made this statute completely ineffective, and, so far as we can discover, it has never been employed in a dumping case.

With the end of World War I, the postwar depression, and the fear that foreign cartels were planning to stifle America's "war baby industries" and reestablish their prewar monopolies, it became necessary to devise a more effective method for the prevention of dumping. The Tariff Commission in 1919 conducted an extensive survey on the needs of the American economy and the methods best suited to antidumping enforcement. In 1921, the House Ways and Means Committee introduced a bill (H. R. 2435) incorporating many of the recommendations of the Tariff Commission and of others who had been studying the problem. In place of the ineffective criminal practices of the 1916 act, the Ways and Means Committee approved a bill imposing dumping duties on all imports which were priced in the United States market below the home market value of the commodity in the country of exportation, the additional duty being equal to the full difference between the United States price and the home market price.

This House-passed bill was almost identical with the Canadian antidumping law, which had been adopted many years before as a protection against dumping by the United States. Under the House bill, as under the Canadian law, the dumping duty was to be imposed by the appraiser on any merchandise sold for less than the home price. There was no requirement for a showing of injury to a domestic industry, no proceedings, no policy determinations. The imposition of dumping duties was to be, like the Canadian law, automatic and mathematical.

The purpose of the legislation, according to the report filed by the Ways and Means Committee, was stated thus:

"It protects our industries and labor against a now common species of commercial warfare of dumping goods on our markets at less than cost or home value if necessary until our industries are destroyed, whereupon the dumping ceases and prices are raised at above former levels to recoup dumping losses" (Report No. 1, 67th Cong., 1st sess., on H. R. 2435, p. 23).

In the Senate Finance Committee, the bill was turned over to Mr. John E. Walker, Chief of the Legislative Drafting Section, who wrote into the bill the tests that now appear therein. The term "foreign home value" in the House bill was changed to "foreign market value," which was specifically defined to mean either the home price, the third-country export price or the cost of production, under specified circumstances. In the Senate committee, also, there was added the requirements of section 201 of the act, directing the Secretary of the Treasury to make two determinations before any dumping duties could be imposed: (1) that the imports were being sold at less than fair value and (2) that these imports were injuring or likely to injure an industry in the United States.

Under the law that was finally enacted, therefore, the measure of the dumping duty remained automatic and mathematical, but the imposition of the duty did not. The interposition of two policy determinations by the Secretary, coupled with the clear expression of the type of commercial warfare at which the statute was aimed, indicate that it was not the intent of Congress to impose additional duties in every case of a differential, however slight or however innocent, between the export price and the foreign market price. If that had been the intent of Congress, the original House bill, patterned after the Canadian law, would have been adequate and much simpler to administer.

That a lower price in one market than in another can nevertheless be a fair and normal price is recognized by every authority. The Tariff Commission, in its 1919 report on dumping legislation, pointed out that "restrictions are contemplated only when [the price cutting] is accompanied by unfair circumstances or by unfortunate public consequences." Professor Viner explains, with reference to his definition of dumping, that "it is not intended here to make the term 'price-discrimination' necessarily denote unfair competitive practice. Some types of price discrimination may be regarded as fair and others as unfair by the mores and the law" (Viner, p. 8).

That the 1921 act was aimed only at unfair dumping seems evident from the legislative history directed exclusively to the monopoly aspects of predatory dumping; from the frequent reference in the course of debate to "unfair trade practices, "unfair dumping," and the like; and from the constant and undeviating reference to the predatory dumping of I. G. Farben and the Steel Trust during discussion of the bill. Perhaps the clearest evidence of the limited definition of "dumping" intended by Congress appears in the Congressional Record (vol. 61, pt. 2, at p. 1194) during Senate debate on the bill. Senator Stanley there stated:

"Hon. William S. Culbertson, member of the Tariff Commission, in a recent and very admirable work entitled 'Commercial Policy in Wartime and After,' inserts a most instructive chapter on antidumping legislation. He defines three kinds of trade practices properly falling under the head of 'dumping,' as follows:

"(1) The sporadic selling of goods in order to relieve a surplus; that is, the offering of bargain sales in international trade;

"(2) a permanent policy of foreign industries of selling in this country a portion of their output at a price below their domestic price in order to keep their factories running full time; and

"(3) unfair price cutting, the object of which is to injure, destroy, or prevent the establishment of an American industry.

"The sporadic selling of goods to relieve a surplus and a custom of selling a portion of the output at less price than in domestic markets is almost universally practiced and justified by American industries. This act is ostensibly designed to meet the condition described by Mr. Culbertson as unfair price cutting, the object of which is to injure, destroy, or prevent the establishment of an American industry."

In the Senate, where the bill was rewritten in the form in which it finally passed, the principal proponent of the measure described it thus:

"There may arise 2 months from now a condition in which some foreign business concern desiring to enter the American market may be willing to slaughter its profits for a given length of time for the purpose of destroying the American industry. This bill * * * is simply aimed at that possible condition" (Congressional Record, vol. 61, pt. 1, p. 1024).

"Dumping" as used in the 1921 statute, therefore, does not, and was not intended to, encompass every form of price differential that falls within the economist's concept of "technical dumping." Where the price differential is not "accompanied by unfair circumstances or by unfortunate public consequences," to use the Tariff Commission's words, the penalty of the act was not meant to be applied.

What are the circumstances under which a price differential is not unfair—that is, is not dumping within the meaning of the act? A few examples should suffice:

(1) Sporadic dumping to relieve a casual overstock. This was cited by Commissioner Culbertson and Senator Stanley as a practice universally accepted and justified. It relieves a temporary situation, offers no real threat to the competing industry in the importing country, and has as its chief effect the offering of a temporary bargain to consumers and industrial users in the importing country. Of this type of dumping Professor Viner says: "Such dumping may prove to be troublesome to the domestic producer insofar as his profits are concerned, but it cannot appreciably affect his volume of production or his continuance in business. The gain to the consumer from sporadic dumping, such as it is, is probably not offset in the majority of cases by the injury to the domestic producer."

(2) Innocent dumping resulting from a change in price levels while goods are being readied for an order or are in transit.

(3) The lowering of prices in one market to meet the competition of that market. Where prices in the United States, for example, are set by the domestic industry, which dominates the market in that commodity, a foreign producer who is forced to follow that price trend and lowers his prices to retain some part of his sales in the United States market is not engaged in the prohibited form of dumping, even though conditions in his home market are such that he can hold his regular price levels there. In internal economic practice, this is just the type of situation in which price discrimination is permitted by the Robinson-Patman Act, because this is a type of price discrimination which is not unfair, injurious, or improper. Exactly the same is true of international price discriminations.

These three examples of "technical dumping" are typical of many situations where the practices would be condemned as dumping under the Canadian law because of the mere existence of a price differential, but should not be treated as dumping under the United States statute because they are neither unfair nor injurious under the intent of that law.

Where large quantities of a commodity are unloaded on a market at below-cost prices, or where a consistent program of dumping is carried on for the purpose of eliminating competition or destroying an industry or preventing a new industry from getting a start, or where a dumping program causes a sharp and injurious drop in domestic price levels, then the Dumping Act should and must be applied. This is the type of dumping Congress wanted to prevent, and this is the concept of dumping it wrote into the 1921 statute.

True, by rejecting the 1916 act Congress eliminated the need for proving a subjective intent to destroy on the part of the dumpers. But it clearly did not intend to eliminate all objective consideration of the purpose and the effect of any price differential that might exist. The type of dumping condemned by the 1921 act was basically the same type of dumping that had been condemned by the 1916 act. The change was a change in the manner of proof, and a change from a criminal to an administrative method of enforcement. This was exactly the change recommended by the Tariff Commission in its 1919 report, where it criticized the 1916 act on several counts, and recommended that future dumping legislation should "instruct the President or Secretary of the Treasury to impose additional duties or refuse entry whenever the existence of dumping in any industrially destructive form is established" (p. 33).

This phrase of the Tariff Commission is as good a thumbnail description as there is for the type of dumping meant to be prohibited by United States antidumping legislation. Not any dumping; not dumping wherever a price differential exists, but "dumping in any industrially destructive form."

WHAT IS A "SALE AT LESS THAN FAIR VALUE"?

For 33 years, the Treasury Department interpreted a sale "at less than fair value" as being identical with a sale "at less than foreign market value." It refused to recognize any distinction between the terms "fair value" and "foreign market value," although the latter was clearly defined and utilized in nine different places in the statute, while the former was used only once in referring to the Cabinet-level policy determination to be made by the Secretary of the Treasury.

The use of different terms lends credence to the conclusion that a different meaning was intended. Moreover, it is illogical that a mere arithmetical computation was intended to be made by a cabinet officer, or that his task was only to check the additions and subtractions of his subordinates.

The obvious intent was to provide a wide area of discretion in which the Secretary was to act, falling between the rigid requirements of proof embodied in the 1916 penal statute and the meat-ax approach of the Canadian law and the original House bill. If there was a price discrimination and the Secretary should find that that price discrimination was unfair, then the necessary finding was to be made. There is no purpose in preventing Americans from buying at low prices, unless those prices are unfair. There is no purpose in preventing an American businessman from driving a hard bargain, unless the resulting price is unfair to his competitors or tends toward monopoly or otherwise is dangerous to the economy.

Basically, it is the country that is forced to pay a higher price that should be complaining of the price discrimination, not the country that is enabled to buy at the lower price. The lower price is evil only when its purpose or effect is predatory. This is the "fair value" concept which was meant to be written into the law, but which the Treasury Department has declined to accept. Recently, the Department did for the first time officially recognize a distinction between "fair value" and "foreign market value," but chiefly for the purpose of simplifying and speeding up the period of investigation, rather than writing the necessary equitable principles into the determination.

The Anti-Dumping Act, fundamentally, is to foreign trade what the Robinson-Patman Act is to domestic trade. However, it has never been given the safeguards written into the domestic legislation. The result is that it has been applied in situations which were never considered as either harmful, unfair, or even "dumping." For example:

> Case A: A textile fiber, competitive with cotton, priced at about the same level as cotton. During 1 year, the price of cotton in the United States fell from about 40 cents to about 32 cents. The price of the fiber did likewise. The same price drop did not occur in Europe. As a result, European producers could continue to sell their fiber at home for prices ranging from 36 to 40 cents, but if they were to sell in the United States market at all, it would have to be at 32 cents or even lower. The share of the market taken by imports during this period and before was constantly declining. Importers did no more than match the price decline dictated by the domestic economic conditions. Yet this was held to be a sale at less than fair value.
>
> Case B: An iron and steel product, used in construction, with imports totaling less than 1 percent of domestic production. Domestic sales, capacity, prices and profits steadily improving. In less highly competitive markets having little or no domestic capacity, it was possible to obtain higher prices. In the United States market, the imports were sold in minute quantity at the highest price that could be obtained, which because of competitive conditions was below the price in other parts of the world. Here, too, a finding of sales at less than fair value.

To an economist, these sales are technically dumping sales. But these are not unfair prices, or predatory prices, or injurious prices, and we firmly believe it was not the intent of Congress to prohibit such sales unless they were at unfair prices—or, in the language of the act, "at less than fair value."

Because the United States market is the world's most highly competitive industrial market, in the normal course the domestically-set prices of industrial goods would tend to be lower than in a less highly developed region. A strict application of nothing more than mathematical differentials would cast the cloud of potential antidumping penalties over a wide variety of products—perhaps even a majority of all industrial imports—when there is absolutely nothing unfair or predatory about the prices charged for those imports.

WHAT IS "INJURY TO AN INDUSTRY IN THE UNITED STATES"?

Except for a general agreement that the injury specified in the Anti-Dumping Act must be a "material injury," there has never been a clear explanation of the tests applied in the past by the Treasury Department to determine whether an industry in the United States is being injured by imports coming in at less than fair value.

Recently, however, the United States Tariff Commission (which was given the task of determining injury and has made five such determinations in the past year) handed down its first major decision on the issue of injury—a decision that threatens to make the antidumping law the greatest deterrent to United States foreign trade since the Smoot-Hawley tariffs of 1930.

It found that imports which constituted less than four-tenths of 1 percent of domestic production caused "injury to an industry in the United States," even though that industry had consistently increased its production, sales, capacity, prices, and profits during the period of the imports.

The only clue in the Tariff Commission report to the basis of such a determination was its conclusion that the segment of the industry located in a particular State, and representing less than 10 percent of the United States producing organizations and less than 8 percent of the United States production, constituted an industry of its own within the meaning of the act. Even considering this segment as a separate industry, imports into that State constituted less than 3 percent of production in that State. Moreover, it appears that only one domestic producer in the State had shown losses during the period of imports, and his losses had been as consistent and apparently as great during the period before the imports ever entered the market.

Since there is no industry in the United States, however prosperous or expanding, that does not have at least one marginal producer, it is conceivable under this test that every industry is entitled to protection against these imports. This, we submit, is a far cry from the "destruction of an industry" that the Anti-Dumping Act was intended to prevent.

NATURE OF AN ANTIDUMPING INVESTIGATION

Complicating the antidumping policy even more is the fact that a mere investigation under the act can be disastrous to imports, importers, and industrial consumers of imported commodities, even if it is eventually determined that there was no dumping to begin with. During the period of investigation, and for 120 days prior to the first suspicion or complaint of dumping, the imports cannot be cleared through customs. All appraisals on such commodities are withheld. The result is that importers cannot determine their costs, no prices can be fixed, and the entire trade operates under a cloud of possible retroactive penalties. The restrictive effect of such an investigation is obvious. Many importers feel that the restrictions during the investigation are even worse than the penalties assessed after an actual finding of dumping.

More and more domestic manufacturers are discovering that this is one case where they can win even if they lose. Even if there never is a finding of dumping, the manufacturers can restrict the competition of imports, in some cases eliminate it entirely, merely by setting the investigative process into motion.

For this reason, the restrictive effect of our antidumping policy must be reckoned not in terms of the 8 findings of dumping that have been issued since 1934, but in terms of the 165 dumping investigations that have been completed.

CONSISTENCY OF OUR ANTIDUMPING POLICY WITH BASIC TRADE PRINCIPLES

Unfair price discriminations that threaten destruction to an industry or offer ruinous competition or injure a domestic economy should and must be prohibited. This is basic policy to all trading nations, and has been clearly articulated in the United States for the past 40 years. This is, and should be, the purpose of the Anti-Dumping Act.

But our antidumping policy forms only a small part of a more basic and overriding national policy, the policy of encouraging a higher level of world trade for the benefit of our own citizens, our standard of living and our national strength, as well as the strength of the free world. It is vital, therefore, that the antidumping policy be restricted to the evils which Congress intended to prevent, and that it not be used as a major hurdle to imports that are priced fairly and do no injury to the United States economy.

With the tremendous variation among the markets of the world, it is normal and inevitable that prices will vary from one market to another. With the United States as the most competitive of all industrial markets, it is normal and inevitable that many industrial products would be priced somewhat lower here than in, say, Afghanistan or the Congo. If this is taken as a test of sales at less than fair value, there are few industrial imports that would not at some time fall within that definition.

If this test is coupled with an injury criterion that allows a prosperous industry to claim injury when only one marginal producer or a small group of high-cost producers is not faring as well as the rest of the industry, then a substantial portion of our $26 billion trade program is threatened with extinction by perversion of the congressional purpose. Such a perversion is inconsistent with the basic principles of international trade and diametrically opposed to the foreign economic policy goals of our Government. I respectfully suggest that this misapplication of a congressional directive warrants careful study in the vital and worthwhile task that this subcommitte has undertaken.

Mr. Barnhard. I want to thank the chairman for the opportunity to discuss this phase of our trade policy, the phase that many of us fear is suddenly reaching the proportions of a major threat to the basic trade programs, both here and throughout the world.

There are a growing number of us who have been involved or interested in this problem of dumping, who fear that the antidumping policy being adopted today in the administration and enforcement of our Antidumping Act could constitute a greater deterrent to our $26 billion worth of imports and exports than anything since the Smoot-Hawley tariffs of 1930. We say this recognizing that dumping policy itself is a very minute part of our overall trade policy, but the implications of some of the more recent decisions, and the administration of this act are beyond comprehension.

The way this 1921 statute is being administered today it restricts trade that it was never meant to affect, it penalizes United States businessmen for wrongs they never heard of committed by people in a foreign land. It punishes American businessmen for no more than driving a good bargain. It inflicts severe penalties on American businessmen, even when there was no violation at all. This violates every principle of fair play and sound administration, as well as the avowed trade policies of the Government.

First, let me make one point clear: None of the people I have talked with or worked with would tolerate dumping. It is universally agreed that dumping is an unfair trade practice that should be stopped. The difficulty lies in the varying definitions of "dumping."

To the businessman, fearful of import competition, the term "dumping" is used to cover a wide variety of circumstances, usually covering any form of import competition. This has been recognized by Professor Viner in his classic book on dumping, by the Tariff Commission in its early study on dumping practices, and by many others.

To the economist "dumping" is probably best defined in the terms that Professor Viner used—price discrimination across national boundaries.

To the economist any price discrimination is by definition "dumping." Professor Viner, however, points out, as the Tariff Commission has in the past pointed out, that price discrimination is not inherently evil; that the ability to buy at a low price is not an evil; that, as a matter of fact, there is very often greater justification for complaint by the person who has to pay the higher price than the one who has to pay the lower price.

In a comparable situation in the domestic economy, under the Robinson-Patman Act, we have recognized that there are circumstances where a price discrimination is, nevertheless, a fair price.

The problem is that to the economist every price discrimination is by definition dumping. But the legislative history of the Antidumping Act, as it was enacted in 1921, demonstrates very clearly that this broad definition of dumping was not what Congress was intending to prevent. There was no reason for Congress to prohibit American businessmen from driving a good bargain if nobody was hurt by it. There was no reason for Congress to prevent sales in the United States at a lower price if there was nothing unfair or injurious about that price. Basically, there is nothing wrong with low prices.

Then what was it that Congress was interested in? What is the basis of our antidumping policy? You must remember the year was 1921. That was the decade that spawned the most extreme examples of predatory dumping, particularly after the war, when America was faced with a postwar depression, the fear was generated of European cartels attempting to reestablish their prewar monopolies by killing off the war-baby industries that had developed in the United States during the war period. The fear was directed principally at I. G. Farben, the chemical industry, although by no means restricted to that one cartel. It was this predatory dumping that Congress feared, and their purpose in writing the antidumping statute was to prohibit predatory dumping.

An attempt had been made earlier in the United States, in 1916, to prohibit dumping by writing a criminal section as part of the antitrust laws, imposing criminal penalties on a dumper who systematically dumped goods in this market with the intent to destroy.

As you know, the proof of intent, particularly intent on the part of a person not even in this country, is almost impossible. As a result, the criminal section was completely ineffective.

Instead, Congress in 1921, desperate to find a better method of stopping predatory dumping, devised an administrative sanction by the imposition of dumping duties, where imports were coming in at less than a fair price and were thereby injuring a domestic industry. But the evil at which the 1921 act was aimed was the same evil at which the 1916 act was aimed, and that was predatory dumping, dumping that would tend to create a monopoly, or restrict competition, or result in ruinous price declines, or otherwise threaten the destruction of an American industry.

The written statement that I have filed goes into some detail on the legislative history and the methods of enforcement that have been adopted in recent years, but I would like to point to just two circumstances:

As the act was written, it imposes on the Secretary of the Treasury a duty to make two findings before dumping duties can be imposed: One, that imports are coming in at less than fair value, and, second, that those imports are injuring an industry in the United States.

The basic problem is, what is a sale at less than fair value. For 33 years the Treasury believed that any sale at less than the foreign-market price was automatically a sale at less than fair value.

Let me cite one example, where I think the inappropriateness of that definition is clear: There was a reecnt case involving a textile fiber.

The fiber was produced worldwide, in the United States, which is the larger producer, and in many other countries throughout the world. This textile fiber is directly competitive with cotton. Here in the United States, with our very strict agricultural control laws, the price of cotton, which had been 40 cents at the beginning of the year, 40 cents a pound, dropped to about 32 cents. The result was that in the United States market the price of this competitive textile fiber similarly dropped from about 38 to 40 cents down to 32 cents. This fiber could not be sold at anything higher than the price of cotton. Imports of this fiber, before the war, had taken as much as 90 percent of the United States market. The market in this fiber had been developed by imports at a time when there were few productive facilities in the United States.

During the war the domestic production increased tremendously. After the war imports never sold at more than 33 percent of the market, and at the time of this particular investigation were taking only 23 percent of the market. In other words, there was a steady decline in the volume of imports; no increase in imports. At this time, because of domestic economic factors, this fiber could sell in the United States for no more than 32 cents. However, the competitive factors which occasioned this drop in the United States were not also present in Europe. The Swedes, Norwegians, Belgians, and so forth, could still sell their fiber at the same price they sold it the year before, roughly 35 or 36 cents. If they wanted to sell any of their established customers in the United States they could sell at 32 cents or not at all.

In order to retain at least a small part of their established business, they sold here at 32 cents. To the economist that is technically a dumping price, but obviously it was not a dumping, not a predatory dumping action. Obviously, they were meeting competition in the domestic market. They did not influence the price. They were merely trying to meet it. Yet this was found to be a sale at less than fair value.

Now, on the injury side, which is the second determintion to be made by the Treasury, and today by the Tariff Commission, since the Customs Simplification Act of 1954 transferred that function to the Commission, I would like to cite very briefly a decision which was handed down just 10 days ago, and which more than any other one thing has raised the specter of this 1921 statute as the greatest potential stumbling block to our trade program.

In that case it was found that imports which constituted less than four-tenths of 1 percent of domestic production were injuring the domestic industry, although the domestic industry consistently for a period of more than 5 years, ever since the import started, each year showed greater production, greater sales, higher prices, and greater profits.

Now, the only basis that we know of for reaching this astounding conclusion was the Tariff Commission's definition of the term "industry." The statute says the injury must be to "an industry in the United States," and in this particular case the industry consists of more than 60 different producers scattered throughout the country. Six of those producers happen to be located in the State of California. Eight are in the State of Alabama. Two are in Pennsylvania, two in

Texas, and various others scattered throughout the country. The Tariff Commission, by dividing vote, defined an industry in the United States as consisting of the six producers of this partcular product in the one State of California, saying that they constituted a separate industry in and of themselves.

Mr. BOLLING. Will you state that decision specifically?

Mr. BARNHARD. That was the decision in the Castiron Soil Pipe case, sir, which is known as investigation No. 5, under the Antidumping Act before the United States Tariff Commission.

Mr. BOLLING. Thank you.

Mr. BARNHARD. Even if you segment the industry and consider only the one State of California, which has only about 10 percent of the United States producers, and less than 8 percent of United States production, even if you segment that and define it as a separate industry, imports into the State of California were never greater than 3 percent of California production, and yet there was a finding of injury. This despite the fact that the industry as a whole was selling more, producing more at higher prices, and even the producers in California were selling more and making more and selling at higher prices.

The basis of that decision, I believe—and this appears nowhere in the official report, for the offical report consists of only four short paragraphs, stating a very general finding in the terms of the statute—I believe the basis of the decision was the fact that one marginal producer located in one city in this particular State was not making a profit. I think the record will show that he had been in and out of this same business three times previously, within the past 20 years, and had never made a profit even when there were no imports. The investigation was initiated on the complaint of this one producer, who has never made a profit in the production of this material, regardless of the status of imports, and the only testimony at the hearing that showed any losses was the testimony of this producer.

What this means, since there is not an industry in the United States, however prosperous or however expanding or however well established, since there is not an industry in the United States that does not have at least one marginal producer, there is not an industry in the United States which could not be covered by this newly devised protective device.

The United States is the most highly competitive industrial market in the world. As a result the prices of industrial goods—and I refer particularly to industrial goods rather than specialty consumer items, like whisky, perfumes, lace, and so forth—but it would be perfectly natural for the prices of industrial goods, particularly the semimanufactured goods that require further processing, to be lower in this market than they are in, say, Afghanistan or Siberia, or other less well developed industrial markets.

Since there is a tremendous variation in the local economies throughout the world, it is logical, it is only natural and fair to have these goods command different prices in different markets, and it would be normal that the lower price frequently would be in the highly competitive United States market. So that if you adopt these two tests, of injury and of a sale at less than fair value, whenever there is a price differential, even if the price differential should be beneficial, even if it causes no harm to anybody, and even if it is merely meeting local conditions, if you define this mathematical price differential as a sale at less than fair value—that is, a dumping sale, and if you say that an industry can be suffering an injury if only one marginal producer is not up to the industry's level of profits, then I submit, sir, that there are practically no imports that cannot be stopped under this interpretation of the antidumping law.

Mr. BOLLING. Thank you very much.

Mr. BARNHARD. One sentence I would like to conclude with, sir, and that is that the antidumping law is to international trade as the Robinson-Patman Act is to domestic trade, and the Robinson-Patman Act makes very specific exclusions. That is, domestic price discrimination is bad only when it tends to create a monopoly, when it has an injurious effect on competition, when it is not made in good faith to meet the competition of the local market. These are reasonable tests and fair tests which have been adopted by Congress, and in the comparable situation, at the very least, those tests should be read into the antidumping law.

Mr. BOLLING. Thank you very much, Mr. Barnhard.

Mr. BARNHARD. Thank you, sir.

Mr. BOLLING. The committee will adjourn until tomorrow morning at 10 o'clock in this same room, and the subject will be multilateralism in trade.

(Whereupon, at 4:03 p. m., the subcommittee adjourned until Thursday, November 10, 1955, at 10 a. m.)

FOREIGN ECONOMIC POLICY

THURSDAY, NOVEMBER 10, 1955

Congress of the United States,
Subcommittee on Foreign Economic Policy of the
Joint Committee on the Economic Report,
Washington, D. C.

The subcommittee met at 10 a. m., the Honorable Richard Bolling, chairman of the subcommittee, presiding.

Also present: Grover W. Ensley, staff director; Charles S. Sheldon II, staff economist; and Henry P. Balivet, Jr., administrative assistant to Senator Flanders.

Mr. Bolling. The subcommittee will come to order.

In the hearings of this subcommittee yesterday, the foundation was laid for our investigation of foreign economic policy. In the morning we explored the problems of making international comparisons. In the afternoon we were introduced to the principles of comparative advantage and the adjustment of the balance of payments and exchange rates. These introductory studies are going to be elaborated and analyzed in the sessions which follow.

This morning, our general topic is Multilateralism in Trade. Our first speaker is Prof. A. K. Cairncross, the Director of the Economic Development Institute, an agency of the International Bank for Reconstruction and Development. Dr. Cairncross is something of an anomaly on our program. He is the only foreign visitor to be included. I should point out that he has been invited to appear because of his exceptional personal qualifications. He is not appearing as an official British spokesman in any sense.

Professor Cairncross is on leave from the University of Glasgow in Scotland. Before coming to the World Bank he was an economic adviser of the OEEC in Europe, and for a decade an adviser to the British Government.

The title of his report is: The Contribution of Multilateral Trade to Economic Efficiency and Growth. Professor Cairncross, we are happy to have you with us.

STATEMENT OF PROF. A. K. CAIRNCROSS, DIRECTOR, ECONOMIC DEVELOPMENT INSTITUTE, INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Dr. Cairncross. Gentlemen, I am very much honored by the invitation to appear before you today. I am also embarrassed, not for the reasons for which persons with foreign connections are sometimes embarrassed when they appear before congressional committees, but because I am a little diffident about my capacity to say anything to so distinguished an audience as I have today that would contribute to an understanding of the very complicated subjects which you are now discussing.

I would like to make it clear, as you did, sir, that I am not speaking either as a spokesman of my own country or as a spokesman of the International Bank, with which I am now connected. I am speaking entirely in a private capacity.

I should also like to make it clear that what I have to say relates to economic efficiency and growth outside the United States more than economic efficiency and growth inside the United States. I am assuming that I shall be of most service to you if I express a point of view that may be held outside this country.

With your permission, I should prefer not to read the rather long and rambling statement that I have put before you, but confine myself to some of the major points that arise from it.

It has been the experience of most countries that economic efficiency and growth are promoted by a large foreign trade; that an export market is essential if they are to be able to return to account the resources that they find within their own borders, whether national resources or resources in the form of skill or equipment. It has also been the common experience that efficiency and growth have been promoted more rapidly where the foreign market has been an expanding one. An expanding foreign market frequently leads to the creation of conditions of labor scarcity, which are one of the first steps toward rapid development. This is not so true of an expanding home market, because an expanding home market in a country undergoing rapid development may lead to balance of payments difficulties, which in turn check and arrest development.

I have laid stress on an expanding foreign market without introducing the issue of multilateralism. It might turn out that the trade of a particular country assumed a bilateral shape, that the markets that it found were entirely satisfactory to it, and that the sources from which it drew its imports were the most suitable from its point of view, but it is likely, and it has been the experience, that rapid expansion in international trade usually does involve extensive multilateral settlements between different countries.

It would be foolish for any country to turn its back deliberately on the possibility of triangular or multilateral settlements, if that were going to raise costs and reduce the market in which sales could be made. It might not be foolish in all circumstances, and I have in my paper elaborated on some of the circumstances in which a country might find that it was preferable to push some bilateral trade in order to be able to make full use and satisfactory use of its resources.

Apart from any questions associated with bilateral trade between two countries, there are many issues that arise where a large number of countries are involved. The pattern of multilateral trade as it grew up in the 19th century involved extensive multilateral settlements between large trading areas. A typical arrangement was one under which the United Kingdom was in export surplus with the other countries which now form part of what is called the sterling area, while at the same time the United Kingdom was in deficit with a wide variety of other countries, including the United States. The countries of Western Europe, in turn, were frequently in surplus with Great Britain, but in deficit with the countries now forming part of the sterling area. The United States was able to engage in multilateral trade largely by drawing heavily on what I have called the tropical countries, in Africa, South America, or Asia, and at the same time having a surplus in its trade with Britain and Western Europe.

Now, that pattern was firmly established and worked satisfactorily during the period before the First World War. During the interwar period, international trade was dislocated, the previous multilateral settlements broke down, and many countries then retreated toward selfsufficiency as a means of escaping the embarrassments in which they would have been involved if they had tried to continue along those lines.

In the postwar period there have again been important difficulties in reestablishing multilateral trade, first, because of the dislocation of the European and Asian and other economists as a result of the war. That meant that these economies were not in a position to revive and expand their exports in a manner that would permit them to pay for even the minimum of imports that would allow them to recover rapidly. At the same time the gradual expansion of the United States economy and North American economy tended to bring about an unbalance between that area and other areas in the world in international trade, so that those areas found themselves short of dollars and began to practice discrimination against North America and the dollar area.

These difficulties were, as you well know, greatly mitigated by the extensive economic aid that the United States afforded to many of the countries in Western Europe and elsewhere. That aid enabled those countries to continue to import on a large scale from the United States, and to make dispositions that assisted and accelerated their economic recovery. It also meant that any discrimination that was practiced was a great deal less severe than it would have had to be if the wartorn countries of Western Europe had been obliged to reduce their imports from North America as abruptly as would otherwise have been the case.

The formation of a new pattern in international trade which appears to be coming into existence now has been greatly assisted by a continuous expansion in imports into North America. Those imports have grown steadily over the past 4 or 5 years, and indeed ever since the war, and the expansion in imports has made it easier to visualize a final pattern of trade at a high level rather than one involving adjustments that would have reduced the total volume of international trade.

I have suggested in my statement that discrimination has not done a great deal of damage to the countries against which it was practiced, and that it has been of substantial service to the countries that did engage in it. It did not prevent a rapid growth in the total trade of Western Europe and of other areas where discrimination was indulged in. The trade of those countries has expanded perhaps more rapidly than ever before. At the same time the trade of the United States has been maintained at a very high level, and it would be difficult to argue, I think, that discrimination put pressure on the United States to limit her imports to any remarkable extent. The usual objection to discrimination, apart from the political objections of unfairness, etc., is that discrimination reduces the field for exports of one country, and, therefore, obliges it to limit the total volume of its trade, but in the case of the United States it would be difficult to sustain that that was the outcome.

If we are discussing a departure from multilateral trade that involves principally the relationships between the United States and the rest of the world, it is important to bear in mind that the United States represents about half the economic potential of the world, and that multilateral trade withint he other half has in recent years been fairly free and has not been interfered with to any great extent, particularly since the establishment of the European Payments Union.

The extent to which discrimination has been practiced against the United States would appear to have declined over the past few years. One of the effects of the devaluations of 1949 was to reduce the need for such discrimination since these devaluations raised the price of American exports in European markets and other markets of the world relative to the price of goods manufactured in Western Europe.

I would take the view, for this and other reasons, that it should be possible to continue dollar liberalization and to remove gradually the discrimination that is still practiced by many European countries against North America; all the more so since most European countries are now not merely in a far stronger position from the point of view of what they are producing and the strength of their economies, but because they have much more substantial reserves of gold and dollars than they previously had.

It was obvious from what took place in 1953–54 that the world outside the United States had been placed—thanks largely to the economic aid I have spoken of—in a much stronger position to withstand temporary misfortunes or temporary failures in dollar earnings, than it was in 1948 or the immediate postwar years. But it would be a mistake to assume from that experience that, no matter what takes place in the United States, the rest of the world can remain on an even keel and continue to expand and grow.

One of the major requirements of continuous growth and expansion is undoubtedly that the United States join in this growth, that the market in the United States continues to expand, and that the pressures that are exerted from what is now the center of the network of international trade, the United States, are in an expanding rather than in a contracting direction.

We saw only too well in the interwar period what could happen, if a strong deflationary pressure was exerted on the world economy, both to international trade and to production; and in the postwar period the fact that the pressure has been in the opposite direction has made an enormous difference to the potentialities of other countries.

My general conclusion, therefore, is that given patience and given continuation of economic expansion in the United States, it ought to be possible to push ahead further with liberalization of trade, both between the non-dollar area and the dollar area and within the non-dollar area.

Thank you.

(The complete statement of Professor Cairncross is as follows:)

STATEMENT BY PROF. A. K. CAIRNCROSS ON THE CONTRIBUTION OF MULTILATERAL TRADE TO ECONOMIC EFFICIENCY AND GROWTH

1. The advantages of multilateral trade between the citizens of a single country are obvious enough. They are practically identical with the advantages that flow from the use of money as a medium of exchange and the consequent escape from the inconveniences of barter. Producers are offered a wide market without having to arrange a series of swaps, and consumers are able to choose exactly what they want against payment in an acceptable form. Producers can specialize freely and consumers can buy in the cheapest market without either party having to submit to direct pressure from the other.

2. These advantages are equally apparent in trade between the various regions of a single country. If each of the 48 States that form the Union had to achieve an exact bilateral balance with each of the others, every State would be obliged to satisfy some part of its needs at higher cost. The ores of Minnesota, instead of moving to a limited number of metallurgical centers, would have to provide the means of settlement with Washington, Alabama, and every other State; and the citizens of Minnesota would find themselves pressed to use whatever goods Illinois, Pennsylvania, and other heavy importers of metalliferous ores could supply. Markets would be unduly restricted and scarce natural resources and human skills would be misapplied or fail to be developed.

3. In the absence of multilateral trade the same situation would threaten countries that were dependent almost exclusively on 2 or 3 exportable commodities to provide means of payment for a wide range of imports. A country like Colombia, which derives about five-sixths of its earnings of foreign exchange from exports of coffee, would be in a very vulnerable position if it had no option but to import from the countries to which it sold its coffee. Most countries, particularly underdeveloped countries, do in fact draw a large proportion of their export earnings from a narrow range of commodities; and a quite surprising proportion of international trade, at least one-third, is in staple commodities which are produced in a small group of countries. This fact, taken in conjunction with the convergence on a limited number of markets of the trade in many important commodities, suggests the need for triangular or multilateral settlements on a considerable scale. It happens, however, that countries with a specialized export trade often find it convenient to obtain their imports mainly from the countries to which they sell and that the large markets of the world are generally in countries that can supply a wide range of exports at low cost. In consequence, there are relatively few examples of countries that remain in heavy and continuing deficit in one direction and heavy and continuing surplus in another. Most countries can set off at least half their receipts from trading partners against payments due to the same partners and more commonly the proportion is two-thirds or more.

4. The advantages of multilateralism are thus essentially the same as arise within a country and consist primarily in the economies that result from greater specialization. One country is rich in resources that are scarce in another; multilateral trade allows the riches to be spread and the scarcity to be relieved. Each country can limit the range of its activities to those that best fit its natural endowment, or the skills that it can most readily create, without finding its market cramped by the need to keep imports and exports balanced in every direction.

5. There are, however, well-recognized limitations to the value of a multilateral system of exchange even within a country. The flow of money may break down in an economic crisis so that those who have specialized for a market that no longer exists are left unemployed or are forced to retreat to more self-sufficient pursuits. The distribution of the gains from a money economy may be highly uneven and offend the popular sense of equity. Some areas may find that trade ebbs away from them or that they lag increasingly behind the rest of the country. For these and other reasons no modern government is content to leave domestic trade unregulated or waive all responsibility for the existing distribution of industry between areas.

6. In the world economy these limitations gain additional force. Each government has to consider not only the general gain from multilateral trade but the gain to its own country and citizens. It is faced with balance-of-payments problems that are settled automatically within a country. It must concern

itself with the terms on which trade is conducted with the rest of the world—an issue that, within a country, presents itself in terms of the prices at which individual industries can market their goods. It has to ask itself whether specialization has taken the wrong turning and exposes the entire economy of the country to excessive risks or slows down long-run development by failing to create the physical assets and human capabilities and incentives that successful development demands. It has to examine whether the gains from trade are monopolized by sectional interests that are already comfortably off or will render no continuing service to the rest of the community, or whether the gains are widespread and in the general interest. In the pursuit of its various objectives, it is likely to find good grounds for imposing some restrictions on its trade and these restrictions may require to be discriminatory to be effective.

7. Departures from multilateralism may be either in the direction of bilateralism or discrimination. Bilateralism is itself an extreme form of discrimination, since it usually means that two countries bind themselves to buy from one another up to some agreed figure. By the same token, both countries fail to make their purchases elsewhere even if they could be made at lower cost. The normal objective of a bilateral agreement is to economize "scarce" or "convertible" currencies so that the agreement inevitably discriminates against countries using these currencies or insisting on payment in them.

8. Discrimination may be used on a temporary or a permanent basis. In the postwar world some economists have sought to justify it as a temporary expedient while others have treated it as a natural and justifiable counterpart to a "cronic" dollar problem. It is impossible to enter into either set of arguments in any detail but their general bearing is clear enough.

9. As a temporary expedient, trade discrimination by a country with low reserves of convertible currency can be justified on much the same footing as the control and allocation of scarce materials in wartime. Given low elasticities of response to changes in price, it is often better, in the face of intense pressure of demand, to introduce a system of rationing rather than allow a violent disturbance in normal price relationships. Similarly, given low elasticities of response in the balance of payments of a country to changes in the rate of exchange of its currency, it may be better to ration foreign exchange for a time than to allow violent fluctuations in exchange rates. It can be argued that, in the postwar period, rates of exchange, particularly after the devaluation of sterling in 1949, were not badly out of line with the requirements of a satisfactory long-term pattern of trade and payments. If these rates could be held, and existing impulses toward the necessary new trade structure could be given time to make themselves effective, it might be preferable to ration foreign exchange and control imports costing convertible currencies rather than allow market forces free play. If, moreover, the balance of payments of the dollar countries was particularly unresponsive to changes in the rates of exchange of other currencies, it could legitimately be urged that a common effort of discrimination against dollar imports would keep to a minimum the harm done by policies of import restriction in the nondollar world. Discrimination would allow the nondollar world to expand its economic potential and whittle down its initial adverse balance in dollars until ultimately the need for discrimination no longer existed.

10. The argument for indefinite discrimination against dollar imports comes down to this: That there is a strong secular tendency for American exports to grow, uncompensated by any tendency of similar force on the side of American imports; that at current rates of exchange there would therefore be a growing difficulty in settling accounts; that this difficulty would not be overcome by relatively minor changes in exchange rates but would probably involve a large and progressive deterioration in the terms on which nondollar goods could be exchanged for dollar goods; and that the sensible way out of the dilemma is for the rest of the world to limit its dollar imports by a policy of discrimination. This argument is not logically self-contradictory, nor is it altogether implausible. The experience of the past few years, however, does not offer it much support; American imports have expanded considerably and the competitive position of American exports appears to have deteriorated, especially outside the Western Hemisphere, rather than gained additional strength.

11. Although no friendly country is likely to proclaim open adherence to a policy of indfinite discrimination against dollar imports, it may well happen that discrimination does continue intermittently and that countries are just as reluctant to commit themselves to forgoing discriminatory policies as to embracing them as a matter of principle. There may be times like the present when liberalization of dollar imports is obviously possible and desirable; but circumstances

may also arise when the rest of the world is again in serious difficulties in confining its dollar outlay within the limits of a relatively inelastic total of dollar earnings and, when discrimination offers, not just the easy way out, but a way out that does less damage to the world economy than any alternative course of action. Whether such circumstances will arise, leaving the world in a limbo where discrimination comes and goes, and currencies alternate between convertibility and inconvertibility, de facto but never de jure, depends as much on the policies pursued by the United States as upon the policies of the rest of the world.

12. In viewing this possibility, the United States should not regard itself as simply one country trading with others but as half the entire economic world, measured in terms of purchasing and productive power. If the policies of discrimination pursued by the rest of the world are directed exclusively against the dollar area, these policies will still permit countries outside this area to enjoy multilateral trade with one another without the loss that would result from strictly bilateral arrangements. Departures from multilateralism will raise costs far less if countries with widely different needs and complementary resources are joined together in a single trading area, within which discrimination is banned, than if these countries are forced into bilateral dealings with one another. In the case of the OEEC countries about three-quarters of their trade is with the countries in the EPU area, within which there is little or no discrimination on balance-of-payments grounds, while only about 15 percent of the imports into the OEEC countries come from the dollar area. The proportion of the trade of the OEEC countries affected by discriminatory policies is thus relatively small, though by no means unimportant. On the other hand, from the point of view of the United States, not much more than one-third of her exports (excluding special category exports) go to the EPU area and a smaller proportion to the OEEC countries, while nearly half her exports (excluding special exports) are to other members of the dollar area. These circumstances do not make discrimination less discriminatory but they limit any damage that may result from discrimination against American exports.

13. While there is a general presumption that multilateral trade will promote an expanding world economy and make for higher standards of living through a wider division of labor, this presumption is thus subject to some important reservations. These reservations, when looked at from the point of view of trade, center around discrimination; when looked at from the point of view of finance, they center round inconvertibility. But trade discrimination and inconvertibility of currencies are opposite sides of the same coin. When currencies are freely convertible, as they were universally before World War I, trade is fully multilateral and nondiscriminatory. When convertibility is suspended and dealings in foreign exchange are controlled so as to economize some currencies more than others, a policy of trade discrimination automatically follows. Efforts to put an end to discrimination are dependent on success in reestablishing convertibility of currencies.

14. Trade and finance are linked in more ways than one. If multilateral trade is to expand smoothly, it is essential that international credit should be adequate to allow some latitude in the establishment of debtor and creditor positions. It should be possible to run a larger deficit in a given direction without having to rely on a larger surplus emerging simultaneously elsewhere. Within a country, multilateral dealings between areas usually rest on an efficient banking system which can transfer funds readily from one area to another and is able to leave open, within limits, the debtor or creditor positions that arise. In international trade it is more difficult to insure that credit will be effectively mobilized without periodic scares and flights of hot money. If reserves are low and lines of credit are limited and uncertain, there will be a strong disinclination to risk large deficit positions or to try and ride out temporary squalls, even when, by running these risks, the economy might gain additional momentum and in due course, greater stability. Naturally, there are also times when extra credit has a less healthy effect and merely serves to let countries pursue lax financial policies for a longer time. But without some latitude in a system in which countries are expanding at different rates, the general forward movement is sure to be slowed down. There is not much doubt, for example, that the extra elbow room that the European Payments Union has given to its members over the past few years has contributed to the quite surprising pace of expansion in European markets.

15. While multilateral trade makes for growth, it is only one element in economic development and is often a quite subordinate element. Some countries,

rightly or wrongly, may turn their back on foreign markets and seek to accelerate development by efforts to expand their domestic market. Their first measures are likely to restrict imports, and although in due course imports may expand again as industrialization proceeds, the chances of a quick restoration of the previous level and trend of imports are extremely poor. Other countries, on the other hand, may find that international trade offers them their only real opportunity of employing valuable assets advantageously and raising income levels. In their case, prosperity rests on, and does not merely issue in, an extensive commerce.

16. In the 19th century, international trade played a particularly conspicuous role in world economic development. Large areas were in the course of settlement, often with the help of foreign capital, and generally to snpply foreign markets. The world economy revolved round a single focus in Western Europe, from which came settlers and capital and to which went most of the exports. The risks of international specialization were limited by interdependence of old and new areas and by the comparative tranquillity of international relations. It could fairly be claimed at that time that international trade was not a mere concomitant of successful development but was the main driving force behind it.

17. The situation today is a very different one. North America is now a far more important industrial center than Western Europe. There are no "new" areas to be opened up and what once were new areas of settlement no longer depend, to any comparable extent, on foreign markets. Yet international trade is far larger than ever before and is growing faster than ever before. This is largely due to the greater freedom with which the great industrial countries trade with one another. A new pattern of trade is coming into existence in which the multilateral element is less prominent than 50 years ago but the scope for continuing expansion is more firmly based.

18. In the pattern of world trade and payments that grew up before 1913, the multilateral element played a crucial role. It introduced an element of play, not merely into the trade of one country with its neighbors, but into the trade of large groups of countries with one another. Continental Europe was able to offset a surplus in trade with the United Kingdom against a deficit in trade with the United States and with the areas of primary production in other parts of the world; the United States in turn was in deficit with tropical countries in Africa, Asia, and Latin America; and the United Kingdom was in surplus with these areas but in deficit with all the other principal trading regions. The network of world trade at that time was woven around the markets of Western Europe and, above all, of the United Kingdom. A flow of British capital and British exports in one direction was accompanied by a movement of dividends and imports in the other, and as the British drew a large part of their imports from countries with which they were in deficit, the pattern of settlements was inevitably multilateral. If for any reason the British market ceased to expand, as happened in 1930, the whole network was liable to shrink as countries tried blindly to create new surpluses in place of the old without any clear picture in their minds of a possible eventual pattern of settlements.

19. The old pattern of settlements was under strain even before 1913 because of the emergence of a growing surplus in the trade of the United States with Western Europe—a surplus that was to some extent offset by increasing imports into the United States from India, Brazil, and other tropical areas that were in deficit with Western Europe. Between the wars it became apparent that a major change in the structure of world trade was in progress involving a displacement of Britain by the United States as the center of the network of trade, and this change was accelerated by the Second World War. Before 1913 the readiness of the United Kingdom to run substantial deficits with most of the large trading areas of the world enabled those countries to run deficits elsewhere with fair confidence that they would be able to balance their accounts. This pattern was increasingly jeopardized, however, by the difficulties experienced by the United Kingdom in establishing a sufficient dollar surplus to offset the deficits that it continued to run.

20. One of the obscurities of the postwar period has been the pattern of dollar surpluses and deficits that would come into existence in an expanding world economy to replace the pattern of prewar years. The question at issue for the nondollar world has been whether a consistent pattern could be created without deliberate efforts to reduce triangular settlements in which one party had to provide dollars. The dilemma was perhaps most striking in the case of Canada, which has traditionally been able to square accounts by meeting her deficit with the United States out of her surplus with the United Kingdom.

This arrangement turns on the power of the United Kingdom to earn dollars from countries (including the British colonies) that are in surplus with the United States. The failure of the United Kingdom to earn an adequate surplus of dollars in some other direction was bound to knock out one leg of the triangle and so cause it to come near to collapse. The reemergence of triangles of this kind presupposes the existence of other triangles in which the United States is in deficit and it has been more difficult to visualize such triangles in the trade of the United States (in the absence of grants, loans, military expenditures abroad, and other perhaps exceptional transactions) than it was formerly when most settlements were made in sterling.

21. World economic development no longer pivots decisively on an expanding market in Western Europe, nor is it by any means wholly dependent on an expanding market in North America. But without an expansion in the North American market the difficulties in maintaining the pace of development throughout the world will tend to multiply. The more North America dominates the world economy, as a financial center, as a market, as the leader in technological advance, as an industrial area, the more the pressure to expand or contract elsewhere in the world is governed by changes in the American market and in American import requirements. The last few years have shown that the rest of the world has sufficient strength to withstand a minor shift of weight in America; but it would be foolish to read too much into this and conclude that an expanding market in America does not remain one of the primary requirements for a balanced and growing world economy.

22. In the light of all this, how important is multilaterialism to the United States and to the countries with which she trades? Have the discriminatory policies pursued since the war inflicted serious injury on United States producers? Will convertibility mean a great change in trade prospects for the countries that practice discrimination or that suffer from it?

23. Discrimination on the part of the leading trading nations has made a diminishing contribution to the remedying of their balance of payments difficulties during the past 5 or 6 years. By far the most important factor in the postwar decade has been United States economic aid, which brought most of these countries far more dollars than they were ever able to economize by discriminating against dollar imports. Indeed, there has been a general tendency to exaggerate the influence of discrimination on the pattern of world trade and to ignore other factors which have softened its impact. Devaluation, Marshall aid, the gradual economic recovery of the rest of the world, United States military expenditure overseas, ets., have all eased the necessary changes in structure and have made it possible to maintain purchases from the United States without the savage cuts in imports that intense discrimination would have called for. Had really large cuts in fact been put into force, they might well have penetrated to the quick of the economies adopting them and done about as much harm as the general contraction in activity that a nondiscriminatory policy would have involved.

24. By the same reasoning, United States producers have suffered less from discrimination than is commonly assumed. Discrimination today is probably far more nominal than real; at current costs, United States goods would probably find only a limited additional market if discrimination were abandoned, and the countries practicing discrimination might well be pressed to show a little more boldness in putting liberalization to the test. In the past, the markets that discrimination denied to some United States producers were probably largely compensated by the markets that other United States producers were able to maintain. To the extent that imports from the United States were limited by dollar earnings, and that these in turn were highly inelastic to changes in price, in exchange rates and even in economic activity abroad, the effect of discrimination was to redistribute dollars between different groups of American exporters. Most of what was earned from sales to the United States was spent; but as it could not be stretched to meet all that importing countries wanted to buy from the United States, it was spent primarily on imports approved by the governments of those countries as indispensable.

25. Thanks largely to the very substantial aid that was furnished by the United States Government, the world has never been nearly as far from multilateralism as the conspicuousness of discriminatory policies might be thought to imply. Inconvertibility has always been limited in a multitude of ways by partial convertibility. Thus the experience of the past decade does not prove that discrimination, even in the absence of retaliation, inflicts little injury or that multilateralism is of little importance to economic efficiency. If, as has been

suggested earlier, the United States represents about half the world's economic potential, the maintenance of multilateralism within the United States, and, in large measure, between the countries making up the rest of the world, would of itself greatly limit the damage done by discrimination against the United States, especially as the trade between the United States and the rest of the world is a relatively small proportion (about 15 percent) of total trade. But this would not be true of discrimination against other countries that possess a less rich and diverse range of resources within their borders. Nor would it be true that the kind of intensive discrimination that might be resorted to if a sudden drop took place in the world's dollar earnings would do little harm. It could do very great harm even in the narrow sphere of economics; and it is inconceivable that the harm would be confined within those bounds.

Mr. BOLLING. Our next witness is Dr. Edward M. Bernstein. In addition to experience as a professor of economics, he has served many years in the United States Treasury, and more recently the International Monetary Fund, of which he is the Director of Research and Statistics. He is the author of many writings in economics and monetary subjects. It is worthy of mention that Dr. Bernstein directed the staff study of a well-known 1953 report entitled "A Trade and Tariff Policy in the National Interest" and designed to aid the incoming President of the United States; it is commonly referred to as the Bell report.

We have invited Dr. Bernstein, not as an official of the fund, but because of his solid reputation as a scholar and experienced person in this field. His subject is Problems Relating to Currency Convertibility.

Dr. Bernstein, we are happy to have you with us.

STATEMENT OF DR. EDWARD M. BERNSTEIN, DIRECTOR, RESEARCH AND STATISTICS, INTERNATIONAL MONETARY FUND

Dr. BERNSTEIN. Thank you, Mr. Chairman.

I have taken the written statement that I put before you and cut it roughly in half. It might be easier for me to read that portion which I have retained; but if in discussion anyone wants to refer to more detail, it will be in the longer statement.

Perhaps I ought to start by making clear what currency convertibility is and why it is important, and instead of doing it in a theoretical way I will use a concrete illustration.

A country like Brazil sells its exports, coffee, cotton, forest products of various types, all over the world. When it sells the coffee to the United States, it is paid in dollars. When it sells the coffee to the United Kingdom, it is paid in sterling. When it sells the coffee to France, it is paid in francs. When it sells the coffee to Eastern Europe, it is paid in an imaginary currency called "payments agreements dollars." When Brazil imports from the United States, it can use the dollars it has and buy anything it pleases. If it wants to buy more than it has earned in dollars, there is no way by which it can do so except by borrowing or drawing on its reserves. If it wants to buy from the United Kingdom, it can use the sterling that it has earned and buy what it wishes there. It can, incidentally, buy with that sterling from a group of other countries, too, in the transferable area. But it cannot use the sterling to buy in the United States or in Canada. If it wants to buy something in Eastern Europe, it can with the payments agreements dollars, but it cannot use these payments agreements dollars to buy anything in the United Kingdom or in Western Europe or in the United States and Canada or any other countries.

The consequence of this is that a country like Brazil has to balance its trade with each of these little groups of countries, and often it must buy things it has little need of, while it is excluded from buying things it has great need of.

If Brazil could use the proceeds of its exports from all parts of the world to buy the goods it wants from any part of the world, we can be sure that the people of Brazil would have the best collection of import goods that their exports can pay for.

You will notice that I have put emphasis here on Brazil's interest in multilateral trade and not on ours.

Incidentally, the exporters of the United States might sell more to Brazil, but we must not exaggerate how much more they could sell in the aggregate. In fact, they could not sell much more in the aggregate unless other countries earned more in the aggregate.

On the other hand, it would save exporters of the United States from what often turns out to be arbitrary and sudden changes in the attitude of countries toward imports from the United States.

Currency convertibility, then, is essentially the concept that a country that earns sterling—and I use "sterling" only because it is by far the most important currency in the world, after the dollar—should be able to use the sterling to buy goods anywhere and not just from the sterling area. This could take the form of making payments for the goods in sterling. The American exporter paid in sterling could then sell it for dollars. Convertibility could take the form of having the monetary authorities of Brazil sell the sterling for dollars in an exchange market. Or convertibility could take the form of presenting the sterling to the Bank of England and saying, "Would you mind giving us dollars for it?" All of these concepts are equally valid for achieving the convertibility of currency that would provide the financial basis for multilateral trade.

If that little simple technical introduction helps, I will go on with a discussion of the problems of convertibility.

The articles of agreement of the International Monetary Fund state that one of its objectives is to assist in the establishment of a multilateral system of payments in respect of current transactions. That is what we mean by convertibility. Nevertheless, in the postwar transitional period, and I quote from the articles of agreement of the fund—

> members may maintain and adapt to changing circumstances, restrictions on payments and transfers for current international transactions.

This provision—the one I have just read—permits countries to restrict transfers of currencies and to discriminate in payments on the basis of the country to which, or the currency in which, payments are made. In brief, the temporary inconvertibility of currencies is authorized under the transitional arrangements of the fund agreement.

It is important to see why this provision was made for the continuance of inconvertibility and other exchange restrictions during a postwar transitional period. The war involved for more destruction and disruption than is generally realized. The most urgent task that confronted the war-ravaged countries was to restore quickly their capacity to produce and to trade. Otherwise, the economic efficiency of these regions might have been seriously impaired for a long time.

Their reconstruction needs were expected to be exceptionally large. Their resources from their own production, and from the use of their foreign exchange reserves, were known to be small. With their own production far below prewar levels, the limited reserves of these countries could have been quickly dissipated in meeting the war-borne hunger for goods. The United States and Canada were almost the only large sources of ready supply for goods of all kinds. By restricting their dollar purchases to the most essential goods, the countries engaged in reconstruction could begin to equip their factories and revive their own production. With the necessity of providing billions of dollars of aid to hasten recovery, it could only add to the burden of the United States to insist on premature removal of restrictions against dollar imports. I really don't see how we could have been better off if every country in Europe had said, "Look, we are not going to discriminate against dollar imports, but really you must give us aid to enable us to do this." We were already paying for reconstruction on a very large scale.

In the actual event, severe import restrictions could not provide the resources for reconstruction on the scale and at the pace that proved to be necessary, postwar aid from the United States, Canada, and other countries, and from international institutions was indispensable. We must not, however, underestimate the contribution that these countries made to their own reconstruction through hard work and self-denial. Large and generous though foreign aid was, the greater part of the resources for reconstruction came from the production and the savings of their own people. Remember, for every dollar of resources that went into the reconstruction of Western Europe, there may have been 3 or 4 dollars' worth of their equivalent work and savings going into it, and that meant that they had to deny themselves consumption through rationing, and in other ways, to enable them to do it.

The reconstruction of wartime damage and the resumption of disrupted trade had been virtually completed in most countries hard-hit by the war; a far better recovery has been made this time than after the First World War. The economic conditions that necessitated the postwar transitional arrangements are passing away. The extent to which the world economy has recovered from the effects of the war is indicated by the growth in production and trade. In the large trading countries of Western and Northern Europe—these are the nine countries which are members of the Fund and whose currencies are inconvertible—industrial production in the first half of 1955 was about 70 percent higher than immediately before the war, in 1937, 1938, or 1939. Now, of course, the increase in gross national product is not as large as the increase in industrial production, and allowance must also be made for the fact that their population is now about 13 percent higher than it was in 1937.

A similar recovery has taken place in world trade. In the first half of 1955, the volume of world trade—this is volume, it has nothing to do with inflated prices—was nearly 70 percent larger than before the war. This is for the entire free world, exclusive of the Soviet bloc of countries. Most of this increase has taken place since 1948, and much of it is accounted for by the expansion of exports of the large trading countries of Western and Northern Europe. While the dollar value of world trade increased by 50 percent between 1948 and the first half of 1955, the dollar value of the exports of these 9 countries increased by nearly 90 percent, and a very substantial part of this increase has been in exports to dollar countries—not just the United States, but as Dr. Cairncross indicated, third markets, which are dollar markets, too.

The consequence of the growth and redirection of world trade has been the emergence of a surplus in the overall dollar accounts, including aid, of the rest of the world. Since 1950, the free countries, outside the United States, have added nearly $10 billion to their gold and dollar reserves. Nevertheless, despite this great addition, the reserves of some important trading countries, notably the United Kingdom, are still far too small for their present and prospective needs. As a matter of fact, the United Kingdom has added very little to its gold and dollar reserves during this great period of expansion of reserves.

Although the world economy has recovered from the effects of the war, many countries are still confronted with payments difficulties, but these payments difficulties are not postwar transitional problems. They are largely the manifestation of inflationary pressures, arising from overambitious plans for investment and excessive expectations for consumption. Such pressures must be expected to recur from time to time in individual countries. They are part of a dynamic world in which national policies are adapted much too slowly to the changing circumstances which they must deal with.

The nature and magnitude of the payments difficulties now being experienced by the United Kingdom and the sterling area are themselves indicative of the great change in the world-payment situation. In the past 15 months, there has been a decline of about 240 million pounds in the reserves of the United Kingdom, say around $650 million paid out in gold and dollars by the United Kingdom on its own behalf and on hebalf of the whole sterling area. Such a deficit is not large compared either to the total payments of the sterling area—remember, they import more than $22 billion worth of goods a year—or to total production in the United Kingdom. It is essentially the result of excessive demand in the United Kingdom, and some commonwealth countries.

The world has moved a long ways since balance of payments deficits were measured in billions and every country was desperate for dollars. Not in a generation, in my opinion, has the world's dollar payments position been so strong, or its prospects so promising. Under the circumstances, it is understandable that there should be some impatience that inconvertibility should continue under the transitional arrangements. This impatience must not lead us to overlook the notable progress that has been made toward convertibility during the past few years.

There is a tendency to think of convertibility in absolute terms. This is a common fallacy. A currency is said to be either convertible or inconvertible. As a practical matter, there are vast differences among currencies classified as inconvertible. Some are a little better than blocked funds. For example, the balances of payments agreements dollars, in the Eastern European payments agreements are practically blocked funds. On the other hand, there are other inconvertible currencies which are almost equivalent to dollars. Sterling, the German mark, and other currencies of Western Europe are in that category. If we think of convertibility in relative terms, we can see much better how close sterling has come to being convertible outside the sterling area.

American account sterling, that is the kind of sterling which an American exporter is paid in by a resident of the sterling area, could always be sold on the official exchange market for United States dollars at a rate of exchange within three-fourths percent of parity. That is to say, with $2.80 the par equivalent of a pound sterling, an American exporter could always sell any sterling he took in payment for his exports to the United Kingdom or sterling area, sell it for $2.78. He might even get more than $2.80. On the other hand, until recently, transferable sterling—that represents the receipts from current transactions by residents of all countries except those in the sterling area and in the dollar area, could not legally be sold for dollars under the exchange control provisions of the sterling area. In practice such transactions were arranged in some markets of uncertain respectability. It has always been true that you could sell sterling for dollars, even when it was illegal, but until recently it couldn't be done respectably. It was done under-the-counter.

Just before the devaluation of the year 1949, transferable sterling sold for a discount of about 20 percent. Today transferable sterling can be sold for dollars at a discount of 1 percent in the exchange markets in Zurich and New York, and what is more, you can ask the finest banking houses in New York to handle the transaction for you. While such transactions are not nominally in accord with the exchange regulations of the United Kingdom, no effort is made to prevent them, and in the last few months there has been official support to keep transferable sterling from departing too far from official sterling. In fact, transferable sterling is now around $2.77 when official sterling is $2.79 or $2.80.

Progress toward reducing dollar import discrimination in the United Kingdom and the sterling area has not kept pace with the de facto convertibility of sterling in the exchange market. Nevertheless, considerable progress has been made in the United Kingdom and in the sterling area. In England most raw materials and foodstuffs, including all the major ones, can now be imported without discrimination. There isn't an important foodstuff or raw material for which the United Kingdom will pay 1 penny more in order to pay for it in sterling rather than in dollars. In other sterling area countries a substantial part of their imports is bought on a competitive price basis without preference for nondollar currencies. What remains of dollar discrimination in the United Kingdom and the sterling area, although not negligible, is relatively small in comparison with the total imports of these countries, and in comparison with the discrimination that prevailed only 5 years ago. It is a different world.

As sterling and other leading European currencies become in practice more and more equivalent to dollars through de facto convertibility in the exchange market, the reliance on dollar discrimination for balance of payment purposes will gradually pass away. Nothing is more nonsensical than to keep discriminations against dollars when people can acquire dollars for the sterling you give them, or pay higher prices in sterling when the sterling, in turn, is sold for dollars. So long as world trade is at a high level—and I emphasize this—so long as dollar payments are well balanced, so long as dollar markets are open and prosperous, few countries will be willing to enter into special arrangements involving discrimination, accumulation of inconvertible foreign exchange, and excessive dependence on controlled markets. The trade policy of the United States is of vital importance to convertibility.

With the world payments environment favorable to convertibility, with exchange markets behaving as though the leading currencies were almost convertible, why this hesitation in taking the final step and saying, "These currencies are convertible." Of course, this big step depends on sterling. It is the great currency after the dollar; and you understand if I speak about sterling it is not because any sterling area country discriminates more than any other country. It is because streling will set the pattern for other countries. In any case, it is easier to speak of convertibility in concrete terms, and that means in terms of sterling.

There is a tendency in the United Kingdom to exaggerate the adverse effects on sterling area payments of the heightened competition of convertibility. It is true that convertibility means more competition. Temporary payments difficulties should involve no greater strain on the gold and dollar reserve, with convertibility, than they do now. Directly or indirectly—this is important—the United Kingdom is already paying gold and dollars or their equivalent for the deficits of the sterling area. The only protection for the reserves of the sterling area is a strong payments position. It is not to be found in a little weak wall of inconvertibility, which is a symbol of weakness and provides no defense whatever.

Nevertheless, many people in Britain have great emotional resistance to convertibility. They are apt to associate convertibility at this time with the great deflation in the 1920's when the gold standard was restored, or with the rapid depletion of reserves during the abortive attempt to undertake convertibility in 1947. When payments difficulties do arise, and let's recognize it, gentlemen, there will always be payments difficulties for some countries sometimes, in the United Kingdom they are going to be attributed to convertibility. This is a practical political obstacle to early sterling convertibility. It is not just emotion, however. There are some real problems in connection with convertibility and we must not overlook them. We have to deal with them.

The United Kingdom is concerned that other countries should not impose restrictions and discriminations against the sterling area, for the sole purpose of converting sterling into gold or dollars. It is precisely because sterling is the second most important currency in the world, because the receipts of sterling by people outside the sterling area may reach $15 billion a year; that it is the favorite currency which so many people sell, despite exchange control regulations, to secure dollars. You can always find a buyer for sterling. That is why sterling is the currency that gets used in these deals; and, of course, that is the reason why the United Kingdom more than any other country fears that if it makes sterling convertibility, others will begin to discriminate and restrict against the United Kingdom and the sterling area, in order to convert sterling receipts into gold and dollars.

Now, I think the countries contemplating convertibility need assurance that they will not be hampered in competing for world trade by such measures, particularly systematic discrimination through bilateral agreements. This is a job for the fund, and the fund is already taking steps to secure the full collaboration of all countries in reducing and eliminating as rapidly as practicable their reliance on bilateralism. In Brazil, there isn't a person in authority who doesn't see clearly now that they have cheated themselves in their bilateral payments agreements. They have sold their coffee for imports with the equivalent of 20 cents a pound in some places when they could get imports with 50 cents in the United States and Western Europe.

The United Kingdom also needs assurance of adequate reserves to enable it to proceed with convertibility of sterling when conditions are favorable. There is a possibility that whenever sterling is made convertible, even in favorable circumstances, there will be some immediate impact on the exchange market, particularly through capital movements. So there will be some outward capital movement until things settle down. Such capital movements will probably soon be reversed, but reserves should be available to meet this contingency and to give confidence that the continued convertibility of sterling once undertaken can never be in doubt. The fund has stated on a number of occasions that it is prepared to use its resources generously to help countries undertaking convertibility.

The worldwide trade and payments conditions necessary for convertibility are being achieved. The practical problem is to find the means to move from the transitional arrangements which permit inconvertibility, to the permanent arrangements which require convertibility. The movement to this regime must be accomplished without risking the progress already made in strengthening the pattern of world payments. With good will and mutual understanding among the great trading countries—and I mean particularly the United Kingdom and the United States—with leadership and strength provided by the International Monetary Fund, I am confident that this problem can be met.

Mr. Bolling. Thank you, Dr. Bernstein.

(Dr. Bernstein's prepared statement follows:)

Statement by Dr. E. M. Bernstein on Problems Relating to Currency Convertibility

The central principle of a system of multilateral trade is that each country will buy the goods its people want to import in the best market—that is, where they pay the lowest prices; and that it will sell the goods its people produce for export in the best market—that is, where they receive the highest prices.

Convertibility and Multilateral Trade

Currency convertibility is an essential requirement of multilateral trade. For unless each country can use the proceeds of its exports to every country to pay for its imports from any country, it will be unable to buy and sell in the best markets. Without discussing the technical distinctions among various types of convertibility, it may be accepted that the currency convertibility with which we are concerned is that which will provide the financial basis for a general system of multilateral trade. We can think of convertibility in this sense as involving the right of exporters of other countries, receiving payment in some currency, to use the proceeds of their exports freely—to transfer that currency to other holders anywhere in payment for goods or services and to sell that currency in any market for dollars or any other currency.

The natural consequence of the convertibility of currencies would be the disappearance of discrimination in international trade and payments for balance-of-payments reasons. Most small countries are not in a position to determine independently whether to make their currencies convertible. At present, a considerable number of countries aply currency and country discrimination to their imports and other payments only because an important part of their receipts are in the form of inconvertible currencies. The few countries that make no distinction between their dollar and other payments (and have made their own currencies convertible) are able to do so largely because a substantial part of their exports are to the United States and other dollar countries.

The practical problem of establishing convertibility is confined to the leading currencies of western and northern Europe. The convertibility of sterling, 1 of the 2 principal reserve currencies, is clearly of strategic importance. The sterling area does more than 25 percent of total world trade, and the $10.8 billion of sterling balances represent about 30 percent of the gold and foreign exchange reserves of the free world outside the United States and the United Kingdom. It should be noted that sterling balances held by the monetary authorities of sterling area countries are convertible into dollars, but these countries are exjected to apply much of the same restraints on dollar payments as the United Kingdom.

If the currencies of the great trading countries were made convertible, a general system of multilateral trade would inevitably be restored, and trade and payments discriminations for balance of payments purposes would soon disappear. For no country can find it worthwhile to discriminate on a currency basis if all of its payments are made in equivalent currencies—that is, convertible currencies. Discrimination in trade on a country basis could, of course, persist, but its purpose would be mutual protection of import-export markets. Such discrimination is not likely to have the scope or to be on the scale of the payments discriminations that result from the inconvertibility of leading currencies.

A substantial degree of multilateralism in trade and payments has been achieved in recent years. The most important limitation on a general system of multilateral trade arises from the discriminations still applied against dollar imports and dollar payments. Such discriminations are obviously of special importance to the United States and Canada, and to other countries—Mexico, Venezuela, etc.—that do their business on a dollar basis. It would be a mistake, however, to assume that the wider establishment of convertibility would result in a large increase in the exports of the dollar countries. That is unlikely unless and until the gold and dollar earnings of the rest of the world increase to approximately the same extent. Convertibility would, however, bring an end to the discrimination which exposes all dollar exports to sudden and arbitrary curtailment.

CONVERTIBILITY AND THE INTERNATIONAL MONETARY FUND

The Articles of Agreement of the International Monetary Fund state that one of its objectives is "to assist in the establishment of a multilateral system of payments in respect of current transactions." To implement this objective, the agreement provides that no member shall "engage in any discriminatory currency arrangements or multiple currency practices except as authorized under this agreement or approved by the fund." The agreement also provides that each member shall buy balances of its currency held by another member, paying for its currency either in the currency of the member making the request or in gold. These are the provisions that commit the members of the fund to establishing and maintaining the convertibility of their currencies.

The fund agreement provides that "in the postwar transitional period members may, notwithstanding the provisions of any other articles of this agreement, maintain and adapt to changing circumstances * * * restrictions on payments and transfers for current international transactions." Members are committed, however, to withdraw restrictions when their payments position enables them to do so. This provision permits countries to restrict transfers of currencies and to discriminate in payments on the basis of the country to which or the currency in which payments are made. In brief, the temporary inconvertibility of currencies is authorized under the transitional arrangements of the fund agreement.

It is important to see why provision was made for the continuance of inconvertibility and other exchange restrictions during a postwar transitional period. The war involved far more destruction and disruption than is generally realized. A country like the United Kingdom, for example, put all of its resources into the war. Industrial investment was cut to the bone, consumption was severely restricted, and long-established export trade was abandoned for the duration of the war. A considerable amount of the gold and dollar reserves of the sterling area were spent and some of its most profitable foreign investments were sold to pay for war material procured abroad, principally in the United States, before lend-lease.

The most urgent task confronting these countries was to restore quickly their capacity to produce and to trade. Otherwise, the economic efficiency of these regions might have been seriously impaired for a long time, with incalculable loss to themselves and with a depressing effect throughout the world. Their reconstruction needs were expected to be exceptionally large; their resources were known to be small. The transitional arrangements, under which they could restrict transfers and payments on a discriminatory basis, were intended to enable them to conserve their resources for reconstruction.

With their own production far below prewar levels, the limited reserves of these countries could have been quickly dissipated in meeting the war-born hunger for goods. The United States and Canada were almost the only large sources of ready supply for goods of all kinds. By restricting their dollar purchases to the most essential goods, the countries engaged in reconstruction could begin to equip their factories and revive their own production. It is true that imports of some goods were permitted from other countries, even when imports of similar goods were severely restricted from dollar countries. The reason, however, was that such trade involved little or no drain on the gold and dollar reserves. With the necessity of providing billions of dollars in aid to hasten recovery, it could only add to the supply and financial burden of the United States to insist on premature removal of restrictions against dollar imports.

It may be asked whether these countries could have conserved their gold and dollar resources for reconstruction without discriminations against dollar imports. Conceivably, they could have depreciated the dollar value of their currencies so much that it would not have been feasible for their people to buy dollar goods. In the abnormal conditions immediately after the war, devaluations on such a scale would have risked the utter destruction of confidence in European currencies. It would have forced an enormous rise in the costs of food, raw materials, and equipment; it would have encouraged a bidding up of prices and wages that would have added a gigantic postwar inflation to the already considerable wartime inflation. The long-run interests of American producers could not be served by putting dollar goods in a price range beyond the reach or the hopes of European consumers.

In the actual event, severe import restrictions could not provide the resources for reconstruction on the scale and at the pace that proved to be necessary. Import restrictions had to be supplemented by rationing of consumption in order to leave more output for investment and for exports. Even so, postwar aid from the United States, Canada, and other countries, and from international institutions was indispensable. At the same time, we must not underestimate the contribution that these countries made to their own reconstruction through hard work and self-denial. Large and generous though foreign aid was, the greater part of the resources for reconstruction—perhaps three-fourths or four-fifths in some instances—came from the production and the savings of their own people.

EXTENT OF POSTWAR ECONOMIC RECOVERY

The reconstruction of wartime damage and the resumption of disrupted trade have been virtually completed in most countries hard hit by the war. A far better recovery has been made this time than after the First World War. The world economy today is prosperous and strong. We have good reason to believe that most countries will deal with their internal and external economic problems in a broad and constructive way. It is for these reasons that the Managing Director of the International Monetary Fund, Mr. Ivar Rooth, has said "that the conditions that necessitated the postwar transitional arrangements are passing away."

The extent to which the world economy has recovered from the effects of the war is indicated by the growth in production and trade. In the large trading countries of western and northern Europe,[1] for example, industrial production in the first half of 1955 was about 70 percent higher than immediately before the war. Of course, the increase in the gross national product is not as large as the increase in industrial production, and allowance must also be made for the fact that their population is now about 13 percent higher than it was in 1937.

A similar recovery has taken place in world trade. In the first half of 1955, the volume of world trade (outside the Soviet bloc) was nearly 70 percent larger than before the war. Most of this increase has taken place since 1948, and much of it is accounted for by the expansion of exports of the large trading countries of western and northern Europe. While the dollar value of total world exports increased by 50 percent between 1948 and the first half of 1955, the dollar value of the exports of these countries of western and northern Europe increased by nearly 90 percent. A very substantial part of this increase has been in exports to dollar countries.

The consequence of the growth and redirection of world trade has been the emergence of a surplus in the overall dollar accounts, including aid, of the rest of the world. In 1953, the countries outside the United States (exclusive of the Soviet bloc) added about $2.5 billion to their gold and dollar reserves. In 1954, they added another $1.7 billion to their reserves. The replenishment of reserves is continuing, although on a more limited scale. Since 1950, the free countries outside the United States have added nearly $10 billion to their gold and dollar reserves. Nevertheless, the reserves of some important trading countries, notably the United Kingdom, are still far too small for their present and prospective needs.

Although the world economy has recovered from the effects of the war, many countries are still confronted with payments difficulties. These payments difficulties are not postwar transitional problems. They are largely the manifestation in actual or suppressed payments deficits of inflationary pressures arising from overambitious plans for investment and excessive expectations for consumption. Such pressures must be expected to recur from time to time in individual countries. They are part of a dynamic world in which national policies are adapted much too slowly to the changing circumstances with which they must deal.

The nature and the magnitude of the payments difficulties now being experienced by the United Kingdom and the sterling area are indicative of the great change in the world payments situation. In the past 15 months there has been a decline of about £240 million in reserves of the United Kingdom. Such a deficit is not large compared either to the total payments of the sterling area or to total production in the United Kingdom. It is essentially the result of excessive demand in the United Kingdom and some Commonwealth countries. It is heartening to have the Chancellor of the Exchequer say: "It is not by physical controls that we intend to solve our difficulties, nor shall we go back on our policy of widening trade and moving to a system of freer payments."

The world has moved a long way since balance of payments deficits were measured in billions and every country was desperate for dollars. Not in a generation has the world's dollar payments position been so strong or its prospects so promising. Under the circumstances, it is understandable that there should be some impatience that inconvertibility should continue under the transitional arrangements. This impatience must not lead us, however, to overlook the notable progress that has been made toward convertibility during the past few years.

DE FACTO CONVERTIBILITY OF STERLING

There is a tendency to think of convertibility in absolute terms. This is a common fallacy: a currency is said to be either convertible or inconvertible. As a practical matter, there are vast differences among currencies classified as inconvertible; some are little better than blocked funds, others are almost equivalent to dollars. If we think of convertibility in relative terms, we can see much better how close a currency like sterling has come to being convertible outside the sterling area. In particular, the widening of the transferable account area, which now embraces all countries outside the sterling area and

[1] These data refer to the following 9 countries: United Kingdom, France, Germany, Italy, Netherlands, Belgium, Sweden, Norway, and Denmark. The currencies of these countries are not convertible.

the dollar area, has added enormously to the multilateralization of trade, since transferable sterling can be used for payments to and from all countries except in the dollar area, and can be converted into all currencies except those of the dollar area.

Apart from this, there has been a steady approach in the equivalence of sterling and dollars in the exchange market. American account sterling, representing receipts from current transactions by a resident of dollar countries, could always be sold on the official exchange market for United States dollars at a rate within three-fourths of 1 percent of parity. On the other hand, until recently transferable sterling, representing receipts from current transactions by residents of countries not in the dollar area could not legally be sold for dollars under the exchange control provisions of the sterling area. Actually, such transactions were arranged in some markets of uncertain respectability.

Just before the devaluations of 1949, transferable sterling sold for a discount of about 20 percent. Today, transferable sterling can be sold for dollars at a discount of 1 percent below the rate for American account sterling in the exchange markets in Zurich and New York. While such transactions are not nominally in accord with the exchange regulations of the United Kingdom, no effort is made to prevent them; and there is official suport to keep transferable sterling from departing too far from official sterling. Even security sterling, representing capital transfers of nonresidents of the sterling area, can be sold at about the same rate as transferable sterling.

Progress toward reducing dollar import discrimination in the United Kingdom and the sterling area has not kept pace with the de facto convertibility of sterling in the exchange market. Nevertheless, considerable progress has been made. In the United Kingdom, most raw materials and foodstuffs, including all the major ones, can now be imported without discrimination. In other sterling area countries, a substantial part of their imports is bought on a competitive price basis, without preference for non-dollar countries or for payments in non-dollar currencies. What remains of dollar discrimination in the United Kingdom and the sterling area, although not negligible, is relatively small in comparison with the total imports of these countries and in comparison with the discrimination that prevailed only 5 years ago.

The conditions necessary for convertibility are being rapidly attained. The dollar earnings of the rest of the world are large and there is good reason to expect that they will continue to grow. Under such conditions, it should be possible to establish and to maintain a strong and balanced pattern of international payments under the heightened competition of convertibility. As the world approaches such a pattern of payments, we shall find that countries will behave as though their currencies are in fact convertible, even if the currency is not convertible de jure and even if the country clings to the transitional provisions of the Fund Agreement.

As sterling and other leading European currencies become, in practice, more and more nearly equivalent to dollars through de facto convertibility in the exchange market, the reliance on dollar discrimination for balance of payments purposes will gradually pass away. It is an illusion to believe that a great trading country can attach to itself a large trading area in which an inconvertible currency will continue indefinitely to be used in international payments and held as reserves. So long as world trade is at a high level, dollar payments are well balanced, and dollar markets open and prosperous, few countries will be willing to enter into special arrangements involving discrimination, accumulation of inconvertible foreign exchange, and excessive dependence on controlled markets. The trade policy of the United States is of vital importance to convertibility.

PROBLEMS OF CONVERTIBILITY

With a world payments environment favorable to convertibility and with exchange markets behaving as though the leading currencies were almost convertible, the question arises why there is hesitation in taking the final step of placing international payments on a convertible currency basis. The United Kingdom and the sterling area are having some difficulties in keeping their payments in balance. These difficulties are not large in magnitude and they should be overcome in the coming year, now that more forceful financial policies are being put into effect. It is understandable that convertibility of sterling should be put off temporarily to a more favorable time. The problem, however, is not wholly one of timing.

There is a tendency in the United Kingdom to exaggerate the adverse effects on sterling area payments of the heightened competition of convertibility. Temporary payments difficulties should involve no greater strain on the gold and dollar reserves with convertibility than they do now. Directly or indirectly, the United Kingdom is already paying gold and dollars for nearly all the deficits of the sterling area. The only protection for the reserves of the sterling area is a strong payments position.

Nevertheless, many people in Britain have great emotional resistance to convertibility. They are apt to associate convertibility at this time with the great deflation in the 1920's when the gold standard was restored, or with the rapid depletion of reserves during the abortive attempt to undertake convertibility in 1947. And when payments difficulties do arise, as they must from time to time, they will somehow be attributed to convertibility. This is a practical political obstacle to early sterling convertibility.

There are some real problems that must be dealt with before sterling is made convertible. The United Kingdom is concerned that other countries should not impose restrictions and discriminations against the sterling area for the sole purpose of converting sterling into gold or dollars. Countries contemplating convertibility need assurance that they will not be hampered in competing for world trade by such measures, particularly systematic discrimination through bilateral agreements. The fund is already taking steps to secure the full collaboration of all countries in reducing and eliminating as rapidly as practicable their reliance on bilateralism.

The United Kingdom also needs assurance of adequate reserve to enable it to proceed with convertibility of sterling when conditions are favorable. Once the convertibility of sterling is undertaken it must become the settled policy of every British Government to maintain it in accordance with the articles of agreement of the fund. There is a possibility that whenever sterling is made convertible there will be some immediate impact on the exchange market, particularly through capital movements. Even though such capital movements would probably soon be reversed, reserves should be available to meet this contingency and to give confidence that the continued convertibility of sterling, once undertaken, can never be in doubt. The fund has stated on a number of occasions that it is prepared to use its resources generously to help countries undertaking convertibility.

CONCLUDING OBSERVATIONS

The world-wide trade and payments conditions necessary for convertibility are being achieved. The near equivalence of the leading currencies in the exchange market, the real cost of maintaining trade and payments discriminations, and effective international economic cooperation are moving the world steadily toward a multilateral system of payments based on the convertibility of currencies. I have no fear that countries will depend on the technicalities of the transitional provisions to delay unduly the restoration of convertibility. As the Chancellor of the Exchequer said at the Annual Meeting of the Fund in Washington in 1954:

"Article XIV of the fund, which permits a fairly facile use of restrictions to deal with balance of payments difficulties, was intended as a temporary provision to deal with the difficulties of the postwar situation. There may well be danger in continuing for too long a transitional provision of this kind. It is important that the international rules and regulations correspond with the realities of current conditions."

The practical problem is to find the means to move from the transitional arrangements permitting inconvertibility to the permanent arrangements requiring convertibility, with exchange restrictions and discriminations subject to the fund agreement. The movement to this new regime must be accomplished without risking the progress already made in strengthening the pattern of world payments. With goodwill and mutual understanding among the great trading countries, with leadership and strength provided by the International Monetary Fund, I am confident that this problem can be met.

Mr. BOLLING. Prof. O. Glenn Saxon is our next witness. Professor Saxon has had varied experiences as an importer, as a political economic adviser, and for many years in the field of applied economics at Yale University. He has written on trade matters, and appeared previously before the Joint Committee on the Economic Report. His subject today is "The Relative Burdens of Various Kinds of Trade Controls on the Economy."

Professor Saxon, we are glad to have you with us.

STATEMENT OF O. GLENN SAXON, PROFESSOR OF ECONOMICS, YALE UNIVERSITY

Mr. SAXON. Mr. Chairman, members of the subcommittee, I want first of all to apologize for not having handed you a prepared statement, but I prefer to talk extemporaneously, and while I am talking to the subject which I have been asked to talk to, it turns fundamentally to convertibility.

Under present conditions, particularly in this country, we have had recently a great emphasis on tariff reductions in an effort to aid the balance of payments situation in other countries, the demand for dollars, and also, at least theoretically, the desirability of obtaining the maximum and most efficient use for all our resources in this country, by being able to buy from abroad those things that foreigners can produce more effectively and at lower costs than we can, and sell to them those things which we can produce more efficiently for them.

Now, I want to preface my remarks here by saying that I agree generally with what has been said here already, but I don't think we have gotten to the root of the problems that face the country and the world in the drive to expand international trade. I fully accept the need for the great assistance which the United States has given abroad since the end of World War II, which has been close to 50 billions of dollars. Without that aid, the recovery which Dr. Bernstein has mentioned could not have been attained, but on the other hand, I think that in our approach to the problem we have not tackled its fundamentals. It comes back primarily to convertibility.

Tariffs are only a very minor factor in the present international situation. If we completely eliminated all our tariffs tomorrow, it is estimated that not more than $3 billion, at the maximum, of additional imports would come in. Three billion scattered among the nations of the world would give little or no relief to the so-called payments or dollar shortage problem, as it exists even today, despite the improvement which has been mentioned here.

The real obstacles to continuous expansion of international trade lie in other areas. Fundamentally, the chief obstacle is the lack of convertibility of currencies of the world. We have been talking about convertibility here but we have never mentioned convertibility into what.

In the century prior to World War I, we had convertibility of all foreign countries, with few exceptions, on gold. Gold was in effect a world currency. Every major nation in the world had gold as a common denominator of its currency which was automatically exchangeable into other currencies at fixed prices, based upon their respective gold content. I don't think we are going to get back to the type, volume, and freedom of international trade which the world needs and which it had before World War I until we do return to an international gold standard.

Dr. Bernstein has been talking about convertibility here, but despite the degree of convertibility which he says we have now attained, every nation is maintaining exchange discriminations, exchange quotas, exchange subsidies for its exports and as a consequence, not only is there gross discrimination against the United States, and other dollar countries, such as Canada, but there is also gross discrimination in other respects for competitive reasons, particularly with reference to Germany and Japan. Those are the two major competitors that the sterling area fears, both currently and in the future.

Germany has almost made a sharp recovery, satisfied her domestic demands, even satisfied the demands of continental Europe for German products, and from now on she is going to become progressively more and more aggressive in the export markets of the world.

Germany is in a position in which she could return to international gold payments tomorrow, and that in itself is going to increase the embarrassment of the sterling area if it does not return to gold payments.

Now, convertibility is, in my opinion, the greatest barrier not only to the attainment of stability of our present world trade, but its constant expansion in the future, to meet the needs of growing populations and maximization of the uses of world resources. This country is rapidly expanding populationwise at the rate of 4 million or more per year—more than Soviet Russia. Our population has increased approximately 26 percent since 1939. Europe's population is rising not as much, but it is expanding, and to meet that expansion we have got to have expansion in world trade as well as expansion in domestic trade. Europe has already attained the point where its production is adequate for that expansion, but so long as we make it easy for them to sell to us in dollars, they are not going to service their traditional prewar markets (which they should be servicing) until they return to a multilateral trade basis—which if possible with convertibility of currencies—preferably in gold.

We must recreate a situation where you can sell anywhere in the world anything you produce anywhere in the world, and convert any currencies that you get in exchange for those sales, not merely into dollars, not merely into sterling, but into gold which in turn, means automatic convertibility into any currency desired.

Therefore, you would have, after allowing for tariffs and transportation costs, the price of everything practically the same in terms of gold, throughout the entire world, without discrimination. Brazil, for instance, could sell its coffee to Siam and still buy what it needed from the United States. Until we get that kind of convertibility—in gold—we are not going to have either stability of international trade or multilateral trade. Nor can we eliminate the present discriminations in international trade. Nor will we be able to expand international trade (as growing world population is going to require), in order to get the maximum benefits of specialization of various nations in certain productive areas where they are most efficient for the benefit of the entire world.

What we need today is not free trade, it is freedom to trade, to get away from all the many restrictions, all the many discriminations, all the various quotas on exports and imports, quotas on exchange, and so forth.

Until we get free of all these restrictions of that type, tariffs will remain a relatively minor factor because exchange differentials, exchange preferences, exchange subsidies can overcome any reasonable tariff of the levels that prevail today.

Now, what is this gold convertibility? You can have convertibility not only on gold, but you can have convertibility on free markets. What Dr. Bernstein is talking about is convertibility into dollars at artificial rates, where by international agreement the International Monetary Fund says that sterling is worth $2.80 per pound and the franc is worth so much and the lire is worth so much, and so on, but by calling a mouse an elephant doesn't make it that. That is merely an arbitrary agreement because these other currencies have no gold value, as does the dollar. In most of those agreements foreign currencies have been generally overvalued in terms of dollars convertible into gold. That, again, creates an excessive demand for dollars. If a foreigner can buy automobiles and other things at substantially lower prices than they are really worth in terms of their own inconvertible currencies, there is never going to be an end to their demand for dollars.

Now, if we allow sterling, francs, and other foreign currencies to fall to their normal market level through free trading on free markets, you will have true, realistic convertibility of every currency in the world without any question of over-or-under valuation. The result of such free market convertibility would be that prices of American products in terms of foreign currencies priced on free markets would be high, much higher than they are today. This would have the effect of restricting those countries that have been overpurchasing American products and thereby creating so-called dollar shortages. It would mean, furthermore, that products of other countries which are now overpriced in terms of American dollars would be much lower, so that Americans would be buying more and more British products, more and more Brazilian coffee, and so forth. But, so long as we are under-valuing dollars and providing that we can't trade freely in foreign currencies in exchange for dollars or insisting that sterling cannot be sold except at a fixed rate we are perpetuating the dollar-shortage problem. And this talk about selling and buying foreign currencies only through respectable firms doesn't mean anything realistically. The result is that you either have a black market or you have a free market, and, if you establish price controls, we know from our own experience in this country that, excepting in time of war, you are not going to have respect for any price-control system. You are going to have black markets develop and black markets are nothing but an attempt to establish free markets, gentlemen.

Most of our economic theory of international trade was based upon the fundamental principles of free competitive enterprise, free markets for commodities, free markets for currencies (unless they are convertible into gold), and also free constitutional democratic systems of government, but we have today a world where those things no longer exist in large areas. We don't have free markets in many countries today. Price controls are still prevailing, or we have the equivalent of them in other types of controls, such as exchange controls.

We certainly don't have any free market in currencies today. What is a currency of another country in terms of the United States? It is nothing but a commodity. You cannot buy anything in this country with any foreign currency. You can only legally make payments in this country in terms of dollars. Therefore sterling to American citizens is nothing but a commodity. A franc is nothing but a commodity, and you can have convertibility of those currencies on a free market at any time that you want it by simply going back to free markets for currencies, reestablishing free markets for all currencies as they existed prior to the organization of the International Monetary Fund.

If the world or its major nations were on an international gold standard, all currencies would be automatically convertible into so many ounces of gold and you would have a common denominator for them—in effect, a world currency which would eliminate the present greatest barrier on international trade. You can have convertibility therefore, in two ways: Convertibility on the free market or convertibility in gold.

We have neither today. We have nothing but what we call administrative convertibility—artificial convertibility by agreement—which essentially has resulted in overvaluation of foreign currencies in terms of the dollar. This is, as I have said before, merely a perpetuation of the problem that we are really trying to solve, this so-called dollar shortage. The result is that we cannot return to multilateral trade and without multilateral trade we have resort to what is in effect nothing but barter. That is all that bilateral agreements are. Brazil, say, sells coffee for dollars. She can buy in the United States those things she needs only to the amount of dollars she gets for the coffee sold here. She cannot use here sterling she got from sale of coffee to England. She might just as well barter her coffee for the things she needs here. The result is the same. That condition limits the volume of business that can be done between the two countries; on the other hand, it would make no difference where Brazil sells if the currencies of the buying countries were convertible on a free market or convertible into gold at fixed ratios. There could be multilateral trade. She could sell in England for sterling and buy in the United States for dollars.

The gold standard has been mentioned only once in this discussion until I began to talk. Dr. Bernstein stated that after the World War I we had disruption of the gold standard. The disruption was not as great as after World War II so far as destruction of physical properties—plant, equipment, and productive facilities—are concerned, but the disruption in international finance, international currencies, and foreign trade was just as great. Yet the world returned to convertibility on free exchange markets immediately after World War I, and England, Dr. Bernstein intimated, made a mistake in coming back to gold convertibility too early. The mistake wasn't that she came back to gold too early—in 1925; it was that she came back to gold at too high a price. She tried to maintain the old prewar value of the pound sterling in terms of gold. She came back at $4.86 per pound, when the pound sterling 2 or 3 years before had been selling on free markets as low as $3 a pound. If she had allowed the pound to find its own level on free markets and then come back to gold at that level, she would not have had the deflationary problems—which Dr. Bernstein mentioned—that developed after she did come back to gold on a highly overvalued basis. This overvaluation was finally recognized and the pound was devalued in 1931 by almost 40 percent.

Consequently I deny the implication involved in that, in his statement. He also stated that many people in England are emotionally opposed to coming back to convertibility. I don't know whether he meant convertibility on free markets or in terms of gold, but I do say this: That the rest of the world, Western Europe, at least, is in a position to come back to gold. Great Britain would come back to gold if she were forced to it, and she will, in my opinion, comparatively soon be forced to it by Germany because of the advantages that Germany is going to get out of convertibility of her mark into gold.

Now, whether it is emotional or not, or whether it is based on misunderstanding, I don't accept those emotional reactions or reactions based on misunderstanding as something which should bar us from doing what we ought to do. Let's face the facts. We will have stability, we will have freedom to trade, if not free trade, and we will have an opportunity to expand markets on a multilateral basis only if we come back to convertibility, and on gold, as soon as possible, and meantime let's have convertibility on free markets rather than the artificial convertibility of today.

The International Monetary Fund has done a wonderful job in the 10-year period since World War II ended in maintaining this so-called administrative convertibility by agreement, but that kind of convertibility is not realistic, now that the postwar emergencies are behind us. I don't know whether sterling is worth $2.80 a pound or not today. No one can say. You can only test that out by having a free market. It may be that it is worth only $3 or $3.50 or it may be it is only worth $2.50 or $2, but you could soon find out by freeing sterling and other currencies to a free market.

So far as sterling being now convertible, that one can now buy dollars with it at merely a cent below the official par—as Dr. Bernstein stated—that may be true when dealing with the so-called respectable agencies that trade in currencies, but I know of exchange transactions in connection with commodity imports into this country from Malaya and India where sterling is being sold at as much as 20 percent below par, and the owners don't consider they are doing anything disrespectful. They are simply taking advantage of free markets as and where they find them, and that is the function of traders in a realistic world. If "blocked" sterling can't be sold legally in England and the United States at discounts below par, it can be so sold elsewhere.

In final conclusion, I want to say this: There is another factor, too. We talk of the free world as if it were a group of nations that have a consensus in respect to these things that we are discussing, that is, free competitive enterprise and free markets, and so forth, but many of the nations of the so-called free Western World are socialistic in their ideologies, to say the least, and, as a consequence, they are using international trade as a socialistic device, to assure—and properly so; I don't oppose it, if that is what they want—but they are using international trade as a basis of assuring domestic "full" employment, as they call it, and to prevent depressions.

I don't think any free society is going to stabilize markets forever, or prevent price fluctuations over the business cycle. Only a totalitarian system can do that anyway, and at the price of political freedom, but we here must think in terms of what type of free markets, what type of international trade do you want. We can't for long have United States working on a free competitive enterprise system and expect them to act as such in competition with the other nations that are demanding managed currencies which is a Socialist device in the sense which I use the term "management of currency"—and refuse to come back to either open market convertibility, or return the world or the major nations of the world to the gold standard that showed in the century before World War I that the only sound basis of an expanding international trade is an international currency, which gold, in effect, is. The gold standard before the war had defects, but there are various ways in which we can improve it, but in any case, throughout all recorded history, going back four or five thousand years, gold has proven to be the best basis, the soundest basis for the currency of any or all nations.

I want to close these introductory remarks by simply saying this: That Karl Marx said the surest way to destroy a free society is to debauch its currency. That is what we have when we have currencies that are politically or arbitrarily controlled as to their value, rather than controlled by economic factors. A condition that exists under an international gold standard.

Thank you.

Mr. BOLLING. Thank you, Professor Saxon. I am sure your testimony will prove stimulating.

You may not be aware, gentlemen, that it is our custom after the statements of the various members of the panel to provide opportunity first to members of the panel to discuss the statements of the others. Professor Saxon was apparently not aware of that. I am tempted to give him some time now to discuss the subject, Relative Burdens of Various Kinds of Trade Controls on the Economy, but foregoing that I will proceed to see if other members of the panel and Professor Saxon are stimulated by remarks that have been made by other members of the panel to comment on each other's statements.

Dr. CAIRNCROSS. Sir, we are ready and eager to go if you are willing to listen to us.

Mr. BOLLING. That is what I would like.

Dr. CAIRNCROSS. I couldn't help reflecting, listening to Professor Saxon, that my conservative friends in Britain and in Europe would be saddened to learn that managed currencies and full employment were Socialist devices. They are now regarded as among the most orthodox and conservative.

Mr. SAXON. That is one of the things that worries me most, sir.

Dr. CAIRNCROSS. If I might turn from that to one of the more important points in what Mr. Saxon said, I thought that there was, if I may say so, some contradiction in the two major conceptions of convertibility that he was putting before you. I thought he was trying to ride two horses of quite different colors, one involving the gold standard and one involving free and fluctuating rates of exchange. The gold standard is not a standard in which there is no control. On the contrary, it involves fixing the price of foreign currencies, controlling that price rigorously and regulating the whole of this economy to that fixed point.

Mr. SAXON. Could I clarify that?

Mr. BOLLING. Just a second. I would like to conduct these hearings in a certain fashion. Nobody interrupted you. I would prefer the statement be made, and you will have plenty of opportunity for rebuttal.

Dr. CAIRNCROSS. The decision as to what rate of exchange to adopt, where a fixed rate of exchange is involved, and where a fixed parity with gold is involved, is an extremely difficult one to make, as Mr. Saxon agreed with respect to Britain's return to the gold standard in the early twenties. Whatever rate is taken it is one that must be adhered to, and must be adhered to by trimming all other policies so that they square with that fixed rate of exchange.

It is possible to take an entirely different point of view and suggest that no one ever does know the value of a currency until it is tested in the free market. But even in the free market the rate established can vary within very wide limits.

It is quite easy to visualize conditions in which the rate may slide very abruptly and the balance of payments of the country concerned may change remarkably little. The depreciation of sterling from $4 to $2.8, for instance, in 1949, did not have the tremendous impact that one might have been tempted to expect in advance on the British or the sterling areas balance of payments.

I can quite well visualize that if the United Kingdom were now to engage in full convertibility, with fluctuating rates of exchange, that a decline in the rate of exchange would not necessarily operate strongly to introduce a correcting movement, but might continue for quite a time in one direction and then shoot upward again with equal violence.

It is precisely to eliminate those movements in the rate of exchange, which have consequences that are often very disconcerting to an economy dependent on international trade, that countries have now on the whole come to the conclusion that fixed rates are preferable. Whether these fixed rates are linked with gold or not does not appear to me to be really material to what we are discussing. If the rates of exchange are in fact fixed, and if it is possible for a country to pay for all its buying, that is what matters. People want payment, and if they are given payment to their satisfaction then it will not matter to them primarily whether they are paid in gold, goods, or in any other way. What will matter is whether they get their goods disposed of at a suitable price, and whether they are able to buy at a suitable price.

If I may turn from that to one of the things that Dr. Bernstein introduced, I think it is extremely difficult to pass judgment on the whole problem of convertibility within a few minutes, but since I didn't touch on this in detail, in my submission, I would like just to remark for a few minutes longer on it.

As you have heard, the position today is that many of the more important currencies are almost on a de facto convertible basis. The fact is that most people who are paid today in pounds, for instance, are getting a currency which they can convert into dollars with remarkably little loss, if any, and that a very large proportion of the total payments that are made in international commerce are in convertible or very near convertible currencies. But there is a major difference, I think, between maintaining de facto convertibility and adopting as a matter of principle de jure convertibility. That is putting the pound on a footing where you are obliged to maintain convertibility, come hell or high water.

Most people, I think, are a little afraid, not just in Britain or elsewhere, that there may be considerable fluctuations from time to time in the degree of pressure to which international currencies are subjected; that the degree of convertibility, if you like, and the degree of convertibility established by the existing pattern of trade varies through time. It would be quite easy to visualize circumstances in which many countries become eager again to obtain dollars, although at the moment, as Dr. Bernstein has explained, their anxiety to obtain dollars has been very greatly reduced, and many of them are in possession of comparatively ample reserves. From the point of view of the United Kingdom, there would be, in my judgment, important responsibilities assumed by that country if she were in the near future to become fully convertible. Apart from the quite practical difficulties that one can visualize when the balance of payments is only to a negligible extent in surplus (if it is in surplus) there is always the danger that the first country in Europe, or elsewhere, to take this leap becomes the backdoor to the acquisition of dollars.

Now, it is quite true at present countries would be unlikely to attempt to possess themselves of more sterling in order to obtain more dollars. That is not a likely circumstance at present, but I can well visualize that in some years to come circumstances of this kind might arise, and if the United Kingdom had by that time put on record that she was prepared to go on paying out dollars to anyone who was able to furnish the necessary sterling, a great many countries would clearly be under a strong temptation so to direct their trade that they did by one means or another obtain the necessary sterling. It happens that since sterling markets, including the whole of the sterling area, are wide, it is perhaps a great deal easier to obtain the necessary sterling than it is to obtain the necessary dollars.

Therefore, a great many countries faced with an unbalance in their dollar position might attempt to remedy that by conducting their trade so as to obtain more sterling.

Apart altogether from that, it is clear that convertibility would require on the part of the country becoming fully convertible very substantial reserves and the reserves of the United Kingdom are now far, far below what they were in relation to the trade in prewar years. I think I am right in saying that before the war they were equivalent to over 9 months' imports into the United Kingdom, where now the equivalent is less than 3 months' imports, and in relation to total imports into the sterling area, which is what matters, they are, of course, still lower.

If I am quite frank on this, I must say that I am a little nervous about one country, whose importance in the world has greatly diminished, trying to assume again the kind of responsibilities that she had in the 19th century, and to a considerable extent between the two wars, and I think it is perhaps a preferable arrangement—I won't say this dogmatically, but I think perhaps that it is a preferable arrangement—that the United Kingdom should be joined with the other European countries in the kind of organization represented by the European Payments Union so that there is then a wider base on which to conduct the transactions of Europe and the sterling area, rather than pin everything on the single currency sterling.

I agree that this is not perhaps very flattering to the potential economic strength of the United Kingdom, nor to the views which have been held strongly in the city of London, but I do think that there is at least an arguable case for saying that it would be preferable to try to tie sterling and some of the major European countries together so that they have common reserves and a common currency, rather than make everything turn on one currency, sterling, so long as the United Kingdom remains in the kind of situation she has been in for the past 10 years.

Mr. BOLLING. Dr. Bernstein.

Dr. BERNSTEIN. Mr. Chairman, I don't want to be petty about another man's statement, but Professor Saxon is mistaken in thinking that I was passing judgment on whether sterling convertibility into gold in 1925 came early or late, whether it was at a good or a bad rate. All I said was: "Many people in Britain have great emotional resistance to convertibility. They are apt to associate convertibility at this time with the great deflation in the 1920's when the gold standard was restored." That was purely a statement of fact; there wasn't any judgment on my part.

Nevertheless, I am more than prepared to say that the postwar policies of the 1920's were so far inferior to the postwar policies after 1945 that it is impossible to speak of them as really being comparable.

There are other statements that Professor Saxon has made to which some exception must be taken—not serious exception, but I think we ought to clarify what it is that he has in mind. It is quite true that the convertibility I have been talking about is the convertibility that is relevant to multilateral trade. As a practical matter if you had that kind of convertibility, you would have convertibility into gold, not by the United Kingdom saying "Here, come and get the gold for sterling," but through the exchange market and the gold market.

Mr. SAXON. Through dollars, you mean?

Dr. BERNSTEIN. That is right, through dollars.

Any country earning sterling, when it is convertible, selling it for dollars, could turn to the Federal Reserve Bank of New York and buy gold. Then, too, we mustn't overlook the fact that the biggest gold market in the world today is in London; that this market operates every single day, with the leading dealers in the United Kingdom matching buying and selling orders from all parts of the world. As a matter of fact, I think it is instructive to make the point that it is possible to get gold for sterling today with great ease.

I will show you how even an individual can get gold for sterling. An exporter in Latin America sells commodities in the United Kingdom for transferable sterling. He asks the First National City Bank to sell that sterling, transferable sterling, for dollars. He then has the bank sell the dollars to the United Kingdom authorities for "registered sterling," which is the type of sterling used to buy gold in the London market. He then asks the bank to buy gold for him in the London market at just under $35 an ounce. The upshot of this business is that the Latin American exporter has acquired gold from London for his sale of export goods to the United Kingdom. I don't say many exporters do this; all I say is that it can be done.

Mr. SAXON. May I interrupt to clarify?

Isn't that limited, however, to registered sterling, as you say, and there are large areas of sterling in India and Egypt which that is not true; war sterling demands are excluded. Therefore, India and Egypt cannot use that sterling to buy in other areas than Great Britain or the sterling area?

Dr. BERNSTEIN. Every country in the sterling area which holds sterling reserves is entitled to get dollars from the United Kingdom for it. They have always been given dollars. It is quite true that the grant of dollars may have been accompanied by a request, and even an entreaty, "Go easy in spending dollars because our common reserve is a bit low." But as a matter of entitlement, they are entitled to get dollars and they do get dollars for sterling. That is the first thing.

The second thing is I am not talking about the exporter who sells for registered sterling. In fact, registered sterling is not used in international trade. I am talking about a man who exports to the United Kingdom and takes payment in transferable sterling. I am now assuming that he can evade his exchange authorities, or in some countries like Siam, it doesn't matter, because there the exchange authorities don't care. A dealer exports tin from Siam to the United Kingdom, gets payments in transferable sterling, and the exchange authorities in Siam don't really care what you do with it. He can sell the sterling for dollars, either in the Far East or in New York. He can then take the dollars and acquire registered sterling, which is a type of sterling owned by nonresidents of the United States and nonresidents of the sterling area, and can be used for making payments in the London gold market. He then orders some London bullion dealer to buy gold with registered sterling. At present, he will get that gold for just under $35 an ounce.

With the convertibility of transferable sterling de facto in the exchange market you can get gold for it. I don't really believe that this extra piece of icing on the cake that Professor Saxon wants is anything more than unnecessary calories. It adds nothing at all to the nutrition of this cake nor to its taste.

Mr. SAXON. May I interrupt again, Mr. Chairman?

Mr. BOLLING. Professor Bernstein has the stand.

Dr. BERNSTEIN. I will stop after this next point, which is a statement of fact, and maybe I will save my comments on what Dr. Cairncross has said to a later point.

Mr. BOLLING. Continue as you please and then Professor Saxon and then Professor Cairncross we will hear from you.

Dr. BERNSTEIN. I may have misheard Professor Saxon that sterling is at a 20-percent discount for someone somewhere. That statement is not a correct statement of fact.

Mr. SAXON. I disagree.

Dr. BERNSTEIN. There is no place on earth in which any kind of sterling, no matter how it is denominated, is sold at a discount of 20 percent. The lowest price for any kind of sterling—and I got this in the mail this morning, or last night, was the price for sterling notes—and sterling notes were sold in New York a day ago for $2.63. That is a discount of around, let us say, 5 percent, but that is sterling notes. If a person owns treasury bills of the United Kingdom, he could have a New York banker convert those treasury bills into dollars at the equivalent of $2.75. I don't really know any kind of sterling of any sort that anybody holds which is being sold at a 20-percent discount.

But I will be glad to check the facts again.

(The following was later received for the record:)

STERLING ABOVE PAR

The sterling-dollar rate has this week broken through the line of the official parity. At the beginning of the week the spot rate was hovering around \$2.79 11/16. On Tuesday, following the Chancellor's counterattack on his budget critics and his assurances that the drain on the gold and dollar reserve was slowing down, the rate moved up and for a fleeting moment touched \$2.80. On Wednesday, however, the advance gathered momentum and although reputedly held back by some official offering of sterling against dollars the rate crossed the parity line and closed at \$2.80 3/32 on the reassuring gold figures. It closed at \$2.80¼ on Thursday.

The improvement has also spread to the forward rates. A week ago the premium on 3 months dollars was around 1½ cents. It has since narrowed to a middle rate of 1 3/16 cents. The foreign exchange market in London reports little commercial demand for dollars, though normally it is still in spate at this time of the year. Part of the seasonal demand for dollars was undoubtedly anticipated in July and August when rumors of an impending devaluation or freeing of sterling were rife. The run on sterling, which in 1 week of July is believed to have cost the reserve over \$70 million, in part took the form of premature buying of dollars and other foreign currencies in respect of requirements that would normally have been satisfied later in the year. To that extent the autumn pressure was merely advanced.

The firmness of the official rate has been reflected in the unofficial rates for sterling against dollars. Transferable sterling has moved up to \$2.77¼ and security sterling to \$2.75¼. Even the decidedly "gray" rate for resident sterling in which there is an active market in New York is now \$2.75, the margin of dealing rates for that type of sterling being appropriately wide—\$2.74¾–\$2.75¼. All these rates lie within the range of a 3-percent variation either side of parity which, in the discussions leading up to the European monetary agreement, was deemed to be the maximum that could be tolerated for any currency that became convertible and required greater flexibility. The only rate for sterling in New York that lies beyond this 3-percent range is that for pound notes, now at a posttourist season ebb and quoted \$2.63.

Sterling has also been steady in terms of most continental currencies though in these markets it has not advanced as strongly as against the dollar. There are widely conflicting reports of the extent to which the short position in sterling on the Continent remains uncovered. The funds lent to London discount houses by overseas and foreign institutions seem to be much below normal. That implies that the running down of sterling working balances—a major factor in the run from sterling earlier this year—has by no means been made good. Once the balances are restored sterling should benefit.

Source: The Economist, November 5, 1955, pp. 499–500.

That covers what I had to say on sterling; any notion that sterling is worth much less than \$2.80 under present conditions seems to me unreasonable.

Now, Professor Cairncross has spoken about the responsibility we are asking the United Kingdom to take. I know there is such a thing as appealing to pride in the sterling area, pride in the great tradition of sterling. When I was a boy we used to speak of something as being as sound as the Bank of England. What was it, sound as a dollar note or safe as the Bank of England, or was it as safe as a dollar note and sound as the Bank of England?

Dr. CAIRNCROSS. They were convertible.

Dr. BERNSTEIN. Thank you. They were convertible.

Any notion that we are trying to put more responsibility on the United Kingdom than on other countries, or that we would want the United Kingdom to undertake any commitment against its interests, is a mistake. It is a fact that if the United Kingdom undertook convertibility by itself it would find certain pressures, particularly in Europe, in which sterling would then be used as a vehicle for earning dollars.

If, in fact, sterling was alone convertible, some difficulties of that sort might arise. Countries would deliberately restrict their imports from the United Kingdom and the sterling area to convert into dollars. But nobody suggests that sterling be made convertible alone. Ask the Minister of Finance of Germany when the mark will be convertible, and he says, "15 minutes after sterling is convertible."

Now, the next proposition: It is a fact that as of today the United Kingdom bears a responsibility for its currency which is greater than the responsibility of most other countries for their currencies. That is inherent in sterling. It is a fact that because sterling represents a currency used in 30 percent of the world's trade, because perhaps $15 billion of sterling are received by nonsterling area members from trade and payments every year, that the easiest currency to sell in order to acquire dollars is sterling. Sellers are there in large numbers. And don't forget the buyers are there, too.

It is true that sterling is already being used as the currency for arbitrating to and from dollars. I cannot see much more pressure from making sterling convertible than you already have. Whatever harm can be done by such transactions is already being inflicted on the United Kingdom and the sterling area. Making sterling convertible would simply assure the United Kingdom of receiving the benefits from this unique position of sterling in world trade and payments. I believe it is in the British interest.

One last proposition: The inconvertibility of sterling leads to such complete nonsense in international trade that it really takes a madman to explain it to a sane person.

I am going to give you an example. Brazil is heavily in debt to the United Kingdom for arrears and it is paying off these arrears under an agreement. Its earnings of sterling were being diverted because of its exchange system. Its coffee exported to the Netherlands and to Germany was being reexported to the United Kingdom, so that Brazil couldn't earn sterling.

What did the Brazilians do then? They stopped importing from the United Kingdom. When asked why they didn't buy sterling with dollars, they said: "The British don't think that sterling is as good as dollars, so why should we use dollars to get sterling?"

Before the war, the most natural thing in the world for Brazil was to use its dollars to buy European currency—today not. Instead the Brazilians stopped importing from the United Kingdom entirely. They wouldn't use the dollars to buy sterling, but in the end they had to pay dollars, at greater cost, for such imports.

Here is why: Goods that couldn't come from any other country, machine parts, etc., were imported through an American trader who got the parts from London. Allocations of dollars were available, so importers paid with dollars that way and paid 25 percent more.

I want to give you two more examples: German marks were also in great demand, but the Brazilians wouldn't buy German marks with dollars, either, because the Germans didn't say that marks were as good as dollars. Why should the Brazilians be so bold as to say that to them the mark was as good as the dollar? As a consequence, in the exchange auction, bigger premiums were paid for marks than for dollars. An importer in Brazil was paying not the dollar equivalent for marks, but 20 percent more. That is ridiculous, but that is exactly what happened. Still the Brazilian Government wouldn't use its dollars to acquire marks and offer them in the exchange market.

One last illustration and I will be through with this mad type of economics in a world taught to think that currencies cannot really be equal in value if one is called convertible and the other not. After selling their coffee to Czechoslovakia for the equivalent of 20 cents a pound in imports, instead of 50-odd cents a pound, Brazil not being able to find anything to import from Czechoslovakia, the Czechs have very generously bought German goods, relabeled them "Made in Czechoslovakia," exported them to Brazil at 100 percent above the German price.

So long as you keep saying that sterling is not as good as dollars, then there are enough people in the world who believe what you say, so that they will act as if sterling is not as good as dollars. And the irrational behavior you get under such circumstances operates adversely to the interest of the United Kingdom, and adversely to the interest of the countries dealing with the United Kingdom. To have multilateral trade on a nondiscriminatory basis, we want convertibility of all of the great trading currencies, as soon as possible, and approximately simultaneously.

Mr. BOLLING. Thank you, Dr. Bernstein.

Professor Saxon.

Mr. SAXON. First of all, I want to say I agree wholeheartedly with what Dr. Bernstein has said about the crazy economics of this situation, and the confusion that results from it, all of which would, in my opinion, be eliminated if you had a common currency, which is gold, or currencies convertible into gold at fixed ratios.

This confusion is simple, naturally, and it is due to the fact that Dr. Bernstein still keeps talking about various kinds of sterling—registered sterling, transferable sterling, and other kinds. Sterling, as such, is not convertible.

What I mean by convertibility is that all kinds of sterling be convertible, on the demand, not merely registered or any other kinds of sterling, but all sterling, and until all sterling is convertible on demand you don't have free convertibility as do dollars. So far as Professor Cairncross' misunderstanding—what I said is this: I am not for permanent free markets for sterling, or any other currency. That free market convertibility is simply an intermediate stage before return to gold convertibility, but a stage which I say is preferable to this arbitrary, artificial establishment of exchange rates by agreement. Under present artificial determination of values, we are overvaluing one currency in favor of another, or vice versa, and it simply means that, if sterling is overvalued every time an American sells in sterling, he is getting less value in dollars for his product than he is entitled to, and every time he buys in sterling he is paying more for the product than he should be paying, and as a consequence foreign trade is reduced in volume.

Professor Cairncross also said the devaluation of sterling in 1949 did not result in what the British had anticipated, an expansion in British trade abroad, and why?

Quite simple. There were two reasons for it, primarily. Great Britain retained price controls for some years after the devaluation and didn't allow domestic prices to rise, and, as a consequence there was a tremendous internal demand for home consumption of goods that were being produced and sold below their true value.

The consequence of that was that they didn't have as much export material as they expected to have. It was absorbed by the domestic economy. The net result was that the balance of payments situation was not improved by the devaluation. It would have taken a year, or year and a half, for prices to adjust to the devalued rate.

I am only advocating free markets in substitution for the arbitrary controls and not for the gold standard. Once you come back to gold, you don't have the wide fluctuations (mentioned by Dr. Cairncross). However, a nation cannot maintain the gold standard without accepting the disciplines that it imposes and that means internal balanced budgets and elimination of inflation. It means maintenance of balance of payments on international exchange and international trade accounts. There are things a nation must sacrifice in order to enjoy the benefits of the gold standard, but it is as I said before, uncompatible with many of the socialistic doctrines which now prevail in certain countries. They want currency controls, exchange quarter, exchange subsidies. It is in order to reduce imports, in order to expand exports, in order to discriminate against United States, Japanese, and German exports, and in order to assure more employment internally, et cetera. Today there is overemployment in Great Britain, as has been pointed out, and Dr. Cairncross gives that as a reason why the British don't want to come back to convertibility. But, if competitive nations return to gold, England will be forced to follow.

Germany is not working a 42-hour week. Germany is working 48 hours; Japan, 49 or 50 hours per week. Consequently, how can Britain expect to continue to compete with those aggressive nations, if it is going to have a much shorter workweek without a correspondingly higher productivity? A nation cannot overcome those disparities merely by exchange manipulations or overvaluations of its currency, and this overvaluation cannot continue for long in a realistic world.

Dr. Bernstein still talks about convertibility of registered sterling and different kinds of sterling. The world is crying for full convertibility of all major currencies on gold so as to revive multilateral trade and freedom to trade. We are now in position to come back to gold in the Western World. The sooner we come back, the sooner we will avoid all these arbitrary controls that we now have, controls which result in exchange subsidies, exchange preferences, exchange quotas, with all these devices added on top of high tariff rates, preferential tariff rates, cartel operations, state trading and state financing. We can only get away from all those trade barriers and get back to freedom to trade—rather than free trade—by reestablishing a common currency for the world, which means coming back to the gold standard, perhaps in a modified form.

We have adequate gold reserves through the world to do it with some reallocation, perhaps, which the United States could assist the rest of the world in effecting. We have, furthermore, a new gold field that was discovered in Africa about 5 years ago which next year will be exporting more gold than the famous Rand ever produced at its maximum. That new gold resource would satisfy the world requirements for gold today without any difficulty.

Mr. BOLLING. Thank you, Professor Saxon.

Unless there are other comments from other members of the panel, I think we will proceed to some questions from the staff.

Mr. Balivet.

Mr. BALIVET. I would like to ask of Dr. Cairncross and Dr. Bernstein a few questions on behalf of Senator Flanders.

Dr. Cairncross might care to answer this: Do you see the problems of convertibility among and between the Western European countries, including the United Kingdom, as greater or less than those problems among and between that bloc and the dollar area?

Dr. CAIRNCROSS. I think the answer to that is that it should be easier to have full convertibility between the Western European currencies than convertibility between their currencies and the dollar, but the margin of difference is obviously extremely slight.

To take an illustration, I think it would have been possible for the European Payments Union to step up to a hundred percent the gold element in settlements within the Union, without necessarily committing all the members of the Union to full convertibility with the dollar, but it would have been a difference more of title than of fact.

It would have been a matter of the administrative arrangements under which convertibility was approached.

I think also that the question could be taken to refer to a high degree of multilateralism between Western European countries rather than full multilateralism to the same degree, vis-a-vis the dollar, and there I should certainly agree that it is possible to make progress toward multilateral trade between the European countries, and has proved so, than to achieve the same measure of multilateralism in relation to the dollar value.

Mr. BALIVET. I would like to turn the same question to Dr. Bernstein, in slightly different wording: Would you say that British convertibility would be less of a problem if confined to a nondollar area?

Dr. BERNSTEIN. You have that already. Sterling is convertible for every country in the world outside the dollar area and into all currencies except the dollar.

Mr. BALIVET. In your opinion would the dollar payments problem be less difficult if free convertibility existed among the western and northern European countries and the sterling areas?

Dr. CAIRNCROSS. Is that for you?

Dr. BERNSTEIN. For you.

Dr. CAIRNCROSS. There has been full convertibility, of course, in the sense that any deficit within the European Payments Union is met automatically and by regulations laid down in advance as to how much is credit and how much is gold. There is no question of inconvertibility of currency there. All deficits and surpluses are brought to settlement automatically once a month and have been ever since the Payments Union was established.

Dr. BERNSTEIN. Before that, the currencies received and paid are arbitraged in London and other leading exchange markets in Europe. Only net balances are brought in for settlements.

Mr. BALIVET. That assumes, of course, the participation of the United States in the European's Payment Union?

Dr. CAIRNCROSS. No. I was speaking only of the degree of convertibility within the Union. The United States is not a member. If the United States became a member the situation would change completely. As of now, of course, it is true to say that through the European Payments Union and through the sterling area the convertibility de facto of sterling to dollars establishes de facto convertibility of the western European currencies on very much the same footing.

Mr. BOLLING. Dr. Sheldon?

Dr. SHELDON. After some of the excitement this morning that related to differences of opinion in these matters concerned with the convertibility, I hesitate to turn back to a very simple and elementary point.

On the occasion of our meeting yesterday it was pointed out that we feel part of our effort here is an educational one, to try to make as clear as we can some very simple concepts. Forgive my turning back to some of these more elementary principles for a moment. Professor Cairncross, I wonder just by way of summary if in a few words you could show us how if a country makes sales to the United States and earns dollars, but does not spend those dollars here, that the United States still need not worry necessarily about its total exports?

Dr. CAIRNCROSS. Certainly. I think it can be best done by way of an illustration of the kind of trade in which the United States is presently involved. The most familiar example to me would be that of Malaya, from which the United States purchases heavily both tin and rubber. Malaya, in turn, purchases heavily from the United Kingdom. Many of her requirements are met from that country and the United Kingdom in turn requires dollars in order to meet her deficit with the United States, so that the original receipt of dollars by Malaya comes back again in the form of an import into the United Kingdom from the United States, leading to a similar dollar payment to the United States, and the circle is then closed. There are many other circles of the same type which arise and if there were to be any hitch at any point, if, for instance, American purchases from Malaya fell heavily as they did in 1948 and 1949, either in quantity or in value, then that would embarrass other countries that were at some point on the circle, and they would be obliged in consequence to restrict their trade, and it is certain one of the countries that would then be injured would be the United States. It would be injured more directly if the restrictions that were imposed were discriminatory, it would be injured indirectly if the restrictions imposed were nondiscriminatory. The chances are that different people would feel the impact in the United States, but the impact would be just as great in the end.

Dr. SHELDON. I am sure you realize my reason for asking a question of this sort is that very frequently in the discussions which have concerned our trade policy there have been witnesses who have made the point that other countries, in specific cases named one at a time, have not taken their proper share of goods from the United States.

The claim is made we have made purchases from them and yet they haven't in every case been willing to spend exactly the same number of dollars here and this has resulted in various upsets in this country.

Mr. SAXON. The answer to that is simple. The dollars are spent.

Dr. BERNSTEIN. Yes; but it is not quite that easy. The funds earned may be held in idle balances, invested or used in a number of ways which create some difficulties, which cannot be disregarded.

Dr. SHELDON. I think the comments of all three of you are ones that I hoped would be brought out; first, the point that multilateral settlement really is our concern; second, the point that, after all, the only reason other countries acquire dollars is presumably to spend them; and third, the very important qualification, of course, that we still have problems because we don't know how soon the dollars will be spent or for what they will be spent. Surely all three of these are factors which must be taken into account.

I have just one question for Dr. Bernstein. At one point in your statement, you suggested that in postwar recovery abroad, that for every dollar of United States aid expended some of these other countries spent the equivalent of $3 or $4 in local funds for their own rebuilding. They made a very great effort themselves. I am not disputing the accuracy of that estimate. I wonder, just as part of this educational process, again could you describe for us very briefly what we mean by "counterpart funds"; a part of this expenditure, of course, was related to the specific device of counterpart funds.

Dr. BERNSTEIN. What I had to say really was even simpler than the machinery through which bookkeeping of aid is needed, and how it is ultimately regarded as having been put into the hands of the recipient country for specific reconstruction projects. What I meant was even simpler than the allocation and use of counterpart funds, although I will be glad to explain that point, too.

If the United States gave, say, $6 billion of aid to the United Kingdom in loans and grants during a certain period, say, 1947–51, regardless of the form in which the aid was given, regardless of what goods were imported from the United States, regardless of where the goods were destined to be shipped, I regard this $6 billion of aid as contributing so much in real resources to investment in reconstruction in the United Kingdom. I won't chase the aid funds around the circle, but the aid will wind up as a net addition of real assets for the British people—including foreign assets.

I next take the aggregate gross investment in reconstruction in the United Kingdom, in all forms, in rebuilding houses, building factories, in acquiring equipment, whether it is made in the United Kingdom, whether it is imported from the Continent of Europe, whether it is imported from the United States.

The data show that the aggregate domestic investment was about five times the size of the United States aid to the United Kingdom. That would seem to indicate to me that four-fifths of the real resources to rebuild the United Kingdom in this period came from the work, directly or indirectly, and the savings of the British people. Remember, whenever the British people put their work into reconstructing, whether it is a house or a road or a factory, they have got to save. They have got to give up consumption. They did this on a large scale. Some of it was mighty painful consumption to give up. That is what I had in mind.

(The following table was later supplied for the record:)

United Kingdom domestic and foreign investment, 1946–51 [1]

	Millions of pounds							Total (million United States dollars)
	1946	1947	1948	1949	1950	1951	Total 1946–51	
1. Domestic investment:								
Gross fixed capital formation at home	905	1,173	1,406	1,552	1,678	1,851	8,565	[2] 29,700
Value of physical increase in stocks and work in progress	−54	309	175	65	−210	575	860	[2] 3,000
Total	851	1,482	1,581	1,617	1,468	2,426	9,425	[2] 32,700
2. Net foreign investment [3]	−140	387	182	187	41	329	986	[2] 3,500
3. Total investment	711	1,869	1,763	1,804	1,509	2,755	10,411	36,200
4. United States aid:								
Grants			144	244	239	72	699	2,306
Loans [4]	149	707	94	57	4	5	1,016	4,087
Total	149	707	238	301	243	77	1,715	6,393

[1] Sources: United Kingdom National Income Blue Book (1955) and United Kingdom balance of payments white papers. See also table 12 in United Kingdom section of 5th Balance of Payments Yearbook.
[2] 1946–48 figures converted at US$4.03 per £1; 1949 figures roughly converted at US$3.70 per £1; 1950–51 figures converted at US$2.80 per £1; totals rounded to nearest US$100 million.
[3] Excludes extraordinary economic aid, and monetary movements (change in sterling liabilities to nondollar areas and in United Kingdom gold, dollar, and nondollar currency holdings).
[4] Excludes repayments on official loans. Repayments on United States and Canadian loans in each of the years shown amounted to 32, 36, 25, 15, 37, 51 million pounds.

Now, as for the counterpart funds, when the United States gives a country aid in the form of goods or a right to acquire goods in the United States, the right to import may be sold by the exchange authorities to a local merchant or the goods may be imported and sold by a government agency. Local merchants buy either the import goods or the right to acquire them, by paying in their own currency, just as they would buy foreign exchange.

There is this difference, however. When the monetary authorities sell foreign exchange that they have acquired from exporters the sale of the exchange merely offsets the sterling or the francs that have been paid to exporters for this same exchange. In the case of aid there is no such offset. Therefore, the local currency accrues as a receipt to the government of the country.

Now, the United States required that this sum be set aside in special accounts, and they were called counterpart funds. They are the counterpart in local currency of the aid that we gave. These counterpart funds were assigned in different ways, in different countries, for different purposes.

In some cases they were directly assigned to specific projects of reconstruction, so one can say that this road, this bridge, this factory, was built with counterpart funds. In other countries, a different technique was used. The country went ahead without previous arrangement to get counterpart funds for the purpose and did the reconstruction. It was then agreed to release counterpart funds equivalent to a certain amount of reconstruction to the authorities and they used it, of course, to restore the cash position they would otherwise have had. It should be added that some of the counterpart funds have been retained for use by the United States and have been used for all sorts of purposes, including the expenses of the United States Government in these countries.

Dr. SHELDON. Thank you.

Mr. BOLLING. Dr. Ensley?

Dr. ENSLEY. One brief question to our British friend, Dr. Cairncross. This was discussed yesterday, but I can't miss the opportunity of asking you. It is a question that is raised repeatedly in debates over the tariff, and import restrictions, and that is, How can the United States compete with the lower wage rates prevailing in foreign countries?

Dr. CAIRNCROSS. Did I understand you right, the question is how the United States can continue to compete with her high wages with countries where wages are very much lower?

Dr. ENSLEY. Yes, sir.

Dr. CAIRNCROSS. It is a very strange thing, but I hear in the United Kingdom both types of argument, the argument it is impossible to compete with the United States where there is such a high standard of living and the argument, it is impossible to compete with Japan where there is such a low standard of living. I never quite settled which argument people really put their money on. I think that part of the answer is that the high rates of wages paid here correspond to high rates of productivity, associated with greater skill than most other countries of the world possess, and with very much better and more elaborate equipment than most countries in the world possess. I think it is also to some extent a reflection of the much larger scale of operations in this country, with its very wide market, compared with the operations in other countries. It doesn't necessarily mean that the average factory and plant here is a lot bigger than the average plant in many other places, but countries like my own, for instance, tend to be engaged in supplying a scattered assortment of markets all over the world, so that it is impossible to have that uniformity and simplicity of operations that you can have in the average large American factory.

There are a large number of reasons, in other words. I have mentioned some. Then there is your greater endowment with natural resources, the high quality, and abundant supply of minerals and also your rich agricultural land. I would place most emphasis on a factor I haven't mentioned so far and that is the rapid technical development which is always taking place in your industries, rapid technical development that is made possible because of the high levels of skill that can be commanded and the high standard of education that you have.

Dr. ENSLEY. Thank you.

Mr. SAXON. Isn't it quite possible, sir, that if you had a free competitive market in Great Britain among your producers, rather than a cartelization of those industries, that you would have necessarily the same type of technological development forced on your industry as we have here? And you would attain the productivity. You can buy the same type of equipment from us, which we have here, available for our factories. Your labor can be trained just as efficiently as our labor can. So I don't follow that argument.

Dr. ENSLEY. Mr. Saxon, of course, we have cheap TVA power here. That makes a difference in cost perhaps?

Mr. SAXON. They have a higher power cost, without doubt.

Dr. CAIRNCROSS. I was not intending to contrast the United States exclusively with the United Kingdom or to suggest that there was no technical development there. I can remember a whole string of technical developments from TV to the magnetron and the gas turbine that have come from the United Kingdom and I wouldn't by any means be thought to wish to suggest that technical development doesn't exist elsewhere. I was contrasting the United States primarily with countries where wages were extremely low, not just with the countries with which the United States competes.

Mr. SAXON. Dr. Ensley, would you say the power content of our cost is a very major factor? I think it is a very nominal factor in the overall cost of most of our industrial products.

Dr. BERNSTEIN. May I get into this, sir?

Mr. BOLLING. Certainly.

Dr. BERNSTEIN. I think the reasons for differences in productivity are far more complex. They are so complex that they can't be attributed to any single thing, including the single thing of technological development. I heard the director of the industrial relations section of the Department of Economics at Princeton University describe a research study of the steel industry in the United States and in Germany. Germany is certainly not a backward country. The startling thing was the difference between the organization of the steel industry in these two countries in certain typical plants. Among the differences that were discovered were the fact that in the United States the proportion of metallurgists to ordinary workers was much greater. In Germany the proportion of foremen to workers was very high. We hardly use foremen any longer in most of our large plants. The difference in organization started in the office force and wound up in the handling of the finished products. Mind you, nobody was prepared to say the Germans were unaware that our productivity was greater. It is quite true they could buy all the equipment that we use, but they did not find it would pay in product and cost to shift to our type of organization. Other cases were cited in a certain Middle East country, where textile equipment coming right out of American and British factories was being used by local people and the output per worker with those machines was one-sixth of what it was in the United States.

I wouldn't say it is machines, I wouldn't say it is power, I wouldn't say it is even the ingenuity of our businessmen. There is a whole set of social and economic forces at work that we can't altogether set out, and when they are in operation, they seem to make an American worker able to produce a good deal more than others. Maybe the reason is that here a worker is convinced his wages are going to go up on that account, and elsewhere you will find workers taking the view that it doesn't pay to try so hard.

Mr. SAXON. I think all he says is very true, but I would say that it would take a lot of those factors to overcome the wage differential which is in Germany today, in the electrical industry—I don't happen to have the figure for the steel industry, but in the electrical industry, which is probably just as efficient as the steel industry in Germany, the ratio of German workers' average weekly rate of pay to the United States worker is 22 percent. The ratio has gone down rather than up as compared to prewar days. The British rate correspondingly would about 28 percent.

Mr. BOLLING. Gentlemen, if that is all the comment, I would like to thank you all for your contribution. I think the discussion has been very informative, generally elevated, and consistently lively. We are grateful to you.

The subcommittee will now adjourn until 2 o'clock this afternoon in this same room, when the subject will be interaction between foreign and domestic commerce.

(Whereupon, at 12:03 p. m., the subcommittee recessed until 2 p. m., the same day.)

AFTERNOON SESSION

The subcommittee met at 2 p. m., the Honorable Richard Bolling (chairman of the subcommittee) presiding.

Also present: Grover W. Ensley, staff director; Charles S. Sheldon II, staff economist; and Henry P. Balivet, Jr., administrative assistant to Senator Flanders.

Mr. BOLLING. The subcommittee will be in order.

The session this afternoon is being devoted to reports on two major pieces of research of interest to the Subcommittee on Foreign Economic Policy. The work has been technical, and of considerable importance to scholars in the field. The summary results should be important for policy guidance as well.

The first presentation will be by Dr. Herbert B. Woolley of the National Bureau of Economic Research of New York. Dr. Woolley has served in the Department of State, and with the Foreign Trade Subcommittee of the Small Business Committee of the Senate. He is going to report to us on portions of his research entitled, "The structure of world trade and payments."

Dr. Woolley.

STATEMENT OF DR. HERBERT B. WOOLLEY, NATIONAL BUREAU OF ECONOMIC RESEARCH OF NEW YORK

Dr. WOOLLEY. Mr. Chairman, and members of the subcommittee, in response to the invitation to comment on the structure of world trade and payments, I have prepared a formal statement for inclusion in the record. It is confined pretty much to facts and goes more into detail than there is time for now. I propose to summarize the statement, and then make several comments on it.

(The statement of Dr. Woolley is as follows:)

OBSERVATIONS ON THE STRUCTURE OF WORLD TRADE AND PAYMENTS

(By Dr. Herbert B. Woolley, director, Study of Structure of World Trade and Payments, National Bureau of Economic Research)

Events intimately linked to our foreign relations have profoundly affected the level of economic activity in the United States and the character of our economic progress and stability especially as they have shaped decisions taken domestically. They cannot be disregarded by those concerned with the level of economic activity in the United States. To complete a circle of interdependence, those concerned with the economic policies of the United States must be concerned with their impact upon the rest of the world because of the great importance of the United

States in the world economy and the link betwen economic, political, and military events at home and abroad. So I am delighted to find a subcommittee of the Joint Committee on the Economic Report inquiring into the relevance of foreign economic policy to the growth and stability of the United States economy.

Because the United States cannot ignore the far-reaching and indirect effect of its policies and decisions on the world, the American people and their Government must have a more detailed and systematic understanding of the economic interrelationships among all countries of the world. We must understand thoroughly the ramifying effects of economic developments originating in the United States and elsewhere. Even more, to exercise the leadership in the free world which our great size and resources impose upon us, we must be in a position to assess the effect of developments and actions everywhere upon the political and economic strength of the free world. Accordingly we have set out to study the structure of world trade and payments at the National Bureau of Economic Research with this in mind. I would like to lay before you a few of the salient features of world economic relations which I believe should always be kept in mind in assessing economic policy alternatives.

1. Economic relationships in the free world radiate to and from three main centers

Trade among free world countries focuses on three major centers of economic activity. Practically every country outside the Soviet bloc can be identified as principally interested in either the United States, the group of continental European countries which participated in the Marshall plan, or with the United Kingdom or other sterling area country. In their turn each of the three market centers can be identified as principally interested in the countries that are principally interested in them. Japan is difficult to fit into this scheme and 2 or 3 other lesser countries do not fit in too nicely. Nevertheless the three-bloc scheme holds as a generalization.

The proportions in which countries have traded in recent years with world areas reveal their principal trading interests. We arrayed 81 countries in 3 lists according to the descending order of the proportion of their exports or imports traded (*a*) with the United States, (*b*) with the sterling area, and (*c*) with continental countries participating in the Organization for European Economic Cooperation (OEEC) in 1951. There was not one instance of a country high up on more than 1 of the 3 lists. None of the 81 countries both sent a high proportion of exports to one of the major economic centers and secured a high proportion of its imports from another. Countries sending a high proportion of exports to a center also tended to show a high proportion of imports from the same market.

A line across each list at the level of 30 percent of exports or imports cutting out countries with smaller trading interests from each list pretty well divided the 81 countries into 3 fairly distinct groups according to their principal trading interest. In no case did a country appear on all 3 lists as conducting 30 percent or more of its exports or imports with 1 of the 3 major markets and not as much as that with either of the other 2 or any other of the 13 world areas.

Two countries were not on one of the three lists—the United States and France. The United States secured over 50 percent of its imports from countries of the Western Hemisphere and sent them over 40 percent of its exports. Clearly its principal trading interest is with Canada and Latin America. France had its heaviest trading interest in the franc area, its next most important interest on the Continent, and a strong interest in the sterling area as a source of imports.

The remaining 16 countries were in the somewhat ambiguous position of trading 30 percent or more of exports or imports with more than 1 of 13 areas. On further study all but Japan could be identified as principally interested in 1 of the 3 main markets. For example, Yugoslavia secured 38 percent of its imports from the United States and traded 56 percent of its exports and 39 percent of its imports with continental OEEC countries. Its trade with continental EPU countries is so much heavier than with the United States that we are justified in considering that Yugoslavia has its principal trading interest with the continental OEEC group. The same kind of evidence permitted identifying most of the other cases with 1 of the 3 principal economic centers, and for a handful of other countries financial interests could be adduced to determine their basic orientation.

Japan's situation is particularly difficult to assess. The proportion of its trade with the sterling area was somewhat heavier than with the United States, but Japan has not been able to tie in with 1 of the 3 main centers. A large part of its current earnings in 1951 accrued in dollars from invisible transactions associated with the occupation and the Korean war. It had a heavy stake in trade both with the United States and with the sterling area. But its dollar availabilities depended greatly on temporary factors. Its exports went mainly to the sterling area in 1951—a time of a seller's market, but the sterling area has shown great reluctance to encourage Japanese hopes for expanding sterling earnings as its temporary dollar earnings declined. I very tentatively count it as principally interested in the sterling area feeling that in the long run it might work out a basis for trading with that area.

A single year's trading is actually enough to reveal the basic pattern of principal trading relationships so stable is it from year to year. However, we also examined the proportions in which countries traded with different areas in 1950, 1952, 1953, and 1954 where possible. Individual proportions differ slightly from year to year, but the broad picture for the other years was the same as in 1951. Only in 1 or 2 marginal cases did later information indicate a different orientation than appeared in 1951. Principally interested in the United States are the Philippines, Israel, Saudi Arabia, Liberia, Netherlands Antilles, and all Western Hemisphere countries except the River Plate countries—Argentina, Uruguay, and Paraguay; the United States reciprocates, being principally interested in the Western Hemisphere as a trading partner. Principally interested in continental OEEC markets are Yugoslavia, Spain, Iceland, Argentina, and Uraguay, Egypt, Syria, Lebanon, and the OEEC countries themselves and their dependencies (excepting the Netherlands Antilles). I include France as oriented toward continental OEEC countries with the reservation that its trading interests in French overseas territories are prior. Countries in the sterling area (except Iceland), the Sudan, Iran, and Ethiopia in the Middle East, and in the Far East Indonesia, Thailand, and (possibly) Japan are principally interested in the sterling area market and most of these focus on the United Kingdom itself. The United Kingdom reciprocates with a principal interest in the rest of the sterling area. The Communist countries form a fourth trading bloc in the world.

2. Estimates of current transactions between world areas in 1951

The orientation of countries toward the principal market areas and secondary trading interests is reflected in the pattern of current transactions between world areas in 1951 set forth in table 1. Five broad divisions of the world are distinguished in the table: the sterling area, the nonsterling EPU area, the United States and Canada, Latin America, and "other" including transactions of the free world with the Soviet bloc. This is not exactly the division of world area I would like to have made, but it is the one which most closely approximates a common denominator for the regional scheme employed in the published balance of payments statments of all countries. "Other" includes countries oriented toward each of the three main centers; Latin America includes the River Plate countries principally interested in the Continent; Iceland is in the sterling area although mainly trading with the Continent; and the Netherlands Antilles is in the nonsterling EPU area although its main activity is refining Venezuelan crude oil for British and American oil companies and most of its imports are from the United States.

Analysis of the reports of countries of transactions between world areas indicates that current payments (debits) in 1951 were reported somewhat more fully than receipts (credits). I have made up table 1 mainly from the information given on the paying side of transactions being guided by creditor reports, particularly by the United States and Canada. Using debit figures avoids the possible double counting of freight and insurance payments and Government purchases which might result from taking transportation and Government transactions from the debt side (where they are best reported) and combining them with merchandise credits. It also provides a basis for estimating the gross goods and service transactions of some areas including countries which report only net transactions—for example the United Kingdom reports only the net balance of overseas transactions of its shipping, insurance, and oil company transactions. By taking figures on the paying side, however, we tend to show the country originating goods as receiving payment when in fact some middleman country may have interposed.

In spite of limitations and the preliminary character of table 1 it provides the first accounting ever given of the exchange of currently produced goods and services between world areas in a recent year, and in broad features the gross trade between the areas shown cannot be far wrong. Current transactions of the free world amounted to $97 billion. Not including gold sales, merchandise makes up $75 billion and services $22 billion. The sterling area, nonsterling EPU countries and Western Hemisphere countries each made close to 30 percent of the total of payments (debits) and a little more than 10 percent was made by "other" (only a small fraction by Soviet bloc).

About 1 percent of the debit total could not be allocated to partner receiving payments or enjoying credits. That 1 percent is concentrated in the debit transactions of Latin America and "other," representing about 3 percent of the total by each; 1 percent of nonsterling EPU debits are not allocated by area credited; an insignificant proportion of sterling area debits and none by the United States and Canada.

TABLE 1.—*Merchandise and service transactions between world areas in 1951*

[Millions of dollars]

Receiving area (credited)	Paying area (debited)					
	All	Sterling area	Nonsterling European Payments Union [1]	United States and Canada [2]	Latin America	Other
All areas	97,262	27,276	28,464	20,821	9,795	10,906
Unallocated	1,088	95	334		324	335
All allocated	96,174	27,181	28,130	20,821	9,471	10,571
Sterling area	25,240	12,315	5,116	3,824	923	3,062
Nonsterling European Payments Union [1]	26,623	5,611	13,635	3,044	1,766	2,567
United States and Canada [2]	24,427	4,542	4,469	6,971	5,597	2,848
Latin America	8,935	1,089	2,182	4,405	765	494
Other	10,949	3,624	2,728	2,577	420	1,600

[1] Includes European Payments Union.
[2] Includes international agencies located in the United States

But for the other 99 percent of world's trade we are able to indicate the pattern of transactions between world areas.[1] That $96 billion was received (credited) to areas about in the same proportions as it was paid (debited). Each of the five world areas covered a high proportion of its current debits from current credits or spent most of its current earnings for current goods and services. The net balance of each broad area with the world as a whole thus came to a small fraction of its total credits or debits.

The orientation of countries toward the three major markets can be seen in the table. Intrasterling area transactions accounted for 45 percent of allocated sterling debits and 49 percent of sterling area credits. Intra-non-sterling EPU transactions represented 49 percent of debits and 51 percent of credits of the area. Taking the United States, Canada, and Latin America together we have intra-Western Hamisphere trade accounting for 59 percent of Western Hemisphere debits and 53 percent of Western Hemisphere credits. Within the Western Hemisphere, United States, and Canada had a little more than half their debits and credits with the Western Hemisphere, and Latin American debits and credits are half or more with the United States and Canada. Transactions of "other" spread out over the 3 main markets as might be expected from the inclusion in the group of countries oriented toward each of the 3 major economic centers. If a clean-cut grouping could have been made following the orientation of countries to the three main centers, leaving the Soviet bloc as a fourth area, we could have expected to see even higher proportions traded within interest groups.

[1] Transactions excluded are those in gold (monetary or nonmonetary), in military aid items, between Soviet bloc countries, and between United States and its possessions. Included are some but not all transactions between overseas territories of Western Europe and their respective metropoles. Notably omitted are travel, investment income, government, and miscellaneous service transactions between France, Portugal, and Spain and their respective overseas territories. Accounts of the U. N., IMF, and IBRD are included with the United States and Canada and the EPU account is included with nonsterling EPU countries.

In contrast to the evident concentration of transactions to and from the three main centers, transactions between Latin American Republics and among "other" countries (including transactions between and among independent, nonsterling countries of the Middle East and Far East) are at a much lower level. They are clearly of secondary interest to countries in the areas in question.

Secondary trading interests of sterling area in nonsterling EPU (mainly with the Continent) and United States and Canada (mainly United States), of nonsterling EPU countries in the sterling area and United States and Canada, and of the United States and Canada in the other two major centers also are manifest in the table.

3. Contrasts in the structure of trading relationships within interest groups

The strong trading and financial ties of each of the countries principally interested in the United States run to the United States itself.

While most of the countries principally interested in the sterling area similarly have their strong trading or financial ties directly with the United Kingdom, several are considered interested in the area because of trading ties with some other sterling area member. The trading relations of the Far Eastern countries in the group are dominantly with each other. Burma, Ceylon, India, Pakistan, the Malayan dollar area, Hong Kong, Indonesia, and Japan trade heavily with each other, and it is the combination of trade in currencies linked to sterling which justifies counting these countries as principally interested in the sterling area. Singapore and Hong Kong are British entrepot centers in the area serving as distributing points for British merchandise and as collecting points for primary goods marketed by British merchants elsewhere. British commercial firms and banks operate extensively in all the commonwealth and colonial territories, so that it is not easy to draw a boundary marking off trading ties with the United Kingdom from those of other parts of the sterling area.

The group of countries principally interested in the continental OEEC market stand in sharp contrast with those oriented toward the United States and those oriented toward the United Kingdom. Except for the overseas territories whose trading ties run heavily to the mother country, the trading interests are with the whole group, not so much in any particular country. The proportion of any country's trade with a single continental country is always small, frequently smaller than its trade with the United States or United Kingdom, but as it trades small proportions with several countries in the group the total adds up. This characteristic applies to each continental OEEC country. The trading interests on the continent spread out in a network. It is this network of interdependence among the continental OEEC countries which underlies and in large measure explains the success of the cooperative approach to promoting European recovery, particularly through the formation of the European Payments Union and the liberalization of trade restrictions within the group. Every one of the continental members of OEEC in 1950–52 and also in the prewar years 1937–38 had 30 percent of its exports or imports with the group as a whole (France can be included only if we add French overseas territories to the group or consider only French trade outside the franc monetary area). Each continental member of OEEC thus had a strong and direct interest in the economic recovery of the group as a whole. Western Germany, Austria, Greece, Belgium, Switzerland, and Yugoslavia had 50 percent or more of either exports or imports with continental OEEC countries in 1951 (and also in 1950–54[2]).

While the continental countries do not concentrate their trading interest on a single country in the group, it is possible to observe a tendency for countries to divide pretty much as they trade more or less heavily with Western Germany or the United Kingdom. Because of the late return of Germany to world markets, the relationships can best be seen in figures more recent than 1951, and I have worked with 1953 data.

If we focus on Western Germany as the rather imperfect center of the continental trading community, we see that countries next to or nearby Germany and down the Danube into the Balkans tend to trade rather more heavily with it than with the United Kingdom. The six countries making up the Coal-Steel Community—Germany, Netherlands, Belgium, Luxembourg, France, and Italy—form a group of countries with strong trading ties with Germany and each other. Four other countries—Austria, Switzerland, Greece, and Turkey—form a group of countries each trading 20 percent or more of exports or imports with Western Gemany in 1953 and substantially smaller proportions with the United King-

[2] Taking the middle of five figures.

dom. The Scandinavian countries in contrast all marketed 20 percent or more of sales in the United Kingdom (Denmark 41 percent) and Portugal traded somewhat less heavily with the United Kingdom, but still more than with Germany. Thus, while the principal ties of continental countries run toward the group as a whole, some have strong secondary interests in the United Kingdom. Although trading modestly with the United Kingdom itself, France and Italy secured 25 percent of their imports from the whole sterling area and the other four countries in the Coal-Steel Community also bought (and in the case of the Netherlands sold) 15 to 20 percent of their goods in the sterling area. Each of the continental OEEC countries has at least a 10-percent secondary trading interest in the sterling area. On its side the United Kingdom has a secondary interest in the continental market as a whole amounting to more than 20 percent of exports and imports quite dispersed over the whole group. The interlaced interests between the Continent and the sterling area made it sensible to bring the United Kingdom into the European recovery program and to link sterling into the European Payments Union.

4. Complementary and competitive relationships between world areas

Economic relationships among free-world countries thus define 6 groups of countries—the 3 major market areas—the United States, the Continent, and the United Kingdom (or other sterling area)—and the outside countries principally interested in them which we may call the affiliates of the 3 centers. The 3 economic centers, of course, include practically all the exporters of advanced manufactures in the free world. Canada, Japan, and (with respect to textiles) India are about the only other sources. Countries outside the 3 main centers concentrate on the export of more or less refined foodstuffs and materials (including petroleum). Free-world trade basically consists of an exchange of foodstuffs and materials from the affiliated countries for the advanced manufactures of the 3 main centers and, I might add, their shipping, insurance, return on capital, and other services.

This basic pattern of complementary trade between the 3 centers and their affiliates is complicated by 2 other features. The United States is not only a source of advanced manufactures; it also is a very important source of foods (and tobacco) and materials (including coal) to Western Europe and affiliated countries of all three areas. Moreover, countries on the continental fringe also are important suppliers of foods and materials: the Scandinavian countries of foods, forest products, and iron ore, as well as advanced manufactures; the Mediterranean countries of tobacco, olive oil, cork, citrus, and a variety of nonferrous metals (scarce ones like tungsten, mercury, and chrome and the more common ones like copper and zinc). Even in the industrial heart of Europe is found an important exchange of German coal for French iron ore, a trade basic to the Coal and Steel Community. Several of the OEEC countries, notably France Turkey, and Sweden, have exportable surpluses of cereals, and a variety of foods move from the Low Countries and Italy into Germany. Thus within the continental group and, I might add, between the Continent and the United Kingdom, there is a substantial trade in foods and more or less refined materials. In addition the United Kingdom and several continental countries are merchanting centers for the foodstuffs and materials which they buy (or which foreign branches and subsidiaries of their firms produce) mainly in countries affiliated with them but also bought from Latin America (e. g., Brazilian coffee and cocoa and Cuban sugar). Thus, trade between the industrialized countries of the world is not confined to trade in advanced manufactures; it is heavily a trade in foods, fuels, and more or less refined materials.

In the main the United States, the United Kingdom, and larger industrial countries on the Continent are rival suppliers of advanced manufactures to the rest of the world. They are also rival buyers in world markets of the foods and materials which the United States imports heavily. These foods and materials which both the United States and Western European countries buy are supplied by affiliates linked to each of the three centers, so that we must think of some affiliates in each group as being rival suppliers to the industrial centers, but for some reason or other finding one industrial center a better market than another. Thus Latin American coffee, cocoa, and sugar producers are rivals of producers of these things in Africa.

I do not know of any important food or material imported by the United States which Europe does not also import, but there are several which Europe imports and the United States does not; indeed, the United States exports some. For this last group of foods and materials the United States is a supplier in competition with some affiliates of the three main centers. Thus, in supplying wheat and cotton to the world, the United States competes with Canada, Mexico, Argentina, Brazil, Pakistan, Egypt, Australia, and New Zealand, and in supplying rice it rivals Burma and Thailand.

For completeness mention should also be made of the competitive relation (*a*) between Scandinavia, Canada, and Russia in supplying coniferous forest products to the Continent and (*b*) between the continental Mediterranean producers of olive oil and citrus in supplying Europe vegetable oils and fruits in competition with vegetable oils and citrus producers on the southern and eastern shores of the Mediterranean and also in Florida and California.

5. Determinants of the radical structure of world trading relations

With the United States, United Kingdom, and continental countries basically rival suppliers of advanced manufactures to the rest of the world and rival buyers of foods and materials from affiliates and with affiliates rivaling each other in supplying foods and materials to the industrial centers, how does it happen that trading relations produce the curious result that countries fall so neatly into three broad groups trading principally with each other? How are we to explain that the copper of Rhodesia and the Congo goes mainly to the United Kingdom and Belgium while the copper of Chile goes mainly to the United States? That the coffee of Latin America goes mainly to the United States while the coffee of Africa goes mainly to western Europe? That Canadian forest products come mainly to the United States while Scandinavian forest products go to the Continent and United Kingdom? On the other side, why do we see advanced manufactures (e. g., equipment) of the United Kingdom going mainly into the rest of the sterling area while those of the Continent go mainly to the Continent itself and countries outside the sterling area and the dollar area and while those of the United States go mainly to the Western Hemisphere?

I do not have a full answer to this question and am only able to suggest the directions in which an answer lies. Economic geography clearly plays an important part, but quite as important a part is played by the commercial and financial policies of governments, the structure of foreign investment holdings, and the structure of industrial arrangements.

That trading ties within the British Commonwealth and Empire are strengthened by tariff preferences is well known but not always well appreciated, and they have been reinforced (except with respect to trade between Canada and the others) by governmental management of sterling in the postwar era. Quite as important are the ties of enterprise and foreign investment which link the United Kingdom to the rest of the sterling area. Estimates I have made of the foreign investment earnings of the United Kingdom (including the earnings on overseas activities of their petroleum, shipping, and insurance companies which the United Kingdom does not report in its balance of payments as investment income) indicate that in 1951 close to half of the United Kingdom's earnings on foreign investment originated in the sterling area and earnings from outside the sterling area came mostly from three petroleum sources—Iran, Venezuela, and Indonesia. Information published by the Bank of England on United Kingdom overseas investments indicates that they are mainly investments associated with the production of foods and materials—in mining and smelting (including gold and diamonds), in petroleum, and in plantation agriculture (rubber, tea, etc.). Many other British overseas investments are in transport, communications, public utilities, and financial services, and these facilitate the movement of foods and materials from producing countries to markets in the United Kingdom and other industrial centers.

Similar ties of commercial policy, currency arrangements, and foreign investment link continental metropolitan countries to their overseas territories, and place rival suppliers either of foods and materials to the metropoles or of advanced manufactures to the territories at a competitive disadvantage, even as non-British (or nonsterling) rivals are at a disadvantage in the sterling area. At the present time the discriminatory trade liberalization within the European Payments Union strengthens especially the complementary relations among continental OEEC countries and sterling area countries to the disadvantage particularly of competing dollar sources of supply. Investment ties among the continental countries do not appear to be as strong as those between the United Kingdom and the rest of the sterling area, but about 40 percent of continental OEEC foreign investment income seems to have originated with other continental OEEC countries and this does not count investment income by France or Portugal from their overseas territories.

Whereas governmental policy in the guise of commercial policy, import licensing, and the management of inconvertible currencies, serves to tie one group of countries to the United Kingdom and sterling area and another group to the continental countries, countries oriented toward the United States are only in small measure affected by governmental commercial policy preferences. As far as I know these extend only to Cuba and the Philippines among countries outside the United States customs area.

The group of countries trading principally with the United States mainly do so because of private commercial reasons rather than because governmental arrangements make it preferable to do so. However, it must not be overlooked that United States investments in enterprises producing and exporting many of the foods and materials supplied in the other Western Hemisphere countries and Eastern Hemisphere countries in great measure determines the direction of the flow of these foods and materials to the United States rather than, say, to Europe. Thirteen United States imports in 1952–54 from Latin American countries (excluding Argentina) and Curacao (Netherlands West Indies) accounting for from 83 to 89 percent of all items from that source were coffee, petroleum, cane sugar, copper, cocoa, lead, iron ore, bananas, zinc, tungsten, wool, tin, and manganese. Except for coffee, cocoa, and wool, every one is the product of foreign enterprises in which Americans have invested heavily. Similarly, 13 items from Canada accounting for 71 percent of all United States imports from Canada in 1954 were newsprint, paper-base stocks, sawmill products, nickel, grains (imported for milling in bond for reexport), aluminum, fish, copper, asbestos, zinc, meat products, lead and iron ore. I do not know about grains, fish, and meat products, but all others are products of industries in which Americans have invested heavily in Canada. The Commerce Department has estimated that in 1946–50 "about a quarter of the goods then imported by the United States was supplied by United States controlled enterprises abroad." [3] As the total includes sizable amounts of wool, rubber, and tin from the Far East in which the United States does not have particularly large investments, I would suspect the proportion from Western Hemisphere sources supplied by United States-controlled enterprises was much higher.

The mutual trading advantages linking countries in three interest groups thus appear to reflect partly natural geographic advantages, partly governmental commercial policy and financial (currency) arrangements and partly private investment interests. I would also add the structure of international industrial arrangements. The grouping of countries into three blocs according to their principal trading interests and the concentration of each center on supplying its affiliates in many ways parallels the characteristic international private cartel agreements on advanced manufactures dividing world markets in the interwar period. Under those agreements, especially those based on an exchange of patents and technology, the British Empire—the home market, colonies, and dominions except Canada—was generally reserved to the British company or group. If not reserved, at least British interests were accorded a dominant position. North and Central America and United States possessions were generally reserved to the American company or group, but sometimes Canada was shared with the British group. National continental markets and their associated overseas possessions were usually reserved to the respective national companies if there were any; Germany secured in addition dominance in eastern and central Europe, and France exclusive rights in the franc area. Japan usually secured rights to the Japanese Empire. This left the less industrialized European fringe, South America, and a scattering of rather unimportant markets in the Middle East and Far East as nonexclusive territory. Frequently the larger South American mar-

[3] Foreign Investments of the United States, Department of Commerce, 1953, p. 2.

kets became the subject of sharing arrangements or joint-participation enterprises.[4]

6. Shifts in the trading pattern, 1937–54

Trading ties between the three economic centers and their respective affiliates have been considerably strengthened by World War II and events since.

Major wars have always modified the pattern of world trade. World War II was no exception. Interruption of supplies from Europe gave new industries in Latin America, the Far East, and Oceania a start, and postwar shortages (and considerable protection) have strengthened their position. Populations have increased and moved to the cities to man new industries, cutting into exportable supplies of foodstuffs. Industrialization also has cut into exportable supplies of materials and sometimes has even produced a demand for net material imports. It has usually increased the need to import fuels. The prewar complementarity between industrial Europe and many customers across the seas has been weakened as new industries, for example in Latin America and India, have come to meet local requirements and preempt local food and material supplies. Much of Europe's postwar economic problem has stemmed from an inability either to forestall or reverse this development by offering other countries a better alternative or to adjust to it rapidly by shifting resources into the production of the new things these countries want.

The war brought high levels of employment to the United States, and with continued expansion the United States has been a much better market than before the war. Indeed the growing costliness of domestic materials has prompted United States firms and the United States Government to seek out new supplies abroad and much of the outflow of capital from the United States since the war has been connected with expanding the supply of foreign materials for American use. Likewise, the United Kingdom has concentrated its new foreign investments in the outer sterling area in an effort to develop new supplies of foods, materials, and fuel.

Countries in Eastern Europe and parts of the Far East have fallen under Soviet control with the consequent redirection of their trade away from nearby partners. This meant a redirection in the supplies of foods and forest products available to Western Europe and Japan which have had to seek alternative sources. North America has provided the only ready and elastic supply since other suppliers in the free world have been directing their energies to industrialization, unwilling to risk greater commitment of resources into expanding food and material supplies for the highly uncertain European market.

When we compare the pattern of trading in 1954 with 1937 we see a broad shift toward increasing trade with the United States. A little over half the countries of the world for which figures are given by the International Monetary Fund in International Financial Statistics (34 out of 53) show a larger proportion of their exports to the United States and Canada in 1954 than in 1937 and an even larger number show the share of their imports from the United States and Canada increased (38 out of 53).

The relative growth of trade with the United States more frequently has characterized countries principally trading with the United States or with the Continent than with the sterling area. There are about as many countries with a

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[4] The division of markets by the incandescent electric lamp cartel (Phoebus) provides an example. The cartel distinguished three types of markets: home markets, British overseas empire (including dominions except Canada), and common territory. Home markets were reserved to each member. The British overseas empire was left dominantly to the British firms with lesser shares given Dutch, German, Hungarian, and American firms. North America (including Canada), Central America, and United States possessions and dependencies (except the Philippines) became the exclusive territory of the United States cartel member. The sales territories of the continental producers were:

German: Germany and a share of Austria, Italy, Spain, and the British overseas empire.

Dutch: Holland and Belgium in their territories, a share of Italy and Spain, and junior participation in the British overseas empire.

French: France and overseas territories and a share of Spain.

Hungarian: Hungary, and shares of Austria, Italy, and British overseas empire.

Japanese: Japanese Empire.

The remaining common market was mainly in the unspecified European countries and South America. The German firm had preferred patent rights in Scandinavia, Central and Eastern Europe, the Balkans, and Turkey, and with Dutch and Hungarian producers had practically all the common European market. In Argentina several producers—United States, German, Hungarian, and Dutch—sold through a joint subsidiary.

The Phoebus cartel is summarized by George W. Stocking and Myron W. Watkins in Cartels in Action (Twentieth Century Fund, New York, 1946, pp. 335 ff.).

decreased share of trade with the United States and Canada among sterling-oriented countries as with increased shares.

The shift of trading ties toward the United States by the Western Hemisphere countries has been spectacular. Without exception Canada, the Philippines, and the 17 Latin American Republics not located on the River Plate secured a larger proportion of their imports from the United States and Canada (which, of course, means mainly the United States) in 1954 than in 1937. In half the instances the United States and Canada increased their share of the market by a third. (Of course, where the United States had a preponderant prewar position a large percentage increase in its share was not possible.) The shift toward trade with the United States was so great that in 15 of 19 instances imports from the United States and Canada rose to 60 percent or more of the country's total in 1954. All but 4 of the 19 increased the proportion of their exports going to the United States and Canada (the 4 were Cuba, Honduras, Nicaragua, and the Philippines). Half or more of the other countries increased exports to the United States and Canada so much more than to other destinations that the share taken by the United States and Canada increased 40 percent or more, and by 1954 for 12 out of 19 countries the United States and Canadian share of exports was 60 percent or more of the total.

The great increase in the participation of the United States and Canada in the trade of countries trading principally with the United States has been accompanied by a general decline in the proportion of their trade with Western Europe. With few exceptions both the exports and imports of these countries have gone to and come proportionately less from the Continent and the United Kingdom. Notable exceptions are the relatively greater exports of Cuba to the Continent and sterling areas and Philippines to the Continent.

For all Latin American countries taken together we find for the latest year for which IFS gives figures (1953) that the proportion of exports to the United States and Canada had increased 33 percent from 1937 and the proportion of imports 34 percent while the proportions going to and coming from continental EPU countries dropped by 31 and 34 percent; proportions of trade going to and coming from the sterling area dropped by 43 and 45 percent.

The great shift in Western Hemisphere trade toward the United States is matched in the United States trade record by a 50-percent increase in the proportions of both imports and exports (apart from military aid) traded with the Western Hemisphere. In the record of trade by continental EPU countries it shows up as a 40-percent decline in proportion of imports from Latin America almost offset by an increase in proportion coming from the United States and Canada (1953) and a slightly smaller proportion of Continental exports going to Latin America; the United Kingdom trade record shows a sizable drop in the proportion of both imports and exports traded with Latin America.

Within the group of countries principally interested in the sterling area, the pulling power of the United States market has been much less. Indeed 10 independent sterling area countries (including Iceland but also the large ones) sent a smaller proportion of their combined exports to, and drew a smaller proportion of their combined imports from, the United States and Canada in 1954 (or 1953) than in 1937. This was also true of United Kingdom trade with the United States and Canada. The United Kingdom also shows a considerably greater dependence on other sterling countries as sources for imports and outlets for exports. IFS does not give figures on the proportions in which British overseas territories distribute their trade, but the trade records of a number of important colonies indicate that between 1937–38 and 1950–52 the imports of British colonies (including Malaya) generally tended to come relatively more from the United Kingdom. However, exports of 10 important colonies in as many instances tended to be sold relatively less to the sterling area in the postwar period as more. One striking shift in exports by a sterling country has been by Burma—a shift of rice exports from India, Ceylon, and Malaya-Singapore to Japan and Indonesia. This shift reflects the breakdown of the customs and currency unit linking Burma and India in the prewar period and the postwar effort of India to become less dependent on imports of rice. Ceylon's well-publicized swap of rubber for Chinese rice has expanded the proportion of its trade done outside the three main centers while its trade with the sterling area has fallen in proportion.

The outer sterling area countries generally seem to be directing a greater proportion of their exports to promising markets outside the area; but the United Kingdom has maintained its position as a supplier in the independent sterling countries and has increased its role in the colonies. This favorable outcome may, of course, be connected with the heavy investments which the United Kingdom has made in the outer sterling area since the war.

The United Kingdom has succeeded in emerging from the war with its principal trading relations pretty well intact. Only a couple of countries (Bolivia and Denmark) which before the war directed principal trading relationships toward the United Kingdom have so shifted their trading relations as to be principally interested in another major center. However, Argentina, Uruguay, Egypt, Finland, and Iceland are countries which previously bought a sizable part of imports from the sterling area and in the postwar period (1954) tended to buy a much smaller proportion from sterling countries. Argentina and Uruguay have shifted toward Latin American sources, Egypt to the Continent and United States, Iceland to the United States, and Finland toward the Soviet bloc. The United Kingdom has sought to recover the situation by directing a greater part of its energies toward its own overseas territories and the preference markets of the sterling area.

France and Portugal give evidence of having done much the same. France in 1954 sent considerably smaller proportions of its exports to the Continent, United States, and sterling area than in 1937 and expanded its reliance on the market in overseas France. It also bought relatively less from the United States and Canada and Continent than prewar, but relatively more from the sterling area. Portugal also traded relatively more with its overseas territories and exported a smaller part to the continent and sterling area and bought a smaller part from the sterling area and United States and Canada. However, its exports to the United States and Canada were a larger share of its total in 1954 and it imported a somewhat higher proportion from the Continent in 1954.

Otherwise only Switzerland and Turkey, among continental EPU countries, traded a smaller proportion of their total with other continental EPU countries in 1954 than in 1937. All other continental EPU countries in 1954 were selling and buying on the Continent more heavily than in 1937.

The disruption of East-West trade on the Continent particularly affected Germany, Greece, Austria, Switzerland, Yugoslavia, and Turkey each of which traded 10 percent or more of its prewar imports or exports with what now is the Soviet bloc in Europe. Where foods had come from the East, the deficit has tended to be replaced by imports from the United States and Canada. None of these countries secured as much as 10 percent of its imports from the United States and Canada before the war but in 1954 every one except Turkey (a food surplus country) imported more than that. In the other direction, Finnish reparations obligations have taken a sizable proportion of its exports, and Finland has also increased imports from the Soviet bloc out of proportion to its total.

Out of the welter of shifts and changes this much stands out. The free world has tended to adjust to wartime disruption by developing more strongly the principal trading relationships between the three economic centers and their respective affiliated countries. The British Empire trading bloc has grown more closely knit excepting possibly the Far Eastern countries with recently won independence; the Western Hemisphere trading bloc is more closely knit, and so is the continental group.

At the same time centrifugal forces can be observed in the trading behavior of countries which gain freedom to make their own commercial policy. We see the Philippines expanding trade with the Continent. We hear that Indonesia seeks to establish direct trading ties with the United States (at a recent trade fair), we see Burma strike out for new markets in Japan and (more recently) Russia. The desire for betterment expressed through rising nationalism seeks to find a solution through developing new alternatives to buy and sell in new markets.

The observed shift in the structure of trading relations is a consequence in large part of the postwar economic policies of governments. The management of inconvertible currencies, commercial policies, investment policies, even the way in which United States foreign aid has been extended, have contributed to shaping the result. We must ask whether the pattern has been developing in a desirable direction with increased alternatives for traders around the world to buy and sell in the most advantageous market—particularly buyers and sellers in the economically weak and politically vulnerable underdeveloped countries specializing in the export of foods and materials—or whether government policies work in the direction of reducing those alternatives.

7. Interarea deficits and surpluses

To understand international economic relationships we must go beyond an examination of the structure of gross transactions to consider how trading relations emerge on balance. At the Bureau we are preparing an analysis of the network of interarea deficits and surpluses among the three major centers, their affiliates, and the Soviet bloc to show how the shifting pattern affects the financial position of the several groups. This work is still in progress. The light I can throw on the pattern of net deficits and surpluses among areas is confined to a single year, 1951, and presents the pattern of balances between the five areas distinguished in table 1.

Table 2 shows the net current balances between five world areas derived from regionally allocated transactions shown in table 1, the extent to which each current balance was financed by international transfers (government aid and private gifts), and the remaining deficit or surplus.

The level of current transactions paid by an area (table 1) generally is the same order of magnitude as its receipts from that partner. In only 2 instances out of the 10 pairs of areas does the debtor area's debits with a partner exceed its credits by more than 25 percent and in no instance more than 50 percent. Consequently, the net goods and services balances between areas derived from the allocated transactions in table 1 are the result of fairly small relative differences between credits and debits in the account of paired areas. We can thus be a good deal more certain of the pattern of gross transactions between world areas than of the net balances between them. Small errors in accounting for gross transactions carried into the net balance may change it considerably. While only 1 percent of all debits are unallocated, that 1 percent represents more than $1 billion earned somewhere. There is no reason to believe that these earnings are concentrated in particular areas (had there been a reason, they would have been allocated). It is plain, therefore, that the pattern of net balances derived from the allocated debits and credits is subject to considerable uncertainty. Since the unallocated debits represent payments by nonsterling EPU countries, Latin America, other, and to a lesser extent the sterling area, the true pattern of net balances for these areas seems likely to be somewhat less favorable than shown, and for the United States and Canada somewhat more favorable.

TABLE 2.—*Net balances between world areas in 1951*

[— = net credit of area at top and net debit of area at left. Millions of dollars]

Receiving area (credited)	Paying area (debited) All	Sterling area	Nonsterling European Payments Union [1]	United States and Canada [2]	Latin America	Other
Sterling area:						
Goods and services	−1,941		−495	−718	−166	−562
Private transfers	22		−21	43	2	−2
Official transfers	234		5	252		−23
Surplus or deficit [3]	−1,685		−511	−423	−164	−587
Nonsterling EPU: [1]						
Goods and services	−1,507	495		−1,425	−416	−161
Private transfers	173	21		128	24	
Official transfers	2,004	−5		2,052		−43
Surplus or deficit [3]	670	511		755	−392	−204
United States and Canada: [2]						
Goods and services	3,606	718	1,425		1,192	271
Private transfers	−335	−43	−128		−31	−133
Official transfers	−2,996	−252	−2,052		−17	−685
Surplus or deficit [3]	275	423	−755		1,144	−547
Latin America:						
Goods and services	−536	166	416	−1,192		74
Private transfers	4	−2	−24	31		−1
Official transfers	17			17		
Surplus or deficit [3]	−515	164	392	−1,144		73
Other:						
Goods and services	378	562	161	−271	−74	
Private transfers	136	2		133	1	
Official transfers	751	23	43	685		
Surplus or deficits [3]	1,265	587	204	547	−73	

[1] Includes European Payments Union.
[2] Includes international agencies in the United States.
[3] Represents gold and capital movements, interarea transfers, and residual error.

While considerable uncertainty attaches to the pattern of net balances on goods and services account between the five world areas, I am inclined to feel that the direction and general order of magnitude of the current trade balances are probably correctly stated in table 2. The "United States and Canada" and "Other" were in overall surplus while the other three areas ran net deficits with the world. The sterling area was in deficit with every area in 1951; the nonsterling EPU area in deficit with every area but the sterling area; "Other" enjoyed a surplus with both parts of the EPU (sterling and nonsterling) but ran deficits with both parts of the Western Hemisphere; Latin America enjoyed surpluses with every area except the United States and Canada; and the United States and Canada had a net credit balance with each other area. The relationships can be diagramed as in figure 1.

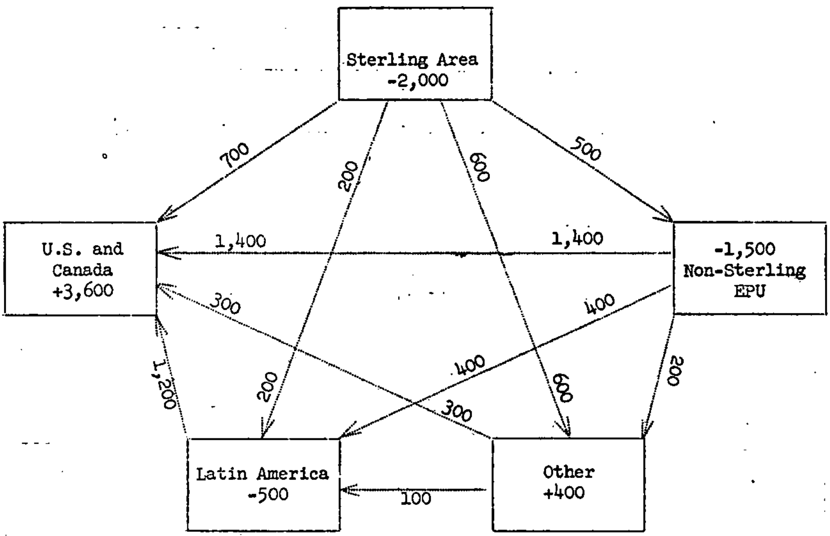
Since the net current balances in 1951 represent fairly small differences between much larger gross receipts and payments, the pattern of interarea balances may very likely change from year to year considerably. On this point I can only give a warning. The year 1951 was an unusual year and a year of crisis for sterling. We might anticipate that in other years the size and perhaps even the direction of the net current balance were different.

Part of the current deficits in 1951 were financed by private and official transfers—United States economic aid, contributions of the American Jewish Community to Israel, remittances of emigrants to the old country, and the like. Such transfers between countries, we have estimated, were almost $5 billion (gross) of which private transfers were nearly $1 billion and those of governments nearly $4 billion. United States Government aid was a little more than $3 billion; the balance is largely made up of counterpart returned to the United States and grants by international institutions (EPU and U. N. organizations)

Figure 1

The Pattern of Current Balances between Five World Areas in 1951
($ millions to nearest hundred million)

(arrow shows the direction of net debits)



which received contributions from the United States and other countries and in turn dispensed grants. To deal with transfers through international agencies we have combined the account of the EPU with the nonsterling EPU area and that of the U. N. agencies with United States and Canada in table 2.

The Continent was the biggest beneficiary of (net) transfers in 1951; countries outside EPU and the Western Hemisphere, notably Yugoslavia, Japan, and Israel, received less than half as much but still over $1 billion. The sterling area received a little more than half a billion dollars, Latin America less than $20 million of Government transfers and about $50 million of private.

The pattern of current account balances in figure 1 is modified in important respects by international transfers. The two big aid-receiving areas (non-sterling EPU and other) turn from deficit to surplus with all areas and the United States and Canada. The sterling area current account deficit was not fully offset by aid in 1951.

The net surplus and deficits shown in table 2, to the extent they are not in error, were financed in 1 of 2 ways: By transactions in gold monetary or newly mined or by capital movements (including use of exchange reserves). In addition deficits of an area with one partner may have been met by a transfer of funds secured by the area from a surplus with a second partner area although in these days of inconvertible currencies such multilateral settlements are limited and instead of transfers surpluses and deficits by an area may simply represent credit extended to one area and debt incurred to another. The sterling area produced close to $500 million of new gold in 1951, and this covered part of its deficit with the Western Hemisphere and other. Its deficit with the nonsterling EPU area was more than covered by credit extended by EPU.

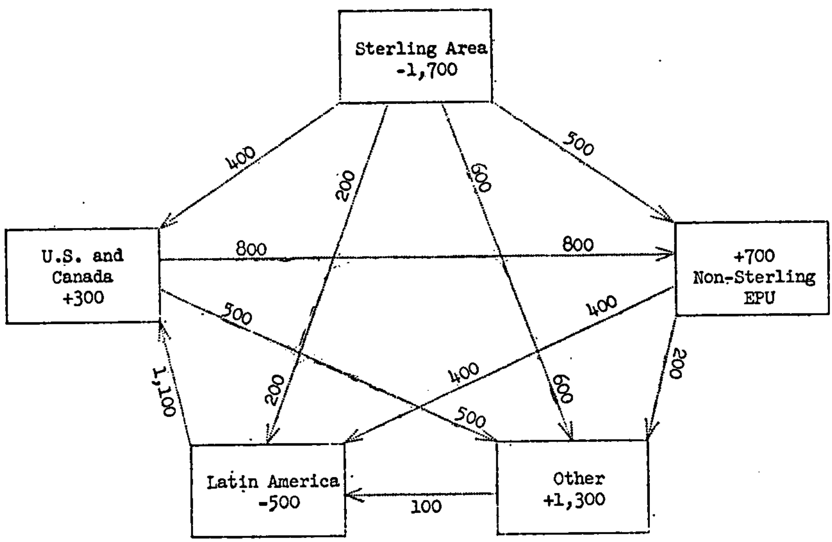
The pattern of interarea surpluses and deficits after aid is given in figure 2 which shows nonsterling EPU able with United States aid to cover its deficit with the United States and Canada and have a balance exceeding its deficits with Latin America and other.

While revealing something of the broader features of the pattern of net balances between areas, the five-area scheme employed in table 2 does not reveal the triangular trades by which Canada employed surpluses with Western Europe to settle part of its deficit with the United States and by which parts of the outer sterling area drew on surpluses with the United Kingdom to cover deficits with the United States while another part of the sterling area ran a surplus with the United States and banked the proceeds in the United Kingdom. A really satisfactory analysis would bring out these features of the pattern of world trade and payments, and also reveal more of the nature of the capital and gold movements which covered the net surpluses and deficits.

Figure 2

The Pattern of Balances Financed by Gold and Capital Movements between Five World Areas in 1951
($ millions to nearest hundred million)

(arrow shows direction of net capital movement or gold flow)



Dr. WOOLLEY. Because the United States cannot ignore the far-reaching and indirect effect of its policies and decisions on the world, we need to have a detailed and systematic understanding of economic interrelationships among all countries.

Accordingly, we at the National Bureau of Economic Research have set out to study the structure of world trade and payments. We have not completed our work, and the materials I present have not gone through the usual review process of Bureau studies. I make this presentation on my own responsibility and ask that the findings be considered preliminary.

Looking at the structure of world trade and payments in recent years, we find the trade of free world countries basically radiating to and from three main industrial centers.

Practically every country outside the Soviet bloc can be identified as principally interested in either the United States, the group of continental countries participating in the Marshall plan, or the sterling area, and most of these last are principally interested in the United Kingdom.

There are also important secondary relationships, notably between continental countries and the sterling area, among Latin American countries, in the Middle East, and in the Far East, but the dominant economic ties link each of the three centers to a set of countries which can be said to be principally affiliated with, or interested in, that center.

Thus, we must think of the free world as consisting of three trading systems. And then the Soviet bloc makes up a fourth.

This radial structure can be observed in the proportions in which countries trade with world areas. It just happens that most countries have a much higher proportion of their trade with 1 of the 3 main markets than with the other 2, or with any other area.

We do not find countries sending a high proportion of exports to one major economic center and buying a high proportion of imports from another. Countries sending a high proportion of exports to a center also tend to import a high proportion from there.

There are some more or less ambiguous trading situations, but these are found, on closer examination and considering financial interests as well as trade, to fit into the pattern.

In their turn, each of the three major markets is principally interested in the group of countries oriented toward it.

Japan does not fit well into the three-group scheme.

France fits into the three-group scheme only with the proviso that its most important relations are with the rest of the franc area. Apart from that trade, which might be considered internal for France, its principal trading interests are on the Continent.

The three interest groups are closely related to, but not coincident with, United Kingdom Treasury definitions for the dollar and sterling areas nor with the nonsterling countries clearing transactions through the European Payments Union. My groupings are broader and differ in some particulars.

Principally interested in the United States are four Eastern Hemisphere countries (the Philippines, Saudi Arabia, Israel, and Liberia), the Netherlands Antilles, and all Western Hemisphere countries except those on the River Plate (Argentina, Uruguay, and Paraguay).

Principally interested in the continental OEEC countries are Argentina and Uruguay in the Western Hemisphere, Iceland in the sterling area, Finland, Yugoslavia, and Spain in Europe, Syria and Lebanon in the Middle East, and the continental OEEC countries themselves and their overseas territories except Netherlands Antilles.

Principally interested in the sterling area, and for the most part focusing on the United Kingdom, are all sterling area countries (except Iceland), Sudan, Iran, and Ethiopia in the Middle East, and in the Far East Indonesia, Thailand, and (possibly) Japan.

The United States is clearly the focus of interest within the group of countries oriented toward it. The United Kingdom is less clearly the focus of countries oriented toward the sterling area, but then we must remember that British firms operate extensively throughout that area.

In contrast, the interests of countries oriented toward the Continent do not focus on a single country. Rather, small trading interests with many in the group result in a network of interdependence among members of the system.

It is possible to discern a division on the Continent between countries trading rather more with Germany than with the United Kingdom. The latter includes Scandinavia and Portugal. Countries next to or nearby Germany and down the Danube tend to trade rather more heavily with it than the United Kingdom, and the six countries making up the Coal-Steel Community form a group of countries with strong trading ties with Germany and each other.

Secondary trading relations between continental countries and the United Kingdom or outer sterling area are particularly strong.

One can see in the complex of mutual trading interests in Western Europe the fundamental reason for the successful application of a regional approach to the problem of European recovery.

Underlying the radial pattern, trade between countries consists fundamentally of an exchange of more or less refined foods, materials, and fuels supplied by affiliated countries for the advanced manufactures and services of the three centers.

Thus, the three major markets are rival buyers of foods and materials and rival suppliers of advanced manufactures while affiliated countries are rival suppliers of foods and materials and rival buyers of advanced manufactures.

The simplicity of this basic structure is complicated by the fact that the United States is also an important supplier of foods and materials rivaling some affiliates, and in a lesser way some continental countries also supply foods and materials rivaling some affiliates and the United States. Canada, Japan, and India are also sources of advanced manufactures in competition with the major centers.

We ask: How does it happen, in view of the complementary and competitive relations, that countries fall so neatly into three broad groups each consisting of a set of affiliated countries focusing on an industrial center? This question opens up a whole field of inquiry. I can only suggest that the answer lies (*a*) in the force of economic geography, (*b*) in the force of government commercial and financial policies, (*c*) in the distribution of foreign investments, and (*d*) in the structure of international business and industrial arrangements. The first two are pretty well known. Less well appreciated is the extent to which both United States and United Kingdom imports reflect the pattern of their foreign investments. These are heavily concentrated in industries producing foods and materials in the countries oriented toward the two centers.

It is also not widely appreciated that the radial structure of economic relationships strikingly parallels the characteristic international cartel agreements dividing world markets for advanced manufactures in the interwar period. Under those agreements the British Empire—except Canada—was generally reserved to British companies, North and Central America to United States companies—frequently Canada was shared with British firms—and continental producers found their main market among countries with principal trading interests on the Continent. French firms secured the French

Empire and Japanese firms the Japanese Empire. The remaining common market mainly consisted of South America.

The tendency for trading relations among free countries to concentrate on three main centers has been accentuated by the disruption of World War II and measures taken to recover. Contrasting 1954 trading patterns with 1937, we see a striking increase in the proportions traded by almost all Western Hemisphere countries with the United States and Canada and corresponding decreases in proportions traded with the Continent and United Kingdom.

The United Kingdom has shifted toward greater reliance on the rest of the sterling area, and the rest of the sterling area shows a tendency to buy more heavily from the United Kingdom. France and Portugal have tended to increase proportions traded with their overseas territories, but continental countries generally now trade more heavily with the group than before the war. Some continental countries have had to make up deficiencies in supplies from Eastern Europe by importing relatively more from the United States and Canada.

At the same time that principal trading relations have tended to be strengthened, centrifugal forces have been at work. Several countries, which before the war traded primarily with the United Kingdom and other sterling countries, have expanded trade in other directions. Important sterling countries send a larger proportion of exports to countries outside the area. There is some evidence that countries gaining freedom after the war have tended to broaden their trading relations, seeking to improve their economic position by developing new ties.

In the statement before you are two tables and figures showing the pattern of transactions between world areas in 1951. Because of the way countries publish balance-of-payments accounts, we have not been able as yet to show relations among the three economic centers, their affiliates, and the Soviet bloc as I would like. However, we can gain some insight into the structure of the world economy from them.

Table 1, page 7, gives preliminary estimates of goods and services transactions between 5 world areas in 1951. The areas distinguished are the sterling area, nonsterling EPU countries, the United States and Canada, Latin America, and other. While the fivefold scheme does not correspond exactly to the three major centers and their affiliates, we can see the dominance of trading within interest groups in the figures.

Current transactions within the sterling area are nearly half the payments and receipts of the sterling area; those within the nonsterling EPU area are a little more than half its totals; and transactions within the Western Hemisphere more than half the Western Hemisphere totals. Latin-American transactions are principally with the United States and Canada.

The extent of secondary relations between the sterling area, the nonsterling EPU areas, and the Western Hemisphere also show up in the table. Trade among and between countries in Latin America, the Middle East, and Far East is seen to be of minor proportions to those countries.

Table 2, page 29, shows the net interarea balance on goods and services account derived from table 1. Since each area covers most of its current payments to a partner by current earnings from the partner, net balances in total and between areas represent small differences between large aggregates. Hence small uncertainties in the pattern of gross transactions may produce relatively large uncertainties in the nets.

Still I believe we can be fairly confident of the size of each area's overall net balance on goods and services account as shown in table 2. Balances between areas are more uncertain. Yet the order of magnitude and direction of payments between areas in figure 1, page 31, are probably about right.

In 1951 sterling countries paid every other area; nonsterling EPU countries paid all but the sterling area; other countries paid Latin America and the United States and Canada; Latin America paid the United States and Canada; and the United States and Canada earned from all other areas.

Figure 2 on page 34 shows the pattern of balances after we take account of private gifts and government aid. Most such transfers in 1951 came from the United States and went to nonsterling EPU and other countries. They were sufficient to change the balance of those two areas with the world as a whole and also with the United States and Canada from deficit to surplus.

Net surpluses and deficits in table 2 and figure 2 represent gold flows, capital movements, multilateral settlements, and residual error.

The interarea pattern of net balances probably has changed considerably from year to year since 1951. Only small changes in the pattern of gross interarea transactions are needed to change net deficits into surpluses. The 1951 pattern should not be taken as generally characteristic of other years.

1951 is of interest as an account of 1 year and as an illustration of the kind of record we need to have for other and more recent years. I would also feel that we need a more illuminating record than this one. I would like to see the triangular relationships through which parts of the three trading systems developed surpluses in one direction to offset deficits in another. And I would like to see the capital movements, gold sales, and multilateral settlements which financed the net deficits and surpluses in figure 2.

As I have reflected on these features of the structure of world trade and payments, against the background of 10 years spent as a Government economist concerned with international commodity problems, commercial policy, foreign investment policy, financial problems, and trade analysis, I have been struck by the way they help to an understanding of a number of facets of our foreign relations. I shall comment on four.

1. The unique and asymmetrical position of the United States in the world economy and our concern with foreign events.

2. The appropriateness of the regional approach to current problems of various countries; in particular, the contrast between conditions in Europe and the Far East.

3. The impact of changing levels of economic activity on the world economy.

4. The importance of weighing the effect of alternative policies on the pattern of trading relations around the world.

1. Note the unique and asymmetrical position of the United States in the world economy. It is the largest single country and the focus

of 1 of 3 main trading systems of free countries. Yet it has reaped so fully the advantages of thrift, specialization, and trade within a wide and homogeneous internal market, has such a large gold reserve and strong competitive position in world markets, that it pays little heed to possible losses of international money. It determines domestic economic policies rather with regard to other conditions, quite unlike other countries. While other countries are greatly dependent on us, we are relatively little dependent on them.

We are concerned with foreign economic policy not because of our dependence on foreign supplies, nor because of our desire for foreign markets (though particular industries may find these important), nor because we look for further gains from trade, but because of our concern for the economic well-being of friendly nations and all that their well-being means for our military position and the prospects for peace.

Being such an important factor in the world economy, we have a special responsibility to examine the consequences of our actions for other countries.

Being relatively wealthy and self-sufficient, we are in a position to employ commercial and financial concessions to others, not to secure immediate gain for ourselves, but to secure such modifications in the trading arrangements among other countries as will gain for them many of the advantages we already have. For I have been impressed, in observing the structure of little national markets outside the United States, by the way in which the existing commercial and financial policies of other countries prevent them from reaping the advantages of specialization and trade we enjoy from our large, continental market.

2. This leads to a second observation. An understanding of the extent to which countries in Western Europe have concentrated their trading interests in one direction or another helps us understand the pull and tug of economic forces underlying the movement toward European integration or preventing one country or another from committing itself fully.

The movement for European integration centers on six countries with heavy trading interests in common. But the tendency for trade to focus on Western Germany, evident in recent figures, gives some governments pause, especially those with trading ties lying in other directions. French ties to overseas France, providing as they do protected markets for manufacturers and preferred supplies of foodstuffs and materials, would surely be weakened by integration on the Continent for it would open overseas France to competition from other continental suppliers and buyers.

Scandinavian ties, running more heavily to the United Kingdom than Germany, indicate why these countries are not active participants in the European integration movement. United Kingdom interests indicate the reason for its reserved position toward underlying European markets. With primary trading relations directed toward the sterling area but with a strong secondary interest spread widely throughout the Continent, the United Kingdom, even more than France, has not pushed moves, like customs unions, which would accord continental rivals an equal competitive footing in its preferential market. Instead it has sponsored measures like widening the transferable sterling area (which encourages continental countries to buy in the sterling area).

The success of European cooperation has prompted suggestions for applying the regional approach to other areas. But nowhere else in the free world can one find a repetition of the network of mutual trading interests in Europe. The trading ties of every other area—Latin America, the Middle East, and the Far East—are not principally within the group, but run toward one of the three main centers. This makes it very difficult to design workable regional currency and trading arrangements of the discriminatory European kind.

To attempt a solution of the Japanese problem by creating a yen area within which Japan would develop trading relations with other Far Eastern countries under protection of special trade concessions and an inconvertibile currency would seem to me highly doubtful of success and raise new problems.

Every other free Far Eastern country has its principal trading relations directed toward the United States or United Kingdom or other sterling-area country. To seek a preferential position for Japan in these markets would not be acceptable to other far-eastern countries nor to the centers with which they now mainly trade.

The great merit of discriminatory trade liberalization within Europe was that it expanded the area of competition within Europe. A regional bloc in the Far East carving out a protected market for Japan, rather than enlarging the opportunities for other Far Eastern countries to buy and sell, would, like the old coprosperity sphere, reduce them.

I would seek to fit Japan into the world economy rather by removing discriminations against Japanese goods everywhere. This would open up alternatives to buyers and sellers and spread the impact of Japanese competition widely.

3. The structure of relationships I have described helps us understand the impact on the world of changes in the level of activity in the United States and elsewhere.

The three trading systems of the free world contribute about equally to world trade as we see from table 1 of my statement. Changing levels of activity in any one of the main centers can affect the world economy quite as much as changes elsewhere, but they will affect sets of affiliates differently. Effects of a United States recession impinge most heavily on the group of countries principally trading with the United States. Affiliates of Western Europe may feel mainly the competitive effects of depressed markets in rival sources of supply in the Western Hemisphere. Quite possibly Eastern Hemisphere trade will continue high while stocks pile up in the Western Hemisphere. Industrial centers in Europe can even gain from a recession in the United States because of an improvement in their terms of trade with producers of foods and materials.

Because of the differential nature of change in the United States on various parts of the world, a United States recession can be offset in its worst effects on the Eastern Hemisphere by the maintenance of high levels of activity in Europe. The effort to do so, however, will tend to impair European exchange reserves unless dollar discrimination is tightened. So a United States recession provides a positive incentive for Europe and its affiliated countries to strengthen mutual commercial, financial, and industrial ties. This is the reason for Europe's determination to maintain the EPU intact even when European currencies become convertible.

The maintenance of high levels of economic activity in the United States is a necessary, if not sufficient, condition to making progress toward removing dollar discrimination and establishing the convertibility of European currencies.

And, with United States markets continuing strong, the centrifugal forces at work among countries more or less artificially linked to Europe will exert a continuing pressure on European governments to enlarge the opportunities for affiliates to buy and sell in the most advantageous markets. Authorities in the United Kingdom, Low Countries, and Germany have maintained positions this last year indicating their feeling that they have much to gain from placing their economies on a competitive footing with the United States.

4. The fact that European finance ministries avoided precipitous action in 1953–54 to widen the soft-currency trading area has been heartening, and strikes me as persuasive evidence that Western European governments now prefer international trade policies which will check the recent tendency of countries to form into more or less distinct trading blocs separated by government artifice from each other.

At the same time the tendency for principal relationships to strengthen since 1937 suggests that we should ask of new policies and proposals whether they would open up new alternatives for buyers and sellers, especially in certain countries now affiliated with the major economic centers to trade with other centers. A most important aim of United States and western policy, I think, should be to find means of widening the area of effective competition within which countries trade.

For a situation in which governmental and business arrangements attach countries to one particular economic center with little opportunity to buy and sell in other major centers is fraught with political danger.

Measures which increase competition between the advanced centers in supplying and buying in other countries are to be preferred to measures reducing the alternatives open to other countries. The European Payments Union and European trade liberalization were particularly meritorious in this respect. We should now look for moves to bring western European sellers of advanced manufactures more into competition with United States sellers in world markets everywhere.

Thank you.

Mr. Bolling. Thank you, Dr. Woolley.

Our next witness is Mr. Walter S. Salant, of the Brookings Institution of Washington. He has established an unusually high reputation among professional economists for his many excellent articles and studies appearing in various journals. In addition to his academic experience on both sides of the Atlantic, he has been on the staff of the President's Council of Economic Advisers.

Mr. Salant also has had experience with the Treasury, the Securities and Exchange Commission, the senior staff of the Secretary of Commerce, and as a consultant for the NATO.

Most recently at the Brookings Institution, he has been engaged in a study of the impact of imports on the economy and of the place of export trade. The Joint Committee on the Economic Report has lent its support in the provision of some of the statistical data from Bureau of the Census which were required to make this study. He is going to tell us about his findings now.

Mr. Salant.

STATEMENT OF WALTER S. SALANT, THE BROOKINGS INSTITUTION

Mr. SALANT. Thank you, Mr. Chairman.

I would like to say, first, that in this statement I shall be expressing my personal views, which may or may not be shared by the Brookings Institution, and I should also like to add that the research in which I am engaged consists to a considerable degree, or at least for a considerable part of the time, in manufacturing component parts. An assembled product is not obtained until a very late stage. Unfortunately, that stage has not been quite reached, so much of what I am going to say in this statement will not be a reflection of the work on which my time has been primarily spent.

My assignment, as I understand it, is to discuss the short-run domestic consequences of reductions of import barriers, including the dislocations to the domestic economy that they would cause, their effect upon exports, and the economic adjustments that they would require.

In discussing this I think I should say at the outset—and not repeat—that this is only one aspect of the problems at issue in connection with commercial policy, and that whatever conclusions one arrives at concerning a short-run effect will not necessarily indicate what policy should be when longer run issues are also taken into account.

In the public discussions of dislocations from reductions of import barriers, some extreme statements have been made by both protectionists and some freetraders, especially with regard to the effects upon employment. On the protectionist side, it has been said that a lowering of import barriers would create a major business depression.

On the other hand, some freetraders mention the beneficial effect of trade liberalization on our exports while failing to mention the possible adverse effects.

The wide range covered by statements such as these partly reflects confusion between various concepts of economic effects. It is important for clear thinking about this subject to distinguish between several such concepts, all of which are relevant to some policy question but each of which is relevant to a different one.

First, people may have in mind the effects of liberalization on total national production, employment, or profits. This concept of economic effects is relevant to the question whether liberalization would have a depressing effect on business activity, and, if so, how great the effect would be. To estimate this effect requires estimating the stimulating as well as the depressing effects and striking a balance between them.

Second, people may have in mind the effects only on the industries producing import-competing goods, but still assuming that everything unrelated to these reductions remains exactly the same.

A third concept is also relevant for some purposes: The total change of employment, profits, etc., in an import-competing industry over a period of time, taking into account not only the reduction of import barriers but other developments affecting the industry. For example, growth of the market would offset the adverse effects;

changes in tastes might aggravate them, and technological change might do either. So far as employment is concerned, moreover, whether import liberalization requires the actual discharge of workers in an import-competing industry depends not only on the net effect of the liberalization and other factors, but also on the rate of normal separations in the industry due to retirement, death, and other normal causes. Because of these separations, it is possible to reduce the labor force in an industry without actually firing anyone.

It is obvious that the net change in employment and the rate of actual discharging in import-competing industries, which depend not only on commercial policy but other factors as well, are more closely related to the human problems of an industry's actual hardship than the first two concepts I have mentioned.

I should like to consider first the question of total effects on the national economy.

During the past 10 years the economy has had to adjust to several substantial dislocations of a depressing character.

Our experience with these adjustments indicates that, so far as aggregate effects on the economy as a whole are concerned, a substantial decline in one area of expenditure—of something of the order of seven or eight billion dollars a year—need not have adverse effects on the general level of prosperity. Whether it does or not depends on whether demand in other areas is rising. Our experience has shown that the increases in other expenditures that helped sustain the economy as a whole also helped reduce the dislocation or ease the adjustment to it for many firms and individuals. Where demand for labor in particular spots decreased on balance, workers were often able to find jobs elsewhere. I mention this partly to bring out the importance of mobility in the economy, but partly also to point out that mobility is useless unless there is some place for labor and capital to move to.

So far as a reduction of import barriers is concerned, it is sufficient to note at this point that it would take a very substantial reduction to cause an increase of imports of as much as $1 billion in a year. I do not know anyone who believes that such an increase would be possible under existing law. Moreover, it would give rise to at least some partially offsetting stimuli to exports. Making all allowances for possible reverberations through the economy because of further effects upon the income and spending of people in the industries affected, it is not possible for the effect on the level of total economic activity to be perceptible, let alone substantial. The net effect on the gross national product of the maximum changes possible under the present law would be less, I suspect, than the margin of error in our national income statistics.

This is not the dislocation problem with which people are most seriously concerned, however, and I have discussed it mainly in order to dispose of it. The fact that the effect on our economy as a whole would not be significant does not mean there are no problems. Dislocations would be suffered by specific industries, firms, individuals, and communities, which although not big enough to affect the national economy, are nevertheless the proper concern of Government policymakers.

I may help in identifying the areas of the economy primarily affected to outline briefly the nature and direction of the specific forces that are set in motion by a reduction in import barriers.

The first effect of such a reduction is to permit foreign products to be sold in the domestic market at a lower price, and to divert domestic purchasers from the domestic to the foreign product to some degree. The domestic industry may anticipate this shift by meeting the lowered prices at which the foreign goods are offered. In that case, the tendency toward the shift of buying from domestic to foreign goods may never become actual. The reduction of barriers will simply result in a reduction of the domestic price and profit margin and may leave unchanged the proportions of foreign and domestic goods that domestic buyers purchase. If the domestic market is sensitive to price reductions, more of both domestic and foreign goods may be purchased.

If domestic buying does shift toward the foreign product, there tends to be a decline in employment in the import-competing industries and their suppliers and an increase in imports. This is not the end of the chain of effects set up by the reduction of import barriers, however. We must also take into account certain other effects, of which the most important are probably the depressing effects induced by the changes in income of those who are engaged in the import-competing industries and their suppliers, and the stimulus to our export industries resulting from the increase of incomes and dollar earnings of those who supply the imports. The improvement in foreign countries' balances of payments may also encourage American investors to increase the flow of capital to these countries. If so, there would be additional stimulus to our export industries.

Some of the increase in foreign earnings might also be regarded as making possible a reduction of foreign aid and this might be regarded as permitting a reduction of taxes not otherwise possible. If so, there would be a further stimulus to the extent that taxpayers increased their purchasing.

Reverberations of changes in domestic incomes would be widely dispersed among the different industries of the economy. We may therefore concentrate on the import-competing industries and their suppliers and, later, on the export industries.

I should like to be able to give you some estimates of the effects on employment of some specified reduction of import barriers upon individual import-competing industries and upon the economy as a whole. It is impossible to estimate with much accuracy the effects of a specific program of reductions. We would have to know the nature and magnitude of a great many economic reactions that we do not know, not only in this country but in the rest of the world. In any event, such estimates would not be applicable to other programs of liberalization. I believe it is possible, however, to indicate the orders of magnitude of primary employment effects per million dollars of import increase. By "primary employment effects" I mean employment effects which occur independently of any changes in income, that is, the effects on the number of workers producing the goods with which the additional imports compete, not only in the final stages of their production but also in the domestic industries supplying goods and services for these final stages, such as raw materials and transportation, and also in the industries which in turn supply goods and services to these supplying industries. While I am not in a position yet to indicate the difference in these effects between given import increases for different protected commodities, I think it is possible to place a maximum figure on primary employment effects.

In industries producing goods and in those producing services mainly for commodity-producing industries, the average income originating per person engaged was $5,213 in 1953 and $5,232 in 1954. Among these industries, 75 percent or more of the workers and proprietors are in industries in which the average income originating per person exceeded $3,500. In none was the average below $2,500. These industry averages would nearly all be higher in 1955.

This fact makes it possible to develop a crude but simple test to see whether a figure given for the employment effects on import-competing industries and their suppliers of a given increase in imports is at least within the range of reason. This test consists of adding 25 percent to the assumed increase of imports, which in our trade statistics is based on values at foreign ports, to bring it approximately to a basis of values at domestic ports, and then dividing the resulting figure by the number of workers who are said to be displaced. The result is the implied average value added per worker. If it is below $2,500 the employment estimate is certainly too high.

Thus, if it were said that an increase of imports of $2 billion resulting from a reduction of import barriers would displace 5 million workers in import-competing industries, we can tell at once that it is absurd, because it would imply displacement of domestic goods worth about $2.5 billion, and would also imply an average value added per worker of only $500, which is outside the range of possibilities, especially for industries employing 5 million workers.

We can also use the minimum average value added per person to make our own rule-of-thumb estimate of the maximum primary employment effect of a given increase of imports due to a reduction of import barriers. Simply raise the import increase by 25 percent and divide by $2,500, or more simply divide the import increase by $2,000. This tells us that a $2 billion increase of imports could be equivalent to no more than 1 million workers.

Conversely, if no import figure is given we can tell, from the number of workers who are said to be displaced by a given proposal, the very minimum increase of imports that this number of workers implies, and consider the reasonableness of the resulting figure.

This rule of thumb makes many crude assumptions. I have tried to allow for their crudity by using figures which are extremely conservative, that is, which give maximum employment effect per dollar of import increase. I put this rule of thumb before you not because it has any great accuracy but because it may provide a useful and quick check of oral statements.

Please note also that this rule of thumb indicates only a relationship between employment and production. It can therefore serve only to check implied relationships between changes in employment and in imports due to changes in import barriers. It contributes nothing to answering the question "How large an increase in imports would result from a given program of reductions in trade barriers?"

These figures correspond to the second concept of employment effects which I mentioned in the earlier part of my statement. They represent the primary employment effects, that is, before taking account of any effects on production caused by changes in income in the import-competing industries or by changes in exports.

It is worth dwelling for a moment on the distinction between what are commonly called the "import-competing" industries, on the one hand, and their direct and indirect suppliers, on the other. The term "import-competing industry" is normally used in a narrow sense to refer to the industry that is in the last stage of the process of producing the goods with which the imports compete. This industry, however, may add little to the final value of the domestic product and may therefore employ only a small proportion of the total number of workers involved in producing the commodity. Most of the final value of the product may be added by other industries from which it purchases component parts or raw materials and most of the workers may be employed in them. These other industries, in turn, may also get supplies from still other industries. In such cases the employment effects in the industry at the last stage in the productive process will not be a large fraction of the total immediate employment effects.

The point can be illustrated by taking the case of motorcycles and bicycles. If a reduction of import barriers for these commodities were to reduce their domestic output by $1 million and if employment in them and their supplying industries fell in the same proportion as output, the primary employment decrease would be 171 employees. But only about 52 percent of them would be in the motorcycle and bicycle industry. About 24 percent would be in such industries as steel works and rolling mills, manufacture of tires and inner tubes, internal-combustion engines, metal coating and engraving, and even wholesale trade, and the remainder would be scattered through the rest of the economy.

The fact that a substantial portion of employment effects may be indirect, that is, in other industries which are immediate or even remote suppliers, is important in connection with such questions as who is hurt and whether the industries hurt are also being injured by other dislocations or are benefiting from offsetting expansionist influences.

To know the magnitude of the effect upon exports of an initial increase of imports of $1 million for any given commodity, we would have to know the nature and size of many reactions.

Will the increase in imports lead the Congress to reduce foreign aid and, if so, how great will the net rise of foreign dollar receipts be?

How much of their increased dollar receipts will foreign countries use to increase their purchases in the United States? Foreign countries have a wide variety of possible responses to those increases of earnings, owing to differences in economic structure, policies, or particular circumstances, for example, their desire for additional reserves or the percentage of capacity at which their economies are operating. For our purposes it is sufficient to note that insofar as any of the countries uses its additional export proceeds to increase its purchases from the United States, there is an employment-increasing effect here which partly offsets the employment-decreasing effect upon our import-competing industries.

I do not feel that it is possible to give reliable estimates of the ratio of increase in exports to the increase in imports. It is possible, however, to say something about which export industries would be most affected by whatever increase of exports does actually occur. If it is reasonable to assume that a country would use additional dollars to buy substantially the same goods it bought in 1953, we can get answers to such questions as: Which export industries would be most affected if the additional buying is done by country A and which if it is done by country B? Does it make much difference what countries do the additional buying?

It is probable that a substantial part of the increased buying would be done by the countries supplying the imports on which barriers are reduced. In that case, which export industries are stimulated would depend in great part upon which import barriers are reduced. With these considerations in mind your committee has had a tabulation made of the purchases in the United States in 1953 by each of 32 countries which were major suppliers of imports subject to barriers classified by industries which represent the last stage of fabrication of these exports. This tabulation shows that there were substantial differences in the pattern of commodity purchases made here by major suppliers of protected imports. It also shows that products of the categories "food grains and feed crops," nonelectrical machinery, chemicals, and transportation equipment were of greatest importance to these countries.

The production, sales, employment, and profit effects of increased exports, of course, will not be confined to the industries at the final stage of fabrication, but will occur partly in their immediate and remote suppliers, just as we found to be the case with import-competing industries.

Let us now consider what, if anything, can be said about the net effect of import liberalization and expansion of demand required for normal growth, first for the economy as a whole and then for protected import-competing industries.

Using estimates of the increase in the civilian labor force made by the joint committee's staff, it appears that markets would have to expand 1.5 percent a year to keep the unemployed percentage of the civilian labor force down to the 1955 level, at present output per man-hour and present hours of work. Their estimates of increases in output per man-hour in private industries, if applied to all civilian employment, would require a further market expansion of 2.7 percent a year. Thus it would require an expansion of markets of 4.2 percent a year to prevent the present percentage of unemployment from rising. This is equivalent to $16 billion at the 1955 level of total production. This, it should be noted, is a problem we face year after year, not just in 1 or 2 years.

The question I want to put is "How much more would markets have to increase if import barriers are reduced than they would if these barriers are not reduced?" I should think it unlikely that import barriers would be reduced in any one year enough to increase imports by as much as $500 million a year, but let us use this figure in answering the question. Assume also that the increase in exports resulting directly from the increased dollar earnings of foreign countries is only 40 percent of the increase in our imports, that is, it is only $200 million. This is a conservative figure. The net decrease of purchases would then be $300 million. Now, allowing for secondary effects twice as great as the effects which cause them, the total net decline of markets would be 3 times $300 million, or $900 million. Stated alternatively, on these assumptions the expansion of markets required to offset the aggregate effects of liberalization would add $900 million to the $16 billion, or about 6 percent, to the expansion that would be required in any event. This small addition to the necessary expansion would not occur every year but only in the years when the shift of demand from domestic to foreign products took place. It should also be noted that this figure relates to unilateral reductions of import barriers, not to reciprocal reductions.

It seems clear that, from the point of view of its effect upon the economy as a whole, the problem created by a reduction of import barriers could add very little to the normal problem created by growth of the labor force and rising productivity. If we solve the growth problem, the effects of import liberalization on the total economy would not be perceptible.

It does not follow from this conclusion, of course, that the expansion of markets accompanying normal growth of the economy would necessarily take care of the problems of the industries competing with imports, especially those concentrating on import-competing goods. They might or might not participate in the general expansion of markets.

I should first like to point out, incidentally, that changes in productive techniques are also not distributed uniformly over industry, and that the commodities adversely affected by a technical change may not participate much in the general expansion of demand. It is nevertheless true that the employees and capital displaced are likely to benefit from such expansion because it increases the alternative employment opportunities available to them.

Unfortunately, no positive and well-founded generalization can be made, so far as I know, about the extent to which protected import-competing industries, even in the narrow sense, have been participating in general economic growth, although the data necessary for valid generalization are available. It is sometimes said that the import-competing industries generally have subnormal growth or actual stagnation, but I have never seen the basis for such statements. Of course, many of the import-competing industries have been declining, but the impression that this is true of most of them arises, I suspect, largely from the fact that it is the declining ones, for example, briar pipes, fur-felt hats, and hat bodies, wool, that have complained most of foreign competition. Even the industries claiming injury from tariff reductions are not all declining industries. The main complaint of the watch industry, for example, has been that they have failed to share sufficiently in the growth of our economy. The chemical industry and the electrical manufacturing industry are also protected import-competing industries, and they can by no means be regarded as laggard in growth. Moreover, if the generalization is doubtful when applied to the industries at the stage of production closest to the competing import, it is much more doubtful when applied to their direct and indirect suppliers.

A second question is whether normal separations are low in the import-competing industries so that they will do little to mitigate the dislocations of employment. It is often said that workers in these industries are less mobile than others because they have special skills which are useless elsewhere, or because they are older, and that it is therefore more difficult to move them geographically or to retrain them. I know of no valid statistical basis for this generalization either.

A third statement sometimes made is that the import-competing industries are either more affected than other industries by other changes now going on in the economy, such as technological change, shifts in demand, etc., or are less able to adjust to them. Whether these dislocations themselves are greater in the case of these industries than in the case of other industries or not I believe we do not know. It clearly is true for some industries such as textiles, coal, and woolgrowing but how about chemicals, electrical manufacturing, or petroleum which are also protected import-competing industries?

While the problem of dislocation is not a serious one so far as the prosperity of the national economy is concerned, we can be fairly certain that some industries, at least, will suffer dislocations and, in addition, have difficulty in adjusting to them. The fact that others such as export industries may receive a stimulus from the same cause may be no consolation to the import-competing industries. This fact clearly does raise policy questions for the Government. I should like to suggest a number of these questions for the subcommittee's consideration.

First, I should like to remind you that dislocations are occurring every day as a result of technological change, shifts in taste, and many other causes. They are a normal part of the economic process. The problems raised by a reduction of import barriers are similar; they do not reflect an inherent conflict between the needs of the domestic economy and the needs of international economic policy, but, rather, the more general conflict between the security of the status quo of an individual or a firm or an industry and any change, whatever its cause.

The fact that specific dislocations occur every day does not of itself imply, however, that Government has no responsibility to avoid or prevent the dislocations that may result from its own acts, such as a reduction of import barriers. Some people argue that it is in the nature of business that it involves risks and that the Government need not be concerned. Others argue, or more often imply, that Government should not take the actions which will result in dislocations. It appears to me that if the Government is convinced that a reduction of import barriers would be desirable and would be in the general interest on other grounds, it ought not to refrain from reducing them merely because somebody would be hurt. At the same time, I believe it clearly has a responsibility to undertake the reduction in a manner that causes the minimum of hardships.

A second question is: Exactly what is it that the Government has a responsibility to protect? Here I mean to make the distinction between the protection of individuals and the protection of particular kinds of productive activity. It appears to me that in the general case, the Government has at most a responsibility to protect the position of individuals, for it is individuals who, in the literal sense, suffer hardship. I say that this is true in the general case because the interests of national defense are an exception; they may require the protection of a particular productive activity, such as manufacture of a particular type of product.

A third question is whether the Government ought to be concerned when only the relative but not the absolute share of a domestic industry in the total market for its product is being reduced. When an industry is simply not experiencing the expansion that it might have had if barriers had not been reduced, I doubt that it is suffering an injury against which the Government has any duty to give protection.

A fourth general question is how the natural factors helping to minimize the hardships can best be exploited. A number of possible answers to this question are implied in the considerations that I have brought forward in this statement. The factors of normal growth and turnover can be exploited by making reductions gradually. Growth alone can be exploited by selecting reductions which affect industries having rapid growth. Third, mobility can be exploited by making reductions in commodities in which the affected industries are likely to have the highest mobility, such as those having a relatively youthful labor force, or located in communities where there are other healthy industries. Fourth, the reductions can be concentrated on commodities produced by industries which suffer least from other dislocations. Fifth, limited administrative discretion may be given as to the effective dates of the reductions, with legislative instructions as to the factors that should be considered in using this discretion. It might be specified, for example, that the executive branch of the Government should consider the state of inventories of the industry, the condition of its order books, and the general business situation.

Finally, I should like to make the more general suggestion that in setting goals for the expansion of markets for domestic production we ought not to take into account merely the expected growth of the labor force and the expected increase in output per man-hour. We ought also to include whatever further expansion is required to offset the net employment decreases caused by policies that are regarded as desirable. The expansion of markets should be sufficient to employ people who are now producing goods that we do not want and people who are now producing goods that we could obtain more efficiently in other ways. In this way we would set our sights at levels that facilitate not only the employment of new members of the labor force and the reemployment of those displaced by technological improvement, but also the reemployment of those displaced by policy actions that are regarded as in the general interest.

(The complete statement of Mr. Salant is as follows:)

Statement by Walter S. Salant on Short-Term Domestic Economic Effects of Reducing Import Barriers

By way of identification, let me say that I am at present a member of the staff of the Brookings Institution, where I am working on a method of estimating the effects on employment of reductions of import barriers. I was a senior member of the staff of the Council of Economic Advisers from 1946, when it was first organized, until September 1952, and was in charge of the staff work on international economics. I left the Council in September 1952 to become a consultant for the Economics and Finance Division of NATO, where I helped prepare their annual review for 1952. In the autumn and winter of 1953–54 I acted as economic consultant to the Committee for a National Trade Policy; and in the spring of 1954, prior to joining the staff of Brookings, I was visiting professor of economics at Stanford University. So much for a summary idenification.

I want to say, also, that in this testimony I am expressing my personal views, which may or may not be shared by the Brookings Institution.

My assignment, as I understand it, is to discuss the short-run domestic consequences of reductions of import barriers, including the dislocations to the domestic economy that they would cause, their effect upon exports, and the economic adjustments that they would require.

In the public discussion of dislocations from reductions of import barriers, some extreme statements have been made by both protectionists and some freetraders, especially with regard to the effects upon employment. On the protectionist side, it has been said that a lowering of import barriers would create "a major business depression." One speaker said that workers will be thrown out of jobs in industries employing four or five million people. (He did not say, however, that four or five million people would be thrown out of work.) The adverse effect is often exaggerated and is usually treated as though it is the total net effect. Actually, it is not; offsetting favorable effects upon job opportunities must not be ignored.

On the other hand, some freetraders occasionally exaggerate or mislead in the opposite direction. They sometimes mention the beneficial effects of trade liberalization on our exports and on employment in our export industries while failing to mention at the same time the possible adverse effects on the industries that compete with imports. This tends to convey the impression that a reduction of our import barriers can be confidently counted upon to stimulate employment. Others admit that there will be some loss of jobs, but ignore or treat as unimportant the serious human problems that these losses would create.

The wide range covered by statements such as these partly reflects irresponsibility in the use of figures. But I think it also reflects confusion between various concepts of economic effects. It is important, for clear thinking about this subject, to distinguish between several such concepts, all of which are relevant to some policy question but each of which is relevant to a different one.

First, people may have in mind the effects of liberalization on total national production employment, or profits, resulting from the effect of liberalization on general business conditions. This is the concept of economic effects that is relevant to the question whether liberalization would have a depressing effect on business activity, and, if so, how great the effect would be. To estimate this effect requires estimating the stimulating as well as the depressing effects and striking a balance between them.

Second, people may have in mind the effects only on the industries producing import-competing goods but still considering only the difference between their position if import barriers were not reduced and what their position would be if import barriers were reduced but everything unrelated to these reductions remained exactly the same. An estimate of these effects requires estimating the effect of trade liberalization alone on the industries producing these goods and on their direct and indirect suppliers, without including the effects of other factors unrelated to liberalization that also might be affecting these industries at the same time, such as changes in popular taste, competition from new products, or changes of consumer income resulting from independently caused economic expansion or contraction.

There is a third concept which is also relevant for some purposes: The total change of employment, profits, etc., in an import-competing industry over a period of time, taking into account not only the reduction of import barriers but other developments affecting it. For example, growth of the market would offset the adverse effects; changes in tastes might aggravate them; and technological change might do either. So far as employment is concerned, moreover, whether import liberalization requires the actual discharge of workers in an import-competing industry depends not only on the net effect of the liberalization and other factors, but also on the rate of normal separations in the industry, i. e., turnover due to retirement, death, normal shifting to other industries, and other normal causes. Because of these separations, it is possible to reduce the labor force in an industry without actually firing anyone, simply by failing to replace those who leave in the normal course of events. If the required reduction in the labor force of an industry or firm is sufficiently small, it may be fully accomplished in this way. Thus, if a reduction of import barriers causes employment in the competing domestic industry to be 15 percent less than it would otherwise have been but factors unrelated to trade policy are tending to expand such employment by 5 percent in the same period, the actual reduction of employment will be only about 10 percent, and the percentage discharged may be still less.

It is obvious that the net change in employment and the rate of actual discharging in import-competing industries, which depend not only on commercial policy but other factors as well, are more closely related to the human problems of an industry's actual hardship than the first two concepts.

All of these concepts are useful, but they relate to different questions and therefore serve different purposes.

TOTAL EFFECTS ON THE NATIONAL ECONOMY

I should like first to consider briefly the question of total effects on the national economy. Perhaps the best way to get perspective on this question is to back away from the problem of import barriers and consider for a moment the economy's ability to adjust to dislocations in general, and the factors that influence this ability.

During the past 10 years, the economy has had to adjust to several substantial dislocations of a depressing character. The major dislocation—perhaps the most important to which the American economy has ever been subjected as a result of Government action—was the reduction of war expenditures at the end of World War II. In the short space of 2 years, the Federal Government's purchases of goods and services for national security purposes fell from $90 billion to about $20 billion.[1] In the first half of 1945, when the higher figure prevailed, the economy was working under forced draft. It was not necessary, therefore, for this entire decrease of expenditure to be offset by increases elsewhere in the economy in order to maintain high levels of employment by peacetime standards. Nevertheless, the increase in other expenditures that was required was a very large one. This increase did take place. As a result, the level of involuntary unemployment was quite low in 1947 and the adjustment was made with surprising ease, when looked at from a very broad point of view.

A second change began in the second quarter of 1947, when the various foreign-aid programs of the immediate postwar period began to run out and the Marshall plan had not yet begun. Foreign aid fell by an annual rate of $4.8 billion between the second quarter of 1947 and the second quarter of 1948. This decrease was equivalent to slightly over 2 percent of the gross national production in the second quarter of 1947. Exports fell during the same period by an annual rate of $3.7 billion, which was 1.6 percent of the gross national product in the second quarter of 1947. These percentages would be equivalent to declines of $7 billion or $8 billion now. While the decline was clearly not so great as the massive cut in war expenditures after hostilities ceased, it was substantial. However, it caused no general economic disturbance, and, in fact, was probably not even noticed by anyone who did not study the composition of the national expenditures. During the year when this decline occurred (i. e., between the second quarters of 1947 and 1948), employment and probably also total production rose, and many commodities were in short supply at the time. Domestic demand was unsatisfied and insistent, and this fact prevented any general economic dislocation.

A third major curtailment in a large component of national expenditure began in the second quarter of 1953. At that time national-security expenditures were running at an annual rate of $53.2 billion and they fell to $30.4 billion in the second quarter of 1955. This decline, amounting to 1¾ percent a year of the GNP at the beginning of the period, was equivalent to one of about $6.5 billion a year from present levels. The rate of decline was almost as rapid, on a per annum basis, as the decline in foreign aid during 1947–48, and it was probably reinforced by a tightening of credit. This time the level of economic activity did fall, as is generally known, but a recovery began in the autumn of 1954. Why did economic activity fall then when it did not in 1947–48? Probably in large part because there was less pressure of private demand, even independently of credit policy, and this in turn probably resulted from the fact that wartime backlogs were worked off to a much greater extent than they had been in 1947–48. When a rise in other expenditures did occur, business expenditures played a smaller role than in 1947–48, and policy actions, such as tax cuts, an easing of housing credit, and of general credit conditions, played a greater role.

Two of these major postwar cuts of expenditure failed to create any recession of business activity below normal peacetime levels. The third did cause some, but it was not lasting or deep from the point of view of the economy as a whole.

[1] The figure for the second quarter of 1947 includes net outflow of Government capital to abroad, which Department of Commerce figures for national product and expenditure include in the net foreign investment component of gross national product.

The first general conclusion to which one is led is that, so far as aggregate effects on the economy as a whole are concerned, a substantial decline in one area of expenditure—of something of the order of 2 percent of GNP or more a year—need not have adverse effects on the general level of prosperity. Whether it does or not depends on whether other demands are rising, either spontaneously or as a result of Government policies.

Although the dislocations caused by these declines were not great when viewed from the point of view of the economy as a whole, they were substantial for many individuals in the spots specifically affected, including, of course, management and stockholders as well as labor. The increases in other expenditures that helped sustain the economy as a whole also helped reduce the dislocation or ease the adjustment to it for many firms and individuals. For example, the decline in production of tanks was replaced by the rising production of automobiles in 1946, and these two changes affected the same industry. Thus, even at the level of a specific industry, the dislocation did not necessarily involve economic hardship. (This may be the case in some industries affected by declines in import barriers, as we shall see.) Where demand for labor in particular spots decreased on balance, workers were often able to find jobs elsewhere. I mention this partly to bring out the importance of mobility in the economy, but partly, also, to point out that mobility is useless unless there is some place for labor and capital to move to.

So far as a reduction of import barriers is concerned, it is sufficient to note at this point that it would take a very substantial reduction to cause an increase of imports of as much as $1 billion a year (as valued in our trade statistics). I do not know anyone who believes that such an increase would be possible under existing law. Even when converted to a domestic port basis, this would be only about one-third of 1 percent of our current gross national product. Moreover, it would give rise to at least some partially offsetting stimuli to exports. Making all allowances for possible reverberations through the economy because of further effects upon the income and spending of people in the industries affected, it is not possible for the effect on the level of total economic activity to be perceptible, let alone substantial. The net effect on the gross national product of the maximum changes possible under the present law would be less, I suspect, than the margin of error in our national income statistics.

This is not the dislocation problem with which people are most seriously concerned, however, and I have discussed it mainly in order to dispose of it. The fact that the effect on our economy as a whole would not be significant does not mean there are no problems. Dislocations would be suffered by specific industries, firms, individuals, and communities, which although not big enough to affect the national economy, are nevertheless the proper concern of Government policymakers.

It may help in identifying the areas of the economy primarily affected to outline briefly the nature and direction of the specific forces that are set in motion by a reduction in import barriers, ignoring other forces that may be at work in the economy at the same time and are independent of such reductions.

The first effect of a reduction in import barriers is to permit foreign products to be sold in the domestic market at a lower price, and to divert domestic purchasers from the domestic to the foreign product to some degree. If, prior to the liberalization, the domestic industry has not been a highly competitive one from a price point of view, it may anticipate this tendency for domestic consumers to shift by meeting the lowered prices at which the foreign goods are offered and bring down its own prices. In that case, the tendency toward the shift of buying from domestic to foreign goods may never become actual. The reduction of barriers will simply result in a reduction of the domestic price and profit margin and may leave unchanged the proportions of foreign and domestic goods that domestic buyers purchase. If the domestic market is sensitive to price reductions, more of both domestic and foreign goods may be purchased.

If the domestic market has been highly competitive in terms of price prior to the reduction of import barriers, it will be more difficult for it to meet the lower prices at which foreign goods may enter after liberalization occurs. The tendency for domestic buying to shift toward the foreign product is then likely to develop into an actual shift. In these cases, there tends to be a decline in employment in the import-competing industries and their suppliers and an increase in imports, expressed in terms of the number of dollars earned by the foreign seller. This is not the end of the chain of effects set up by the reduction of import barriers, however. We must also take into account certain other effects, of which the most important are probably the effects induced by the changes in income of those who are engaged in the import-competing industries and their suppliers, which is a depressing effect, and the effect upon the countries supplying the imports, whose incomes and earnings of dollars are increased, which is a stimulating effect. The latter are concentrated in our export industries. The improvement in foreign countries' balances of payments may also encourage American investors to increase the flow of capital to these countries. If so, there would be additional stimulus, again to our export industries.

It is also possible that some of the increase in foreign earnings would be regarded as making possible a reduction of foreign aid and that this would be regarded as permitting a reduction of taxes not otherwise possible. If so, there would be a further stimulus to the extent that taxpayers increased their purchasing.

Reverberations of changes in domestic incomes would be widely dispersed among the different industries of the economy. We may therefore concentrate on the import-competing industries and their suppliers and, later, the export industries.

EFFECTS ON IMPORT-COMPETING INDUSTRIES

I should like to be able to give you some estimates of the effects on employment of some specified reduction of import barriers upon individual import-competing industries and upon the economy as a whole. It is impossible to estimate with much accuracy the effects of a specific program of reductions. We would have to know the nature and magnitude of a great many economic reactions that we do not know, not only in this country but in the rest of the world. In any event, such estimates would not be applicable to other programs of liberalization. I believe it is possible, however, to indicate the orders of magnitude of primary employment effects per million dollars of import increase. By "primary employment effects" I mean employment effects which occur independently of any changes in income; i. e., the effects on the number of workers producing the goods with which the additional imports compete, not only in the final stages of their production, but also in the domestic industries supplying goods and services for these final stages, such as raw materials and transportation, and also in the industries which in turn supply goods and services to these supplying industries. While I am not in a position yet to indicate the difference in these effects between given import increases for different protected commodities, I think it is possible to place a maximum figure on primary employment effects.

A crude measure of primaary employment decreases

In industries producing goods and in those producing services mainly for commodity-producing industries, the average income originating per person engaged was \$5,213 in 1953 and \$5,232 in 1954. Among these industries for which separate figures of "income originating" are given, 75 percent or more of the workers and proprietors are in industries in which the average income originating per person exceeded \$3,500. In none was the average below \$2,500. (These industry averages would nearly all be higher in 1955.)

This fact makes it possible to develop a crude but simple test to see whether a figure given for the employment effects on import-competing industries and their suppliers of a given increase in imports is at least within the range of reason. (I hasten to add that this method bears no resemblance to the method I am using in my present research, the results of which have not yet emerged.) This test consists of adding 25 percent to the assumed increase of imports (which in our trade statistics is based on values at foreign ports) to bring it approximately to a basis of values at domestic ports, and then dividing the resulting figure by the number of workers who are said to be displaced. The result is the implied average value added per worker. If it is below \$2,500, the employment estimate is almost certainly unreasonably high.

Thus, if it were said that an increase of imports of \$2 billion resulting from a reduction of import barriers would displace 5 million workers in import-competing industries, we can tell at once that it is absurd, because it would imply displacement of domestic goods worth about \$2.5 billion, and would also imply an average value added per worker of only \$500, which is outside the range of possibilities, especially for industries employing 5 million workers.

We can also use the minimum average value added per worker to make a rule-of-thumb estimate of the maximum primary employment effect of a given increase of imports due to a reduction of import barriers. Simply raise the import increase by 25 percent and divide by $2,500 or, more simply, divide the import increase by $2,000. This tells us that a $2 billion increase of imports could be equivalent to no more than 1 million workers.

Conversely, if no import figure is given, we can tell, from the number of workers who are said to be displaced by a given proposal, the very minimum increase of imports that this number of workers implies, and consider the reasonableness of the resulting figure. Thus, if it is said that 5 million workers would be displaced, we multiply this by $2,500 per worker and we know at once that this would imply displacement of domestic goods worth $12.5 billion at the very least. Subtracting 20 percent to adjust the domestic port values roughly to the basis of foreign port values, we get at least $10 billion as the increase in imports that would be required to cause a displacement of 5 million workers in import-competing industries and their suppliers. In short, the minimum implied import increase is the stated primary employment decrease multiplied by $2,000. When it is realized that total United States imports are only about $11 billion and that only about $5 billion are subject to import restrictions of any kind, the improbability of permissible reductions causing an import increase of $10 billion becomes perfectly apparent, for it would imply that the reductions of trade barriers under discussion would triple our total protected imports.

There are probably no commodity-supplying industries, even in a highly detailed classification, in which the average income originating per person engaged (which includes proprietors) is below $2,500. One can therefore use this low figure confidently even for liberalizations confined to these industries.

The formula is,

Maximum primary employment decrease=

$$\frac{\text{import increase (as valued in trade statistics)}}{\$2{,}000},$$

and conversely,

Minimum implied import increase (as value in trade statistics) = primary employment decrease × $2,000.[2]

This rule of thumb makes many crude assumptions, for example, that every increase of imports worth $1 at foreign ports and resulting from a reduction of trade barriers displaces domestic products valued at $1.25. I have tried to allow for the crudity by using figures which are extremely conservative, i. e., which give maximum employment effect per dollar of import increase. I put this rule of thumb before you not because it has any great accuracy—it certainly does not—but because, however crude it may be, it is a great deal less crude than some of the estimates that are often given, even in congressional testimony, and because it provides a very simple rule of thumb that may provide a useful and quick check of oral statements.

Please note also that this rule of thumb indicates only a relationship between employment and production. It can therefore serve only as a check upon implied relationships between changes in employment and changes in imports due to changes in import barriers. It contributes nothing to answering the question, How large an increase in imports would result from a given program of reductions in trade barriers? One has to know the increase of imports in order to judge the order of magnitude of the employment effect. Conversely, one has to have a figure for the primary employment effects in order to deduce the implied increase of imports. One cannot deduce from this implied increase in imports what degree of reduction in trade barriers is implied.

These figures correspond to the second concept of employment effects which I mentioned in the earlier part of my statement. They represent the "primary" employment effects, i. e., before taking account of any effects on production caused by changes in income in the import-competing industries or by changes in exports.

Effects of import competition are not concentrated wholly on "import-competing" industries in narrow sense

It is worth dwelling for a moment on the distinction between what are commonly called the import-competing industries on the one hand, and their direct and indirect suppliers on the other. The term "import-competing industry" is normally used in a narrow sense to refer to the industry that is in the last stage

[2] An explanation of the assumptions underlying this formula is given in addendum A of this statement.

of the process of producing the goods with which the imports compete. This industry, however, may add little to the final value of the domestic product and may, therefore, employ only a small proportion of the total number of workers involved in producing the commodity. Most of the final value of the product may be added by other industries from which it purchases component parts or raw materials and most of the workers may be employed in them. These other industries, in turn, may also get supplies from still other industries. In such cases the employment effects in the industry at the last stage in the productive process will not be a large fraction of the total immediate employment effects. This fact should be borne in mind whenever statements are made concerning the effects upon a given import-competing industry.

The point can be illustrated by taking the case of motorcycles and bicycles.[3] If a reduction of import barriers for these commodities were to reduce their domestic output by $1 million, and if employment in them and their supplying industries falls in the same proportion as output, the primary employment decrease would be 171 employees. But only about 52 percent of them would be in the motorcycle and bicycle industry. About 24 percent would be in such industries as steelworks and rolling mills, manufacture of tires and inner tubes, internal combustion engines, metal coating and engraving, farm equipment, and even wholesale trade, and the remainder would be scattered through the rest of the economy.

The fact that a substantial portion of employment effects may be indirect, i. e., in other industries which are immediate or even remote suppliers, is important in connection with such questions as who is hurt and whether the industries hurt are also being injured by other dislocations or are benefiting from offsetting expansionist influences.

EFFECTS ON EXPORT INDUSTRIES

To know the magnitude of the effect upon exports of an initial increase of imports of $1 million for any given commodity, we would have to know the nature and size of many reactions. First, how much do the dollar earnings of foreign countries increase per million dollars initial direct increase in imports? This question arises because production of the competing domestic industry and its suppliers is somewhat diminished and, insofar as these industries use imported materials, there will be some partially offsetting decrease of other imports. Consequently the primary increase of imports and the increase of foreign earnings will be somewhat less than $1 million.

Second, will the increase in imports lead the Congress to reduce foreign aid; and if so, how great will the net rise of foreign dollar receipts be?

Third, how much of their increased dollar receipts will foreign countries use to increase their purchases in the United States? Foreign countries have a wide variety of possible responses to those increases of earnings, owing to differences in economic structure, policies, or particular circumstances, e. g., their desire for additional reserves or the percentage of capacity at which their economies are operating. For our purposes it is sufficient to note that they may use a very substantial portion or perhaps all of the additional export earnings to increase their gold and dollar reserves, to increase their imports from countries other that the United States, or to increase their purchases from the United States. If they use these earnings to increase their gold and dollar reserves, there is no stimulating effect upon United States exports. To the extent that they use them to increase their purchases from other countries, the same questions must be asked about what these other countries do with the proceeds of their increased exports. Insofar as any of the countries uses its additional export proceeds to increase its purchases from the United States, there is an employment-increasing effect here which partly offsets the employment-decreasing effect of the reduction of import barriers upon our import-competing industries.

[3] This is a good case, partly because these two commodities are both protected and bicycles have recently been the subject of an escape clause action, but mainly because they happen to constitute an entire industry in the interindustry study of the Bureau of Labor Statistics which is the source of essential data for the illustration. These studies were discontinued in 1953.

I do not feel that it is possible to give reliable estimates of the ratio of increase in exports to the increase in imports arising from liberalization of import barriers. It is possible, however, to say something that probably bears on the question of which export industries would be most affected by whatever increase of exports does in fact occur. If we make the assumption—admittedly a dubious one—that a country would apportion its additional purchases in the same way as its total purchases in 1953, we can get answers to such questions as which export industries would be most affected if the additional buying in the United States is done by country A and which if it is done by country B? Does it make much difference what countries do the additional buying?

It is probable that a substantial part of the increased buying would be done by the countries supplying the imports on which barriers are reduced. In that case, which export industries are stimulated would depend in great part upon which import barriers are reduced. With these considerations in mind, your committee has had tabulated some foreign trade data which would throw light upon this question. I have identified for the committee's staff 32 countries which are major suppliers of imports now subject to barriers and the committee's staff has recently obtained from the Bureau of the Census a tabulation of purchases made in the United States by each of these countries in 1953, classified by industries which represent the last stage of fabrication of these exports. In other words, we have now a tabulation which enables us to say "Of the total of $580 million of goods which the United Kingdom bought from us in 1953, 14 percent were products of the food-grain and feed-crop industry, and 18 percent were products of the machinery industry, and so on for all of a detailed classification of industries, whereas, in the case of France or India or any of the other countries, the percentage distribution of their purchases from us in 1953 was thus and so." This tabulation shows that there were substantial differences in the pattern of commodity purchases made here by major suppliers of protected imports. It also shows that products of the categories "food grains and feed crops," nonelectrical machinery, chemicals, and transportation equipment were of greatest importance to these countries.[4] The percentage distribution among industries of United States exports to each of these countries is shown in table 3, addendum B.

To illustrate, let us assume that there is a reduction of protection on two classes of imports, watches and clocks and motorcycles and bicycles, in an amount sufficient to increase the combined dollar earnings of the three major suppliers of each class by $1 million, and that this million dollars is distributed among these three major suppliers in the same proportion as were their total earnings from sales of these goods to the United States in 1953. Let us assume also that these supplying countries increase their merchandise purchases in the United States by half of the increase in their dollar earnings and that they distribute these additional purchases in the same manner as their total merchandise purchases in 1953. (For simplicity, I ignore the fact that any increase in their purchases from other countries would probably cause these other countries, also, to buy more from us.) The table enables us to say that, on these assumptions, the liberalization of watch and clock imports would raise exports of textile mill products by about $43,000 and apparel by about $11,000 whereas that of motorcycle and bicycle imports would raise them by only about $900 and $500, respectively. On the other hand, liberalization of motorcycle and bicycle imports would raise exports of tobacco by $95,000 against only $32,000 resulting from watch and clock liberalization and would raise exports of petroleum and coal products by $30,000 compared with a rise of only about $5,600 from watch and clock liberalization. These differences result mainly from the differences between the patterns of buying in the United States on the part of the United Kingdom, the chief supplier of imported motorcycles and bicycles, and Switzerland, the chief supplier of imports in the watch and clock category.

[4] This statement is based on the range of percentages of total purchases which each country devoted to the products of an industry and on an unweighted average of these country percentages for each industry. While a weighted average would have been more relevant for some purposes, an unweighted average was believed to be more relevant to the effect of the country distribution of a given addition to dollar earnings.

Comparative effect on selected industries of additional United States exports resulting from additional United States imports of watches and clocks and of motorcycles and bicycles [1]

[In thousands of dollars]

Source of additional dollar earnings and country receiving and spending them	Total additional purchases in United States	Additional exports of selected United States industries					
		Food grains and feed crops	Tobacco	Textile mill products	Apparel	Petroleum and coal products	Transportation equipment
Watches and clocks:							
Switzerland	472.0	7.5	28.0	43.2	10.6	5.1	45.0
West Germany	26.5	5.4	3.3			.4	.2
United Kingdom	1.5	.2	.3			.1	
Total	500.0	13.1	31.6	43.2	10.6	5.6	45.2
Motorcycles and bicycles:							
United Kingdom	388.0	56.1	83.8	.5	.3	28.2	3.6
West Germany	84.0	17.0	10.4	.1	.1	1.3	.6
Italy	28.0	3.1	.4	.3	.1	.6	.7
Total	500.0	76.2	94.6	.9	.5	30.1	4.9

[1] The figures in this table were derived from the assumptions stated in the preceding paragraph and from table 3, addendum B of this statement.

The production, sales, employment, and profit effects of increased exports, of course, will not be confined to the industries at the final stage of fabrication, but will occur partly in their immediate and remote suppliers, just as we found to be the case with import-competing industries. Of course, some industries that supply parts and materials to protected import-competing industries also supply them to export industries. Insofar as the same industries are affected by both, the industry dislocation is reduced.

IMPORT LIBERALIZATION AND GROWTH

Let us now consider what, if anything, can be said about the net effect of import liberalization and expansion of demand required for normal growth, first for the economy as a whole and then for protected import-competing industries.

Expansion required in the economy as a whole

Using estimates of the increase in the civilian labor force made by the joint committee's staff, it appears that markets would have to expand 1.5 percent a year to keep the unemployed percentage of the civilian labor force down to the 1955 level, at present output per man-hour and present hours of work.[5] Their estimates of increases in output per man-hour in private industries, if applied to all civilian employment, would require a further market expansion of 2.7 percent a year. Thus it would require an expansion of markets of 4.2 percent a year to prevent the present percentage of unemployment from rising. This is equivalent to $16 billion at the 1955 level of total production. This, it should be noted, is a problem we face year after year, not just in 1 or 2 years.

The question I want to put is, How much more would markets have to increase if import barriers are reduced than they would if these barriers are not reduced? I should think it unlikely that import barriers would be reduced in any 1 year enough to increase imports by as much as $500 million a year, but let us use this figure in answering the question. Assume also that the increase in exports resulting directly from the increased dollar earnings of foreign countries is only 40 percent of the increase in our imports, i. e., it is only $200 million. This is a conservative figure, especially if one takes account of the possibility that the strengthening of foreign currencies might encourage an expansion of our foreign investment. The net decrease of purchases would then be $300 million. Now, allowing for secondary effects twice as great as the effects which cause them, which appears generous in view of the existence of built-in stabilizers, the total net decline of markets would be three times $300 million or $900 million. Stated

[5] Computed from data in Potential Economic Growth of the United States During the Next Decade, Joint Committee Print, 83d Cong., 2d sess. (1954), table 1, p. 19.

alternatively, on these assumptions the expansion of markets required to offset the aggregate effects of liberalization would add $900 million to the $16 billion, or about 6 percent, to the expansion that would be required in any event. This small addition to the necessary expansion would not occur every year but only in the years when the shift of demand from domestic to foreign products took place. I think this overstates the problem for the economy as a whole. Besides assuming a small effect upon exports, this figure makes no allowance for any increase in the amount that consumers spend at given levels of income, despite price reductions and possible increases in the variety of goods available. It should also be noted that it relates to unilateral reductions of import barriers; not to reciprocal reductions.

It seems clear that, from the point of view of its effect upon the economy as a whole, the problem created by a reduction of import barriers could add very little to the normal problem created by growth of the labor force and rising productivity. If we solve the growth problem, the effects of import liberalization on the total economy would not be perceptible.

Import liberalization and growth in import-competing industries

It does not follow from this conclusion, of course, that the expansion of markets accompanying normal growth of the economy would necessarily take care of the problems of the industries competing with imports, especially those concentrating on import-competing goods. They might or might not participate in the general expansion of markets.

I should first like to point out, incidentally, that the same thing may be said of the dislocations resulting from increases in output per man-hour due to changes in productive techniques. The average increase in productivity for the economy as a whole is no distributed uniformly over industry but reflects quite substantial reductions of labor requirements per unit of output in some industries and very small reductions or none at all in others. While the commodities most affected by a technical change may not participate much in the general expansion of demand, the employees and capital displaced nevertheless are likely to benefit from such expansion because it increases the alternative employment opportunities available to them. Similarly, if a reduction of import barriers does reduce the sales, production and employment in an import-competing commodity owing to lack of growth in the demand for it, the resulting disclocation will be less painful for most of the people involved if demand for other commodities is expanding than if it is not, because it is then easier for labor to find other jobs and for capital to find other investment outlets.

Unfortunately, no positive and well-founded generalization can be made, so far as I know, about the extent to which protected import-competing industries (even in the narrow sense) have been participating in general economic growth, although the data necessary for valid generalization are available. It is sometimes said that the import-competing industries are generally characterized by subnormal growth or actual stagnation, but I have never seen the basis for such statements. Of course, many of the import-competing industries have been declining, but the impression that this is true of most of them arises, I suspect, largely from the fact that it is the declining ones (for example, briar pipes, fur-felt hats and hat bodies, wool) that have complained most of foreign competition. Even the industries claiming injury from tariff reductions are not all declining industries. The main complaint of the watch industry, for example, has been that they have failed to share sufficiently in the growth of our economy. The chemical industry and the electrical manufacturing industry are also protected import-competing industries, and they can by no means be regarded as laggard in growth. Moreover, if the generalization is doubtful when applied to the industries at the stage of production closest to the competing import, it is much more doubtful when applied to their direct and indirect suppliers, which are in general more diverse and, therefore, more likely to resemble the economy as a whole. And a substantial part of the total dislocation may be in these supplying industries.

A second question is whether normal separations are low in the import-competing industries so that they will do little to mitigate the dislocations of employment. It is often said that workers in these industries are less mobile than others because they have special skills which are useless elsewhere, or because they are older, and that it is, therefore, more difficult to move them geographically or to retrain them. I know of no valid statistical basis for this generalization either. But here again, we may say that, if the mobility of workers in the last stage of fabrication of these goods is much below the average for the economy as a whole, the mobility of workers in the supplying industries is likely to be higher.

A third statement sometimes made is that the import-competing industries are either more affected than other industries by other changes now going on in the economy, such as technological change, shifts in command, and so forth, or are less able to adjust to them. Whether these other dislocations themselves are greater in the case of these industries than in the case of other industries or not, I believe we do not know. It clearly is true for some industries such as textiles, coal, and wool growing, but how about chemicals, electrical manufacturing, or petroleum, which are also protected import-competing industries?

If the question at issue is not the extent of other dislocations to which these industries must adjust, but their difficulty in making the adjustment, then the point reduces to one of growth or mobility, to which I have just referred, or else to unusual inefficiency of these industries in adopting new techniques or altering their products.

SOME POLICY QUESTIONS CONCERNING DISLOCATIONS

What I have said thus far may give the impression that I think the problem of dislocation is not a serious one. That is certainly my opinion so far as the prosperity of the national economy is concerned. I have not intended to imply, however, that there will not be dislocations or that they are not a proper cause for concern. We can be fairly certain that some industries, at least, will suffer dislocations and, in addition, have difficulty in adjusting to them. The fact that others, such as export industries, may receive a stimulum from the same cause may be no consolation to the import-competing industries. This fact clearly does raise policy questions for the Government. I should like to suggest a number of these questions for the subcommittee's consideration.

First, I should like to remind you that dislocations are occurring every day as a result of technological change, shifts in taste, and many other causes. They are a normal part of the economic process. Some of these dislocations involve an almost complete wiping out of demand for a product and may, in some cases, involve an entire community. To illustrate, the Randall Commission heard testimony that the change in public demand from wooden to metal station-wagon bodies caused a serious crisis for the community of Iron Mountain, in the Upper Peninsula of Michigan, because it caused the closing of a Ford Motor Co. plant on which the community was almost wholly dependent. I cite this case to point up the fact that the questions raised by specific industries or plant dislocations are general questions. The problems raised by a reduction of import barriers do not reflect an inherent conflict between the needs of the domestic economy and the needs of international economic policy, but rather the more general conflict between the security of the status quo of an individual or a firm or an industry and any change, whatever its cause.

The fact that specific dislocations occur every day does not of itself imply, however, that Government has no responsibility to avoid or prevent the dislocations that may result from its own acts, such as a reduction of import barriers. Some people argue that it is in the nature of business that it involves risk and that the Government need not be concerned. Others argue, or more often imply, that Government should not take the actions which will result in dislocattions. It appears to me that if the Government is convinced that a reduction of import barriers would be desirable and would be in the general interest on other grounds, it ought not to refrain from reducing them merely because somebody would be hurt. At the same time, I believe it clearly has a responsibility to undertake the reduction in a manner that causes the minimum of hardships. It seems to me perfectly feasible to work out a way of protecting the import-competing industries from the worst effects of dislocation without avoiding dislocation itself. The painful effects can be minimized in a number of ways. I believe that it would also be possible to work out schemes to facilitate the adjustment to these dislocations without getting into the difficulties that are involved in proposals to compensate for injury.

A second question, which I believe has not been posed by others, is: Exactly what is it that the Government has a responsibility to protect? Here I mean to make the distinction, which I consider important, between the protection of individuals and the protection of particular kinds of productive activity. It appears to me that in the general case, the Government has at most a responsibility to protect the position of individuals, for it is individuals who, in the literal sense, suffer hardship. I say that this is true in the "general case" because the interests of national defense are an exception; they may require the protection of a particular productive activity, such as manufacture of a particular type of product. That this distinction between individuals and productive activity is of some practical significance is illustrated, I believe, by the case of garlic, for which producers sought action under the escape clause a few years ago. If I recall this case correctly, it was found that increased imports attributable to a reduction of import barriers were having an adverse effect upon garlic production. It was also found, however, that virtually all producers of garlic produced other things and that the production of garlic was only a small part of the total production of most of them. Thus, although the reduction of import barriers on garlic might have a serious adverse effect upon garlic production, it might not do serious injury to any individual. It appears to me that this is exactly the sort of situation that need cause the Government no particular concern. (Let me make it clear that in saying this I am not expressing an opinion about the garlic case—or garlic itself. I am merely using it to illustrate a general point.)

A third question is whether the Government ought to be concerned when only the relative but not the absolute share of a domestic industry in the total market for its product is being reduced. If the absolute level of production and employment in an industry is not shrinking, it is hard to see how any individual is being injured, even though the relative share of the industry in the total market for foreign and domestic products combined is declining. The industry is simply not experiencing the expansion that it would like to have and might have had if barriers had not been reduced. I doubt that this is the sort of "injury" against which the Government has any duty to give protection.

A fourth general question is how the natural factors helping to minimize the hardships can best be exploited. A number of possible answers to this question are implied in the considerations that I have brought forward in this statement. The factors of normal growth and turnover can be exploited by making reductions gradually. Growth alone can be exploited by selecting reductions which affect, directly or indirectly, industries having rapid growth. Third, mobility can be exploited by making reductions in commodities in which the affected industries are likely to have the highest mobility. This is likely to mean, generally, industries having a relatively youthful labor force, or located in communities where there are other healthy industries and similar considerations. Fourth, the reductions can be concentrated on commodities produced by industries which suffer least from other dislocations. Fifth, limited administrative discretion may be given as to the effective dates of the reductions, with legislative instructions as to the factors that should be considered in using this discretion. It might be specified, for example, that the executive branch of the Government should consider the state of inventories of the industry, the condition of its order books, and the general business situation.

Finally, I should like to make the more general suggestion that in setting goals for the expansion of markets for domestic production we ought not to take into account merely the expected growth of the labor force and the expected increase in output per man-hour. We ought also to include whatever further expansion is required to offset the net employment decreases caused by policies that are regarded as desirable. I have in mind not only net decreases of employment that are expected to result from reductions of import barriers but net decreases of employment that would result from the attainment of any of the accepted goals of economic policy. The expansion of markets should be sufficient to employ people who are now producing goods that we do not want and people who are now producing goods that we could obtain more efficiently in other ways. If we measured it in this way, we would set our sights at levels that facilitate not only the employment of new members of the labor force and the reemployment of those displaced by technological improvement, but also the reemployment of those displaced by policy actions that are regarded as in the general interest.

ADDENDUM A

ASSUMPTIONS IMPLIED IN FORMULA RELATING IMPORT INCREASES AND PRIMARY EMPLOYMENT DECREASES DUE TO UNILATERAL REDUCTIONS OF IMPORT BARRIERS

DERIVATION OF FORMULA IN STATEMENT

The formula in the body of the statement for estimating maximum primary employment decreases from given import increases is based on the following more general formula:

Maximum primary employment decrease=import increase×average ratio of domestic to foreign port value of imports÷average income originating per person engaged in affected industries,

and, conversely, for estimating minimum import increases implied by given primary employment decreases, the more general formula is:

Minimum implied import increase=primary employment decrease×average income originating per person engaged in affected industries÷average ratio of domestic to foreign port value of imports.

In order to provide a rule of thumb for general use, the formula in the text uses 1.25 as the average ratio of domestic to foreign port values. This is an upward rounding of the actual average of 1.19 for 1952 imports (weighted by actual imports). For average income originating per person engaged, it uses $2,500, the round figure below which no industry fell in 1953 or 1954 (using the industry classifications given in the Department of Commerce's national income and product statistics for national income and persons engaged). If these figures, 1.25 and $2,500, are inserted in the above formula, the formula given in the body of the text are obtained.

For any specific program of import liberalization, a closer approximation would be obtained by using figures for the ratio of domestic to foreign port values and average income per person engaged that are more relevant to the imports and the industries affected by that program. The former ratio requires special tabulations which are not generally available (although one has been made for 1952), but the figure of 1.25 is a reasonable one for general use. The average national income per person engaged in each industry likely to be affected by import competition is shown in table 1 and a frequency distribution of persons engaged among these industries is shown in table 2.

ASSUMPTIONS IMPLIED IN USE OF THE FORMULA

The formula tends to overstate the primary employment changes associated with a given increase of imports caused by a reduction of trade barriers and, conversely, to understate the import increase required to produce a given primary employment effect. It implies that an additional dollar's worth of imports displaces an equivalent value of domestic goods. A reduction of import barriers, however, causes a fall in price and, in some cases, probably also an increase in the variety of goods from which buyers may choose. It is, therefore, likely to cause some increase in the total quantity of goods purchased, so that the displacement of domestic goods is not likely to be as great as the increase of imports. Furthermore, the formula implies that a reduction of $2,500 worth of domestic output eliminates one job. In most cases this overstates employment effects, for two reasons. In 1954, 75 percent of the persons engaged in the industries that could be affected were in industries where the average income originating per person exceeded $3,500; if we eliminate agriculture, where the effects of a decline in demand may not take the form of unemployment, the percentage in industries with averages above $3,500 is 90 percent. In 1955 both of these percentages are undoubtedly higher. Table 1 suggests that for import liberalization programs that do not greatly affect employment in agriculture, textiles, and apparel, a figure of $4,000 or more could be used for average income per person engaged; the figure of $2,500 probably overstates primary employment effects per $1 million of imports by 60 percent or more and understates implied imports per person proportionately. Moreover, the formula assumes that changes in primary employment are proportional to changes in the value of production that cause it. This contributes to an overstatement of the maximum change of employment because, in many industries, a portion of the labor requirement is largely independent of the volume of production. In some industries this portion is a very large one. In general, therefore, employment varies in smaller proportion than production.

It should also be noted that the assumed value of production of displaced commodities represents the sum of the gross income originating in the industries that produce these commodities, whereas the formula divides this figure of gross value by an average net income originating per person. Gross income originating per person, a conceptually more appropriate figure, would be higher. It would give a lower maximum employment for a given rise of imports and a higher minimum import for a given value of employment. Finally, the use of averages based on number of persons engaged rather than on number of employees substantially reduces the average income originating per employee in some industries, and thus overstates the effect upon hired workers.

TABLE 1.—*National income per person engaged and number of persons engaged, by selected industries, 1953 and 1954* [1]

Industry	1953		1954	
	Number of persons engaged (thousands)	National income per person engaged (dollars)	Number of persons engaged (thousands)	National income per person engaged (dollars)
Farms	5,540	2,895	5,556	2,846
Agricultural services, forestry, and fisheries	286	2,528	290	2,610
Metal mining	110	7,145	104	6,712
Anthracite mining	56	3,482	42	3,690
Bituminous and other soft coal	296	5,098	234	4,987
Crude petroleum and natural gas	312	7,942	317	7,940
Nonmetallic mining	114	5,684	113	6,168
Food and kindred products	1,582	5,037	1,557	5,122
Tobacco manufacturers	104	5,923	102	7,088
Textile-mill products	1,192	3,690	1,078	3,469
Apparel, etc	1,262	3,147	1,202	3,131
Lumber and wood products	788	3,527	718	3,568
Furniture and fixtures	378	4,196	351	4,234
Paper and allied products	532	6,220	533	6,304
Printing, publishing, etc	814	5,450	826	5,521
Chemicals and allied products	810	7,741	796	7,829
Products of petroleum and coal	256	12,984	247	13,490
Rubber products	280	6,061	253	5,573
Leather and leather products	388	3,508	371	3,585
Stone, clay, and glass products	554	5,475	529	5,688
Primary metal industries	1,340	6,985	1,187	6,521
Fabricated metal products	1,384	5,350	1,226	5,400
Instruments	331	5,906	316	6,006
Miscellaneous manufacturing	512	4,457	488	4,418
Machinery, except electrical	1,741	6,083	1,571	6,068
Electrical machinery	1,221	5,809	1,094	5,823
Transportation equipment	1,017	5,634	963	5,865
Automobiles and automobile equipment	922	8,206	787	8,224
Wholesale trade	2,932	5,788	2,941	5,831
Banking	504	8,387	521	8,555
Security and commodity brokers	68	3,853	69	6,870
Finance n. e. c	165	7,424	176	7,415
Insurance carriers	672	4,156	694	4,248
Insurance agents	256	5,211	259	5,606
Railroads	1,360	5,658	1,209	5,491
Highway freight transportation, etc	765	5,009	752	5,132
Water transportation	138	7,232	125	7,104
Air transportation	110	6,245	110	6,691
Pipeline transportation	28	10,857	27	11,296
Services allied to transportation	184	4,315	176	4,273
Telephone, telegraph, etc	746	5,505	739	5,939
Radio broadcasting and television	65	7,554	71	7,761
Electric and gas utilities	556	9,536	560	10,195
Local utilities and public services, n. e. c	33	4,939	32	5,062
Business services, n. e. c	585	4,894	597	5,075
Legal services	239	6,280	244	6,352
Engineering and other professional services	217	5,705	220	5,814
All private industries [2]	54,447	4,905	52,913	4,962

[1] All private industries producing commodities and all those producing services mainly for commodity-producing industries. Private industries excluded are contract construction, real estate, retail trade, local and highway passenger transportation, and all industries classified in the source of the data as service industries, other than "business services not elsewhere classified," legal services, and engineering and other professional services.

[2] Covers all private industries, including those not itemized above.

Source: Number of persons engaged comes from National Income and Product of the United States, 1954, Survey of Current Business (July 1955), table 28. National income originating in each industry (now shown in above table) comes from table 13 of the same article.

TABLE 2.—*Distribution of selected industries by average national income per person engaged, 1953 and 1954*[1]

Average national income per person engaged	1953			1954		
	Number of industries	Number of persons engaged (thousands)	Percent of total engaged	Number of industries	Number of persons engaged (thousands)	Percent of total engaged
Under $2,500	0	0	0.0	0	0	0.0
$2,500 to $3,499	4	[2] 7,144	21.2	4	[2] 8,126	25.1
$3,500 to $4,499	8	4,182	12.4	7	2,840	8.8
$4,500 to $5,499	9	6,269	18.6	7	5,607	17.3
$5,500 to $6,499	14	10,944	32.4	14	10,601	32.7
$6,500 to $7,499	4	1,753	5.2	7	1,873	5.8
$7,500 to $8,499	5	2,613	7.7	4	1,971	6.1
$8,500 to $9,499	0	0	0.0	1	521	1.6
$9,500 and over	3	840	2.5	3	834	2.6
Total	47	33,745	100.0	47	32,373	100.0
Total income originating (millions)		$175,898			$169,360	
Average per person engaged		5,213			5,232	

[1] Includes all private industries producing commodities and all those producing services mainly for commodity-producing industries. Private industries excluded are contract construction, real estate, retail trade, local and highway passenger transportation, and all services other than "business services not elsewhere classified," legal services, and engineering and other professional services.

[2] Includes 5,540,000 and 5,556,000 in agriculture in 1953 and 1954, respectively.

Source: Table 1.

TABLE 3.—*Percentage distribution of 1953 United States exports, by industry, for 32 selected countries of destination* [1]

Industry and Standard Industrial Classification [2]	Argentina	Australia	Austria	Bahamas	Belgium-Luxembourg	Brazil	Canada	Cuba	Denmark	Ecuador	Egypt
Meat animals	0.08	0.08	(3)	0.09	0.14	(3)	0.08	0.08	0.06	0.15	(3)
Poultry and eggs	.01	----	----	.67	(3)	(3)	.02	.80	----	.04	0.04
Farm dairy products	----	----	----	.24	----	----	(3)	.02	----	----	----
Food grains and feed crops	.02	----	42.44	.02	16.08	3.80	.46	.97	.85	2.49	33.07
Cotton	----	2.30	18.50	----	3.79	----	1.37	.36	15.03	1.84	----
Tobacco	----	15.64	3.09	.24	2.23	.14	.06	----	18.97	----	6.05
Oil bearing crops	----	(3)	----	.03	1.52	----	.43	.01	10.86	(3)	----
Vegetables and fruits	----	.07	.01	.86	1.70	.22	2.38	3.20	.13	.05	.07
All other agricultural	.33	.01	.10	.11	.24	.50	.21	.21	.66	.16	.09
Fisheries, hunting, and trapping	.10	----	.04	----	.15	(3)	.23	(3)	----	----	----
10. Metal mining	(3)	(3)	.15	----	.01	.05	1.05	(3)	----	(3)	----
11. Anthracite mining	----	----	----	----	----	----	1.72	.13	----	----	----
12. Bituminous coal and lignite mining	5.17	----	.93	----	2.50	2.85	5.37	.08	.15	(3)	.68
13. Crude petroleum and natural gas extraction	3.10	----	----	----	----	----	1.56	1.92	----	----	----
14. Mining and quarrying of nonmetallic minerals except fuels	.52	2.97	.93	.04	.79	.86	.81	.15	.62	.10	.08
15. Building construction, general contractors	----	----	----	----	----	----	----	----	----	----	----
16. Construction other than building construction	----	----	----	----	----	----	----	----	----	----	----
17. Construction, special trade contractors	----	----	----	----	----	----	----	----	----	----	----
19. Ordnance and accessories	----	(3)	.01	----	.01	.01	.11	.01	(3)	.08	(3)
20. Food and kindred products	.22	.42	4.70	10.49	5.67	1.35	3.06	27.42	2.03	11.27	7.63
21. Tobacco manufactures	.01	.62	.42	1.23	1.58	.01	.08	.29	3.30	1.86	.81
22. Textile mill products	.52	.99	.64	2.43	2.44	1.19	3.34	7.99	2.92	7.46	1.05
23. Apparel and other finished products from fabrics	.02	.04	.27	3.12	.76	.07	.94	1.32	.08	.69	1.03
24. Lumber and wood products, except furniture	.01	3.12	.18	3.49	.46	.08	1.07	.91	.26	.03	.28
25. Furniture and fixtures	(3)	.01	(3)	1.85	.08	.05	.34	.51	.01	.62	.06
26. Paper and allied products	.27	.49	.04	1.35	.60	.79	1.26	3.72	.08	.99	.20
27. Printing, publishing, and allied products	.02	.53	.06	.53	.18	.48	1.69	.42	.62	.39	.31
28. Chemicals and allied products	21.88	6.13	3.81	2.22	11.45	10.13	7.20	8.37	5.02	11.92	11.36
29. Products of petroleum and coal	5.42	6.13	1.03	1.52	4.00	4.84	4.16	3.34	3.56	1.68	16.55
30. Rubber products	.28	.28	.20	.43	.60	.15	.83	1.07	.17	1.81	.14
31. Leather and leather products	.01	.01	.05	1.11	.19	(3)	.41	1.17	.01	.14	(3)
32. Stone, clay, and glass products	.28	.76	.19	1.47	.69	.78	2.59	2.76	.54	2.28	.29

See footnotes at end of table.

69375—55——17

ADDENDUM B—Continued

TABLE 3.—*Percentage distribution of 1953 United States exports, by industry, for 32 selected countries of destination* [1]—Continued

Industry and Standard Industrial Classification [2]	Argentina	Australia	Austria	Bahamas	Belgium-Luxembourg	Brazil	Canada	Cuba	Denmark	Ecuador	Egypt
33. Primary metal industries	12.91	5.84	2.48	.83	3.18	9.24	6.45	2.99	7.24	3.96	1.43
34. Fabricated metal products except ordnance machinery and transportation equipment	.86	1.53	.09	3.88	1.33	3.01	4.45	3.45	.90	4.44	.82
35. Machinery (except electrical)	24.92	38.60	11.75	8.55	12.13	27.55	23.07	9.01	10.12	18.05	7.20
36. Electrical machinery equipment and supplies	7.48	2.55	.58	29.56	4.01	9.07	5.48	5.31	2.52	4.14	1.38
37. Transportation equipment	13.53	8.60	.24	3.01	18.04	19.49	11.50	7.45	8.16	19.03	6.84
38. Professional, scientific, and controlling instruments; photographic and optical goods; watches and clocks	1.45	1.29	.71	.84	1.98	2.06	1.92	1.17	1.90	1.33	.56
39. Miscellaneous manufacturing industries	.08	.20	.15	.93	.59	.57	1.62	1.77	.45	.84	.47
Unclassified	.50	.79	6.21	18.86	.88	.66	2.68	1.62	2.78	2.16	1.51
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Total value (thousands of dollars)	$104,173	$134,575	$60,193	$16,838	$229,472	$294,703	$2,941,820	425,261	$38,282	$41,261	$60,231

Industry and Standard Industrial Classification [2]	Finland	France	Greece	Hong Kong	India	Iran	Italy	Japan	Mexico	Netherlands	New Zealand	Norway
Meat animals	0.06	0.01	----	----	(3)	----	0.01	0.03	0.25	0.12	0.02	0.15
Poultry and eggs	----	(3)	(3)	(3)	----	0.14	(3)	(3)	1.45	.02	----	----
Farm dairy products	----	----	----	0.13	----	----	----	(3)	.01	----	----	----
Food grains and feed crops	----	2.68	23.21	(3)	28.79	----	11.21	14.10	7.70	13.94	----	14.93
Cotton	----	25.05	----	.38	3.75	----	14.97	17.16	.31	5.06	----	2.91
Tobacco	9.43	1.01	----	7.68	.13	----	1.55	1.26	.18	6.56	14.76	6.78
Oil bearing crops	----	1.65	----	1.92	----	----	----	7.62	(3)	6.00	----	3.92
Vegetables and fruits	----	.33	3.49	5.61	(3)	.02	.05	.05	1.61	2.28	.30	.05
All other agricultural	.23	.25	.50	1.45	.06	.24	.18	.03	.60	.37	.11	.02
Fisheries, hunting, and trapping	----	.32	----	.01	----	----	.13	.06	.01	.05	----	.02
10. Metal mining	(3)	.41	.01	(3)	----	----	.03	.71	.04	(3)	----	(3)
11. Anthracite mining	----	----	.38	----	----	----	----	(3)	.01	----	----	(3)
12. Bituminous coal and lignite mining	----	1.03	----	----	----	----	5.71	5.10	.03	4.11	----	1.35
13. Crude petroleum and natural gas extraction	----	.43	----	----	----	----	.34	.33	.37	----	----	----
14. Mining and quarrying of nonmetallic minerals except fuels	.16	.79	.05	.01	.94	.03	.60	.57	.24	1.19	8.95	.08
15. Building construction, general contractors	----	----	----	----	----	----	----	----	----	----	----	----
16. Construction other than building construction	----	----	----	----	----	----	----	----	----	----	----	----

17. Construction, special trade contractors	----------	----------	----------	----------	----------	----------	----------	----------	----------	----------	----------	----------
19. Ordnance and accessories	.01	(3)	.01	.01	----------	.35	(3)	(3)	.03	(3)	(3)	.01
20. Food and kindred products	1.17	1.53	24.77	9.81	.90	6.31	2.21	12.65	3.70	10.87	1.43	7.55
21. Tobacco manufactures	.38	.75	.01	8.71	.75	.03	.49	.09	.36	.42	(3)	1.14
22. Textile mill products	1.08	1.87	1.64	17.51	.04	8.50	1.01	2.51	1.91	2.00	.37	1.80
23. Apparel and other finished products from fabrics	.58	.33	1.62	4.01	.02	.29	.31	.12	.84	.32	.06	.09
24. Lumber and wood products except furniture	.14	.43	.45	.46	.25	.04	.53	1.09	1.13	.50	.84	.69
25. Furniture and fixtures	.02	.18	1.13	.13	.02	.35	.04	.03	.39	.01	.02	.02
26. Paper and allied products	.05	.69	.31	1.92	.07	.25	.30	.59	1.62	.23	1.37	.12
27. Printing, publishing, and allied products	.10	.20	.19	.64	.41	.21	.16	.18	.54	.17	1.09	.29
28. Chemicals and allied products	6.68	8.38	3.93	7.70	10.52	15.70	10.89	8.95	11.75	12.55	3.08	5.35
29. Products of petroleum and coal	2.01	1.80	1.88	1.40	11.53	1.73	1.97	4.39	5.[illegible]8	1.78	15.21	7.93
30. Rubber products	.30	.37	.74	.47	.65	12.67	.09	.08	.69	.11	.40	.39
31. Leather and leather products	----------	.16	.31	1.09	.11	.03	.22	.06	.27	.14	(3)	.28
32. Stone, clay, and glass products	1.08	.67	1.30	1.04	.91	1.65	.45	.69	1.89	.46	.47	1.11
33. Primary metal industries	9.23	5.26	4.44	5.19	4.35	5.32	7.16	1.24	5.95	8.18	5.59	11.91
34. Fabricated metal products except ordnance, machinery and transportation equipment	9.74	.87	2.13	1.67	1.36	2.66	1.44	.58	3.28	.65	1.87	1.38
35. Machinery (except electrical)	36.42	26.58	10.09	5.13	19.53	15.88	19.38	9.00	19.48	7.67	37.45	18.09
36. Electrical machinery, equipment, and supplies	2.96	5.33	5.54	2.30	4.17	7.56	4.97	1.37	5.44	1.91	1.37	5.09
37. Transportation equipment	14.83	7.83	3.33	.93	7.28	16.74	2.34	3.37	14.65	10.12	2.44	4.28
38. Professional, scientific, and controlling instruments; photographic and optical goods; watches and clocks	1.44	1.10	2.73	3.69	1.39	1.43	1.46	.75	1.70	.73	1.19	1.42
39. Miscellaneous manufacturing industries	.61	.76	.34	4.08	.12	.52	.29	.35	1.02	.17	.09	.11
Unclassified	1.29	.95	5.47	4.92	1.95	1.35	9.51	4.89	4.97	1.31	1.52	.74
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Total value (thousands of dollars)	$22,141	$336,098	$50,103	$33,970	$152,286	$21,442	$284,557	$669,226	$636,606	$251,756	$31,378	$64,588

See footnotes at end of table.

ADDENDUM B—Continued

TABLE 3.—*Percentage distribution of 1953 United States exports, by industry, for 32 selected countries of destination* [1]—Continued

Industry and Standard Industrial Classification [2]	Philippine Republic	Portugal	Spain	Sweden	Switzerland	Turkey	United Kingdom	West Germany	Yugoslavia	Range of percentage		Average percent distribution
										Minimum	Maximum	
Meat animals	0.03		0.03	0.02	0.07	1.61	0.05	0.01	1.40		1.61	0.14
Poultry and eggs	.01		.01		.04		[3]				1.45	.10
Farm dairy products	.01										.24	.01
Food grains and feed crops	[3]	17.50	19.58	.15	1.58	.02	14.45	20.21	45.88		45.88	10.50
Cotton	.67		28.73	5.20	2.96		9.16	12.30	10.87		28.73	5.71
Tobacco	2.68	8.33	1.38	5.40	5.93	.02	21.61	12.41	1.22		21.61	4.84
Oil bearing crops	.20			[3]	.07	.02	.53	2.64	.54		10.86	1.19
Vegetables and fruits	.44	.01	.16	1.19	.80	[3]	.33	.40	.60		5.61	.83
All other agricultural	.05	.01	.05	.02	.21	.10	.17	.42	.01	0.01	1.45	.24
Fisheries, hunting, and trapping		.05		.10	.79	[3]	.85	.10			.85	.09
10. Metal mining	[3]			.37	.01		.61	.37			1.05	.12
11. Anthracite mining									.41		1.72	.08
12. Bituminous coal and lignite mining		.36	.54	.51	1.36			7.73	3.52		7.73	1.53
13. Crude petroleum and natural gas extraction							.23				3.10	.26
14. Mining and quarrying of nonmetalic minerals except fuels	.20	.02	.02	.57	.62	[3]	1.05	.62	.27	[3]	8.95	.78
15. Building construction, general contractors												
16. Construction other than building construction												
17. Construction, special trade contractors												
19. Ordnance and accessories	.02	.02		[3]	.01	.01	[3]		[3]		.35	.02
20. Food and kindred products	15.17	1.07	1.82	4.91	8.40	.30	3.05	7.25	5.13	.22	27.42	6.38
21. Tobacco manufactures	1.43	2.96	3.44	4.58	1.57		.26	.49	.95		4.58	1.22
22. Textile mill products	22.59	1.25	3.19	3.56	9.15	.99	.12	.17	.01	.01	22.59	3.51
23. Apparel and other finished products from fabrics	.95	.15	.18	.22	2.25	.10	.09	.15	.02	.02	3.12	.66
24. Lumber and wood products, except furniture	.10	.48	.02	.24	.20	.12	1.22	.73	[3]	[3]	3.49	.61
25. Furniture and fixtures	.24	.05	.08	[3]	.07	.22	.01	.01	.03	[3]	1.85	.21
26. Paper and allied products	3.81	.22	.25	.27	.58	.24	1.78	.49	.02	.02	3.81	.78
27. Printing, publishing, and allied products	.94	.20	.07	.31	.25	.19	.77	.17	.06	.02	1.69	.39
28. Chemicals and allied products	8.74	9.80	3.45	6.73	12.50	4.59	7.40	9.96	3.63	3.08	21.88	8.49
29. Products of petroleum and coal	1.58	4.85	4.35	8.04	1.08	5.04	7.27	1.55	.59	.59	16.55	4.49
30. Rubber products	1.87	.45	.14	.43	1.00	2.53	.06	.06	.09	.06	12.67	.92
31. Leather and leather products	1.47	.03	.01	.01	2.23	.01	.11	.02			2.23	.30
32. Stone, clay, and glass products	1.40	.48	.16	1.68	1.09	.58	.49	.36	.26	.16	2.76	.96
33. Primary metal industries	3.99	10.07	4.53	6.13	8.32	12.88	5.60	3.48	5.47	.83	12.91	5.96
34. Fabricated metal products except ordnance, machinery and transportation equipment	4.13	1.15	1.30	1.76	1.30	4.92	.78	.16	.25	.09	9.74	2.13
35. Machinery (except electrical)	11.23	19.72	14.37	17.56	12.85	40.99	18.00	5.35	10.93	5.35	40.99	17.71
36. Electrical machinery, equipment, and supplies	4.18	10.08	7.98	2.90	2.36	10.25	.84	.46	2.91	.46	29.56	5.06
37. Transportation equipment	5.91	6.69	2.34	24.26	9.53	11.33	.92	.77	1.10	.24	24.26	8.34

38. Professional, scientific, and controlling instruments; photographic and optical goods: watches and clocks	1.67	2.48	.56	2.00	2.49	1.41	.70	.64	1.49	.56	2.73	1.49
39. Miscellaneous manufacturing industries	1.33	.58	.21	.22	7.20	.62	.16	.23	.01	.01	7.20	.83
Unclassified	2.96	.94	1.05	.66	1.13	.91	1.33	10.29	2.33	.50	18.86	3.10
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	----------	----------	----------
Total value (thousands of dollars)	$350,970	$26,010	$70,110	$101,824	$131,173	$64,460	$580,550	$347,888	$109,372	----------	----------	----------

[1] Selected countries are those which were major suppliers of protected imports in 1953. Figures in the table represent percentage distribution of United States exports of domestic merchandise to each country (i. e. excluding reexports). They exclude "special category" exports, which are omitted from basic data of exports to individual countries because of security regulations. The exports represented in the table total $8,683 million and constituted 75.3 percent of total United States exports of domestic merchandise other than special category exports and 55.4 percent of total United States exports of domestic merchandise including special category exports.

[2] The first 10 industry divisions are a special classification of the agricultural sector not related to the Standard Industrial Classification. Other industries are numbered in accordance with SIC code numbers.

[3] Less than 0.05 percent.

Source: Bureau of the Census, U. S. Department of Commerce.

Mr. BOLLING. Thank you, Mr. Salant.

First, I would like to inquire of you gentlemen if you would like to comment further on your own statements or on any questions that were raised in the statement of the other?

Mr. SALANT. No, sir.

Mr. BOLLING. Occasionally this has brought forth fire.

Mr. SALANT. I cannot contribute to any fireworks.

On my part, I would like to say that if the purpose of the hearings is educational some result has already been achieved because some of Doctor Woolley's results I think will be very useful in my research.

Dr. WOOLLEY. I think we constitute a two-headed Janus, looking in opposite directions.

Mr. BOLLING. Mr. Balivet, do you have some questions?

Mr. BALIVET. No, sir.

Mr. BOLLING. Dr. Sheldon?

Dr. SHELDON. I want to turn, first of all, to the statement which Doctor Woolley presented.

You pointed out that many of these trading relationships of the major areas are pretty well set into two-way patterns; that there are some secondary patterns that have developed and, of course, some multilateral relationships.

Do you consider this multilateral trade of minor importance? Is it something we could forego and just concentrate on the major relationships which exist in these several regions of the world or is it possible that this multilateral trade, even though secondary, is still pretty significant from an economic point of view?

Dr. WOOLLEY. First, I would like to know more about the character of multilateral trading relations. This was the import of my comment, that I find the pattern which I am able to present to you today in figures 1 and 2 inadequate because it represents, or shows, the multilateral relations between five areas. Since the basic structure of trading relations involves at least 7 areas (the 3 centers, the 3 affiliates, and the Soviet bloc), I feel that we need to understand more fully the nature of the multilateral trading relations between them.

Now, I would not wish to minimize the importance of multilateral trade. On the contrary, my disposition is to feel that governmental policies and events of postwar period have tended to go too far in strengthening principal trading relations at the expense of the kind of division of labor among countries which would more fully exploit the possibility of multilateral trade.

Multilateral trade is really only possible when countries can offset deficits in one direction by employing the proceeds of surpluses in another. This requires that the earnings from one direction be convertible to the currency of another direction, and since we live in a world of inconvertible currencies, the fact that currencies are inconvertible has tended to prevent this kind of development.

Dr. SHELDON. You stated there had been some fairly marked structural changes in these flows of trade, comparing 1937 with 1951. If I understood what Dr. Bernstein said this morning, he indicated that some of the prewar patterns of trade were beginning to reappear in greater measure.

Now, I realize you are comparing primarily 2 individual years. Has your research gone far enough to indicate that even though 1951 is quite different in some respects from 1937, still it represents a stage back toward a prewar pattern?

Dr. WOOLLEY. I was comparing 1937 with 1954. Actually, the comparisons can be made, or can be seen (and the figures that I quoted are) from the International Financial Statistics figures on trade. A recent issue will show 1937 compared with 1952–54.

I think, in general, the outstanding characteristic of the present situation, compared with prewar, is the marked shift that has occurred. It is very possible that when examining particular trades in detail one would find a tendency for the pattern to change back, and indeed I believe this is very likely to be the consequence of the efforts being followed in Europe to increase the degree of convertibility of currencies.

However, I submit the figures on 1954 are the latest we have, and they do show that in spite of the fact that nearly 10 years from the end of the war there remains a very marked shift. And any shift from year to year, of course, has to be considered in the light of the peculiar characteristics of that year, so one has to take averages to talk about structural change. I am not in position to dispute the statement.

Dr. SHELDON. I think we had another comment that was quite apropos to this same problem. Professor Millikan made the point that some of these changes relate not alone to the upsets of World War II, but to economic development of backward areas. That kind of shift is likely to be something that will stay with us, even when any recovery from war dislocations has been completed.

In your analysis I notice that you have used the expression "World trade and payments," implying, of course, much more than just merchandise trade. You have spoken of the service items, and in going over the paper in detail I think these are pretty well specified as to what you mean, but just to make it clear now, what are some of the kinds of service items which go into this total flow of which you speak?

Dr. WOOLLEY. We have treated them in these categories. There are transportation services, the services accorded travelers, services on foreign investments (including interest and profits, dividends remitted, and also earnings reinvested), and then there are a variety of miscellaneous services, including the disbursements of Government agencies in foreign countries, royalties, fees, rental on machinery, the services of migrant workers, the services of managing firms, and so forth.

One of the categories in the balance-of-payments account as it is formally maintained is the account of Government transactions—the so-called Government services.

Now, this particular account poses some difficulty for us because in many countries it includes transactions on things like merchandise and the use of ships, shipping services, and the like, which are not essentially the same kind of category as the others.

Nevertheless, they are distinguished in published payments accounts, and we have kept them separately, also.

Dr. SHELDON. Your total flow includes both visible trade or merchandise trade, and the services which we frequently call invisible trade?

Dr. WOOLLEY. Yes, sir.

Dr. SHELDON. Is it correct that actually trade in either the visible or invisible category still in many ways is equally important to the balance of payments, not in quantitative amount, perhaps, but in character equally important to the economies which are involved?

Perhaps my question is too broad in this respect. Let me rephrase it.

Sometimes when we make purchases from other countries the long-run offsetting transaction will be export trade of our own flowing out in merchandise. Isn't it true that it is just as helpful to provide services to other countries? Likewise, a useful offset to American exports are American tourist expenditures abroad, as one example. This, again, is pertinent to some of the discussions which come up on trade policy, of course.

Dr. WOOLLEY. It is equally a good way to make a living.

I might say that in the total figure we have in table 1, $97 billion for 1951 of goods and services transacted between countries in the world, $75 billion represents merchandise, and $22 billion consists of the services that I have mentioned. I might say that these two figures are presented here for the first time. We think they are about right. It has been a lot of trouble to get them together.

The services that are rendered in the world are supplied mainly by the advanced countries. This is particularly so of the services that attach to foreign investments and the management of businesses around the world.

The United Kingdom and the United States, particularly the United States, make most of the foreign investments in the world.

The shipping services are rendered mainly by the maritime countries of the world, which include the United States, the United Kingdom, and a number of the continental countries. There are some fleets in other areas, but mainly the shipping tonnages under the ownership, if not necessarily the flag, of those countries. However, much of the disbursements that come in the transportation account include port disbursements of those fleets so that they tend to be offsetting transactions.

Another item, also in the transportation account, is the expenditure of fleets for bunkers, and bunkers, of course, are supplied mainly by petroleum companies—mainly American and British companies.

The travelers in the world tend to come from the United States, Canada, the United Kingdom, and on the Continent, and they tend to go to various affiliated countries of the centers. The miscellaneous services are mainly supplied by the advanced centers, and the governmental purchases are mainly by the United States.

Dr. SHELDON. I don't want to make the discussion too technical on this point. I was very interested in hearing of figures on the relative proportions of merchandise trade and of services. Is this division something which would—it undoubtedly would—change if you made an arbitrary decision to use an f. o. b. or c. i. f. valuation of imports? In one case you would leave out shipping services as a part of the price of the merchandise, and in the other case you would throw it in. That would change these relative proportions, wouldn't it?

Dr. WOOLLEY. In this presentation, since we are dealing here with a kind of tabulation that shows payments to and from areas, we have to treat the valuation the same on both sides, and the only feasible way to treat it is to show merchandise value, f. o. b., and to put all of the transportation charges into the service account.

I might also add that the same kind of problem arises from including gold in merchandise. We have excluded gold from the merchandise account, even though it may be newly produced by South Africa, because on the receiving side, countries would count this as monetary gold rather than as gold newly produced by South Africa and consequently gold is not included in the current, or goods and services account.

Dr. SHELDON. Where do unilateral transfers fit into this picture?

Dr. WOOLLEY. In table 2. The net goods and services balance between areas of the world is shown as being partly financed by interarea transfers, and we show separately those that originate with private persons and institutions and those which originate with governments. These are lines 2 and 3 in each box, on page 29.

There is a complication in accounting for official transfers. It is a technical matter. Some of the official aid of the United States, and other countries, was given to the European Payments Union, and also to the United Nations organizations, and in turn was extended by these international institutions to other countries.

Now, in this accounting we have shown both transactions. This is partly because of the fact the receiving country will show the assistance as coming from the international institution. In a sense there are two aid extensions made, so we show both. This tends to make the total official transfers somewhat larger than it would otherwise be, but, of course, underneath that total there are pluses and minuses offsetting.

Dr. SHELDON. I have just one other question about some of the things that you have said.

The figures which you have presented in these tables, and the charts, are for just the year 1951, are they not?

Dr. WOOLLEY. Yes, sir.

Dr. SHELDON. By the time you proceed to figure No. 2, which takes into account unilateral transfers, as well as the trade, you still have some balances left over.

Dr. WOOLLEY. Figure 1, sir, is goods and services net.

Figure 2 is after taking account of gifts and aid, and the balances shown are the balances that would be financed by gold movements, by capital movements, by multilateral settlements, by interarea transfers of funds, and also our errors are in there, too.

Dr. SHELDON. Is it possible that any of these net figures are a reflection of short-run conditions? It happens to be what the figures are for 1951, but do you feel also that is indicative of the pattern of this general period?

Dr. WOOLLEY. I feel that the patterns we show in figures 1 and 2 must be considered as peculiar to the single year, 1951. We hope to be able to show how this picture changes from year to year, and I hope we can cover 1953 and perhaps later times. I could speculate a bit about how I think the pattern may have changed from time to time. I know in 1952 and 1953 things were pretty good in the sterling area, and I believe they ran surpluses overall. Hence, they must have earned from some areas and paid to others, so that I would expect in looking at other years, to see this pattern changing from year to year. I think that would make an interesting story as we get the figures.

Dr. SHELDON. Thank you very much.

Mr. Salant, in your presentation, you discussed the importance of various kinds of factors which affect the well-being of particular industries. I have a question which I don't believe it would be possible to answer directly from your paper. How do we sort out the relative importance of all the factors which are present in any practical problem of studying conditions of an industry? How do we know how much of its problems are caused by import competition and how much may be a matter of market changes, technological change, or every inefficiency in a particular company? Are we without an answer to this problem, or is there some way that we can assign responsibility among these several factors? This again is pretty important when there is resort to the escape clause, even if the law doesn't require us to make this distinction.

Mr. SALANT. Well, it seems to me rather hard to make a generalization about a question like that. Sometimes statistical methods will lend themselves to giving you an idea in which you have a fair degree of confidence at least as to how important one factor is and how important another factor is, and sometimes that is not possible. Perhaps in the usual custom of those who can't answer the question that is asked of them, I should try to substitute another question, and that is to raise the question of how often does it really matter. Sometimes it does, but I suspect not quite as often as it may appear to. That, I think, is one of the implications of some of the points I made in the last part of my statement, but to return to the question, I think, for example, if an industry has been enjoying a rather rapid expansion of markets, and there is then, for example, a sharp reduction in protection which was very considerable before, and a large flow of imports comes in and simultaneously the output diminishes, or the demand diminishes and you can see the connection fairly clearly, you may have a good deal of confidence that the cause of reduction in that industry's output is to a very considerable extent the reduction of the protection.

Occasionally, if the figures permit, you may go further into these things and you may find other things which would upset that conclusion, but it is very difficult to generalize about it, so I revert to my substitute question, that before you break your head on that question, I think it is good to ask the question whether you need to know.

I mention that because it seems to me that the question comes up, for example, in proposals to give compensation to those who are injured by reductions of import barriers. It comes up there because most such proposals propose that the compensation be adjusted to the degree of injury which was caused by reduction of import barriers. Then some administrative agency, if such a proposal is put into effect, would have to decide not only how much injury there was but how much was attributable to the reduction of tariff barriers.

Now, it might well be that there was injury attributable to the reduction of tariff barriers, but no net injury, that is, the industry is not any worse off that it was before because other factors are helping it out. There would be a question then of whether public policy involved giving any kind of compensation.

There is also the question of whether whatever assistance for adjustment is given should be on that basis at all, of compensation for injury, or whether it should have an entirely different rationale, namely, to help them adjust to the situation, without actually compensating them. I think in both of these cases the question might appear to arise, but I would say properly should probably not.

Dr. SHELDON. I asked my question in very general terms, I realize. I didn't want to take a specific case, because that would involve us in questions of fact.

To turn to one case with which most people are familiar, would you feel that the questions raised by the coal industry in the case or residual oil imports could be assessed by statistical means? Could we have confidence in weighing the evidence available in statistical form to determine whether the injury that the coal industry feels it has suffered has been the result of residual oil or whether other factors have been at work? Is this something which is subject to statistical test? I ask because there has been violent disagreement as to the significance of available statistics on this question.

Mr. SALANT. I should think if you know where the coal had been going before the output went down and you knew where it was going now, and you knew which buyers had reduced their use of it, you would have a pretty fair idea.

Now if you were to find, for example, that the buyers who are using it are not using any commodity which is coming in in greatly increased proportions, owing to any reduction of import barriers, I should think you could be fairly safe in concluding that the reduction of import barriers was not the cause of it.

I suppose there are such statistics for most industries and if you find that some other thing has been going on at the same time, as you may be able to from such statistics, you ought to be able to get a pretty good idea.

My impression in that case—perhaps I shouldn't say anything about it, because I have not myself studied it, but I will take a chance—is that other factors are largely responsible in that case, and that there are some figures which make a conclusion possible.

Dr. SHELDON. Thank you.

Let me ask just one more question: In your discussions of primary effects of imports on the economy and indirect effects, am I correct in thinking that this concept is separate and distinct from the concept of the multiplier, which economists use?

Mr. SALANT. Yes; I think you are correct. I meant by the primary effects, the effects before including any of those effects which resulted from the change in income and the subsequent changes in expenditure of the people whose incomes had changed. The concept of the multiplier, as you know, includes or is in fact intended to take account of those changes induced by changes in income.

Now, when I used the terms "direct" and "indirect," I intended those to refer to component parts of the primary effect. By "direct" I meant the effects in the industry in the last stage and by "indirect" I meant the effects upon the supplying industries and the suppliers' suppliers, and their suppliers, which incidentally may get back to the first industry.

Dr. SHELDON. Thank you. That is all.

Mr. BOLLING. Dr. Ensley?

Dr. ENSLEY. Mr. Salant, I gathered from your paper that it is your feeling that the adjustment hardships growing out of increased imports are comparatively minor or would be comparatively minor in comparison to the adjustments that we make continually in a dynamic economy such as ours resulting from technological change, changes in tastes, regional differences within the continental United States, and so forth. Is that conclusion warranted from your analysis?

Mr. SALANT. Minor in magnitude in terms of number of people affected but naturally for the people affected they are not minor.

Dr. ENSLEY. That is right.

Mr. SALANT. I want to emphasize that I did not imply that that point should be disregarded.

Dr. ENSLEY. That is right. All of these adjustments, whether they grow out of automation or change in taste or technological change or imports, create hardships and are responsible for the large number of distressed labor market areas that we have in the United States at the same time.

We have been hearing in recent days of a comprehensive program to deal with such distressed areas. Could you visualize a broad comprehensive program so designed to serve the purpose of relieving the hardship in an area, which has resulted from either imports or from technological change, or from change in consumer tastes or the whole combination of other causes?

Mr. SALANT. I——

Dr. ENSLEY. Or is there something unique about the adjustment problems growing out of imports that would make a comprehensive program for these other purposes inapplicable, or ineffective in the case of the hardships or distressed areas developing out of imports?

Mr. SALANT. I can't think offhand of any reason why a program designed to deal with the general problem would not be appropriate for the particular kinds of hardships created by a reduction of import barriers, and I don't know if that was the main part of the question.

Dr. ENSLEY. That is the sense of the question.

Mr. SALANT. You put it first in terms of whether I could visualize a program to deal with these problems in general. My ability to visualize it has been made much easier by seeing a bill or two.

Dr. ENSLEY. You are referring to Senator Douglas' bill which deals with distressed area problems?

Mr. SALANT. I think there are others also. I can't think of any reason why there is a particular problem about the hardships arising from reduction of import barriers that could not be dealt with in the same way as hardships arising from other causes. I think there are occasions where some of the proposals made may not be useful for any of them, as for example, where the effort is confined to restoring the economic life of a particular community when that is based upon, for example, the presence of a natural resource which is depleted.

You may not want to give the assistance, or whatever it is, in the manner that will help to build up the same community, but this has no particular relevance to the distinction between hardships resulting from reduction of import barriers and hardships from other causes.

Dr. ENSLEY. This matter of distressed areas can perhaps be added to your list of criteria that appear on page 27 of your statement.

Mr. SALANT. I think it could well be, but I would want to make this proviso, that there is sometimes nothing very advantageous about preserving the particular community as against assisting a movement outside if people were willing to move to outside. That would be the only qualification. I think it probably is not of great quantitative importance.

Dr. ENSLEY. Thank you very much, Mr. Chairman.

Mr. BOLLING. I gather, Mr. Salant, if I understood your figures correctly, that in terms of the future, to maintain reasonably full employment, we would need the increase of 4.2 percent in GNP per year. Do I remember correctly?

Mr. SALANT. That is the figure I had in my paper. I did not emphasize, I think, that this is not the figure of the joint committee staff but is a figure I computed based upon some work of the joint committee staff and it assumes the present hours worked per week. I was concerned not so much with the figure itself as with the relation between it and the additional amount that would be added to it by what I thought was a generous figure for the reduction of import barriers.

Mr. BOLLING. I was getting to the relationship. I wanted to be sure I understood. You then make certain assumptions arriving at a figure of less than a billion dollars as the possible direct and indirect impact of any conceivable reduction in tariffs under present law.

Mr. SALANT. On an annual basis under present law; yes, sir.

Mr. BOLLING. And that your 4.2 percent came out to be about 16 billion?

Mr. SALANT. That is correct.

Mr. BOLLING. So that any conceivable impact under present law might contribute about one-sixteenth; less than a sixteenth of the problem that is built into the situation?

Mr. SALANT. That is correct, from the point of view of the total demand, total market expansion required in the economy.

Mr. BOLLING. And you felt that your figure of $900 million was based on, in a sense, the most conservative approach that you could make. That would be a very generous figure, in other words.

Mr. SALANT. I think so. The element of conservatism came chiefly in the assumption that for every additional dollar of imports only 40 cents would come back to the United States as additional exports.

Mr. BOLLING. The clear indication is obvious, that the major problem is a dynamic economy domestically. Our major domestic problem is certainly not the question of whether tariffs are lowered or kept the same.

Mr. SALANT. That is correct. That is the correct conclusion from the point of view of employment.

Mr. BOLLING. Thank you.

I want to thank you gentlemen both for a very constructive and helpful contribution. We deeply appreciate your time and effort. Thank you for being with us.

The subcommittee will now adjourn until Monday morning at 10 o'clock, when the subject will be Domestic Reactions To Trade.

(Whereupon, at 3:50 p. m., the subcommittee adjourned, to reconvene at 10 a. m. Monday, November 14, 1955.)

FOREIGN ECONOMIC POLICY

MONDAY, NOVEMBER 14, 1955

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met at 10 a. m., Hon. Richard Bolling (chairman of the subcommittee) presiding.

Present: Senator Ralph E. Flanders.

Also present: Grover W. Ensley, staff director; Charles S. Sheldon II, staff economist.

Mr. BOLLING. The subcommittee will be in order.

Last week the subcommittee heard witnesses discuss statistical availability of data, conceptual problems of international comparisons, fundamental principles of trade and payments, and, finally, how to assess the impact of imports on the domestic economy.

With this background, we are prepared this morning to hear a number of witnesses present particular problems and points of view in the general area which we are labeling "Domestic Reactions to Trade." We have many to hear, and time is severely limited. We want to have discussion and questioning of witnesses, as well as hearing their summary statements. To conserve time, I will keep introductions brief, and we must limit the time of each witness to his fair share. That will mean, as much as I regret it, I must at the end of 8 minutes say "the time is up."

The printed record will give opportunity later for full statements.

We will hear first from Prof. Don D. Humphrey, of Duke University, who has just completed a major study for the National Planning Association and the 20th Century Fund on import competition. Dr. Humphrey will speak on establishing criteria for judging the effects of foreign competition on United States industry, agriculture, and labor.

STATEMENT OF DR. DON D. HUMPHREY, PROFESSOR AT DUKE UNIVERSITY

Dr. HUMPHREY. Mr. Chairman, thank you.

Since my remarks will be critical of the escape clause, I want to make it perfectly clear that I support the program for expanding trade; that I think it is a notable accomplishment to have reduced duties on imports by 75 percent; and that my objective is constructive. My criticism deals entirely with the means to that end.

I am going to be critical of the escape clause, and of the President's handling of his responsibilities. I will confine my remarks to these two specific issues.

I have called this trade-agreements program Janus-faced because it looks forward to the liberal tradition of expanding mutually beneficial trade and, on the other side, looks back toward protectionism with the promise that no home industry, however small, will be seriously injured as a result. Clearly, it is a poor policy to reduce tariffs and displace domestic production, and then raise them again and displace foreign production. It would be better to limit imports in the first place to a rate that can be accommodated by the transfer of resources out of the protected industries that are vulnerable to foreign competion. We already attempt to do this with the idea of reducing tariffs gradually. That is, of course, an entirely desirable approach and necessary, but the gradual reduction of tariffs isn't enough because we live in a highly dynamic economy, and there are many other things going on, and when we superimpose the displacement from tariff reduction on top of the displacements that arise in connection with internal growth, we get sometimes a more rapid total dislocation than the economy can absorb, and most of the escape-clause problems arise for this reason.

The second point I am concerned with is equity. This is a difficult program, the removal of tariff protection from industries that have enjoyed it for generations, and some standards of equity are essential in making this adjustment.

The first and most fundamental proposition I would suggest is that growing industries have no legitimate claim to protection in order to attract workers and expand at the expense of competing American industries that would otherwise be able to employ these same workers to produce goods of greater value. The specific amendments in the present escape clause procedure that I would like to suggest are these:

To make it clear, first, that protection can be eliminated more promptly in the case of rapidly growing industries that can absorb foreign competition, without the necessity of contracting domestic employment. There are many instances where the expansion of consumption will take care of the increase in imports and still enable the domestic industry to grow.

My second amendment, and this is an extremely important one because the Congress this year moved in the opposite direction, which I submit is the wrong direction, is that the test of injury should be applied to the industry as a whole, and not to a single product. Where foreign competition can be absorbed within a single industry, by changes in the composition of output, there is no serious injury. Moreover, it is my judgment that most of our mass production industries will enjoy a net benefit. They may have to contract production of some specific products, but others will be expanded.

My third specific suggestion in connection with the escape clause is that in those home industries where employment is already contracting, the growth of imports should be limited so far as practicable, to a rate that can be accommodated by the shift of employment, and that if for any reason the industry is seriously threatened the escape clause should be used as a reprieve to provide time for adjustment, rather than as permanent protection. The protection could be for a specified period, with duties, or quotas reverting automatically to lower levels as the reprieve expires.

I do think that both domestic and foreign producers are entitled to a clearer idea of what to expect than is possible under the present system, which creates unnecessary uncertainty.

Finally, I believe that in adjusting tariffs and in administering the escape clause, the rate of contraction of employment in the industry should be the major guide. This would take into account all the other factors of dynamic growth, as well as the displacement by imports. So long as the employment in protected industries is contracting, I do not feel we need worry too much about the rate of duty.

I would add one further amendment for clarification, and that is that imports which create their own market have a different status from those which displace domestic production. Where the market is enlarged because of the expansion of imports, for reasons other than the lower price, there is no displacement of domestic production.

Quite clearly agriculture causes our most difficult problem because it is already subject to the most severe displacements, owing to the higher birth rate on farms, technological advance, and the inelastic market for food and fiber. I would still suggest, in connection with agriculture, that the best rule is to apply the same test that we apply to both big and little business, which is to limit the growth of imports to the rate at which workers can be transferred to more productive employment.

In all that I have said I have assumed that we are agreed that trade is mutually beneficial, and that it involves shifting workers and capital to other products and other industries where they will produce goods of greater value, and that this is a source of strength and a means of raising the standard of living, and my comments have been directed entirely to this process of insuring that the adjustment is a gradual one.

Now——

Mr. BOLLING. Thank you, Dr. Humphrey. That was a perfect point, exactly 8 minutes.

Dr. HUMPHREY. Mr. Chairman, the administration of the escape clause has created unnecessary uncertainty because the criteria laid down by the Congress are ambiguous and because of President Eisenhower's unique interpretation of his responsibility.

In the bicycle case and others, for example, the President referred to the following issues: (1) The value to the United States from strengthening our allies; (2) the building of export markets for our farms, factories, and mines; (3) the question of compensating tariff reductions to other nations, if concessions on a specific item are withdrawn; (4) the protection of consumers against unnecessary price increases.

The President then says:

> The Tariff Commission has the responsibility with respect to the first of these questions. * * * The President has the responsibility of considering, not only the question of injury to a domestic industry and measures recommended for its relief, but also the other fundamental questions bearing on the security and well-being of 165 million Americans. The Preident's final judgment in each case must represent the best composite evaluation he can make of these questions.

This view can only result in confusion and uncertainty. Clearly, these are issues of the highest importance. But they are relevant to the question of whether or not we should have an escape clause and they are not material to the question of whether or not a specific industry is seriously injured.

To strengthen the economy of other nations by expansion of mutually beneficial trade is of major importance and should play a role in determining our tariff policy. It may be argued that we ought to accept serious injury to some industries in the interest of higher objectives. But this is not the position the President has taken in declining to invoke the escape clause after the Tariff Commission found serious injury. Instead, the President has found, contrary to the Tariff Commission, that the industry was not seriously injured. I have trouble in understanding how the question of foreign policy is relevant to whether or not a domestic industry is seriously injured.

In the case of screen-printed silk scarves, the President's position seemed to imply that different standards might be justified because the imports were from Japan (rather than from Canada, for example). The case for some form of compensation is very strong, indeed, if this view were carried out. It is inequitable to require one industry to bear more serious injury than another because of the dictates of foreign policy.

Much the same difficulty arises from the other issues that the President has considered. The building of export markets and protection of consumers are compelling reasons for a liberal trade policy. The protected industries have no legitimate claim to protection in order to bid resources away from competing home industries that would otherwise employ these same resources to produce goods and services of greater value. But the President has only the tariff-making powers delegated to him by the Congress. And it seems a little gratuitous for him to assume responsibility for the interest of exporters and consumers after the Congress has already made this decision. The very principle the Congress has laid down, which is that domestic producers shall not be seriously injured as a result of concessions, precludes taking into account the interest of competing home industries.

As I have already testified, I believe that the escape clause should be modified in several important respects. But once the Congress has laid down a policy calling for withdrawal of concessions to avoid serious injury, I believe that the standards should be applied uniformly even though some of us may believe that the standards are misguided and should be amended.

It is highly desirable that the Congress continue to delegate the responsibility for tariff adjustment to the President, and that he be left a measure of discretion in invoking the escape clause. However, the standards should be improved and clarified. Both foreign and domestic producers are entitled to a better idea of what to expect than is possible at present. The standards laid down by the Congress should be systematically and uniformly applied unless the consequences would gravely affect our foreign relations, in which case some form of compensation is called for.

Thank you, Mr. Chairman.

(The complete statement of Mr. Humphrey is as follows:)

THE ESCAPE CLAUSE

Statement of Don D. Humphrey, professor at Duke University

Expansion of trade is like introducing a new machine or a new technique. It makes each day's labor more productive and, therefore, is a source of strength and a means to higher living standards both at home and abroad.

The effectiveness of our program for expanding mutually beneficial trade is seriously impaired by the escape clause which provides that imports are to be restricted if domestic producers of any article are seriously injured or threatened as a result of tariff concessions. Foreign producers are deterred from finding out if they can develop an American market by the express threat that it will be cut off if they are successful. I am here this morning to urge a better procedure.

Clearly, it is a poor policy to reduce tariffs and displace domestic production, and then raise them again and displace foreign production. It would be better to limit imports in the first place to a rate that can be accommodated by the transfer of resources out of the protected industries that are vulnerable to foreign competition. We already attempt to do this by reducing tariff gradually. But this is not enough. In a highly dynamic economy there are many other forces, such as technical improvements, new materials, changes in taste, and growing population that also require the shift of resources. Imports may not respond to lower duties for a decade, and then increase quite rapidly, owing to changes of costs or because a niche has been discovered in the American market.

The road to freer trade is difficult because, although the gains exceed the losses, the distribution of benefits is inequitable. Some industries will benefit while others suffer as a result.

The problem of full employment does not concern the tariff. Most of our major industries do compete with cheap foreign labor, and very successfully, too. In protecting those industries that cannot compete, we are injuring other home industries that can. Growing industries have no legitimate claim to protection in order to attract workers and expand at the expense of competing American industries that would otherwise be able to employ these same workers to produce goods of greater value.

Difficult adjustments call for some standards of equity. Those industries where employment is already contracting may fairly claim enough time to adjust to foreign competition without unnecessary hardship and financial loss. While the adjustment is painful in any event, it is bearable if it can be made by attrition of labor force and depletion of fixed investments.

In our experience thus far, most cases of serious injury have resulted from the fact that the industry did not have time enough to adjust. In my opinion, some of them failed to obtain relief under the escape clause. Usually, this was because they were hit by other dislocations in addition to foreign competition. It would be entirely appropriate to provide some kind of assistance to facilitate reemployment, migration, and the development of new industries in a locality that is vulnerable to foreign competition. But, with or without public assistance, it would be better to limit the rate of increase in imports relative to the domestic market than to encourage trade and at the same time threaten to restrict it. One is reluctant to recommend quotas because they are easily abused. But I would rather use quotas or some other "gimmick" to expand trade than to restrict it, or to threaten continually that it may be restricted.

We want more mutually beneficial trade. The adjustment is difficult. My suggestion for dealing with the question of injury can be summarized in five points:

1. Eliminate tariff protection for growing industries that can absorb foreign competition without the necessity for contracting domestic employment.
2. Most of our mass-production industries can adjust to foreign competition by changing the composition of the output. The test of injury should be applied to an industry and not to a single product. It will often be found that there is a net gain within the industry from the expansion of trade.
3. In those home industries where employment is already contracting, the growth of imports should be limited, so far as practicable, to a rate that can be accommodated by the shift in employment.
4. If, for any reason, an industry is seriously threatened, the escape clause may be used as a reprieve to provide time enough for adjustment, rather than

as permanent protection. The protection would be for a specified time period with quotas and duties automatically reverting to lower levels as the reprieve expired. Both domestic and foreign producers are entitled to a clearer idea of what to expect than is possible under the present system which creates unnecessary uncertainty.

5. Finally, I believe that, in adjusting tariffs, the rate of contraction of employment in an industry should be the major guide. This would take into account the displacement from technology and other dynamic factors of growth as well as the displacement by imports. So long as employment in protected industries is contracting, I do not feel that we need worry too much about the rate of duty.

Agriculture poses the most difficult problem. The solution is to stop producing surpluses by getting the excess of farm labor into nonfarm employment. Agriculture is already under a heavy burden of adjustment because of (1) the relative high farm birth rate, (2) technological advance which reduces labor requirements, and (3) the inelastic markets for food and fiber. In addition there has been a drastic postwar adjustment which has reduced agricultural exports and increased agricultural imports. This adjustment is far from completed. The restrictive effect of tariffs and quotas on agricultural imports today probably exceeds that on all other products. Nonetheless, much of the criticism of protection for agriculture is unfair in that it employs grossly inequitable standards. There is no equality of treatment in lowering trade barriers equally between agriculture and the mass-production industries. There is probably no important branch of industry in which the reduction of employment has been so great as in agriculture and where competitive imports are permitted in such large volume in the face of ample domestic resources and relatively low incomes.

Let us apply the same test uniformly and systematically to big business, little business, and agriculture. Limit the growth of imports to the rate at which workers can be transfererd to more productive employment. And, beyond this, require shifts in the composition of output to make the best use of resources both in manufacturing industries and within agriculture.

I fully recognize that this adjustment will take a much longer time in agriculture than in manufacturing. That is a good reason for getting started. I am not arguing for lower farm incomes. But whatever means are used to raise incomes, it should not interfere with the shift of workers to nonfarm employment, or with the better use of resources within agriculture.

Mr. Bolling. As I said earlier, I very much regret having to be so strict on time, but there is little choice.

Next, I am going to call on a former distinguished Member of Congress, Mr. Voorhis.

STATEMENT OF JERRY VOORHIS, EXECUTIVE DIRECTOR, THE COOPERATIVE LEAGUE OF U. S. A.; ACCOMPANIED BY WALTER J. CAMPBELL, DIRECTOR, THE COOPERATIVE LEAGUE OF U. S. A.

Mr. Voorhis. Thank you, Mr. Chairman.

I have been asked to speak from the point of view of the interest of consumers in foreign trade. I would like to say that I am going to leave out some of the qualifications of my statement, in the interest of time, so that it is going to sound, I am afraid, a little more dogmatic than it ought to. But I am going to just hit the main points.

(The full statement of Mr. Voorhis is as follows:)

The Consumers' Interest in Foreign Trade

Statement of Jerry Voorhis

From the beginning of human civilization the people have had an interest in trade. At first practically all of it was "foreign" trade, because the clan or tribe was the unit of government. Production was primitive and almost exclusively extractive. So the only way in which life could be enriched with new physical satisfactions was by trade and barter with other clans or tribes. It was evident to all that, so long as the exchanges were reasonably fair, both groups benefited from such trade. It provided them with things they could not otherwise have, with things they could not produce for themselves, but which others could and did produce.

Actually the same principles of benefit to the people as consumers from foreign trade which applied in primitive times apply today in the same basic way. But we have developed a lot of foliage in the past 15,000 years or so which tends to obscure the trees.

The unit of government is now the nation instead of the tribe. And the people of many nations, notably our own, have become to a remarkable degree self-sufficient in supplying their needs. Furthermore the relation of production to consumption—once a very direct one—is now tenuous to say the least. We work at a tiny fraction of the production or distribution processes respecting single items. Most of us are paid wages or salaries. With these wages we must buy all the things we need for our family life—things which are the result of an extremely complex process engaged in by countless of our fellowmen. With a perhaps natural tendency to think in the areas easiest of comprehension, we tend to identify our total economic welfare with our positions, earnings, and circumstances as producers. We accept our fate and welfare as consumers without thought and without consideration of whether or not it is as it should be. This is still generally true in the United States.

It is much less true in older countries. And the inexorable march of events will shortly compel a change among us. For, if automation and all the related phenomena mean anything, they mean a sharp decline in the importance and strength of position of man as a producing agent and they mean a greatly increased relative economic importance of people as consumers.

For no matter how many crackers or automobiles or what not can be produced without contact with human hands, there still is no real sense in producing crackers unless they can be sold to and consumed by people. Nor is there any purpose in producing automobiles unless they can be sold to people and driven—for better or worse—on highways and streets.

With the coming of an intensified consumer consciousness on the part of the people will come inevitably a different and more sensible attitude toward foreign trade. People will see more clearly than they do now that there are two ways—not one only—of improving their living standards and enriching their lives. One, it is true, by increasing the number of dollars in one's income. The other is by having each of those dollars command a wider variety of goods and services at lesser cost per unit. Were we at this stage in the development of attitudes among the American people my testimony here this morning would be less necessary.

Another basic fact is that, while some progress has been made, the central economic problem of our time has not as yet been directly faced or grappled with, much less solved. That is the problem of maintaining a balance between active consumer buying power on the one hand and productive capacity on the other. If it were known that we had in operation in this country an effective mechanism for increasing the total volume of active consumer demand in line with increases in national productive capacity without increasing debt, then there would no longer be fear on the part of producing companies or their employees that imports from foreign countries would create unemployment and economic dislocation at home. But as of today these rather obvious economic adjustments remain to be made—even, in fact, remain to be seriously considered.

So we must take the situation as it is and admit that were we to adopt a free-trade policy tomorrow the gains for the people as a whole as consumers would be counterbalanced to a degree by the losses—in some cases severe ones—of certain particular groups of producers. In the kind of world in which we are now compelled to live we cannot fail to take account of these dangers nor to provide for their avoidance when they are really serious.

Let us try to state in one sentence the legitimate interest of all the people as consumers in increasing foreign trade in the light of the facts of our present situation. Here is my attempt at such a sentence: It is in the general interest of the whole American people to increase imports from foreign countries of (1) any goods or varieties of goods not produced in the United States and (2) any goods or varieties of goods whose production costs in foreign countries and hence whose cost to American consumers would be substantially less than is the case with the same goods domestically produced.

It is, of course, to be understood that when a domestic industry is really essential to our Nation's defense in time of crisis, such an industry must be maintained. But with all the misinformed outcry about farm subsidies, I would respectfully suggest that the better way to maintain such an industry might be by a direct subsidy which would clearly reveal the degree of its inability to survive under conditions of true competition rather than to call upon American consumers to pay that difference to the industry indirectly in uneconomically high prices.

The reason I connect this with what are mistakenly called farm subsidies is that one of the reasons farmers need protection in recovering cost of production for their labor and investment is because those costs are held by our protective tariffs at a higher level than they would be if trade were carried on more freely.

But to return to my theme sentence. The question arises as to why I place emphasis on increased imports rather than speaking about exports. This is because, given American ingenuity and aggressiveness in marketing, if imports are increased so as to enable foreign countries to earn more dollars, there is little doubt about our exports increasing, at least correspondingly. Furthermore, since we are a creditor nation, our imports should exceed our exports if the commerce of the free world is to achieve the kind of balanced health which would be one of the most severe blows that could be dealt to communism. So it is the imports that are the critical question—particularly from the point of view of the whole people as consumers. From the cold economic viewpoint of consumers, the matter of primary interest is, precisely, how much goods and of what quality they have the opportunity and means to provide for their families—regardless of where they come from.

I say "primary interest" because there are other considerations which modify the statement just made. For example, American consumers will not want to enjoy products which are cheap only because the workers who produce them receive substandard wages. Few such products, however, can successfully compete with American mechanized production. The far more common reason and the right reason for foreign products being cheaper—when they are—is some natural advantages enjoyed by the foreign country such as available natural resources, special skills, and the like. There is also the question of the extent to which purchases from potentially hostile countries are contrary to national policy. By and large, however, the above statement of consumer economic interest stands.

At present we as a nation are trying to eat three cakes and keep for ourselves also a large share of the fourth one. It cannot be done.

The first cake is interest and other income from our loans and investments as the world's No. 1 creditor nation. We want to continue to receive this income and indeed we probably can't keep from doing so with the economic scales weighted as heavily in our favor as they are.

The second cake is shipping. We want to develop a merchant marine and keep what we have busy. To do so we require certain shipments to be made in American bottoms. I am not arguing the policy involved in this—only pointing out the economics of it. We insist that a considerable portion of shipping costs be paid to American shipping companies, not to foreign ones.

The third cake is a so-called favorable balance of trade—favorable temporarily to Fort Knox, that is. What we mean by this is an excess of exports over imports. Since World War II, this has amounted to $39 billion. In 1953 alone the excess of exports was $5 billion.

We want to eat all three of these cakes, the creditor cake, the shipping cake, and the favorable balance of trade—to Fort Knox—cake. There is one way to do this. That way is to give back to the foreign countries that are paying for these three cakes a fourth cake large enough to equal all three of them. Since World War II, we have almost done this. Our various aid programs totaled $33 billion. But now we are talking about reducing the size of this fourth cake, the only one going outward bound. If this is done, the size of the inbound cakes must be reduced. It's a simple matter of mathematics.

The technical-assistance program is the best weapon we have in fighting communism. It should not be reduced but expanded. And it costs, comparatively, very little money.

As for other features of our aid program, most foreign countries would much prefer that we develop genuine two-way trade with them as a substitute for outright aid. But it has to be one or the other. Either we have to import more than we export—or else we have to give back, somehow, the purchasing power to enable other countries to buy our excess exports. Which do we want to do?

From the point of view of American consumers, it would be vastly better to allow imports to increase. From the point of view of basically strengthening the free world—Japan to take a critical example—the some conclusion is true.

Our consumer, this American family operator, has as a consumer paid every tariff that was ever levied by this country. If the tariff was high enough to keep foreign goods out, he paid the tariff on every unit of the goods domestically produced behind that tariff wall. If the goods came in over the tariff, he paid the duty multiplied 2, 3, or 4 times, depending on the number of middlemen who had a chance to mark up the price before he got a chance to buy it. Thus, though higher prices, consumers are paying whatever it costs to make it difficult for our friends abroad to sell their products in the United States.

It would be to the interest of the American people as a whole, as consumers to have tariffs sharply reduced, to have both imports and exports—particularly imports—move in larger volume, and thus to have more goods at lower prices to buy. It would have been to their interest not to have had chemical items stricken from the list of items on which the United States was prepared to negotiate under the Reciprocal Trade Agreements Act. The chemical industry is doing very well—sales in 1955 are expected to top $23.5 billion, a 20-percent increase over 1954. And a handful of companies—maybe one—control this industry. It would have been to American consumers' interest not to have had the cost of bicycles go up by $2 apiece as a result of a tariff increase. There are even tariffs on some exhaustible natural resources which slow imports of these and hasten the day when our own supply will be gone. This is economic folly at its worst—from a national point of view.

The State Department estimates that if all tariffs were reduced by 50 percent, the industries seriously affected would include only 200,000 workers. Some provision would need to be made to avoid hardship in these cases. But surely the problems would be far from insurmountable.

And every family in the United States would benefit—because every family is a group of consumers.

Mr. VOORHIS. People have always had an interest in trade, and in the beginning it was mostly foreign trade, because the unit of society was the clan or the tribe. Most of the production was extractive and primitive so that the only way people had of raising living standards was by trade. My first proposition is that these same principles of benefit to the people as consumers from foreign trade apply today the same as they did in primitive times, except that we have got a lot of foliage developed which obscures the forest.

We are now organized into large nations which have some of them, notably our own, achieved a great degree of self-sufficiency. We furthermore, most of us, work at parts of a productive job which are not a total job of producing whole products, but of making contributions toward that production or distribution.

In the next place we tend to identify our total economic welfare with our positions, earnings, and circumstances as producers, and we tend also to accept our faith and welfare as consumers without too much thought and without consideration of whether or not it is as it should be.

This is generally true in the United States, somewhat less true in older countries. But the inexorable march of events will shortly compel a change among us for if automation and all the related phenomena mean anything they mean a sharp decline in the strength of position of man as a producing agent, and they mean a greatly increased relative economic importance of people as consumers. It doesn't do much good to produce crackers or automobiles without the touch of human hands unless you can sell the crackers to people to eat, and the automobiles to people to drive on the highways and the streets.

With the coming of an intensified consumer consciousness on the part of the people will come a different and more sensible attitude toward foreign trade. People will see more clearly than now that there are 2 ways, not 1, of improving their living standards and enriching their lives. One, it is true, is by increasing the number of dollars in one's income; the other is by having each of those dollars command a wider variety of goods and services at lesser cost per unit. Were we at this stage in development of attitude among American people my testimony this morning would be much less necessary.

We have to take account of the fact that if we adopt a freer trade policy the gains for the people as a whole as consumers would be counterbalanced to a degree by losses, in some cases severe ones, to certain particular groups as producers, and certainly provision has to be made to prevent this falling with devastating impact on certain groups or industries. But with this qualification, I would like to state in one sentence the legitimate interests of all the people as consumers, in increasing foreign trade in the light of the facts of our present situation.

Here is my attempt at such a sentence: It is in the general interest of the whole American people to increase imports from foreign countries of, first, any goods or varieties of goods not produced in the United States, and second, any goods or varieties of goods whose production costs in foreign countries, and, hence, whose cost to American consumers would be substantially less than is the case with the same goods domestically produced.

It is, of course, to be understood that when a domestic industry is really essential to our national defense in time of crisis such an industry must be maintained, but I would respectfully suggest that the better way to maintain such an industry might be by a direct subsidy, which would clearly reveal the degree of its inability to survive under conditions of true competition, rather than call upon American consumers to pay that difference indirectly in uneconomically high prices.

Since we are a creditor nation, our imports should exceed our exports if the commerce of the free world is to achieve the kind of balanced health which I submit would be one of the most severe blows that could be dealt to communism. So it is the imports that are the critical question, particularly from the point of view of the whole people as consumers. From a cold economic point of view, of consumers, the matter of primary interest is how much goods and of what quality they can have the opportunity and means to provide for their families, regardless of where they come from.

I said that was a cold economic point of view. It is to be qualified, and I did in my prepared statement, but I am not going to take time to do it now.

Our consumer, the American family, has, as a consumer, paid every tariff that has ever been levied by this country. If the tariff was high enough to keep foreign goods out completely, he paid the tariff on every unit of goods domestically produced behind the tariff wall. If the goods came in, he paid the duty, multiplied by the number of middlemen who had the chance to mark up the price before he bought it. Thus, through higher prices, consumers are paying whatever it costs to make it difficult for our friends abroad to sell products in the United States. It would be to the interest of the American people as a whole as consumers to have tariffs sharply reduced, to have both imports and exports move in larger volume, and thus to have more goods at lower prices to buy.

I submit and explain in my written statement that I think if imports increased exports would automatically increase. It would have been to the interest of all the people as consumers not to have had chemical items stricken from the list of items on which the United States was prepared to negotiate under the Reciprocal Trade Agreements Act. The chemical industry seems to me to be doing quite well. Sales in 1955 are expected to top $23½ billion, and that is a 20-percent increase over 1954. A handful of companies, maybe one, control this industry.

It would have been to American consumers' interest not to have had the cost of bicycles go up by $2 apiece as a result of a tariff increase. There are even tariffs on some exhaustible natural resources which slow imports of these and hasten the day when our own supply will be gone. This seems to be sheer economic folly from the national point of view.

The State Department estimates that if all tariffs were reduced by 50 percent the industries seriously affected would include about 200,000 workers. Provision would need to be made to avoid hardship in these cases, but surely the problems will be far from insurmountable. And every family in the United States would benefit, because every family is a group of consumers.

As I see it, Mr. Chairman, we are now in the process of trying to eat three cakes and retain most of a fourth one. The first of these cakes is income from loans and investments as the world's No. 1 creditor nation. We want to continue to receive that income and probably can't very well help it under present economic circumstances.

The second cake is shipping. We want a merchant marine and want to keep it busy. To do so we have certain requirements for shipments in American bottoms. I am not questioning this as policy, but only pointing out the economics of it.

The third cake is the so-called favorable balance of trade cake, which is mainly of temporary benefit to Fort Knox, perhaps, but the fourth cake is the only one that goes the opposite direction, and that is the means whereby you give away purchasing power, after having accumulated it in all three of these ways. If you are going to talk about saving money on this fourth cake, which is being sent abroad at present in the form of various kinds of aid, then you have got to be prepared to see imports increase. The simple mathemtics of the thing is that you have to balance these matters one way or another. If you are not going to balance it, by a heavy aid program, you have to balance it by permitting imports to flow in larger volume.

Mr. BOLLING. Thank you very much.

The next witness is Mr. Elmer Cope, international representative of the United Steel Workers of America, and a former member of the Randall Commission staff.

STATEMENT OF ELMER COPE, INTERNATIONAL REPRESENTATIVE, UNITED STEEL WORKERS OF AMERICA

Mr. COPE. Mr. Chairman, I would like to offer Mr. McDonald's apologies for not getting here. Commitments made it impossible. He planned up to the last minute to get here. However, he has prepared a paper, and there, again, I want to apologize. The paper was not designed for 8 minutes, because for some reason or other we did not get the information of the limitation of time. I will attempt to summarize.

Mr. BOLLING. It will be included in the record.

(The statement referred to is as follows:)

STATEMENT BY DAVID J. McDONALD, PRESIDENT, UNITED STEELWORKERS OF AMERICA

The subject I have been asked to discuss with you is "Plans for Offsetting the Dislocations Caused by Increased Imports." I am happy to have the opportunity to discuss this very important matter with you.

What I have to say about "adjustments plans" is necessarily tied in with and flows from considerations involving the foreign trade and tariff policy of the United States.

I was a member of the Commission on Foreign Economic Policy (the Randall Commission) which made its report to Congress in January 1954. I dissented in a number of respects from the recommendations of the majority of the group since I was convinced that their recommendations did not go far enough toward establishing a national trade policy which would enable this country to meet the challenge of the economic and political problems of the present-day world.

Nevertheless, in January 1955, I appeared before the Ways and Means Committee of the House of Representatives, in support of H. R. 1 in the belief that, even though the proposed legislation was far from perfect, it was better than no trade legislation at all.

My position since then has not changed and what I am about to say is for the purpose of reaffirming what I said as a member of the Randall Commission and in subsequent congressional testimony.

The recommendations of the Randall Commission on tariffs and trade were very moderate. They consisted of a series of compromises upon which all but 3 of the 17-man membership of that body—all but the 3 extreme protectionist members—were in fundamental agreement.

The new Trade Agreements Act of 1955, in fact, is a compromise of a series of recommendations which were already the result of fundamental compromise. A brief comparison of what the Commission recommended on tariffs and trade and what Congress finally enacted will be sufficient to point up the inadequacy of present trade laws in providing the framework for a trade policy which will actually bring about significantly increased foreign trade.

The Commission recommended that the President be empowered to reduce tariffs by 50 percent of existing levels on products that are imported into the United States in negligible quantities, or not imported at all. The Senate eliminated this provision.

The Commission recommended that the President be authorized to lower to a ceiling of 50 percent ad valorem duties in excess of that figure, either through negotiation or unilaterally. Congress eliminated the unilateral provision and granted this power only on a reciprocal basis.

Congress also tightened the escape clause in number of respects, thereby making it easier for domestic producers to demonstrate injury or threat of injury from imports in Tariff Commission investigations.

As far as the stimulation of international trade is concerned, the new Trade Agreements Act is the weakest trade legislation that we have had on the statute books in the last 20 years. About all that the President can do under it, in the way of liberalizing trade, is to enter into trade agreements with other countries under which he may lower duties by 15 percent of existing levels over a period of 3 years. If one-third (i. e., 5 percent) of this power is not used in any 1 year, it is forefeited.

The new act gives the impression of going much farther along the road of trade liberalization than it really does. I know of no case—and I believe that I am sustained in this view by competent tariff experts—in which a 15-percent reduction in existing duties can have any appreciable effect upon imports.

The present list of commodities eligible for tariff reduction at Geneva looks impressive. The press has made much of this and has succeeded in misleading and scaring many domestic producers and workers. As a matter of fact, of the 420 commodities listed, the maximum reduction that can be made on most of them is 5 percent per annum (not percentage points, but only 5 percent of existing duties) for 3 years. In the case of only 18 commodities has the administration asked that the President be impowered to lower duties to the 50-percent ceiling provided for in the new law.

The fact that as late as 1955 Congress saw fit to tighten rather than to liberalize, the escape clause, announces, so I believe, to the entire world that the United States has little serious intention of increasing imports. Administrative actions since the enactment of H. R. 1 have done little to correct this impression. Indeed, they have done much to confirm it.

Since the new law was enacted the administration has missed a number of opportunities to demonstrate that it really intends to stimulate trade among the free nations.

The President has seen fit to accept, at least partially, the recommendations of the Tariff Commission on increasing the tariff on bicycles. The President proclaimed an increase in this rate on August 18, 1955.

Eight days later the Defense Department awarded two electrical equipment contracts to domestic firms, even though the bids of foreign firms were considerably lower.

At about the same time another Cabinet officer suggested that foreign bids not be accepted at all if there is any evident reason for believing that their lower bids might be turned down. Thus, it is suggested that the United States Government turn away from worldwide competitive bidding in procurement in favor of a strict "Buy American" policy.

Day-to-day actions have a greater impact upon the attitudes of friendly nations than do pronouncements of overall good intentions.

I am afraid that bold and imaginative leadership has not yet been forthcoming as far as international trade policy is concerned. There is still considerable confusion, even on the part of advocates of a liberal trade policy, between lowering tariffs per se and the encouragement of imports. There is little point in lowering tariffs if the reductions do not result in greater trade. Lowering tariffs in such ways as not to increase imports deceives no one but ourselves. I am afraid that we have been long on promises and generalities but oftentimes short on specific performance.

Congress even failed to accept the mild Randall Commission recommendation that the President be empowered to disregard Tariff Commission recommendations in peril-point and escape-clause investigations in cases where he finds that it is in the national interest of the United States to do so. It is true that he already possesses this power but it is significant that Congress failed to write consideration of national interest specifically into the law in clear and unmistakable language. Since Congress did not accept this recommendation it seems fair to conclude that the President in the future will not go beyond the peril points set by the Tariff Commission, or refuse to accept Tariff Commission recommendations in escape-clause cases, even in the national interest, except in cases of dire emergency.

It is clear that the United States is still pursuing a policy of avoiding injury to domestic producers by restricting imports. There is little evidence that Congress or the people understand how essential it is that imports from certain friendly countries be allowed to increase as a matter of our own self-interest. Once this basic fact comes to be appreciated the need for a nationally oriented adjustment assistance program will be understood. This is a basic issue that confronts the United States today—whether we wish to continue the present narrow policy of keeping out any and all imports that threaten any producer or whether, on the other hand, we should turn our vision outward and recognize that in the interest of our own national security we should encourage imports from certain countries that are sorely pressed for essential goods that can be obtained only with dollars.

Of one thing we may be certain, and that is that to the extent that foreign aid is slowed down, or terminated, there will be adjustment in the international accounts. Foreign aid is still unbalancing our international accounts to the tune of about $4.5 billion a year.

Foreign aid, especially economic aid, is becoming less and less important in the context of temporarily balancing international accounts at higher levels than would be possible in its absence. The relatively small amounts involved in programs of assistance to underdeveloped areas will be of little force in this respect. Economic adjustments are bound to occur as foreign aid is tapered off. Such adjustments will take the form either of decreased exports, or increased imports, or some of each. To the extent that we are successful in stimulating new American investment abroad—and the Randall Commission went far in this direction—it probably will be possible to postpone the day when imports must be increased relative to exports. Eventually, however, the adjustment must take place. However, unless there is a big and rapid increase in new foreign investment some adjustment will come soon. The only other choice is to continue foreign aid for an indefinite future.

Failure on our part to increase imports, or to expand net foreign investment, inevitably will result in a falling off of our own exports after foreign aid is terminated. The repercussions of such failure would be worldwide and because of the consequent weakening of our own economy we would be failing to do the most important thing that we can do as far as other countries of the free world are concerned, namely, to keep the United States economy as strong and healthy as possible.

Thus, adjustments to decreased exports would involve not only the economy of the United States, but also the economic strength of the entire free world.

On the other hand, increased imports will also call for some economic adjustment. If imports were to increase significantly certain American producers might find themselves hard-pressed by intensified foreign competition. The important thing to the United States is to weigh the cost of these adjustments against those that would result from a curtailment of exports and the resulting decline in economic growth and living standards of our allies.

To the extent that we facilitate increased imports and maintain our level of exports we shall be pointing our policies and programs in the direction of an expanding economy. However, to the extent that we allow exports to shrink, in order to avoid increased imports, we shall be pointing our policies and programs in the direction of a contracting economy.

It is certainly easier to adjust to an expanding, than to a contracting, economy. If the United States economy were to contract the results would be disastrous to the peace and prosperity of the entire free world.

As I said in my testimony before the Ways and Means Committee last January, "We are only too well aware that our economic and political freedom depends upon the national security of our country, and there is no better assurance that this security will be maintained, than for us to have strong allies. In the present struggle against communism we cannot rely upon military strength alone. The mutual good will of all free people is essential to our very survival. It would be a sorry situation, therefore, for us to isolate ourselves from the rest of the world. In and of itself, trade is no guarantor of peace. But the throttling of trade can well be the forerunner of war and economic and social disintegration."

The important thing is not merely to reduce tariffs, but to increase imports.

I have no intention of minimizing the injury that might take place among some workers, industries, or communities if imports were to be allowed to increase substantially. As president of one of the country's most important labor unions I certainly would not support a policy of increased foreign trade if I thought that such trade would be injurious to the American workingman. It is because I believe that it is in his own interest that I support a liberal trade policy at this critical juncture of our Nation's history.

It is because of my firm belief in the desirability of increased trade that, as a public member of the Randall Commission, I proposed a program of adjustment assistance to those who might find themselves adversely affected by increased imports resulting from tariff concessions granted in foreign-trade agreements. Without such a program it is probable that we shall grant only nominal tariff and quota concessions. If the concessions are really to result in increased trade those who run the risk of injury must be safeguarded. If they are not safeguarded, real concessions will not be possible.

Furthermore, if I thought that reductions in American tariffs would result in an avalanche of imports I would be doubly cautious. The facts in the case, however, do not warrant such an assumption.

The problem of import competition is often greatly magnified. To hear some people talk, one would think that increased imports would all but wreck the American economy. Some propagandists have even gone so far as to spread the fear that substantial reductions in American tariffs would throw between 5 million and 10 million workers out of their jobs.

Such estimates are little short of ridiculous. Expert opinion, as set forth in the staff papers of the Randall Commission, shows that even if all tariffs were to be reduced by a full 50 percent, the increases in imports that would result would be small. Even upon such a bold assumption as an across-the-board 50 percent tariff reduction, it has been estimated by the Bureau of Labor

Statistics and other experts that the displacement effects would touch not more than 100,000 man-years of jobs.

The workers represented by this figure, however, should not be disregarded. There is no reason why they should be called upon to bear the brunt of increased imports, even if such imports are necessary to the peace and security of the United States and the free world generally.

If imports are to be allowed to increase in any substantial degree, it will be necessary that those few people who might be injured by such increases be provided with some sort of adjustment assistance. This is the substance of what I proposed to the Randall Commission. I believe now, as I believed then, that mine is the consistent position and that the position of the majority of the Commission in rejecting my proposal is the inconsistent one. If some such machinery were to be made available there would be greater likelihood that the President of the United States would be willing to grant tariff reductions that would, in fact, result in increased imports. In the absence of such machinery the President cannot help but feel that every time he goes beyond a peril point, or disregards an escape-clause recommendation, in order to act in the national interest, he will be forcing a relatively small number of people to pay the price of such action in terms of their own livelihoods.

It is unfortunate that the administration cannot get away from the idea that the only way to increase imports is by what often amounts to "across-the-board" reductions of duties. The American businessman and worker know all too well that even without a single reduction of duty, imports from certain low-wage countries such as Japan and Italy hit vulnerable spots in the American economy. Imports of certain textiles, hand-blown glassware, certain kinds of ceramic goods, some toys, and a number of other items are troublesome to domestic producers who are in a weak competitive position.

On the other hand, it is little short of ridiculous for a domestic industry which enjoys 90 percent of a vast American home market to maintain that it is being injured by foreign competition. Yet, this is what is frequently maintained.

We should never overlook the fact that, although imports and exports constitute only a small proportion of the vast national income of the United States, the absolute volume of the foreign trade of the United States is far greater than that of any other country, including even countries such as Denmark and the United Kingdom, whose foreign trade accounts for as much as 25 to 40 percent of their national incomes. The United States is big; most other countries are small by comparison. In consequence, whatever the United States does to increase or decrease foreign trade has a tremendous impact upon them.

As in the early days of the trade-agreements program, we can reduce tariffs on a selective basis, introducing such safeguards as are necessary, and still increase imports. To the extent that we can increase imports of goods, the competitive impacts of which would be upon strong, rather than weak segments of the American economy, we shall be helping solve the problem of international economic imbalance. The most important ingredient of policy, and the one which we seem to lack most of all, is imagination.

Japan's dollar deficit is running currently at about a billion dollars a year.[9] If the free world could manage to absorb not more than a billion dollars' worth of Japanese goods, that action would go a long way toward relieving Japan's dollar deficit and toward insuring Japan's loyalty to free world institutions. Japan must export. If she does not she will be unable to maintain even her present low plane of living. If she does not trade with the countries in the free world she has no alternative but to trade with the countries of the Communist bloc. But trade she must and trade she will.

If a bold and imaginative program were to be pursued by the United States, the adjustments that would be necessary within our own economy would be slight indeed. Certainly, such a program would affect nothing like the 100,000 workers referred to in the Randall Commission staff papers, assuming a 50-percent reduction of all United States tariffs.

There probably would be some domestic producers who might be injured even by such a modest program of increased imports. These people, it seems to me, should not be called upon to bear the cost of a necessary national foreign economic policy. The Federal Government should come to their assistance and facilitate the economic adjustments that will have to take place in any event. Small though they are, such adjustments can be painful to the individuals concerned.

A few persons have tried to block this proposed program by calling it socialistic. Some have called it un-American. Other opponents of expanded trade appear not to like it because they fear that it will, in fact, be an effective means of increasing imports.

I submit that for the United States Government to come to the assistance of those who might be hurt by a national policy which is clearly necessary in the national interest is not socialistic. It is not even a subsidy program, and even if it were, subsidies are hardly an un-American way of solving troublesome economic problems. There is nothing out of step with American traditions for the strong to come to the support of the weak whether the weakness has been occasioned by fire or flood or by a necessary policy in the national interest.

The adjustment assistance that I have proposed would simply mobilize the forces of Government assistance along lines already provided for in existing law for aiding unemployed workers and hard-pressed capital.

In my dissents to the majority report of the Randall Commission I urged technical assistance to companies and communities affected by such import competition. I suggested loan assistance by the Small Business Administration, accelerated tax amortization, and preference in the placing of Government contracts. I proposed further that export industries be encouraged to establish plants in communities that are vulnerable to increased imports, that displaced workers be entitled to special unemployment insurance, and that special provisions be made for intensive counseling and placement of workers, for training allowances, moving allowances, and early retirement of workers who are unemployable.

The substance of these recommendations has been embodied in several adjustment assistance bills that have been introduced into both the Senate and the House of Representatives. These bills differ only in detail. Their fundamental philosophy is the same and they would implement many of the ideas that I have just set forth. I was more than a little disappointed that the various bills received not even a partial hearing from the appropriate committees of Congress. It is my hope that in the coming session of Congress similar bills will be introduced and given a fair hearing and serious consideration.

Not only do I believe that such a program is workable but I believe that it is in keeping with the finest American tradition of self-help. I am convinced that instead of constituting an interference with the working of the free enterprise system it would be a lubricant that would make the system work more smoothly and effectively.

I was pleased to read in the newspapers a few weeks ago about the reports from Denver to the effect that the administration has finally recognized that active programs of aid to depressed areas within the United States have become necessary. Previously the administration had taken the stand that "a large part of the adjustment of depressed areas to new economic conditions both can, and should, be carried out by local citizens themselves" (from the Economic Report of the President, 1955, pp. 56–57).

Now the administration suggests a domestic assistance program which could be a responsibility of the Department of Commerce, the Department of Labor, or a new agency, to point the way to communities whereby they could help themselves.

The President's Economic Report refers to the "adjustment of depressed areas to new economic conditions." This phrase describes perfectly the objective of the adjustment assistance program that I have proposed. If the administration really has decided to accept the principle of helping localities to adjust to new economic conditions, there is fundamental agreement between us as to the necessity of adjusting to increased imports, especially when such increased imports result from policies pursued in the national interest.

If the President proposes and the Congress enacts such legislation, as they should, I sincerely hope that it will include specific provisions to deal with dislocations resulting from increased imports.

I am in favor of such a program because it is the only realistic way whereby we can make feasible a program that will lead to effective increases in imports. I shall not attempt to judge the right of any American producer to remain in business by virtue of tariff protection. In this sense I am neither a free trader nor a protectionist. Whether producers of goods who cannot stand up against foreign competition without tariff protection should be encouraged to remain in business by one means or another is a policy question that can be decided only by the representatives of the people in Congress assembled.

We cannot, however, in our own national interest afford to postpone the solution of the problem of international economic imbalance until this basic question is resolved. The protectionist-free trade debate has been with us for a long time and it undoubtedly will be with us for a long time to come. Meanwhile the problem of international economic imbalance must be solved by a formula that is acceptable to the vast majority of the American people.

Our present Trade Agreements Act, as amended, does not fulfill this requirement. It gives the impression of increasing foreign trade but the tariff concessions which it makes possible are so small that they can have but little effect in solving the problem. Congress should face this problem squarely. Up to now I am afraid it has not done so. The time when it should have enacted legislation designed to increase imports has long since passed.

Congress also must act upon the proposed Organization for Trade Cooperation (OTC). It must act upon customs simplification and it should repeal the Buy American Act.

I cannot leave this subject without saying a few words regarding the East-West trade problem. Here, too, I believe that my position on the Randall Commission was the correct one. I say this after giving due consideration to the recent Geneva talks.

Therefore I do not believe that the United States should encourage trade between the countries of the free world and the countries behind the Iron and Bamboo Curtains. The distinction that is often made between goods that might contribute to military strength and other goods is more apparent than real. No one, of course, would advocate shipping commodities that can be used in military operations to these countries. But what about goods that serve to strengthen the economies of those countries, as such? Does not every bit of economic improvement behind the Iron Curtain make it just that much easier for the dictatorship to claim credit for improving the living conditions of the people, as well as to release productive capacity for military purposes?

I believe that the trade of Western Europe needs to be stimulated, but the stimulation should not be with Communist countries. Rather it should be with the United States. Here is where the effective lowering of United States tariffs comes in. If the United States in fact opens even partially its doors to larger imports from Western Europe and Japan the expansion of that trade will more than make up for the trade that otherwise inevitably will develop between Western Europe and Eastern Europe. The East-West trade question illustrates the vital importance of United States foreign trade policy.

I want to conclude by pointing out that the members of the Randall Commission could not help but be impressed by the paucity of reliable, official appraisals of the effectiveness of individual tariff duties. The Commission had no alternative but to rely upon the estimates made by one of its own staff members in a recently published book. As far as they went, these estimates were impressive. But, having been made by an individual expert, rather than by a Government agency, they could not carry the weight that they would have carried had they been official. Furthermore, they need to be brought up to date.

It is a sorry commentary upon Government that, notwithstanding the vast funds that are being spent, including the gathering and publishing of statistics, nothing is being done to make such estimates and keep them current. In the Randall Commission report I urged that industry-by-industry estimates be made of the potential displacement resulting from tariff reductions by a special interdepartmental committee to be established for the purpose. I also urged that the Department of Labor and the Department of Commerce be directed to study the effects of such displacement and that adequate funds be made available by Congress to enable them to do so.

The majority of the Commission did not adopt this recommendation, I am sorry to have to say.

In my opinion, however, such action is vital and I intend to urge, wherever and whenever an opportunity presents itself, that Congress act in this respect.

Mr. COPE. As you are aware, Mr. McDonald was a member of the Commission on Foreign Economic Policy (the Randall Commission) which made its report to Congress in January 1954. He supported the Commission's majority proposals on trade and tariffs though he felt they did not go far enough toward establishing a national trade policy that would meet present-day world problems.

Furthermore, in January 1955, he appeared before the Ways and Means Committee of the House of Representatives in support of

H. R. 1. This bill was supported even though it was a watered-down version of the Randall Commission proposal; it was considered better than no trade legislation at all. As far as stimulating international trade, it is our opinion that the new Trade Agreements Act is the weakest trade legislation adopted over the past 20 years.

There is a basic issue that confronts the United States today—it is whether we intend to continue the present narrow policy of keeping out any and all imports that threaten the producers of any commodities, or whether, on the other hand, we accept our responsibility and encourage imports from certain friendly countries that are sorely in need of goods that can be obtained only with American dollars. To make clear how we feel about this responsibility, I would like permission to quote a paragraph from the testimony Mr. McDonald presented to the House Ways and Means Committee last January when he supported the passage of H. R. 1. He said:

> We are only too well aware that our economic and political freedom depend on the national security of our country, and there is no better assurance that this security will be maintained, than for us to have strong allies. In the present struggle against communism we cannot rely upon military strength alone. The mutual goodwill of all free people is essential to our very survival. It would be a sorry situation, therefore, for us to isolate ourselves from the rest of the world. In and of itself, trade is no guarantor of peace. But the throttling of trade can well be the forerunner of war and economic and social disintegration.

The important thing is not merely to reduce tariffs, but to increase imports.

The concessions that were made in Congress this year, which weakened the international trade program submitted by the President, definitely limited the possibility of extending trade through increased imports. The new act gives the impression of going much further toward trade liberalization than it actually does. The maximum possible reduction in tariffs, under this act, is 15 percent over a period of 3 years. We have been unable to discover any instances where a 15-percent reduction in existing duties can have any appreciable effect upon imports.

The present list of commodities eligible for tariff reductions at Geneva next year during GATT negotiations looks impressive. However, of the 420 commodities listed, the maximum reduction that can be made on most of them is 5 percent per year. Only 18 commodities included in the list might be subjected to greater than the 5-percent reduction.

The tightening of the escape clause in the 1955 act, the use of the peril-point provisions and the apparent policy of the administration to turn away from worldwide competitive bidding in procurement in favor of a strict buy-American policy, we believe tell the whole world that the United States has little serious intention of increasing imports.

It is the day-to-day actions that have the greater impact upon the attitudes of friendly nations than do pronouncements of overall good intentions.

We feel very strongly that it would be possible, through a process of selection of commodities that are to be imported, to import a great number of items in much larger volume without causing any great injury to industry in this country. There is no reason why, when we negotiate with other countries, we cannot select commodities for importation that other countries are now producing, or encourage the production of articles they are not now producing, that would not compete with the more sensitive items produced by our industries. By a careful process of selection, it would be possible, in our estimation, to increase imports considerably without causing great damage to our industries.

On the other hand, it seems out of keeping with our general international position for corporations and industries who are now enjoying better than 90 percent of our domestic market to demand tariff protection to further exclude foreign imports.

However, if imports are to be permitted to increase in any substantial degree, it will be necessary that those peoples who might be injured by such a process be provided with some sort of adjustment assistance. This is what Mr. McDonald proposed to the Randall Commission and later to Congress. The program called for loan assistance by the Small Business Administration, accelerated tax amortization, and preference in the placing of Government contracts. Export industries should be encouraged to establish plants in communities that are vulnerable to increased imports. Displaced workers should be given special unemployment insurance and special provisions provided for intensive counseling and placement of workers, for training allowances, moving allowances, and early retirement of workers who are unemployable.

May I remind this committee that last year I presented to you this entire program in detail. I don't want to repeat it. It is incorporated in the report of the hearings of the joint committee of last year, on pages 627 to 633.

I do want to point out, however, that although increased import competition would no doubt affect a group of American workers, the extent of the probable injury has been exaggerated greatly. I think this committee has been told during previous hearings that the injury might reach such proportions that from 5 to 10 million workers might be displaced. These estimates are little short of ridiculous. Expert opinion, as set forth in the staff papers of the Randall Commission, indicate that even if all tariffs were to be reduced by a full 50 percent, the increases in imports would be small. If we assumed that across-the-board decreases in tariffs of 50 percent would be applied, it has been estimated by experts that the displacement effects would touch not more than 100,000 workers' jobs. These workers, even though they will be much smaller in number, should not be disregarded. They should not be called upon to bear the brunt of increased imports. The United States Government should see that the cost of assisting the workers, industries, and communities to readjust should be distributed over all the country.

We think our program calling for Federal assistance in making the necessary adjustments to increased imports is still valid. We were pleased to read in the newspapers about the reports from Denver that the President and his economic advisers have finally recognized that active programs of aid to depressed areas within the United States are necessary.

May I, in conclusion, quote from Mr. McDonald's statement his opinion of Dr. Burns' proposal? He said:

The President's Economic Report refers to the "adjustment of depressed areas to new economic conditions." This phrase describes perfectly the objective of the adjustment assistance program that I have proposed. If the administration really has decided to accept the principle of helping localities to adjust to new economic conditions, there is fundamental agreement between us as to the necessity of adjusting to increased imports, especially when such increased imports result from policies pursued in the national interest.

If the President proposes, and the Congress enacts, such legislation—as they should—I sincerely hope that it will include specific provisions to deal with dislocations resulting from increased imports.

Mr. BOLLING. Thank you very much, Mr. Cope.

The next witness is Mr. James Mark, Jr., international representative of the United Mine Workers of America.

STATEMENT OF JAMES MARK, JR., INTERNATIONAL REPRESENTATIVE, UNITED MINE WORKERS OF AMERICA

Mr. MARK. Mr. Chairman, Vice President Kennedy regrets that a last-minute appointment in the State of Pennsylvania kept him from appearing before you. I shall read the statement prepared by Mr. Kennedy.

For a number of years representatives of our organization have appeared before various congressional committees with reference to this subject. We opposed the last reciprocal trades agreement enacted by the last session of Congress. We felt then and we believe now that our prophecies have been confirmed by the reciprocal-trade program which caused serious dislocations in American industry, resulting in unemployment and the placing of many more areas in the distressed area category.

We note that some of the unions which favored reciprocal or free trade are now changing their attitude due to dislocations caused by increased imports and are substantially taking the same position as the United Mine Workers of America. Specifically, the United Mine Workers of America are opposed to the dumping of residual oil on the eastern seaboard. Administration officials in Washington threatened to put a quota on increased importation. However, we have heard nothing about this for the last several weeks. The records of the American Petroleum Institute and the United States Bureau of Mines indicate that instead of residual oil imports being reduced, they are rapidly increasing. For instance, the daily average of imports of residual oil in October of this year was 207,100 barrels. In the year to date, 115,033,000 barrels of residual oil were imported or a daily average for the year to date of 391,300 barrels, as a result of which approximately 28 million tons of bituminous coal have been displaced. Substantial tonnage of anthracite has also been displaced.

In the bituminous industry this would mean approximately 3 weeks of lost work and in the anthracite a great deal more. These figures do not include any importations of crude oil or any other petroleum products. Approximately 155,000 men are unemployed in the mining industry, both anthracite and bituminous. The bulk of the unemployment is situated in Pennsylvania, West Virginia, Kentucky, Ohio, and Illinois. Other coal-producing States are likewise affected to some degree. Recently the President of the United States issued a statement relative to a proposed 4-point program to help out in the distressed areas of unemployment. The program has not been spelled out.

It seems to us that we should tackle the problem first as to what causes this unemployment in these distressed areas in the coal industry. Then, as affecting the coal industry, the first attack should be on the dumping of residual oil, most of which comes from Venezuela, a nation functioning under a military dictatorship and in which country recently the labor member of the ILO, Director Adrian Vermeulen, of the Netherlands, was not permitted to attend the ILO oil conference in Venezuela, because he was a union representative.

Our Government is taking a rather inconsistent attitude in the matter. On one hand, in Europe and Asia we are opposed to the denial of freedom to the people of some of the countries back of the Iron Curtain, including Russia and Eastern Germany, while in our attitude toward Venezuela and some of the other Latin American countries, we seem to be aiding and abetting governments that follow similar practices.

In conclusion, with respect to the matter of residual oil, we believe that the committee should recommend:

1. That the dumping of residual oil should be stopped.
2. That a quota should be set on residual oil so as to avoid dislocation in the coal industry.
3. The question of bottoms and ocean freight rates should be studied so that more and more American coal, including bituminous and anthracite, can be exported to Europe and Asia and to Latin American countries, which are in need of this coal and can use it without dislocating their own coal-mining industry, in the respective countries where coal is mined. In the interest of conserving our natural resources, and in the first interests of national defense, the promiscuous use of natural gas and fuel oil should be curtailed, and a national fuel policy should be outlined by the Congress.

Mr. Bolling. Thank you very much, Mr. Mark.

The next witness is Mr. Bert Seidman, staff economist of the American Federation of Labor.

STATEMENT OF BERT SEIDMAN, STAFF ECONOMIST, AMERICAN FEDERATION OF LABOR

Mr. Seidman. Thank you, Mr. Chairman.

From the earliest days of trade unions in the United States, international trade policy has always been a matter of great concern to the American labor movement. At one time, organized labor stressed mainly the need for tariffs to protect American labor standards. More recently, trade unions have placed their main stress on the need for diminishing the barriers to trade among the free nations of the world.

Labor has had a great interest in international trade despite the fact that foreign trade does not bulk large in the American economy. Perhaps the most important reason for labor's concern with foreign-trade policy is that labor recognizes international-trade policy as an important part of the Nation's overall foreign policy. In this framework, international-trade policy should be aimed at assuring domestic economic prosperity and improving the economic conditions of the rest of the free world.

We cannot escape the fact, however, that removal of trade barriers will create difficult problems. Because of the high level of productivity of our industries and the diversity of our economy, foreign producers have by and large been able to compete with American industry only in the narrow sector of our economy which has been relatively least efficient and has experienced a declining trend. Many plants in industries such as textiles, jewelry, gloves, and coal are located in depressed areas which face critical problems of unemployment and underutilized resources.

The concentrated impact of imports has meant that the workers and employers in the industries most affected often seem to have the loudest voice in discussing international-trade policies. As a consequence, our foreign-trade policy has tended to aim at minimizing injury to firms and employees affected by import competition. This emphasis on avoidance of injury will continue to be necessary until procedures are developed for assuring smooth readjustments in industries facing import competition.

In order to determine the precise effects that might be expected, industry by industry and item by item, of tariff reductions of specific proportions, a thorough investigation should be made of our present tariff structure. This is an appropriate time for such an investigation because the 3-year reciprocal-trade program has set the limits for the immediate future. Perhaps such an investigation could be made by a group sponsored by this committee with a membership including Members of Congress, representatives of the executive agencies as well as representatives of labor, management, and the general public.

Such an investigation will undoubtedly reveal that there are some areas in which tariffs can be reduced with no appreciable effect on our domestic industries but also probably without resulting in a substantial increase in United States imports. There is another area of our economy where, because of defense or other factors critical to our national security, present tariffs would have to be maintained in order to maintain the capacity of our domestic industry.

There would still remain the hard-core problem of industries which would be seriously affected by tariff reductions. Temporary suspension of all tariff duties might result in an increase of 8 to 17 percent in total imports and 18 to 38 percent in dutiable imports. However, even the higher figure is less than one-half of 1 percent of our gross national product. Employment displacement might range from 60,000 to 128,000 workers.

The major impact of such an expansion in imports would be felt in approximately 30 fields of production, mostly consumer goods, for which United States demand has been growing least rapidly. Despite the small sector of the economy that would be seriously affected, the Nation cannot ignore the problems such industries would face. Practicable procedures should be developed to assure that tariff reductions will not place an undue hardship on particular industries or groups of workers.

Continued tariff protection is justified whenever American producers are confronted with unfair foreign competition, one evidence of which would be maintenance of unfair labor standards by competing firms in the other countries.

The principle that tariff concessions should not be granted on products made by workers receiving wages which are substandard in the exporting country has been stated by the President's Commission on Foreign Economic Policy and endorsed by the President. It was also made the basis for a commitment to maintain wage standards and practices at fair levels in Japanese export industries by the representative of the Japanese Government in the recent United States-Japan tariff negotiations.

Labor standards should be emphasized in future tariff negotiations not only as a protection to the standards of American workers but also in order to improve the standard of living of workers abroad and as an incentive to improving productivity in the exporting countries. The United States Government in future tariff negotiations should refuse to grant tariff concessions unless the exporting country guarantees to establish and maintain fair labor standards. Failure by the exporting country to maintain fair labor standards should be regarded as a valid cause for withdrawal of tariff concessions.

Too little attention has been paid to potential benefits of expanding United States exports despite the fact that more than 2 million nonfarm workers depend on exports for their employment. Increased awareness of the advantages of developing United States exports can be achieved if the public is informed in advance of possible items for which tariff reductions by other nations might be requested. One important objective in tariff negotiations should be to develop foreign markets for products of our depressed industries and areas by seeking reduction in the tariffs of other nations on such products.

Reduction of barriers to international trade is not an end in itself but only a means by which we can strengthen our own economy and the economy of the free world. In developing trade policies, however, we cannot afford to ignore our own national interest which, because of the predominant position of the United States in the free world, is in a very real sense the concern of the entire free world. This means that we must develop policies which will mitigate any injury or hardship resulting from reduction of tariffs.

We cannot realistically think in terms of reducing all tariffs and certainly not of their complete removal. Changes will have to be gradual to permit necessary readjustment both in our own country and in foreign nations. A workable program for expansion of international trade will be supported by the American people and welcomed by people all over the world. Such a program will help to advance economic prosperity in our own country and throughout the free world.

(The complete statement of Mr. Seidman is as follows:)

SUMMARY—LABOR'S INTEREST IN INTERNATIONAL TRADE

Statement by Bert Seidman, staff economist, American Federation of Labor

From the earliest days of trade unions in the United States, international trade policy has always been a matter of great concern to the American labor movement. At one time, organized labor stressed mainly the need for tariffs to protect American labor standards. More recently, trade unions have placed their main stress on the need for diminishing the barriers to trade among the free nations of the world.

Labor has had a great interest in international trade despite the fact that foreign trade does not bulk large in the American economy. Perhaps the most important reason for labor's concern with foreign-trade policy is that labor recognizes international trade policy as an important part of the Nation's overall foreign policy. In this framework, international trade policy should be aimed at assuring domestic economic prosperity and improving the economic conditions of the rest of the free world.

While the economic dependence of other nations upon the United States is greater than our need for their products, it is still true that as part of an interdependent world, our country needs the trade of other nations. We must also recognize that unless the other free nations can trade with the United States they will trade with the Soviet bloc and thus help to strengthen Russia and its satellites. Therefore, it is in our own national interest as well as in the interest of the other free nations to remove restrictions to trade among the nations of the free world.

We cannot escape the fact, however, that removal of trade barriers will create difficult problems. Because of the high level of productivity of our industries and the diversity of our economy, foreign producers have by and large been able to compete with American industry only in the narrow sector of our economy which has been relatively least efficient and has experienced a declining trend. Many plants in industries such as textiles, jewelry, gloves, and coal are located in depressed areas which face critical problems of unemployment and underutilized resources.

The concentrated impact of imports has meant that the workers and employers in the industries most affected often seem to have the loudest voice in discussing international trade policies. As a consequence, our foreign-trade policy has tended to aim at minimizing injury to firms and employees affected by import competition. This emphasis on avoidance of injury will continue to be necessary until procedures are developed for assuring smooth readjustment in industries facing import competition.

In order to determine the precise effects that might be expected, industry by industry and item by item, of tariff reductions of specific proportions, a thorough investigation should be made of our present tariff structure. This is an appropriate time for such an investigation because the 3-year reciprocal-trade program has set the limits for the immediate future. Perhaps such an investigation could be made by a group sponsored by this committee with a membership including Members of Congress, representatives of the executive agencies as well as representatives of labor, management, and the general public.

Such an investigation will undoubtedly reveal that there are some areas in which tariffs can be reduced with no appreciable effect on our domestic industries but also probably without resulting in a substantial increase in United States imports. There is another area of our economy where, because of defense or other factors critical to our national security, present tariffs would have to be maintained in order to maintain the capacity of our domestic industry.

There would still remain the hard-core problem of industries which would be seriously affected by tariff reductions. Temporary suspension of all tariff duties might result in an increase of 8 to 17 percent in total imports and 18 to 38 percent in dutiable imports. However, even the higher figure is less than one-half of 1 percent of our gross national product. Employment displacement might range from 60,000 to 128,000 workers.

The major impact of such an expansion in imports would be felt in approximately 30 fields of production, mostly consumer goods, for which United States demand has been growing least rapidly. Despite the small sector of the economy that would be seriously affected, the Nation cannot ignore the problems such industries would face. Practicable procedures should be developed to assure that tariff reductions will not place an undue hardship on particular industries or groups of workers.

Continued tariff protection is justified whenever American producers are confronted with unfair foreign competition, one evidence of which would be maintenance of unfair labor standards by competing firms in the other countries.

The principle that tariff concessions should not be granted on products made by workers receiving wages which are substandard in the exporting country, has been stated by the President's Commission on Foreign Economic Policy and endorsed by the President. It was also made the basis for a commitment to maintain wage standards and practices at fair levels in Japanese export industries by the representative of the Japanese Government in the recent United States-Japan tariff negotiations.

Labor standards should be emphasized in future tariff negotiations not only as a protection to the standards of American workers but also in order to improve the standard of living of workers abroad and as an incentive to improving productivity in the exporting countries. The United States Government in future tariff negotiations should refuse to grant tariff concessions unless the exporting country guarantees to establish and maintain fair labor standards.

Failure by the exporting country to maintain fair labor standards should be regarded as a valid cause for withdrawal of tariff concessions.

Too little attention has been paid to potential benefits of expanding United States exports despite the fact that more than 2 million nonfarm workers depend on exports for their employment. Increased awareness of the advantages of developing United States exports can be achieved if the public is informed in advance of possible items for which tariff reductions by other nations might be requested. One important objective in tariff negotiations should be to develop foreign markets for products of our depressed industries and areas by seeking reduction in the tariffs of other nations on such products.

Reduction of barriers to international trade is not an end in itself but only a means by which we can strengthen our own economy and the economy of the free world. In developing trade policies, however, we cannot afford to ignore our own national interest which, because of the predominant position of the United States in the free world, is in a very real sense the concern of the entire free world. This means that we must develop policies which will mitigate any injury or hardship resulting from reduction of tariffs.

We cannot realistically think in terms of reducing all tariffs and certainly not of their complete removal. Changes will have to be gradual to permit necessary readjustment both in our own country and in foreign nations. A workable program for expansion of international trade will be supported by the American people and welcomed by people all over the world. Such a program will help to advance economic prosperity in our own country and throughout the free world.

Labor's Interest in International Trade

International trade policy has always been a matter of great concern to the labor movement of the United States. From the earliest days of trade unions in this country, labor organizations have focused serious attention on such questions as the competition of imports, the need for tariffs to protect American labor standards and other aspects of foreign-trade policy. More recently, organized labor has been among the earliest and staunchest proponents of the reciprocal trade program and has supported every effective effort directed toward diminishing the barriers to trade among the free nations of the world.

The forthright stand of the American Federation of Labor in support of expansion of world trade was expressed in the following policy statement unanimously adopted by the most recent convention of the A. F. of L. held in September 1954:

"In furtherance of our basic policy of seeking to obtain expansion of international commerce and removal of barriers to world trade, our Federation should continue to support the reciprocal trade program. At the same time, every effort must be made to be certain that the Nation's trade and tariff policies safeguard the employment opportunities of American workers and protect labor standards, both in our own country and abroad."

In a statement to the President's Commission on Foreign Economic Policy on October 28, 1953, President George Meany of the A. F. of L. set forth the basic principles which should guide our international trade policy. In that statement President Meany said:

"American foreign trade and exchange policy cannot be developed in a vacuum. It must be a means to a positive goal. We believe that the goal of such a policy should be the achievement of expanding trade, rising production, high productive employment and increasing real income for all nations concerned. This policy goal simply means that if it is our concern to maintain and increase the prosperity of the American people, it must also be our concern to help other peoples enhance their prosperity through their own efforts."

The increasing interest of organized labor in foreign-trade matters has been shown in other ways. For example, President David J. McDonald of the United Steelworkers of America served as a member of the President's Commission on Foreign Economic Policy which issued the well-known Randall Report. Reflecting the personal interest of President Meany and the general concern of the A. F. of L. with international trade problems, I had the privilege of serving as a labor member of a four-member advisory group at the recent trade negotiations between the United States and Japan.

A number of unions have testified at the hearings held before tariff conferences to state their views regarding ensuing trade negotiations. Others have asked for increases in tariff duties through participation in escape-clause actions. These are only some of the diverse ways in which trade unions have manifested their growing concern with policies in the field of international trade.

REASONS FOR LABOR'S CONCERN

What factors account for labor's interest in international trade? Foreign trade does not bulk large in the American economy. In recent years, exports have amounted to only 4 to 5 percent of our gross national product and imports even less. Yet despite the comparatively small role foreign trade plays in our national economy, it is considered by labor, as it is by most other groups, a major area for economic policy decision. It is worthwhile seeking the reasons for labor's concern with foreign trade.

Undoubtedly the most important reason for labor's concern with foreign-trade policy is that labor recognizes international trade policy as an important facet of the transcending issue of the Nation's overall foreign policy. As the United States seeks in its overall foreign policy to strengthen our own Nation and the entire free world, so our international trade policy must be aimed at the twin objectives of assuring our domestic economic prosperity while at the same time improving the economic conditions of the rest of the Free World.

The United States plays by far the predominant role in the economic life of the free nations of the world. These nations depend greatly upon the united States for markets for their products and for raw materials as well. While the dependence of the other nations upon the United States is undoubtedly much greater than our need for their products, it still remains true that our Nation is only one part of the interdependent world. We need their trade just as they need ours.

Moreover, the alternative for the other nations to trade with the United States is undoubtedly trade with the Soviet bloc, trade which can only bind their economies to Russia and its satellites and weaken the economic ties of the free nations. It is a truism in international economic life that to import a nation must export and vice versa. The other nations in the free world need raw materials for their own industries which they can obtain either from the United States and other countries in the Western Hemisphere or from the Soviet Union, Red China, and their satellites. Likewise they face the same alternatives in seeking markets for their products. If they cannot ship goods to the United States to be sold in our markets, goods which may compete with the products of our own industries, they will seek to create new markets behind the Iron Curtain. On this basis, it is in our own national interest as well as in the interests of the other free nations to do everything possible to remove restrictions to trade among the nations of the free world.

We must frankly face the fact, however, that while such a policy is necessary and desirable, it does create very difficult problems, problems with which many individual unions and the labor movement as a whole have been seriously concerned. These problems created by the impact of imports upon our domestic economy constitute the second major reason for labor's interest in international trade policy.

THE PROBLEM OF COMPETITIVE IMPORTS

In attempting to ship goods to us to be sold in the American market, foreign nations are faced with the almost insurmountable problem of trying to compete with the highest level of productivity in the world. Our national level of productivity is nearly double that of any other nation (except Canada whose economy is closely related to ours). Moreover, the fact that our economy, owing to its vast size and our huge supply of natural resources, has become greatly diversified also greatly strengthens our ability to withstand foreign economic competition.

Increasingly, therefore, foreign nations have been able to compete on equal ground with American industry only in those relatively narrow sectors of our economy which have lagged behind in the Nation's rapid economic growth. These are the industries which, relative to the rest of the economy, have been least efficient and have experienced declining trends of output and employment. By and large, these industries require relatively small amounts of capital investment and consequently have a relatively low output per man-hour. To some extent also, the firms in these industries which have been most susceptible to injurious competition from foreign imports, have also been engaged in a life-and-death struggle to maintain their markets against inroads by new, and often more efficient, plants in other areas of our own country. In such industries as textiles, jewelry, gloves, and coal, such enterprises are often located in depressed areas which face critical problems of unemployment and underutilized resources.

Thus the impact of imports has been greatest in a relatively small sector of American industry and this will be increasingly true in the future. For that very reason, both workers and employers in these industries which have been most affected by import competition have been most vocal on foreign trade issues. Since the beneficial effects of exports are more diffuse through the economy than the much more concentrated injurious impact of imports, it is not surprising that those affected by imports often seem to have the loudest voice in discussing international trade policies.

The concentrated effect of import competition perhaps accounts for the emphasis in our foreign-trade policy until now upon the development of policies which would minimize the injury to firms and their employees resulting from competition of imports. Thus in the main, our tariff negotiators have sought not to reduce tariffs on items which would be severely hurt by foreign competition. We have also developed the escape-clause and peril-point safeguards in our tariff legislation in order to reduce import competition where it would have the most telling effects. Actually, this emphasis on the avoidance of injury to domestic employers and workers will continue to be necessary until practicable and fair procedures are worked out for assuring smooth readjustment in industries which would be faced by increased import competition if the existing level of tariffs were to be reduced.

This raises the important questions of what industries would be faced with injurious competition in the event of tariff reduction and with respect to which particular products. More specifically we need to determine the precise effects, industry by industry and item by item, of tariff reductions of specific proportions. These are not easy questions to answer and obviously the answers cannot be predicted exactly. Nevertheless, a thorough investigation, item by item, of the commodities which are now subject to tariff duty would help to define the limits of the problem that we face and suggest alternative policies.

This is an appropriate time for such an investigation. Although the 3-year reciprocal trade program authorized by Congress this year is, of course, not perfect, it does provide a framework for the conduct of our international trade policy for this limited period. In effect, the limits have been set for the immediate future.

A thoroughgoing and objective investigation of our present tariff structure therefore could be made before the present reciprocal trade program expires. Such an investigation would not require the haste which is usually found under the time pressures which exist prior to tariff negotiations, and it would not be made in the heat of controversy which is usually present in escape-clause actions. Perhaps such an investigation could be made by a group organized under the sponsorship of this committee with a membership which would include members of Congress and representatives of the executive agencies as well as representatives of labor, management, and the general public. In its preliminary stages, such an investigation would have to be highly technical and would have to be handled largely by a competent staff of technicians, but the findings developed by the staff might then be weighed and sifted by the kind of public body I have suggested.

As a result of such an investigation, we would then have the detailed information for reappraising our tariff structure. Undoubtedly, it will be found that there are some areas in which tariffs can be reduced without creating any appreciable difficulty for American firms and their employees. We actually have some tariffs on items for which our firms are undoubtedly by far the most efficient producers in the world and where there is not the slightest possibility that foreign competitors could make appreciable inroads in the American market. There seems to be little justification for not reducing tariffs on such items. However, it must also be recognized that reduction, or perhaps even outright removal, of tariffs on such items would not really result in a substantial increase of United States imports and therefore would have minimal beneficial effects on the economies of foreign countries.

There is another area of our economy where, because of defense or other factors critical to our national security, we would want to maintain the capacity of our domestic industry regardless of any other considerations. Once it is determined that it is in the interest of the Nation that such industries be maintained at a minimum capacity, it will be necessary to take whatever measures are required to assure such industries that they will not be faced with competition of imports that would require reduction of their output below this minimum required level. If it appears that tariff reductions would threaten the existence or the necessary size of such industries, we should frankly face the fact that we will have to maintain tariffs for the items produced by these industries at the level necessary to assure the needed domestic industrial capacity.

There will still remain the hard-core problem of the industries which would be seriously affected by reduction of tariffs on their products. It has been estimated that if in 1951 all tariff duties had been temporarily suspended, there would have been an increase in imports of $800 million to $1.8 billion annually after a lapse of 3 to 5 years. This represents an increase of 8 to 17 percent in total imports and 18 to 38 percent in dutiable imports.[1] Even the higher figure, however, constitutes less than one-half of 1 percent of our gross national product. It has also been estimated that employment displacement resulting from such a drastic shift in trade policy might range from 60,000 to 128,000 workers.[2]

The major impact of such an expansion in imports, however, would be felt in approximately 30 fields of production including such items as fur felt hats, leather gloves and leather handbags, clay, tile, and handblown glassware. These are products, mostly consumer goods, for which our own demand in the United States has been growing least rapidly. Moreover, as has already been indicated, in these industries technological development has lagged behind the economy as a whole.

Even though the industries which would be most seriously affected by tariff reductions represent a small sector of the economy, this does not mean that the Nation can or should ignore or minimize the problems they face and the hardships employers and workers in such industries would have to bear. We cannot simply say that the thousands of families which depend on these industries for their livelihood have no right to the protection of tariffs and therefore whatever consequences befall the employers and workers in these industries are not a matter which should concern the Government in developing its international trade policy. We cannot escape the fact that a myriad of decisions have been made in the past to invest funds in these firms, to seek jobs in them, and to sell to them materials and equipment in the expectation that long-established tariff protections would be continued. The choice therefore is between continuing these protections or providing effective measures for readjustment. Therefore, if it is in the interest of our own Nation and of the free world as a whole, to reduce barriers to trade for items now produced by industries which would be most seriously affected by import competition, we must develop practicable programs which will permit a shift of financial, material, and manpower resources from such industries to the more prosperous expanding sectors of our economy.

Suggestions have been made for Government assistance to communities, employers, and workers to mitigate the problems that would be faced by increased import competition resulting from tariff reductions. A particularly constructive proposal was developed by Mr. David J. McDonald, president of the United Steelworkers of America, when he was serving as a member of the President's Commission on Foreign Economic Policy. Certainly it is essential that practicable procedures be developed to assure that any tariff reductions that may be put into effect will not place an undue hardship on particular industries, areas, firms, or groups of workers.

FAIR LABOR STANDARDS—AN ESSENTIAL OBJECTIVE OF FOREIGN TRADE POLICY

Before reaching the conclusion that certain industries now protected by tariffs are really unable to compete economically with foreign producers, it is important to make sure that these industries are not faced with unfair foreign competition, for continued tariff protection is justified if American producers are confronted with unfair foreign competition. One evidence of unfair foreign competition would be the maintenance of substandard wages by the competing firms in the other countries. The problem here is to determine criteria of fair labor standards in international trade. While American unions recognize that it is unrealistic to expect other countries to meet immediately the relatively high level of American labor standards, some criteria of fair labor standards should be developed on an international basis.

In recent years, there has been increasing acceptance of the principle first advanced by organized labor that improvement of labor standards should play an

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[1] Staff Papers Presented to the Commission on Foreign ,Economic Policy, February 1954 p. 298.

[2] Ibid., p. 379.

important role in international trade policy. Thus in its January 1954 report, the President's Commission on Foreign Economic Policy stated:

"The clearest case of unfair competition is one in which the workers on a particular commodity are paid wages well below accepted standards in the exporting country. In such cases, *our negotiators should simply make clear that no tariff concessions will be granted on products made by workers receiving wages which are substandard in the exporting country.*" [Committee's emphasis.]

In a statement on foreign-trade policy, President Eisenhower endorsed the recommendation of the Commission on Foreign Economic Policy that the United States refuse to reduce tariffs on products made by workers receiving wages which are substandard in the exporting country. During the recent tariff negotiations between the United States and Japan, explicit recognition was given for the first time in the framework of a tariff conference to the importance of fair labor standards as an objective in traiff negotiations. At the conclusion of that conference, the head of the Japanese delegation formally stated to the chairman of the United States delegation:

"In connection with the recently concluded tariff negotiations sponsored by the contracting parties involving Japan, it is the foremost concern of the Japanese Government that wage standards and practices be maintained at fair levels in industries, including export industries, of Japan."

This is an important step forward which should be emphasized in future tariff negotiations. Labor standards should be an important aspect of international trade policy for two reasons. In the first place, there is no reason why American workers and American industry should have to face foreign competition which derives a cost advantage from substandard wages and working conditions that may prevail in the competing foreign firms. It should be recognized, however, that aside from the need to maintain fair labor standards in international trade in order to protect American workers, promotion of fair labor standards on an international basis would help to improve the standard of living of workers abroad and thereby to strengthen the economies of all nations. Moreover, in the experience of our own country, unions in the United States have found that improvement of labor standards has been the most powerful incentive to the enhancement of productivity.

If it is recognized that promotion of fair labor standards is a primary objective in our international trade policy, the United States Government should henceforth refuse to grant tariff concessions unless assurance is given by the exporting country that effective steps will be taken to raise its labor standards to the highest possible level within the economic capabilities of that country. Guaranties by exporting countries to establish and maintain fair labor standards should be made a prerequisite for United States tariff reductions. Furthermore, failure by the exporting country to maintain fair labor standards should be regarded as a valid cause for withdrawal of tariff concessions. American workers and American industries should not be forced to compete with foreign producers unless the foreign producers maintain fair labor standards.

IMPORTANCE OF EXPORTS

Most of the foregoing discussion has dealt with the import side of the international trade ledger. Actually, far too little attention has been paid to the potential benefits which could be achieved through expansion of exports. As has already been indicated, a considerably greater number of workers in the United States depend in whole or in part on exports for their livelihood than the number who are concerned by the competition of imports. More than 2 million nonfarm workers depend on exports for their employment.[3] Yet very little attention has been directed to the export aspect of international trade policy.

When the Committee for Reciprocity Information holds hearings prior to tariff negotiations, very few witnesses appear to indicate items for which tariff reductions by other countries should be sought in order to expand markets for United States production abroad. In part, this is because no tentative list of items is indicated for which reductions might be sought as is done for the items for which we might offer tariff reductions to other countries.

The public should be informed in advance of the possible items which might be included in the list for which tariff reductions by other nations would be requested and the Government agencies involved in this program should make every effort to secure the views of interested firms and unions on items that might be

[3] Op. cit., p. 373.

included in the request list from which they would derive particular benefit. One important objective in tariff negotiations should be to open up foreign markets for the products of our depressed industries and areas by seeking reduction in the tariffs of other nations on such products. All of this would help to emphasize in the public mind the two-way character of trade and the give-and-take possibilities in tariff negotiations.

CONCLUSION

Reduction of barriers to international trade is not an end in itself but only a means to an end. The objective is to strengthen our own economy and the economy of the free world and to improve the welfare of people everywhere. We must never lose sight of the fact that if our policies are not developed in such a way as to open up trade opportunities to the other free nations, the Soviet Union will jump in to fill this gap.

It would be folly in the development of our trade policies to ignore or minimize our own national interest. Moreover, since the United States is so overwhelmingly predominant in the economic life of the free world, our own national interest in a very real sense is also the concern of the other nations of the free world. Prosperity of the American economy is required not only for our own welfare and security but for the prosperity of the rest of the world.

Our national interest and the interest of the entire free world lies in the expansion of international trade. Nevertheless, we cannot afford to close our eyes to the effects that the changes in our trade policy which are required to achieve this objective will have in some areas of our economy. Indeed, to ignore the injury and hardship that might result from such changes would jeopardize the entire possibility of removal of barriers to trade.

There are two minimum prerequisites for the reduction of tariffs. One is that effective means be developed for providing for a smooth readjustment without undue hardship to firms and workers that would be affected. Second, there must be assurance that before any tariff reductions are contemplated, guaranties are made by the exporting country to maintain fair labor standards in the exporting industries. Even with such protections, however, it is clear that we cannot realistically think in terms of reduction of all tariffs, much less their complete removal. Any changes that are made will have to be made gradually to give sufficient time for necessary readjustment, both in our own country and in foreign nations.

If we meet these problems squarely and effectively, we can develop a workable program for expansion of international trade which will be accepted and supported by the American people and welcomed by people all over the world. Such a program will help to advance economic prosperity in our own country and throughout the free world.

Mr. Bolling. Thank you, Mr. Seidman.

The next witness is Dr. Samuel Lenher, president, Synthetic Organic Chemical Manufacturers Association, and vice president of Du Pont.

Dr. Lenher.

STATEMENT OF DR. SAMUEL LENHER, PRESIDENT, SYNTHETIC ORGANIC CHEMICAL MANUFACTURERS ASSOCIATION

Dr. Lenher. It is a privilege for me to appear in these hearings. In my 26 years' service in the chemical industry I have been concerned variously with research, production, sales, and management. These fields of activity within one of the Nation's key defense industries give me a certain vantage point for my remarks on criteria for judging defense essentiality. With my industrial background I am deeply interested in the topic the subcommittee assigned to me.

It is difficult to sustain the Nation's military and industrial might to the pitch of preparedness needed for prompt and decisive resistance to acts of aggression. Until the present the defense mobilization planning, however brilliantly conceived, was allowed to repose for the most part on paper. Only the overwhelming significance of Soviet aggression in the present era has persuaded us to make the political judgments required for the translation of mobilization planning into actual industrial capacity.

There is a single exception to the pre-Korean hiatus between planning and capacity in being. This is the tariff protection conferred with the wisdom of World War I experience on the industries that were hastily called into action to supply the sinews of war cut by the Allied blockade of Germany.

That World War I experience illustrates one criterion for judging defense essentiality. The extraordinary efforts which the Government urgently expended to provide the coal-tar chemical intermediates needed for the manufacture of explosives, dyes, chemical warfare agents, medicinals, and industrial chemicals for other industries, is direct evidence of the essentiality of the organic chemicals industry. It is established that our Nation lacked such an industry because of the overwhelming cost advantage of the dominating German chemical industry. Similar observations could be made regarding certain other key industries.

There are a number of industries in the United States whose production techniques are commonly shared in the world community and which necessarily involve a relatively large amount of highly skilled labor. The products of these industries are used in the same form in peace and in essential defense production. Their peacetime existence is indispensable to the industrial capacity required in wartime.

The training time needed to achieve the manpower skills in these industries rules out the possibility of reviving them under a forced draft to discharge essential production responsibilities. The highly skilled labor content of production costs makes peacetime existence precarious or unattractive in a capitalist economy without tariff assistance. In the organic chemical industry the dyes, pharmaceuticals, flavoring, and fine chemicals branches are representative of this type of manufacture.

In World War II substantially the entire capacity of the organic chemical industry was devoted to the production of direct military or essential civilian goods.

The extent to which productive capacity located outside the United States would be available to supply America's wartime needs is essentially a military determination. I have my views as a layman, and I find them in accord with President Eisenhower's judgment reflected in his statement of March 26, 1954, on the subject of stockpile objectives. He announced the principle that for the purpose of calculating our objectives it would be assumed that, in the event of war, supplies would not be available from foreign sources except in a limited group of countries to which wartime access can be had with the same degree of reliance afforded by sources within our own country. This is taken to mean the Western Hemisphere, and eliminates the large manufacturing facilities located in Western Europe.

Perhaps the dominant characteristic of the post-World War II era has been the peaceful revolution in the technology of war. In an age of jet aircraft, guided missiles, and atomic and thermonuclear weapons, technological superiority is as much an essential defense resource as productive capacity itself. Though Government-sponsored research is truly formidable, the Government itself is the first to acknowledge that the technological advances flowing from the research and development activities of private industry are of at least equal importance.

Patience rather than speed is characteristic of research. Technological superiority cannot be achieved by willing it to happen and suddenly pouring vast amounts of energy and money into the effort. A sustained, broadly based, continuing program of scientific research in the laboratories of industry is vital to the essential security resources of the Nation. A new criterion has been supplied for judging defense essentiality.

Industries that sustain a high level of continuing scientific research and development as an integral part of their business are essential to the national security. The Paley Commission identified the synthetic organic chemicals industry as outstanding in this respect.

The industry's importance in this respect reaches far beyond its own boundaries. An intertwining of technology links progress in metals, transportation, textiles, and public health to chemical research. A loss of research effort in any branch of the chemical industry would be felt in many other industries. Without organic chemicals there could be no lightweight metals for aircraft, no hydraulic fluids, engine coolant or lubricants for aircraft operation; no synthetic rubber for tires, self-sealing gas tanks or aircraft parts; no jet fuels or aviation gasoline to propel the planes. The efforts of a number of organic chemical manufacturers were required in the wartime atomic-bomb project. The chemical industry alone contained the number of technically trained research men needed for that project though it concerned more matters of physics than chemistry. Today's oil, rubber, and steel would be impossible without organic chemicals. The chemical industry's products used as insecticides, soil conditioners, and feed supplements have made the Malthusian law obsolete by a 50-percent increase in the productivity of our static farm acreage.

These facts will perhaps help you realize that industrial production today is so complex and interrelated that many products and materials not recognizable as end items of war are indispensable as the raw materials of industry to the functioning of a war-production economy. The reports of the War Production Board and the actions of the National Production Authority and its successor agencies in the Korean emergency identifying these products which serve behind the lines, provide us with still additional criteria for judging defense essentiality. These actions were manifested in priorities, allocation orders, conservation orders, and expansion goals. This administrative record is a useful basis for identifying products and capacity which are essential to the functioning of a defense economy.

Since Korea the chemical industry has spent $5 billion in the largest expansion in its history. To meet defense-production goals, an unprecedented increase in production capacity for more than 60 key chemicals has been installed. Each of these chemicals is essential to national defense. National-defense policy recognizes that much of this capacity is in excess of civilian needs. Much of it, too, is in areas of production involving technology commonly shared by all industrial nations. Much of it is also dependent upon a relatively high amount of skilled labor so that the labor content of production costs without the benefit of tariff assistance would place our domestic industries at a serious competitive disadvantage with foreign producers.

From the Nation's defense-production experience commencing in World War I, therefore, we can select empirical criteria for judging defense essentiality. Domestic producers identified by any of the following criteria should be eligible for tariff assistance as a national-security measure where they are at a cost disadvantage with foreign producers.

1. Those whose products have continuing application to military or essential uses, and which in time of war or defense emergency have been under priorities, allocation, or conservation orders, or whose capacity has been expanded to provide increased production of products for military or essential civilian uses.
2. Those with productive capacity convertible from peacetime to wartime or essential civilian production without major adaptation.
3. Those in which skilled manpower is essential for production of military or essential civilian goods and where the training time would seriously handicap an expansion.
4. Those with manpower skills essential for production of war materiel or essential civilian goods which require not only long training time but continuous application to the put-through of such products to remain functional.
5. Those which maintain extensive research and development activities in fields of technology pertinent to military or essential civilian materiel or services.
6. Those whose research and development activities contribute to a high level of scientific inquiry in fields essential to United States leadership in the technology of war.
7. Those which draw upon raw materials available in abundance in the United States for the production of items directly useful in war or essential in the civilian economy in time of war, or whose products are adaptable as substitute materials for critical items in time of emergency.

Mr. BOLLING. Thank you very much.

(The full statement of Dr. Lenher is as follows:)

CRITERIA FOR JUDGING DEFENSE ESSENTIALITY IN APPLYING PROTECTION AGAINST IMPORTS

Statement of Samuel Lenher, president, Synthetic Organic Chemical Manufacturers Association

I. INTRODUCTION

A review of the use of tariffs as an instrument for the maintenance of industrial capacity essential to national defense has special relevance at this time. With the Korean emergency, Congress called for an industrial mobilization program that would make this Nation second to none in its military effectiveness.[1] Continued international tension has brought an awareness that our national security depends more heavily each day on the country's ability to shift from the domestic economy to a war footing on a moment's notice.[2] Under the Defense Production Act of 1950 and its amendments, large expansion in the Nation's basic industries has materially increased our capacity to produce both for war and for peace.[3] This huge industrial expansion has been aimed at overcoming shortages vital to our defense economy. With the major part of this construc-

[1] H. Rept. No. 1, 84th Cong., 1st sess. (1955), p. 1.
[2] Ibid., p. 1.
[3] Ibid., p. 2.

tion now behind us, the task remains to maintain our defense mobilization base in the maximum possible state of readiness.[4] Time is no longer a weapon in the arsenal of democracy; a potential enemy has the power to strike a crippling blow at the Nation's industrial and population heart without warning. If war should come, great expansion of plant capacity under these circumstances would be out of the question.[5]

The use of tariffs as an instrument for the maintenance of defense industries against foreign competition possessing superior cost advantages is generally accepted as a valid exception to the foreign economic policy demanded by classical theory for the maximization of income.[6] Some, while recognizing the validity of special action to maintain industries essential to national security, would prefer to see measures other than tariffs attempted where possible.[7] Others, however, regard tariffs as the preferred instrument for protecting domestic industrial capacity from such foreign competition.[8]

Tariffs for the development and maintenance of defense industries have generally been established in the immediate aftermath of war when the appreciation of their importance is fresh in the mind of the Government. The domestic industries established during World War I to supply the chemicals, dyes, surgical equipment, and optical and scientific glassware needed when imports from Germany were cut off by the Allied blockade are cases in point.[9]

The fact that war-production shortages stemming from the loss of imports occasioned the creation of these key industries is indicative of the cost disadvantage under which they operate. Brief reference to the domestic dye industry will illustrate this point. As Dr. Taussig observed, from a strictly economic point of view, the domestic industry lacked a comparative advantage vis-a-vis the German industry. The industry's processes "are painfully detailed and elaborate, highly trained and highly paid labor being applied slowly and carefully to a variety of products." [10] Though that eminent economist reluctantly acknowledged the defense exception to free-trade policy, he conceded that the domestic coal-tar industry was apt for its application:

"At a point in the processes which is considerably advanced there can readily be a diversion in one direction or another—either to the manufacture of dyestuffs or to the manufacture of the shell-filling high explosives. Not only has the same plant much apparatus which is available for both purposes, but the same set of trained chemists and skilled workmen can be used. * * * But, after all qualifications are made, a strong argument remains in favor of regarding the dyestuffs manufacture as potentially a military industry. It has the further advantage of being a military industry which can be utilized in times of peace." [11]

Thomas Walker Page gave his support to the defense- or key-industry exception in an able discussion of the surgical-instruments and coal-tar chemical industries which were so urgently and precipitously called into existence in World War I to replace the lost German imports. His thesis that the industries of this type must be assisted by a tariff which would make possible competition with imported products at prices sufficiently above domestic costs to insure the continued support of capital investment [12] has lost none of its validity with the passage of time. Competent economic commentators with the benefit of more recent events for perspective have affirmed the application of the defense exception to chemicals [13] and the competitive disadvantage which domestic producers (notably of synthetic organic chemicals) are under in comparison with foreign

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[4] Ibid., p. 7.
[5] Ibid.
[6] Towle, International Trade and Commercial Policy (1947), pp. 324, 325; Wilcox, A Charter for World Trade (1949), p. 36; Young, The International Economy (1942), pp. 443, 444; Kress, The Economics of Diplomacy (1949) (ibid.); Delle-Donne, European Tariff Policies (1928), p. 280; Schultz, Shrink Agriculture or Shift Tariff Protected Industries (excerpted from Agricultural Emergency in Iowa, 1933), pp. 194. 195.
[7] United States Council, International Chamber of Commerce, The Expansion of Trade (1953), p. 11; Bradford Smith, in National Industrial Conference Board, The Economics of Tariffs (1953), p. 68; Myrdal, The Reconstruction of World Trade and Swedish Trade Policy, Svenska Handelsbanken's Index (supplement B, 1946), pp. 13, 16; Kestnbaum, Committee for Economic Development (statement to Commission on Foreign Economic Policy, 1953), p. 10.
[8] Buchanan and Lutz, Rebuilding the World Economy, Twentieth Century Fund (1947), pp. 242, 243.
[9] Diebold, New Directions in Our Trade Policy (Council on Foreign Relations, 1941), pp. 52–55.
[10] Taussig, The Tariff History of the United States (8th ed., 1931), pp. 472 et seq.
[11] Taussig, Free Trade, the Tariff and Reciprocity (1920), p. 200.
[12] Page, Making the Tariff in the United States (Brookings Institution, 1930), pp. 75–77.
[13] Young, op. cit., pp. 443, 444; Kress, op. cit.

producers due to lack of any special advantage in raw material costs, volume of output, or production techniques.[14]

There is understandable concern on the part of responsible groups that the scale of our military planning be commensurate with the nature and magnitude of the threats to our security. This, it is recognized, must be adequate to give the United States global striking power as well as the ability to fight local wars if needed. This defense capacity includes help in the rearmament of our allies.[15] The immensity of our national responsibility as principal guarantor of the freedom of the Western World is glimpsed in the fact that we are obligated by treaty for the protection of 37 countries and, in addition, would probably defend some 12 to 15 others whose security is regarded as important to our own. Dr. Abbott's admonition here is apt:[16]

"Certainly it would not seem the part of wisdom to undertake commitments or pursue policies that leave us little or no margin of productive capacity, manpower, or taxpaying ability—for under those conditions we would not, in case of a vital emergency, have reserves available on which to draw."

This advice, which argues for the retention of the defense exception to our foreign trade policy as a means for maintaining industrial capacity essential to the national security in a state of readiness, is reminiscent of the advice of another responsible group in 1940:

"In order to defend our security in war, and our prosperity in peace, our Government must have power to assure to this country a supply of all necessary materials, and also to protect our interests against economic pressure from any hostile power. This necessity requires a recognition, in acts as well as in words, that the system of international free trade cannot function as long as any important part of the world is controlled by powers which can take advantage of that system to threaten our security."[17]

II. DEFENSE CRITERIA—WORLD WAR I

The principal guidelines of defense criteria based upon the Nation's World War I experience have been supplied by Bernard M. Baruch. From his report to the President in 1919, there emerge the following principles:[18]

1. Wars are won, if at all, by a mobilization of the Nation's full economic resources—industrial, agriculture, and financial.
2. Productive capacity must be achieved and balanced in a measure sufficient (*a*) to provide the instruments of war, (*b*) to sustain the civilian population, and (*c*) to preserve the economic strength of the Nation.
3. Production of industries making goods essential to the war effort must be expanded; nonessential industries must be converted wherever possible to essential output.
4. During the postwar period there should be in existence an agency with power to mobilize the economic resources of the Nation in time of emergency. This organization should develop mobilization plans to be placed in operation in the event of emergency.
5. By means of a protective tariff, bonus, tax exemption, or otherwise every possible effort should be made to develop production of strategic metals such as manganese, chrome, and tungsten; dyes and coal-tar chemicals; nitrogen and its substitutes; and other critical raw materials usually imported which can be produced in quantity in the United States.
6. Plants for the manufacture of military hard good end items should be maintained on a standby basis. Necessary tooling for the expansion of these industries should be kept on hand.

The report of the War Industries Board in 1921 discloses the basis for Mr. Baruch's recommendation to the President that the production of the dye and coal-tar chemicals industry be stimulated by means of a protective tariff. It details the loss of German dyes and intermediates and the huge war demand for the same chemicals which were constituent materials of dyes for the manufacture of high explosives. It recounts the extraordinary efforts of the Govern-

[14] Committee for Economic Development (Research and Policy Committee), United States Tariff Policy (advance text, 1954), pp. 7, 11, 16, 18–19, 29–31.

[15] Woodrow Wilson Foundation and National Planning Association, The Political Economy of American Foreign Policy (1955), pp. 12, 13.

[16] Abbott, The International Position and Commitments of the United States (American Enterprise Association, 1953), p. 8.

[17] Committee on Economic Defense, Total Defense (American Council on Public Affairs, 1940), p. 7.

[18] Letter to the President, December 24, 1919.

ment to establish the manufacture of dye intermediates for explosives and of finished dyes for the textile industry. It indicates that by the close of the war the dye industry was in a favorable condition for full development.[19]

Mr. Baruch's recommendation for adequate tariff protection for the dye and coal-tar chemicals industry was faithfully carried out. President Wilson, an advocate of liberal foreign-trade policies, was in agreement that the defense exception should be applied in behalf of the industry. In a message to Congress in May 1919 he had asked that special consideration be given to an adequate tariff which would provide for the domestic manufacture of dyes and related chemicals. His objective was the successful maintenance of many strong and well-equipped chemical plants.[20] Imposing a temporary embargo[21] to insure that the synthetic organic chemicals industry would suffer no adverse effects until it enacted permanent tariff legislation, the Congress devoted its attention to a comprehensive schedule of duties which were subsequently enacted as part of the Tariff Act of 1922. The legislative history of that act clearly indicates the understanding of the Congress that the synthetic organic chemical industry is essential to national security as well as the advance of medical and industrial chemistry.[22] These tariffs were carried forward in virtually the same form in the Tariff Act of 1930 on the basis of a clearly revealed congressional intent to provide for continuation of the research and development activities of the industry and an increase in its productive capacity because of the industry's importance to national defense and public health.[23]

It was not until 1931, however, that the Nation's first industrial mobilization plan was submitted to the War Policies Commission. This body, created by a joint resolution of the Congress, held hearings commencing in March 1931 under the chairmanship of Secretary of War Patrick J. Hurley. In his statement before the Commission, Mr. Baruch emphasized the following principles:[24]

1. Plans can and must be made to convert domestic industry to a war footing with the least possible disruption.
2. Government controls must be used to (*a*) check inflation, (*b*) allocate shortage items, (*c*) conserve essential materials (*d*) provide for substitution of materials for shortage items, and (*e*) develop new sources of supply.
3. The objectives of industrial mobilization should be (*a*) to supply materiel to the Armed Forces when, where, and in the quantity desired by them, (*b*) to accomplish this job without undue dislocation within an industry, (*c*) maintenance of superior United States economic strength, (*d*) to avoid economic and social disruption in the aftermath of war.

The War Department plan for industrial mobilization submitted to the Commission was parallel in many respects to Mr. Baruch's principles. It declared that the success of the fighting forces was directly and immediately dependent on the ability of the Nation's industries to satisfy promptly its requirements in munitions. In addition, industry must be capable of producing all of the material things on which the health and well-being of the civilian population depended throughout the war. The report ackowledged that the folly of permitting the Nation to drift into war without provisions for the prompt mobilizaion of industry had been brought home to the people and their leaders in World War I. Grave consequences for the United States were avoided then because of the protection afforded by our allies and the inability of the enemy to capitalize on our lack of preparedness.[25] It was part of the War Department's plan that the Army and Navy would separately estimate their requirements for materiel, the allocation of these requirements to industry, the determination of probable effects of these requirements on industry, and development of measures to assist industry in absorbing the load. The final step was the development of an organization and methods for exercising industrial controls.[26]

The British were as fully aware as the United States of the necessity of establishing a strong organic chemical industry. In December 1920 an act was passed

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[19] Baruch, American Industry in the War (1941), p. 191 et seq.

[20] U. S. Tariff Commission, Census of Dyes and Coal-Tar Chemicals, 1918, Tariff Information Series, No. 11 (1919), p. 73.

[21] Title V, Emergency Tariff Act of 1921 (Dye and Chemical Control Act, 1921), Public Law No. 10, 67th Cong.

[22] H. Rept. 248, pt. 1, 67th Cong., 1st sess., p. 21; S. Rept. 595, pt. 1, 67th Cong., 2d sess.. pp. 9, 10; congressional debates, 62 Congressional Record 11498, 11502–11505, 12713.

[23] H. Rept. 7, 71st Cong., 1st sess., pp. 14, 15; S. Rept. 37, 71st Cong., 1st sess., pp. 2, 4; 71 Congressional Record 1199–1201, 4020, 4894–4895.

[24] Baruch, op. cit.. pp. 378–386.

[25] H. Doc. 163, 72d Cong., 1st sess. (1931), pp. 401, 402.

[26] Ibid., pp. 405–407.

prohibiting the importation, except under board of trade license, of a wide range of all synthetic organic dyes and intermediates. In August 1921 the Safeguarding of Industries Act was passed to safeguard certain special industries, later to be referred to as "key industries." [27] Included in key industries at the outset were optical glass, laboratory apparatus, scientific instruments, and synthetic organic chemicals.[28] Thus the critically important dyes and intermediates were subject to an absolute restriction on importation and could only be brought in under license, while all other synthetic organic chemicals were subject to the special duties imposed under the "key industries" act.

In 1936 a report of a committee appointed by the Board of Trade on the importance of the key industry duties to imperial defense concluded that in no industries were research and development of more vital importance than upon those in which the United Kingdom was dependent for its defense. Under the protection of the key industries duties these strategic industries had expanded their productive capacity. Specifically, it was reported that in the synthetic organic-chemical industry (described as the "fine" chemical industry) "prolonged and extensive research is usually necesary before the stage of commercial production is reached and that without long-term security such research could not be undertaken." Optical instruments, scientific instruments, and scientific glass were stated to require the benefit of the duties in view of the long period of apprenticeship training essential for the skilled operators employed in those industries. Adverting to the fact that dyes and intermediates, on the one hand, and synthetic organic and fine chemicals, on the other, formed complementary parts of a special field, special treatment was recommended for the fine-chemical industry to conserve its relationship to the dye and intermediate industry which continued to receive the benefit of the restriction on importation except under license. Accordingly, the key industry duties were recommended for a further 10-year extension.[29]

The passage of time in the interwar period soon dulled the understanding in America of the chemical industry's importance to national defense. The Technology Subcommittee of the National Resources Committee was moved to comment in 1937 that the lack of understanding of chemical products by the ultimate consumer was a weakness because of the need for a sympathetic understanding of the industry by the public. The subcommittee observed that the chemical industry served all other industries though that fact was but little understood by the public.[30] This report offers a valuable contemporary view of the synthetic organic-chemical industry on the eve of World War II. Since the primary concern of the report was technology, major emphasis was given the research activities of the industry which had yielded such outstanding developments in the field of synthetic medicinals and pharmaceuticals, plastics, fibers, and solvents.[31] The report noted that "the most outstanding trend in the chemical industry since the war has been that for all industrial nations of the first class and many others to strive toward national independence, particularly in the production of strategic chemical materials." [32]

An independent appraisal of the readiness of the chemical industry on the very eve of World War II gives further point to the accomplishments of the beneficial tariff policy which the United States had adopted for it. It stated:

"Production of chemicals, like that of iron and steel, constitutes one of the basic industries in a wartime as well as a peacetime economy. It performs a direct service to national defense by furnishing the materials and facilities for making explosives, gases, and gas masks. Its indirect value, however, is perhaps still greater, for countless industrial processes are dependent on chemical products. * * *

"The chemical industry today is much better prepared than it was in 1914. * * * The total value of its output then was about a sixth of what it is now. The United States had virtually no dye industry and produced only very small quantities of organic medicinals, potash, and nitrates. It imported 90 percent of its consumption of dyes, as well as 90 percent of the coal-tar intermediates needed as raw materials for its small domestic output. By 1939,

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[27] 11 and 12 Geo. V, ch. 47, August 19, 1921.
[28] See Kreider, The Anglo-American Trade Agreement (1943), pp. 13, 14; McClure, A New American Commercial Policy (1924), p. 216.
[29] Report of a committee appointed by the Board of Trade (London, 1936), pp. 7, 9, 10.
[30] Technological Trends and National Policy, National Resources Committee (1937), pp. 289, 290.
[31] Ibid., p. 312.
[32] Ibid., p. 313.

however, imports of dyes had declined to less than 5 percent of consumption and those of intermediates to less than 1 percent. This country can now produce adequate quantities of drugs and medicinals, and is able to furnish its own chemical apparatus. In the past decade the chemical industry, in contrast to many others, has continued its rapid development. * * * Moreover, the United States, by spending more money on chemical research than any other country, has kept well abreast of scientific and technical progress." [33]

III. DEFENSE CRITERIA—WORLD WAR II

The growth that occurred in the chemical industry, notably in the synthetic organic segment of the industry, during the interwar period was a product of the beneficial tariff policy established by the Congress upon the advice of Bernard Baruch and at the request of President Wilson. The chemical schedule of the Tariff Acts of 1922 and 1930 was a silent sentinel unfailingly performing its duty in maintaining the synthetic organic chemical industry in a dynamic state quickly convertible to war production. The other measures which had been placed upon the planning boards of the Defense Establishment suffered from lack of positive and continuous application to keep industrial capacity abreast of advancing worldwide technology or in phase with the scale of effort which was to be demanded by an all-out war of materiel.

So discouraging was the failure of mobilization planning to prepare the Nation for the tasks of war production that the Senate Subcommittee on War Mobilization was moved to report in 1943 that the principal cause for the Nation's failure to meet production goals was the lack of proper mobilization policies and necessary organization to excute them. In the teeth of the actual war emergency the committee with great clarity emphasized the total dependence of the Nation upon its industrial resources of every description with these words: [34]

"War necessarily dictates that manpower, facilities, materials, and every other resource in every field, all are the components in our war economy and must move together in balance to obtain maximum production. Every resource is essential and upon their proper joint scheduling rests the possibility of the success of our entire production program."

The status of the chemical industry as a key defense industry is strikingly confirmed by its production record in World War II. More than 95 percent of the production of basic coal-tar and related chemicals was consumed in the manufacture of products vital to the conduct of the war.[35] Basic chemicals were used in virtually every field of war producition, including conspicuously synthetic rubber, aviation gasoline, plastics, rayon, nylon, explosives, and propellants, protective coatings, dyes, fertilizers, insecticides, and medical supplies.[36] Major production battlenecks in chemicals were few.[37] In addition, during the 4½ years of United States participation in the war, the chemical industry supplied over $2 billion of chemicals and drugs to our allies.[38]

War Production Board records establish that chemicals underlie the proper functioning of virtually every phase of the civilian and war economy. Any dislocation of the chemical industry's productive capacity causes widespread dislocation throughout other branches of the chemical industry as well as the many other industries dependent upon chemicals for their output.[39] An intertwining of technology links progress in metals, transportation, textiles and public health to chemical research. A loss of research effort in any branch of the chemical industry would be felt in many other industries. Without organic chemicals there could be no lightweight metals for aircraft, no hydraulic fluids, engine coolant or lubricants for aircraft operation; no synthetic rubber for tires, self-sealing gas tanks or aircraft parts; no jet fuels or aviation gasoline to propel the planes. The efforts of a number of organic-chemical manufacturers were required in the wartime atomic-bomb project. The chemical industry alone

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[33] de Wilde and Monson, Defense Economy of the United States: Industrial Capacity, Foreign Policy Reports, February 15, 1941, p. 296.

[34] Subcommittee Rept. 1, Subcommitte on War Mobilization, Committe on Military Affairs, U. S. Senate, 78th Cong., 1st sess. (1943), pp. 2, 3.

[35] U. S. Tariff Commission, War Changes in Industry Series, Rept. 19 (1946), p. 68.

[36] Krug, Wartime Achievements and the Reconversion Outlook, War Production Board, Doc. 334 (1945), p. 90.

[37] Ibid., p. 91.

[38] Ibid., p. 92.

[39] Letter, Reid, Deputy Director General, WPB, to General Hershey, March 1, 1943; letter, Donald Nelson to Paul McNutt, March 11, 1944; letter, D. P. Morgan to Donald Nelson, February 2, 1944; letter, J. W. Raynolds to David Ziskin, January 25, 1944.

contained the number of technically trained research men needed for that project though it concerned more matters of physics than chemistry. Today's oil, rubber, and steel would be impossible without organic chemicals. From a life of 2,500 miles yesterday and 25,000 miles today, the automobile tire with organic chemicals as important constituents will tomorrow last for 100,000 miles. The chemical industry's products used as insecticides, soil conditioners, and feed supplements have made the Malthusian law obsolete by a 50-percent increase in the productivity of our static farm acreage. For these reasons the balanced growth of the industry is of fundamental importance in peace and war. Without tariff assistance the industry's capacity, technology, and its research programs would be distorted by the flight of capital from areas made unattractive by import competition. In defense emergencies these distortions would be magnified as the inadequate capacity and technology of the stunted areas spread their retarding effect throughout the other areas of industry dependent on them for raw materials.

IV. DEFENSE CRITERIA—POST-WORLD WAR II

In the development of criteria for judging defense essentiality and applying protection against imports, an obvious choice is to accept judgments which the Government itself has made in other contexts coping with problems where the relationship of an industry to national security is the norm of action. The problems which had to be met and resolved in our Nation's participation in World Wars I and II provided the occasion for a multitude of such determinations of defense essentiality pertaining to our domestic industries.

One of the chief capabilities which the tariff on chemicals was intended by Congress to provide the domestic industry was that of a sustained incursion into the extensive fields of research and development. The benefits of a tariff for the industry must be sufficiently great to attract capital investment for the heavy expenditures occasioned by these activities over long periods of time. The achievement of the domestic chemical industry in research and development was thoroughly examined by the Paley Commission, whose postwar report states:[40]

"In the United States, the chemical industry may be considered to have come of age only after the First World War. Since that time, it has made phenomenal progress by concentrating intensively on research and development. Practically every industry is dependent on the chemical industry to a considerable degree, and this is also true of every household and consumer. * * * Heavy annual investments both in research and in plant have been necessary to achieve these results. Continued heavy investment is necessary for further development."

The Commission found that through organic chemistry we have command over the structure of materials to an extent which permits the tailoring of molecules to produce new materials containing properties desired for particular purposes. The ability of the organic chemist to synthesize materials may perhaps be the most powerful tool of technology which the Nation possesses for solving the materials problems present and in the future.[41] The most notable supplements to our materials stream in recent years have been the new synthetics-plastics, fibers, pharmaceuticals, synthetic rubber, and the like.[42] The greatest scientific activity in the past three decades has dealt with matters of chemistry and within this realm the development of organic materials has been outstanding.[43]

A great advantage of the American economy from the national defense point of view, in comparison with other countries, is that it draws on raw materials which constitute one of the fixed factors in the success of any national economy.[44] The Paley Commission underscored the versatility of the chemical industry in this respect.[45]

"Chemical industry also, above all other industries, has a great capacity for adapting itself to variations in raw materials, because to a large extent it can work out methods for using raw materials interchangeably. Finally, it has a great capacity for meeting crises. Examples are many—dyestuffs, fixed nitrogen, medicinals, synthetic rubber, silk, quinine, ivory, camphor."

Thus the dominant industrial criteria of national importance emphasized by the Government in this period—research, the promise of technology, and versatility in use of available raw materials—apply uniquely to the chemical industry. They affirm the key defense determination of earlier periods.

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[40] Report, President's Materials Policy Commission, vol. II, p. 103.
[41] Ibid., vol. IV, p. 21.
[42] Ibid., vol. I, p. 10.
[43] Ibid., p. 142.
[44] H. Rept. 1845, 80th Cong., 2d sess. (1948), pp. 870, 871.
[45] Report, op. cit., vol. II, p. 103.

V. DEFENSE CRITERIA—KOREA AND AFTER

The Korean emergency brought America up sharply on the necessity for effective defense mobilization of industrial capacity. The conscience and aspirations of the Western World were epitomized in our national policy, declared in the Defense Production Act of 1950, "to oppose acts of aggression and to promote peace," and "to develop and maintain whatever military and economic strength is found to be necessary to carry out this purpose." [46]

The initial effort was devoted to creating adequate Armed Forces in being and bringing weapons production to an adequate level. Once these initial objectives were achieved, the emphasis shifted to completing the industrial production capacity needed as a basis for full mobilization. The assumption underlying this firmly accepted policy is that the Nation must maintain a high level of military preparedness over a period of years—a new concept in our history.[47] The projects for expansion of industrial capacity under tax-amortization certificates are intended to assure ample plant and equipment in basic industries to meet any foreseeable military and civilian demands under partial mobilization and contribute substantially to the increased requirements of full mobilization.[48]

The welcome truce in Korea has not terminated the defense mobilization program. The Nation has learned from experience "that sounds from behind the Iron Curtain intended to suggest that there is no danger of war cannot be so interpreted." [49] We have also not lost sight of the intensive continuing efforts of the Soviet Union to maximize production within its own borders and within those of the captive countries of Europe. A continued dynamic economic growth in the United States matching or surpassing that of the Communist bloc is indispensable to the maintenance of world stability and as a force for world peace.[50]

In the post-Korean period the mobilization program has been refined "to achieve and maintain the strength necessary to protect the Nation and to discourage aggression; to bring material supplies and production capacity to a level of readiness which will enable us to move rapidly into a maximum military effort in a full emergency, while providing for essential exports to our allies; and to improve the Nation's defenses against an attack on its industrial centers, with an ability to rapidly recover should an attack occur." [51] Under this program large expansions in the Nation's basic industries have been completed and the all-important job facing both industry and government now is that of keeping this expanded capacity in a state of maximum readiness for any emergency.[52]

Under the current mobilization program many determinations have been made by the responsible Government agencies of the defense essentiality of the chemical industry. The Defense Production Administration in the first year of the emergency identified the chemical industry along with aluminum, blast furnaces, steelworks, rolling mills, and petroleum-refining industries as a key industry in the defense effort.[53] Early recognition was given to the fact that chemical capacity is an important factor as a basis for other defense-production programs, and that the accomplishment of chemical-plant expansions has implications both for defense and for peace.[54]

During the Korean hostilities, priorities and allocations of certain chemicals were recognized as essential to support military and atomic-energy activities.[55] Production goals for chemicals continued to be recognized as representing basic capacity for the defense effort.[56] From the outbreak of the Korean emergency through 1954, the chemical industry, making the largest expansion in its history, had invested $5 billion in production facilities. Defense production goals were established for about 60 chemicals. These expansion programs provided for unprecedented increases for a wide range of chemicals.[57]

The 1953 amendments to the Defense Production Act restated national policy. To provide for the national defense and national security in view of the present

[46] Sec. 2, Public Law 774, 81st Cong.
[47] Report, Advisory Committee on Production Equipment (1953), p. 4.
[48] Second Annual Report, Joint Committee on Defense Production (1952), pp. 51–52.
[49] Ibid., p. 34.
[50] Trends in Economic Growth, Study for the Joint Committee on the Economic Report (Legislative Reference Service, Library of Congress, 1955), p. iv.
[51] H. Rept. 1097, 83d Cong., 2d sess. (1954), p. 7.
[52] H. Rept. 1, 84th Cong., 1st sess. (1955), pp. 1, 2.
[53] S. Rept. 1040, 82d Cong., 1st sess. (1951), pp. 21, 186–187.
[54] Ibid., p. 40.
[55] Second Annual Report, Joint Committee on Defense Production, p. 34.
[56] Ibid., pp. 35–36, 205–206, 220.
[57] H. Rept. 1, 84th Cong., 1st sess. (1955), p. 2.

international situation, the mobilization effort was declared to require expansions of production facilities beyond the levels needed to meet the civilian demand.[58] This policy, in view of the cessation of hostilities in Korea and the consequent cutback in military procurement, requires understanding and substantial assistance to private industry by the Government if private plants expanded or created to meet mobilization goals are to be maintained in a state of readiness.[59] Continued tariff assistance to defense industries is surely one important form of such assistance.

A complicating factor is that for the first time in its history domestic industry is faced with the very real possibility of being a primary target for the enemy. This gives rise to the grim problem of maintaining production under attack by atomic and thermonuclear weapons.[60] This possibility makes all estimates of industrial capacity required for defense bare minimum goals.

Major emphasis in our mobilization planning is now placed upon retention by the United States of technical superiority to offset the size of military forces. The achievement of technical superiority is dependent upon research and development.[61] Revolutionary developments, notably in the field of jetplanes, guided missiles, rockets, and fissionable materials, magnify the importance of technological preparedness.[62] This aspect of the mobilization program has created a major problem in maintaining the required amount and achieving the proper distribution of skilled manpower resources.[63] The occupations most critical to the national security require extended periods of training.[64] If highly trained manpower resources are not to be a crippling factor in the Nation's capacity for mobilization, incentives must be provided to sustain a progressive growth in the labor force for skilled technologists. A technologically superior domestic chemical industry is an essential factor in providing for these resources. The chemical industry employs twice as many research engineers and scientists on private research as any of the other major industries.[65] In the 14-year period 1941–54, the synthetic organic chemical industry more than quadrupled its employment of technically trained research workers, from 2,957 to 13,474.[66]

The additional defense industry criteria supplied by this period are expansion of productive capacity under defense mobilization goals, and the development of highly trained scientific and technical personnel through sustained research and development activity. As in each of the earlier periods, the chemical industry is positively identified as a defense industry under these criteria. The necessity for tariff assistance has not abated, as the industry faces the task of keeping private production capacity in excess of civilian needs in a state of readiness and sustaining its research and development activities, and hence its resources in skilled manpower, on the increasing scale demanded by the struggle for global technological superiority.

VI. DEFENSE CRITERIA—CONCLUSIONS

With the perspective afforded by the background supplied by our wartime and Korean experiences, we can select empirical criteria for judging defense essentiality. Domestic producers identified by any of the following criteria should be eligible for tariff assistance as a national security measure where they are at a cost disadvantage with foreign producers:

1. Those whose products have continuing application to military or essential uses, and which in time of war or defense emergency have been under priorities, allocation, or conservation orders, or whose capacity has been expanded to provide increased production of products for military or essential civilian uses.
2. Those with productive capacity convertible from peacetime to war or essential civilian production without major adaptation.

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[58] Sec. 2. Defense Production Act of 1950 as amended by Public Laws 94 and 95, 83d Cong.
[59] H. Rept. 1, op. cit., pp. 8, 9.
[60] H. Rept. 1097, 83d Cong., 2d sess. (1954), p. 69; National Planning Association, A Program for the Nonmilitary Defense of the United States, etc. (1955), pp. xvii, 50.
[61] H. Rept. 1097, op. cit., p. 5.
[62] Ibid., p. 67.
[63] Ibid., p. 72.
[64] Manpower Resources for National Security, ODM (1954), p. 53.
[65] Trade, Strength and Security, SOCMA, New York, 1953, p. 122. As of January 1, 1952, the chemical industry so employed 13,264 research engineers and scientists. The next closest industry was electrical machinery, with 6,915 so employed.
[66] U. S. Tariff Commission, annual reports on synthetic organic chemicals.

3. Those in which skilled manpower is essential for production of military or essential civilian goods and where the training time would seriously handicap an expansion.

4. Those with manpower skills essential for production of war materiel or essential civilian goods which require not only long training time but continuous application to the putthrough of such products to remain functional.

5. Those which maintain extensive research and development activities in fields of technology pertinent to military or essential civilian materiel or services.

6. Those whose research and development activities contribute to a high level of scientific inquiry in fields essential to United States leadership in the technology of war.

7. Those which draw upon raw materials available in abundance in the United States for the production of items directly useful in war or essential in the civilian economy in time of war, or whose products are adaptable as substitute materials for critical items in time of emergency.

Our industrial mobilization base does not consist merely of mass-production industries possessing a comparative advantage over those of foreign countries. It includes as an indispensable part many efficiently operated industries which have a comparative disadvantage with their foreign counterparts. For these industries a defense exception must be made to our foreign economic policy. The above criteria should prove to be a reliable means of identifying the industries essential to national defense.

Mr. Bolling. The next witness is Mr. Richard S. Leghorn. Mr. Leghorn is manager of the European division of Eastman Kodak and a colonel in the Air Force Reserve. He is here, however, as an author and military analyst. Therefore the views he expresses will be his own and not necessarily those of his company or the Air Force.

STATEMENT OF RICHARD S. LEGHORN, AUTHOR AND MILITARY ANALYST

Colonel Leghorn. With the single exception of export controls on strategic shipments, all justifications for trade restrictions in the name of national security rest on one basic and common assumption. This tacit assumption, which is rarely questioned, is that a broad mobilization base is of such essentiality to our national security that it overrides all other aspects such as our foreign economic policy.

Of course, convincing arguments have been made raising serious doubts whether trade restrictions do, in fact, strengthen the mobilization base. And alternatives to trade restrictions have been discussed and presented as superior methods for strengthening the mobilization base. The discussion has also extended to the question of whether we should be building a mobilization base in the United States alone or one throughout the entire western community. But to date the worth of the mobilization base itself has not been seriously questioned.

It is the purpose of these remarks to raise certain questions about the validity of the basic assumption that the mobilization base is of overriding consequence.

The industrial mobilization base is the prewar economic structure from which armaments production can be expanded after D-day. It is a costly total of vast raw materials stockpiles, standby industrial capacities, and reserves of industrial skills which, in the event of national emergency, can expand production of armaments.

In World Wars I and II the mobilization of our industrial strength for war was the decisive element in victory. In those days of total conventional warfare the rate of production of armaments was greater than the rate of their attrition through military action. The lesson of these wars is that total conventional wars are long, and that the side which has a greater ability to build and transport armaments to fighting fronts can win this type of war.

Perhaps the first and most germane question to ask is whether future wars will be long or short.

The important question is whether or not nuclear weapons will be used in future wars, for nuclear wars will be short. It is useful to classify possible future wars into three categories: general war such as a NATO-Soviet conflict; limited war, such as in Korea; and guerrilla war, as in Malaya.

No responsible authority expects that a general war can be anything but nuclear. It will therefore be short, and the mobilization base for it will be valueless.

As for guerrilla wars, they will probably not be nuclear and they probably will be long. But only very limited arms production is needed to satisfy the appetite of guerrilla warfare, and it can hardly be argued that a mobilization base of the sort we are discussing is necessary.

This leaves the matter of limited warfare of the Korean type. It is considered desirable for the West to plan to use nuclear weapons in any future limited war, not only because this is the only way the West can be sure of stopping superior Soviet-Chinese conventional arms at tolerable costs, but also because this is the best way to establish a deterrent to such wars, just as we have established a nuclear deterrent to general wars. Furthermore, the use of nuclear weapons in such wars is fast becoming inevitable. This is not just because of the western need for them, or because of their efficiency, but primarily because the Soviets have, and the Chinese may soon have, tactical atomic weapons. Because our opponent may use them we must disperse our defending troops. Therefore, we must plan to use nuclear weapons to give our dispersed troops enough firepower to repel the aggression. The possession of tactical atomic weapons by both sides virtually insures their use in war.

But can nuclear weapons be used in limited war without causing the war to spread geographically and become general? For some reason sufficient attention has not yet been given to a consideration which may provide the answer.

We could declare that in repelling aggression by conventional armed forces the United States will use nuclear or chemical weapons only for the defensive protection of its own or Allied territory; that is, to our rear of the de facto preaggression political boundary. Nuclear weapons delivered within a short distance of the border can decimate any surface conventional attack into bits. What remains can easily be dealt with by defending conventional forces. With nuclear air defense weapons, the same will be true against mass conventional air attack.

But even if we put the short-war argument completely aside, there is another important question that needs to be asked about the worth of the mobilization base. In case of war with Russia what would the first explosion of an atomic weapon on United States soil do to our mobilization base? Would our industrial employees with their 1 or 2 cars per family remain at their lathes, or would they flee in panic to the country? Are not our civilian-defense authorities virtually insuring their flight by advocating evacuation as the only recourse? Is the mobilization base concept compatible with civilian-defense policy? And even beyond this, will not the delivery of 100 modern weapons on city targets demolish half our integrated industry and bring meaningful production to an early halt? What value is a mobilization base then? Should not these questions be answered before we continue to restrict trade in its behalf, stockpile materials at the rate of almost $1 billion a year, continue to pay for defense plants and equipment in mothballs or operating at inefficiently low production levels, forego tax receipts due to defense writeoffs, and pay vast subsidies to maintain production skills for presumed use after D-day?

There is one area where some sort of mobilization base will undoubtedly have value some day. Our principal security reliance since 1946 has been our air-atomic superiority. There is a possibility that this reliance may be changed in some future year to one dependent on some system of armaments control yet to be evolved and proved. But if some such system should in time prove effective and lead subsequently to a reduction of our air-atomic armaments, we will still need some sort of protection against either violation or abrogation of the agreement by other nations. Such a protection and deterrent to violation of the agreement may be found in a sort of automatic rearmament reflex composed of standby funds and air-atomic arms production capability. But it is very doubtful if this sort of mobilization base would bear much, if any, resemblance to the mobilization base as we know it today.

Thus far, I have been questioning the real worth of the mobilization base. I would like now to raise a few questions suggesting that it may actually be causing major damage to our national security.

First, does not every defense dollar spent on the mobilization base mean one less dollar for our forces-in-being, which all authorities acknowledge to be our principal security reliance. Can we logically search for savings or cutbacks in the Defense Department without launching an even more exhaustive search within the Office of Defense Mobilization?

Second, can we really justify the enervating distortions and restrictions in the free-world economy which are caused by defense tariff walls and certain trade and exchange controls undertaken in behalf of the mobilization base? And is it logical to construct free-world defenses of collective political and military strengths, without simultaneously building collective economic strength as their basis? Do we want indefinitely to continue trying to rest our collective military and political strengths on the economy of one nation?

Third, although the buoyant United States economy could continue to carry the expensive luxury of a broad mobilization base, are these costs supportable by Europe? If the European countries could be relieved of the costs of striving for a mobilization base with which to fight another World War II would not their economies be measurably strengthened and could not our defense aid costs be trimmed?

Fourth, in the long-term ideological conflict with communism, now that superiority in the arms race is no longer so meaningful, may not the competition be fought out primarily in the economic field?

To this competitive end should we not make greater use of our huge trading, capital, and technical resources and rely more on the problem-solving ability of world economic development? While continuing military strength and a period of military standoff and a balance of terror are necessary to avoid losing the present world conflict, we cannot look to such military strength to win or solve the central world problem of our times. We must surely place increased reliance on free world economic strength and free economic institutions.

Therefore, before we continue blindly to accept the mobilization base as justification for trade restrictions, perhaps we should undertake a searching inquiry into the possibly very damaging effects on our whole security system, particularly the levels of our forces in being and the supporting collective economic strength of the free world.

There is one last question that might usefully be asked. In these circumstances, does the Congress wish to continue to delegate total responsibility for mobilization base policy to the Executive, irrespective of its effect on foreign economic policy and its possible harmful effects on national security? As long as the mobilization base and its administrators occupy their present position of virtual inviolate sanctity, the net effect is the delegation of the formulation of certain basic national policies to a specific office. Perhaps the Congress should at least explore the policy ramifications of the questions noted in these remarks, in an effort to provide the Executive with some guidance in this area which has such broad implications to many basic national policies.

In summary, the questions I have posed are three:

First, is the present mobilization base any longer contributing very much to our national security?

Second, is the present mobilization base harming our national security by weakening the free-world economy and taking funds away from those needed to build and maintain military forces-in-being?

Third, where some value is found for a type of mobilization base should not the Congress determine the standards for judging its value for our country, and establish policy guidance for the executive branch through appropriate legislative action?

All of these questions have a direct and fundamental bearing on our foreign economic policy and the work of this committee. May I suggest, in closing, that this important joint committee of the Congress consider the initiation of a comprehensive study into the very nature and worth of our mobilization base, perhaps to be undertaken jointly with the Armed Services Committees.

Mr. Bolling. Thank you very much, Colonel Leghorn.

(The full statement of Mr. Leghorn is as follows:)

The "Defense Mobilization Base" and Foreign Economic Policy

Statement by Richard S. Leghorn [1]

With the single exception of export controls on strategic shipments, all justifications for trade restrictions in the name of national defense rest on one basic and common assumption. This tacit assumption, which is rarely

[1] Mr. Leghorn is manager, European Division, Eastman Kodak Co., and a colonel in the U. S. Air Force Reserve. He appeared in a personal capacity as an author and military analyst. The views he expressed are therefore his own and do not necessarily represent those of either the Eastman Kodak Co. or the U. S. Air Force.

questioned, is that a broad mobilization base is of such essentiality to our national defense that it overrides all other aspects of national policy. The mobilization base concept impinges particularly on one area of national policy and that is foreign economic policy.

It is my purpose in this paper to raise certain questions about the validity of this basic assumption. First, is the mobilization base a meaningful concept in the light of our present-day defense and warfare requirements? I suggest that there are many indications that it may not be. The nature of warfare and, correspondingly, the nature of military defense, has undergone a shattering revolution in the past 10 years. The nature of this revolution is such that it leads to the conclusion that future wars will be very short. The mobilization base cannot serve a useful function in a short war.

Second, if the mobilization base concept serves little or no useful purpose, can it be said that adherence to it is detrimental to our national interest? I suggest that this may be so for many areas of national policy. I shall question, in particular, whether the mobilization base does not, in fact prejudice the effective use of policies designed to strengthen the free world economy. I also ask whether it may not weaken military security by diverting defense funds from vital deterrent military forces.

Third, could the liberation of our foreign economic policy from the restraints imposed upon it by the requirements of the defense mobilization base improve our national security? My suggestion is that a positive foreign economic policy, including a program for the expansion of free world trade as an important component, can be employed as an essential part of our competitive strategy in the long-term struggle with communism.

NATURE AND PAST IMPORTANCE OF THE MOBILIZATION BASE

The mobilization base has two parts—a military part and an industrial part. (Although the cost of the military component is not without relevance to national economic problems as a whole, it is the latter part which is most pertinent to foreign economic policy.) The industrial mobilization base is the economic structure from which armaments production can be expanded after D-day. It is a costly total of vast raw materials stockpiles, standby industrial capacities, and reserves of industrial skills which, in the event of national emergency, are relied on to expand production of armaments.

In World Wars I and II, the mobilization of our industrial strength for war was the decisive element in victory. In those days of total conventional warfare, the rate of production of armaments was greater than the rate of their attrition through military action. The lesson of these wars is that total conventional wars are long, and that the side which has a greater ability to build and transport armaments to fighting fronts can win this type of war.

The Germans in World War II made the great strategic error of calculating that initial power was the key element. They failed to recognize that the capability to create new military power was the decisive characteristic of warfare at that time and they failed to estimate properly the ability and the will of the United States to mobilize. The Allies very logically attacked the Axis mobilization base through bombings of factories; to bomb an opponent's industrial base and retard his rate of buildup was perfectly sound strategy because the ability to mobilize additional military power was the key to victory in those times. The Allied mobilization base, in contrast to that of the Axis powers, remained safe and sound in then remote North America. With this "arsenal of democracy," Allied mobilization was more than enough to offset initial German strength. Our war production was the decisive factor in the conflict. It is little wonder, then, that we treat the mobilization base concept so tenderly today.

PRESENT STATUS OF THE CRITIQUE OF THE MOBILIZATION BASE CONCEPT

The mobilization base concept has, until now, dominated our thinking. As a result, there has been a very natural conflict between the requirements of the mobilization base on the one hand, and the requirements of our position of world economic leadership on the other. Various attempts have been made to reconcile the requirements of these two aspects of national policy. But the unquestioned priority of the mobilization base has been subjected hitherto to a different type of examination than that to be offered in this paper.

The following observations are illustrative of the traditional critiques have been directed at the mobilization base concept:

1. Do trade restrictions in fact strengthen the mobilization base? It has been pointed out that restrictions favor the weaker domestic industries which, in general, are not the ones most vital to the mobilization base. It is the export industries, which are our growing and innovating industries, that make by far the most important contribution to the mobilization base. Trade restrictions, which inevitably hamper our exports, retard the development of these stronger industries.

2. Is present mobilization base policy based on a static conception of the economy which does not properly take into account the dynamics of technology and improving productivity on war-production requirements? In practice, the present application of the concept tends to introduce rigidities into the economy. It is, therefore, incompatible with our national desire to keep the economy dynamic, growing, changing, and competitive. Import competition has a salutary effect on this process. By exerting a pressure on domestic costs of production, it provides an incentive for the use of improved technology. With improved technology comes less reliance on compartmentalized artisan skills and on specific production facilities.

3. Are the present criteria of defense essentiality such that no clear distinction is being drawn between essential military needs and the normal requirements of the civilian economy? The present tendency to classify uncritically so much of the economy as "defense essential" has become fresh fuel for the fires of extreme protectionism.

4. Do import restrictions on raw materials impair rather than improve the mobilization base? We should husband our scarce domestic resources and use to a maximum the more economical supplies of raw materials available abroad. By depleting our domestic supplies, we will be left in time of war with fewer raw materials that will be available only at higher real costs.

5. Are there no alternatives to trade restrictions that offer preferable ways for strengthening the mobilization base? Among the suggested alternatives is the authorization of direct subsidies to specific industries for the maintenance of required skills and standby production facilities. Such subsidies would be charged to the defense budget.

6. Should we be building a mobilization base in the United States alone or throughout the entire Western community? We are in danger of constructing an economic "Festung America" which implies that we intend to go-it-alone economically with our home-defense mobilization base. Collective free world military defense should be supported by collective economic strength in the free world.

WILL FUTURE WARS BE LONG OR SHORT?

While the present critique of existing mobilization policy is logical and requires corrective action, it is the basic thesis of this paper that the mobilization-base concept itself has become the casualty of the revolution in military and defense strategy that characterizes this atomic age.

The lessons of earlier wars in this century—and it is these lessons that support and lend credence to the mobilization-base concept—are that wars are long and the crucial factor in victory is the capacity to build up weapons production. The balance of military judgment is that today's unlimited weapons, if used, mean a short war, particularly as we have abandoned "unconditional surrender" as a war objective and the objectives of our future wars will be limited.

With nuclear weapons, the rate of attrition of military strengths is far greater than any possible rate of buildup through production. A few days of world war III will see hundreds of times the destruction of 4 years of World War II. The military decision will be achieved within weeks, and the threat of further destruction can be used to bring the enemy to terms very shortly thereafter. A mobilization base is virtually valueless in such a war. The outcome will depend rather on military forces in fighting readiness at the outset. Those built from a broad mobilization base, however efficiently organized and shipped across oceans, will not be available until long after the whole issue has been decided. A mobilization base, although the key strategic element in a nonatomic war, is thus a useless millstone around our necks in preparing to fight a modern nuclear war.

The important question to ask now is whether or not nuclear weapons will be used in future wars. It is perhaps useful to classify possible future wars into three categories: General war, such as a NATO-Soviet conflict; limited war, such as in Korea; and guerrilla wars, as in Malaya.

No responsible authority expects that a general war can be anything but nuclear. For reasons already noted, it will therefore be short, and the mobilization base for it will be relatively valueless.

As for guerrilla wars, they will probably not be nuclear, and they probably will be long. But only very limited arms production is needed to satisfy the appetite of guerrilla warfare, and it can hardly be argued that a mobilization base of the sort we are discussing is necessary.

This leaves the matter of limited warfare of the Korean type, which may assume renewed importance in connection with Formosa and the Pescadores. If nuclear weapons were employed, this type of war would indeed be short. It is militarily desirable for the West to plan to use such weapons in future limited war because this is the only way the West can be sure of stopping superior Soviet-Chinese conventional arms at tolerable costs. It is also the best way to establish a deterrent to such wars—a point which will be elaborated on later.

Furthermore, the use of nuclear weapons in such wars is fast becoming inevitable. This is not just because of the Western need for them, or because of their efficiency, but primarily because the Soviets have, and the Chinese may soon have, tactical atomic weapons. Because our opponent may use them, we must disperse our defending troops. Therefore, we must plan to use nuclear weapons to give our dispersed troops enough firepower to repel the aggression. The possession of atomic weapons by both sides virtually insures their use in war.

But can nuclear weapons be used in limited war without causing the war to spread geographically and become general?

A possible answer is that we declare that in repelling aggression by conventional armed forces, the United States will use nuclear or chemical weapons only for the defensive protection of its own or allied territory—that is, on our side of the de facto preaggression political boundary, or in the open seas. Nuclear weapons used within a short distance of the border can decimate any conventional surface attack. What bits remain can be dealt with by conventional defending forces. With nuclear air defense weapons, the same will be true against mass conventional air attack.

The history of continental powers, particularly Russia and China, is ample proof how effectively mass can serve the defender. Now that we have mass on our side in the form of massive stockpiles of massive weapons, are we not clever enough to put it to work in defense of the free world? Historically, Anglo-American reliance has been on air and naval power, whose mobility must be used in offense and with surprise for maximum effect. But need we be so blinded by the past that we cannot see that we too now have mass as well as mobility, and thus can project a defense any place in the world we like and without recourse to depth or time? Or perhaps we suffer from a slogan blindness, and the catch phrase "air-atomic" has inhibited our realization that in strategic planning the "air" (mobility and surprise in offense) may be conceived separately from the "atomic" (mass in defense).

If nuclear weapons are used only defensively behind our borders, or those of our allies, need we fear the spread of nuclear warfare? If it spreads this could only come from deliberate offensive use of nuclear weapons by the aggressor. If he had originally envisioned nuclear aggression, he would commit the nuclear forces in the first action rather than have his conventional forces needlessly chewed up. If our strategic deterrent of massive retaliation deters him from offensive nuclear war in the first place, it will deter him equally well from offensive nuclear war even if his offensive conventional forces meet defeat in limited aggression.

This notion about the defensive use of nuclear weapons to deter or repel conventional armed aggressions is spreading. There is every reason to hope that this concept might soon become security policy and therefore that even limited wars in the future will be short wars. And as the short-war logic gains acceptance, the mobilization base concept becomes increasingly untenable.

IS THE MOBILIZATION BASE CONCEPT COMPATIBLE WITH CIVILIAN DEFENSE?

Even if we put the short-war argument completely aside, there is another important question that needs to be asked about the worth of the mobilization base. In case of war with Russia, what would the first explosion of an atomic weapon on United States soil do to our mobilization base? Would our industrial employees with their 1 or 2 cars per family remain at their lathes, or would they flee in panic to the country? Are not our civilian defense authorities virtually insuring their flight by advocating evacuation as the only recourse?

And even beyond this, will not the delivery of 100 modern weapons on city targets demolish half our highly interdependent industry and bring meaningful production to an early halt? What value is a mobilization base then?

Should not these questions be answered before we continue to restrict trade in its behalf, stockpile materials at the rate of almost $1 billion a year, continue to pay for defense plants and equipment in mothballs or operating at inefficiently low production levels, forego tax reecipts due to defense writeoffs, and pay vast subsidies to maintain production skills for presumed use after D-day?

ARMS REDUCTION AND THE MOBILIZATION BASE CONCEPT

There is one area where some sort of mobilization base will undoubtedly have value someday. Our principal security reliance since 1946 has been our air-atomic superiority. There is a faint but hopeful possibility that this reliance may be changed in some future year to one dependent on some system of armaments control yet to be evolved and proved. If some such system should in time prove effective and lead subsequently to a reduction of our air-atomic armaments, we will need some sort of protection against either violation or abrogation of the agreement by other nations. Such a protection and deterrent to violation may be found in a sort of "automatic rearmament reflex" composed of standby funds and air-atomic arms production capability. But it is very doubtful if this sort of mobilization base would bear much, if any, resemblance to the mobilization base as we know it today.

DOES THE MOBILIZATION BASE DAMAGE NATIONAL SECURITY IN ANY WAR?

Thus far, I have been questioning the worth of the present mobilization base. I would like now to raise a few questions suggesting that it may actually be causing major harm to our national security.

First, does not every defense dollar spent on the mobilization base mean one less dollar for our forces-in-being, which all authorities acknowledge to be our principal security reliance? Can we logically cut back and search for savings in the Defense Department without launching an even more exhaustive search within the Office of Defense Mobilization?

Second, can we really justify the enervating distortions and restrictions in the free-world economy which are caused by defense tariff walls and certain trade and exchange controls undertaken in behalf of the mobilization base? Is it logical to construct free-world defenses of collective political and military strengths, without simultaneously building collective economic strength as their basis? Do we want indefinitely to continue trying to build our collective military and political strengths on the economy of one nation—the United States?

Third, although the buoyant United States economy could perhaps continue to carry the expensive luxury of a broad mobilization base, are these costs supportable by Europe? If the European countries could be relieved of the costs of striving for a mobilization base with which to fight another World War II, could not their economies and military establishments be measurably strengthened?

Therefore, because we continue blindly to accept the mobilization base as justification for trade restrictions, perhaps we should undertake a searching inquiry into the possibly harmful effects on our whole security system, particularly on the levels of our forces-in-being and the supporting collective economic strength of the free world.

A SUGGESTION FOR CONGRESSIONAL INQUIRY

There is one additional question that might usefully be asked. In these circumstances, does the Congress wish to continue to delegate total responsibility for mobilization base policy to the Executive, irrespective of its effects on foreign economic policy and its possible harmful effects on national security? As long as the mobilization base and its administrators occupy their present position of virtual inviolate sanctity, the net effect is the delegation of the formulation of certain basic national policies to a specific office. Perhaps the Congress should at least explore the policy ramifications of the questions noted in these remarks, in an effort to provide the Executive with some guidance in this area which has such broad implications to many basic national policies.

FOREIGN ECONOMIC POLICY AND THE WORLD CONFLICT

We have discussed to this point the impact of nuclear technology on military and mobilization factors, and the consequent implications for foreign economic policy. But in addition to nuclear weapons, there is another new and dynamic force in the world which foreign economic policy must take into account. World communism has recently revealed its intentions to use economic measures as a primary instrument of expansion toward world domination. I suggest that by liberating our foreign economic policy from the restraints of the mobilization base psychology, our policy can be set free so that we can compete more effectively with communism.

That the deep-seated conflict between freedom and communism will be long is well understood. But not so well understood is the recent major change in Soviet overall strategy for winning the struggle. Nor is it generally understood that the United States has not developed a positive, long-range strategic concept for winning this conflict.

Until recently, communism had sought world domination principally through subversion, revolution, and war when profitable. Subversion still remains a major element of Communist conflict strategy. But when Khruschev says the Kremlin will no longer export revolution we can believe him only in the sense that Russian communism no longer sees major opportunities for revolution in the West.

Obviously, if a situation is ripe for conquest by revolution, particularly if it can be supported from an adjacent Communist base as in southeast Asia, we must expect the Communists will foment revolution just as hard as they can. But I am persuaded they recognize that revolutionary circumstances do not represent opportunities, except in the weaker nations of southeast Asia.

As for the use of war in conquest, I believe the Russian Communists unquestionably view their direct engagement in war as unprofitable at the moment. Free-world "civil wars" may occasionally present exploitable opportunities as in the current Israeli-Egyptian crisis. But I think they will not regard direct Russian Communist involvement in war as an opportune means of conquest. Three things could change this picture, but the first two are extremely unlikely, and the third is readily preventable. First, instead of continuing to strengthen our system of graduated deterrents to all kinds of armed aggression, particularly our deterrents to limited wars, we might conceivably lower our guard so much that they could risk a war without inviting too great a loss. Second, the Russians might discover some new air-defense technology before we do, and thus be able to attack from a protected base. (It is for this reason that our own air-defense research effort is so critically important today.) Or, third, after achieving a strategic thermonuclear statemate, they might blackmail the western nuclear powers by the threat of devastating nuclear reprisal if we enter the limited war, while they militarily occupy first nonvital areas and then perhaps even continental NATO countries. But this eventuality can be countered by the defensive adoption of tactical nuclear deterrence, already described. All in all, direct involvement in war does not offer Russian communism many opportunities at the moment.

The Chinest Communists, on the other hand, can hardly be counted on to forego the temptation of war in the Communist drive for world domination. Military action has always been profitable for them—in China, Korea, Tibet, and Indochina. Flushed with victory after victory, even the restraining hands of Khrushchev and Bulganin, who perhaps fear their junior partner will involve them unwillingly in war as Austria involved Germany in World War I, may not deter them unless we also present the Chinese with deterrents.

The improvement of our ability to deter limited wars can inhibit Russian blackmail as well as Chinese military adventures in Formosa and elsewhere. If we act vigorously all forms of armed aggression could, I believe, be made unprofitable for communism, as will be discussed shortly. And when this is done, I believe the realism of the Communists should not be doubted when Kruschev says they have abandoned direct involvement in war as a method toward world domination.

Once we have taken the profit out of little, as well as big wars, it is only logical for communism to seek its opportunities elsewhere. Is not economic penetration coupled with subversion to become a mainstay in Communist conflict strategy? Do not Communist opportunities lie in this direction? The new economic ventures in Afghanistan, Burma, India, Egypt, and elsewhere indicate an increased awareness of the conquest possibilities in economic penetration. Might their announced reduction of troops by 650,000 and their May 10 proposals further to cut their troops by about two-thirds in an arms agreement, be taken perhaps as a recognition of air-atomic realities plus a desire for resources with which to wage economic warfare and competition—rather than solely as a need to satisfy consumer demands at home? In the light of this attitude toward conventional arms reduction, the insistent demands for East-West trade should perhaps be regarded not so much as a desire for strategic materials, but more as opening the way for later economic penetration. The Czech-Egyptian arms-for-cotton deal is unquestionably a means to provoke "civil" war in the West, but it should not be forgotten that it is also a means to economic-subversive penetration. And could not Soviet moves in Germany be interpreted at least in major part as including a plan to use East Germany for the economic penetration of West Germany? Their offer in Moscow to Dr. Adenauer of permanent access to Chinese markets is another important indication of their intentions to emphasize economic means to achieve political objectives.

Communist geographic closeness to underdeveloped countries and their obsolescent equipment are ready assets for economic penetration in the Near East and Asia. Furthermore, their own recent experience is closer to the needs of underdeveloped lands. Economic infiltration as a prelude to subversive conquest is logically the emphasis of greatest opportunity in the revised Communist conflict strategy.

Because his areas of opportunity are changing, Khrushchev should be "believed" when he renounces revolt and war in the West, reaffirms Communist goals "until the shrimp whistles" and declares they will be sought in "competitive coexistence." This "competition" means to him that economic and subversive warfare offer greatest opportunities for future Communist expansion. And the nature of this new strategy in the continuing conflict is confirmed at Geneva where Molotov shows no interest to negotiate a settlement but only an interest in increasing Communist capabilities for economic and subversive warfare and in restricting western opportunities to penertate the Communist empire.

Turning to United States strategy in this long-term conflict, have we yet developed a satisfactory approach? Containment has been called too negative a concept, and liberation premature and a misnomer implying as it does that we intend to impose a change from without.

With communism still bent on world domination and permanently organized for conflict, we still need a positive strategy that can change the Communist threat through altering the nature of their intentions, or by reducing Communist capabilities to impotence or some combination of the two. We must develop a positive plan to reduce substantially this threat to freedom. Because any positive approach on our part must be nonviolent, and carried out in peace, we might say that we must develop a strategy for enforced, competitive peace.

A POLICY OF ENFORCED, COMPETITIVE PEACE

As the name suggests, such a policy has two aspects:

1. Enforcement of the peace, through a system of "graduated deterrents;"
2. The competitive use of nonviolent means eventually to alter communism or render it impotent.

The military aspect is to provide security during the approaching "arms standoff." Eventually, disarmament measures may reduce the costs of this security system. The competitive aspect emphasizes informational, social, and economic means marshaled in an aggressive strategy for peaceful competition.

United States security reliance has until now been placed on air-atomic superiority cast in the posture of threatening massive retaliation in case of general war. Security against limited wars has been left to fend for itself haphazardly—witness Korea (reaction with conventional arms), Indochina (no action), and Formosa (threat of atomic counteraction).

A revised defense policy of "graduated deterrence" is being urged in order to adjust security concepts to the reality of the approaching strategic stalemate, to forestall Soviet atomic blackmail, to take the profit out of further Chinese military adventures, and to control the use of arms as a prelude to control of their possession.

In principle, graduated deterrence to aggression or its extension means (1) the availability of a graded series of limited, flexible, military responses, and (2) the will to use the minimum force necessary to repel any manner of aggression. These graduated deterrents to armed aggression include local police forces supplemented by our own air-mobile units and marines, suitably situated to deter and repel guerrilla aggressions and Communist-supported rebellions. They include tactical nuclear forces and of course the ultimate deterrent of massive retaliation.

This principle of graduated deterrence, coupled with the defensive concept for nuclear weapons discussed earlier, leads to the advocacy of the following three security policies:

1. Against conventional armed aggression, whether surface or air, we would use nuclear or chemical weapons only defensively on our side of the preaggression boundary, in protecting United States or Allied territory.

2. Against nuclear aggression, we would not attack, except in reprisal, city areas proved by inspection to be "open" of air-weapon systems, such as military airfields, guided-missile sites, carrier and submarine bases.

3. Except in reprisal, we would never use bacteriological weapons or nuclear weapons in radioactivity attacks.

The announcement, in these terms, of a new security concept of graduated deterrence would best enable us to secure the peace during the period of military standoff and "balance of terror" while paths to enforceable and universal disarmament are being explored. Graduated deterrents are necessary to avoid losing the present world conflict. But we must look to other instruments to win. One of the most important is foreign economic policy. It is the one that today demands our attention especially, because the Russians have given every indication that they intend to rely heavily on this instrument, with subversion, to gain their political goal of world domination. Can we evolve an economic strategy which makes better use of our huge trading, capital, technical, and human resources?

Although the United States has undertaken programs to strengthen free-world economic strength which have achieved a measure of success, these programs have tended to be sporadic, uncoordinated and, at times, mutually contradictory. For example, in the area of trade policy, there is little evidence that we have pursued a policy that is energetic and effective. It has rather been characterized by modest progress periodically compromised by either administrative or legislative contradictions or retrogression.

The uncritical application of the mobilization base concept has particularly been allowed to make serious inroads on the positive character of our trade policy. While in 1955 the Congress granted, for the first time in 10 years, a modest increase in tariff-reducing authority, it also gave the President authority to impose quotas if imports "threaten to impair the national security." There was no specification of what impairment of the national security meant. Also, administrative interpretation of the Buy American Act as well as the peril-point and escape clauses have tended to retard our positive trade policy. Even the "bold new program" of technical and economic aid to underdeveloped countries has been a victim to the uncritically accepted mobilization base concept, for the shift in foreign aid from development to defense needs has reflected, in some part, the desire to export the mobilization base notion.

Contrast the actions and policies which have marked recent activity in the trade field with the requirements of trade policy. What is required is imagination and boldness in order to exercise the leadership of the economic policy of the West. If we must lead the free world through force of circumstances, let us not lead with faltering, timid steps with eyes cast longingly in the backward direction of economic nationalism.

We need to plan and execute an economic strategy that is fully as purposeful and consistent as a well led and objectively developed military strategy. It is the essence of strategy making to survey the threats and weaknesses on both sides as well as the opportunities and threats on both. A strategy implies a calculus, an ordering of priorities, and a coordinated evaluation of the costs and benefits of alternative policies.

I suspect that if such a review is made and policy reformulated on the basis of it, that our foreign economic policy will not require a radical change in emphasis. Rather, it will require that we do more, and with more vigor and leadership, of what we are doing and make sure that we don't undercut the effectiveness of one policy by another. I suspect also that we will find that one of the major values in economic competition will be the free market and the free energies of individuals and democratic institutions. And we might also decide that a portion of the savings in funds and economic energies now going to the mobilization base could be used to start a major world economic development program, even prior to a start on disarmament.

A competitive contest waged in the economic arena may be appealing to both sides. To the Soviets, as Khrushchev has intimated, it may present an opportunity to vindicate their dogma of the inevitable collapse of capitalism. For Americans the competitive spirit is psychologically appealing and is compatible with our pragmatism. We would relish nonviolent competition with the Soviets and letting results determine which system can provide more economic, cultural, and spiritual benefits.

These comments are merely suggestive of the problems to be looked at in the formulation of a comprehensive, competitive economic strategy in the new phase of the world struggle. At least, they indicate a new planning problem of major importance which must be taken centrally into account in developing future foreign economic policy.

SUMMARY AND RECOMMENDATIONS

In summary, the questions I have posed are four:

1. Is the present mobilization base any longer contributing very much to our national security?
2. Is the present mobilization base harming our national security by weakening the free-world economy and taking funds away from those needed to build military forces-in-being?
3. Where some value is found for a type of mobilization base, should not the Congress determine the standards of judging value and establish policy guidance for the executive branch through appropriate legislative action?
4. In the light of the recent Soviet shift to more emphasis on economic and technical penetration and subversion as the primary offensive arms of militant communism, should not our foreign economic policy be reshaped to emphasize positive counteracting measures?

All of these questions have a direct and fundamental bearing on our foreign economic policy and the work of this committee. May I suggest in closing that this important joint committee of the Congress consider the initiation of:

1. A comprehensive study into the very nature and worth of our mobilization base, perhaps to be undertaken jointly with the Armed Services Committees in the light of new military realities; or, alternatively, that the Congress request the Executive to undertake such a study with a view to developing possible recommendations for legislation.
2. A comprehensive study of the new Soviet economic offensive, its implications in the struggle of freedom with communism, and the principles of a grand economic strategy to contain and defeat Soviet economic penetration undertaken for political purposes.

This statement has suggested more questions than it has proposed answers. But perhaps in this complex field of rapidly changing issues the right answers may come more rapidly if we begin by asking the right questions.

Mr. Bolling. Our next witness is Mr. Oscar R. Strackbein, chairman of the Nationwide Committee of Industry, Agriculture, and Labor on Import-Export Policy.

Mr. Strackbein.

STATEMENT OF OSCAR R. STRACKBEIN, CHAIRMAN, THE NATIONWIDE COMMITTEE OF INDUSTRY, AGRICULTURE, AND LABOR

Mr. Strackbein. Mr. Chairman, the subject that was assigned to me was not of my own invention, nor necessarily of my preference. Nevertheless, I shall try to do with it what I can. It is called The Reconciling the Desire for Expanded Exports With Fears of Increased Imports.

I believe, in a sense, to start with, that this title indicates that expanded exports should have the highest priority in economic consideration. I do not believe that expanded exports are entitled to such priority as a generality. If we analyze this question, I think you will find that we can increase our imports in over half the field of trade without upsetting domestic production.

I refer to that part of our imports that are now free of duty and for over 40 years have been free of duty. They represent about 55 percent of our total market for imports and are generally noncompetitive. Those imports can be increased so long as the prosperity of this country is maintained at its present level, or at an expanded level. They have been increased in the last 15 or 20 years in physical volume, measured on a per capita basis. I don't think that anyone disputes the desirability of increasing such imports. Where the trouble comes in is in the increase in imports of competitive products.

My statement points out that even there an increase in imports does not necessarily mean injurious competition. It all depends upon the particular product involved. Also it depends upon the capacity of our own industries to face import competition. That capacity is unequal, for obvious reasons. The large mass-production industries that have all the benefits of mass production and low unit costs, in spite of high wages, are much better prepared than the smaller industries, hundreds of them, that do not have the advantage of such mass production.

It seems to me that it is foggy thinking to characterize the American economy as if it were all based upon mass production. It just isn't true. That is a very inaccurate characterization.

Now, as for the priority of exports as a claimant in formation of our economic policy, I do not believe that it holds water. Our exports were artifically stimulated during the war and after the war because of war demand, and postwar demand, the latter caused by the war devastation of many of the leading countries of the world, and by their consequent call upon us for materials for reconstruction and recovery.

Now, naturally, as those countries recover and reconstruct their machines and plants their own needs for our goods will be lessened, and they will again undertake to recapture their prewar markets. That is naturally to be expected. That is the natural course of events, and it is happening.

Actually, it is quite surprising that our exports have held up as well as they have. On the side of the imports, our imports have not been similarly stimulated by artificial demand, and the capacity of this country, of our economy, to absorb imports is not measured by our capacity to export. The exporting industries are not generally the industries that take the brunt of the import competition. A good part of our need for exporting comes from the piling up of surplus agricultural commodities, the two most important being cotton and wheat.

Our production of wheat was greatly stimulated by war and postwar demand. The acreage went up to something in the magnitude of 75 million acres. It has now been cut back to some 55 or 60 million acres. Nevertheless, other countries have resumed the production of wheat and consequently their demand for our product has fallen off. Now, wheat production in this country is protected by one of the most highly restrictive import quotas that we have. It amounts almost to an embargo. Cotton has virtually priced itself out of the world market, and our exports are declining year after year to the point where it now appears that the cotton production in other parts of the world perhaps will make it unnecessary for them to import much more raw cotton in the future from us. Again, cotton is highly protected by import quotas. Yet for the sake of exporting the surplus of cotton and wheat, other industries are to be called upon to absorb a greater volume of imports in order to supply other countries with dollars with which to buy wheat and cotton and similar goods. It is not the export industries that are asked to make any kind of a competitive sacrifice. They are to be the beneficiaries. The other industries are to be sacrificed.

Now, when I use the term "sacrifice," of course that again is a black and white term. Not in all cases will an industry be sacrificed to imports, but I do believe, considering how far we have already reduced our tariffs, by a full 75 percent in the last 20 years, that the time has come when any further tariff reductions must be very carefully considered before they are placed into effect. We have made these tariff reductions during a period of time when we have had a natural protection. That is to say, war demand and postwar demand, where the consumer demand has been so strong that it could absorb all domestic production and imports at high prices. When we get away from that situation we will be faced, let us say, with a buyer's market, as contrasted with a seller's market, and that is the time when the need for protection comes to the fore. It is not in a time of a seller's market. Most of our industries can go along with imports in a seller's market. The really big question, Mr. Chairman, is, Can we maintain the present high levels of employment and production and profits and investment? If we can, then the import problem will not be a very difficult one. If we cannot—and it has not been proved that we can—then imports and import competition must be watched, because when we come into a position where deflationary forces drive us downhill into a recession or a depression, then, imports, competitive imports, will add to the deflationary forces and will help precipitate the very thing that we must avoid. If we can maintain this prosperity than our market for goods from other parts of the world will of itself be assured. A prosperous United States is the best guaranty for the highest level of trade.

Thank you very much.

Mr. BOLLING. Thank you, Mr. Strackbein.

(The complete statement of Mr. Strackbein is as follows:)

RECONCILING THE DESIRE FOR EXPANDED EXPORTS WITH FEARS OF INCREASED IMPORTS

Statement of O. R. Strackbein, chairman, the Nationwide Committee of Industry, Agriculture, and Labor on Import-Export Policy

The question of expanding exports while there is fear of increased imports might appear to pose a baffling dilemma. However, contrary to common belief, the desired increase in exports is not necessarily gained only at the price of an increase in the kinds of imports that produce fear.

Two reasons explain this:

(1) Not all imports are competitive with domestic products; and

(2) An increase as such in the imports of competitive goods does not or need not necessarily denote injury to domestic producers.

Details on these two points follow:

(1) Over half of our imports are completely free of duty. Generally these imports do not compete. (Frozen tuna is a notable exception. It pays no duty but competes directly with our own tunaboats and fishermen.)

Noncompetitive imports can obviously be increased, as they have in the last decade, without upsetting our own producers. The principal single item of all our imports today is coffee; and coffee is both noncompetitive and on the free list.

Imports of the berry have risen considerably in recent years both in quantity and value and may rise still more in coming years without striking fear into the hearts of nonexisting American coffee producers. Other examples could be given.

The possibility of increasing general exports in keeping with increased imports of coffee and other such noncompetitive items then depends upon the possibility of increasing their consumption by the American people. This in turn depends upon a growing population and maintenance of the present level of income per capita or its increase. Of course such favorable developments might be offset by unfavorable terms of trade. In the case of coffee such a turn might come from overproduction in Brazil, Colombia, Central America, or elsewhere. Nevertheless, it is clear that imports of coffee and other free-list items may be increased by the United States and exports expanded as a result without upsetting domestic producers of other products.

Since free-list items altogether represent from 55 to 60 percent of our total imports it follows that over half our imports could be increased without injuring domestic industry at all. Such increased imports would then presumably enable us to expand exports by a roughly equal amount.

The most assured way of increasing imports of products that do not compete with domestic production would lie in a continuation of a high level of prosperity in this country. There is a close correlation between the trend in total imports and the level of domestic business activity, production, employment, and wages. Whatever would contribute to maintenance of the present level of prosperity or its elevation would result in the most favorable outlook for a high level of imports. And this should also mean a high level of exports.

(2) If we turn from the field of noncompetitive to competitive imports or the remaining 45 percent of our import trade a somewhat different set of conditions confronts us. We come then to deal with the dutiable items among our imports.

It goes without saying that the competitive impact varies greatly from product to product. Our own industries, agricultural, mining, and fishing pursuits, on their part also differ in ability to absorb competition from abroad. Even companies within a given industry vary in this respect. Some of the difference arises from location. Companies that are located and whose market lies along the seaboard may be more vulnerable to import competition than those located in the interior. The size of the individual company may affect its competitive capacity. Small concerns are generally more vulnerable than large ones. Degree of mechanization is another factor. Sometimes size determines the possibility of installing laborsaving equipment.

Inability to meet import competition is therefore not of itself evidence or even a presumption of inefficiency. Quite aside from the competitive differentiation among domestic producers just mentioned, all of them are burdened with many rigid or quite inflexible elements of cost that lead to high production outlays per unit of output. Minimum wages, obligatory collective bargaining (which in a seller's market pushes wages well above the minimum), limited hours of work, price supports, unemployment insurance and other social-security outlays, very high taxes, et cetera, are all burdens on production. Some foreign producers also carry similar burdens but the differential in wages in many instances is so wide that the gap is not bridged. It would be difficult in any event to find an industry in this country that would be unable to compete with imports if it could cut its wages at will to fit the competitive needs—in the extremities even to the levels prevailing in the country or countries exporting the competitive products to us.

This is nevertheless not to say that even competitive imports may not be increased without creating havoc for domestic producers. It becomes a question of how best to maintain the domestic economy in operation at a high level. Imports of competitive products can increase in an expanding domestic market without doing serious damage provided the increase stays within bounds. What the domestic producers of competing goods cannot stand is an unrestricted flow of imports when surplus supplies begin to accumulate. This is the difference between a seller's and a buyer's market. But even in a seller's market a domestic industry cannot withstand a sharp price handicap, quality for quality. The bicycle industry offers a good example. An import price advantage of 25 percent or more, quality for quality, is an almost insuperable handicap; and fear of such imports can hardly be condemned when the domestic producer is burdened artificially by costs that he cannot cast off.

By most measurements, total imports per capita since 1938–39 have increased at least 50 percent in physical volume. Our economy has succeeded in absorbing this increase because of the generally high level of prosperity current during this 15-year period.

It is probable that most of the increase in imports took place in free-list or noncompetitive items inasmuch as over half of our imports consist of such items. Nevertheless our economy has undoubtedly also absorbed a great increase in imports of competitive items. The conditions were favorable to such a development. Domestic consumption in nearly all lines of goods increased measurably and in many instances quite sharply after the war. Unprecedented purchasing power banked during the war and shortly thereafter while production of civilian goods lagged laid the groundwork for a high level of prosperity. Added to this was the vast volume of demand that sprang up abroad as a result of the devastation of the war.

The question arises, if our economy has succeeded during the past 15 years in absorbing an increasing volume of competitive imports (with some painful exceptions), what is there to fear in the future?

Obviously the fear is that the level of prosperity will not continue indefinitely to hold an umbrella over both imports and domestic production. Two recessions, 1 in 1949 and 1 in 1954, lifted the lid sufficiently to give a glimpse of what may be expected if the present level of prosperity declines. What we saw was not wholly reassuring. There is still the possibility that a more serious setback than that recorded by the two postwar recessions may sometime develop. A part of the fear is that rising competitive imports may contribute materially to deflationary forces that could upset the balance between production and consumption and thus set in motion the forces that we must be on guard against.

The season of greatest vulnerability of our domestic economy to competitive imports is during the period of delicate balance between production and consumption. Such a time comes when our expanded producing facilities catch up with demand and the outlook is not encouraging for further expansion. Imports can readily produce a gloomy market picture under such circumstances.

It is today well understood that a steady flow of investment into plant renewals, modernization of equipment, research and development, and also plant expansion is necessary if purchasing power is not to lag behind output. Import competition may put a damper on investment plans on a sufficiently wide front to affect the whole.

Sometimes the fear of imports is, of course, much more direct and immediate. If foreign producers, now in many instances much better equipped with machinery than in the past, can lay down their wares in this market at costs well below those of our producers, obviously such competition strikes home very quickly. It is pinpointed and may be very painful. Nationally, however, such blows could still be absorbed unless they should fall upon too many fronts at the same time and cripple too many industries all at once. Under the confluence of deflationary tendencies from the homefront itself at the same time, deep trouble could develop in a short time.

These are not mere ghostly fears. Until it has been demonstrated beyond any reasonable doubt that we need no longer fear the onset of another recession or depression it would be improvident and indeed stupid to ignore the damage that is potential in import competition; and just as we should not relinquish certain domestic measures to avoid economic trouble we should not throw away nor fritter away our economic defenses against injurious imports.

Most of the insistence on dismantling of the tariff comes from the desire and need for expanded export markets. Before we raise this desire or need to the level of a categorical imperative, we should examine the credentials of the claimants.

Most of the pressure for expanded export markets comes from growers of wheat and cotton, on the agricultural side, and from automotive, machinery, packinghouse products, office equipment, iron and steel and other mass-production manufacturers, on the industrial side. Farm and labor groups identified with these agricultural and industrial pursuits are usually arrayed accordingly.

Oddly enough wheat and cotton are themselves sheltered by extreme forms of protection, i. e., by import quotas that resemble embargoes. This is because they are beneficiaries of price supports.

Unquestionably they need export markets but neither crop contributes anything to the precious dollar holdings of other countries which could be used to buy more American exports. Since, however, they feel keenly the need for greater exports they look to other industries to accept increasing volumes of imports to provide the needed dollars overseas—not, indeed, to buy the products of the domestic industries that are asked to take the brunt of import competition, but to buy—what? Naturally, cotton and wheat. With themselves thoroughly insulated against foreign competition, the growers of cotton and wheat are very brave in behalf of their fellow producers of other products, singing to them the praises of freer trade.

The automotive industry, which also has been smitten with the lure of foreign markets, is likewise insulated against imports, although not by quotas or a high tariff. To make any significant inroads into this market by foreign producers would require the outlay of hundreds of millions of dollars. Such a requirement alone is sufficient to kill the threat of serious import competition.

The need for exports may be admitted without raising it to the level of an overriding priority. Exports from this country, it should be remembered, were stimulated far beyond previous normal levels by the war and its aftermath. Imports were not similarly stimulated. Our exports were drawn into markets that were previously supplied in good part by Britain, Germany, Japan, and other war-torn countries. When such markets revert, as some have been in the process of doing, our exports might be expected to shrink or at least to fall back in relation to our total national output. Under these circumstances we cannot expect our export trade to continue along early postwar lines.

Consider the two crops already mentioned. Other countries have resumed the growing of wheat, while cotton production has expanded abroad beyond any previous levels. Of itself this would indicate a shrinkage in foreign markets for these two crops and there are complicating factors that add to the difficulty.

The need for exports should be weighed within its context, international as well as domestic. In many instances our exports compete directly with those of the countries that must export or die. These are usually the very countries whose friendship we profess to need and to seek. Why then insist upon a policy, through thick and thin, year in and year out, that conflicts with the export needs of those countries?

Offering these countries, Japan, Britain, Germany, France, Italy, etc., a larger market in this country as a substitute for their prewar markets elsewhere is not doing the best either by them or by our own domestic producers who would take the brunt of the competition. We create a great part of the problem which it is our national policy to solve by our unseemly and unnecessary overemphasis of exports.

Nevertheless we can properly grant to export interests the consideration to which they are entitled without catering forever to their whims and without turning all else upside down to pacify their clamor. We can determine with respect to competitive imports what share of the market can be relinquished to imports without exposing our domestic producers to unfair import competition, defined in the light of rigid high-cost burdens imposed upon our economy by public policy expressed in the various laws and controls, mentioned above.

Reasonable tariff protection offers one method; but in many instances import quotas would be a superior instrumentality. They may be made more flexible, more responsive to changes in industry, in trade and technology.

The tariff itself should remain flexible but horizontal rate changes, either up or down, should be avoided. Rates should be changed individually and only after adequate hearings by an agency of Congress, such as the Tariff Commission. The criterion should be the establishment of fair import competition.

Import quotas set at points which would permit a liberal flow of imports should be geared to the total market. They should be designed to assure participation by imports in consumption trends, up or down. Should consumption increase, imports should be granted a proportionately higher volume; but should consumption decline imports should also be cut back proportionately.

By sharing the market with imports domestic producers of competitive products would contribute to the conditions that make for rising imports and therefore for expanding exports. By being assured against progressive loss of the market to imports, domestic producers could better plan their own production schedules, renewal of equipment, expansion of plant, outlays for research and development, sales promotion, etc.

Removal of the element of uncertainty and fear from import competition would improve the climate for continuing prosperity at the very time when the economy is most sensitive to deflationary onslaught.

Unfortunately the Department of State took the lead in the General Agreement on Tariffs and Trade (GATT) in the outlawing of import quotas. This was without congressional mandate and a patently unconstitutional exercise of power by the executive.

Unfortunately, also, the State Department clings stubbornly to its usurped position of power and wastes its time in futile efforts to solve a problem that is to a considerable degree of its own creation.

The expansion of exports, willy-nilly, is not justifiable. There is no right of eminent domain vested in the desire or need to export. The sooner this lesson is learned the sooner will the tariff and trade problem become amenable to accommodation of the various interests concerned, national and international.

Mr. BOLLING. The next witness is Dr. John F. Fennelly, of Chicago, partner of Glore, Forgan & Co., investment bankers. He is speaking for the Committee for a National Trade Policy.

STATEMENT OF DR. JOHN F. FENNELLY, COMMITTEE FOR A NATIONAL TRADE POLICY

Dr. FENNELLY. Thank you, Mr. Chairman.

The most penetrating statement I have ever read on the subject of tariffs and free trade was written not by an economist but by a British theologian. In one of his essays the late Dean Inge of St. Paul's Cathedral, London, wrote as follows:

> Free trade is the policy of the strong, and protectionism the policy of the weak. Great Britain turned to free trade in her hour of greatness, and back to protectionism when the sceptre passed from her hand.

The moral to me seems obvious. Today is certainly the age of economic greatness for the United States, an era when world leadership has been thrust upon us whether we like it or not. These circumstances have forced on us the virtual necessity of leading the free world in the direction of greater freedom of international trade and finance.

A policy of protectionism was a very different matter in the earlier years of our country when our infant industries were struggling for survival. Under such circumstances, our protective tariff system may well have justified itself, despite the high economic cost of all tariff subsidies. Today, however, the situation has changed radically. Now the development of mass-production techniques permits large segments of American industry to compete successfully throughout the world despite tariff and quota restrictions and the instability of most foreign currencies.

In my opinion, the insatiable foreign demand for American products is the fundamental factor behind the so-called dollar shortage in foreign countries. On the other hand, the need for a steadily widening export market for our manufactured products, as well as for many agricultural commodities, is the basic fact which called the Committee for a National Trade Policy into existence. For the first time in our history many of our diversified representative manufacturers have realized that their economic welfare depends upon an opening up of the channels of international trade and finance. They are also aware that such a policy, designed to strengthen the bonds between all parts of the free world, has become vitally important for our national security. As a result, this group has joined together in support of President Eisenhower's foreign economic policy program.

This program, despite its very moderate character, is being bitterly opposed by certain segments of American industry. The arguments used by these groups are many and varied, but none is more important than the statement that our national wage levels and the American standard of living depend upon the maintenance of our protective tariff system and other obstacles to freer importation. It is upon the fallacious nature of this argument that I should like to concentrate my attention today.

At the outset it should be obvious that wage levels in any country are determined by its most efficient industries and not by its least efficient which feel the need of tariff protection. In a dynamic economy such as ours the introduction of labor-saving devices and other improvements in manufacturing techniques automatically increases the productivity of labor, reduces unit labor costs, and thus permits a rise in wages. This in turn attracts labor from the less efficient industries and finally forces the latter to bring their wage rates up to the level of the more efficient units.

Most of us can remember when Henry Ford startled the world by the announcement of a minimum wage of $5 per day for common labor in his plants. Such developments place a steadily increasing economic pressure on all industries which fail to keep pace with the technological improvements effectuated by the more efficient.

The result is that what our inefficient industries suffer from is not primarily the competition from cheap foreign labor but from the competitive struggle for labor within our own country induced by progressive reductions in unit labor costs on the part of our most efficient industries. This competition within the country is the dynamic factor in our economy and the resulting pressure of foreign competition on our less progressive industries is an aftereffect rather than primary cause of their difficulties. As the differential in labor productivity between our Henry Fords and our industrial laggards in productivity tends to widen, the latter will feel a greater and greater need for tariff protection in order to pay the mounting spiral of wage rates forced on them by our more efficient industries.

From this it follows that a reduction or even elimination of tariff duties cannot of itself cause a reduction in the wage levels and living standards of our people. The industries which have created our high wage standards do not need protection and are able to compete successfully in world markets and still pay the highest wages in the world. Increased imports as a result of freer trade will enable our efficient industries to widen their export markets and employ more workers. Thus the chief long-run economic result of reduced tariffs will be a shift of capital and labor from our less efficient to our more efficient industries with an overall net gain in the national income.

An important corollary to the above is to expose the fallacy of the so-called scientific attempt to equalize domestic and foreign wage rates by means of tariff duties. The difficulty is that the widening differential in unit labor costs against our static industries tends over a period of years to make any given set of tariff rates inadequate for the protection of the latter. Today we are in the midst of another industrial revolution in which mechanization and automation are running a hectic race in an effort to reduce unit labor costs in face of the steadily mounting spiral of money wages. The result must be a progressively widening differential against those industries which do not, or cannot because of their nature, keep pace with the leaders. Thus it will only be possible to provide adequate protection for these laggard industries by means of steadily rising tariff rates adjusted upward to keep pace with the widening differential in unit labor costs.

Such a policy would impose an intolerable burden upon our efficient exporting industries and upon our economy as a whole.

I am convinced that a dynamic and ever-progressing economy such as ours must constantly be sloughing off industries and segments of industries if it is to retain its dynamism. The elimination of such industries or segments thereof causes hardships on the sufferers but these hardships are identical with those suffered by the marginal businessman who is forced into bankruptcy because of his relative inefficiency in the competitive struggle. In all such cases, whether it be the individual businessman, a segment of industry, or a whole industry, the basic cause is the competitive struggle within our own country and not the influence of foreign competition. It is the price we must pay in the elimination of the unfit if we are to maintain the benefits of a vigorous competitive economy.

As an example of a segment of industry which is facing a hard struggle for survival, I would cite heavy generating equipment produced by our principal manufacturers of electrical appliances. This machinery is now custom made in individual units and necessarily involves a very high labor content. On the other hand, the same manufacturers produce a vast volume of other articles which are mass-produced by the most efficient manufacturing techniques. Such articles are sold abroad in an annual aggregate volume of many hundreds of millions of dollars. Thus it is the very efficiency of these same electrical manufacturers in reducing unit costs for most of their products, along with the Henry Ford's and others, which has made it difficult for them to compete in the production of tailormade articles. They, as much as anyone else, have forced up the price of labor in this country to a point where it appears uneconomic to use such labor in the manufacture of heavy generating equipment by means of existing techniques. Thus it is inevitable that such equipment will be produced more cheaply and efficiently in other countries where labor is less scarce and a less valued factor of production.

If it is impossible to rationalize the manufacture of generating equipment by mass production methods, I can see no economic justification for the maintenance of this segment of industry by means of tariff or other import restrictions. It merely means an inefficient use of our working population and of the capital involved. My own guess is that a substantial part of this segment would survive even without any protection. The paradox in the situation is the likelihood that these electrical manufacturers would gain more than they would lose from a general reduction of tariff duties. The resulting expansion in the markets of the articles which they now export should permit a shift of capital and labor out of the manufacture of heavy generating equipment with little if any transitional hardships and with a long-run net gain in total profits for thmeselves.

It should be clear to everyone that a protective tariff duty is nothing other than a subsidy to the protected industry. It imposes a burden on all domestic consumers in the form of higher prices and a burden on all of our exporting industries by restricting the markets of the latter. Moreover, the burden imposed on the exporting industries, and on the economy as a whole, is necessarily greater than the benefit received by the subsidized industry. This result comes about in several ways. In the first place, the added volume of sales which otherwise would accrue to the exporting industries would be handled at reduced unit costs and therefore the profit increment to the exporters should be greater than the loss suffered by the industry from which the tariff subsidy had been removed. Second, insofar as the articles freed from the tariff burden entered into the production processes of the exporters, the unit costs of the latter would be still further reduced. Finally, with money wages remaining unchanged, the real wages of our workers would be enhanced by the extent to which the cost of the commodities which they purchase had been reduced by the removal of tariffs.

Finally, I should like to make it clear that the Committee for a National Trade Policy does not now favor any sudden elimination of tariffs or even a drastic reduction in rates. Any such program would almost certainly produce violent repercussions in our domestic economy. Instead, we stand squarely behind President Eisenhower's program for a gradual, moderate, and selective reduction in duties accompanied by equivalent concessions by other countries.

I hope I have made it clear that even a maintenance of existing rates must eventually cause adjustments as the differential in productive efficiency widens between our most progressive and our least progressive industries. We must be prepared, therefore, to face the fact that even a moderate program of tariff reduction is certain to cause some temporary hardships. We should be prepared to provide some measure of relief for any distressed areas which may develop in the process. Moreover, we should do everything possible to assist our workers in making the shift into those industries which will be able to absorb them. One fortunate circumstance in this connection is the fact that highly mechanized industries generally require less specialized skills than do the older handicraft jobs. This means that a shift from the latter to the former should not impose serious hardships on the workers involved. Another equally fortunate circumstance is that so much of American industry is diversified. Adjustment, therefore, would likely require less the disappearance of firms than internal changes in the character of the product.

Nevertheless, we are convinced that the only rational course for the United States is to pursue a vigorous policy designed to open the channels of international trade and finance. Only by such a program can we hope to retain the unique dynamic qualities of our economy and also to maintain our leadership of the free world.

Mr. Bolling. Thank you very much, Dr. Fennelly.

I would like to thank every one of you for your cooperation and self-restraint. We came very close to achieving our schedule.

As is our custom, the next step will be to give some time so that members of the panel may comment on each other's statements, or make additional comments. Since there are a rather large number of witnesses I would request that when you desire recognition, you ask for it. I think it would be preferable if we didn't interrupt each other in presentations.

Would somebody like to start this procedure? I cannot imagine after listening to all these statements that there isn't some conflict of views.

Mr. Strackbein. Mr. Chairman.

Mr. Bolling. Mr. Strackbein.

Mr. Strackbein. I think it was our friend, Dr. Humphrey, who took exception to the escape clause.

I think that the burden of his argument was that the very existence of the escape clause put a damper on exports from other countries to the United States; is that correct, Doctor?

Dr. HUMPHREY. The constant threat that imports will be cut off, once they have been stimulated and encouraged by the reduction of duties is certainly a serious deterrent. I think the threat is more serious than the actual use that has been made of the escape clause today.

Mr. STRACKBEIN. That is just the point that I want to speak to, and very briefly. The importation of bicycles in the face of two escape clause actions constantly went up. So far as I know, they are still going up, in spite of the actual invocation of an increased tariff.

In the case of frozen ground fish fillets, again in the face of two escape clause actions, the latter of the two being a recommendation to the White House for the imposition of import quotas, I say in the face of those two escape-clause actions, not merely the threat of an escape-clause action, of the mere fact that the escape clause was on the statute books, did nothing to deter the imports. Actually, imports continued upward and reached the highest on record in 1954.

Dr. HUMPHREY. Mr. Chairman, we ought to be clear, first, about what we mean by an escape-clause action. I mean one where the escape clause is invoked.

Mr. STRACKBEIN. That is what I mean.

Dr. HUMPHREY. Of which there are only six instances. There are 6 instances of the escape clause actually being invoked out of about 61 applications.

Mr. STRACKBEIN. Then you no longer say the mere existence of the escape clause dampens the foreign exports of this country?

Dr. HUMPHREY. I certainly do. I don't think the fact you can point to 2 instances out of 2,000 or 3,000 or 5,000 items is particularly significant. Imports may continue to grow because of our expanding national income.

Mr. STRACKBEIN. Here were cases where the escape clause was actually invoked.

Dr. HUMPHREY. Let us be clear about the facts. Bicycles is one case. It was just invoked in August of this year. The escape clause was not invoked, if I am correct, on the frozen fillets of fish. Mere investigation may easily result in temporary increases of imports in order to beat the gun.

Mr. STRACKBEIN. The first escape-clause action in the case of bicycles was instituted about 1951 or 1952. The same was true with the frozen fish fillets. Now, in spite of that, I mean according to your theory, the exports should have stopped. They certainly should not have expanded, because the obvious possibility was that the rates would be increased, and the foreign exporter would be deprived his market, so therefore he should not expand his exports or even make plans to expand them.

Colonel LEGHORN. Mr. Chairman.

Mr. BOLLING. Colonel Leghorn.

Colonel LEGHORN. I have not appeared before this subcommittee as a member of the chemical industry, or as a representative of my company; I have appeared as a writer on military affairs. Nevertheless I would like to address a few comments to this question of the chemical industry, in the light of my experience in research and development and the management of international operations, in a portion of that industry.

There are four points. In the first place, the chemical industry, as near as I can determine, is a very profitable industry when you look at return on investment from that industry. It is relatively high. In the second place, research and development expenditures are high. The industry spends much more for research and development per sales dollar than industry generally. However, as a French economist once said, any product has three ages: A patent age, a know-how age, and a cost age. The third age has reference to the fact that the know-how from making it is widely held, and competitive success depends on costs. If a management cannot pay off its research and development costs during the patent and know-how ages of the product, then I would suggest there is something wrong with that management.

Thirdly, as far as skills are concerned, there is a small portion of the chemical industry where there are "artisan" employees, but by and large the chemical industry is one of the most automated industries that we have. There are a lot of professional men involved in this production, but not a high percentage of what you would call "artisan" skills. And, fourthly, I think the chemical industry should be classified as one of our efficient exporters rather than as a weak, inefficient industry. I know from personal experience how the chemical industry as exporters have suffered from import restrictions. When I was in Switzerland, after the watch tariff affair, I had one of our people there, one of our dealers, tell me pointblank that he would not buy any more production from our American plant. He would take it from our English or French plants, but not from our American plant.

I went from Switzerland to Austria, and the bicycle question was pending. The Minister of Trade there said they were withholding import licenses for American merchandise until this bicycle tariff thing was resolved. I just want to leave the impression that the chemical industry, as a whole is not weak and dependent on import protection but rather has an important stake in export markets.

Thank you, Mr. Chairman.

Mr. Bolling. Thank you.

Dr. Lenher. Mr. Bolling, I would be very happy to make some observations about the chemical industry, since it has been adverted to several times, and I am glad to confirm the statements that the chemical industry is indeed a very profitable one, but that doesn't seem to me to be on the point of this meeting this morning.

I was asked to speak on criteria for judging defense essentiality, and your distinguished staff economist asked me to limit my remarks to that field alone, and I so did. Now, I would be very happy to have those observations discussed or to discuss the tariff generally on any ground that you would choose to set forth, but with that exception I will not talk on the chemical industry unless you ask me to say more on general research and development, but on the matter of criteria for judging defense essentiality I think we can rest with a good deal of confidence on the record that is cited in my full brief, rather carefully, I think, of the actions of the United States Government over a period of 36 years.

Now, if that policy with regard to the organic chemical industry, not the chemical industry, is to be changed, then let it be changed with careful thought and study, but not on the basis of broad generalizations, quoting from the English clergy, or from broad philosophical or economic considerations about the disposition or subsidies to be applied to displaced labor. We should consider our own future in a troubled world when we are talking of defense criteria.

Mr. BOLLING. Thank you, Dr. Lenher.

Dr. Fennelly?

Dr. FENNELLY. I just want to ask Dr. Lenher one question that puzzled me in his statement. I understood you to say that most of the synthetic organics involved a high degree of skilled labor content. Now, it has been my understanding, which may be fallacious, that such a chemical as anhydrous ammonia is produced by an almost completely automatic process which involves an extraordinarily low degree of labor content, except for a small staff of supervisors; and that it involves a high capital expenditure, low labor content, and in the case of that item a high transportation cost.

Now, I just pick out that one example since I know something about it. I wonder if you would give us some examples of the chemicals that involve a high degree of labor content. Am I not right in that one case?

Dr. LENHER. Yes. I am entirely in agreement with your views on the production of synthetic ammonia, which, of course, is not an organic chemical, but in the field of organic chemicals, the articles that I am speaking to most seriously are those in which we have made steady representation before the House Ways and Means Committee, Senate Finance Committee, Committee for Reciprocity Information, and the Tariff Commission, to have a protection maintained, only on a factual showing of the actual cost of labor in production cost. The whole group of dyes, the whole field of coal-tar intermediates and finished products characteristically covered by paragraphs 27 and 28 of the tariff act, and some other paragraphs, but principally 27 and 28, Dr. Fennelly, are the ones I am speaking of.

Most recently, before the CRI and the Tariff Commission, I think last fall, in the spring, in the matter of the Japanese and Swiss agreements, there were rather full presentation of costs given in confidence to the Tariff Commission. I know only the costs out of the industry of which I am a member, not that of the others, but the showing was such that the duty is not significantly changed on either dyes or intermediates on the current position of profitability, and high labor-cost content.

Dr. FENNELLY. Those profits are involved.

Dr. LENHER. Yes. On a dye, for example, the labor content on a dye of which there are about 9 to 11 hundred currently commercial in this country, may vary in a general range from as low as about 30 percent—I am talking about operating and maintenance labor, and laboratory cost now, to as high as 50 or 60 percent. There is a very wide spread. I would say, on balance, for a large manufacturer, of which there are about half a dozen or 8 out of the 40 or 50 manufacturers, the average labor cost, content of total cost, is about 45 percent, which I think is very high in the chemical industry.

Mr. BOLLING. Thank you.

Mr. Cope.

Mr. COPE. I would like to ask, Mr. Chairman, in connection with the trend of that discussion—and it gets back to what Oscar Strackbein was saying relative to the escape clause. It deals with the question of how far we break down the industries for purposes of determining injury.

It seems to me it is the logic of the position of Dr. Lenher that you break the industry down commodity by commodity, and if a company cannot make its way on any particular commodity or import competition is keen for any one commodity, then you exclude that commodity by import quotas or tariff impositions. I think that is one of the points that should be made in detailing the weakness of the last bill that was passed on reciprocal trade. It is the fact that under the present escape-clause procedure it is possible now to break industries down pretty much on a commodity basis, and even though the chemical industry is a profitable industry, on the whole, it has to make money on every commodity it produces or tariff protection is invoked in order to make profitable the production of any commodity they produce.

Am I right or not, that the logic of this position leads in that direction?

Dr. LENHER. Well, sir, that is a very difficult point which the administration has had to consider a number of times, and I am very happy to find that they did so change H. R. 1 to include that breakdown which you outlined, but you have a mixed position in the chemical industry, where a diversified manufacturer may be less hurt by a radical downward change in the tariff, though a particular segment of his business may be hurt, but you also have a very large group of small manufacturers who make a few products under this tariff provision which has been here for a good many years, whose business is solely a half dozen or so products that they have. They would be liquidated, having no other base to change to quickly, with a change in the tariff, a downward change in the tariff. If they had capital resources and research facilities, true, they could diversify, but plenty of them are not in that position, so you have a mixed situation of large industries and small, which require different consideration for their existence.

As far as the industry as a whole is concerned, I don't think the national interest would be served, except by the specific product by product consideration that has been proposed by the President in his statements of the last couple of years with regard to tariff changes. I think only there can you be sure that the future position of the country will not be harmed.

Mr. COPE. Mr. Chairman, I would like to conclude, if I may, that it seems as if the logic of that position leads to trade stagnation.

Mr. STRACKBEIN. I think that this breakdown of industry into segments, for the bringing of an escape-clause action, is based exactly on the point that not all of our industries are integrated industries; that the smaller companies generally are much more specialized than the large ones. If you want to undertake a system of protection that is good only for the large integrated industry, then you should have to find the injury to the whole industry as a condition precedent to escape-clause action, but if you are interested at all in the smaller companies and the smaller units in an industry, then you must go along with this new definition of industry.

Mr. COPE. For the purpose of clarification, let me indicate that I am not opposed to small segments, but I object to the integrated industry climbing in and taking advantage of loopholes.

Mr. STRACKBEIN. You don't have to. You can stay out of it.

Colonel LEGHORN. Mr. Chairman?

Mr. BOLLING. Colonel Leghorn.

Colonel LEGHORN. This discussion perhaps suggests one useful distinction might be considered, in dealing with this matter. The distinction between large integrated industry and small industry. I would suggest in dealing with the problems of small industries we might face it not through tariff restrictions but through adapting the principle of compensation that has been discussed here this morning in connection with labor mobility, and so forth. Perhaps the principle of compensation needs to be applied, not only to displaced workers but also to displaced small nonintegrated industries.

Mr. BOLLING. Mr. Campbell.

Mr. CAMPBELL. I would like to say that while this is an important consideration, that it can be driven back to the place where it becomes absurd. The question has been raised as to whether or not consideration should be based on industries or commodities. If you take one step further back and consider trade policy in terms of companies as such, you will see the absurdity of this method of forming policy. Your committee is concerned with foreign economic policy and not with the application, either to an industry or a commodity or a company. After you have established policies in their general aspect you can then apply those policies to the specific and the particular.

Jerry Voorhis this morning was speaking for what is usually the "forgotten man" in discussions of tariff, the consumer. He pointed out that the consumer has paid every tariff that ever was levied in this country. I want to reemphasize that the consumer has not only paid all of the tariffs we have ever levied but has usually paid a markup on the goods that are brought in, plus a markup on the amount of the tariff. The consumer also has to pay a markup in the cost of goods produced domestically that were protected by the tariffs.

There are two basic problems here that your committee must face. First, is the question of protecting defense industries so that we will not be crippled in case of war. Second, we must protect labor and small business from any harm that comes by a change in foreign economic policy. To try to protect either defense industries or labor and small business by tariffs is an unfortunate and indirect expense and an unsatisfactory way to meet the problem that you are trying to solve, speaking from the consumer's point of view. We feel that to lick these problems, if there is a subsidy needed to keep certain businesses going that are essential to defense, it will be much cheaper to pay a direct subsidy rather than to force consumers to pay an indirect tax to meet that same cost. It is a legitimate cost and must be met.

On the second point, protection of small businesses and labor who will be hurt by readjustments in the tariffs ought to be met by compensation, such as Mr. Leghorn has talked about this morning. It is a legitimate cost, but it will be much cheaper for the economy as a whole, and tremendously cheaper for the consumer if we recognize it as a legitimate cost, and pay it as a legitimate cost, not as a tax on all consumers.

Mr. BOLLING. Mr. Seidman.

Mr. SEIDMAN. It isn't often that I take issue with my good friend, Wally Campbell, but I think in this situation I will. There isn't one of us at the table here this morning who has argued in favor of immediate removal of all tariffs, or even, I gather, immediate reduction of all tariffs. This mean that—including Mr. Campbell—this means that while we may perhaps agree on the overall objective of expanding world trade, and particularly expanding the United States share of world trade, this whole problem can only be discussed meaningfully in terms of specifics rather than in terms of general overall principles.

We have to know specifically, for example, in what areas can we expand exports, and in that connection I would recommend that the present procedure is perhaps somewhat defective in encouraging this.

What seems to happen is that prior to trade negotiations, when hearings are held, there are a great many witnesses who come in, as they properly should, to state the views of their industries or their unions as to what the effect would be of reducing tariffs, but nobody comes in, or very few people come in, to discuss what concessions we should request on the tariffs that are imposed by other countries.

I think one reason for this is that perhaps because of this emphasis on imports, the Government agencies do not prepare the same kind of a list of possible tariff concessions that might be requested of other nations. Therefore, the average person who might have an interest, unless he has detailed technical knowledge, has no guidance on this question. And, therefore, I would suggest that at least an investigation be made into the feasibility of doing on the export side what we are already doing on the import side.

Now, with regard to the import side, it seems to me that one of the difficulties we have had is that the whole question of what can be done in the way of reduction of tariffs is usually considered in two specific circumstances: One, immediately prior to a trade negotiation, which means that it is done under considerable heat, and more particularly under a very considerable time pressure. I had the good fortune to participate as a member of a public advisory group at the recent trade negotiations with Japan. I was impressed by the fact that necessarily in this kind of a situation, which arises very quickly, the technicians have to deal with it almost on an immediate basis, without a proper opportunity for full investigation of all of the factors involved.

The second situation is even worse. That is under an escape-clause situation, where, whether it is justified or not, it is under extreme heat, if not necessarily quite the same kind of time pressures, although even there there are such pressures. And, therefore, I would like to repeat again my recommendation that an investigation be made during this 3-year period when our policy, whether for good or bad, is established, into determining just what can be done after this 3-year period is over. This can't be done in terms of generalities. It has to be done in terms of the specific impact of particular proposed tariff reductions at particular levels, and then we will have some idea of the readjustments that are involved.

It seems to me you can't ignore sectors of industry, particularly because of the reasons that have been advanced. While treating this as a commodity-by-commodity problem for integrated industries may not be necessary, there are some firms within a large industry which produce only a certain limited number of commodities, or only one, and in their case, it seems to me obvious that the problem has to be approached on a commodity rather than an overall industry basis.

Mr. Bolling. Dr. Humphrey?

Dr. Humphrey: Mr. Chairman, we all want and need to bring all our skill and knowledge and information to bear on this question of adjusting to freer trade, but I want to emphasize that after we have done that, we don't really know what the effect of lowered tariffs is going to do for sure until we try it, until we try it under circumstances which will remove this constant threat, that if imports do increase, then they may be chopped off.

Now, I am very much concerned about the small business and in my book I think I have emphasized that problem more than any other book on the subject. But the way to protect these groups, I suggest, is to handle the escape clause and the tariff adjustment in a manner which will limit the increase of imports to a rate that can be accommodated by the transfer of resources out of these industries, and they are entitled to every sympathetic consideration. But just to emphasize how difficult it is to really anticipate what the result is going to be, let's remember that after 20 years of experience and reduction of our average duties by 75 percent, the overall effect is that the American economy has displaced imports instead of imports displacing domestic production.

In manufactured cotton textiles, for a good many years I have been noticing that we were exporting 7 or 8 times as much as our imports, even after we had started reducing tariffs, quite substantially. Now, I believe today the cotton-textile industry is in rather a tight squeeze. Their exports are declining and imports are increasing, but it is still a fact that last year, the exports of cotton-textile manufacturers were four times as great as our imports.

In the total chemical industry we exported a billion dollars of chemicals and imported a quarter of a billion dollars, and there have been quite a few duties in chemicals reduced. In the coal-tar sector of chemicals our exports were twice as great as our imports. In the photographic industry, one of our most highly protected industries, exports last year were four times as great as imports.

I certainly don't deprecate bringing to bear on this issue every bit of knowledge that we all have, but in the end we won't know the effects of tariff adjustment until we experiment and try. The sound basis for expanding trade is some gimmick, something that will carry out the principle that we will limit the increase in imports to a rate that can be accommodated by internal adjustments.

The domestic economy we all know isn't static. Just to give you an example. I live in the South. Take the 13 Southern States from the Potomac to the Rio Grande. In the 20 years from 1930 to 1950, in those 13 States, 40 percent of the agricultural workers moved out of agriculture. This adjustment is still going on. They are better off. The South is richer. We want to keep this kind of adjustment going. The same is true of these protected industries and small producers who can't use resources as productively as their competitors here at home. They can integrate, they can move into other fields, they are entitled to time enough to make this difficult adjustment, without unnecessary financial loss or hardship, but we will have a higher standard of living, we will support our foreign policy, if we keep pushing in this direction, of getting people into the employment where they can produce more than in those industries where they have to have protection.

Mr. BOLLING. Thank you.

Mr. MARK. Mr. Chairman.

Mr. BOLLING. Mr. Mark.

Very shortly I am going to have to close this period. The clock tells me it is about time for the committee members and staff to ask some questions.

Mr. MARK. I am not an economist, Mr. Chairman; I am just a coal miner. We have been trying reciprocal trade for a number of years. The only criteria we have to base its effect on—and we are in a peculiar position, because we have been one of the organizations of labor that for years, even before Henry Ford's Swedish engineer set up his mass-production line, have advocated technocracy, machinery, automation, if you please; we have lost some men to that cause, but, in trying the free trade, we have lost the great majority of our employees to residual oil. We know what it is. Our people are now subsisting, if you please, on surplus commodities handed out by the Government. I think our people deserve something better than that and I don't think that you can attack this problem of trade as an overall problem unless you are going to do irreparable injury to a good many industries of this country.

Now, my people are not looking for a subsistence of any kind. They are looking to increase their productivity as they have throughout the years and to enjoy the fruits of their labor, by the sweat of their brow and not by some charitable institution handing them a crust of bread.

Thank you. That is all I have to say.

Mr. BOLLING. Mr. Strackbein.

Mr. STRACKBEIN. Mr. Chairman, I was interested in the latter part of Dr. Humphrey's statement, as to the possibility of limiting, or putting into bounds, the adjustments that have to be made. I would like to ask him whether he contemplates possibly the use of import quotas.

Dr. HUMPHREY. I would like to see our intelligence and ideas pooled on that. I have some ideas and could contribute a nickel's worth.

I think moving averages in some cases, possibly quotas, but I am reluctant to use them, because they are so easily abused. I would rather see quotas used to expand trade than to restrict it.

Dr. LENHER. I would like to make two references with reference to my friends representing the consumers' interests and Dr. Humphrey's observations. Speaking in favor of a tariff is a very unpopular thing; it is like being against love and marriage, but it has one justification for its spokesman and that is his experience. The chemical industry has been where Professor Humphrey thinks we might go. We have been there. We were without tariff protection and the organic chemical industry didn't exist in the United States. You know that story. It has been repeated frequently, and it could happen again with a further reduction of the tariff as far as this segment of the industry goes. The foreign competitors are now strong. Their industry is rebuilt, with all of the modern facilities which we have here.

Now, competitively, if the German manufacturers would care to do as the Swiss manufacturers have done, or as the British have done and come over here and manufacture and compete with us in our own market, labor cost, and quality, we are delighted to have them do that and take such profits out of the industry and return it to their homeland as they wish, but to bring products in with a lower capital charge for their plants and a lower labor cost without some equalization, is, I think, a very doubtful matter and here I come to the consumer interests: I certainly sympathize with the objections to a tariff, but what better device is there if you are going to give special consideration on a defense or other basis to certain industries than the tariff?

Broad proposals have been made. I don't think they have been as documented as the tariff record. I think, as far as the commodities and products which I am representing, the levy on the consumer is very modest indeed. I think you have to admit there is one—to the extent there is a tariff, there is a levy which would not be there, but it is a very modest one indeed against the cost of dyes in a suit of clothes, or in a shirt, or on this carpet, or whatever. It is a very small one.

Mr. BOLLING. Thank you.

At this point I will call on Senator Flanders for any questions he may have, any questions or observations.

Senator FLANDERS. First, I would like to ask Professor Humphrey whether he looks on free trade as the ultimate good.

Dr. HUMPHREY. I look upon the expansion of mutually beneficial trade as desirable. I can't see far enough ahead to foresee that we would ever arrive at completely free trade, and I would say that there are conditions and circumstances with respect to particular industries where it is undesirable.

On defense, for example, I wouldn't for a moment want to see any vital branch of the chemical industry liquidated. But some expansion of trade might expand our chemical industry.

Senator FLANDERS. In a peaceful world, would you think of free trade as the ultimate good?

Dr. HUMPHREY. I could only say I believe, Senator, what I have, that as long as I can see the expansion of trade as being mutually beneficial I think we all will be better for it, but I can't foresee the conditions under which completely free trade might be realized today.

Senator FLANDERS. Well, now, just one other question, something of the same sort. Can you conceive of our present progress as being in this direction: That provided we continue to equip the rest of the world with the best machinery and advise them as to the best methods of production, that we can devise ourselves; does not that lead to a time when there will be not much left for us to trade? I am trying to see where I am going, you see——

Dr. HUMPHREY. Yes, sir.

Senator FLANDERS. Not just enjoying the scenery along the way to an unknown destination. But does not that point on the whole toward a period in which only mass industries will survive—mass industries which survive the wage, know-how, and equipment competition of foreign countries? We have fostered everything except the wage competition. There is also the problem of our agricultural product which we deliberately exclude from world markets by means of price support.

Are not those two of the destinations in the foreseeable future on our present products?

Dr. HUMPHREY. Well, there are 2 or 3 questions there, and you interrupt me if I haven't understood you correctly, Senator.

On the first question, I think there is a definite answer. Even if we could get the rest of the world to technical equality with the United States, and as of the end of the war, I think we wouldn't be too far off if we think of the average of the United States as being about three times as productive, just in terms of technical competence, as many nations—but even if we could get other countries to the level of technical parity with ourselves, there would still be abundant opportunities for mutually beneficial trade, owing to differences in resources, owing to differences in the organization of industry, and owing to differences in our relative supplies of capital stock and of labor. So I don't think we need to be concerned about improving the efficiency of other countries to the point that there won't be abundant opportunities for specialization and mutually beneficial trade.

Senator FLANDERS. I am now going to ask you a question which I had been planning to ask my old friend, John Fennelly. In his first paragraph he refers to one of Dean Inge's essays. What is the name he gives to them? They are delightful reading.

Dr. FENNELLY. I haven't read them in quite a number of years. I will try to dig them up for you.

Senator FLANDERS. They were popular essays. It says:

> Free trade is the policy of the strong, and protectionism the policy of the weak. Great Britain turned to free trade in her hour of greatness, and back to protectionism when the sceptre passed from her hand.

Can't we give another reason for that change? Protectionism was necessary when the Great Britain manufacturers of textile machinery equipped the factories of Japan and India, who thereupon entered the world markets for textiles. Wasn't that the time when Great Britain began to turn to protectionism, when she had equipped the rest of the world to do as well as she did?

Dr. HUMPHREY. Senator, one is tempted to draw that conclusion, and it certainly was a factor, but let's remember that this turn to protection occurred in a most awful depression. If we had avoided that depression, it is not at all clear that we would have had such a serious increase in trade barriers. Certainly it is not clear that protectionism would have been to Great Britain's or anyone else's advantage if we had had the kind of prosperity in the interwar period that we have had since the Second World War. I think the stronger force may have been the depression.

Dr. FENNELLY. Might I add one item to that, Senator? It seems to me what Professor Humphrey said is a relatively small matter. I would put as a vastly more important factor in this change the development of great continental empires, with great internal markets of free trade, such as the United States has been the great example in the world, and Germany was to a lesser degree.

In other words, it seems to me that the competition of Germany and the United States was a much more important factor than the development of textiles in India.

Senator FLANDERS. Well, it was a fact, I think, however, that Great Britain led in equipping the rest of the world with capital goods during at least two generations.

Dr. FENNELLY. That is correct.

Senator FLANDERS. Now, Dr. Fennelly, you have introduced another subject which I am going to ask him. You see, I asked him one I was going to ask you. We will reverse the process and keep the balance even.

Professor Humphrey, I had the privilege of attending a conference in Europe this summer, made up of government officials, industrialists, bankers, journalists, principally from the NATO countries, and one of the items on the agenda was the question of establishing a European customs union. It is an old thought, and everybody agreed that it was a good idea, and then they set to work to tell the different things that would have to be straightened out before they could have a customs union.

I will give you briefly my contribution to the discussion. The first was that Europe could do far more for itself in generating its own mass market than the United States could ever do for it, by tariff changes; that if they have their own mass market, that their problems would largely disappear, looking at Europe as a whole.

The second thing I called to their attention was that the very things that they introduced as the difficulties in the way were the same things that raised questions in American businessmen and American labor as to the wisdom of our forming a customs union with Western Europe, which is essentially what they want, so that that problem came right home to roost.

There is nothing we can do for Western Europe that would be as useful as their forming a customs union of their own.

Well, this time I am telling you what I think, instead of asking your views. Have you any comment to make on that position?

Dr. HUMPHREY. Yes, sir; that I agree with you as to the importance of expanding trade within Europe. But a customs union is more difficult to achieve than it may appear.

Dr. FENNELLY. So do I, very much.

Mr. COPE. Senator, may I address myself to the last point you made about mass markets?

Senator FLANDERS. Yes, sir.

Mr. COPE. Those of us in the trade-union movement over the last several years, especially in connection with the United States foreign aid program, the Marshall aid, and so forth, have been trying to do what we could to see that a great deal of increased productivity and the money that we put in foreign countries gets, so to speak, down to the worker, because we don't think you get mass markets without workers having the money to buy the commodities.

Senator FLANDERS. No; you don't.

Mr. COPE. Consequently, we have worked a good deal on that. We have asked the Government to cooperate in establishing trade unions that aid in distributing the results accomplished by our foreign-aid programs so that all the people have higher living standards.

Mr. STRACKBEIN. I had a comment, Senator.

Senator FLANDERS. I was going to turn to another subject.

Mr. STRACKBEIN. I did want to comment on the equipment of the rest of the world by the leading industrial nations. You know ordinarily it is said that our productivity is so much higher than that in other countries that our high wages are actually offset by our higher productivity. Now, if you take a case of particular industries, let us say, in Japan, such as textile manufacturing, where they might introduce the most modern technical equipment, and where yet their wages remain extremely low—15 or 20 cents an hour, against $1.50 an hour to $2.50 an hour—obviously, in such instances, our higher productivity cannot possibly offset their lower wages, because they have the advantage of the latest technology.

Therefore, I want to agree with Mr. Seidman in saying that in approaching any of these questions, we must go from the general to the specific and not from the specific to the general; to generalize in this particular field leads us nowhere.

Senator FLANDERS. Thank you.

Now, I want to comment on the position taken by Mr. Campbell, who particularly refers to the interest of the consumer. I would like to introduce another element and that is that the consumer is also an earner, and we want to make sure that the consumer has some wages to pay for his consumer goods, so I think that brings us back to the question of the effect of tariffs on employment as one of the elements in the situation, so think of the consumer as a wage-earner also.

Mr. CAMPBELL. May I comment?

Senator FLANDERS. Yes, you may comment.

Mr. CAMPBELL. We do. In fact, all of our working days we are forced to think of ourselves as producers. Our appeal is that at least once in a while we must think of our consumer interests. I think that has been the one factor that has been most neglected in usual tariff discussions. This is especially true when you abide by the particular instead of the general policy.

I would like to set the record straight as far as the question raised by Bert Seidman earlier is concerned. We are not advocates of free trade for free trade's sake, and we are not advocates of an immediate drastic downward change in our tariff policy. We feel there must be a gradual, moderate reduction of trade barriers with the adjustments taken care of; but we feel the principle ought to be established and then applied toward the end in view.

Senator FLANDERS. Mr. Chairman, if my questions seem to indicate any hostility to a more general world trade, I want to at least say that I played an important, and I think perhaps principal, part in retaining the 3 years instead of 2 years for the reciprocal trade treaties, but nevertheless I don't think any of us should go overboard on anything, and it is for that reason that I am raising some of these questions.

Now, Mr. Seidman talks on a very important point, and I hope that our report will emphasize it, and that is that we must make good bargains. We must bargain for an export position, as well as concede an import position, and I am of the impression that that part of the bargaining has not been sufficiently emphasized. I hope, Mr. Chairman, that our report will emphasize the necessity for bargaining for export positions in recriprocal trade agreements.

Mr. BOLLING. I have a strong suspicion that with your interest it will.

Mr. SEIDMAN. Mr. Chairman, may I comment on that for a brief moment.

Mr. BOLLING. Mr. Seidman.

Mr. SEIDMAN. My observation of the Japanese negotiation was that our negotiators, representing the various Government agencies, kept that foremost in their minds, but that there was not enough public awareness of this problem so that they would have the same guidance from the public on this phase of their operations as there was on the phase of reduction of imports.

Senator FLANDERS. Nevertheless, there was more fear than enterprise in American industry. Is that the idea?

Mr. SEIDMAN. I don't think that there is enough guidance given in the form of specific information prior to the negotiations on the export side.

Dr. LENHER. May I comment on that last observation of yours, Senator?

Senator FLANDERS. Yes.

Dr. LENHER. Last Tuesday morning I appeared before the Committee of Reciprocity Information and made before the committee, I think, the point which you suggest should be considered and I hope the committee will consider that carefully because in the past, chemical items have been considered without benefit of expert treatment from the American side and I made a plea for that for the future, since there are hundreds of items on the current list.

Senator FLANDERS. Now, I have just one more line of observation to make, Mr. Chairman, and that is in connection with the recent treaty negotiated with Japan and the fears that it is going to undermine a considerable segment of American industry.

I have here an article, a reprint of an article which appeared in the Wall Street Journal. I don't have the date of it. It tells what or how American importers are swarming all over Japan, and expecting to get a lot of stuff from there at a very much lower rate.

The letter is dated November 9, and the article is entitled "Japan at Macy's." I should think it would be "Macy's at Japan." I don't understand that title. "Giant retailers underline export Nippon drive." It has been a point to me and the point was brought out by one of the panel, Mr. Chairman, that with the great differential in wages in Japan, that still our textile exports have exceeded our imports. It is also brought out by one of the witnesses that our excess of exports is diminishing, and it remains to be seen, along with the suggestion of Professor Humphrey, that we can't foresee but should wait and see, as to whether that excess of our textile exports over imports will survive the Japanese situation.

I said a while back that I had long been convinced that Europe can do more for itself in making its own customs union than the United States can do for it in the way of trade agreements. I have been very much puzzled by the situation in eastern Asia, and I intend to get unpuzzled as soon as I can.

You remember that Japan went to war to establish what they called "the Greater East Asia coprosperity sphere," which in essence was simply swapping Japanese manufactures for southeastern Asia rice.

Now, why in the world does Burma have to sell her rice to the Soviet Union, or sell her rice in the Soviet area instead of forming that natural connection between inexpensive manufactured goods in Japan and a rice surplus in Burma?

That is a mystery to me. It would seem as though that were the field for the expansion of Japanese manufactures, and not in the high-cost areas, high-wage areas of the rest of the world.

As I say, that disturbs me so that I am going to find out what the reason for this is. Professor Humphrey has an idea. Let's hear it.

Dr. HUMPHREY. I have talked with a number of Japanese econmists and Government officials over the past 4 years on exactly the point you raise. They are very much aware of it. They are most anxious to develop the kind of trade you suggest, and many of them are even saying that they can't expect to penetrate seriously the American and British market. This is very familiar with them. They are seeking support for expanding their trade in other directions, but what they say to me is, "We need capital to finance the sale of our manufactured goods in these countries. Won't the United States furnish it?"

Senator FLANDERS. I think it would be a whole lot better for us to do that than it is for us to open up an import business with Japan which would rest solely on low wage rates.

Now, Mr. Chairman, I have taken too much time, much too much. I am just going to make one other observation and that is this, very briefly: Our tariff wall, it is a plateau of high wages, high prices, and high profits. Other countries are surrounded by other plateaus of varying lower prices, low wages, and low profits, and instead of trying to scale a tariff wall, which isn't a wall, but a plateau, people living on other plateaus want a ladder to get from a low-wage plateau to a high-priced plateau, so let's do away with the tariff wall picture, and picture instead a series of plateaus of various heights, and still I voted to extend the trade legislation from 2 years to 3.

Mr. BOLLING. Thank you, Senator.

Dr. Ensley?

Dr. ENSLEY. I just have one question. I was rather surprised to hear Mr. Strackbein's comment on the escape clause. Did I understand you, Mr. Strackbein, to say that where it has been applied, imports of those covered commodities have actually increased?

Mr. STRACKBEIN. I said that where it was invoked, the imports continued to go up, even though the Tariff Commission was giving consideration to a succession of such cases, meaning that the action before the Tariff Commission did not in any way put a damper on the exports to this country.

Dr. ENSLEY. Does that suggest to you that the escape clause is not providing a restraint that it was intended to perform?

Mr. STRACKBEIN. The escape clause is often attacked on the ground that its very existence on the statute books puts a damper on exports to the United States. I say that it does not do so, and proof of it is that even in these cases where the escape clause was actually invoked, imports continued to increase at a steady rate.

Dr. ENSLEY. That is what I thought your position was.

If that is the case, what purpose is served by the escape clause from the standpoint of protectionist industries?

Mr. STRACKBEIN. In the frozen fish fillet case, the President did not accept the Tariff Commission's recommendation and imports have continued to increase. In the bicycle case, the President did accept in part, but only in small part, the recommendation of the Tariff Commission.

Now, it is really a little too early to say what the effect will be, but it stands to reason that the effect will be almost nil, because the increase in the rate was so small that it cannot possibly have much effect on imports.

Dr. ENSLEY. Do you see any value of having the escape clause?

Mr. STRACKBEIN. If properly administered there would be value.

Dr. ENSLEY. But as presently administered——

Mr. STRACKBEIN. As presently administered it is of very little value.

Dr. HUMPHREY. This is just my interpretation, but I think Mr. Strackbein is saying that when there is an escape clause investigation and the Tariff Commission holds hearings and makes an independent study and may recommend higher duties—that importers may try to import as fast as they can before the President has actually raised the duties. What could be more obvious? Importers try to increase their inventory before the cost goes up.

Mr. STRACKBEIN. Now, Professor Humphrey, that does not accord with the facts.

Dr. HUMPHREY. Well, cite them.

Mr. STRACKBEIN. Let's take the period when the frozen fish fillet case was before the Tariff Commission. According to your theory the imports would increase during that period, because of the fear that the tariff might be increased, and would then drop, because they had sent more to the United States than normally. The figures will not bear you out. The increase was quite steady, and you cannot find any correlation between the two Tariff Commission actions and the actual trend of imports, either in bicycles or in the frozen fish fillets.

Dr. HUMPHREY. Mr. Chairman, what Mr. Strackbein is not pointing out is that the tariff was never increased on fish. The escape clause was not invoked. In 1952 the Commission recommended no action. In 1954 it reversed itself but the President declined to act on its recommendation. Because of growing consumer incomes and growing popularity of frozen fillets of fish, I would expect the result Mr. Strackbein describes. In the bicycle case, the President first delayed action which may have hastened importing. Duties were raised in August of this year so that there has not yet been time to assess the full effect of the change on the level of imports.

Mr. STRACKBEIN. I want to make it clear I am speaking to the point which is often made by those who would eliminate the escape clause or peril point, or both, that the mere existence of these administrative remedies put a damper on exports to the United States. I say the facts do not bear out any such conclusion.

Dr. ENSLEY. Then I can't understand why the industries that are fearful of imports are so determined to see that those clauses are always retained in every extension of the reciprocal trade program, if they feel they do not serve as a deterrent to imports.

Mr. STRACKBEIN. The mere existence of them does not. The possibility of successfully invoking the escape clause remains a hope that still has to be hatched in the future.

Mr. BOLLING. Mr. Cope, I think, had a comment.

Mr. COPE. Of course, I think what they usually say, Mr. Strackbein, in connection with the effect of the escape clause, is usually, that in order for foreign competitors to get their products on the American market a lot of planning and capital development is involved.

Now, the story we get from these potential exporters abroad is that they can't venture into projects for the purpose of exporting to us under trade agreements, that might be overthrown suddenly by escape-clause action. This threat is a real deterrent. It isn't a question of having the escape clause on the books. It is the fear that it might be invoked.

Mr. STRACKBEIN. That is what they tell you.

Mr. COPE. That is why industry wants it in.

Mr. STRACKBEIN. The facts don't bear that out.

Mr. COPE. Because you haven't had the kind of competition that you would get without the escape clause, sir.

Mr. STRACKBEIN. I beg your pardon. I can reenforce these 2 cases with 1 more, and that is tuna fish, fresh and frozen tuna. The increased imports not only survived an escape-clause action, which was not successful, but a bill in Congress to put the 3-cent duty on frozen tuna.

Again, that did not put a damper on the Japanese investment in tuna exports. They went right ahead.

Mr. COPE. That is not the whole story.

Mr. BOLLING. Gentlemen, I think perhaps we have pursued this thing enough, in view of the lateness of the hour, if it is agreeable with you.

Dr. ENSLEY. That is all.

Dr. HUMPHREY. Yes, sir; but the escape clause was never invoked on tuna.

Mr. BOLLING. Dr. Sheldon.

Dr. SHELDON. I have one question for Mr. Campbell.

In Mr. Voorhis' statement, he made the point that imports should be greater than exports because we are a creditor nation. I realize that the British did run an import balance, quite necessary to their economy. The imports were a reflection of interest earned on investments. Is the United States necessarily in this position or isn't there a possibility that in net balance we should still be an exporter of capital and consequently there is no particular reason why imports should be larger than exports at this stage of our history?

Mr. CAMPBELL. I think the point Mr. Voorhis was making was that our exports are now very much greater than our imports; that we balance them at the present time with foreign-aid program, and that if we are ever going to get away from having to have a foreign-aid program, we must get those imports up, even to the point of where we will have more imports. We should strive toward the point of balance, or it would even do us good if we had more imports than exports, because we already have such large capital investments overseas. The old myth of a favorable balance of trade, as Mr. Voorhis points out, is favorable only to Fort Knox in that we are able to build up some more available gold or equivalent to go into hiding. It is really not a favorable balance of trade to American consumers or to the American economy to have more exports than imports.

Dr. SHELDON. Thank you. Mr. Seidman, one question for you: You made the point that we want to try to make sure that when goods come into the United States, that they have been produced under working conditions which do not entail use of unfair labor standards. What I want to have clarified is whether you mean substandard conditions for that particular country, or do you mean that we have to insist that foreign workers have the same kind of wages and hours and working conditions that our own workers have, even though normally their wages and working conditions are much poorer than ours?

Mr. SEIDMAN. No. I think that realistically this criterion has to be determined in terms of the economy of the particular country, and that we would stop all trade if we insisted that all countries have the same labor standards as we have in the United States. That is obviously a goal, but it isn't anything that can be realized in the foreseeable future.

Therefore, it seems to me that criteria have to be developed for determining whether labor standards in particular exporting industries are substandard in terms of the economy and the level of productivity of a particular country.

Dr. SHELDON. Thank you.

Mr. BOLLING. Gentleman, on behalf of the subcommittee I want to thank each of you for your contribution, and particularly on behalf of the chairman I want to thank you for your cooperation. You have made this a very pleasant morning.

The subcommittee will recess until this afternoon at 2 o'clock.

(Whereupon, at 12:30 p. m., the subcommittee recessed until 2 p. m., the same day.)

AFTERNOON SESSION

The subcommittee met at 2 p. m., the Honorable Richard Bolling, chairman of the subcommittee, presiding.

Present: Senator Ralph E. Flanders.

Also present: Grover W. Ensley, staff director, and Charles S. Sheldon II, staff economist.

Mr. BOLLING. The subcommittee will be in order.

During the morning session today we heard a considerable number of witnesses cover a wide range of interesting problems associated with domestic reactions to trade. This afternoon in effect we are continuing that same topic, but concentrating on the problem area of conflicts between agricultural policy and foreign economic policy. These are problems which have proven to be especially difficult to resolve, and we are grateful to have a panel of such experienced witnesses to discuss this subject for us.

As was the case this morning, we are somewhat pressed for time, so I will ask you gentlemen if you can to keep your initial presentation down to somewhere between 10 and 12 minutes. After the statements, as I imagine some of you know, there will be opportunity for further discussion among the panel and for questions from the members of the committee and staff of the panel.

The first witness is Prof. Oscar B. Jesness, of the University of Minnesota, where he is head of the department of agricultural economics. He was formerly on the staff of the Randall Commission. Dr. Jesness will lead off the discussion on the topic Reconciling Agricultural Policy at Home With Foreign Economic Policy.

Professor Jesness.

STATEMENT OF DR. OSCAR B. JESNESS, HEAD, DEPARTMENT OF AGRICULTURAL ECONOMICS, UNIVERSITY OF MINNESOTA

Dr. JESNESS. Mr. Chairman, in my preliminary statement I shall aim to spell out what the essential features of the conflict are. This is done quite effectively in the report of the Randall Commission on Foreign Economic Policy, where attention was called particularly to the conflict between price supports, especially of the rigid variety, and some of our international policies.

The reason why this conflict arises is that an attractive price invites production here at home, and certainly is one of the forces at work in creating some agricultural surpluses, although not the only one, and then, secondly, such a price at levels above world prices attracts imports from abroad.

This conflict was recognized quite early in our agricultural program. As you will recall the Agricultural Adjustment Act was first enacted in 1933, and the Congress added what is known as section 22, in 1935. Section 22 authorizes the administration to restrict imports which interfere or threaten to interfere with the operations of the support program.

These controls take on two forms: They may be either quotas or embargoes—quantity restrictions—or they may be in the form of additional import duties, referred to in this instance as import fees.

During the war there was no particular need for resorting to these measures but after the war some feeling was apparent that the administration was not using section 22 with adequate vigor, and, consequently, section 104 was added to the Defense Production Act. This differed from section 22 in that it did not merely provide discretionary authority but established specific mandatory controls in case of imports of some commodities under certain circumstances. It is no secret to members of this committee that this resulted in considerable unfavorable reaction from some other countries, particularly in Western Europe.

Section 104 expired and we returned to reliance on section 22. As of now, section 22 controls are in force on six groups, including cotton, wheat, some dairy products, flaxseed and linseed oil, peanuts and peanut oil, and rye. Until very recently we also had controls on oats, barley, and certain of the tree nuts but these were allowed to lapse on September 30.

Controls are quotas, except in the case of flaxseed and linseed oil and peanuts and peanut oil. It is not difficult to find persuasive arguments for applying these controls if we are thinking only in terms of making our price-support program operative but there is more to the picture than that because it means that we are imposing some import barriers at the very time that we are encouraging other nations to expand their trade and seeking to develop international cooperation, at least within the free world.

Then there is another aspect of the support program, which enters here in that the existence of sizable surpluses of some farm commodities creates a condition in which we look to exports as an outlet. This invites a variety of schemes to expand exports by selling our products abroad at whatever prices they will bring.

Many Americans seem to be surprised at the fact that this operation on our part in effect constitutes dumping as it is defined internationally and consequently something against which other nations may apply restrictions whenever they see fit to do so. Then these exports that we sell abroad at bargain prices as part of our surplus disposal program raise another point which I believe is significant: Unless we give these products away, they call for dollar exchange which might otherwise provide payment for other exports that might be more logical. The conflict, as I have already suggested, becomes even more undesirable and questionable when we consider the leadership that we are exercising and the very deep interest we have in developing more effective international cooperation.

This does not mean, in my judgment, that in order to end the conflict we have to discontinue farm programs. It does mean that we need to begin to deemphasize our reliance on price supports as the remedy for the agricultural ills. We must recognize that our surpluses come partly from an overexpanded production as a result of the war period, as in the case of wheat, and partly from the fact that we are developing new methods, new technology which increase our agricultural productivity very rapidly. That means that we have a fundamental problem here of bringing about an adjustment in our productive capacity in some lines of agriculture to fit it to available markets. As long as we rely on price supports to solve this problem we are not meeting the basic issues involved.

I am bringing that in, although I imagine this committee is not particularly concerned with the specific methods of handling the agricultural problems, because I think an understanding of some basic facts regarding the farm problem is necessary to help us get away from the conflict we are discussing here this afternoon.

Mr. BOLLING. Thank you very much.

(The complete text of Dr. Jesness' statement is as follows:)

CONFLICT BETWEEN OUR DOMESTIC FARM PROGRAM AND INTERNATIONAL PROGRAM

Statement by O. B. Jesness, head, department of agricultural economics, University of Minnesota

As the Randall Commission on Foreign Economic Policy pointed out so clearly in its report, there is a very direct conflict between some aspects of our domestic farm programs and our international aims and objectives. The Commission observed that the inherent conflict is not between foreign trade and farm policy as such but rather between foreign trade policy and the means by which an important phase of our farm policy is implemented. It referred particularly to price supports at levels which turn them into price-fixing programs that encourage surplus production at home and lead to barriers against imports of supported commodities.

Efforts to improve upon the economic situation of farm people quite naturally become concerned with farm incomes and with increasing farm prices as the means of raising such incomes. But the role of prices in agriculture is not restricted to their influence on farm incomes. They also serve as guides to farmers in deciding what and how much to produce. An attractive price, whether established by the market or by Government supports, serves as an incentive to expand output. On the demand side, a higher price leads in the opposite direction in that it acts as a repellent. Instead of performing the customary price functions of working in the direction of a balance between offerings and takings in the market, arbitrary price supports may keep production out of balance with the market's willingness to absorb with the result that surplus stocks may accumulate in Government hands.

Nor is the pull of an attractive price limited to domestic production. A price above world levels becomes a magnet to draw supplies from other lands to add to the surplus. Such a prospect was foreseen in the early days of the program with the result that Congress 20 years ago added section 22 to the Farm Act to cope with such a situation. This section authorizes and directs the President to impose curbs on imports which interfere or threaten to interfere with price support operations.

There was some feeling after the war that section 22 authority was not used with sufficient vigor. Congress added section 104 to the Defense Production Act in 1950. This act made embargoes or quotas mandatory instead of discretionary on certain products under specified conditions. This action came at a time when European agricultural recovery had advanced to the point where foreign markets for some farm products were being sought by various nations of Western Europe. Supported prices and eagerness to acquire dollar exchange added interest to possible sales in our markets. We heightened that interest by reminding other nations that our program of foreign aid was to help overcome the ravages of war and to promote economic recovery rather than something on which they could rely indefinitely. It was up to them to restore and improve their production and thereby get into a position where they would be able to earn the needed dollars by trading with us.

The war put the mantle of leadership on our shoulders. This responsibility involved developing trade and other forms of effective cooperation among the countries of the Western World. Some of these countries were quick to see the inconsistency between our efforts to encourage our trade and our program of increased bars to certain agricultural imports. The reaction to the latter move did not strengthen our hand in building international cooperation and good will. While section 104 was temporary legislation which was allowed to expire, it served to focus the spotlight on the conflict between some aspects of our farm program and our international aims. The sharpness of the focus was not lessened by the expectation that the expiration of section 104 was to be offset to some degree by a more vigorous use of section 22.

As of October 15, 1955, controls under the authorization of section 22 were in effect on six groups of commodities: Cotton, wheat, some dairy products, flaxseed and linseed oil, peanuts and peanut oil, and rye. The restrictions on cotton and wheat date back to 1939 and 1941, respectively, while the others were inaugurated more recently. Controls on oats, barley, and certain tree nuts were allowed to expire on September 30; however, not without protest from some who viewed this lapse as a threat to the program. These controls are in the form of quotas except in the case of flaxseed and linseed oil where there is an import fee of 50 percent ad valorem, and peanut oil, where an ad valorem fee of 25 percent is in effect on imports in excess of 80 million pounds. Some of these quotas permit only very limited imports, as for instance, 800,000 bushels of wheat, 4 million pounds of wheat products, 707,000 pounds of butter, and about 3.3 million bushels of rye.

If we looked at the situation only from the domestic point of view, it is not difficult to find very persuasive arguments for restrictions on imports in the case of price-supported products on the grounds that without such curbs the surpluses would increase and cost to the taxpayer of the support program would mount. That, however, fails to see the whole picture. For one thing it glosses over the fact that it is an arbitrarily created price structure of our own making which attracts these imports. It also loses sight of the conflict between such restrictions on our part and the efforts we are making to get other nations to reduce some of their barriers against entry of our goods into their markets.

There is still another aspect to this picture. As it is to be expected, some of the products thus restricted are prominent in the list of surplus accumulations in Government hands or under Government loans. How to dispose of these surpluses has become a $64 question. Some think they see an answer to this question by moving surpluses into export. There is considerable pressure to draw down excess stocks by selling abroad at whatever prices they may bring while maintaining domestic prices at support levels. In fact, while the Farm Act limits very decidedly domestic sales of accumulations, specific authorization to sell abroad for a lower price is provided. We are observing right now considerable support for increased use of two-price programs to achieve this end.

Such sales might not be unwelcome abroad were we the only source of supply of these products or were we the only nation troubled with surpluses seeking markets elsewhere. This is not the case. There are other exporting nations and some of these same products are in surplus elsewhere. Wheat provides an illustration. Such nations cannot be blamed for viewing our efforts along these lines as endangering their best interests. Importing nations have various programs intended to encourage home production of these products and may see in such sales by us unfair competition for their own producers.

While two-price proposals may be workable to a moderate degree under certain circumstances, it is well for Americans to recognize that they constitute dumping as defined in international trade and consequently are subject to the controls and counteractions with which nations rather generally have equipped themselves. Export dumping does not promise a solution to the problem of surplus accumulations under our support program nor does it have appeal as a way of developing foreign outlets over the longer run.

International commodity agreements may be suggested as one way of avoiding antidumping restrictions. The International Wheat Agreement provides a way of selling limited amounts of wheat abroad below domestic prices. However, operations under this agreement give no hope that this is the ultimate answer. In fact there is no certainty at this time that the wheat agreement will be renewed on expiration.

Dumping operations, to the extent they may be carried on, in turn will create additional demands for import curbs to keep products sold abroad at lower prices or commoditites to the production of which such exports contribute from returning to or entering our markets. One prospect of travel down this road is that the destination may be further restriction on rather than liberalization of world trade.

But may not interferences with international trade be avoided by concentrating on sales for local currencies to countries which do not have access to dollar exchange, exchanging surpluses for strategic materials we want to stockpile, or outright gifts to needy people elsewhere? All of these may have their place. What we must avoid is expecting too much from them. Sale for local currencies becomes gifts unless we put the payment to uses which will provide us with returns not otherwise available. If we buy imports with them they must be additional, not replacement. The same applies to the use of the local currencies by our nationals abroad. Exchange for strategic materials which we otherwise would purchase for dollars does not increase the sum total of trade. In the case of gifts, the costs fall on American taxpayers. There is also the problem of reaching those who are really in need. In all of these cases there is ever present the possibility that the commodities involved may replace sales rather than provide additions.

Talk in some circles appears to follow the reasoning that it is the attitude of the State Department which prevents exports of farm products in greater volume. Some seem to think the State Department is too fearful about antagonizing other nations. Some urge the Department of Agriculture to be more forceful in presenting the case for exporting surpluses. One cannot help but wonder how carefully holders of such views have thought about the many troublesome problems involved. It does not take a great deal of effort to discover that they are much more than figments of someone's imagination.

Some of the pressure for export subsidies and other aids to expanded foreign sales is in terms of retaining our share of the world market. Certainly no one wants to give up a foreign market which we can get and hold by legitimate trading. How to determine our share except by leaving it to the operations of the market is a question for which there is no ready answer. Which represents our share of the world's wheat market: The amounts we shipped out from say 1945 to 1948, largely under our program of aiding European recovery; or the very small exports during the years 1935 to 1939? What would happen to foreign trade if wheat-exporting nations generally were to decide to retain the volume of exports they had during their peak periods in the absence of a market for anything like that total? Does anyone believe that the trade conflict which would develop out of such a situation would contribute to world understanding and cooperation so essential for enduring peace?

A contention for which considerable support may be marshaled, if not examined too closely, is that world trade is so universally hampered by tariffs, quotas, embargoes, exchange restrictions, and state trading, that our operations under the farm program, including import restrictions and dumping, are justified in consequence. It is said that "we must fight fire with fire." However, there may be something to be said for not fighting arson with arson. That is, we need to be on guard least we destroy the very foreign trade we claim to be seeking.

We are an outstanding leader among nations in the free world. We cannot shirk our responsibilities of leadership without suffering the consequences. Justifying our trade restrictions and operations by claiming that we are merely doing what others are doing is accepting the role of a follower rather than providing leadership. Viewed in this light the conflict between our domestic farm programs and our international aims and objectives multiplies rapidly in significance and seriousness.

Perhaps it is only natural that the possible effects of certain imports may appear much more certain and significant to many than the broader, and in some respects less tangible effects which restrictions on imports have on our program of developing export markets and of strengthening international cooperation. More careful examination, however, may demonstrate to us as Americans that the latter consequences are of utmost importance to our own welfare, that of coming generations and of the country as a whole.

This is what adds weight to the observation of the Randall Commission that "In the opinion of the Commission, it is necessary to harmonize our agricultural and foreign economic policies without sacrificing the sound objectives of either." This conclusion does not seem open to the interpretation that the Commission saw no place for a farm program. It must be rather clear, however, that if our efforts to carry on a farm program and our efforts to develop and maintain a healthy international trade and effective international cooperation are to be harmonized, we need to reexamine our methods and make the modifications essential to obtain the desired objective.

One essential in overcoming the conflict is that of deemphasizing the part which rigid price supports have played in our domestic farm programs. Price supports have softened the consequences of the loss of war markets for some products. No reasonable person will advocate sudden and complete removal of present supports. They have helped build up surplus stocks which hang over the market and which would create chaos were they thrown on the market suddenly. The accumulation of over $7 billion of stocks in Government hands or under Government loans is one of the penalties of the support program. Another may be that our hope and faith in the price treatment may keep us from attacking causes rather than consequences and thereby delay improvement.

Wheat represents a case of carryover of war-expanded production into peacetime when the need which led to the expansion is past. Market quotas which curb all classes and grades and all growers alike are not the answer. Without restrictions on diverted acres, they tend to spread the surplus problem to feed grains and other lines thereby building up a case for more controls. Eventually, the result may create a livestock problem. Lower supports on wheat may induce some farmers to shift some land out of wheat. They also may bring some wheat into feed use. However, for some areas, particularly the Southwest, where grasslands were plowed up to grow wheat, there is a place for special programs to shift wheat acres back to grass. Incentive payments, purchase and extinction of acre allotments, and land rental may help achieve this end.

Some moderation in cotton supports should help the United States retain its place in the world market and relieve the Nation of serving as the storehouse for the world. To the extent adjustments in production are needed, they should be on acres which ought to go out of cotton rather than across-the-board cuts. Because of the importance of labor in cotton production, continued growth of nonagricultural job opportunities in areas going out of cotton are important.

Dairy products, aided by moderated price supports, active selling and growing population, give promise of attaining reasonable balance within 3 to 5 years with a continuation of prosperity in the rest of the economy. Production adjustments may involve some shift out of dairying for areas having alternatives or which lack advantages in dairying. Careful consideration should be given to the advisability and possibility of achieving some improvement by moderation in some of the internal barriers affecting certain metropoltan milk markets.

The current situation in hogs, the decided drop in cattle prices of 3 years ago, and the low prices for eggs last year are illustrative of overadjustments farmers make to favorable prices. While there may be a place for efforts at times to ease some of the worst consequences of cattle- and hog-cycle swings, the major corrective lies in the farmer's own hands rather than being a responsibility of the public generally. The same applies to a considerable degree to the maintenance of an adequate supply of feed grains for use on the farm.

Proposals to have the Government rent land and help create "soil-fertility banks" are receiving wide attention, but need to be approached with caution. Unless administered with great care, such a program may saddle the Government with payments for considerable land of low productivity. Without careful controls and supervision, the program may be subject to abuse. Many farms are too small today for best operation. It will be a doubtful expedient to shrink them in size and thereby provide incentive for even more intensive use of land.

A long-time cityward migration of farm people is continuing at a stepped-up rate. Instead of deploring this as some do, it should be recognized as a way of bringing about a better balance in earning power and incomes. This will permit more farms to approach the size which will fit modern machines and technology. It is not a case of "driving" people off the land. Instead, it is a case of attracting them by opportunities elsewhere. No basis is seen for accepting the doleful forecast that this means corporate farms. The farms will remain individual units, but will come nearer to the size which will enable the farmer and his family to have a level of living which compares favorably with others.

Prospects for expanding the per capita consumption of food in this country are not promising. However, with rising incomes consumers can afford better diets. Shifts to more dependence on animal products will help expand the overall market for farm resources and is something deserving encouragement.

The farmer today is more dependent on the rest of the economy than ever before. A very important aid to agriculture hence lies in maintaining economic stability at a high level. This is a responsibility not only of Government but of labor, industry, business, finance—in fact, all of us. Such a level provides a market for farm products, the production of goods needed by farmers, and nonagricultural job opportunities for farm people.

Mr. Bolling. The next witness is Mr. Ernest Baughman, assistant vice president of the Federal Reserve Bank of Chicago. He, also, was a member of the Randall Commission staff.

STATEMENT OF ERNEST T. BAUGHMAN, ASSISTANT VICE PRESIDENT, FEDERAL RESERVE BANK OF CHICAGO

Mr. Baughman. Mr. Chairman, the setting within which the conflict between domestic agricultural policy and international economic policy has developed has been well set forth by Dr. Jesness. We have excess capacity in our agricultural industry. In an attempt to minimize the impact of this excess capacity, on the flow of income to the agricultural sector of the economy, we have developed programs which largely are price-supporting programs, and which are independent to a large extent of the current rate of output in the industry and also of the world level of prices for the supported commodities. This means, then, that prices are prohibited from doing their usual job of equating output and consumption in the economy, and that they interfere with the flow of agricultural commodities into export.

I probably should mention also that the international economic policy we are talking about is one in which the United States, over a period of time, is attempting to achieve a system of multilateral world trade on a basis of currency convertibility, and with nondiscrimination in trade.

Conflict with the achievement of that international economic objective develops on two fronts: On the domestic front, as Dr. Jesness has pointed out, with the price programs we have, we tend to accumulate as surplus stocks any excess of current output over the amount that moves into current consumption in the domestic market at the support price, and to attract supplies from outside the country. Actions to restrict such imports place us in a position of recommending to the free world a move in the direction of relatively free, multilateral trade, while at the same time we are building restrictions on trade. It may put us in the position where our actions speak so loud that what we say cannot be heard.

After we have accumulated large surplus stock there is the problem of how to dispose of them. We have developed a number of programs to increase the disposition in the domestic market, but have found that they have quite limited potential. Attention then turns to the export market, and there is great temptation to implement almost any technique which holds some promise of moving a larger quantity of commodities outside the United States.

Unfortunately, programs which have any promise of moving a substantial volume of surpluses outside the United States and not simply displacing our dollar exports or exports of friendly countries, tend to involve trading practices which are inconsistent with our international economic policy objective.

One of these, for example, is the program to barter agricultural commodities for other kinds of commodities. In general, the United States has opposed this kind of trading practice. We have held the view that this practice, if generally adopted and used in international trade, would in the long run work to our disadvantage. We would not like to see it adopted generally by all trading countries.

Another one is sale for foreign currencies not readily convertible into dollars. Very often we have found that bilateral trading arrangements have blocked our attempts to expand exports into particular areas. Sales for foreign currencies tend to be largely bilateral government-to-government deals and may foster trading practices which will work to the disadvantage of the United States in the long run. Again, it is a trading practice which is inconsistent with the development of a relatively free movement of goods internationally, a type of trade which we have believed would serve the best interests of the United States.

Other special programs have been developed in an attempt to move a larger quantity of agricultural commodities outside the United States. One of these is export subsidies. If used with a good deal of discretion and no attempt is made to push a large enough volume of commodities outside the country, so that other exporters get the feeling that we are encroaching on what they consider to be their markets; the net result may be that of offsetting the effects of the domestic price-support program on exports. But if there is an attempt to use export subsidies for the purpose of moving a substantial volume of commodities outside the country, or into markets which we normally do not supply, it is reasonable to expect that other exporters and possibly even the countries receiving the commodities will retaliate.

We also tie-in exports of agricultural commodities with foreign-aid programs and have a rather liberal program of grants and gifts in circumstances where, due to natural disaster or other cause, the current output in an area is severely reduced, or their capacity to purchase commodities is curtailed.

One feature common to all of these special export programs, is that they involve a type of operation which almost inevitably transfer the critical decisions on exports from the hands of the private trade to the hands of the Government. Once this is done, whosoever in the Government is responsible for these programs finds he is in an exposed position. It is fairly easy for people to reconcile themselves to the decisions of the rather impersonal operations of a market, especially a market where prices are free to change, but to reconcile oneself to the decisions of an individual, even if the decision might, in fact, be about the same as would have been rendered by the market, is quite another thing. There is a clear target at which criticism can be directed. For this and other reasons, noneconomic factors tend to become more and more important factors in trade decisions. In other words, costs and profits are deemphasized. This is one of the reasons for a good deal of concern, I think, on the part of other countries in the direction that United States trade practices on agricultural commodities has taken in the last several years.

One final observation, the capacity of these special programs to move agricultural commodities outside the United States is probably much more limited than we have generally recognized, and their costs are relatively higher in economic terms and may be quite high also in political terms. We may have opportunity to develop that a bit further in the succeeding discussion.

Mr. Bolling. Thank you, Mr. Baughman.

(The complete statement of Mr. Baughman is as follows:)

Reconciling Domestic Agricultural Policy With Foreign Economic Policy

Ernest T. Baughman, Assistant Vice President, Federal Reserve Bank of Chicago

THE SETTING

The domestic agricultural situation includes, among other things, the following features:

(1) Declining prices of agricultural commodities and a reduced flow of income to the agricultural sector of the economy;

(2) A declining agricultural labor force and a smaller number of people living on farms;

(3) Large, and still growing, surpluses of a number of agricultural commodities—CCC inventories, loans, and purchase agreements resulting from price-support programs increased about $6 billion in fiscal years 1953, 1954, and 1955 and now probably exceed $7.5 billion.

(4) Prices of some commodities supported at levels which continue to stimulate expansion in production capacity even though large surpluses have been accumulated;

(5) Acreage and marketing controls which limit the amount of land used for certain crops but do not require land to be retired from production, and, therefore, have only a small effect on total agricultural output;

(6) A growing recognition of the high cost to the Treasury and taxpayers of programs which withdraw large amounts of commodities from their usual markets and attempt to divert them to special outlets, domestic and foreign;

(7) domestic prices of major export commodities supported above world prices and a strong tendency for commercial exports of such commodities to decline;

(8) a variety of special programs to increase disposition of agricultural surplus commodities in both domestic and export outlets;

(9) some gradual moves to adjust downward those support prices which clearly are out of line with the current supply-demand situation, usually after burdensome stocks have been accumulated.

Burdensome domestic supplies are at the root of the conflicts between agricultural policy and foreign economic policy. This supply situation results from a combination of factors. Probably most important is the great abundance of agricultural resources in the United States. Important also has been the rapid pace of technological progress which has increased the output per worker to such an extent that a declining agricultural work force has produced an abundance of agricultural commodities. This has created an excess of workers in agriculture, to be drained off into other activities. The size of the flow has been augmented also by the relatively high birth rates in agricultural areas. This combination of factors—the abundance of agricultural resources, technical progress in production and the tendency toward a perpetual surplus of agricultural workers—have permitted the output of agricultural commodities to be expanded whenever demand was increased. Production expanded, for example, in response to the increased demands associated with World War I and, under the impacts of the subsequent reduction in export demand and the effect of farm mechanization on output, tended in the direction of surpluses in most of the ensuing years. Temporary and intermittent relief was provided by severe and widespread drought in the midthirities, the heavy demands of World War II, the large foreign-aid programs in the early postwar years of reconstruction and the temporary spurt in demand associated with the outbreak of hostilities in Korea. But as these developments provided relief to burdensome supply situations, they also provided additional stimuli to further expand agricultural production capacity.

During World War II and the early postwar years, agricultural production increased again. From an index of 76 (1947–49=100) in the prewar years 1935–39, United States farm output advanced to 104 to 1948, a record that was to stand for 3 years. After declining somewhat in 1949 and 1950, production turned upward in 1951, and in 1952 it advanced to 107 where it held about steady until the current year. Output in 1955 is estimated to exceed that of any previous year, by a margin of about five points, despite acreage and marketing controls on some crops, falling market prices, mounting surpluses and drought in some areas. The major features of the current domestic agricultural situation therefore reflect the persistent tendency for domestic production to outstrip demand.

AREA OF CONFLICT

The conflicts between domestic agricultural policy and international economic policy, in turn, stem from the kinds of domestic measures used to minimize the impact of the excess capacity in agriculture on farm income. While conflicts emerge at several different points, each has its roots in the policy of supporting domestic prices above the prices which would prevail under conditions of a relatively free market. Prices that are supported above their free market level not only lose the capacity to adjust to changing conditions but tend to further augment existing imbalance. They stimulate further expansion in production capacity and at the same time provide some limiting effect on domestic consumption and exports. As surplus stocks accumulate, there is a strong tendency to look to the export market as a place to dispose of the surpluses. Furthermore, the domestic-supported price, in addition to being attractive to domestic producers, is attractive to foreign producers and tends to attract additional imports. This, in turn, results in actions to restrict imports.

The achievement of a system of multilateral world trade based on currency convertibility and nondiscrimination in trade has long been a fundamental foreign economic policy objective of the United States. Conflict with this objective results from programs which foster increased restrictions on trade, tend to defer elimination of existing restrictions, perpetuate existing international imbalance in production, prices and trade or defer the convertibility of currencies. It is our objective also to help develop and maintain strong and expanding economies in the countries of the free world to the end that this will add to the military, political, and economic strength of these countries and aid in the maintenance of peace. An expanding international trade based upon the most economic utilization of the resources of the free world can make an important contribution to the achievement of that goal.

Conflicts between domestic agricultural policy and international economic policy arise largely from the widespread acceptance of parity prices as goals of agricultural programs and from the support of prices at specified percentages of parity regardless of the amounts produced or of world prices of commodities produced for export. When world prices fall below those in domestic markets any excess of supply above domestic requirements tends to be accumulated as surplus stocks. Such withdrawal from world markets invites other areas to expand output to fill the void. This was evident, for example, on cotton in the 1930's, and it is happening again currently. To provide some limit to the cost of the price-support program, domestic production may need to be controlled. If allowed to enter, the additional imports attracted by the high domestic prices tend to increase domestic stocks and add to the cost of making the support program effective. This leads to demands for added restrictions on imports and may place the United States in the position of having erected additional trade barriers while concurrently urging the free world to reduce trade barriers. Is this not a situation in which our actions speak so loud that what we say may not be heard?

A similar area of conflict emerges as we turn our attention to programs to expand exports of agricultural surplus commodities. There is strong temptation to resort to some kind of export subsidy so as to dump the commodities into world markets at prices below domestic prices. If used sparingly and with great discretion, export subsidies may have the effect of largely offsetting the effect on exports of the domestic support program. However, if used to move a larger than usual volume of commodities into export or into other than usual markets, or if other exporters or importers think the program is unfair to them, retaliation may be expected. Producers outside the United States may consider any increase in United States exports, or even the maintenance of some historical level of exports, to be unfair competition if accomplished with the aid of the tremendous resources of the United States Treasury. The result may be the erection of additional trade barriers or the continuation of existing barriers which the United States would like to have lowered or removed.

Possibly the most serious difficulty resulting from domestic price-support programs, and the ensuing export subsidy and other programs to expand exports, is the transfer from private trade to the Government the responsibility for the critical decisions regarding amounts, destinations, prices and grades of commodities exported. Even if the decisions were to be the same as would have been reached under the guidance of the impersonal market place, it nevertheless tends to invite criticism and complaint to the Government official and department of Government directly responsible for the decisions. For this and other reasons, the actions of governments may be based on other than economic considerations. And a central feature of the United States objective of a system of multilateral world trade based on currency convertibility and nondiscrimination is that trade be conducted in response to basic economic forces which tend to achieve the most efficient use of the free world's resources.

RESOLVING THE CONFLICT

A resolution of the conflicts between domestic agricultural policy and international economic policy would involve the use of a double-edged sword. On the one hand, it appears clear that measures to support the flow of income to the agricultural sector of the economy should be of a type that would not seriously interfere with the functioning of a system of relatively free market prices. "Flexibility" in the level of price support or in the amount of subsidy (as the term is now commonly used) will not accomplish the job of adjusting domestic prices, day to day and grade by grade, to changes in supply and demand, both domestic and worldwide. Only a system of free-to-change market prices can accomplish such price adjustments in a timely fashion and maintain some semblance of balance between current output and current consumption. Under such a system there would be less need to provide additional barriers to imports. It would be possible for domestically produced commodities to move into export trade in competition with similar commodities from other areas without the use of export subsidies or other direct Government intervention to augment exports. Furthermore, this type of price program holds much greater promise of maintaining a sizable export market for those farm commodities in which the United States has a comparative advantage than a program which relies heavily on direct control of output and which is likely to result in a gradual withdrawal of our commodities from the export market as the responsibility for export trade is shifted from the private trade to the Government.

Embracing a system of relatively free market prices would not preclude the provision of aid to agriculture if such aid were deemed necessary and desirable. However, it would require abandonment of the program of supporting market prices above their competitive "free" market levels. Programs to speed up the transfer of excess workers out of agriculture and into occupations where they would earn higher incomes and contribute a substantially larger volume of products to the Nation's output, to withdraw certain land from crop production, to maintain a high level of general economic activity and to provide income payments to farmers under certain conditions would have a place under farm policies consistent with our international economic policies.

The other edge of the sword would be used to carve out some changes in the area of foreign trade policy and practice. As domestic agricultural commodity prices were permitted to respond to overall supply and demand conditions, it would be possible to reduce direct Government activity in the export of agricultural commodities and to foster trade on a multilateral and competitive basis, i. e., competitive in the sense that the value judgments of the market would be reflected to farmers and help to guide them in their production decisions.

It would not be feasible, of course, to release the hoard of surpluses accumulated from past harvests into commercial markets except under conditions of sharp increase in demand or substantial reduction in current output. Such action would seriously disrupt markets for current output. What, then, is to be done with current stocks? Efforts to dispose of them in commercial markets abroad by sale for foreign currencies or other methods of export subsidy are encountering strong opposition from friendly suppliers of the same and similar commodities. This, of course, is to be expected. In part, it is the normal reaction of suppliers to increased competition. But it is also a reflection of the uncertainty that can be injected into a market when a powerful seller gives evidence of acting without regard to the usual economic factors of costs and profits.

If current surplus stocks are to be moved into consumption without disrupting domestic or world markets, and in the absence of reduced current output or substantial increase in demand, it will be necessary to move them in such ways and such areas that they result in increased consumption—not merely displacement of consumption of other commodities or of the same kind of commodities from other sources of supply. The best opportunities to achieve this objective are among the low-income low-consumption areas of the world.

It is apparent that many consumers could benefit from additional consumption. It is not a simple matter to raise their consumption level however. Usually consumption is limited by income and it must be assumed that consumers are spending their income in the way that they believe maximizes their own satisfaction (wants). Thus, the mere availability of additional supplies of any commodity cannot be expected to make much change in their pattern of expenditure.

Distribution of commodities directly to consumers in forms usable by them would result in somewhat higher levels of consumption. However, even free distribution is not fully effective in expanding consumption since the distribution of any substantial amount of commodities in this manner tends to result in the creation of a secondary market in which the commodities are traded for items more desired than additional amounts of food. The result is displacement of usual marketings, to some extent. Furthermore, little long-run gain could be expected to result from short-run or intermittent free distribution of surplus agricultural commodities.

The real need of most of the world's low-income areas is additional capital and skill to more adequately exploit the areas' resources. This would permit the development of higher real incomes and higher levels of consumption. Since in most of these areas large numbers of workers are unemployed or underemployed, it should be possible to accelerate the rate of investment in capital development projects. As the accelerated rate of investment spending increased incomes it would be necessary to expand the supply of consumer goods if inflation was to be held in check. Agricultural surplus commodities could be used effectively to that end. Food accounts for a large proportion of total consumer expenditures in low income economies. Thus the injection of additional amounts of agricultural commodities could have the effect (1) of minimizing inflationary pressures as capital development projects were expanded and the rate of investment was accelerated, (2) of boosting consumption levels, and (3) facilitating the rate of accumulation of capital and therefore the rate of growth in real income in the area.

Studies in a number of low-income areas indicate that about one-third to one-half of the total cost of many capital development projects could be provided by the use of agricultural surplus commodities. However, the mere reorientation of programs for the foreign disposal of agricultural surplus commodities from the commercial markets usually supplied by the United States to the low-income areas would not in and of itself assure increased consumption and a minimum of displacement of "usual" marketings of the United States and other countries. It would be necessary in fact to achieve a higher rate of investment in the areas, an expansion in the flow of income and an increased volume of expenditure for agricultural commodities if the consumption level was to be raised permanently to a higher level.

Little return would be realized from the surplus agricultural commodities, at least in the short-run; it would be necessary to make commitments of commodities in support of capital projects for several years; the amount of commodities which could be used effectively in such a program would depend largely on the willingness and ability of recipient countries to enter into expanded development programs; considerable time would be required to achieve much expansion. This is not an easy answer to the surplus problem and may not be an answer at all for some commodities. Nevertheless, this type of program appears to have much to recommend it as compared with programs which almost certainly result largely in displacement of other supplies.

It should be apparent that there is no easy way of returning commodities to commercial markets once they have been withdrawn from such markets. Furthermore, there appears to be no simple and effective way of utilizing a large volume of commodities outside their usual commercial uses except at great cost to the Treasury and considerable economic loss to society. Substituting relatively expensive for relatively cheap commodities is inherently wasteful.

The possibilities of exporting a large volume in any relatively short period of time also are quite remote. Programs which attempt to do this usually involve trading practices which are in conflict without long-term international economic objectives. Examples include barter, sale for blocked or inconvertible currencies, subsidy payments to exporters, sale of Government stocks at prices below domestic market prices, and to a lesser extent sale at nominal prices for specific "unusual" uses and grants or gifts. These trading practices may be used with some limited benefit in certain unusual circumstances. However, if they are used to facilitate the export of a large volume of commodities or over any considerable period of time they clearly cannot be characterized as nominal or temporary exceptions to our general international economic policies. Any proliferation or prolongation of such trading practices, therefore, should be considered carefully "lest the exceptions become the rule" and our long-run goals be sacrified to "temporary" expedients.

Conflicts between trading practices which have their roots in the domestic price-support program for agricultural commodities and our international economic policies probably can be resolved only by a basic reorientation of our domestic programs. If our domestic programs are not reoriented, it is quite possible that actions taken in the international arena in an effort to shore up the domestic program will make it impossible to mark up any further substantial progress toward international economic goals deemed to be in the long-term best interests of the United States and the free world.

Mr. Bolling. The next witness is Dr. D. Gale Johnson, professor of economics, University of Chicago, who I understand recently returned from an agricultural mission to the Soviet countries.

Dr. Johnson.

STATEMENT OF DR. D. GALE JOHNSON, PROFESSOR OF ECONOMICS, UNIVERSITY OF CHICAGO

Dr. Johnson. Thank you.

I realized when I acceded to the request to appear before this session that if I were to follow both Dr. Jesness and Mr. Baughman that most, if not all, of the pertinent and relevant points on this would be covered before me, and I think my realizations have been rather well fulfilled.

But what I would like to do is to talk rather specifically on three ways of trying to do something about the specific reconciliation of this conflict; not that I necessarily am convinced that in these three ways we have found an answer, but that they are worthy of study and consideration, and it might make some small contribution to the resolution of the type of conflict which does exist.

The first of these three ways would envisage attempts to move our products into international markets at the same price as in the domestic market. This would avoid having the domestic programs conflict with the free movement of food and other farm products into international markets, and would relieve ourselves of some of the criticisms that other countries can, I think, legitimately make of us. This could be done if we should have, for example, a price-support program on a specific commodity, such as cotton. We should not make the terms more favorable to the export buyer than to the domestic buyer, which would involve in this case, if we were to operate on this principle, making a supplementary payment in the domestic market as far as the producer is concerned. That is, we would see to it that the producer got the support price, but that the domestic market could buy at whatever price was required to more or less equate supply with demand.

The advantage of this is, at least to the outside world, and I think also to ourselves, is that the American market, which is by far the largest and richest market in the world, would be utilizing this commodity domestically to the fullest extent within the framework of the amount that was produced and alternative outlets elsewhere. Our market is such a large part of the world market, for so many of these commodities that we are dealing with, that the increased consumption at home that would follow from such a practice would undoubtedly relieve some of the pressure on world market prices that would be involved if we moved our supplies abroad under a dumping basis.

I think particularly in this connection of the line of argument that was used, I believe, by New Zealand against an export subsidy on butter by the United States. They argued against this on the basis that they didn't object to our selling butter abroad, say, for 55 cents a pound in direct competition with them, if we would allow the American consumer to have a chance to buy butter at the same price, arguing that the American market is so large that if we were to sell butter on that same basis consumption would be substantially increased, and that the amount that would be available for sale abroad would not be so large as to really cut into their markets.

So it seems to me that if we have to lower the price to get an export market some consideration should be given to the possibility of allowing this commodity to sell for the same price in the domestic market as a means of taking advantage of the huge consumption capacity, if one may use that term, of the American market.

A second possibility of relieving the conflict, and one that I am sure is not likely to be utilized overnight, would, of course, involve some lowering of the prices actually paid the farmer on those commodities in which we are accumulating surpluses and are having difficulty in moving the products in international markets.

The reasoning behind this statement is that while the reasoning behind the previous procedure which I have described helps to maintain consumption at a high level in the United States, the relatively high support prices in a few cases also help to maintain production. Though allowing all the product to move into consumption is of real assistance in resolving the conflicts, it perhaps does not go all the way.

If we were, of course, to adopt the policy of allowing some gradual lowering of the support prices, which, as was pointed out, occurred in the last few months, it seems to me other means of meeting what can be called legitimate demand for farmers might be required.

Dr. Jesness, in his prepared paper, referred to one or two of these, mentioning the adjustment in wheat acreage by establishing a program that would take some of the land out of wheat in the western part of the Great Plains on a reasonably attractive basis. This would serve as a means of getting our wheat productive capacity somewhere in line with our total demands.

Other measures might be required in the case of cotton. I suspect that over the long run the most important adjustment that needs to be made in the cotton-producing area is something that would generally be advantageous to us in any case, namely, perhaps developing a program that would aid in the movement of some people from agriculture into nonagricultural pursuits.

The third type of thing that might be done would be to consider foreign-aid programs, particularly as far as the underdeveloped countries are concerned, on a somewhat different basis than we have in the past. It seems to me that there may be some possibilities, and again I don't say that I have studied this out fully, because I have not, of trying to use our surplus food as a part of fairly comprehensive programs of aiding some of the underdeveloped areas of the world where incomes are very low. If carefully formulated, this method would not particularly interfere with the flow of products into the normal export markets of the world.

It seems to me it might be possible to utilize our food in terms of improving literacy in some of the countries of the world. This would definitely have to be experimented with, but since a major item of cost in education is essentially the food that is required for the teachers, and to pay the workers, and so forth, for building the rather modest type of school buildings that are required, we might be able, through the use of our food, to be able to support upward of half to two-thirds of the cost of an expanded educational program. I have in mind mainly education at the primary level. Making food available to these countries might be justified on the grounds that they would be able to take the necessary steps to expand their educational system.

It might also be necessary to supply additional funds to this to help them in buying whatever materials are required that need to be imported.

The same type of activity might be thought through with respect to items that might be called community overhead, or general social overhead in underdeveloped countries; roadbuilding, for example, has a very high requirement of local goods, or local goods and services. Under the conditions under which roadbuilding appears in many of the poorer sections of the world it consists largely of labor and certainly this labor can be supported to the extent of a half or two-thirds through food grants.

There are other kinds of things of this same sort, construction of sewers in cities, perhaps improving water transportation, constructing airports, and so forth, where the amount of local labor required is very high; that support for these kinds of activities which would be of advantage to the people receiving them and in the long run we would hope would be of advantage to us by increasing their incomes, and increasing their ties to us, might well be feasible.

As I say, this is put forward on a tentative basis, but with some thought, the scope of such a program might be reasonably significant. However, both of these programs, particularly the one relating to education, could not be a short-run program. It would have to be something we would be willing to engage in for a decade or two if it is going to have a substantial or long-run impact.

However, in operating any of these disposal programs of this sort, or others, in the low-income areas of the world, the underdeveloped areas, we do have to be careful that we do not take measures which will actually harm the development of agriculture in the areas where we are trying to help.

I have in mind here a suggestion that was made a number of years ago as a method to dispose of large amounts of dry milk in 1 or 2 of the Asiatic countries, where the local dairy industry was struggling to become established. It is quite possible that if such a program had been encouraged on a large scale that the competition of this cheap milk from the outside would have essentially meant that this dairy industry would not have been able to develop any further for some time to come.

I think that concludes my remarks.

Mr. BOLLING. Thank you very much, Dr. Johnson.

The next witness is Dr. Lloyd C. Halvorson, economist of the National Grange.

Dr. Halvorson.

STATEMENT OF DR. LLOYD C. HALVORSON, ECONOMIST, THE NATIONAL GRANGE

Dr. HALVORSON. Mr. Chairman, I am going to start in a rather broad way, because I want to make sure that what I say is not misunderstood.

The main consideration of the National Grange in foreign economic policy is the preservation of peace and we feel very confident that our success in preserving peace will depend to a large extent upon how successful we are in promoting the interchange of goods, services, ideas, and people between the nations of the world, and to the extent that we succeed we will raise the living standards of the world, and that also will contribute toward peace.

We feel that the American people are willing to make a sacrifice if necessary for preservation of peace, and our foreign economic aid program has been to some extent a sacrifice on the part of the American people, but it has contributed to world peace, and I think it has been our human responsibility to do such things.

Our foreign economic aid has created much good will that will serve us to good purposes in the future. We have proved our good intentions to many parts of the world with our foreign economic aid and we have proved to the world also that our economic system is possibly the best kind of economic system in the world.

We feel that expansion of trade by lowering of barriers does not constitute an economic sacrifice. We feel that trade is beneficial, not only to other parts of the world, but it is also beneficial to us.

Now, the second main interest of the Grange is the preservation and expansion of markets. We recognize that if we are to sell things abroad, this country has to buy something. We feel that to the extent that trade is based on comparative advantage, that it will raise the standard of living throughout the world, and thereby contribute to peace as well as toward better markets.

The present depressed farm situation reflects the fact that to some degree American agriculture has been the victim of our foreign economic policy and the economic policies of foreign nations. That needs explanation.

During World War I we greatly expanded our agricultural market production to meet our own food needs and the food needs of our allies in other parts of the world. As a result, certainly after World War I, prices collapsed when export markets fell off. I think the tariffs that we imposed after World War I, and the Smoot-Hawley tariff of 1930 also contributed toward loss of foreign markets for certain agricultural export crops which had repercussions everywhere. The price support program of the 1930's also, I think, contributed to a loss of the agricultural export markets.

During World War II we had somewhat a repetition of the pattern of World War I, at least so far as expansion of production was concerned. The slogan at that time was that "Food will win the war, and write the peace," and I think that food was probably as important in winning the war as cannons and warships and other things.

Certainly in regard to the peace, after the war, food was very important. Probably some of the countries would have turned to communism had it not been for our supply of food.

We have got to view the agricultural problem not only from the standpoint of our own shores but from the standpoint of the whole world. Some of the agricultural problems arise from the nationalistic self-sufficiency policies abroad. I think that it should be a very definite part of our foreign economic policy, to bring about food production where it can be produced more efficiently. If our foreign economic policy could succeed in that we would have gone a long ways toward helping our own agricultural problem here.

We certainly cannot sacrifice our own agricultural policy for foreign economic policy. We have a definite agricultural problem which is very severe today. Farm income has come down greatly from 1948, when it reached about 16.7 billion, to about 11 billion today. Farm prices are way down. It is true that the number of people on farms has gone down also, but not in proportion. There is a definite falling off of income in agriculture, but we feel that we should work, and we think this committee is doing a great service in trying to find ways of increasing the harmony and consistency between our domestic agricultural policy and our foreign economic policy.

I don't think that the problem of making our agricultural policy consistent with our foreign economic policy arises out of the inefficiency of American agriculture. A lot of times some industries in this country are bothered by imports because they do not have the American level of productive superiority. They are not able to apply the capital needed to achieve this superiority. When only 10 percent of our labor force in this country is engaged in food and fiber production, and we still have too much, it testifies quite well to the fact that our American agriculture is very efficient.

It is largely because of nationalistic self-sufficiency policies abroad and because of expansion of domestic production during the war periods, that we have these farm problems now.

I think the other speakers have dealt with the heart of the problem before us, and that is the relationship of the price-support program to our foreign economic policy. The other speakers have already pointed out that if we have a price-support program, our prices tend to attract imports. At the same time, when our price is above the world level it makes it difficult for us to export.

If we try to go on as we have, the price-support program will probably get us into difficulty, not only abroad but also domestically, because, for one thing, some of our export crops have to be exported if American agriculture is to have a desirable level of income.

Now, in both wheat and cotton, our exports have been falling off greatly as a result of our price-support program, keeping our price above the world price. It has been offset to some degree by export subsidies. That is the only way we can maintain any fair share of the world market.

Now, the other speakers have mentioned the difficulty we get into in the world with import restrictions, on the one hand, and export subsidies on the other. I think there has been a growing realization that these policies of the United States are not as bad as they seem. The last GATT negotiation, the other countries of the world agreed to a section 22 waiver so that our country, under the GATT agreement, if it is adopted, will still be allowed to apply section 22.

The same way with export subsidies. We will have the right to apply export subsidies in a reasonable manner. We cannot go out and use export subsidies to get a larger share of the world market than we would be normally entitled to. I think that the American agricultural performance during the last war when we supplied a large part of the world with food supplies entitles us to a certain proportion of the world market on that basis.

The National Grange feels that export subsidies are entirely justified. It does not like them too well. We have developed what we call the domestic parity plan. Under this program we do what Dr. Johnson mentioned, keep the price on wheat at the open market level, and it is available for purchase abroad at this free price. By so doing we do not attract imports and at the same time we do not lose our export market by our own price-support program.

Now, this program, however, will be of benefit to wheat farmers because we still seek to give the farmers a parity price, or something like 90 percent of parity, on the part that is produced for the American food market. The way we seek to do that is to give the wheat farmer a certificate which entitles him to a payment of the difference between the market price and the support price. That certificate would be financed by requiring the domestic processors of wheat for food to buy the certificates.

Going into a number of our other points, the National Grange has worked very hard to help expand the agricultural export market. We worked to develop the Foreign Agricultural Service of the country. We brought it back under the Department of Agriculture where we feel it will be in closer touch with our agricultural problems, and also these people will be better able to explain our agricultural problem to our friends abroad, and I think that a lot of this difficulty that arises is due to the lack of proper explanation of our agricultural problems in this country.

Surplus disposal has been quite well covered. While there are criticisms from abroad that our surplus disposal constitutes dumping that tends to depress the world prices, I feel that if it is done in the proper way so as to create jobs or create economic development in these other countries, it need not depress prices but possibly will create the basis for expanded world prosperity.

In the technical assistance program, the Grange feels that it is a good program, and that we should continue it, but the emphasis should not be entirely on agricultural development. We feel there should be balanced agricultural development in these other countries. It does not make good sense to put all our effort in increasing agricultural production to such extent that the people who might be displaced from agriculture in these foreign lands do not have a job in industry to take, so there is not a market for the agricultural production that comes forth from the technical assistance program.

We feel we can use our surplus agricultural commodities for foreign economic aid in building roads, ditches, irrigation ditches, factories, and I didn't mention education but we would certainly endorse that also.

Mr. BOLLING. Dr. Halvorson, I think you have used about 12 minutes, if that covers the main points.

(The complete statement of Dr. Halvorson is as follows:)

STATEMENT OF THE NATIONAL GRANGE, PRESENTED BY LLOYD C. HALVORSON, ECONOMIST, REGARDING FOREIGN ECONOMIC POLICY AS IT RELATES TO AGRICULTURE

INTRODUCTION

The main concern of the National Grange in foreign policy is preservation of world peace. We believe firmly that the prospect of peace is most likely to be improved in direct proportion to the degree or vigor of our modifying or lessening many restrictions on trade and commerce, as well as those on interchange or exchange of ideas and of people themselves. We further believe that these objectives will be more readily attainable as the liberties and opportunities of individuals everywhere to produce and sell or exchange that which they themselves deem—in the light of their own resources available, and their own estimate of their own skills—they can do most efficiently or to their own best advantage. With modern weapons of destruction war today would mean decimation of the human race.

I am quite confident that most everyone would be willing to make economic sacrifices in order to preserve peace. The foreign economic aid that our American people have made available to other countries of the world is a form of economic sacrifice, but it has been very worthwhile to the extent that we have prevented starvation and hunger abroad, and also to the extent that we have helped create a prosperous world. The goodwill that we have gained by our foreign economic aid will be of great benefit to us in proving to the world that we not only have a very good economic system, but also that the American people seek to help rather than to exploit the other peoples of the world.

We do not consider that all of our foreign economic policy involves sacrifice on the part of the American people. Increase in world trade along lines of natural advantage and skills of the people, together with more specialization in production, and the making available of a greater variety of goods for consumers will tend to raise the standard of living not only of the American people, but of all peoples of the world.

Foreign economic policy of our Government will play a large part in the effort to preserve freedom and security in the world. Many of the small countries of the world should specialize their production, in order to have a satisfactory standard of living. This makes it necessary for them to integrate their economies with the economies of other countries of the world, especially the larger ones. A country that is economically oriented toward another one is quite certain to be sooner or later politically oriented toward it also. I believe we have already quite well demonstrated to the countries of the world that it is safe and desirable for them to orient themselves economically and politically toward the United States. We must be careful that our foreign economic policy in the future does not create a setback in this regard.

Because of the everwidening nature of the raw materials which are required to produce the consumer and capital goods of the United States, it is extremely essential that we maintain a world in which we have access to raw materials in all parts of the world. Without such access our economy would be gravely impaired, because we would be forced to sacrifice economy and efficiency in return for security in many ways.

Another important aspect to foreign economic policy is the preservation and expansion of markets for the products of American agriculture and American industry. Even though wages and incomes of the American people are many times higher than abroad, the products of many of our industries are greatly sought after by peoples in other parts of the globe. There is no magic in tariffs and other trade gimmicks. Our high standard of living is simply due to the fact that we have a high output per man and a large national output. This is not to say that there are no sound reasons for having tariffs and other trade restrictions. We must be careful, however, not to place tariffs and other trade restrictions in the way of expanded world trade, if there are no sound reasons for them. Historically there has been no field of economic reasoning that has as many economic fallacies to confuse it as the matter of world trade.

THE FARM PROBLEM AND FOREIGN ECONOMIC POLICY

Progress has many differential effects on the various enterprises and industries of the Nation. Some enterprises greatly benefit by progress, and some are hurt. Reduction of trade barriers also has this differential effect. This problem of depressed industries is one that cannot be ignored if we wish to accommodate progress or a liberalized trade policy.

Agriculture is an industry which has had very rapid technological progress, so that output per man and total supply have greatly increased. Agriculture has more than kept up with the rest of the economy in this respect. On the other hand, however demand for farm products does not increase very fast because of the limited capacity of the human stomach. These two factors indicate the need for tremendous resource adjustment in agriculture to accommodate the differential effects of progress. Unfortunately, agriculture is an industry that finds it very difficult to make rapid adjustment. The result is that farm prices are now far below parity.

The depressed situation of agriculture relative to the rest of the economy is an old one. Since 1929 we have seen a number of farm programs set up to try to bring farm income and farm prices up to a level closer to parity with the other segments of our economy.

It would be unfortunate if we would have to sacrifice our agricultural programs for the sake of consistency with our foreign economic policy. On the other hand, it would be also unfortunate to be inconsistent in our foreign economic policy because of our domestic agricultural policy. These are problems to which the Grange has given serious consideration for a number of years. We believe that we have a number of ideas and suggestions which will increase the harmony between our agricultural policy and our foreign economic policy.

We must also point out that the economic policies of the countries abroad have a terrific impact upon our own American agriculture. Our foreign policy must be concerned not only with reconciling our foreign economic policy with our domestic agriculture policy, but it must also be concerned with getting foreign countries to adopt agricultural policies consistent with sound domestic and international trade policies. We are confident that if our Government could succeed in getting other nations to abandon unsound, nationalistic agricultural policies, our own agricultural problem would be quite near solution and the problem of making our domestic agricultural policy consistent with our foreign economic policy would diminish to zero.

In view of this, it is always well to remember that making our agricultural policies consistent with our foreign economic policies is not only a job for our agricultural leaders and statesmen, but also a job for those who determine and administer our foreign economic policy. To the extent that they succeed in making a more rational economic world, our agricultural problems will have greatly diminished.

The reason that our American agriculture has some problems with imports is not, we believe, due to the fact that our American farmers do not have a comparative advantage over producers in other parts of the world. It is evident that our American farmers have a very large output per man, when they can produce more than enough to supply our Nation's food and fiber requirements, even though they constitute only about 10 percent of our Nation's manpower. Our agricultural problems arises from our overproductivity, not our underproductivity. There are, undoubtedly, other parts of the world where agricultural efficiency approaches ours. However, those other countries of the world, which do not have a comparative advantage in agricultural production would produce in lines of their greatest afficiency, it is quite likely that all of the food and fiber exporting nations of the world would not be suffering their present distress.

Looking at the problem of reconciling our agricultural policy with the foreign economic policy from the national viewpoint alone, rather than from the world view point, it comes down to two major aspects. First of all, when we institute a domestic price-support program, it tends to attract imports from other parts of the world. Such imports would not be normal imports. It is our definite impression that other countries of the world are beginning to understand that it is entirely appropriate for our Government to prevent imports from coming here in excess, simply to take advantage of our price-support program. It is evident that our Government cannot provide agricultural price supports for all producers in the world. I believe that these foreign countries feel that we would be fair if we simply permitted them to continue exporting to us some normal amount, as judged by past periods.

The second major problem arising from our domestic agricultural program is that, as we raised the domestic price level of farm products above the world price level, we tend to become a residual supplier on the world market. This residual will probably shrink to the point that we will have lost our share of the world market entirely. Here also, there is indication that the other countries of the world recognize our right to continue to supply our normal and historical part of the world market, even if subsidies should be involved.

In a letter from the Foreign Agricultural Service, dated May 2, 1955, there is the following statement: "At the ninth session the United States obtained from the other contracting parties a waiver of its obligations under the GATT to the extent necessary to prevent a conflict between that agreement and any actions heretofore or hereafter required to be taken under section 22."

And, also: "GATT contains no provision which prohibits the adoption of a two-price program as such. Further, as you indicated, the price-support program which is restricted to the amount produced for domestic food consumption and which is not designed to afford any incentive to exports may not be considered as export subsidy. In any event, neither the present rules nor the proposed revision prohibit the use of export subsidies on either wheat or wheat flour. The new rules do provide, however, that a subsidy shall not be applied in a manner which will acquire for the subsidizing country more than an equitable share of the world export trade in the product. This provision recognizes, as urged by you, the right of the United States to hold on to our regular and normal share of the world market even though our domestic farm policy may at times result in pricing our commodities out of the world markets."

Some people see in the section 22 waiver and in the export subsidy provision a threat to our agricultural export interests. We believe that the section 22 waiver will not interfere with our agricultural exports, and that the permission for an export subsidy is quite essential to the maintenance of normal exports when we have a price-support program on export crops. The extent to which other countries of the world are willing to depend upon food imports rather than domestic production will be determined by basic factors such as the fear of war on the one hand, and on the other the extent to which they can feel assured of adequate food supplies at reasonable prices from abroad, as from us.

The National Grange recognizes that the reciprocal trade agreements program, if it is to be of any consequence, will mean increased imports into this country. To the extent possible we hope that imports which come in will be complementary to our own domestic production. But we recognize also that in some cases imports will have to come in which are competitive with our own agricultural products. To the extent that our agricultural policy succeeds in bringing about sound adjustment in resource use, it will be much easier for us to accommodate competitive imports. We certainly should not encourage the increase in the production of agricultural products which can be supplied to us reliably from abroad at a lower price. We must, however, take into account the importance of some of our agricultural enterprises to national defense.

IMPORTANCE OF EXPORTS TO FARMERS

One of the causes of the agricultural depression of the 1920's was the decline of the export market after World War I. During the 1930's our exports fell even further and the agricultural problem was intensified. Unfortunately, our agricultural programs during the 1930's themselves contributed to the decline of our exports by raising our domestic price of the export crops above the competitive world price.

World War II again greatly increased the demand for our agricultural products abroad. The Secretary of Agriculture instituted a slogan "Food Will Will the War and Write the Peace." Certainly, without food from the United States there would have been a great deal more suffering on the part of our allies abroad, and neither Great Britain, nor Russia, could have been effective. After the war, also, it is evident, too, that our food supplies played a large role in preserving freedom in the world and in restoring industrial and agricultural production.

We believe that American farmers established some right to a portion of the world market based on this wartime and postwar performance. Surely the American farmers should have the right to produce for the world market at the world price, if they so desire. This right is being denied them to a considerable degree by our present farm program. Export markets are very valuable to the producers of wheat, cotton, tobacco, soybeans, rice, and many other products.

Even if we did not have an agricultural program, a loss of foreign markets for these commodities would result in diversion of acreage to other crops, which would then depress practically all of the agricultural enterprises. With our present agricultural program the loss of foreign markets for our export crops has also resulted in diversion to other farm crops, causing the agricultural prices today to be quite depressed all the way across the board, with only a few exceptions.

It is clear that if we can devise some kind of a program to help our export crops we will be helping not only the export crops, but all of American agriculture.

A DOMESTIC PARITY PLAN

The National Grange favors a domestic parity program for wheat, which we believe is consistent with our foreign economic policy and which will still raise the income of our wheat producers. It will have a good, rather than bad, effect on the producers of other agricultural commodities.

Under this plan farmers would produce wheat without any controls over production or marketing. All the wheat would be sold on the market, and normal market forces would determine the differentials for the various classes and grades of wheat. Wheat would be free to move into the world market at competitive world prices. There would be no subsidy to stimulate wheat exports. Those farmers who could not make a profit producing wheat for the world market at world prices, would undoubtedly quit producing for the world market.

The domestic parity plan for wheat does, however, have a feature which will increase the income of our wheat producers. Each wheat producer would be given certificates in line with his proportionate share of the domestic wheat market used for human consumption. The proportionate share for each wheat producer would be determined by his recent wheat production in relationship to the total quantity of wheat that is estimated to be used for human consumption. The millers, who buy wheat to make foodstuffs out of it, would have to buy the counterpart of the farmers' certificate. The value of the certificate to the farmer and the cost to the wheat miller would be equal to the difference between the estimated market price of wheat for the ensuing marketing year and the support level which may be 90 or 100 percent of parity. The American wheat farmers who are efficient will undoubtedly choose to produce some wheat in addition to that covered by certificates for sale on the world market at world prices or for livestock feed. The number of certificates which a farmer receives will not be the same from year to year. His number of certificates will vary, depending upon how much wheat he produces for feed or for the world market. The more efficient wheat producers who choose to grow wheat for feed and export would gradually get more certificates, while wheat producers in the areas that cannot produce the wheat for feed or export would get a declining number of certificates.

The wheat certificate which the farmer receives is, in a sense, a differential parity payment, which does not interfere whatsoever with the normal marketing of wheat. It need not necessarily, and probably would not, raise the total cost of the wheat purchased by the millers above what they are now paying, but it would certainly give the American farmers an opportunity to produce for the world market at world prices, if the price were still attractive to them, and it undoubtedly would be to a number of them.

We believe that the domestic parity plant could also be applied to other export crops, and especially rice. There is also some possibility that it would work for cotton if further study were given to adapting it to cotton. It should be noted that this domestic parity plan is consistent with our foreign economic policy and that it does not raise the domestic market price of wheat so high as to attract imports from abroad, and at the same time it does not involve export subsidies in order that our American producers can maintain their normal and fair share of the world market.

I wish to point out here that the domestic parity plan for wheat passed the House in 1954, but that there has been practically no action on it in the Senate. The domestic parity plan for wheat has wide support among wheatgrowers. We are very hopeful that during the coming session of Congress it will be enacted into law.

EXPANDING AGRICULTURAL EXPORTS

Without question the foreign economic policy of this country was responsible for a large proportion of our agricultural exports during and after World War II. When agricultural exports began falling off in 1952 it became a serious matter for farmers, which needed immediate attention. The National Grange, along with the other farm organizations, sought to expand and strengthen the Foreign Agricultural Service. Not only was the Foreign Agricultural Service transferred back to the United States Department of Agriculture, but it was also provided with more funds. We feel that bringing the agricultural attachés back under the Department of Agriculture will keep them in closer touch with the problems of American agriculture. There has been a rather widespread feeling in rural America that the State Department has not been able to explain our agricultural problems to other nations properly and to the full extent it should have. Basically we feel that American agriculture would gain greatly if our foreign economic policy succeeded in discouraging uneconomic agricultural production abroad, and in relaxing import restrictions against our farm commodities.

The Foreign Agricultural Service can do a great deal to get foreign countries to reduce their barriers against our products, and also, possibly, to help develop markets for our commercial traders. We believe that the American processing industries should be encouraged to develop foreign markets for their finished products. Because finished food products are more apt to have unique qualities than the raw food materials, a market for them is likely to be more permanent than markets for the raw agricultural products.

TRADE WITH RUSSIA

The National Grange recognizes the importance of restricting the flow of strategic war materials to Russia. We believe, however, that the flow of our surplus foodstuffs to Russia may promote the cause of peace. We should probably give favorable consideration to selling of our surplus farm products to Russia and her satellites at competitive world prices.

We may also be able to obtain in exchange from Russia valuable raw material which we need.

SURPLUS DISPOSAL

At the present time the Commodity Credit Corporation has an investment of around $7 billion in agricultural products. This stockpile is likely to grow in the year ahead. It is evident that something has to be done about this tremendous stockpile. The American market is quite well saturated with food and fiber and it is unlikely that we can increase our domestic consumption of them substantially very soon. Because there is hunger in the world and because many countries of the world do not have as much food and fiber as they could well use, it is logical that we try to find some method whereby we can make these goods available to these peoples abroad at as profitable an exchange as possible.

The National Grange does not want to see our surplus agricultural products dumped upon the world market, thereby creating chaos in the agricultural economies of other countries. We believe, however, that there may be a way of orderly liquidation of these stocks abroad without upsetting markets. Also, as indicated above we do have a right to maintain our normal, fair, historical share of the world market for the various commodities, even if we have a domestic price-support program, which makes it necessary to use export subsidies. It should be recognized that the sale of our surplus products abroad need not necessarily depress markets. If hungry peoples are able to produce something which we are willing to take in exchange, then trade creates its own purchasing power, which does not depress markets, but only results in higher living standards. It is unlikely that there is too much food in the world today, but our foreign economic policy does need to create the devices for expanding profitable trade which creates jobs and purchasing power in other parts of the world.

Surplus food is capital, and it is possible to convert this surplus of consumer capital into producers capital by utilizing human labor. To the extent that we succeed in doing this, we not only find markets, we not only help people to live better in other parts of the world, but we also create the basis for progress in the foreign countries. We believe it is entirely appropriate to dispose of our food abroad, wherever it is possible to put people to work, to create not only current purchasing power, but the basis for future economic progress. It would be just another form of American investment capital going abroad, which is to be encouraged. The National Grange supported Public Law 480 originally and also last year when the authorization was increased. We believe that Public Law 480 is not only consistent with our foreign economic policy, but also that it is one of our best foreign economic programs. We recognize that there are many misapprehensions abroad about our large surpluses and Public Law 480, but it is our opinion that our State Department and our Foreign Agricultural Service should be able to explain that our surplus farm products are an asset to the world and not a liability. This is especially so if we dispose of them under soundly conceived programs for foreign relief and economic development.

The present disposal program should be expanded in every way possible, short of dumping, and we should use our present supplies to an even greater extent in the implementation of United States foreign policy and the strenghtening of the free world. The services of religious and charitable organizations should be enlisted to an even greater extent in sharing more of our war-born abundance with needy men, women, and children of less favorite nations. Increased distribution under these auspices could bring priceless returns to the United States in the entire free world. During the last war we used up many of our natural resources. We think that it is very sound policy to trade our surplus agricultural products for strategic raw materials such as ores of the various metals, or even the refined metals. This will not only contribute to our national security, but will also insure us of reasonable prices into the future, even if the world reserves should become leaner.

Our present surplus agricultural products should also be viewed in the light of strategic reserves of storable farm products for the benefit of the entire free world in this period of international tension. The National Grange is definitely interested in, and will give serious consideration to plans for international commodity reserves.

RECIPROCAL TRADE AGREEMENTS

The National Grange supported the recent bill extending the reciprocal trade agreements program for 3 years. We believe in a program of gradualism in tariff reduction. We believe there will be a continuing need for the reciprocal trade agreements program because we still have some tariffs that are rather high, and there are still further benefits to be gained for our economy and for the entire world from further tariff reduction.

We believe in multilateral tariff reductions, such as is embodied in the General Agreement on Tariffs and Trade. We recognize there is need for some kind of an international organization to administer the multilateral trade agreements, but it should not have supranational powers. It should recognize that a country may enter into an agreement in good faith but find it necessary to make modifications because of unexpected severe repercussions to the home industry. Such modification should not bring about punitive retaliation, but only compensatory action.

The National Grange supports continuation of the escape clause, because this is needed as well as the section 22 to prevent the impact of tariff reduction from being greater than what resource adjustment can accommodate.

TECHNICAL ASSISTANCE

The National Grange supports both bilateral and multilateral technical assistance. We believe that the Congress should decide the allocation of our technical assistance money among the various specialized agencies of the U. N. rather than the U. N. itself.

In the past there seems to have been an undue emphasis on increasing agricultural production in the less developed countries of the world. This may have been well justified when there was an actual food shortage in the entire world. We are of the opinion that time has now come when we must emphasize balanced economic development in the backward countries. It is evident that it is not logical to teach other peoples of the world how to greatly increase agricultural production if there is no market for such agricultural output and if there are no jobs for those who might be displaced from agriculture. There needs to be such balanced economic development that people displaced in agriculture can find jobs in industry to produce something that will make possible worthwhile exchanges with the farmers.

FOREIGN ECONOMIC AID

Is it likely that we will continue to give foreign economic aid for some years yet. Here again, it should be recognized that surplus food is actually capital and that in many cases it is wiser to make this food available to people in foreign countries, and let them use their own people to create the necessary capital improvements. In many cases it might not be logical to send them our expensive machinery and other capital equipment, but it might be better to put the hungry people to work through the use of our surplus food supply and let them with their labor build roads, irrigation ditches, and factories. We recognize that in many cases unskilled foreign labor cannot be used to create the capital goods needed, but it should be wherever it could.

FOREIGN INVESTMENTS

The National Grange has been a strong supporter of the idea of promoting American investment abroad. We believe that the proposed tax credit on earnings abroad should be given serious consideration in this regard. We think that the international lending organizations can play a vital role and we look with favor on the proposed International Finance Corporation.

To the extent that backward countries of the world can be developed by loans and direct investment, there will be less need for these backward countries to drain off their own agricultural products, in order to sell them upon the world market to get the necessary dollars and other foreign currencies, required to buy the necessary capital goods they seek. These foreign investments aboard also will tend to bring about sounder balance in the economies of the underdeveloped countries.

INTERNATIONAL COMMODITY STABILIZATION

No country by unilateral action can stabilize world prices on farm products and other raw materials. Self-centered unilateral action by the different countries of the world might lead to price wars and chaotic conditions. It is quite likely that to achieve international commodity stabilization, we must in our foreign economic policy cooperate with other nations in studies and programs toward this end.

COMMODITY AGREEMENTS

The National Grange has favored the International Wheat Agreement. This agreement has enabled us to maintain a fair share of the world wheat market, even with subsidy without being accused of violating our foreign commitments or being inconsistent with the rest of our foreign economic policy. World wheat prices would probably be much lower today, had it not been for the international understanding fostered by the wheat agreement.

Commodity agreements may also, in the long run, tend to discourage a nationalistic agricultural policy in the consuming nations of the world. If they are assured of adequate supplies at reasonable prices they are more apt to rely upon foreign supplies. We recognize that commodity agreements are not the ideal situation for the world market, but they are an improvement over chaotic conditions. Soundly conceived commodity agreements can leave a large area for free play of prices. Once we get agricultural production adjusted to the efficient areas of the world, and once the ideal resource adjustment is attained within the respective countries, then there will be little need for commodity agreements, but while basic resource adjustment programs are going on, commodity agreements may be very necessary and desirable.

CONVERTIBILITY OF CURRENCY

The dollar scarcity of the world has definitely worked against American agriculture. Agricultural products are more homogeneous the world over than the specialized consumer- and producer-goods. For this reason, many of the countries of the world have sought to conserve dollars by buying their agricultural products in other parts of the world, with the idea of spending their scarce dollars for the unique American consumer- and producer-goods.

Because of the fact that the price levels in the various countries of the world today depend so much upon domestic monetary and fiscal policy, the price levels of the countries of the world today are quite independent of one another. There is no single force like gold to try to keep the various price levels in a rather uniform or fixed relationship to one another. Because of this, we believe that it is necessary that foreign exchange rates have sufficient flexibility to prevent trade distortion and perpetual dollar scarcity.

Some countries of the world use multiple exchange rates as a way of discouraging imports and subsidizing exports. This has often been detrimental to American agriculture, both in regard to unnatural imports into this country, and unnatural competition abroad. To the extent that our foreign economic policy succeeds in getting countries to adopt sound foreign exchange policies, it will help American agriculture.

CUSTOMS SIMPLIFICATION

The National Grange favors customs simplification. The matter of tariff classification should also be simplified and made more definite. It is essential that we make it easier for nations to sell to us, so they can earn dollars, if we expect them to be able to buy from us with dollars.

TRADE FAIRS

There has been some special money appropriated by the Congress for international trade fairs. We believe that these fairs will be helpful to American agriculture. It would be especially helpful if the many consumer food items in this country were made available on the shelves of the grocery stores in the foreign countries. Many of our American food products are the world's best in quality, and they have unique qualities, which, when made available, would expand our market for food products.

APPENDIX TO STATEMENT OF THE NATIONAL GRANGE, PRESENTED BY LLOYD C. HALVORSON

(Taken from summary of legislative policies and programs of the National Grange for 1955)

FOREIGN TRADE

The expansion of world trade on mutually benefiting basis is essential to producers of export crops and other farm commodities, in fact to the economy of the Nation and the peoples of the world who seek to enlarge the areas of freedom and maintain peace.

Many commodities, particularly those which require a great deal of hand labor and agricultural products which require a tropical climate, can be produced more advantageously in various other countries than they can be produced in the United States. In international trade, goods are paid for quite largely with other goods. If a nation does not buy, it cannot sell. In order to develop a market for those products which we can produce efficiently, we should encourage international trade.

Mutually beneficial trade can be expanded and maintained by removing trade barriers including currency restrictions; improving convertibility of currencies; improving quality standards and grades; achieving competitive prices; developing adequate public and private credit facilities; providing foreign relief; helping foreign customers increase their purchasing power; aiding mutual defense in behalf of greater world security; implementing the Foreign Trade Development and Assistance Act to utilize our surpluses in expanding foreign markets; and making a more effective use of our agricultural attachés overseas.

It is the policy of the National Grange to:

1. Continue to work for a progressive and gradual reduction of international trade restrictions and the simplification of customs procedures so that trade and commerce can be established and maintained on a sound economic basis.
2. Explore the possible use of a world food reserve supported by some international finance agency such as the International Bank for Reconstruction and Development into which surplus supplies can be placed and from which they can be withdrawn.
3. Support the multilateral technical assistance program but oppose all efforts to centralize control in the United Nations over (1) the work of the FAO and other specialized agencies, and (2) the funds for carrying out technical assistance.
4. Support the principles of the Trade Agreements Act and the statutory escape-clause procedure, together with other acts (secs. 22 and 32) for the protection of domestic agriculture and the extension of the Trade Agreements Act for a period of 3 years.
5. Continue to support the IFAP and otherwise seek to strengthen the role of farmers in developing policies for the welfare of the agricultural producers of the world.
6. Favor the use of international commodity agreements when practical in expanding trade on a mutually beneficial basis.
7. Favor a reexamination of the Buy America Act, in order to harmonize it with the general trade policies of the Nation.
8. Favor the use of a two-price plan when approved by producers of any export farm commodity, safeguarded to prevent dumping as one way of expanding world trade.
9. Explore the possible development of some tariff drawback plan.
10. Endorse the multilateral negotiation principle in expanding trade, and support provisions which will permit the use of bilateral agreements when they are found to be desirable.
11. Request Congress to reexamine the Tariff Act and modernize its provisions in line with current conditions and needs.
12. Urge that greater consideration be given agriculture by Government agencies dealing with trade matters in negotiations so as to assure farmers of fair and equitable treatment in all trade programs.
13. Support policies designed to encourage, stimulate, and further the use of private trade channels in expanding and developing foreign trade in agricultural commodities, including the development of measures to provide adequate information and other similar export services.
14. Support policies to expand foreign trade through the use of surplus agricultural commodities to acquire increased amounts of strategic materials essential to our national security. The materials purchased should be set aside and stockpiled and be made available for use only in the case of national emergency or for purposes of rotation to prevent deteriorations.

INTERNATIONAL AGREEMENT AND COOPERATION

We must make clear that any international agreement, which does not make provision for the fundamental right of a given people to afford needed economic protection in the domestic market, and at the same time permit the products of that country to be actually competitive pricewise in the world markets would be interpreted by us to be an invasion of the prerogative that is ours in our own domestic affairs.

It is proper, however, for international agreements and organizations to hold that a domestic program must not be the means for unlimited invasion of other markets.

While we strongly endorse the multilateral negotiation principle, we believe that such international agreements as the prospective new General Agreement on Tariffs and Trade should make provision for the possible utilization of certain trade expansion devices—on a strictly bilateral basis. It may be necessary to agree that bilateral concessions can only be made for short periods but at the same time these bilateral concessions in themselves may very well prove to be the only mechanism by which the multilateral concessions of similar character can ever be evolved.

DISPOSAL OF SURPLUSES

The National Grange feels that every effort should be made to move surplus stocks of food to people in dire need through no fault of their own, both in this country and abroad, when this can be accomplished without serious disruption of markets or trade relations.

Mr. Bolling. We will move on to the next witness, Mr. Matt Triggs, assistant legislative director, American Farm Bureau Federation. I understand he is accompanied by Mr. George Dietz of the Farm Bureau.

STATEMENT OF MATT TRIGGS, ASSISTANT LEGISLATIVE DIRECTOR, AMERICAN FARM BUREAU FEDERATION, ACCOMPANIED BY GEORGE DIETZ, DIRECTOR, INTERNATIONAL AFFAIRS DEPARTMENT

Mr. Triggs. Yes, sir; Mr. Dietz is director of our International Affairs Department. He has been with us just 2 weeks but he has had extensive experience as an agricultural attaché and may wish to participate in any roundtable discussion that may ensue.

The statement which we have filed with the committee sets forth our conviction that the maintenance of a high level of agricultural exports and of international trade is one of the important factors contributing to the level of farm incomes; and pursuant to this conviction, Farm Bureau has supported the extension of the reciprocal trade agreements legislation in such form as to make it workable and effective, has supported the enactment of Public Law 480, providing for an exchange of our surpluses for foreign currencies, and the use of such foreign currencies in the development of trade in industry and other purposes by other countries, and other measures designed to maintain international trade at a high level.

As other participants have observed, the question of farm exports is so related to the character of our farm price support program that you can hardly deal with our export situation without some reference to the farm price support picture. It is our belief that our national farm price support policy has interfered in a major way with the maintenance of export of farm products at a high level—at the level that might otherwise have been maintained.

In the case of cotton, for example, our price-support policy has held an umbrella over producers in other countries. It has stimulated production of cotton in other countries, far above the level that would otherwise pertain. While the United States producers have been called upon to make sharp cuts and reductions in acreage of cotton in this country, other countries have substantially increased their acreage of cotton.

Foreign acreage of cotton has increased 21 million acres above the average level in 1945–49. This is more than the total United States cotton allotment.

The national price policy in this country has prevented United States cotton (continuing with this example) from competing in world markets. We have priced ourselves out of the market at times. The gap has been filled by increased marketing by producers located in other countries. The United States is producing today a declining percentage of the world production of cotton. The United States entry into world commerce of cotton is declining precipitously, as compared with the total entry of cotton into world trade.

We have become the residual supplier, able to move at most only somewhere in the neighborhood of three and a half million bales a year, after other countries have disposed of their current production and supplies.

Now, what has happened in the case of cotton competition in other countries has also happened with respect to synthetic-fiber production. We have literally held an umbrella over synthetic-fiber production in other countries. Our price policy has encouraged investment in the rayon industry of other countries, in the growth and development of this industry, in the very markets in which we would hope we could sell our cotton.

Now, to the extent that our price policy has priced us out of foreign markets this has adversely affected farmer incomes for at least two major reasons. The first is that cotton producers of this country have been denied the opportunity to produce and to sell to markets to which they might have sold cotton. And, second, the acreage diverted from cotton which might have been used for cotton does not remain idle but has gone into the production of all other commodities, and has, in many instances, resulted in overproduction of such other commodities, with adverse consequences on the price and incomes of producers of those other commodities. This is where we are today. The consequences of unwise national policy are coming home to roost.

Under the current circumstances, as other participants have indicated, it just looks like an easy answer to our problems that we simply dispose of our surpluses by subsidizing exports in one way or another, and I certainly wouldn't argue that there are no possibilities in this policy, but we do not believe that our problem in the long run can be solved by dumping our surpluses indiscriminately in other people's markets. It is not a wise course for a nation to pursue which desires to build international good will. It is not a judicial policy for an agriculture to pursue, which is as dependent upon foreign markets as is United States agriculture.

On the other hand, we have to deal with the situation that we find ourselves in today. We must recognize the current picture, and we believe that where, because of unwise price policy, United States farm exports are losing markets, losing their normal position in world trade, that action is necessary to prevent our losing our normal trade position.

In the words of our annual meeting resolution on this subject:

> The Federal Government should not stand idly by and watch foreign outlets shrink when supplies are available in the United States. It requires much less effort to maintain an existing market than to regain one that has been lost. Accordingly, whenever supplies threaten to become excessive, action should be taken in a timely manner to permit United States farm products to maintain a fair and stable competitive position in world markets. This should include the use of CCC or other funds.

Now, we don't conceive of this as representing any permanent or continuing answer to the farm problem, which we are convinced in the long run must include competitive pricing on a commercial basis in world markets, but under current circumstances, where our national price policy is pricing us out of foreign markets, and even more important, artificially encouraging the growth and development of competition and substitution in other countries, we feel that we cannot afford to see our markets lost by default.

You might say that this represents our recommendation for reconciling, at least for the time being on a temporary basis, the conflict or the dilemma involved between the need of farmers and the agricultural community to maintain export markets on the one hand, and our national farm price policy on the the other. We don't particularly like the force of circumstances that compels us to reach the conclusion, but we think it is the only thing that can be done under the current situation.

Thank you.

Mr. BOLLING. Thank you, Mr. Triggs.

(Mr. Triggs' prepared statement follows:)

STATEMENT OF AMERICAN FARM BUREAU FEDERATION

On behalf of the American Farm Bureau Federation I wish to express our appreciation for having this opportunity to briefly present some of our views with regard to the subject of this hearing the needs of agriculture and trade. This is a very broad subject and we'll only attempt to deal with a few of the more important aspects. Quoted below is a brief portion of our 1955 resolutions dealing with this matter.

"The prosperity of American agriculture is greatly dependent upon the maintenance of a high level of United States agricultural exports. Loss of export markets has resulted in increasing agricultural surpluses and has contributed to declines in farm income. A large portion of the acres diverted from basic commodities has been made necessary by our loss of export markets.

"To expand export markets for farm products we must be prepared to deliver quality products, competitively priced and vigorously merchandised in markets where customers have the ability and continuous opportunity to earn dollars to pay for these products."

The key words in this policy statement are "quality products, competitively priced and vigorously merchandised." Farm Bureau recognizes the necessity of trade in agricultural commodities. We have an overexpanded agricultural products plant. Our production, even with strict acreage allotment and marketing quota programs, exceeds effective demand.

In 1950–51, agricultural exports amounted to some $4.2 billion. We recognized at that time that this was somewhat of a superficial figure in that a great deal of foreign-aid money was being used to make it possible for foreign customers to buy our products. If agriculture is to be prosperous, and if farmers are to get the highest possible net income—which I am sure we are all agreed is our goal—we must export roughly 4 bales out of each 10 bales of cotton we produce, 4 bales out of each 10 of tobacco we produce, and 4 bushels out of each 10 of wheat we produce.

During the last few years, we have seen our volume of exports decline. During the current year, with all of the programs that have yet been devised, we will export about $3 billion worth of agricultural commodities. We recognize full well that some of this trade is not on a sound basis. Therefore, it is a real challenge to a farm organization such as ours, and I hope it is a challenge to the Members of Congress and similar agencies of Government to try to discover ways and means by which we can increase our export of agricultural commodities on a sound basis. At the highest rate of our agricultural exports, as referred to above, the value of the products amounted to about $1,000 per commercial farm in the United States. At the current rate it is about $700 per commercial farm. But this is not the whole story. If we fail to maintain our export markets, we accumulate burdensome price-depressing surpluses and are forced, under the domestic agricultural programs that have been in operation for a great number of years, to reduce our acreage by strict controls.

Farmers know what makes net income. It is just as true in the operation of a grocery store, a filling station, or a hotel. It is volume sold times price minus expenses equals net income. The gross income in agriculture in 1954 was just slightly below the all-time high reached in 1947. But the net income in agriculture was at the lowest point during the last 10 years. We often hear reference made to the cost-price squeeze in agriculture. Most farmers throughout the United States are feeling this squeeze at the present time. As indicated by the gross-income figures, farmers are still handling a great deal of money, but they have too little left after they pay their expenses.

The American Farm Bureau has taken the lead in developing and supporting major national policies designed to increase foreign trade. For example, we (1) supported the extension of the Reciprocal Trade Agreements Act; (2) recommended the creation of the commission to study United States foreign economic policy (Randall Commission); (3) vigorously supported the International Finance Corporation to stimulate foreign investments abroad; (4) supported customs simplification; (5) supported the repeal of the cargo-preference clause, better known as the 50–50 shipping clause; (6) supported the transfer of the agricultural attachés from the Department of State to the Department of Agriculture and supported increased appropriations for the Foreign Agricultural Service; (7) sponsored the Agricultural Trade Development Act, Public Law 480, which provides for sales of surplus United States farm commodities for foreign currencies. We have instigated and supported many other legislative and administrative actions designed to stimulate trade and increase our ability to sell agricultural commodities in foreign markets. We recognize that some of these may give some temporary relief, but we're interested in programs designed to strengthen our trade relations and increase our ability over a long period to market our commodities. To further emphasize our position with regard to expansion of trade, I would like to quote again from our 1955 resolutions:

"Foreign customers must have the ability and continuous opportunity to earn dollars to buy United States agricultural and industrial products. Most developed countries have the ability, or could themselves develop the ability, to pay for increasing imports. Some underdeveloped countries need capital and technical assistance to expand their ability to buy increased imports. The United States should exert leadership to enlist the cooperation of other nations in providing credit and technical assistance to accelerate the expansion of world trade.

"The United States Government should make clear that primarily reliance must be placed on private investment to assist economic development abroad. It should be made clear that United States resources for public loans are limited and inadequate in relation to total needs, and that public lending is a poor substitute for private investment.

"The United States Government can and should give full diplomatic support to the acceptance and understanding abroad of the principles underlying the creation of a climate conducive to private foreign investment.

"Consideration should be given to the corporate tax rate on income from investments abroad and comparable treatment to individuals who invest abroad."

We were somewhat disappointed in the Trade Agreements Act as extended by the first session of the 84th Congress. This is the most restrictive Trade Agreements Act that we have had since the inception of the idea in the early 1930's. With a limitation of 5 percent a year reduction in tariff, it gives us very little negotiating power in reducing some of the duties that are far in excess of any justifiable figure. We supported the extension of the Reciprocal Trade Agreements Act for a period of 4 years with special emphasis on exclusive industrial tariffs and items with duties in excess of 25 percent ad valorem, in return for concessions from other countries with respect to tariffs, import quotas, exchange controls and other trade barriers. We think one of the keys in our trade policy is to offer more stability in tariff rates to more customers for reasonable periods in return for comparable reciprocal benefits.

We know that this problem goes far beyond tariff rates and schedules. We recognize, for example, that in many Western European countries they have embargoes on the importation of agricultural commodities. They have other regulations which are just as effective as quotas with regard to licensing and exchange control. We believe and we have so recommended to the administrative agencies of government that we should take a tougher attitude with regard to our own negotiations with other countries under the Reciprocal Trade Agreements Act.

If we are successful in attacking this problem along the fronts outlined above, we will have some success, provided we are able to meet the competition of other agricultural producers throughout the world. We should recognize that we in America must change some of our policies and programs if we are to compete in the markets throughout the world.

There is little doubt that we have held "an umbrella" over foreign producers. In the case of cotton, for example, our pricing policies here in the United States have provided incentive for foreign producers, with the encouragement of their governments to increase their production of this commodity. We have reduced our acreage of cotton by some 8 million acres. During the same time foreign acreage of cotton has increased some 17 million acres. We are gradually losing United States export markets for cotton. The consumption of cotton in the United States and throughout the world is not keeping pace wih increased population because of the inroads being made by synthetics. We believe price is a factor which has contributed to both of these developments.

In the October report of the International Cotton Advisory Committee, which is a monthly review of the world cotton situation, this statement appears: "If present trends continue in two more seasons cotton production outside the United States may be sufficient to meet all consumer requirements outside the United States without any importation from that country." What they are simply saying is that under the present programs now in force in the United States, within a 2-year period we will have no export market for our cotton. We doubt if this will be true to the extent indicated in the statement quoted above; however, we have seen good evidence that the demand for United States cotton is decreasing quite rapidly and we could be faced with the situation where 8 million bales of cotton might be sufficient for both domestic and foreign demand. We must give consideration to reconciling our domestic agricultural policy with the realities of the foreign economic situation. The tremendous surpluses of farm products accumulated by Government (which are estimated to reach $10 billion by the spring of 1956), the declining net income in agriculture, the loss of a portion of our export outlets, compel re-examination of the relationship between agricultural commodities and our national price support programs. We do not believe national farm price policies involving rigid price supports maintained without regard to supply and demand conditions represents a forward looking policy in the interest of farm people.

We do not believe the problems of American agriculture can be solved by dumping our surpluses in foreign markets. This is not a wise course for a nation which desires to build international good will to pursue; nor a judicious policy for an agriculture which exports such a large percentage of its production, to support. On the other hand where, because of unwise price policy, United States farm exports are rapidly losing their position in world markets we believe that (in the words of our annual meeting resolution on this subject)—

"the Federal Government should not stand idly by and watch foreign outlets shrink when supplies are available in the United States. It requires much less effort to maintain an existing market, than to regain one that has been lost. Accordingly, whenever supplies threaten to become excessive, action should be taken in a timely manner to permit United States farm products to maintain a fair and stable competitive position in world markets. This should include the use of CCC or other funds, whichever is appropriate, to encourage the movement of commodities directly into world trade through private channels before they become the property of the Government."

We do not conceive of this as representing any permanent or continuing answer to the farm problem—which in the long run must include competitive pricing on a commercial basis in world markets. But under current circumstances where our price policy is "pricing us out" of foreign markets, we cannot afford to see such foreign markets lost by default.

Many thousands of meetings are now being conducted throughout the United States where farmers through their Farm Bureaus are discussing these issues. The recommendations made by the 2,700 county Farm Bureaus through the 48 State Farm Bureaus will be considered at our annual meeting from the 6th through the 14th of December. When the official elected voting delegates of the member State Farm Bureaus have debated, discussed, and finally formulated recommendations on these issues, we will welcome the opportunity of passing along such recommendations.

Mr. Bolling. Mr. James G. Patton, president of the National Farmers Union, sent his regrets and in the letter stating he was unable to be here he asks that his statement be included in the record, and without objection that will be done at this point.

(The statement of Mr. Patton is as follows:)

Agricultural Needs and Foreign Economic Policy

Statement of James G. Patton, president, National Farmers Union

Sliding scale economic policies as applied are endangering the peace and driving down farm family incomes. Unwarranted sliding scale cuts in United States economic assistance to other democratic nations have dangerously slowed down free world economic development and reduced United States farm exports. Domination of foreign and domestic economic policy by sliding-scale advocates is turning control of economic affairs over to domestic monoplies and international cartels. Domestic prices of farm-produced commodities have been driven down. Efforts to bring about establishment of negotiated agencies of economic development and trade expansion, with exception of the Reciprocal Trade Agreements Act and the International Wheat and Sugar Agreements, have been rebuffed by the administration. As a result poverty-stricken people outside the Iron Curtain have received less rather than more encouragement to promote democratic free enterprise. Less rather than more has been done to eliminate poverty as a fertile seedbed for expanding Soviet imperialism. Moreover, falling United States farm exports caused by sliding scale foreign economic policy have been coupled with sliding scale domestic farm income-protection policies to drive down farm family income in 1955 by more than one-fourth since 1952.

National Farmers Union urges the complete reversal of these defective sliding-scale policies in foreign and domestic economic policy. There was no good reason why this Nation needed to have the recession of 1954. There is no good reason why the farmers of this country should now be experiencing a continued fall in income and purchasing power. There is no good reason why bicycle and watch tariffs should have been raised. There is no good reason why the permanent peace of the world should be endangered by the continued refusal of the United States Government to participate fully in programs of cooperative international free world economic growth and price stabilization.

To reverse the current adverse trends in foreign economic policy, National Farmers Union proposes the following actions:

1. Participation of the United States in establishment of a Free World economic development agency of the type proposed as the United Nations special fund for economic development (SUNFED). What is needed is a vast expansion of the type of work done by the Export-Import Bank, World Bank, and the World Monetary Fund, with greater emphasis on economic growth and less upon short-term repayment ability.
2. United States appropriations of economic and technical assistance to other democratic nations and for cultural exchange, such as the Fulbright program, should be greatly expanded with as much as feasible of such aid extended through the instrumentalities of the United Nations and the specialized agencies such as Food and Agriculture Organization.
3. Expand the authorizations of the Reciprocal Trade Agreements Act and encourage the executive branch to use them more fully.
4. Enactment of customs simplification law.
5. Establishment of a trade adjustments aid program to alleviate hardship of United States workers, industries, farmers, and communities injured by tariff and import restriction reductions, including income-protection for family farm volume by means of production payments primarily, at 100 percent of parity for producers of farm commodities that compete with imports.
6. Renewal and improvement of International Wheat and Sugar Agreements and negotiation of other such agreements for all commodities that enter importantly into international trade.
7. Negotiation and establishment of an international food and raw materials reserve or world food bank.

We are convinced that if existing sliding scale foreign economic policy were reversed to move in the directions indicated this would in itself further the prospects of peace as well as increase the demand for United States farm products. We are convinced that such foreign economic policies are a basic part of an intelligent and desirable full parity family farm income protection program that should also include:

I. Fair trade for farmers
   - A. Enactment of mandatory farm income protection for family farm production of all commodities at 100 percent of a fair parity, using production payments in workable combinations with price-supporting purchase agreements, loans, and purchases.
   - B. Revitalize and expand Federal crop insurance program.

II. Expanding human use and demand for farm commodities
   - A. Expanding full employment economy.
   - B. National food allotment or stamp plan.
   - C. Expand school-lunch program to all schools.

D. Federal-financing of two half pints of milk per school child per day.
E. Credit program to encourage improvement of terminal markets for perishable farm commodities.
F. Better terminal market inspection of perishables.
G. Provide more nearly adequate nutrition standards for public institutions.

III. Keeping supply marketed in balance with augmented demand
A. Establish conservation acreage reserve.
B. Revise and extend marketing quotas.
C. Marketing agreements and orders.

IV. Establishment of a yardstick family farm loan agency

Full Parity Family Farm Income Protection Program—A United States Farm Food and Fiber Policy That Makes International Good Sense

(Statement of James G. Patton, president, National Farmers Union)

The existing sliding scale farm price support philosophy and law of the Federal Government seriously interferes with the conduct of an intelligent and desirable foreign economic policy. Moreover, the existing foreign economic policy of our Nation is neither as intelligent nor as effective as it ought to be and could be if less official solicitude were spent to preserve vast monopolist international cartels and more concern were exercised for the coordinated economic development of democratic nations in the interests of all their citizens.

FARMERS HAVE DIRECT INTEREST IN FOREIGN ECONOMIC POLICY

National Farmers Union is a member of the International Federation of Agricultural Producers, an organization made up of national farm organizations of many countries of the free world. As president of National Farmers Union of the United States, I am vice president and a member of the executive committee of that organization. IFAP, for all of its 10 years, has taken an active interest in improved farm life and increased consumer purchasing power throughout the free world in an expanding free economy.

For many years, also, as president of National Farmers Union, I was a member of the public advisory boards of Economic Cooperation Administration, Mutual Security Administration, and Foreign Operations Administration. National Farmers Union members have served as members of United States delegations to all of the early meetings leading up to the establishment of Food and Agriculture Organization and of the United Nations and many of their subsequent meetings.

As a result of this intimate participation in these programs we in National Farmers Union have gained and maintained an active and informed interest in all phases of United States foreign economic policy, trade policies as well as programs of technical assistance and economic development. State and national officials and staff members of Farmers Union have played active roles in the development and conduct of our Nation's foreign trade policies and programs of technical assistance and foreign economic development.

Our participation in these affairs has been grounded upon the direct and manifest interest in them on the part of Farmers Union members and farmers generally, both as citizens and as farmers.

FARMERS' INTEREST IN FOREIGN AFFAIRS

Farmers' basic interest in foreign affairs, economic and political, is grounded upon their deep-seated desire for peace. Farmers are convinced that a permanent peace will be easier of attainment in a world where living standards are rising, where economic growth rather than stagnation gives a basis for hope to replace the feeling of hopelessness generated by generations of chronic poverty.

Farmers everywhere including American farmers, also deeply feel the Biblical injunction to love thy neighbor. American farmers want farmers all over the world and people generally to enjoy and be able to earn a better life and better living.

Moreover, American farmers know that they themselves can earn better livings if people in other nations can earn the purchasing power required to buy the commodities we produce. And it is good sense for us to buy from other nations the things they can produce to a better advantage than we can. Farmers in America are benefited by economic growth in other democratic nations as well as in our own.

For those reasons, National Farmers Union has strongly supported all United States efforts to promote, encourage, facilitate, and assist economic development and growth in the democratic nations of the world.

NEED A DEMOCRATIC WORLD ECONOMIC UNION

We have said that we are convinced that these aims could best be obtained by the early establishment of a democratic world economic union, composed of nations that would subscribe to the kinds of democratic rights and privileges set forth in the United States Constitution and Bill of Rights. Such an economic union of democratic nations, we feel, could develop and operate the economic development and trade promotion programs that would contribute most to a rapid integration and growth of free-world economies.

Until such time as a democratic world economic union can be established and put into operation, we are convinced that the policies of the United States, operating through foreign economic agencies and the United Nations and the specialized agencies, such as Food and Agriculture Organization, should be adapted to coincide as nearly as possible with the kind of economic program for the free world as would be adopted by its representative governing body if such an economic union were in existence.

We feel that the largest possible proportion of our foreign economic programs should be implemented through agencies of the United Nations. Further, we are convinced that those parts of these programs that cannot under current conditions be best administered through the United Nations should be carried out as fully as possible through the voluntary private foreign relief organizations such as CARE, registered for that purpose with Foreign Operations Administration. This has two advantages, we feel. First, it helps overcome the appearance, as well as the actuality, of economic imperialism. Second, we are convinced that we can be more fully assured that the people in other nations who need our economic help most will be more likely to receive it if such programs are administered through private relief organizations than by government-to-government procedures.

WHY COMMUNISM WILL FAIL

We should like to invite the attention of the committee members to an article in the February 1955 issue of Harper's magazine entitled "Why Communism May Fail." The essence of the article is that the Soviet system is most likely to break up because it refuses to recognize the facts of life about family farming. This fact provides a great challenge to America, both domestically and in our foreign economic programs. To quote the author of the article, "Perhaps the most dangerous enemy of communism is the stoic, passive peasant in Eastern Germany, Poland, the Soviet Union itself, China, and Northern Vietnam * * *. The passive figure of the peasant, trapped in totalitarianism, is joined as a potential mortal enemy of communism by the farmers of the free world—notably in the underdeveloped areas and perhaps most notably, at the moment, by the awakening of the Indian peasant."

UNITED STATES SHOULD PLACE EMPHASIS ON AGRICULTURAL LAND REFORM

This challenge has been the basis of the deep interest and strong efforts of National Farmers Union to insist that a central part of United States foreign economic programs should be to promote agricultural land reform in all its phases—secure land tenure, adequate farm protection income programs, development of farmers' purchasing, marketing and service cooperatives, adequate family farm credit facilities, organization and growth of free farm organizations, and the like.

The desire of the agricultural producers of the world to become substantial family farmers with secure tenure and decent incomes can be a strong moving force for expansion of democracy and the basis for a secure peace.

We feel that agricultural land reform has never been given the important place it deserves in our foreign policy. Further, we feel that emphasis upon it has been reduced markedly in the last 3 years. We look on this lessening of emphasis upon agricultural land reform as an adverse and dangerous development in United States foreign economic policy.

We urge your committee to make a special study of this matter to determine the extent to which adequate emphasis is being given to the promising avenues of approach to this problem of giving farmers a strong stake in their land and their national survival.

If time permitted, we would cite in detail the examples where successful, United States assisted agricultural land reforms have had most desirable results, to mention a few: South Korea, Japan, Iran, the Philippines. We think that subsequent events have proved the tragic blunder that the United States made in failing to follow a similar policy in Egypt.

We were deeply concerned that world reaction to the firing of the United States agricultural attaché to Japan, who was so vitally associated with the MacArthur land reform in Japan, would be interpreted as a turning away by our Government from agricultural land reform. Subsequent occurrences have not fully removed the danger.

WHICH WAY?

In exercise of its economic world leadership, the United States can take either of two routes: the road to scarcity or the road to abundance.

Faced with the problems of tariffs, low productivity, dollar shortages, embargoes, and other problems restricting sale of United States farm products in other countries, the United States can take the road of abundance or the road of scarcity.

There are two kinds of scarcity roads:

1. Economic isolation or go it alone, and
2. Exclusive reliance upon cartel-dominated "free trade."

THE "GO IT ALONE" ROAD TO SCARCITY AND CHAOS

The United States can go it alone. American markets for American goods. Hold out competing imports; give up foreign markets for United States production.

The United States farmer would have to shift 50 million acres now producing wheat, cotton, tobacco, rice, corn, soybeans, apples, and other commodities into production of something else that could be sold in the United States.

A large segment of United States industrial production would have to shut down, lay off workers, reduce consumer demand in the United States for farm commodities for lack of raw materials and lack of foreign markets.

United States farmers' cost of production and consumers' cost of living would rise owing to our not being able to buy imported goods.

The entire free world, including United States, production and living standards would be reduced. "Stomach communism" in many areas of the world would be promoted. A "fortress America" would become inevitable.

If we want this, if we want to "go it alone," it can be done with preclusive protective embargoes and tariffs against imports; expansion of "buy American" policies; refusal to support United States and FAO; and stopping United States economic aid to nations of the free world.

THE CARTEL-DOMINATED ROAD TO SCARCITY AND CHAOS

The other road to scarcity is to rely exclusively upon cartel-dominated, so-called free international trade.

We can do this by repealing our tariffs, abolishing our embargoes against competing imports, such as sugar, wool, feed grains, barley, and dairy products; stopping United States economic aid to other countries; abolishing the United States Export-Import Bank, the International Wheat Agreement, pulling out of World Bank and International Monetary Fund, refuse to implement reciprocal trade agreement, repeal section 22, and the escape clause.

International trade would then be dominated by international private cartels—huge international trade monopolies. Only the farmers and other raw-material producers of the world would fully "enjoy" the fruits of "competition."

Foreign countries could not be expected to greatly reduce their government restrictions on trade and currency exchanges. United States producers would be "set free" in an administered-price market dominated by foreign-government regulation and international private cartels. Selling prices received by United States producers would be uncertain and artificially low. Buying prices paid by United States consumers would be uncertain and artificially high.

The "world price" of farm commodities and other raw materials such as tin, rubber, and iron ore, would fluctuate greatly from month to month and year to year. This would discourage productive investments and retard free world economic expansion.

Neither of these scarcity roads is the right road.

ROAD TO ABUNDANCE AND PEACE

The road to abundance is through negotiated international regulation of expanded international exchange of materials—greater international economic cooperation and coordination, preferably through international agreements and agencies comprised of many nations.

These include negotiation and establishment of (1) a World Economic Development Agency; (2) additional international commodity agreements such as the International Wheat Agreement for each and every raw material that enters importantly into international trade; (3) renewal of reciprocal trade agreement; (4) ratification of an international trade agency truly consistent with these principles; and (5) the proposed international food and raw-materials reserve.

If these things are done, this would—

(*a*) Encourage investments;

(*b*) Stabilize markets;

(*c*) Promote increased production in all countries;

(*d*) Reduce, and ultimately eliminate, famines, chronic undernutrition, low living standards; and

(*e*) Make possible the use of abundant food supplies to aid in establishment in the lesser developed area of the world a system of public schools for every child.

Serious gaps now exist in present United States laws and international agreements.

There is no provision for international handling of interrelated financial and commodity market problems.

Thus, the United States, with 7 percent of world's people, 30 percent of world's resources, but 74 percent of world's manufacturing output is using up resources very rapidly and does not have a stabilized source of supply.

While, raw-materials-producing nations are still subject to wild "ups and downs" in world raw-materials market and monetary exchanges. It is our considered and mature opinion that these gaps must be closed. We are convinced they can be closed to the great benefit both of the United States and all the other democratic free nations of the world. We are also convinced that this is the only type of foreign economy that is consistent with an expanding full-employment domestic economy, with the attainment of the needs and aspirations of United States family farmers, and most conducive to national security.

SLIDING-SCALE FARM PROGRAM A HANDICAP

The sliding-scale farm price and income policy now being operated by the Federal Government is a detriment and a handicap to an intelligent and effective foreign economic policy. Exclusive reliance for farm-income protection on market-price propping not only serves as an artificial suction to draw in unneeded imports but invites and requires the imposition of tariffs and import quotas. The exclusive use of market-price propping of sliding-scale farm-price supports may also build up in Government ownership a stock of commodities beyond the need for an adequate national safety reserve. When this happens and such stocks are put into a special set-aside as has been done, for special foreign disposition of the dumping variety instead of being insulated as should have been done, these stocks become a burden on and threat to trade and economic development all over the free world.

We are convinced that our domestic farm income-protection program can and should be made fully consistent with the internationally planned abundance type of foreign economic policy.

The full parity family farm income protection program, the adoption of which is urged by National Farmers Union, is of this nature.

The following is a brief outline of the major phases of the full parity family farm income protection program that we feel is fully consistent with a desirable foreign economic policy.

I. Fair trade for farmers:

A. Enactment of mandatory income protection for family farm production of all farm commodities at 100 percent of a fair parity, using production payment as well as loans, purchase agreements and purchases as methods of support.

B. Revitalize and expand Federal crop-insurance program.

II. Expanding human use and demand for farm commodities:
    A. Domestic consumption expansion.
    B. Expanded exports.
III. Keeping supply marketing in balance with augmented demand:
    A. Establish conservation acreage reserve.
    B. Revise and extend marketing quotas.
    C. Marketing agreements and orders.
IV. Establishment of a "yardstick" family farm loan agency.

FAIR TRADE FOR FARMERS

Almost all family farms today are commercial farms. They must buy a very large part of the machinery, and supplies used for farm operation and for modern family living, about 89 percent, as an average. They sell a very large part of what they produce, averaging over 90 percent. The terms they trade on makes a big difference in the standard of living the family is able to earn.

The prices of things that farmers buy, both production and family living items, are retail prices like the prices all consumers pay. These retail prices, and the wholesale prices behind them, are administered prices—prices set by manufacturers, money-market bankers, railroad companies, and others, on the basis of their ability to withhold supply to maintain the set price. Experience has shown that these prices paid by farmers and consumers rise fast enough in periods of inflation. However, experience has also shown that the prices paid by farmers for things and services they must buy from nonfarmers do not drop very much even in periods of economic stagnation. This is because manufacturers and the others protected by tariffs and corporation laws and Government commissions, can hold down production and maintain price partly because of the small number of firms in each industry. They can do so profitably because overhead fixed costs are a small proportion of total costs thus enabling them to make large cuts in costs as a result of reduced production.

On the other hand, there are about 3½ million farmers selling in competition with each other. None of them controls a significantly large enough share of the total market to raise prices received by withholding supplies from the market. Nor have they been able successfully to band together voluntarily to do so. Moreover, unlike the industrialist, a farmer's fixed costs are a very high proportion of total costs. He cannot reduce costs much by curtailing production. Operating alone, the only out for the individual farmer, is to produce more as long as he can to raise gross income by increasing volume of sales. In competing with each other to do so in the past year by obtaining more land, farmers have bid up land values in the face of falling income. The increased supply resulting from 3 million farmers each doing this causes a very large drop in prices received by farmers. The nature of demand for food and clothing is such that a small percentage increase in supply or decrease in demand will cause a six times greater percentage drop in prices received by farmers.

Coupled with these adverse terms of trade for farmers is the tendency for improved farm technology to cause farm production to increase faster than population and improving diets even if special governmental consumption expanding measures are put into effect.

The net result of farmers' adverse terms of trade is chronic farm economic depression when farmers are not protected from the forces of the so-called free market. The indication of recent history is that even in a relatively full employment economy farm family incomes will drop continuously about 5 percent per year in the absence of fully adequate specific governmental farm income protection programs. This drop will continue until such time as farm families exhaust a substantial portion of their assets and net worth, until they are living in utter poverty, and have worn out their capital equipment and exhausted their soil and water resources. History, as well as current statistical estimates, indicate the bottom of the free market sliding scale is a parity ratio somewhere between 50 and 60 percent of parity.

Experience has shown the only solid protection available to even up farmer bargaining power, and the only way that farmers can obtain fair terms of trade is to make use of programs of the Federal Government—

to increase demand and markets through direct-action programs;

to establish farm parity income program to protect farm income against adverse terms of trade; and

to enable farmers to keep the volume of marketed farm products in reasonable balance with augmented demand.

INCOME PROTECTION FOR FARMERS

National Farmers Union continues to urge the enactment of laws requiring the Government to use production payments and price-support loans, purchase agreements, and purchases in workable combinations to maintain the returns per unit of commodity of the family farm production of all farm-produced commodities at 100 percent of a fair parity.

Parity.—Parity for any farm commodity should be figured as the return per unit of the commodity that would give farm families who produce it an opportunity to earn the equivalent income and purchasing power that can be earned by people in other occupations in an expanding full-employment economy.

Family farm volume protected.—Individual farm family would be eligible to obtain payments and price-support protection on their sales only up to the maximum size of a family farm.

Methods of support.—Price-supporting Government purchases of commodities would be used only where required to relieve temporary seasonal market gluts and where either the commodity can be economically stored from year to year or where noncommercial outlets are in sight for the commodities purchased. Price-supporting purchase agreements and nonrecourse price-support loans would be used to even out seasonal patterns in prices, prevent gluts at harvesttime, and to maintain orderly marketing and market stability. Price-supporting Government purchases would also be used where needed to develop and maintain the Nation's safety reserve, strategic stockpile or ever-normal storehouse of food and fiber commodities. But primary reliance for farm-income support would be placed upon use of compensatory production payments direct to farmers to make up the margin by which market prices received by producers of that commodity were below the parity level for that commodity.

Crop and livestock insurance.—Farm commodity income-support programs protect against unfair economic hazards resulting from their weak bargaining power in the market. They do not help at all in case the crop is a failure because of drought, flood, insects, or other natural disaster or there are livestock losses from natural causes.

To fill this need, National Farmers Union urged adoption and rapid expansion of the Federal crop-insurance program. Its provisions should be expanded to farm livestock. The fundamental idea of this program is that Americans never do sit idly by as their neighbors in another part of the country are subjected to great loss and destruction due to natural causes. Billions of dollars of relief funds in past years have been expended to overcome the suffering due to drought and such after they happened. The idea of crop insurance is that the people in the Nation by paying the administrative and experimental costs of such a program enable farmers through the annual payment of premiums to insure themselves against the income loss due to natural hazards, and thus reduce the future need for special "disaster relief" expenditures.

EXPANDING FULL-EMPLOYMENT ECONOMY

National Farmers Union was one of the original sponsors of the Employment Act of 1946. We are convinced the domestic market demand for farm products resulting from increasing farm productivity can be maintained only in an expanding full-employment economy. The economic history of the Nation shows that over the 45 years, for which statistical data are available, farm family incomes fall in any year when the total national economy grows by less than 10 percent above the previous year. Except in years when total national economic growth is 10 percent or more per year, the terms of trade are against farmers for the reasons discussed in the previous section.

Therefore, National Farmers Union continues to support all policies and programs such as: interest rate reduction; increased personal income-tax exemptions, expanded school, hospital, highways, hydroelectric- and irrigation-dam construction and other public works; higher minimum wages; more nearly adequate social-security protection for unemployed, disabled, and retired citizens; and protection of rights of organization and collective bargaining of those who work for employers.

With a national annual economic growth rate of about 6 percent, industrial unemployment would be reduced to a fractional minimum and consumers purchasing power for farm and other products would be at a maximum consistent with a stabilized price level. This would mean that increasing demand for farm products would lack only about 1 percent per year in keeping up with increasing farm productivity and net farm income would drop only 3 percent per year. Recognizing that economic growth as rapid as 10 percent a year might bring inflation yet knowing that a slower growth rate means falling farm income, National Farmers Union continues to urge adoption of special governmental consumption-expanding programs and a fully adequate farm income-protection program as well as maintenance of a national economic growth rate of 6 percent per year.

EXPANDING DOMESTIC CONSUMPTION AND MARKET DEMAND

Effective advertising and merchandising of farm-produced commodities are of some value in expanding domestic markets for farm products. But they cannot be relied upon to bring about any very large expansion in the total United States demand for all food and fiber. The Nation's leading economists are agreed that the only way to very greatly increase consumer demand for food and fiber is through increased purchasing power of groups of consumers that do not now have sufficient buying power to buy the food and clothing they need and want.

Special consumption expanding programs.—The largest untapped market for fairm products is made up of the unemployed, the dependent widows and children, permanently handicapped, and disabled, the aged, and other low-income consumers. These people, with incomes from private and governmental sources of less than $1,000 per person per year, simply do not have enough purchasing power to maintain all the needs of life and still spend as much for food and clothing as they want and need for adequate standards. These people want to buy more. They will accept commodities provided through direct Government distribution, but they would prefer to be able to buy them at regular stores like anybody else.

To make this possible, and bring about a vast increase in United States consumption of food commodities, National Farmers Union continues to urge—

Adoption of a nationwide food allotment stamp plan;

Expansion to all schools of the national school-lunch program now serving less than one-third of the schools;

Improvement and expansion of the fluid milk for schoolchildren program to provide free at least 2 half pints of milk per child per day and pay local school district administrative costs;

Adoption of improved Federal standards and inspection of perishable farm commodities in terminal, as well as shipping, markets with adequate Federal financing;

Adequate nutrition standards for the Armed Forces and veterans hospitals, penal institutions, hospitals, and other public and private nonprofit agencies by means of commodity donation or food subsidies; and

Adoption of a credit program to encourage modernization and improvement of perishable farm commodity terminal markets.

Adequately financed, the programs listed on the preceding page would keep consumer demand in a full-employment economy increasing as rapidly in the next few years as farm production.

EXPANDING FOREIGN CONSUMPTION AND MARKET DEMAND FOR UNITED STATES FARM COMMODITIES

Many United States-produced farm commodities, up to 10 percent of total production, must in normal years find a market outside our national boundaries. This market can and should be expanded. Additional agricultural attachés and improved advertising and merchandising will help some. But just as in the case of the domestic market, the really big increases in market demand for United States-produced farm commodities can come only from increased purchasing power in foreign countries, or from United States Government purchases designed for foreign shipment. We are convinced that this total can be raised from the current annual export sales of about $3 billion to at least $4.5 billion by the combined and coordinated use by our Nation of the following (and we will be protecting our farmers at the same time, by intelligent methods, rather than restrictive ones, against the ill effects of imports that compete with United States farm products):

Negotiation and establishment of additional international commodity agreements for all raw materials that enter importantly into international trade, similar to the International Wheat Agreement, which will bring into agreement all of the importing nations as well as all of the exporting nations for each commodity.

Negotiation and establishment of an international food and raw materials reserve or clearinghouse, to stabilize supplies, relieve famines, and stabilize prices of all food and other raw material commodities that enter importantly in international trade.

Expand the authorizations of the Agricultural Trade Development and Assistance Act to provide for $1.3 billion per year of donations and sales for soft currencies of United States farm commodities instead of the $600 million per year now authorized and expand the purposes for which donated commodities and loans of soft currency may be used to include establishment and operation of systems of universal free general and vocational education in nations of the free world where such do not now exist.

Continuation and intelligent expansion of the point 4 program of United States aid to economic development of other free nations in a way that will increase coordinated economic growth of the nations of the free world.

Continuation of the reciprocal trade agreements providing for worldwide tariff reductions and customs simplification.

Inauguration of full parity compensatory production payment methods as primary reliance in supporting farmers' returns on farm commodities, some of the supply of which are either imported or exported, as part of a nationwide program of trade-adjustment aids to United States industries, communities, workers, and farmers injured by tariff reductions and elimination of import quotas.

INTERNATIONAL FOOD AND RAW MATERIALS RESERVE

Probably the most persistent, most disturbing, and most perplexing of modern economic problems is the human suffering and relative stagnation enforced upon producers of raw materials by the extreme ups and downs in the prices of raw materials and consequently in their realized and expected incomes. The problem is serious in all the more highly developed nations. It is even more seriously present and damaging in the lesser developed nations.

Wide swings in raw-material prices present prospective investors in raw-material development, whether persons, firms, or states, with a very large range of variation in expectations as to returns that can be earned by opening up and developing an augmented raw-material supply. This condition is one of great risks where at any moment not only might part of the investment be rendered valueless but earnable returns may even fail to cover day to day operating costs and the entire enterprise will have to be shut down with attendant loss of income and human suffering.

Faced with such great uncertainty in in expectations both states and individuals are hesitant to open up or expand enterprises that are currently profitable but which may at any time dip drastically below the break-even line through no fault of the enterprise management itself. The multiplication of this kind of situation throughout farming and all other raw-materials industries puts a very severe damper upon the rate of economic development in these industries.

This slowing down of the rate of expansion in raw-material industries not only reduces the supply of such materials to meet human needs and to fuel manufacturing and other secondary industries, it also holds down the purchasing power of persons and firms on the raw-materials sector and thus cuts down on sales, scale of operation, and consequently of income and purchasing power of the industrial and service segments of the economy. Consequently, the entire economy idles along at a lower rate of production and expansion than should or needs to be the case. In the more highly industrialized nations the symptoms are seen in chronically depressed industries like farming and coal mining in the United States. Among the lesser industrialized nations, a drop in raw-material prices can bring an entire nation dangerously close to bankruptcy and can directly cause a widespread drop in personal income and standards of living of the entire population.

It is only natural that the economic segments and nations involved in these debilitating circumstances would take evasive and protective action just as an intelligent bomber pilot takes evasive action from destructive antiaircraft fire.

Such protective or evasive action when taken unilaterally by different nations helps to solve the problems caused by fluctuating raw-material prices only at the cost of reducing the magnitude of international exchange of commodities and thus results in the loss by each and all nations of the advantages of specialization. Everybody in all nations has less real income and a lower standard of living than they might otherwise be able to attain.

Through the administrative machinery of an international food and raw-materials reserve, the stabilized prices of each different raw material that enters importantly into international trade would be negotiated and agreed upon. The reserve would thereafter stand ready at all times to buy any raw material commodity offered it at the agreed upon stabilized price and would stand ready to sell such commodities at the agreed upon stabilized price.

The industry of advanced nations is chewing up basic resources at a tremendous and rising rate. For example, the United States which has 7 percent of the world's population and 30 percent of the world's natural resources account for 70 percent of the world's manufactured goods. The United States is using up its resources base at a very rapid rate and very much faster than the rest of the world. To be secure in our rising living standards and to retain the resource base for an expanding economy, we must assure ourselves a stabilized source of supply of the raw materials for our manufacturing industry. The same situation is true in other industrial nations such as the United Kingdom, France, Germany, and Japan. The thought-provoking details for different commodities were thoroughly considered in the Paley report of several years ago.

Highly industrialized nations could depend entirely upon private industrial concerns to make long-term contracts with raw-material producers in other lands. And, this should be done. But, it can only be successfully and securely accomplished under the protection and encouragement by governments and international economic accords.

These latter conceivably could be done exclusively through bilateral arrangements between the United States and foreign nations; one nation at a time, one commodity at a time. However, no supplier, private enterprise of state, wants to become dependent exclusively on one buyer; nor does any importing nation or industrialist want to become dependent upon only one seller.

Through the international food and raw materials reserve, exporting nations can obtain assured long-term stabilized markets and importing nations can obtain an assured long-term ample supply at stabilized prices of imports on terms that will not injure domestic producers who must sell their commodities in competition with imports.

The international food and raw materials reserve would operate in coordination with the International Monetary Fund and the World Bank. Many of the national restrictions we now have that hold down greater international exchange of commodities is the desire of nations to preserve their monetary position in different currencies particularly dollars and pounds sterling. The international food and raw materials reserve would completely eliminate this problem by operating in terms of all currencies on the basis of internationally agreed upon official exchange rates.

PERMANENT PEACE DEPENDS ON INTERNATIONAL INSTITUTIONS THAT WILL PROMOTE MORE RAPID ECONOMIC GROWTH

The international food and raw materials resolution has been before Congress for 3 years. The concepts involved in the resolution have their roots in the still-unsolved problems of extreme human need, starvation, economic stagnation, and poverty throughout the world in the midst of surpluses of raw materials that cannot be sold at prices that will return an adequate stable income to producers.

The genesis of the ideas are found in the efforts of National Farmers Union of the United States to work out a solution to the farmer's income problem. Recommendations presented nearly 10 years ago to the International Federation of Agricultural Producers by National Farmers Union representatives were fully considered and favorably acted upon by this international private farm organization, among whose members are all the national farm organizations of the United States.

The international food and raw materials resolution does not itself establish an international agency. The resolution merely calls upon the President to undertake negotiations with other nations to that end. Any agreements reached would, of course, be subject to review and ratification by the Senate of the United States and appropriation of any needed capital and other funds would have to be fully considered by both Houses.

The international food and raw materials reserve will help solve many of our Nation's most difficult problems of both domestic and foreign policy. It will make a major contribution toward permanent peace by facilitating a more rapid rate of economic expansion. Its operation will stabilize world raw material markets. It will put abundant production to work.

THE ROAD TO ABUNDANCE—INTERNATIONAL COOPERATION AND PLANNING

The proposal for the establishment of an international raw materials reserve to cover petroleum, iron ore, tin, rubber, and other raw materials, as well as food and fiber, is not new. An international food reserve resolution was introduced in 1953 by Senator Murray and 23 other Senators and by Congressman Metcalf.

A World Food Board idea was proposed immediately after World War II by Lord John Boyd Orr, first Director General of Food and Agriculture Organization.

An international commodity clearance house was proposed by Committee of Experts of FAO and IFAP, but was never ratified by the governments.

In 1954, the International Federation of Agricultural Producers meeting in Nairobi, Kenya, made the following policy declaration (the eighth in as many years)—

"Intergovernmentally agreed rules be adopted by the countries concerned regarding principles to be followed in the disposal of surplus stocks in the world markets so that they interfere as little as possible with normal production and trade, and that effective intergovernmental machinery be established for consultative purposes.

"The matter of world food reserve should be kept under active consideration and to that end, the committee recommends that the Secretariat prepare a study indicating the nature of the machinery needed to implement the plan and the obstacles that have stood in the way of attainment of this objective and giving all possible suggestions as to how such obstacles might be overcome."

INTERNATIONAL COMMODITY AGREEMENTS

The international food and raw materials reserve should be buttressed and coupled with additional international commodity agreements similar to the International Wheat Agreement.

At its 1954 meeting, the International Federation of Agricultural Producers said in its policy statement:

"IFAP reaffirms its faith in intergovernmental commodity agreements as a means of bringing about greater stability in the prices of major commodities moving in world commerce and will assist in creating a better public understanding of the underlying philosophy of such agreements as an important means of stabilizing trade."

The United States is already embarked upon a small and timid program to make use of abundant United States farm production to further the aims of the United States foreign policy on a unilateral and bilateral basis through:

(*a*) Agricultural Trade Development and Assistance Act of 1954 (Public Law 480) which provides for sales for soft currencies up to $1.5 billion and donations up to $300 million; these authorizations should, of course, be expanded.

(*b*) Title I, Agricultural Act of 1954 (Public Law 690) provides for foreign sale and donation of up to $2½ billion set-aside of CCC stocks.

(*c*) "Farm product sales" amendment to Mutual Security (Foreign Aid) Act provides for sales up to $350 million in this fiscal year.

(*d*) Section 416 of the Agricultural Act of 1954, as amended in 1954, authorizes CCC to sell stocks at "competitive world prices and pay repackaging costs and transportation from present location to shipping port."

(*e*) Section 32, enacted in 1938, allows up to 30 percent of tariff revenues to finance foreign sales of United States farm products.

This program has an excellent aim. The major trouble with it is that which has already been revealed by the extreme slowness with which the program was put into operation. In actual practice, even this unilateral United States program can be carried out only by international negotiation, seldom bilateral but usually requiring consideration for side-effect upon third and fourth parties. How much better if an international institution were available to operate this essentially good program.

NEED FOR ECONOMIC GROWTH OF DEMOCRATIC NATIONS

Half the world's people have just about enough food for minimum subsistence—barely enough to prevent starvation—but not enough for health by any decent standard. Only one-third of the world population has enough food of the right kind to be well nourished.

The average life expectancy in India is only 27 compared to United States figure of 68.

In India, 123 of each 1,000 babies born die in their first year. In the United States the figure is only 29 per 1,000. In Iraq and Egypt, only 600 of each 1,000 babies that are born live to be 5 years old.

To bring the average world textile consumption per person up to only one-half the United States average of 38 pounds per year would require an increase in world production of cotton and other fibers of almost 90 percent.

Population increase in the last 15 years has outrun increase in food and fiber production in the world as a whole and in many different countries of the world, particularly in Southeast Asia, Southeast Europe, Northern Africa, Germany, and Austria.

To be safe, nutritionally, over a long period, requires about 1,900 calories a day, with some protein from animal sources in warmer tropical climates; and 2,200 calories a day in cooler areas, such as the United States. In all the world, except a handful of countries in western Europe, North and South America, Australia, and New Zealand, the people on the average live at or very near this breakover point. Since some people in every country live very well indeed, considerably more than half of the population live below safe nutritional levels most of their lives.

The real answer to the problem of unbalance between productive capacity and effective demand must be found on the side of demand. People have almost unlimited wants—which unfortunately do not always meet with a corresponding purchasing power—for better food, better housing, better clothing, better educational facilities, and for a vast array of various kinds of manufactured goods. There could be an ever-expanding circle of the distribution of these things as opportunity is increased.

The underdeveloped countries may be divided into two classes—those which have large natural resources but small populations and those which have large populations in comparison with their resources of raw materials. The former are largely in Africa, the Middle East and Latin America. The latter are largely in Asia.

In the countries of small populations and large resources the problem is mainly one of securing outside capital for development, although there is also the problem of raising the level of technical skills of the native population.

It is, however, the problem of economic growth of heavily populated underdeveloped countries with relatively limited natural resources that is most difficult of solution. It is in these countries where will be found the vast number of underclothed and undernourished people who could, through economic development, earn the means of payment to absorb enormous quantities of food and fiber.

These countries need technical assistance and capital if their standards of living and purchasing power are to be substantially raised. It is recognized that, in respect to both technical assistance and capital, agricultural development will receive important consideration, for agricultural development must go hand in hand with industrial development if the necessary expansion in consumer purchasing power is to be achieved.

So far as technical assistance is concerned, some progress has already been made through international and national agencies; but much more needs to be done. The problem of capital for development is much more difficult but equally important in this class of country.

UNITED STATES FOOD TO ELIMINATE WORLD ILLITERACY

All of the so-called surplus United States food and fiber production would be but a drop in the bucket, if the democratic nations should agree to use food to finance and make possible the complete elimination of illiteracy by means of nationwide systems of free public schools, including vocational education, for every child.

The average per person real income in the United States is upward of $1,900 per year. This level is approached only by such countries as Switzerland, Canada, Australia, New Zealand, and Sweden. Real income per person in England is half that of the United States; French per person income two-thirds that of England; and Italian is only two-thirds of French.

United States	$1,900	France	$625
England	950	Italy	450

In most of the rest of the world, income and standards of living are very low, averaging $125 per person per year in South and Central America, $75 per person in Africa and Middle East, and $40 per person per year in Asiatic countries.

The United States has 7 percent of the world's people, and 50 percent of the world's income. United States produces one-half of the world's radios, three-fourths of its telephones, four-fifths of its automobiles, one-half of the world's power. In all, United States produces each year 70 percent of the world's manufactured products.

Similar figures for the continents of the world are:

Continent	Percent of world's people	Percent of world's income
Africa	8.8	2.6
South America	4.5	7.8
Asia	53.9	2.0
Europe outside Russia	16.6	16.5
U. S. S. R.	8.1	1.4

WHY UNITED STATES MUST ACT

If history teaches anything it is that situations of this kind cannot long endure. History has a way of removing barriers and evening off such extremes of economic opportunity. Usually this is brought about when the barbarians storm the walls of ancient Rome and burn and sack the city. This pulls down everybody to the lowest level.

It behooves the United States and other industrialized nations to see that the eveningup comes about by expanding economic opportunities in other nations; not through forced reduction of standards in nations with higher incomes.

About a third of the world's people live in the United States, Western Europe, and other democratic nations that are relatively well developed and have fairly high incomes and living standards; another third live in countries behind the so-called Iron Curtain dominated by Soviet Russia and its police state system of control.

The remaining third of the world's people—about 900 million of them—live in nations that have not yet made up their minds about democracy. These are the people of South and Central America, southeast Asia, Africa, and the Middle East. Here "stomach communism" holds out a glittering lure with its false promises of enough to eat.

These nations have not attained the economic development and higher living standards easily possible with modern technology and organization. Extreme poverty is the rule.

The United States must intensify its efforts to assist in the development of a coordinated program of aid to relieve hunger and suffering, and to promote expansion and strengthening of the national economies of the democratic nations in ways that will not destroy the principle of self-determination of peoples. The United States should help these nations to develop economic conditions that will:

(*a*) Create an international community of economic effort for common purposes, avoiding the extremes of either forcing unwanted policies on others as a condition of our help, or of undertaking action ourselves in the absence of appropriate efforts in the countries that participate;

(*b*) Promote material well-being and allow employment, production, trade, and investment in ways that will enrich human life and eliminate economic weaknesses that threaten political stability and inevitable totalitarian imperialism;

(*c*) Afford all democratic nations increasing opportunities for economic growth and improving standards of living in ways which will operate so that economic gains are distributed equitably within countries; and

(*d*) Attract peoples and governments toward the democratic system of political freedom.

To attain these objectives we support continued international economic negotiation; increased United States contributions to the specialized agencies, such as the Food and Agriculture Organization, and expansion of United States foreign economic assistance and of the program by which our advanced technological knowledge is made available to other nations to assist them to increase the efficiency of production and marketing and to improve their agricultural land-tenure systems, eliminate colonialism, and reform their economic and social structures.

The operations of an international food and raw materials reserve would generate the purchasing power and stabilize international markets in a manner that would greatly facilitate more rapid economic development in the free world.

An international food and raw materials reserve would greatly strengthen the operations of our point 4 laws.

The Mutual Security Authorization and Appropriation Acts provide a small amount of United States funds (about $1.5 billion) for loans and grants to other nations to facilitate economic development and expansion and a limited amount of funds (about $200 million) to send United States experts to foreign countries to provide technical assistance or "know-how."

The United States appropriations to FAO and other specialized U. N. agencies and limited United States contribution to expanded technical assistance program of the U. N. should, of course, be renewed.

With an operating food and raw materials reserve, these funds would go a lot further because first they would be augmented by the loans available from sale of buffer stocks. The stabilized international markets would greatly reduce the risks of price fluctuations and thus raise expectations sufficiently to really speed up investment in resource development.

The appropriation for this work has been greatly reduced since 1952. Civilian programs have been submerged and intermingled with large military-aid programs.

Emphasis has been centered on engineering and production techniques and largely shifted away from institutional reform, except that in 1954 the program to help develop labor unions in other countries was reactiviated in the summer of 1954 after having been allowed to lapse for a year.

Attention to organization and development of farmers cooperatives and farm credit agencies has been continued but at a reduced scope. Work on land tenure improvement and setting up free private farm organizations has largely been curtailed or eliminated.

Our Nation must recapture leadership in this vital field. We need to enlist the cooperation of other economically strong nations, preferably under auspices of international organizations.

The proposed international food and raw materials reserve is a necessary supplement to the technical assistance programs of the United Nations, the World Bank, and other specialized agencies.

OTHER MEASURES

In addition to restoring a larger scope of our point 4 programs and establishing an international food and raw materials reserve or world food bank, National Farmers Union urges:

Renewal of the International Wheat Agreement and negotiation of an improved International Sugar Agreement and additional International Commodity Agreements for all commodities that enter importantly into international trade. Such agreements should include net importing as well as net exporting nations and the pricing arrangements should be based upon an international parity or general price index.

Expansion and renewal of Agricultural Trade Development and Assistance Act, to increase scope of program and expand authorization to include establishment of systems of universal free education in nations that do not have them.

Make greater use of the authorities provided in the Reciprocal Trade Agreements Act.

Enact a customs simplification law, and enact legislation to establish a program of trade-adjustment aids to United States industries, workers, communities, and farmers injured by reductions in tariffs and import restrictions. This can be accomplished with respect to farmers by legislation to provide 100 percent of parity income protection primarily by means of production payments. Such action would entail expansion of this type program to include milk and its products and other farm commodities provided in United States and sold in competition with imports as well as wool and sugar for which partially adequate payment programs are in operation.

Mr. Bolling. As is usual in this proceeding, we would now like to see if any of the members of the panel have been stimulated by the comments of other members of the panel to say something further or to make additional comments of their own.

Mr. BAUGHMAN. I would like to pick up a point which Dr. Johnson made in his opening comments and press it a step further, if I might.

Under our program of selling agricultural commodities for foreign currency, we have focused attention on recovery of markets in the hope that we can reestablish a commercial position in such markets. Very often the position we seek to reestablish is one which prevailed in a period of short supply from other areas or subnormal domestic output.

This practice is bringing us a good deal of ill will from some countries. Furthermore, the cost of this program is relatively high, since inconvertible foreign currencies are of limited use to us. We can realize benefit from them only when we can spend them for a commodity or local service that we wish to purchase and it appears that the amounts that can be used for such procurement for the United States is quite limited. This brings us to the possibility of shifting the emphasis in the direction which Johnson has suggested. While this probably wouldn't open up a tremendous capacity to move commodities, still it would seem that we might be well advised to try and use agricultural surpluses to the maximum extent possible in those areas of the world where it is quite possible to achieve increased total consumption of agricultural commodities.

The reason we get an adverse reaction from some countries is that in any market where consumers are generally experiencing a fairly satisfactory level of income, they probably are consuming about as much food as they want to consume. Diets can be upgraded but to get an increase in consumption of food is difficult. We know that from experience in our domestic markets. However, if attention is focused on areas of the world where people's stomachs are not filled every day there is a better possibility of achieving an actual increase. It is that kind of market where these surpluses need to go if they are not to displace other marketings, either dollar exports from the United States or the marketings from other countries, and I would be inclined to view that possibility in somewhat broader terms than Johnson's comments implied.

There is a tendency to think immediately, of course, only of programs which can be handled through the local government, and certainly the local government must play an important role, but the key here, it seems to me, is to get programs going in these countries which will increase the flow of income. The mere fact that consumers would like to have more food doesn't mean that they are going to buy more food if it is made available in their markets. It is necessary to increase income along with the increase in the supply of food. The best suggestion I have heard made thus far as a vehicle for increasing the flow of income is to achieve a faster rate of investment in the recipient country. Most of these low-income countries have unemployed labor or under-employed labor. It should be possible to get more people working, and then as they earn additional income, due to the increased rate of spending on capital projects, to keep that income from bursting out in the form of price inflation, by injecting appropriate amounts of surplus agricultural commodities to soak up a part of it.

In this way, it may be possible to accelerate capital development, to raise the level of current consumption, and over the longer term, as a result of the accelerated rate of investment, to have made a contribution to a permanently higher level of living of the people in those areas.

Mr. BOLLING. Thank you.

Dr. JESNESS. Mr. Chairman, I was wondering since Mr. Baughman and Dr. Johnson brought up this point, whether they would not agree that in this matter of using our food supply as a vehicle for improving levels of literacy and living in other countries, and in view of the fact that this surplus problem is not one on which we have a monopoly, should we not explore rather carefully the possibilities of some international approaches to this situation?

I am thinking, for example, that Canada and Australia—Canada particularly—that is under a much more difficult wheat-surplus problem than we are, and our wheat-surplus problem is our most difficult one—would feel much better over this sort of activity if they had a share in it, and were not left to suspect that this was just an endeavor to maintain our wheat production on our expanded basis.

Do you have any comment on that?

Dr. JOHNSON. I think there is a lot of merit to that suggestion, and that where some of these problems are not just our problem, but the problem of other friendly nations in the world, that if it could be done on a cooperative basis it would have merit in terms of allaying these kinds of suspicions you mentioned, and the problems of making such a program as this work, that Mr. Baughman and I both talked about, sufficiently great that getting as wide a variety of brains applied to it would be a real asset, because the danger of doing things I talked about is that unless they are talked through very carefully, all we may do is add to populations of the countries involved and really complicate their problems for the future. That is why I think emphasis should be given on things that have a long-run prospect of improving basic conditions of the people, such as education, and allowing them to, or hoping through this and other means of increasing their productivity because if you just feed them for a while and do nothing more, this adds nothing. You have got to add to their long-run productive resources. Since the human being is the most important resource in any country, it seems to me major emphasis should be put there, and not the sole emphasis.

Mr. Baughman suggests going on to other capital goods. That certainly has merits. The problem I see there is that many other capital investments require a large amount of foreign exchange so this has to be considered very carefully, if you are not going to force the country into foreign-exchange difficulties if you try to induce them to invest in things that require foreign exchange, unless you are going to be willing to supply it, whereas the kinds of things that I mentioned were projects which required a lot of local labor and other local resources, and relatively little foreign exchange. I am not against those projects that have foreign exchange, but the Nation has to be in position to obtain the foreign exchange some way before they should be encouraged to do so.

Mr. DIETZ. I would like to add something there, sir, if I may.

Mr. BOLLING. You go right ahead, sir.

Mr. DIETZ. During the last 8 or 9 years there have been many of these ideas, schemes—I used the word advisedly—for the distribution of food around the world. Some of them are interesting. Some are a bit academic and extreme. I think we should give them all serious consideration and serious thought. However, I think it is good for us to consider that the surpluses that are in existence now, although there are other nations in the world that have surpluses, are predominantly American, and are owned by the United States and are the result of American efforts, and I think that that is a thing that we should keep in mind.

In discussing the distribution of food to the underdeveloped areas of the world, with Europeans, I have discovered that they fully understand and fully realize the problems that are in existence. There is the problem of how to distribute the food, and there is also the problem of, they say, infringing on traditional markets. Now that word "traditional" is interesting. It means a number of things. It means something to us, it means something to the other export nations.

I just wanted to mention 1 or 2 points that may perhaps be of interest, sir.

Mr. BOLLING. Thank you, Mr. Dietz.

Mr. Baughman?

Mr. BAUGHMAN. I don't want to suggest that this is an easy answer to the problem, or that even if followed out vigorously, it would provide a complete answer. There are definite limits to the quantity of commodities that could be used in this manner, and there is real danger that attempts to use them in this manner will in practice result merely in pushing larger quantities of commodities into the low-income areas.

It is just as easy to displace usual marketings in a low-income market as it is in a high-income market. Unless programs are developed which, in fact, increase the flow of income concurrent with the injection of the additional quantities of commodities, the net result will not be what is desired, namely, an increase in current consumption and long-term improvement in the areas.

As to the need for additional foreign exchange, this certainly is an important relevant point and requires consideration along with other factors. A number of studies have been made of the possible uses of agricultural surplus commodities for this purpose. They indicate that about one-third to one-half of the total cost of additional capital development projects can be covered by the injection of surplus agricultural commodities into low-income economies. However, the rate of capital spending in an economy usually cannot be accelerated rapidly. Thus, this provides no quick answer to our surplus problem. The projects preferably should be those which use a large amount of local resources relative to imported resources, and certainly they should be projects which make sense in terms of the long-term economic development of the country.

Dr. HALVORSON. Mr. Chairman, the National Grange is holding its annual session beginning this week and we are looking forward to resoluting on a number of points that would lead to legislative policy. Now, I know that Mr. Baughman has been making a study of the surplus-disposal programs of the Federal Government, and I was wondering if he might touch on this question, whether or not Public Law 480 is broad enough to accomplish these things which have been discussed here and now.

Mr. BAUGHMAN. I have the impression there are some differences of view. I wouldn't be competent to make a legal determination as to whether it would or would not. I am told by some folks that it is possible to do the kind of thing we are talking about without any modification of the present law and others have suggested that it might involve some modification.

Mr. BOLLING. Are there any further comments by the panel? If not, Senator Flanders, do you have some questions?

Senator FLANDERS. I have 1 or 2 questions.

I wasn't here for Dr. Jesness' discussion. I would like to ask you, sir, a question, however.

I take it it is his right to assume that if we had perfectly free agricultural markets, that the price would move the cargo, whatever it was.

Can you conceive taking the case of wheat, that there has been any time since the early thirties when the price would be such—as I am sure it was for a time then, it hardly paid the cost of moving wheat to market?

Dr. JESNESS. I take it, Senator Flanders, that you omit the period of the war from your question.

Senator FLANDERS. That what?

Dr. JESNESS. That you omit the period of war from your question because obviously——

Senator FLANDERS. Well, I am thinking of the story in the newspapers sometime in the early thirties of the Kansas farmer who brought his wheat to market and couldn't get the price, I presume, owing to the elevators being full and one thing and another, that would hardly pay for the gasoline that he used in getting his wheat there. Am I misremembering that?

Dr. JESNESS. No; I think not. There were a number of stories with respect to other agricultural commodities at the same time. The one I recall, which I am sure you heard, Senator, was the one about the man who shipped some chickens to market and he got a bill from his commission man for the payment of the freight and the handling, because the chickens didn't bring enough to cover these items and his response was, "I have no money, but I am sending you some more chickens."

In answer to the question, outside of wartimes, during the period of the thirties, the world was in a surplus period as far as wheat was concerned. We are thinking in terms of normal markets.

Senator FLANDERS. Yes, sir.

Dr. JESNESS. During that period I recall a Hungarian, Mr. de Heresy, wrote a book on the world wheat problem from which this particular comment always has stayed with me. He said, "I have searched to find a country that was not manipulating the price of wheat during that period and I have been unable to find one." We didn't have anything like a free market. Consuming countries were bolstering wheat prices in order to increase their self-sufficiency and reduce their imports, and the exporting countries had various devices to add to their prices. We relied quite heavily on price supports during that period, at a more modest level, to be sure, than the recent price supports, but even so, we and the world entered World War II with a surplus of wheat, which was quite a striking contrast from the

World War I. You may recall that we used the wheat very lavishly. If my memory does not trip me up, we used as high as 500 million bushels of wheat for animal feed. We used well over a hundred million bushels to make synthetic alcohol, but it was not until 1943 that our wheat stock hit bottom and our expansion in wheat took place beginning with 1944.

Senator FLANDERS. What you are saying is that for 25 years, at least, we haven't had a free market. Is that what you are saying?

Dr. JESNESS. That is right in the sense of being free of Government interference. I do not know whether we are going to return to one, but what we are doing in wheat now in my humble judgment tends to perpetuate this problem. To be sure under the marketing quotas, we have reduced wheat acreage to 55 millions, but in the process we have shifted those acres rather than to take them out of production. We have shifted them to the point where we have surpluses in feed grains.

Senator FLANDERS. Why do you characterize your judgment in this particular case—I won't say in all cases—but in this particular case as being a humble judgment, or an humble one, depending on one's use of the English language.

Dr. JESNESS. I have a reputation for being an outspoken individual in expressing my opinions, and I try to remind myself that I need to be humble at heart.

Senator FLANDERS. That isn't to say your judgment is not a good one in this particular case, without presuming it to extend to all of your opinions.

The problems of the price of agricultural products and world trade seem to me to be in a hopeless snarl. Wheat seems to be the typical case, or perhaps all products are different. I note that one of those present before us today, and so far as I can see, only one, has a remedy in terms that seem to be specific. That is Dr. Halvorson, of the National Grange, and you speak here on page 7 of a domestic parity plan.

Will you tell me in simple language—I hope you are a simple man.

Dr. HALVORSON. I think so.

Senator FLANDERS. I believe in simple men. In simple language just what would be the case how it would work if I had raised 10,000—let's make it 15,000—15,000 bushels of wheat and the price obtainable on the market was 80 percent of parity. Just what would be done for me and how would I go about getting it done?

Dr. HALVORSON. Well, I might explain that our plan would let the price of wheat be free on the market. The market would set the difference for the different qualities and grades of wheat. Dr. Johnson mentioned that as being a desirable goal because you get the Government out of interference with the market, and the Government would not have to buy wheat. Wheat would be free to move into the world market, and our price would be in line with the world market price. In order to have a support program on the wheat that the farmer grows for the domestic human food market, we would give the wheat farmers certificates on, say, 50 percent of the wheat, of this 15,000 bushels, going into human food.

You would get certificates for 7,500 bushels of wheat, and those certificates would be equal to the difference between the market price of wheat, say, $1.50, and 90 percent of support, say $2 a bushel.

Senator FLANDERS. How did you arrive at that 50 cents?

Dr. HALVORSON. Because at present about 50 percent of our wheat production is used for human food, flour——

Senator FLANDERS. Human food in America?

Dr. HALVORSON. Yes, in America. We feel that the American consumer, because of his high standard of living and because of his high rate of return on his labor and investment should be able to pay the farmer 80, 90, or even a hundred percent of parity on wheat that goes into the bread that he buys. Those certificates would be financed by requiring the millers to buy the other half of the farmer's certificate.

Senator FLANDERS. This is something that you are carrying literally, or just figuratively?

Dr. HALVORSON. Figuratively. Some have used it literally to do that. The miller would go to the bank and buy certificates to cover all the wheat that he milled.

Senator FLANDERS. The farmer sells into the elevator. The elevator may wait a month and sell to the miller and the price may change in the meantime.

Dr. HALVORSON. Yes. Well, this certificate is set in value at the beginning of the marketing season, before any wheat moves to market. Therefore, the economists of the Department of Agriculture will have to estimate what they think that the free market price of wheat will be. They might estimate $1.50 and the free market might average $1.60. Well, then the farmer would get in total $2.10, or a little bit above the goal of $2, but the market price might average below $1.50. We feel that the estimated price plus the value of the certificate would work out in the long run to be very close to the price-support level that is set. This method of price estimates is necessary in order to prevent too much administrative difficulty in trying to set the value of certificates from day to day and from market to market.

Senator FLANDERS. Let's see what happens to the miller on his piece of paper. He goes into the market and buys this farmer's wheat or some other farmer's wheat, and how does he get his piece of paper, or how does he get rid of it, or what?

Dr. HALVORSON. The miller is free to buy wheat from any place that he wants in the United States. He will go to the bank and buy these certificates. The bank will turn the money over to the United States Government and the Government will have to check on the wheat miller to see that he has bought as many certificates as he has milled bushels of wheat.

Senator FLANDERS. How is the value set on the certificates that the miller buys?

Dr. HALVORSON. On the same basis as the value to the farmer. It would be the difference between the support price of $2 a bushel in this example and the estimated free market price of wheat, $1.50 a bushel.

Senator FLANDERS. He can't buy wheat without a certificate. What does he do with the certificate? He doesn't turn it over to the elevator or the farmer.

Dr. HALVORSON. No. He just keeps it as evidence for the Government tax collector, you might say.

Senator FLANDERS. That is a receipt?

Dr. HALVORSON. Yes.

Senator FLANDERS. He has paid the money into the Government. Presumably the money he has paid in then pays the farmer in the long run?

Dr. HALVORSON. That is right.

Senator FLANDERS. Again, presumably, the consumer, as he does now, paid the bill.

Dr. HALVORSON. That is right.

Senator FLANDERS. So that there is no change as far as the consumer is concerned?

Dr. HALVORSON. No, but the main objective of this——

Senator FLANDERS. I am not thinking of the consumer as a taxpayer.

Dr. HALVORSON. One of the main purposes of this plan is to permit the farmer to produce for the world market at competitive world prices. We feel that it is unsound to subsidize exports of wheat into the world market the way we are doing now. The subsidy has amounted to something like $700 million under the wheat agreement. We believe if the farmer wants to produce for the world market he should be satisfied with that price and not expect the Government to put in another 20, 50, 70 cents, in order to make it possible for him to export into the world market.

Senator FLANDERS. Have you been able to sell this idea?

Dr. HALVORSON. It passed the House of Representatives 2 years ago.

Senator FLANDERS. Two years ago?

Dr. HALVORSON. Not this past session. From reports on the Senate Agricultural Committee hearings over the country there is a great deal of support and interest. The wheat growers are very strongly behind it and from the checking that we have done with various Senators, there is considerable support for it.

Senator FLANDERS. I may say that I have my own scheme, but if yours has gone this far I am not going to introduce my own scheme. I am going to think some more about yours.

Mr. BOLLING. Dr. Jesness?

Dr. JESNESS. I wanted to interject an additional question to Lloyd Halvorson. Would you eliminate acre controls on wheat under the Grange proposal?

Dr. HALVORSON. We possibly couldn't do it to start with, but we would work toward that end as soon as possible.

Senator FLANDERS. I might ask one other question: Would the price support on export wheat raise hell with the export wheat market?

Dr. HALVORSON. Well, I didn't bring in that angle, but we do recognize that to start with we will possibly have to go slow in giving the farmer this freedom, but in the long run, and possibly that means about 3 or 4 years, we feel that we could give the farmer a great deal of freedom to produce. Now, the price of wheat wouldn't go to ruinous prices. There would always be a feed market for wheat in this country, and we also contemplate in this that the farmer would be free to grow wheat for feed if he wanted to.

Senator FLANDERS. He can't raise enough, but the poultryman can raise wheat without any control at all.

Dr. HALVORSON. What happens now is that the farmer is restricted in growing wheat on his land, but he is free to grow oats, barley, and even corn in many cases.

Senator FLANDERS. I believe we can grow wheat in Vermont and across the State line in New York they can't. We don't raise enough to make a difference.

Mr. TRIGGS. I think an important consideration which should be given to this is the reaction that such a proposal would have on wheat producers in other countries, both consuming countries and exporting countries. This is something for speculation, but let us suppose for a moment that the dairy producers of Scandinavia, grouping them together for a moment, entered into a permanent, continuing, statutory, formalized program involving export of butter in large amounts to the United States at prices that would be less than those received by farmers in Scandinavia, no matter how they received it. I suspect that if that should happen the dairymen of the United States would arise en masse, a regular crusade; they would come to the administration, they would come to the Congress and demand some form of relief from what they would term unfair competition, and I suspect that the administration and the Congress, or both, would probably do something about this in the form of import quotas, or offsetting duties.

Senator FLANDERS. What would happen if Scandinavia and the United States did it simultaneously?

Mr. TRIGGS. We could produce cheap feed for them to export butter to us, I guess.

Dr. HALVORSON. I first want to point out that under this proposal the farmer would get, if the world market was $1.50 a bushel of wheat, only $1.50 a bushel. There would be no export subsidy. I think as long as we have an agricultural program in this country we are apt to have a price level above the world price level for what the American consumer pays. I don't think that is any reason for giving up our normal historical share of the world market. I would also say—you asked a very good question: What would happen to the world market on wheat? That is a question we are concerned with. We do not believe the United States should take on the job of stabilizing the world wheat market unilaterally.

Senator FLANDERS. How would our friends across the border in Canada feel about this scheme?

Dr. HALVORSON. We would say to the Canadians, "If you are concerned about giving the American farmer the right to compete with you on the world market without subsidy, let's get together on a world wheat stabilization program and let not the American farmer bear the whole brunt of cutting down his production in order to keep the world wheat price up."

Mr. BOLLING. Dr. Jesness?

Dr. JESNESS. Mr. Chairman, I have heard the expression "historical world market" or "traditional exports." I am frank to tell you I don't know what that is in the case of wheat. In 1935–39 we had exports running between 50 and 60 million bushels; in 1945 to 1948 we exported between 300 and 500 million bushels. I am certain that neither one of them represents our historic market but what it is I do not know.

Let me follow up Mr. Triggs' hypothetical illustration with one taken from real life. As Senator Flanders appreciates, my area is interested in dairying, particularly from the standpoint of manufactured dairy products, and there is more than a little resentment on the part of dairymen in the Middle West who produce manufacturing milk, over the restrictions of milk order programs in some of the eastern and southern markets which raises the price of class 1 milk apparently to the point, Dr. Halvorson, where the milk producers find it of advantage to expand their production of milk beyond class 1 requirements.

Senator FLANDERS. I didn't get that.

Dr. JESNESS. They expand their production beyond the class 1 requirements, and are competing with middle western dairy areas more and more in the manufactured market. I am afraid that your proposal, even though you say you eliminate subsidy, would create for some growers a situation where the payments on the domestic part of the program would make it worth while to increase production of wheat. The producer would consider the overall price. Consequently other countries would charge us with taking more than our "traditional" share of the world market, whatever that may be. They would look upon it as an invasion of their markets. I am not so certain that this program is as foolproof against the charge of being a form of dumping as some people seem to believe.

Senator FLANDERS. Of course, one of the advantages of the effects on milk of class 1 and class 2 is that the products made from class 2 can be stored, whereas your class 1 fluid milk, up our way at least, is supposed to go immediately into the fluid milk market.

Dr. JESNESS. That is unfortunate from our standpoint.

Senator FLANDERS. Isn't it more or less natural?

Dr. JESNESS. Not when the market is rigged.

Dr. HALVORSON. I had an experience last spring. A dairyman came to the National Grange office and said, "I wish they would change this milk marketing program." He said, "I cannot make money on producing milk up in this territory for the class 3 price. I would just like to produce milk for the class 1 price and not have to produce anything above."

Well, now, in most of these milk markets in order to share in the class 1 price, you have to produce surplus milk. He wished that he could just limit his production to class 1. Under our plan a farmer can limit his production to wheat for the domestic market if he so chooses.

Senator FLANDERS. Cannot he keep in class 1 if he brings his cows in uniformly throughout the year? That would lie in his own hands.

Dr. JESNESS. The only reason he has to produce a surplus is we do not have uniform supply of milk, and you have to have a surplus in flush months in order to have enough in scarcity months.

Senator FLANDERS. Our farmers up home have their cows come in pretty uniformly.

Dr. HALVORSON. That is true in New England.

Take New York State: The New York State farmer, practically all of them, have very high surplus, and if a particular farmer asks for the privilege of cutting down his herd so that he would only produce class 1 milk, they say no, you cannot do that. That stimulates production of surplus even in that area.

Dr. JESNESS. He can if it is producing his class 1 for the year. He cannot for the short-supply season. What New York has done shows up in the figures of manufactured dairy products. New York State is one of the areas that has expanded manufactured dairy products much faster than the manufacturing area in the Middle West.

Senator FLANDERS. May I just ask another question of Dr. Halvorson along this line: Do you feel that there is any application of that procedure you suggested that would apply to dairy products, or is that a case by itself? It seems to me to be on the face of it.

Dr. HALVORSON. No. We feel it has a very good chance of being workable for rice and a number of rice producers have indicated to us their willingness to sit down and try to work out a plan for rice.

With cotton, people have been a little bit afraid of it because there are a lot of complications, but we have had conferences with various cotton groups, and they have come to us to explore this thing, with the possibility of applying it to cotton. The cotton people are getting extremely worried, because of their loss of the world cotton market, and they have come up with proposals which amounted to export subsidy which we think is not nearly as desirable as our plan.

Senator FLANDERS. The question of difference, is the difference, in essence, between an export subsidy and domestic subsidy?

Dr. HALVORSON. Well, yes; there is.

Senator FLANDERS. That is what it comes down to?

Dr. HALVORSON. Yes; there is a difference. We feel that if for no other reason there is a very practical administrative reason. We can force the American consumer, or require the American consumer, to pay the parity price, because if for nothing else we can keep out imports, but there is no way, if we have a high price support on our domestic commodities, where we can tell another country, "You have to buy from us." We would just lose the market.

Senator FLANDERS. How would you keep out of the United States the wheat that came in at the lowered market price? Is that because you won't let the miller mill it without a certificate?

Dr. HALVORSON. Yes.

Senator FLANDERS. That is the control?

Dr. HALVORSON. Yes; that is right.

Senator FLANDERS. It isn't an embargo, it isn't a quota, but it is forbidding the American miller to mill, except as he buys certificates.

Dr. HALVORSON. That is right; he would have to buy a certificate.

Senator FLANDERS. Well, that freezes the farmer and freezes the milk.

Dr. HALVORSON. That is right. I don't know how you would solve the farm problem or how you will benefit the farmer with farm programs unless either the taxpayer pays or the consumer.

Mr. BAUGHMAN. Might I suggest—I am sorry——

Senator FLANDERS. I was going to say that I have become sufficiently involved so that I am willing to cease asking further questions. If there is any observation that can be made, I will be glad to help.

Mr. BAUGHMAN. Dr. Halvorson's last comment as to how you are going to benefit the farmer unless the consumer pays or unless the taxpayer pays stimulates me to make one additional observation. There is a tendency for many people to immediately jump to a conclusion whenever one suggests that there is a need for greater flexibility in the price-making mechanism for agricultural commodities that this will immediately work to the disadvantage of the farmer, probably both in the short run and in the long run.

It seems to me that such a conclusion is not warranted. The basic problem, as I see it, is one of excess capacity in agriculture. How does any industry adjust to a problem of excess capacity? Obviously, there is a need for a transfer of resources out of this industry into another one where those resources will earn a higher return and where they will produce a greater value of products for the benefit of the country and the individuals involved.

This kind of adjustment is taking place at a fairly rapid rate, but not fast enough to keep ahead of improving farm technology. However international economic policies succeed in maintaining a vigorous domestic economy, it will continue to be fairly easy for indivdual industries to make adjustments which are dictated by competitive markets. Thus, I would be inclined to take exception to the suggestion that agriculture can become a healthy industry, providing satisfactory levels of income for the people working in agriculture, only by depending upon the consumer or the taxpayer paying in the sense that they must pay more than would be dictated by competitive market prices.

Dr. HALVORSON. Mr. Chairman, I see that I have to say something to clear myself.

I agree fully that in the long run our objective should be to make agriculture so efficient that it can live even with present prices, although I think that even if we move resources out of agriculture, as Mr. Baughman indicates is desirable, and with which I would agree that might itself raise prices, but I was talking of the short run, the present situation. I think it is well agreed by a good many groups at the present time something needs to be done to boost or to bolster agricultural income, and it is impossible to bring about this adjustment that Mr. Baughman talks about in the short span that I had in mind when I made my comment.

Mr. BOLLING. Is that all, Senator Flanders?

Senator FLANDERS. Yes.

Mr. BOLLING. Dr. Ensley.

Dr. ENSLEY. Mr. Chairman, on Wednesday afternoon we have a session on East-West trade policy, but since Dr. Johnson is here I would like to get his reaction to the current popular proposal to ship food and fiber behind the Iron Curtain.

Does he feel that that would perhaps help break down the Iron Curtain in the direction of peace, or does he believe that it might just permit the Communists to use their resources for war-making equipment and conduct their imperialism more actively? What are his views with respect to shipping surplus food and fiber behind the Iron Curtain?

Dr. JOHNSON. Well, this is an extremely difficult and complex question, and I am not at all confident in my own competence to give an answer to it. I have thought quite a bit about it during and since I was in the U. S. S. R. this summer, though I should say that my experience there does not necessarily give me the necessary background to deal with such a question.

My own feeling would be if I had to make the decision that I would embark upon such program very, very slowly; that I think the real weak spot in the economy of the U. S. S. R. is in agriculture. They have, from all I can see, both while I was there and from what I can understand from the figures which they publish, achieved a very considerable rate of progress in the industrial field. They have not achieved anything similar to that in the way of progress in agriculture, and to in some sense help them to solve this problem, even in the short run, by subsidizing the exports of our products, I doubt if this would be in our own national interest.

If I though that such a program would lead to a genuine expansion of trade on their part, and willingness to import agricultural product over the long run and thus essentially depart from their policy of isolation, my answer to this question might be different because I think that this would imply in a sense a change in policy on their part, or at least some belief that over the long run war was not the answer to their problems. But unless you could be reasonably well convinced that this was to be a permanent change in policy—by permanent, I mean one going on for a decade or so—I am not at all sure it would be wise to move in this direction.

Senator FLANDERS. Along this line, I would like to ask the question, With what would the Soviet Government pay the bill?

Dr. JOHNSON. In the short run I suspect their capacity to give us things we would want is relatively limited. There are certain raw materials, timber obviously, although their timber industry is not functioning well. That is on about the same basis as agriculture. They haven't made that work, either.

Senator FLANDERS. I think the Finns are shipping lumber to Russia.

Dr. JOHNSON. Yes. This may be a matter of transportation, but they do have timber resources, but they haven't made this industry work very well.

As far as I could see from the things in the industrial part—and this is largely agricultural machinery, etc., the types of farm machinery they are now producing are not adapted for the world export markets. The machines are too big for the agriculture of the other parts of the world. However, I see no reason why they couldn't produce machinery if they wanted to that would fit into the export markets. But this would require a realinement of the composition of their output to do this. I think if they wanted to they could produce industrial products for export, but it is a question whether this is consistent with their longer run objectives.

In the short run, the exports they could sell competitively in the world markets would consist primarily of certain raw materials, particularly metals.

Senator FLANDERS. Red China has shipped rice, starving its own people, in return for industrial machinery with the Soviet Government. We could ship wheat, but on a business basis I have always questioned how long the Russians could do that. An indefinite extension of credit would probably be what they would ask for.

Dr. JOHNSON. That is quite possible.

Senator FLANDERS. They don't seem at the present time to have any surplus of anything to trade with.

Dr. JOHNSON. No; this is, I think, as far as industrial products are concerned, essentially a matter of internal policy as to how they want to divide up what it is they produce. If they are willing to give their people a better diet, which means principally allowing more livestock products to enter into it, they could by reducing investment and expenditures in the military field have industrial products to export. This is a matter of policy in the kind of society that they have.

Another thing, and this doesn't deal specifically with the question, I was going to say that one of the things I think we should view very closely in our efforts to get rid of our surplus problems in the world, engaging in dumping, or other price depressing measures, is that it seems to me that the Russians can make a great deal of propaganda hay out of this, by stepping in to bolster a market, say, in southeast Asia, as it is rumored they have done in the case of rice with Burma. I don't know whether it is true or not, but at least the rumor has been reported in the papers, though I don't think the cotton deal with Egypt really is involved here. There are other things behind that, because we have thus far, since we haven't engaged in export dumping operations in cotton, really supported the market for Egyptian cotton. I think we have to be careful we don't allow them to encroach on our political sphere for just the right to get rid of a few thousand bushels of wheat or of rice.

Dr. ENSLEY. If we did ship wheat and cotton to Russia, do you think that they would be used to raise the level of living of the people or would they be stockpiled for possible use in case of war?

Dr. JOHNSON. Both of these products that you mentioned are, of course, very adaptable to a stockpile. I have no idea of what the present stockpiles of the Russians are of these commodities. I have a suspicion they are fairly low, and that it would not be outside the realm of possibility—let us put it that way—that any large-scale imports of these commodities could be stockpiled for a number of years. They talked a number of times, for example, one of the explanations given for the reasons of embarking on this recent expansion of grain production was to increase state reserves. That was definitely to be taken out of current production inside the U. S. S. R. Certainly, United States wheat could substitute for Russian wheat in such a reserve.

Dr. ENSLEY. Thank you very much, Doctor.

Mr. BOLLING. Dr. Sheldon?

Dr. SHELDON. Dr. Johnson has just commented on some of the political implications of trade with the Soviet bloc. There have been recent news stories not only on Russians buying cotton from Egypt, which has very obvious political-military overtones, but they are also selling cotton in Western Europe. In addition to the problem of Russian purchases of rice in southeast Asia, our own economic plans with regard to rice have had repercussions on the rice of southeast Asia.

Mr. Baughman was outlining for us some of the alternative policies which might be considered to solve the agricultural problems we face in the trade field, and we have reviewed a number of them. I wonder whether he would want to comment on the rice problem. We have rice surpluses. It has been suggested that we might ship those to parts of the world where people are hungry.

What are the implications of that kind of rice export from the United States for the economic well-being of countries like Burma and Thailand?

Mr. BAUGHMAN. I don't think I am very well qualified to comment in any detail on the rice market in that part of the world. I, too, have the impression that there have been some vigorous objections raised to proposals that we export rice to that area. I have the impression, also, that some of these objections have been voiced in rather emphatic terms. This is something which those responsible for our relations with other governments must consider pretty carefully.

The possibilities of the United States maintaining a large volume of exports of rice apparently will depend very largely on what happens to rice production in Asia. Prewar Asia supplied its own needs and a substantial volume for export. They have not yet gotten back to that position in the production and distribution of rice in the postwar. Whether or not they will regain their earlier position remains to be seen.

There are some folks in the United States who believe that over a period of time we can maintain a volume of exports of rice approximating the high level of some recent years. I will have to admit that I have a good deal of reservation myself as to whether the American rice producer, except with the strong support of American taxpayers and the Federal Treasury, will find it to his advantage to maintain such a volume of rice exports.

Dr. SHELDON. Dr. Johnson, you pointed out that one of the things we might do with surplus foods is to encourage education, roadbuilding, and similar projects in other countries. In the larger context of the hearings which have been underway here I think this raises rather an interesting footnote: The fact that consumable supplies can be the equivalent of a capital export. Typically one thinks of foreign investments, capital exports, as being machinery and other indirect goods of that sort.

Do I understand from your descriptions that in effect these food exports can become the equivalent of a capital export by their shipment from the United States? They release local resources, where savings otherwise would be very low, to enable capital expansion?

Dr. JOHNSON. Yes; this is the idea behind it, and I am looking on education as kind of an investment, which it really is, and that there are some other kinds of investment which require primarily human labor, and the biggest thing required in education is people, persons. Like roadbuilding, which even in relatively advanced countries, not necessarily our own but in others, roadbuilding is also something requiring primarily labor, and in a poor country the main use that laboring people make of their income is for food and insofar as this is true you can essentially supply the main thing that is required, namely food. But I think Mr. Baughman is quite correct in pointing out first of all you don't want to anticipate that you are going to move tremendous volumes in this way, and, secondly, I think it needs to be pointed out that such programs have to be worked out quite carefully so that you don't disrupt local markets, and discourage local producers of the same commodities, or related commodities.

In many cases they are the same, wheat or rice, as the case may be. I do feel this type of measure, which could have long-run political implications to our advantage, might well be investigated, and at least some trials of it given in the countries that are willing to experiment with it.

I believe there is a big drive throughout most of the world today to try to reduce illiteracy, and this is a drive that has a lot of national enthusiasm behind it, and it is the kind of program which it seems to me we would have advantages in pushing or helping wherever we can. Other things might well be required. You have got to get teachers trained, for example, to do this, and things of this sort.

Mr. BOLLING. Mr. Triggs?

Mr. TRIGGS. I certainly wouldn't speak against the Public Law 480 that we have supported. We are for a reasonable and moderate program in this field, but I think that there is some danger in it being carried too far, because let us not lose sight of the fact that the American taxpayer would be paying for these roads and these schools. We have some interest in this country in a big expansion of Federal financing of our highway building program, and a big program of Federal aid to education. Somehow these things all get related, and a lot of folks would very much criticize a foreign aid program to build roads and schools in other countries when we cannot find the resources to do the same thing in this country.

Mr. BOLLING. If there are no further questions, thank you very much, gentlemen. We thank you for your contribution and your cooperation.

At this point the subcommittee will adjourn until tomorrow morning at 10 o'clock in the same room when the subject will be international cooperation and trade.

(Whereupon, at 3:55 p. m., the subcommittee adjourned until Tuesday, November 15, 1955, at 10 a. m.)

FOREIGN ECONOMIC POLICY

TUESDAY, NOVEMBER 15, 1955

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met at 10 a. m., the Honorable Richard Bolling (chairman of the subcommittee) presiding.

Present: Senator Ralph E. Flanders.

Also present: Grover W. Ensley, staff director, and Charles S. Sheldon II, staff economist.

Mr. BOLLING. The subcommittee will be in order.

This is the fourth day of hearings for the Subcommittee on Foreign Economic Policy. On the first 2 days, the background of statistical analysis and principles was laid. Yesterday we concentrated on domestic reactions to trade. It was clear that American industry, labor and agriculture have strong interests in both imports and exports. I think it is safe to conclude, too, that the United States cannot make its trade policy independent of the behavior and reactions of other countries. We saw that not only do domestic interests react to trade. It was made equally clear by many witnesses yesterday that our conduct, good or bad, inevitably calls for counter moves on the part of other governments.

It is therefore appropriate that we devote this morning's session to international cooperation in trade. All three of our participants are well qualified to speak on their respective subjects, and we expect a profitable discussion.

Our first witness is Dr. Raymond Vernon of the firm of Hawley & Hoops. Dr. Vernon is well known as a writer on economic and political subjects. Until recently he was with the Department of State as the advisor on commercial policy and Deputy Director of the Office of Economic Defense and Trade Policy. Special missions have taken him all over the world. He served on the staff of the Randall Commission. Dr. Vernon is going to discuss the General Agreement on Tariffs and Trade, and the Organization for Trade Cooperation.

Dr. Vernon.

STATEMENT OF DR. RAYMOND VERNON, HAWLEY & HOOPS, INC.

Dr. VERNON. Thank you, Mr. Chairman.

Perhaps I should begin by saying a few words about the General Agreement on Tariffs and Trade, itself.

The agreement and the quasi-organization that it represents has been, I think, something of an unnecessary mystery to the American public and it may be well to try to clarify it in a few words.

The General Agreement on Tariffs and Trade, GATT, came into existence almost as an accident in 1947 and 1948. At that time the shape of postwar planning envisaged three international organizations, an International Monetary Fund, a World Bank, and an ITO. The ITO was an enormous, elaborate, complex enterprise, as it was developed over the course of the years in talks between the United Kingdom and the United States, and later among some fifty-odd countries in Habana. It covered about 106 different articles in 7 or 8 long chapters, comprehended the setting up of a whole series of complex committees, and really covered everything in the trade and economic relations field from soup to nuts.

Now, a lot of European nations in this enterprise had a common concern with respect to our trade. Their question was, "Does the United States propose for the long run gradually to reduce its tariff barriers or not?" If it does, we can envisage ourselves cooperating with the United States program for the gradual reduction of trade barriers, which ultimately would end up with our eliminating our exchange licensing and our quotas, provided that the United States contemplates that for a reasonably long period of time in the future, with a reasonable degree of permanency, it proposes to reduce its greatest impediment to imports, namely, tariffs.

Now, they wanted an earnest of our good intention, therefore, and the United States, considering that this was a perfectly reasonable approach, proceeded to negotiate in Geneva with 19 so-called key countries, on the reduction of tariffs.

Incidental to those negotiations the GATT was created. Everyone anticipated that within a couple of years the GATT would disappear, as ITO came into existence. The GATT was, relatively speaking, a simple trade agreement. Its purpose was to provide a structure within which tariffs could be reduced by negotiation and to lay down rules of the game. Two rules in particular were important: One, that countries should not discriminate in their import restrictions whatever they might be, and the other that ultimately quotas would be eliminated.

There were a lot of exceptions to these simple principles. Some of them were framed at the insistence of the United States. The United States had an agricultural price-support program which created certain difficulties with respect to imports; other countries had economic development ideas, and so forth, but despite these numerous exceptions the general fabric of the structure was perfectly apparent. This was a moderately simple organization, devoted to nondiscrimination and to the gradual reduction of trade barriers.

From 1948, from the time GATT was first created, until 1955, the organization flourished, and I think it is fair to say it flourished in spite of the intent of its participants, not because of it. Nobody was particularly anxious to create an organization out of the GATT. Yet business was put on the plate of the GATT that was tremendously important to the participants in the GATT. Almost reluctantly, they created an ad hoc committee to deal with agenda problems between sessions; they gave more support to the secretariat which initially had been borrowed from the commission that was to go about the business of creating the ITO; and little by little you began to get the trappings of an organization.

It was a very busy little organization. In the course of the 8 years of its existence to date it has conducted three and is now on the verge of conducting a fourth major tariff-negotiating session. In addition, it is in its 10th regular meeting, and in these meetings it deals with the most complex kind of trade complaints, complaints by one country against another involving harmful trade practices.

These complaints are very difficult to deal with because the facts are difficult to establish, and sometimes the roots of the dispute go back 30 or 40 years and have been festering in that long period with no way of being cured. Then every country, of course, has to deal with each of these disputes with one eye on the domestic groups back home and another eye on its international relations. Nonetheless, as I propose to show in the next few minutes, the GATT has succeeded in dealing with these disputes in a way which I believe is quite remarkable.

Now, several years ago the Randall Commission proposed that the organizational aspects of the GATT be reviewed, and as a result of that proposal the United States went to the other contracting parties and said, in effect, "See here, we have been developing something that looks like an organization. Let us bring the thing out in the open, have a good look at it, see whether we really want an organization, and, if we do, let us develop it formally. When we have developed it each of us will take it back to our respective governments and see whether or not our governments want to approve."

Out of that proposal there developed two international agreements, in effect: The GATT, which is a trade agreement, and a so-called agreement to create an Organization for Trade Cooperation.

The two agreements can get easily confused. As far as the United States is concerned, the President proposes to accept the responsibility for having negotiated a trade agreement called the GATT. He is not asking the Congress to approve this. He takes the position, and I think correctly, that GATT was negotiated under the Trade Agreements Act, and under his powers to conduct the foreign affairs of the United States.

He has asked the Congress, however, to authorize him to participate in a small organization, one of whose functions would be to facilitate administration of the GATT.

Now, this, of course, makes it inevitable, and I think it is quite proper, that Congress will in the next session get into the question of the detailed provisions of the GATT. But in the end, as I say, they will not be asked to approve the GATT nor will they in any sense have their hands tied with respect to domestic legislation relating to trade practices. The President will simply have to accept the responsibility for negotiating the GATT and the risk that the Congress at some time or another may pass domestic legislation inconsistent with the GATT. This is a risk which exists in any executive agreement, and, indeed, in any treaty. The President will have it with respect to the GATT even if the OTC is approved.

Let me go on to some of the things which the GATT has accomplished. Some of them make fairly fascinating reading. To begin with, under the general aegis of the GATT, the 34 or so countries that participate have committed themselves with respect to about 60,000 different tariff rates covering about 60 percent of the world's trade. Right at the very moment their commitments are firm, with the exception of such things as escape clauses, until January 1, 1958. This has created a kind of tariff truce the like of which has never existed, I think, in the history of trade relations among modern states. It has created a kind of trade stability which the United States had always hoped to achieve.

But, in addition to these tariff negotiations, GATT has dealt with a whole series of disputes to which I have earlier alluded, and I would like to just cite 1 or 2 of these disputes so that you can get the sense of the kind of problems they are asked to deal with.

The Belgians, for example, had been imposing import restrictions against United States coal. The reason why the Belgians had been imposing these restrictions is fairly complex. Part of the reason was that they were getting substantially increased imports from the five other countries which had joined them in the European Coal and Steel Community, and which now could send coal freely to Belgium. But there was no reason under the sun, so far as the GATT was concerned, why Belgium should be permitted to impose quota restrictions against the United States, and the United States after complaining through diplomatic channels bilaterally and getting no relief brought formal protest in the GATT.

Now, the approach of the GATT to these problems is an approach in equity rather than in law. The GATT participants try to avoid any statement that country X has violated the GATT and therefore should be punished, or anything of that sort. What they do basically is to look at the circumstances of the case and see whether the effect of the particular violation, or whatever you want to call it—they frequently do not call it a violation—has impaired the balance of the agreement, and, if it has, they then ask the offending party to amend his behavior in some stated way.

In this case the Belgians were asked ultimately to eliminate these restrictions, and right at the moment, if I have my facts right, they have very substantially reduced them.

The United States was concerned about the fact that in tariff negotiations with Brazil, although the Brazilians committed themselves to certain tariff reductions, they simply hadn't put the tariff reductions in effect, and after a certain amount of bilateral consultation the United States finally went to the GATT and secured the relief which they wanted.

Norway had a classic dispute with Germany over the prosaic problem of sardines, terribly important to Norway. The dispute goes back about 30 years to the 1920's. The Germans had persisted in making distinctions among different kinds of sardines and from time to time had favored Portuguese over Norwegian sardines. The problem was complicated by the fact that there are a dozen different varieties of sardines and the GATT had to get into the question of whether Germany, in treating Portuguese sardines as different from Norwegian sardines, was discriminating. The GATT said: "Let us not get into these distinctions. The fact is Norway was entitled to assume she would get the same treatment the Portuguese were getting, and she didn't get that treatment. We suggest she do." Germany promptly complied.

These disputes go on and on. I think there were 16 or 17 on the agenda of the 9th session, and I don't know how many there are on the agenda of the 10th, but the odd thing about them is that they get settled.

I say this is odd because the typical dispute before the GATT has historic roots and has festered for some time. This is almost as true of disputes under the United States bilateral reciprocal trade agreements as it was true of other kinds of trade agreements around the world. Bilateral agreements simply do not afford the kind of forum you need to settle international trade disputes.

There is another activity that the GATT engaged in, operating in tandem with the organization that Dr. Friedman has allegiance to, the International Monetary Fund. This was the business of constantly putting pressure on governments which were short of foreign exchange, to reexamine their position and see whether in the circumstances they could not reduce their restrictions against dollar goods.

The GATT engaged annually in consultations with countries which were maintaining discriminatory import restrictions, and annually opportunities were presented to the United States to present its case in an international forum for the reduction of these quantitative restrictions.

The International Monetary Fund did a great deal of important factfinding prior to each of these consultations This was a real illustration in international agency cooperation.

Now, whether it was due to the efforts of the fund, the efforts of the GATT, or the efforts of the third international organization, the OEEC, does not really matter, but the fact is that beginning around 1951 one began to see the beginnings of a substantial reduction in quantitative restrictions Canada had almost eliminated her restrictions in the late forties, South Africa followed with a substantial amelioration of her restrictions, and then all of the western European countries, or almost all of them, began to reduce their restrictions.

While I would not assert that it was the reduction in these restrictions alone which accounted for the enormous increase in Western European imports from the United States over the past year, I have no doubt, no doubt whatever, that a considerable part of that increase in imports by Western Europe would not have occurred in the absence of efforts by these three agencies.

If I were asked to qualify that concept, I think I would almost dare to say that what we are talking about is an increase in imports amounting to some hundreds of millions, perhaps a billion dollars a year, which might well not have flowed from the United States to Western Europe had it not been for these efforts.

Now, one other aspect of the GATT which deserves comment is its relationship to United States political rather than economic objectives.

Let me illustrate my point: When the United States decided that it was important in the interest of the United States that the German economy recover, one of her procedural problems was how best and most rapidly to get the other nations of the world to accept the Federal Republic of Germany's goods on a nondiscriminatory basis. The United States achieved this objective by various devices, bilateral representations, and one thing or another, but one of the important steps in this process was to have the Federal Republic of Germany accepted as a member of the GATT. This had the automatic effect of giving the goods of that country nondiscriminatory access to all of the markets of the world, or at least the markets of the 34 member countries of the GATT.

The United States attempted the same sort of thing with respect to Japan, with a much more limited degree of success, but far more success, I am convinced, than if the GATT had not existed, and Japan now has a nondiscriminatory access for her goods to upward of a dozen countries through her adherence to the General Agreement on Tariffs and Trade.

This is a forum in which nations have to expose their contentions to other nations. They have to put themselves in a defensible position when they resist such a thing as granting nondiscriminatory access for Japanese goods and the reasons given have to be rather better than one would need in private diplomatic exchanges. In the private diplomatic exchanges frequently no reason at all is necessary to deal with a nation's complaint.

Another illustration of the same point was a dreadful dispute between India and Pakistan that was going on in 1951 or 1952. The Pakistani were discriminating in their exports of jute to India; the Indians were discriminating in the way in which they exported coal to Pakistan. Neither country would talk to the other. None of the larger nations wanted to get into the dispute for fear that they would be clobbered from both sides and it took a kind of an impersonal informal little committee such as the GATT is frequently able to create to take these parties aside, talk to them, and try to develop a method of settling the dispute. To everybody's surprise, including Pakistan's and India's I suspect, a basis was found for settling the dispute. It took about 6 months. In the end they eliminated their discriminations and a nasty little situation was solved in a manner which I think only an impersonal GATT organization could do.

This illustrates what is my last point and a larger point. It is this: That just as long as the United States has to accept a portion of the responsibility for—let me use a hackneyed phrase—leadership in the free world, there must be organizational arrangements through which she can exercise this leadership. Bilateralism won't do. The GATT serves that purpose in some limited degree.

In the GATT you get the nations of the free world coming together with their common problems, finding ways of half meeting them, at least reducing tensions, getting the sharp edge off the argument, and providing one element in that loose alliance of free nations which the Soviet Union is able to provide by dictation to the satellites which are a part of her bloc. I don't want for a moment to suggest that the United States position in the free world is analogous to that of the Soviet Union in its bloc. I simply suggest that this loose coalition of the free world needs its economic institutions to remain a coalition and the GATT is a major institution for contributing to that objective.

(The complete statement of Dr. Vernon is as follows:)

STATEMENT BY DR. RAYMOND VERNON ON THE IMPORTANCE OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE TO THE UNITED STATES

There was a time not long ago when experts on the GATT were rare as hen's teeth, when, indeed, the initials themselves were something of a mystery. According to the prevailing notion the GATT was so complex, so lengthy, and so turgid that its provisions would baffle the legislator and be altogether beyond the comprehension of the layman.

I suspect that this ghost is finally beginning to be laid at rest. The GATT is technical, to be sure; it cannot help but be, given the subject matter of international trade. But its main principles are reasonably straightforward. Indeed, compared with the average congressional enactment in the field of customs simplification or tax law, it could almost be called simple and concise.

PROVISIONS OF GATT AND OTC

Let me try to set out the main provisions of GATT. First of all, it is a tariff agreement—an agreement in which each of its 34 signatories commits itself to hold down its tariffs for certain specified products to certain stated levels. This kind of agreement is one with which the United States is now quite familiar. This country has been entering into such agreements since 1934, following the original enactment of the Trade Agreements Act.

The difference between the tariff operations under GATT and those conducted by the United States before the war is that these earlier negotiations were bilateral agreements; each such agreement involved the United States and one other country. GATT tariff negotiations, on the other hand, are multilateral. As a result, GATT provides a way of getting other nations to bargain with each other to reduce their tariffs at the same time that they negotiate with the United States and, since the tariff reductions undertaken by any country in these other negotiations are extended to the goods of all the other GATT countries, the United States has found a way in GATT of obtaining benefits from the tariff negotiations of all its 34 members.

But GATT does not consist of tariff commitments alone. It contains a series of other undertakings to which its 34 members subscribe, commitments which deal with other aspects of their trade practices. Most of these undertakings, like the tariff negotiations themselves, trace back to the principles developed in the United States reciprocal trade agreements before World War II.

One basic GATT principle is the rule of nondiscrimination or most-favored-nation treatment, a principle adopted by the United States in 1922 when Charles Evans Hughes was our Secretary of State. For another thing, the GATT lays down a general prohibition on the use of quantitive restrictions or quotas. Beyond that, GATT deals with a variety of other issues: Among other things, it guarantees the right of its members to move their goods in transit through third countries; it rules out excessive redtape and gross inequities in the administration of customs procedures; and it subjects export subsidies to international security.

Of course, few of these rules of the GATT are free of major qualifications. Like any agreement among soverign nations, GATT has been shaped to accommodate the special economic and political problems of its members. The nations with agricultural price-support programs have been left free, within limits, to maintain these programs and the import restrictions which go with them. The underdeveloped nations have been given a freer hand to protect their infant industries than GATT's general rules would otherwise permit. The countries short of foreign exchange have retained a qualified right to impose import restrictions to ration their inadequate exchange. And all nations have been assured that economic measures directly related to their military defense would not be inhibited.

The instrument therefore has embraced numerous qualifications to its basic rules and these exceptions have figured importantly in the history of GATT's administration. Yet these exceptions have not greatly obscured GATT's principal structure and dominant purpose—those of an agreement devoted to the principles of nondiscrimination and the general lowering of the world's trade barriers.

But the real innovation which the GATT has introduced in international trade relations is the mechanism it has provided for settling trade disputes between nations. In times past, when such disputes developed, they ordinarily were allowed to fester until they had soured political relations between the nations concerned. Bilateral tariff agreements, such as the United States had developed under its trade agreements program in the 1930's, were only a little better in this respect than no agreement at all. When one country accused another of violating such an agreement, there were no parties but the disputants to decide the facts, interpret the agreement, and find a remedy. As a result, any dispute of major proportions under bilateral agreements typically has led to an impasse and to the dissolution of the agreement.

I shall have more to say in a few moments about the GATT's role in the settlement of disputes. At this point, however, it may be useful briefly to describe the proposed Organization for Trade Cooperation. To fit the OTC into the picture, one has to recall that GATT is a makeshift arrangement. It came into being in 1947, almost by accident, while the much more ambitious ITO was being negotiated in Habana. As its creators envisioned it, GATT was to serve as a temporary tariff agreement, pending the time when ITO would come into existence. It was to have no organization, no executive committee, no staff of its own. Its business would be conducted by the signatory governments themselves, meeting from time to time in plenary sessions. As far as the United States was concerned, it was to be simply another trade agreement, albeit a novel one, entered into by the President as part of the reciprocal trade program.

This was fully 8 years ago. In that period these makeshift arrangements have been shaped by necessity and experience into a mechanism containing most of the ingredients of an international organization. Between their annual sessions, the signatory countries have handled their most pressing business in an Ad Hoc Committee with limited powers. A secretariat has been bororowed, first from the Interim Commission for an ITO, then later from the United Nations.

A year ago, under the leadership of the United States, the GATT member countries agreed to try to convert this organization de facto into an organization de jure. An agreement which would establish the OTC was developed for submittal to member governments and, in due course, the United States Congress was asked by President Eisenhower to authorize United States participation. Congress will presumably pass on this question at its next session.

It is important to understand not only what Congress is being asked to approve but also what it is not being asked to approve. Congress is not being asked to approve the GATT; nor is it being asked to curb its inherent right to enact legislation inconsistent with the GATT. The President accepts the responsibility for the GATT as an agreement negotiated by him under the Trade Agreements Act; as far as he is concerned, it needs no further sanction from the Congress. The President also accepts the risk that Congress from time to time may compel him to act in a manner contrary to the GATT; this is a risk he cannot avoid whenever he enters into an executive agreement with other countries. What he asks for is the right to participate in an international organization which would administer the GATT, "facilitate intergovernmental consultations" on trade matters, "sponsor international trade negotiations," and "make recommendations" on trade questions.

As is so often the case with international agreements, the rejection of OTC by the United States would have far more extensive international repercussions than its acceptance. Since the war's end, other nations have never really known whether the United States in principle was prepared to accept the proposition that each nation's conduct of international trade is properly a matter for the collective concern of all trading nations. While the executive branch has given fairly consistent support to the proposition, the congressional view has been more obscure. Anyone wishing to make a case that the Congress still regarded United States trade policy as largely a domestic affair could have found ample evidence in the Congressional Record to support his conclusion. As far as other nations are concerned, then, this is the critical test of whether there is basic support in the United States for international cooperation on trade matters.

TRADE BARRIER REDUCTIONS UNDER GATT

There was a time in the late 1940's when GATT's periodic sessions for the negotiation of tariff reductions might have been construed as a kind of game in which almost all the players were using counterfeit money except the United States. Except for some rather extraordinary redtape in our customhouse and except for quotas on a few agricultural products, the United States had only its tariffs to keep out foreign goods. Most other nations, however, had not only their tariffs but quotas and licenses as well to plague the importer.

This did not mean that all United States exporters to foreign markets were suffering at the time; far from it. Foreign countries were buying every penny of United States goods that their foreign-exchange supplies permitted. It did mean, however, that a tariff reduction on any particular product by a foreign country was far from guaranteeing the effective reduction of governmental barriers to the import of that particular product; for, tariff or no tariff, quotas commonly controlled the import of dollar goods.

Nevertheless, United States representatives doggedly spearheaded a series of negotiations for the reduction of tariffs, reasoning that in the end these reductions would be of value to the United States. By stages, these negotiations brought the world's tariff walls measurably lower in 1955 than they had been in 1947. In the end, about 60,000 tariffs affecting perhaps 60 percent of the world's trade were the subject of these tariff concessions. By 1954 and 1955, this policy of tariff reductions was obviously producing tangible dividends for this country. Beginning in the late 1940's, as European recovery developed, the other principal trading nations of the world began the long job of dismantling the system of quotas and licenses they had imposed earlier to regulate dollar imports. Canada led the trend; South Africa followed part of the way. Then Belgium, Holland, Germany, Sweden, Denmark, and the United Kingdom began to reduce their rationing of dollar goods. By 1954, virtually every country of Western Europe had taken tangible measures toward removing its quotas on dollar goods and allowing such imports to be regulated only by the tariff. Western Europe's imports from the dollar area grew spectacularly after early 1954, the increase alone amounting to about $2 billion a year by early 1955. In this period, for instance, Western Germany's dollar cotton imports went up 47 percent; her dollar chemical purchases rose 46 percent; her machinery imports bought for dollars increased 146 percent. The United Kingdom, for its part, bought 36 percent more dollar cotton; 39 percent more dollar chemicals; 76 percent more dollar nonferrous metals; 44 percent more dollar machinery; and so on.

These import increases, of course, were sparked by Western Europe's extraordinary economic recovery of the last few years. But recovery or no, the rise in imports would have been less pronounced if the United States had not had the foresight through GATT to negotiate for the reduction of the world's tariff walls.

The GATT mechanism can claim a share of the credit not only for the reduction of the tariff levels of the trading world but also for the relaxation of the quantitative import restrictions to which I have referred. During the dark days of the late forties and early fifties, when trade was still being straitjacketed by quotas and licenses, the United States availed itself of each GATT session to impress on other countries the economic and political advantages of mitigating their quota systems. There was a deep-seated skepticism at the time, both within and outside United States governmental circles, that this exhortation would ever do much good; it was widely felt that, by one device or another, the protectionist groups of other nations would keep their economies locked behind the comfortable walls created by quotas. Time proved these skeptics wrong. The GATT and the International Monetary Fund shared credit with the OEEC for providing organized pressures on nations to relax their quotas on dollar goods as their foreign exchange reserves permitted.

SETTLING TRADE DISPUTES

GATT's most substantial achievement, however, is one which has been least discussed in the American press. This is its role in the settlement of trade disputes among the nations of the free world. In the earlier years of the GATT's existence, few disputes had been placed before the GATT signatories for their consideration. Nations were not in the habit of airing their trade grievances in the semipublic forum provided by GATT's meetings. They preferred, instead, to threaten and plead in the relatively private medium of diplomatic exchanges; to retaliate where they dared; and to let their grievances fester when retaliation seemed dangerous.

In 1950, however, Chile laid one of the first of a series of complaints before the GATT members, objecting to Australia's treatment of fertilizer imports. The dispute was soon settled to the satisfaction of both parties, paving the way for much more business of the same sort. Norway, which had been bickering with Germany for 30 years over the latter's discrimination against Norwegian sardines, brought her case to the GATT and obtained a settlement. The Dutch, who felt that the United Kingdom was unfairly placing a luxury tax on some Dutch imports which were not luxuries, managed to get the GATT parties to urge the United Kingdom to change her tax laws, a request with which the United Kingdom complied. Denmark and Norway, on complaining in GATT against a system of Belgian internal taxation which discriminated against their products, managed to get Belgium to eliminate the discrimination from her statute.

Later on, when the United States and the United Kingdom formally complained that Brazil had failed to carry out some of the tariff commitments the latter had previously made, Brazil was persuaded to put them in effect. A United States complaint against France, based on France's imposition of an import duty labeled as a statistical tax had similar happy results. The United States was also the moving party in a complaint against Belgian restrictions on coal imports, managing to get a substantial easing of the restriction as a result of her complaint.

The catalog is longer than this recital of cases and it grows each year. The GATT has managed, almost without being consciously aware of the trend, to provide a forum for the settlement of complaints, quite without parallel in the checkered annals of the world's trade relations.

Of course, many actual or prospective violations of GATT have never had to come before the contracting parties for discussion or adjudication. An impressive number of complaints have been resolved simply by bilateral consultations based on the GATT's provisions. The United States, for instance, commonly obtained redress by these means. Typical of such cases was one involving a British requirement banning the manufacture of pure Virginia tobacco cigarettes and requiring the admixture of small amounts of oriental tobacco; United States protests, based on the provisions of GATT, secured the repeal of the requirement. In another case several large potato shipments from the United States were embargoed by a foreign country in violation of GATT, and again bilateral discussions produced results. Still other situations which were eased through bilateral representations on the basis of GATT provisions included the discriminatory buying of apples by another government, the discriminatory pricing of United States cigarettes by a government tobacco monopoly, and the discriminatory taxing of United States tobacco, foodstuffs, newspapers, and cosmetics.

The strength of the GATT in the settlement of disputes is all the more extraordinary because the GATT parties have no really effective means of enforcing their views on disputing members. Strictly speaking, all that the members can do in any dispute is to state their views on the rights and wrongs of the case in the light of the agreement's provisions and to recommend a remedy. But any disputant, if it wishes to fly in the face of such a collective opinion, may do so. In that case the GATT's members may authorize retaliation by its aggrieved member. But even in this case the transgressing nation is allowed to have the last word; for in such a situation the transgressor is free to withdraw from GATT on 60 days' notice.

One of the ironies of the GATT's administration is the fact that the outstanding case in which a nation has refused to pursue the recommendation of the GATT's signatories in the settlement of a complaint has been provided by the United States. In applying its restrictions on dairy product imports in 1951 the United States violated the GATT's provisions. Despite the complaint of the Netherlands, the President maintained these restrictions. Accordingly the Netherlands was authorized to retaliate by restricting wheat-flour imports from the United States, a right which she retains to this day.

The incident serves to drive home a basic point. The GATT is not a body of international law imposed on nations under penalty of sanction. It is much more nearly analogous to an international contract among sovereigns in which performance cannot be enforced, but damages are due from any errant party. It has both the advantages and the limitations of contracts, as distinguished from law. While it affords some predictability as to the behavior of the other parties, it offers no ultimate means of enforcing such behavior in the face of national resistance.

GATT AS A POLITICAL INSTRUMENT

The GATT has served the interests of the United States in a variety of ways not related to United States trade. For one thing, its existence has provided a ready means for obtaining agreements on trade projects which have had the political support of the United States. The point is well illustrated, by the way, in which Germany and Japan secured reentry into the trading markets of the free world. Germany, it will be recalled, was sponsored by the United States for admission to the GATT as part of a concerted campaign to revive her weakened economy, and her admission to membership in the group was the prime instrument by which German goods secured nondiscriminatory entry to the free world's market.

Japan's admission to GATT, again under United States sponsorship, was a more prolonged process and in the end was only achieved subject to many qualifications. Yet it is fair to conclude that the treatment of Japanese goods in world markets is significantly better today than it would have been in the absence of the agreement.

GATT has contributed in other ways to United States political objectives. When France and Germany undertook in 1950 to create a European Coal and Steel Community in an effort to heal the breach between them, the principal international stumbling block to creating the Community appeared to be the unwillingness of outside nations to tolerate the preferential trading arrangements for coal and steel which were implicit in the Community's creation. It was in the GATT that this issue was first debated. Under the urging of the United States and Canada in the GATT forum, the initial resistance of the United Kingdom and Scandinavia was eventually changed to acquiescence. In the end, safeguards were erected by the GATT members against the unwarranted abuse of these preferential arrangements and the Community was allowed to come into being.

Still another case of significance was the GATT's settlement of an explosive dispute between Pakistan and India, involving Pakistan's sale of jute and India's sale of coal. Relations between the countries were almost unendurably taut. None of the major nations was willing to take on the thankless task of peacemaker. But a relatively nonpolitical agent in the form of a GATT committee could and did act as intermediator, without the risk of political overtones. Within 6 months, the dispute was settled to the satisfaction of Pakistan and India. These cases simply illustrate a general proposition. As long as the United States has thrust upon it the task of providing some sort of economic leadership for the free world, it will need organizations to help in the exercise of that leadership. The GATT provides such an organization. Its disappearance would impair the free world's ability to reconcile their interests in a workable system of world trade.

THE FUTURE ROLE OF UNITED STATES FOREIGN TRADE

Over the years, the domestic growth of the United States has outpaced its foreign trade. As our internal markets have grown, we have lost touch as individuals with the influence which imports and exports exercise upon our lives. In overall figures, of course, this influence does not seem great. But even in products where foreign trade is important, we in the United States are scarcely aware of it. Most American cotton farmers would be astonished to discover that 1 bale in every 4 they raise is consumed overseas. And I am inclined to doubt that many of Detroit's automobile workers are aware that 1 American truck in 5 ends up in foreign markets.

While this overall role of foreign trade in our economic life is not striking in our national totals, there are good grounds for the expectation that the United States direct economic stake in open world markets, such as the GATT aims for, may increase rather than otherwise over the next 25 years. In its use of rew materials, the United States has been engaging in a race of exhausting its resources against developing synthetics. So far, our resource exhaustion has outpaced our synthetic substitution. In forest products, in mineral products, and in agricultural raw materials, we have shifted from net exporters to net importers over the last 50 years. For the long run, our apparent interests lie in a ready access to the world's raw materials; or, to put the matter in the GATT's terms of reference, our interests demand a world in which governments limit their interference with the export of raw materials.

Our interests in world markets, however, do not stop with raw material imports. We have an interest—of late, a growing interest—in selling our goods on world markets. And it is not unreasonable to anticipate that this interest, like our import interest, will increase. Indeed, in the long run it must increase if our increased raw material imports are to be paid for.

It is not difficult to envisage where these markets may grow. The developing areas of the world—Canada and parts of Latin America, the Middle and Far

East, and Africa—are showing the capability to grow at a relative rate faster than the internal American market. This growth will provide the United States with new markets, provided the commercial policies of these areas permit us to sell to them. They are markets which we may well find helpful in sustaining our growth, just as we found the European markets helpful in buoying up our activity when our own economy faltered briefly in early 1954. But the accessibility of these growing markets will depend in part on American commercial policies, not the least of which will be our policies with respect to the support of institutions such as the GATT.

Mr. BOLLING. Our second speaker this morning is Dr. Irving S. Friedman. A writer on economic subjects, he also has served as a monetary and trade advisor in such countries as India, Egypt, and China. He was formerly Director of Monetary Research for the United States Treasury. Since its inception in 1946 he has been with the International Monetary Fund. Dr. Friedman is now the Director of the Exchange Restrictions Department of the fund. His responsibilities in the fund are principally for problems relating to convertibility and foreign exchange practices of fund members and the relation between the fund and GATT. This morning he is going to discuss for us the complementary nature of activities of the International Monetary Fund with those of the GATT.

Dr. Friedman.

STATEMENT OF DR. IRVING S. FRIEDMAN, INTERNATIONAL MONETARY FUND

Dr. FRIEDMAN. Thank you.

I would like to begin by thanking you, Mr. Chairman, and the Subcommittee on Foreign Economic Policy for the privilege extended to me of appearing before it today.

I would like to talk, if I might, about the relations between the International Monetary Fund and the contracting parties to the General Agreement on Tariffs and Trade, particularly as they affect the removal of restrictions and discrimination.

The United States has a keen interest in the removal of restrictions and discrimination which now impede the establishment of a nondiscriminatory multilateral system of trade and payments. The United States and other hard-currency countries suffer the most from the discriminatory practices of other countries. United States exporters of many commodities find that they do not have the same commercial access to foreign markets as do other suppliers.

Moreover, the elimination of restrictions and discrimination is an integral part of any program to place the free world economy on a firm and enduring basis. By giving up reliance on such restrictions, countries get additional major reasons to avoid inflation, to maintain export competitiveness, and to rely upon the market mechanism, domestically and internationally. In this way, the economies of the free world can achieve the strength and flexibility which they need to copy with a dynamic world.

Th United States has contributed to the achievement of these desired conditions in many different ways, including large-scale financial assistance. Another important way has been through its support of the International Monetary Fund and of the General Agreement on Tariffs and Trade, usually referred to as the GATT. These are the two principal international institutions devoted to the achievement of a worldwide nondiscriminatory multilateral trade and payments system. Together they provide the machinery for international collaboration to this end.

The existence of two international institutions with similar objectives which are concerned with similar economic activities necessarily makes important the question of effective collaboration between the two. Thus, in considering ways and means whereby the United States might achieve its traditional objectives of nondiscrimination and multilaterialism, the question arises of how effective is the collaboration between these two international institutions and how it might be improved, if necessary.

Generally speaking, there is a fairly clear division of responsibilities and activities between the fund and the GATT. Much of the work of the GATT, for example, is devoted to what might be called pure trade matters, such as tariff negotiations. Much of the work of the fund is devoted to such matters as exchange rates and the use of its financial resources. Action in the exchange field affects trade, and changes in commercial policy inevitably affect exchange. Both institutions are mindful of these interactions.

For example, when the fund considers a change in the multiple currency system of a country, it takes into account its commercial as well as its financial impact, both on other countries as well as on the country itself. The general agreement recognizes this problem when it provides that the members of the GATT shall not by exchange action frustrate the intent of the general agreement, nor by trade action frustrate the intent of the fund agreement.

Collaboration is most important when both institutions are dealing with a common problem. The most important single area in which this occurs in practice is with respect to restrictions on trade and payments imposed for balance of payments reasons. Let us suppose, for example, that a country encounters a sudden balance of payments crisis which it decides after appropriate consideration to meet through tightening its system of restrictions. Let us also suppose that the situation is such that the country decides to discriminate against dollar imports by intensifying dollar restrictions more than those applying to goods from other sources.

The GATT permits countries to use quotas on imports for balance of payments purposes under specific conditions, but the country must consult with the GATT to insure that these conditions have been fulfilled. The members of the GATT are interested in having these consultations to insure that their commercial interests in the country are protected to the maximum amount feasible in the light of the situation of the country.

The fund also has a clear interest in the changes introduced in the country. The system of exchange restrictions which is within the competence of the fund has been changed. The fund also has the responsibility for advising memebers on ways and means, such as the use of monetary and fiscal policy, of overcoming their balance of payments difficulties.

GATT will be interested primarily in the trade aspects, the fund in the financial aspects, but it is a common problem on which they are working. Effective collaboration is essential. Without such collaboration there would be the danger of conflicting international judgments or advice on the same action. Without exaggerating its likelihood, countries might find themselves in the peculiar position of being told by one international agency that their action was internationally acceptable, and being told by the other that it was internationally unacceptable. Member countries might find themselves being called upon, to an excessive extent, to explain to international bodies the reasons for their action.

In view of the importance of achieving this collaboration, it is not surprising that, with the fund already in existence, there were written into the GATT specific provisions to that end. Much of article XV of the general agreement is devoted to this subject. In its opening paragraph it provides—and I quote:

> The contracting parties shall seek cooperation with the International Monetary Fund to the end that the contracting parties and the fund may pursue a coordinated policy with regard to exchange questions within the jurisdiction of the fund and questions of quantitative restrictions and other trade measures within the jurisdiction of the contracting parties.

The achievement of cooperation between the two institutions does, however, have to overcome certain obstacles. In the first place, the two institutions differ markedly in their method of operation. The general agreement sets forth certain specific policy criteria for justifying the balance of payments need for import restrictions. In the fund agreement, there is a general statement of purposes which include the achievement of a multilateral system of payments for current transactions, but the evolution of policy criteria is left to the Executive Board. At the present time most of the fund members are operating under article XIV of the fund agreement. This permits countries to maintain exchange restrictions necessary for balance of payments reasons, subject to the condition that they consult annually with the fund regarding their continued need for them.

In these annual consultations, the fund expresses its view on the appropriateness of the country continuing to maintain its exchange restrictions. There is in these circumstances considerable leeway for the fund in judging the individual cases made by members. In the case of multiple currency practices, similar to the case of par values, the fund requires that a country obtain the fund's approval before making changes in its system. These approvals are frequently requested on short notice, with absolute necessity for the maintenance of secrecy.

The administration of the two institutions is also quite different. The GATT relies essentially upon periodic sessions of national representatives, with some machinery for collaboration between sessions. Continuity is provided by the Secretariat. The fund has an executive board representing its members which is in continuous session. It therefore can and does act on behalf of its members on very short notice.

Furthermore, the fund is in continuous contact with its members with respect to their use of restrictions. Since 1952, for example, the fund has each year consulted with nearly all of 46 member countries which maintain restrictions, both of a discriminatory and nondiscriminatory character. In this process fund missions have visited nearly 40 countries more than once. In many instances officials from the countries have come to Washington to explain the actions of their countries in this field. The fund is repeatedly being confronted with requests by countries with multiple exchange rates for fund approval to make changes in their rate structures. All of these activities have frequently led the fund to give technical and financial assistance to members to aid them to reduce restrictions and discrimination and to stabilize their domestic economies.

Moreover, these institutions differ in their membership and voting methods. The fund has weighted voting related to size of quotas in the fund, and at the present time has 58 members. The GATT has 35 members, each of whom has an equal voice in GATT decisions.

These factors, of course, also affect the character of the deliberations on any common problem. Finally, the fund is located in Washington and the GATT in Geneva.

Despite these obstacles, the two institutions have worked well together. Both have shown considerable flexibility and willingness to adjust their own activities to help achieve the desired collaboration. Each institution cannot, of course, enter into arrangements which interfere with its own ability to carry out its responsibilities. Each, however, has been sympathetic to the needs and requirements of the other.

The fact is that countries have not in practice received different advice from the two institutions on the same matter. Experience has shown how it is possible for both institutions to act on the same problem without burdening the country excessively. Basically, this is accomplished by having the fund act as its financial adviser when the GATT considers restrictions for balance of payments purposes. Moreover, generally speaking, the right to discriminate in the trade field in the use of restrictions for balance of payments purposes is closely linked with the right to discriminate in exchange field under the fund agreement. Thus, in most cases, if a country has been able to justify its discriminatory practices to the fund, it will not find such discrimination challenged in the GATT.

On many occasions the fund has provided financial advice to the GATT, and indeed is doing so in the session of the contracting parties now taking place in Geneva. The GATT is now considering various aspects of the restrictive systems of Australia, Ceylon, New Zealand, Southern Rhodesia and Nyasaland and the United Kingdom. The fund is contributing to these considerations by providing background material on the position of these countries and, where appropriate, judgments as to their need for the level of restrictions and degree of discrimination. When the fund planned its own work in the field of exchange restrictions during the last year, it kept in mind the needs of the current session of the GATT. It adapted its own schedule of work so that the GATT could be provided with up-to-date reports and advice.

Further progress in achieving closer collaboration will surely be made as more experience is obtained. Much will depend on the future machinery for the administration of the general agreement. The present structure of the GATT places inevitable limitations on its ability to act quickly. Because of the nature of the problems involved, international procedures on exchange rates and practices must be rapid and confidential. If the fullest consideration is to be given to the trade impact of exchange measures and vice versa to the financial impact of trade measures, it is necessary that both institutions be enabled to act with comparable speed. The establishment of intersessional machinery for the GATT has helped to alleviate this problem, but some of it still remains. In the meantime, in the important area of restrictions for balance of payments purposes, collaboration is taking place.

Now that I have dealt with the institutional aspects, I would like to say a few words on the progress made in removing restrictions and reducing discrimination. For a number of years there was a widespread belief that balance-of-payments restrictions were either desirable or at least inevitable. Many felt that discrimination would probably be a more or less permanent feature of international trade and payments. Foreign exchange shortages, particularly of United States dollars, were foreseen for an indefinitely long period of time.

At present, we find that many countries have come to recognize that, whatever the short-run convenience, or even necessity, of such restrictions, they have heavy, even though hidden, costs. The use of such restrictions may encourage inflationary policies and uneconomic production of commodities less necessary for development or basic consumption. Less real income is then available for distribution to the people of a country. They may cause distortions between domestic and external prices. They may complicate monetary and fiscal policies if they lead to a need for subsidies for uneconomic industries. It is now more widely recognized that, when balance of payments restrictions are discriminatory in character, they have the additional adverse effect of weakening export positions relative to those countries which are able to keep costs down by importing on a price basis. This last consideration is of particular importance for countries which depend on exporting on a competitive basis to as wide a market area as possible as the principal means of paying for needed imports.

We are now seeing strenuous efforts being made by a number of countries abroad to reduce their reliance on balance of payments restrictions, particularly in their discriminatory aspects. These efforts can be understood only if we realize that the political leaders of these countries see that such restrictive practices are not a solution to their international financial and economic problems. More and more, countries have come to identify their own national interests with the establishment of a multilateral system of trade and payments.

On the other hand, a number of countries of considerable importance for international trade continue to suffer from the effects of inflation with its inevitable adverse consequences for the balance of payments. Other countries which have largely succeeded in overcoming inflation, nevertheless, still face the more delicate task of maintaining high levels of income and employment without repeated outbreaks of inflationary pressures and excessive drains on reserves. Because of these and other factors, the widespread use of balance of payments restrictions still remains. However, countries are moving further toward their elimination, despite some slowing down of the momentum. What is perhaps most encouraging of all is that, as difficulties arise along the road to the achievement of elimination of restrictions and discriminations, more countries seem determined to take measures which will enable them to avoid retrogression.

The fund and the GATT, and their joint work in their fields of common effort, provide the machinery necessary to achieve the goal of a nondiscriminatory multilateral system of trade and payments. The effectiveness of this machinery depends in large part, however, on the attitude of the members themselves and their willingness to take into account the viewpoints and needs of other countries.

Mr. Bolling. Thank you, Dr. Friedman.

Our final speaker of the morning is Dr. David MacEachron, the director of program of the United States council of the International Chamber of Commerce. Dr. MacEachron has served formerly in the United States Government in Paris, and then in the International Division of the Bureau of the Budget. His writings for the International Chamber have been notable for their thoroughness and clarity. Dr. MacEachron is going to speak now on the subject, "International Cooperation in the Face of State Trading and the Exception Clauses."

STATEMENT OF DR. DAVID W. MacEACHRON, DIRECTOR OF PROGRAM, UNITED STATES COUNCIL, INTERNATIONAL CHAMBER OF COMMERCE

Dr. MacEachron. Thank you, Mr. Chairman.

I appreciate very much the honor of being invited to come down and appear before your subcommittee.

The first problem I was faced with in talking about the subject is to define what I was talking about since obviously international cooperation in trade could mean a number of things. To simplify my problem, I started out by saying that I was going to talk about the kind of cooperation that we find embodied in the GATT, and my reason for doing this are several:

It is the only cooperative trade system that has been developed in the world, as Dr. Vernon pointed out, that embraced a large number of nations, and I think it can be said to have been a successful cooperative system. I don't believe that a system based on small groups of nations, cooperating to the detriment of nations that are outside that group—and I am thinking particularly of a group of nations, for instance, built around the OEEC—I do not think a system of that sort can operate for any length of time, if it is built on the notion of permanent discrimination against the United States, or permanent discrimination against any other nation that is outside that group.

I don't believe that the bilateral type of dealing that the United States was trying to use prior to the development of the GATT is an effective system. So I am going to talk about the outlook for international cooperation that embraces a large group of the non-Communist nations that account for a very large percentage of world trade and a system that is based on a few general principles. Each nation will give the others most-favored-nation treatment. They will as a general rule, not use quantitative restrictions, and they will agree to settle their disputes through consultation. They will recognize that the actions of each member have a significant effect on every other member and must be talked out in common if we are not to resort to trade warfare of the type we had in the interwar period, where every nation was seeking its own best interests in a very short-run manner, and the result was that as tariffs and quotas were increased, and everybody suffered.

There are two major forces that do not seem to fit into this system. The first of these is state trading. State trading can mean a couple of things. It can mean trading by state enterprises within a predominantly free enterprise economy that is one where private citizens make their own individual decisions about what they want to buy and what they want to sell.

Now, I don't plan to talk about this type of state trading because I don't think it is any longer extremely important. During World War II, it was extremely important. There has been a very steady move away from it, and I don't see any particular reasons to think that there will be an increase in this type of trading.

The other type of state trading, which is a much more difficult situation, is that which you find in the Soviet Empire, where the entire economy of a country, or a whole set of countries, is centrally planned and centrally dominated.

I do not believe that there is any prospect for trade cooperation between free-enterprise economies and the Soviet-type economies and I believe this for several reasons.

In the first place, the entire economy in the Soviet Empire is dominated and planned primarily for political purposes, and so the normal considerations that a businessman would face in dealing with traders in another country do not necessarily hold. I am not saying that they might not in certain situations, but there is always the risk that for political reasons, the state trading entities will change the rules of the game and the risks, therefore, are very high. The risks are very high because businessmen outside the Soviet Empire do not have adequate information about consumption, about the growth of markets, about the growth of competition. They would be working in an area where they cannot make reasonable forecasts.

The risks are very high for another reason, because there is no way of knowing what real costs are, and no way of relating real costs in the Soviet Empire to prices. Therefore, in international trade, there is no way of knowing for sure whether the Soviets are dumping their goods or whether they are selling them at reasonable prices. There would be no way for a man who is exporting to the Soviet Empire of knowing whether he was up against really legitimate competition that was based on low-cost production, or whether for some reason the state planners had decided to cut off his markets by underpricing him and presenting him with murderous competition.

One other point I might mention: I don't think there is any sense laboring this. I feel so strongly about the limited possibility for any kind of trade at all, to say nothing of trade cooperation, I don't want to spend a great deal of time on it.

There is no system in the Soviet Empire for patent or trademark protection that gives an individual outside the Soviet Empire any confidence that his products won't be pirated.

With that, let me turn to the other area where you find forces tending to disrupt this cooperative system. This is the area that loosely you can refer to as the exceptions to the basic rules of GATT.

Now, there are four major exceptions that are written to the GATT itself. These have all been mentioned one way or another, but I would like to run over them very briefly because I want to talk about these later on.

There is first the balance of payments exception, which entitles any nation which is very low in its foreign reserves, or facing an imminent drain on its foreign reserves, to use quantitative restrictions to protect its foreign reserves. Even though these quantitative restictions, of course, were used prior to World War II, this exception is in the GATT because of the tremendous economic disruption of World War II.

It was, I think as far as the United States was concerned, only accepting the inevitable to accept that exception on a temporary basis.

The second exception involves the problem of the countries with underdeveloped economies, which wish to speed up the rate of economic development. These nations may use quantitative restrictions, and also have considerable latitude on what they do with their tariffs, to protect their infant industries and infant economies and also to protect their balance of payments situation.

The third exception is primarily one that has its origin in the United States. That is the agricultural exception which permits nations using price-support systems, and which also involve a restriction on domestic production of agricultural crops, to restrict imports so that there is a rough equity between the burden on the domestic producers and foreign producers in connection with the price support system.

The United States has not been able to live under that exception and has actually obtained for itself a waiver at the ninth session of the GATT, which permits us to go considerably beyond what any other nation can now do in this field. In other words, in this area we have more latitude than any other country.

The fourth exception in the GATT is strictly of American origin. I have called this the no serious injury exception, which is taken over by and large from American trade legislation, and permits a nation, where there are unforeseen circumstances, and as a result of the obligation undertaken in the GATT resulting in either injury or threat of serious injury to one of its domestic producers, to raise tariffs.

The fifth exception is not specifically a GATT exception, although there is language in the GATT dealing with security considerations, but is an American problem at the moment, or is becoming an American problem, in my opinion. The 1955 extension of the trade agreement legislation contained a very sweeping authority to the President to adjust imports, apparently with no limitation, in any situation where he found that imports were at such a level as to affect adversely the national security. This is extremely loose language. Adjusting imports apparently involves no limitation on how they can be adjusted, in what manner or what degree.

What the national security is is a very loose concept, and many people have their own definitions for it that vary widely.

In other words, the United States is on the way to developing a very major and very important exception to the whole system of trade cooperation through this defense exception.

I think for any American group looking at this problem, and considering what the outlook for trade cooperation is, the most important single thing—and this is what I would like to emphasize most in my remarks—is the extremely important position of the United States in determining whatever does happen in the whole field of international trade cooperation. Even though our population is not more than 6 percent of the world's, we produce 40 percent of all the goods and services produced each year. In other words, we are close to half of the entire economic size of the rest of the world, and, of course, our position as regards the other members of the GATT is considerably greater, since the whole Soviet system is outside the GATT.

In certain fields we produce considerably more than 40 percent of the world total. We produce half of the world's aluminum, half of the world's steel, half of the world's oil output, and half of the world's energy output, and a third of the world's coal output.

In the agricultural field, we are also very important. We produce 15 percent of world wheat, one half of the world's corn, and a third of the world's oats. We are not only enormous within our own borders but we also are the world's greatest trading nation. We are so enormous domestically that our external trade is not large as a percentage of our gross national product, but we still produce one-fifth of the world's exports and we take about 17 percent of the world's imports. More than any other nation.

We are in a dominant position as regards the trade of a number of the world's important nations. I cite certain figures, based on 1953. In that year we were the largest single supplying nation to 22 other nations. These included all of the major nations of the Western Hemisphere, as well as France, Western Germany,. Iceland, Italy, Spain, and Yugoslavia in Western Europe, and in the Far East, Japan, the Philippines and Indonesia.

In addition, there were 13 other countries, which included practically every other major country in Western Europe and Asia, where we ranked from second to fourth largest supplying nation.

We were the major single largest market for 17 nations, including the Western Hemisphere nations, as well as Japan, Iceland, Philippines, Switzerland, and Turkey, and for another 14 nations we ranked from second to fourth as their most important markets.

In addition to having this very great size and weight in the field of international trade, we have a very great freedom in what we want to do. Because international trade is a very small percentage of our gross national product, and because we are so large in relation to the rest of the world, and because our gold reserves are so extremely high, we can shape our commerce policies with absolutely no fear as to what will happen to our balance of payments.

Let me just make comparison between the United States and the United Kingdom, the second greatest trading nation in the world. Her exports amount to 22 percent of her national product. Her imports amount to 26 percent of her national product, and her gold reserves amount to only 13 percent of her combined imports and exports.

Now, in the United States, imports and exports are each less than 5 percent of our national product, and our gold reserves equal a hundred percent of our combined exports and imports. In other words, whereas the British are constantly in a position of having to watch their whole commercial policy for fear of what it will do to their external reserves, the United States is uniquely able to set its commercial policy without concern about the effect on its international liquidity.

In many other ways the United States also has a unique freedom of action and power of action in the world today. No other nation has a more dynamic and vigorous economy, where more research is going on, where there is more mobility of labor and capital, so that we are able to adjust to changes both internal and external much more easily than any other nation in the world. Certainly no other nation can do it more easily.

Furthermore, because of the tremendous technical leadership we have in most fields, our products have a prestige value throughout the world so that they are desired because they are American rather than because of any intrinsic qualities, which again means that we need never fear about any demand for American products in the foreseeable future.

All of these things add up to the fact that the force of example as well as the force of the actual effect of United States actions on the rest of the world is tremendous. We can expect no other nation to take an action pointing toward effective cooperation unless they are sure the United States is going to be firmly committed to a system of trade cooperation.

Very briefly, I think you can see how the key position of the United States affects each of the major exceptions in the GATT plus the defense exception that I have mentioned.

The balance of payments exception was put in primarily because of the dollar difficulties of the other countries, not because of their general balance-payments problem, although that was important. Certainly the most important, the most difficult problem for each of these nations was the dollar problem.

We have done a great deal and have been very effective in my opinion in this field in helping to do away with the underlying conditions that led to the balance of payments restriction. Through the foreign-aid program and through our activities in the GATT, we have both persuaded these nations that this kind of restriction, if maintained beyond the minimum period of necessity, was harmful to them and we have helped to restore their economies to the point where they do not need to rely heavily on these restrictions.

In the field of economic development exception the United States again has a unique contribution to make in overcoming a basic obstacle to world-trade cooperation. In this case, the obstacle is the desire of these nations to push their economic development very rapidly. The United States is the only great reservoir of technical ability and capital which can be put to work to help speed the process of economic development in these countries, both through public and private channels. Both in this way and by force of example, we can help to dissuade these countries from using restrictions in an uneconomic manner and we can help them to raise their economies to the point where they don't need to rely on the kind of protection that is associated with infant-industry protection.

The other three exceptions, which I will just mention quickly, the agricultural exception, the serious-injury exception, the defense exception, are all ones in which the United States has really been the nation that has insisted on these exceptions. It is within our power, if we wish, to do more than any other nation to get those reduced in importance.

I do not mean to suggest by all this that the United States is the only nation that has a role in the process of building world-trade cooperation. I don't mean to suggest that we can necessarily be successful in whatever we plan to do. I am merely trying to say that this Nation, of all other nations, has more power and more freedom of action to set the course, either toward or away from cooperation in the field of world trade.

I might just give you my own personal opinion as to what might happen if we decide against a course in the direction of cooperation. I think that it would be inconceivable that there would be a real system of world-trade cooperation without the United States participation. I think that the only course the other nations of the world could take would be to do everything within their power to protect themselves against the tendency that otherwise would exist for the United States to drain their gold and dollar reserves. Ultimately there would be a system where each nation was using quantitative restrictions and tariffs as a constant administrative control over its foreign trade. Perhaps not a return to the situation as bad as that that existed between the wars, but an extremely chaotic and disorganized siuation in which to try to conduct world trade.

Mr. Bolling. Thank you, Dr. MacEachron.

(Dr. MacEachron's complete statement follows:)

International Cooperation in Trade in the Face of State Trading and the Exception Clauses

Paper presented by David W. MacEachron, director of program of the United States council of the International Chamber of Commerce

Before discussing the outlook for cooperation in international trade, it is necessary to agree on a meaning for the phrase. There are, of course, at least several forms that international trade cooperation could take and the outlook for the various forms is different.

International trade cooperation as discussed in this paper is defined as follows: (*a*) There must be a common set of rules which a preponderant group of trading nations agree to observe in regulating international trade. Trade cooperation between smaller groups of nations, if it is posed as an alternative to broader cooperation, creates the danger of rivalry and trade warfare between the groups of nations. (*b*) An essential feature of these common rules must be that each member of the system gives equal treatment to all other members. Although a cooperative system is possible in which some members are at a disadvantage, it is hard to imagine that such a system could be maintained except as a temporary, emergency measure. (*c*) Since no set of rules can cover every contingency, the cooperating nations must agree on regular consultation to settle disputes which arise. This implies that each recognizes that its actions necessarily affect others who, in turn, will react on the first nation. (*d*) This cooperative system must as a minimum be based on agreement not to increase governmental barriers to trade and preferably there should be joint effort to lower existing barriers. Cooperation in a situation of increasing barriers to trade would be extremely difficult since the frictions arising from the reciprocal curtailment of markets are severe. (*e*) Finally this international trade cooperation must relate to economies where the price mechanism is allowed considerable freedom to operate and where decisionmaking is reasonably diffuse. This is to say we are talking about a commercial trading system which governments influence for various policy reasons. The purpose of governmental cooperation is to insure that the intervention of individual governments does not produce a situation making private commercial trade impossible.

Although this set of conditions was not deliberately intended to describe the GATT, it is obvious that the GATT does fit these conditions reasonably well. For the sake of convenience as well as to be concrete, the GATT will be used as the model of international cooperation. The rest of this paper will consider the outlook for this cooperative system in the face of two different disrupting forces; (*a*) state trading and (*b*) pressures within the cooperating nations which cause them to disregard or weaken the agreed trade rules.

STATE TRADING

The term "state trading" applies to two essentially different things: First, commercial trade by a state agency in a country with a predominantly private enterprise economy and, second, trade by a country whose entire economy is planned and dominated by the state. Governments in countries with predominately private enterprise economies occasionally in emergencies of one sort or another have taken over all trade in certain fields. During World War II extensive state trading of this sort existed, but well before 1953, as Henry Chalmers noted in his survey of international trade practices (World Trade Policies: The Changing Panorama, published in 1953) this type of state trading was on the decline. The outlook at present seems to be for a continued decline in its importance.

The provisions of the GATT are intended to insure that where such state trading exists it will operate on a nondiscriminatory and essentially commercial basis. It is significant that in recent years there has been only one complaint incidentally involving state trading.

The question of cooperation between the private enterprise economies and the centrally dominated economies of the Soviet empire is quite a different matter.

Under present circumstances cooperation between Soviet and non-Soviet countries seems out of the question. Furthermore, so long as the Soviet economy remains essentially as it is today, trade itself between Soviet and industrialized non-Soviet countries will continue to be relatively slight.

My reasons for believing this to be the case are several, as follows: (*a*) All Soviet economic activity, perhaps foreign trade particularly, is subject to arbitrary manipulation in the interest of political objectives, and this creates a very great hazard for anyone attempting to do business with the Soviets. (*b*) Information about Soviet production, marketing, and consumption is not available in sufficient quantity to foreign businessmen so that they can judge the prospects for continuing trade expansion with the Soviets. (*c*) There is no way of knowing how prices relate to costs in the Soviet system and hence no way of knowing when they are dumping abroad and no way of knowing whether competition within the Soviet empire reflects the real ability of the Soviets to produce competitively or just their decision to price competitively regardless of cost. (*d*) There is a strong tendency in any centrally planned economy for all outside economic dealings to become the marginal factor and the Soviet empire fits the pattern. Businessmen outside the U. S. S. R. cannot build foreign trade on occasional orders placed to cover a shortfall in some domestic production goal. (*e*) Patent and trade-mark protection within the Soviet empire cannot be obtained on a really satisfactory basis.

This all adds up to saying that businessmen trying to trade with the Soviets face a situation where everything is variable and essentially unpredictable. Instead of being subject to impersonal and partially predictable market forces the businessman is at the mercy of decisions by Government officials. Furthermore, there is no reason to think that the hostility of the Soviets has in any way altered. Trading under these conditions would involve an exceptionally high risk element, and compensatingly high profits would seem unlikely.

These reasons lead me to conclude that international cooperation in trade on anything resembling the present pattern simply cannot include a state-dominated economy, particularly one that is animated by a hostile intent. Thus even if the Soviet Empire were in a position to conduct an extensive trade with the non-Communist nations, there is serious doubt about this, it cannot be fitted into a truly cooperative framework.

THE EXCEPTIONS

Under the GATT member nations agree to extend most-favored-nation treatment to each other, to refrain from using quantitative restrictions, and to abide by the tariff reductions they have agreed upon in the negotiating sessions. Since the GATT is not, and cannot be, more than an agreement between sovereign nations it cannot force any member to do anything which it does not wish to do. The agreement necessarily provides for cases in which members feel they cannot adhere to these general rules.

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The exceptions written into the GATT merely reflect then the underlying conditions set by the member nations for adherence to the agreement. The outlook for international trade is not influenced by the existence of the exceptions but by the conditions which gave rise to them.

The GATT itself contains four exceptions:

(*a*) *The balance-of-payments exception.*—Under this exception a nation which faces an actual or imminent serious decline in its foreign reserves or which has very low reserves can utilize quantitative restrictions to limit imports to those essential items which it must import. The need for such an exception arose, of course, from the Second World War which left many nations with depleted foreign reserves and with badly damaged farms and factories. Consumption had fallen to very low levels. In this situation these countries had to limit imports to those items most needed for consumption and to rebuild their production facilities. There was really no alternative.

(*b*) *The economic development exception.*—A member of the agreement whose economy can only support a low standard of living and is in the early stages of development is given considerable latitude under this exception. These countries, consistent with the agreement, may take action to protect their infant industries. They may also use quantitative restrictions to protect their foreign reserves when, in the process of economic development, consumption and investment initially expand more rapidly than production.

(*c*) *The agricultural exception.*—The peculiarities of the economics of agriculture have given rise in many countries, most notably in the United States, to price-support programs of one sort or another. It follows inevitably, once the domestic price of an agricultural commodity is raised above the world market price, that imports must be restricted if the domestic price supports are not to be extended to the whole world. The GATT provides that nations may use quantitative restrictions to limit imports in those cases where domestic production of the same commodity is also restricted. The rationale here is that price-support programs should not work so as to benefit domestic producers entirely at the expense of foreign producers and conversely if domestic production is being restricted then imports may also be restricted.

The United States has not been able to comply even with this exception. At the ninth session of the GATT contracting parties, the United States succeeded in negotiating a special waiver, applicable only to the United States, which permits us to continue using quota restrictions under section 22 of the Agricultural Adjustment Act even in cases where we do not limit domestic production. This waiver was granted the United States alone in the face of strong agricultural pressures from other countries for similar protection.

(*d*) *The no-serious-injury exception.*—This exception is of American origin, being in essence the "escape clause" taken from our trade agreements legislation. It permits a nation to withdraw a tariff concession if it finds that as a result of unforeseen circumstances and of the obligations undertaken in the GATT domestic producers are threatened or actually suffering serious injury. To date the United States is the only country which has taken advantage of this exception.

A fifth major exception which may become important in the United States involves the possibility of special action to protect industries alleged to be vital to the national security. The most recent extension of the Trade Agreement Act contained a sweeping grant of authority to the President to adjust the imports of a commodity when he finds that the commodity is being imported in such quantity as to threaten the national security. Never before has the President been given such broad and poorly defined power over our foreign trade.

Each of these five exceptions reflects a powerful political-economic influence working on various members of the general agreement to hamper the flow of international trade. These influences are (*a*) seriously unbalanced international payments (primarily the dollar balance of payments) arising primarily from war and attendant inflation; (*b*) the desire for rapid economic development; (*c*) the demand by agriculturalists that the prices of their crops be maintained at levels above the level of world prices; (*d*) the desire of some producers to reduce or eliminate foreign competition; and (*e*) the efforts by governments to maintain industries deemed necessary for defense purposes.

There is a strong tendency for each of these retreats from international competition to become permanent and plainly protectionist. The great merit of the general agreement is that it provides a world forum where the use of each of these exceptions can be reviewed and judged impartially. There is probably no other way to prevent the gradual breakdown of any cooperation and a resumption of the type of trade warfare that marked the interwar period.

THE KEY ROLE OF THE UNITED STATES

The most important fact for any group in this country to recognize when considering the outlook for international trade is the predominant position of the United States. Unless full account is taken of the great impact which American actions have on international trade, there is the danger that we will act inadvertently to damage trade relations.

The United States occupies this crucial role in setting the course of trade cooperation first because of the tremendous economic size of this country compared with the rest of the world. We produce over 40 percent of all the earth's goods and services each year. In many fields the United States production is much higher. For example, the United States produces nearly one-half of the world's steel, aluminum, and electric power. The United States produces about half of the world's petroleum and a third of the world's coal.

The United States grows about 15 percent of the world's wheat, half of its corn, and a third of its oats and cotton. Well over half of the tractors in the world are in the United States.

The economic bulk of the United States compared with the rest of the world is such that it is the world's greatest trading nation even though imports and exports are a small percentage of gross national product. With exports of goods and services amounting to nearly $18 billion and imports of over $13 billion the United States currently accounts for over one-fifth of total world exports and over 17 percent of all imports. The United States plays a dominant role in the foreign-trade position of many countries.

The United States in 1953 was the largest supplier of imports for no less than 22 major nations. This group includes all the larger nations in the Western Hemisphere. We were also the major supplier among the Western European nations to France, West Germany, Iceland, Italy, Spain, and Yugoslavia. In Asia we were the principal source of imports for Japan, the Philippines, and Indonesia. For 13 other nations, including most of the other countries of Western Europe, the United States was second to fourth largest supplier.

In 1953 the United States was the largest single market for 17 nations. Again this included all the larger nations of the Western Hemisphere. Outside this region we provided the major market for Japan, Iceland, the Philippines, Switzerland, and Turkey. For another 14 nations including all the larger nations of Western Europe and Asia the United States ranked second to fourth as a market for their exports.

Our great size, our very large gold reserves, and the small percentage that international trade forms of our gross national product gives the United States an unprecedented freedom in dealing with international trade problems. By way of comparison, the second greatest trading nation in the world, the United Kingdom, has exports amounting to 22 percent of gross national product (for the United States this figure is less than 5 percent) and imports amounting to 26 percent of gross national product (the United States figure is less than 4 percent). Our gold reserves amount to 100 percent of our combined exports and imports whereas the United Kingdom's reserves equal only 13 percent of her combined exports and imports. Compared with the United Kingdom our margin of maneuver in the filed of international trade is enormous.

The United States is in a position where it can frame its commercial policy without fear of adverse effect on its balance of payments. Every other non-Communist country is still in a position where foreign reserves and dollar trade must be watched with care even though reserves have risen considerably abroad.

Furthermore, there is probably no nation in the world today with a more dynamic and vigorous economy. Capital and labor, generally speaking, are highly mobile. This means that no nation can so easily reap the full advantages of international trade. We can move our resources into those areas where productivity is highest and exchange the goods of these industries for those which can be made most cheaply in other countries. The total wealth of the Nation obviously will be increased in this manner. Other nations can benefit as much from international trade but the rigidities in their economies are greater and their adjustments will correspondingly be more difficult.

The dynamic quality of the American economy gives us another advantage in comparison with the rest of the world. Research in the United States is extensive and the development of new products in this country is so rapid as to assure us a technical leadership for the indefinite future in most fields. As a result we are reasonably certain of a demand for many of our products up to the limit of other countries' ability to obtain dollars. The sheer prestige value of American products is such that they are often desired by other nations just because they are American and without regard to what is available elsewhere.

Largely because of our wealth and the very great success we have had in expanding our economy, the force of example set by the United States in the field of trade policy is great. The direction we set will inevitably have a profound effect on the patterns of world trade cooperation. Nations which are much smaller economically than the United States can scarcely be expected to expose themselves to the rigors of international trade and a flood of low-cost American exports if the United States feels that international competition is too tough. Conversely we can do far more than any other nation to create truly effective international trade.

The evidence of this decisive United States influence can be seen clearly written in the GATT. The GATT itself is the creation of American leadership in the postwar period. Without a great deal of persuasion and hard bargaining by the United States there would be no GATT today.

A second example of the power of the United States is the recently negotiated waiver to the general agreement on agricultural quotas. Under this waiver the United States has been given freedom to take any restrictive action on agricultural products it wishes under section 22 of the Agricultural Adjustment Act. Even though other countries also support agricultural prices and would undoubtedly have liked such freedom, the United States was able to persuade all other nations to continue to adhere to stricter standards.

With the economic leadership which is ours if we care to use it, the United States can do a very great deal to overcome the basic conditions which give rise to the exceptions in the general agreement. The best example is the experience under the balance-of-payments exception.

The balance-of-payments exception was certainly the most important loophole in trade cooperation in the early postwar years. Through the Marshall plan the United States made a forceful and imaginative attack on the balance-of-payments difficulties which gave rise to the need for this exception.

Many were fearful that Western European producers would become so entrenched behind quantitative restrictions that they would not permit them to be dropped even with the serious imbalances of the postwar period ended. There are compelling reasons, however, why nations should drop quantitative restrictions as soon as possible. Controls of this type have an inflationary impact. They reduce the discipline of competition and tend to isolate prices within the country from world prices. They inevitably inject Government supervision deep into the economic life of the Nation.

As the nations of continental Europe and the sterling area have restored their reserves and brought their payments into balance they have, in fact, moved quite steadily to reduce or abolish quantitative restrictions. Both the GATT and the IMF report that there have been substantial reductions in quantitative restrictions in the last 2 years. Many of the relaxations in the past year and a half have applied to dollar goods. Both agencies report that quantitative restrictions are now at the lowest point since the war.

On the basis of their 1953 trade Great Britain, Sweden, and Portugal have all freed more than 50 percent of their dollar goods from quantitative restrictions. Western Germany has freed 68 percent of her dollar trade from quantitative restrictions, and the Benelux countries have freed up to 87 percent. In most cases countries retaining quantitative restrictions are applying them liberally.

United States aid and United States insistence through GATT and elsewhere that quantitative restrictions should be removed as soon as feasible have contributed directly to the lowering of restrictions. The principles of trade cooperation have had effect here, and everyone has benefited. The United Nations Secretariat in a recent survey pointed to the fact that increased freedom to purchase in lowest-cost markets has helped to strengthen the European economies.

Foreign markets have been opened up to American producers by the same actions.

There has been no comparable United States leadership in connection with the other exceptions. The economic-development exception has not been much used to date, but there is good reason to expect that it will be. The short-range effect on United States trade will not be severe since United States exports to the underdeveloped countries which might restrict their trade with the United States probably are not more than a tenth of our total exports and only a small part of this trade might be affected by higher tariffs or quantitative restrictions in the underdeveloped areas. The effect on the exports of Japan and Western European nations will probably be more serious.

The United States is also in a pivotal position to hasten the day when this type of exception to the general trade pattern can be reduced or eliminated. In this country is the single greatest reservoir of capital and technical knowledge in the world. Through public and private channels we can provide our capital and experience to speed economic development.

The United States can benefit itself and the underdeveloped nations, too, by urging that their protection for infant industries be planned with care and with a view to reducing the protection for these industries within a few years. The danger to the underdeveloped nations and hence to us is that they will plunge into uneconomic industrial development. This will waste resources of nations which have none to waste. It will also reduce the availability of industrial raw materials for them and for us.

The agricultural exception and the no-serious-injury exception have been used by this country with detrimental effect on world trade cooperation. Both of these exceptions rest on ideas essentially autarkic in nature. Each time we impose a new quota or raise a tariff under either of these exceptions we weaken the fabric of world trade cooperation. We do this because of our great economic weight in the world and because these actions reflect uncertainly about the United States adherence to the principles of trade cooperation itself.

The defense exception has not as yet been used, although defense considerations were given considerable weight in the Swiss watch case. It should be noted, however, that it is thoroughly contradictory of our whole strategic and military planning which is built on a system of alliances. We have sought to make these alliances more valuable by strengthening the economies of our allies. We have recognized that a potential aggressor could probably disrupt international shipping very badly and thus cut off American production from our forces and allies overseas. We have made special efforts, therefore, through the foreign-aid program to build up the industrial potential of our allies to back up their defense establishments. Protecting domestic industries at the expense of foreign industries, on the other hand, seems to be based on a concept of surviving alone in a hostile world.

This discussion is not meant to prove that the sole responsibility for creating a world-trade system rests on the United States or that the United States is the only country which has any tendency to deviate from such a system. It is meant to demonstrate the extremely important position of this country in setting the direction of trade cooperation. It also demonstrates how little substance there is in the contention that the United States has not obtained fair treatment in its international trade relations. On the contrary, the United States has on occasion used its strength to obtain special advantages no other nation could obtain. We have accepted discrimination against us in those situations where there was really no alternative; primarily in cases where nations did not have the foreign exchange to pay for our goods in the volume they would have purchased in the absence of restrictions.

The dominant position of the United States in the international trade of the world is a fact. The direction which United States leadership will take is a matter of speculation. It is possible to make some fairly good guesses, however, as to what may happen to world trade cooperation if the United States fails to lead or if it seeks to use its great power to force its exports abroad without regard to the effect this will have on other nations.

Under either of these circumstances the other nations of the world will have but one resort. They will have to devise the best protection they can against the United States. Unless the United States is willing to provide large and stable markets for their goods the other nations of the world will constantly face a drain on their gold and dollar reserves. Quantitative restrictions on imports, or perhaps only dollar imports, will become a permanent feature of their foreign-trade regulations. They may follow a policy of every nation for itself or seek closer ties among themselves, but in either case they will be forced to maintain close supervision over their trade with the United States.

As a result competition will be lessened both in the United States and even more so in other nations. This will inevitably have the effect of reducing the vigor of economic life throughout the free world. Uneconomic production will be fostered and resources will be wasted. The net effect will be a world both poorer and less able to cope with economic change.

Perhaps most important, the political and military cooperation between the United States and the other nations of the world will suffer if we turn away from cooperation in the field of trade. Political and military alliances are only as strong as the economies supporting them. The economies of each of the nations which make up our system of alliances will be weakened if each tries to build mainly on its own resources alone. Trade disputes can also weaken and destroy political and military alliances.

The choice rests with the United States more than with any other nation as to how international trade cooperation will develop. This puts a heavy responsibility on this country, but it also gives us a tremendous opportunity.

Mr. BOLLING. Have any of the statements of the members or the witnesses stimulated other witnesses to further comment or query, and so forth?

Dr. VERNON. If I may, Mr. Chairman, I would like to comment in one or two respects on Dr. MacEachron's statement. There are two points in particular which perhaps would be helped by a slight clarification or perhaps even modification.

If Dr. MacEachron left the impression that the United States was invulnerable in terms of foreign trade, I am sure he didn't intend. As a matter of fact, we do have some elements of vulnerability with respect to our foreign trade. We do, I think, tend to suffer in the long run if we were to impose a system of restrictive imports and to find ourselves faced with a whittling down of our exports.

We would suffer, I think, in the parts of our economy where we can afford to suffer least. If you look at the pattern of United States trade, I think it is fair to assume that on the continuation of the past policy of reduction of import restrictions there will be some adjustments in one industry or another in the United States. We know what those industries are. There have been all sorts of studies on the subject. They are such industries as blousemaking, lacemaking, and perhaps even watchmaking, glassblowing—the sort of industry in which there is a highly specialized, rather rigid skilled labor content in the product.

On the other hand, as foreign trade expands, the kind of industry in the United States which benefits the most is, generally speaking, our agriculture, but also our chemicals, trucks, tractors, machine tools, and so forth. In other words, foreign trade is pushing us toward the end of the spectrum where, I think, on the whole, we want to be. It is pushing us toward the end of the spectrum where mass production can provide some benefits in terms of the reduction of real costs and some benefits in an increase in productivity on the part of labor and away from the end of the spectrum where your technology is sort of frozen. You are not going to produce more hand-blown glassware per man-hour 40 years from now than you are today.

In short, what I am saying is if you want the United States a nation of hand-blown glassblowers, the thing to do is to insure that such industries are thoroughly protected from any whiff of competition and that the sons and the grandsons of the present blowers continue to blow glass.

Now, the other general point that I want to make is that the United States position in world trade is changing, changing in rather interesting ways. We are shifting from net exporters of forest products and nonfood agricultural materials and minerals to net importers. The Pauley Commission illustrated that, I think, quite graphically. As best one can judge, that trend will continue. We are going to become heavier and heavier net importers of raw materials. At the same time, there is a good outside possibility that the economies of the rest of the world, although they won't be anywhere nearly as strong and well off as the United States, will be growing at a faster relative rate. That isn't very hard to do. They are starting at almost zero, many of them, and we are starting at a very high level, and it is no reflection on the United States economy that undeveloped countries may well be growing faster than we over the next 30 years. What this can well mean is that our foreign trade, our exports, may well grow more rapidly than our domestic production, provided there is an open trading system in the world.

Now, to sum this up, what it means is that United States interests lie in greater access, easier access to the materials of the world, and easier access to the markets of the world, and we may see in the course of our lifetime a reversal of the long trend which we have witnessed over the last 60 years and may see a growth in relative importance of foreign trade for the United States. This is something we have to bear very much in mind in determining what general course one ought to pursue.

One other point I want to make is that as one thinks of the possibility of different structures in the rest of the world, assuming the United States says "I am going to take my dollars and go home, I am not playing in this game of multilateral trade any more, I want a freer hand to do what I want to do"—I would envisage personally that the most likely response would be development of a regional bloc built around Western Europe.

You can argue from now until the cows come home whether the development of a regional bloc in Western Europe will increase the relative economic strength of Western Europe. I am much more concerned with what it will do to the politics of Western Europe.

Senator FLANDERS. Excuse me, what it will do with what?

Dr. VERNON. With what it will do with the political orientation of Western Europe. My own feeling is that if some action on our part should precipitate the Western Europeans into closer trading ties among themselves, accompanied by the general exclusion of United States goods from their market, you can very well get a group of economies there which is oriented to the neutralist, third force approach. They may say: "We don't belong with you economically; we don't see any particular reason to belong with you politically." That may not happen in a dramatic way, but I think it will establish a trend, a tendency to regard themselves as the third group in the world, which can play off the Soviet bloc, within limited degrees, against the United States.

Now, I don't think that the Europeans want this. I think most Europeans would dread it as a development. I think it could only occur if we in our blindness should say, "You go along and develop your own economic system, we will develop ours, and we will reserve the right to use trade devices as a weapon for setting up precisely that kind of divided system."

Mr. BOLLING. Dr. Friedman?

Dr. FRIEDMAN. Mr. Chairman, this is not really a followup on what Dr. Vernon has just been saying—and he is opening up some interesting points—but rather a general comment on both of our other witnesses.

Perhaps I detect a tendency to not fully appreciate the extent to which there is still discrimination in the world today and I think it has an important bearing on the points that both of these gentlemen have made.

We really don't know at the present time what would be the United States export potential or even the composition of its exports if there wasn't such widespread discrimination. We have seen, as a matter of fact, a good deal of reduction of discrimination, but much of the reduction that has taken place has been in the field of industrial raw materials and agricultural commodities, the sort of basic necessities which economies abroad require and, therefore, for which they had the most immediate desire to import from the cheapest possible sources.

We have a long way to go yet to see importation of capital equipment or consumption goods on a competitive basis. If one examines the restrictive systems of countries abroad you find that it is still characteristic to find that there is a good deal of discrimination against hard currency exporters in the field of consumer goods and in the field of capital equipment. Therefore, in a way I think it endorses or helps substantiate a point Dr. Vernon has been making. I think it is hard to make any judgment as to the real importance of export trade to the United States, because we just don't know what it would be if there was truly a multilateral nondiscriminatory trading and payments system.

Mr. BOLLING. Dr. MacEachron?

Dr. MACEACHRON. I would like to comment a little bit on what Dr. Vernon has said. I agree with him completely that foreign trade has a very beneficial effect on the United States economy. The additional competition that is provided, both within the United States and abroad, is an extremely important element in making, or helping to make, both our economy and the economies of other countries more dynamic. Foreign trade does have many very important advantages for us; and I would in no way suggest that if our policy was aimed at restricting foreign trade it would not save harmful effects on us.

The point I was trying to get across is that unlike every other nation which must always worry that its exports are going to fall short, and particularly its dollar exports, and must always be worrying that its imports are going to be too large, the United States is completely free of that kind of worry. In fact, it is difficult, I think, for us in this country to put ourselves in the state of mind of other countries who must always judge their commercial policy strictly in terms of the fear the imports will be too big and exports will be too small. Our situation is almost the reverse.

I would also like to mention what seems to me the logical second set of consequences following upon a United States withdrawal, and the setting up of a European trading bloc. It seems to me that the experience we have already had have indicated that such a European grouping probably would not include Japan. It has been only with considerable United States persuasion and leadership that it has been possible to bring Japan within the world trading community. If Japan is excluded, I think that it would be extremely difficult for her to in any way balance her international account or even come close to balancing her international accounts. It would mean that the United States would have the alternative either of continuing to subsidize Japan indefinitely, or witnessing her fall into neutralism, and possibly switch to the other side. I think that there would be an extremely important tendency for the underdeveloped nations, which are particularly the Asian nations, which are outside this European trading bloc, to resent bitterly what would look to them like ganging up against them by the more industrialized nations. There would be a situation which would not be stable but one that would head toward almost certain breakup of the whole free world alliance.

Mr. BOLLING. Thank you.

Are there any further comments? Senator Flanders?

Senator FLANDERS. I am sorry to have had to get in late. I had to take 2 or 3 telephone calls, but I have tried to run rapidly through the 3 papers and to listen when I was here.

Dr. Vernon, I was interested in your putting a political complexion, a possible political complexion, onto the European Customs Union. That is a new argument, and if we are trying to find objections to the European Customs Union it strikes me that you have been quite ingenious in finding one.

Dr. VERNON. I cannot claim credit for it, sir. This is a point which has been made repeatedly, and Dr. Viner, for example, who is the expert on this subject, put it in a book about 5 years ago, pointing out that one impetus for customs unions in Europe historically had been the fear of our competitive strength.

Senator FLANDERS. I see. Then it has an honorable ancestry.

Dr. VERNON. It does.

Senator FLANDERS. As I said yesterday, I think, I attended a conference in Europe, a nonpublicized and private conference of businessmen, Government officials, and newspaper people, and military people in Europe last September, and the European Customs Union was one of the subjects under discussion, and everybody agreed that it was a good idea. They were all for it. But they also listed the difficulties in the way.

I called their attention to the fact that all the difficulties that they mentioned in the way of achieving a European Customs Union were exactly the difficulties that American businessmen and labor see in the way of forming an American-European Customs Union. They are exactly the same objections. And so I asked them to be a bit sympathetic and patient with us, since we were facing the same problems that they were.

I also made this statement, that I felt that the Europeans of Western Europe could do for themselves far more than America could do for them, by making a mass market for their own industries by means of a customs union. I mentioned that yesterday, but I will just state that again.

You have mentioned the question of Japan. Let me first say that I think you have made a contribution, Dr. Vernon, in your paper, in calling attention to the settling of trade disputes by GATT. I think that is not commonly realized, and I think it is a contribution to our knowledge of what goes on in GATT. I am glad that you have done so.

You have mentioned Japan and others. This subject really belongs in tomorrow morning's "Regionalism as an alternative to multilateral world trade." It has always struck me that the Japanese had the right idea commercially in setting up the greater East-Asian coprosperity sphere. You may remember that phrase. The wrong thing about it was their endeavor to establish it by military means, and, as I think I said yesterday, it is a matter of concern to me that the food surplus countries of southeastern Asia for some reason seem to have to send their excess rice to the Soviet area instead of exchanging it in Japan for consumer goods. It seems to me that is a natural thing to do, is the natural market, rather than seeking entry into the United States or Europe on the basis of low labor costs.

That really comes under the head of regionalism, which we will be talking about tomorrow morning.

They had the right idea, in my judgment, and what is holding them up—what the barrier is that is preventing the development of that idea—is beyond me. I am hopeful of getting some light on it in the near future.

Now, I may say that I had a telegram this morning from blouse manufacturers. I had already seen the news in the papers indicating, as I remember, that it was 2 or 3 days ago, as I remember roughly figuring it out, that about 30 percent of American use consumption of blouses for the coming year had been ordered from Japan. That is a major upset.

Dr. VERNON. Senator, may I add one, I think, relevant fact: I really hadn't come here to talk about blouses. I did that the other night on television, and my ears are still red on the subject, but one of the other relevant facts in this situation is that blouse manufacturers have been producing about 20 percent more blouses, themselves, in the United States during this year than in the past year. In short, this great incursion of Japanese blouses which, heaven knows, exist——

Senator FLANDERS. It hasn't come yet. It has just been ordered. It isn't here yet.

Dr. VERNON. Now, if our past experience with Japanese blouses, which have been coming in in quite some quantity, are any guide, they find a market which seems to be different from the American market.

Senator FLANDERS. They put them on people that haven't hitherto worn blouses.

Dr. VERNON. Just as the case of Swiss watches, where your imports, which went up from 2 or 3 million to 10 million, found a new market. They found an $18.75 market instead of a $75 market, and, of course, American producers would like to share in any expanding market. I don't blame them. I would, too.

Senator FLANDERS. Mr. Chairman, I would like to put on record at this point my feeling that the compulsion of the law that we passed leads to an unwise action in the raising of the duties, however, little it was, on watches, and on bicycles. Because on those two things the American manufacturers were asleep at the switch, and they are asking protection against their own lack of enterprise and efficiency.

Mr. BOLLING. As is not unusual, I agree with you wholeheartedly.

Senator FLANDERS. My children have grown up, and the grandchildren are taking on. Anyone who bought an American bicycle 50 years ago was just a damned fool, and I haven't any of those in my family, so they bought English bicycles.

Now, are you saying, Dr. Vernon, that you are quite sure that in textiles that the Japanese production and import will not be a really serious disturbance to the American textile and clothing industry?

Dr. VERNON. I wouldn't want to be pushed that far. I would rather describe history than make a prediction in this case.

So far, notwithstanding very large imports of Japanese blouses, they have found their own markets, and the American producers have increased rather than reduced their own production. Now, that cannot continue forever. There can be a point at which American blouse producers can get into all sorts of real trouble. I don't question that for a moment.

Senator FLANDERS. Again, the matter of finding new markets, I would suggest that Japan go to Bali. Again, it is the greater East Asian coprosperity sphere.

Dr. VERNON. The Balinese are learning how to make blouses.

Senator FLANDERS. I don't want them to put blouses on the Balinese women, but I am going to prophesy. I simply say that I will not be surprised to find that the results are rather serious. That isn't prophecy.

Now, Dr. Friedman, this tendency toward autarky is—there is a tendency toward autarky, isn't there?

Dr. FRIEDMAN. I would say, Senator, that there is a tendency in both directions. I don't think it is really easy, if I may say so, to generalize. I think what we find today is that in a number of countries there is the desire to get more economic self-sufficiency, which undoubtedly can be described as autarky.

On the other hand, I think we are finding that in perhaps an equal number of countries there is a recognition that this economic self-sufficiency is purchased at a very high cost. I think we are finding at the same time, inside these countries, very strong groups, and very strong political leadership, which is trying to take their countries away from autarky, and I would dare say it would be very hard to make a clear and unequivocal judgment on this.

Senator FLANDERS. Your answer is that you see, if I understand it—you do not see any large-scale effective movement toward autarky in varied degrees, in particular countries, and you don't think the world is going that way; is that it?

Dr. FRIEDMAN. I am not sure I understand. I think that what is happening is, for example, illustrated by what we find in a country which is becoming newly developed. The country may have been previously an importer of certain consumer goods, it might have imported certain foodstuffs; it might have imported certain consumer goods and capital equipment. Now, you have an economic development program. The country will, as a rule, try to become more self-sufficient with regard to foodstuffs and will try to reduce its import bill. The country might try, if it has certain industrial raw materials, potential materials like energy, to develop its sources of energy for itself and become less dependent, if possible, on imports.

At the same time, the country may become a larger importer of capital goods. It may become more of an importer of higher standard of living consumption goods which it cannot hope to make for itself.

I think that is one kind of typical situation we have today.

Senator FLANDERS. You wouldn't call that autarky, would you?

Dr. FRIEDMAN. That would be hard to say. In a way it has elements of autarky. In the sense of it trying to become economically self-sufficient with respect to certain things that it could perhaps obtain through international trade, there is an element of autarky.

Senator FLANDERS. Take, for instance, the case of Bolivia, for whom we gave assistance in building a road down into the fertile lowlands on the southeast side. Is it perfectly proper for that country to seek to raise its own supply of food instead of bringing it in tin cans? This really isn't autarky. It is just using its own resources for things that it had been importing.

Dr. FRIEDMAN. That is right. I would agree with that. I think where you have a greater degree of autarky is where a country will try to develop on a very high-cost basis some sources of, we will say, foodstuffs that it might be able to obtain in a nearby region quite economically, but it is, as I know you appreciate, very hard, to think in terms of a generalization. On the other hand, you have the situation of European countries which might conceivably have tried to protect their capital-equipment industries, or their own consumer-production industries from American competition, and yet in some cases we find that this hasn't happened, and that these countries have been willing to accept American competition in fields that are very important for their particular industries.

Now, this, to me, is a tendency away from autarky.

Senator FLANDERS. You are not disturbed about there being any general movement in that direction that will counter the efforts to make trade freer in general?

Dr. FRIEDMAN. Well, the thing that would disturb me, I don't have to be too exact, is that at any given moment there are tendencies in both directions, and at any given moment there are tendencies in both directions internationally and inside individual countries.

Now, one does not know what tendency is going to prevail all the time, and I think that unless you have a general momentum toward getting rid of autarky, toward creating a truly international system of trade and payments, you cannot be sure that even in the same countries, which we would now describe as going away from autarky, you might have a reversal of the trend. I do not see the danger in any present general trend toward autarky. In fact, I think it is away from that on balance, but always there is the possibility that if we don't keep up the progress you could get retrogression.

Senator FLANDERS. Mr. Chairman, Dr. Friedman made reference to capital-goods restrictions on imports and exports. Of course, we have in this country the cases of the transformers and generators, and so forth, which can be furnished more cheaply, and presumably of as good quality, from Great Britain. We had yesterday one of our witnesses, and I forget which one, who suggested that we should make a distinction—I don't suppose legislatively, but commercially and administratively—between electrical goods which were made in high production and specialties, designed to suit a particular application. He suggested we might well leave to the English, a case largely of English manufacturers, the provision of the specially designed apparatus for a special application, and let our manufacturers concentrate on the large-scale production.

That was an interesting idea, and I was glad that it got into the record. I haven't discussed the matter. Mr. Fennelly brought that up. We haven't discussed the matter with the presidents of Westinghouse and General Motors. Just how it would appeal to them, I don't know.

Dr. VERNON. You can make a perfectly safe prediction, sir, that it wouldn't appeal at all.

Senator FLANDERS. Perhaps not.

Now, Dr. MacEachron, I was interested in your reference to international cooperation in the face of state trading and the exception clauses, and I think that is good, Mr. Chairman. That is good material for our east-west trade policy program tomorrow afternoon, and I hope that we can bring into the discussion some of the material which Dr. MacEachron presented.

I am taking too much time, but I have one other thought as an advocatus diaboli. Mr. Talle isn't here, and I hesitate to use Latin when he isn't here.

Mr. BOLLING. I think you are safe in this case.

Senator FLANDERS. You think I am safe? All right.

As advocatus diaboli, I would like to inquire of the three witnesses here this morning whether they have ever heard of, and, if so, whether they have ever considered the general, overall idea that the United States might well tailor its export trade to balance its needed imports, and looking toward building up the low-grade consumer areas of this country to consume an added volume of goods, not exactly the same in detail, numbers, or in amounts, but, in general, on which our dependence is now on the export market.

Did you ever hear of that idea? Is so, what do you think of it?

Dr. VERNON. I think it has to be broken down by parts. It seems to me that with respect to the undeveloped areas of the United States, the question whether we should assist in their development can be dealt with independently of foreign trade. If they are good to develop, they are good to develop whatever our policy may be with respect to foreign trade, so that I think I am perhaps fair in examining the other part of the proposal in a manner which insists it stand on its own feet.

I hope I am not distorting your proposal in restating it. Query: ought you limit your exports in effect to the imports that you need?

Senator FLANDERS. To balance the imports you need to go with all the invisible items and all the rest of it, but make our dependence for a full volume of production on distribution within, rather than without, the country.

Dr. VERNON. Whenever I am confronted with a proposal of this sort I try to look for a principle. If one looks for the principle involved, I think he finds it a little hard to find it. The reason I say that is the following: In the long run, of course, our imports and exports will balance. They must. Once we drain all other countries of gold, or push them to the point where they are fearful that they will be drained of gold, their own actions will see to it that our exports and imports balance.

What this proposal, therefore, must be implicitly suggesting is that we somehow push down the level of our foreign trade to something less than it would otherwise be in the absence of interference. This is the only way I can interpret the proposal.

Now, when you get into the question of pushing down the level of your foreign trade to something less than it would be in the long run, in the absence of interference, your first natural question is, which part of your foreign trade shall you push down, both on the export side and on the import side.

Senator FLANDERS. By the way, how do you push this down?

Dr. VERNON. And how do you push it down.

Senator FLANDERS. I stepped out of my advocatus diaboli then.

Dr. VERNON. I appreciate your assistance, as a matter of fact.

Well, at that point, one gets lost in a morass of governmentally employed techniques, export restrictions, export tariffs, and has to choose a segment of industry to benefit or hurt.

At this point I part company with the proposal.

Senator FLANDERS. You don't object to our very vaguely stressing our own domestic consumption?

Dr. VERNON. Not in the least.

Senator FLANDERS. You work for a candy company, I am told. I am trying to reduce your market, because I am taking saccharin.

Dr. VERNON. I see. Since I appear here in a personal capacity I shall not comment.

Senator FLANDERS. What about you, Dr. Friedman? Have you any comments on that?

Dr. FRIEDMAN. Offhand, the idea sounds appalling, but it is hard to describe exactly why. From a practical point of view it just does not fit. It ignores the fact that there are other countries in the world. I presume if you try to balance United States trade by selling to underdeveloped countries, and importing from those countries, in the first place you would have, I am sure, technically, a severe reduction in trade because your total exports to the underdeveloped countries couldn't hope to maintain a relatively large volume of export trade. We know that trading with other industrial countries has always been a very important feature of United States export trade.

Thus the proposal would lead to a much reduced level of trade.

Secondly, I am not sure how we would make sure that we would import from the same countries to which we export.

Senator FLANDERS. You assume multilateral trade following this theory; wouldn't you?

Dr. FRIEDMAN. You couldn't assume multilateral trade because once you adopted the proposal you would have to assume that every other country, it seems to me, would then try to influence its own pattern of exports and imports, and at this point you wouldn't have multilateral trade. You would have some kind of bilateral trade, and system of trading agreements which are being implemented both on the export and import side by a very extensive system of controls. Otherwise, I don't think you would get this pattern, because you won't get this pattern naturally from economic forces. Therefore, you will have to get them through some kind of intensive governmental intervention.

It seems to me offhand that it is very hard to see, even if you do not have a bias against intervention, which I am afraid I do, how the proposal could be worked out. It would become tremendously complicated to try to find the machinery for its implementation.

On the economic side, I don't think you would be helping the underdeveloped countries, although I think that is what seems to motivate this proposal to a large part, and you surely would not be helping the

United States. I think our experience has been that countries have not been at all injured by the export surplus of the United States. One of the great factors in the rehabilitation of the world, and in the raising of standards of living of other countries, which we have seen taking place in the last 10 years, has been the fact that we have had a large export surplus. I think this is the way by which the United States contributes to the welfare of the world.

The problem of financing the export surplus in the last 10 years has been taken care of largely through United States grants and credits and other forms of aid. Now, what the pattern will be in the future, I don't know. I don't think one should very quickly assume that balanced trade and bilateralized trade of this kind is in the interest of either party engaging in it.

Dr. MacEachron. I would like to add a footnote to what has been very ably said before: I would like to say I don't think there is such a thing as the specific requirement of imports. It seems to me the proposition you are presenting, Senator, implied there was some way you could say "We need this level of imports." Our country is based on a system where individuals can consume what their income will permit, and what they want to consume, and that it seems to me applies to goods whether they come from within the United States or abroad. I don't think that the United States Government should start telling people that they cannot consume British woolens, or even Japanese blouses, if that is what they want to consume.

It seems to me our own economic system is based on this principle, and I think that same principle ought to be applied, as far as our international trade goes.

Senator Flanders. I would like to say, Mr. Chairman, that so far as my experience with this idea goes, it has been applied as a counterargument to this anxiety for increasing our exports. That is, it has not been suggested that we push our exports down, but the question raised is, Why are we so anxious for increasing our exports? Shouldn't we rather see if we cannot increase our consumption in this country?

In other words, it is a negative approach, rather than a positive one.

I have had some discussions on that subject with people over the last 20 years. I do not see that the idea is making any headway, and it did not make any headway, as a matter of fact, here this morning, so far as I can judge.

Dr. Friedman. Mr. Chairman, on this last point, I think a comment may be worth making. I think the Senator has a very real point. There seems to have been a good deal of discussion based on the underlying assumption in the last, say 10 years that the real purpose of international trade is to export.

Now, I think that most of us who are more old-fashioned, think that the real purpose of international trade is to import. I think on this there can be real agreement. The purpose of foreign trade is to increase our own consumption standards rather than provide exports. We get to the export problem because it is one of the technical problems. You have one problem of international trade of expanding exports, but it is not the purpose of international trade. If that is the motivation of the suggestion I think at least for myself I would tend to agree with the basic philosophy that we ought to be primarily concerned with the benefits of international trade through importation, rather than a prior concern with exportation.

Mr. BOLLING. Thank you.

Dr. Ensley?

Dr. ENSLEY. I have no questions.

Mr. BOLLING. Dr. Sheldon?

Dr. SHELDON. Dr. Vernon, one of the questions which has come up in discussions on the GATT and the OTC is the suggestion there is a real danger that acceptance of these groups will allow control of our trade policy to fall into the hands of foreign governments.

Can you give us any assurance on this point that this will not happen?

Dr. VERNON. Well, what I would like to do is to describe the process by which other governments influence our trade policy, and you can draw your own conclusions in terms of influence.

Let us take a specific case. There is one particular instance in which the contracting parties to the GATT, confronted with a claim on the part of one of its members that another member was violating the GATT egregiously, failed to get any remedy for the complaining member. The complaining member was Holland and the country complained of was the United States. The United States had imposed import restrictions on dairy products, as the Secretary of Agriculture felt he was compelled to do by the provisions of section 104 of the Defense Production Act.

The Dutch complained. The Executive of the United States said to the Dutch in the GATT: "I feel that I have been compelled to do this by an act of Congress. I will try to persuade the Congress to alter its act, but I cannot promise you anything."

The executive branch of the Government then sought to persuade Congress to change its mind, and, in the end, he felt compelled to continue to impose the restriction, though under a different provision of law, and the Dutch have never gotten what it was they sought in the first instance.

What they have gotten from the GATT, because of the inability of the United States fully to discharge its obligations under the GATT, was a right to retaliate against the United States. In short, the Dutch are now entitled to restrict imports of wheat flour from the United States under certain circumscribed conditions, and the contract in effect has been modified.

We continue to restrict import of certain Dutch cheeses. They continue not to import wheat flour freely, and the Congress of the United States may do as it wishes in this field.

Now, the fundamental point is that the GATT has no police force. The GATT can simply say to a contracting party "We think that you should do so and so," and the contracting party can say "I am sorry I cannot do so and so," or "I will not do so and so," and if the contracting party chooses to adopt that course the only thing the GATT can do is to unwind the other side of the bargain and said "As long as this country has deviated from its bargain you other fellows are entitled to deviate within certain prescribed limits."

Certainly this represents influence by foreign governments on the policy of the United States. The Executive would probably not have urged the Congress to change this law in the absence of the GATT, but Congress has been known to have its own mind, notwithstanding recommendations of the Executive, and I assume will continue to have its own mind in this regard. I am always mystified as to where one assumes this great locus of power is that will capture the commercial policy of the United States through the GATT. It simply does not exist.

Dr. MacEachron. I think it might be well to add there that in the absence of the GATT, assuming the same action, it seems to me that what would have happened would be somewhat the same, but a little bit worse. The Dutch would have had no place to go to present their case. They would have taken retaliatory action. Chances are it would have been more severe retaliatory action than they took when it had been talked out in the forum of the GATT, which might, in turn, have provoked the United States to, in turn, retaliate and you would have gotten, instead of a situation that is at least kept within bounds, a continuing dispute of the type that was mentioned earlier by Dr. Vernon.

Dr. Sheldon. Dr. Vernon, are any new restrictions put on the United States freedom of action, once we sign up for the OTC?

Dr. Vernon. The general answer to that question is "No," but let me be a little more explicit: Since the passage of the Trade Agreements Act of 1934, the President has considered himself authorized to enter into trade agreements. When a nation enters into an agreement of any kind it presumably intends to live up to the agreement. If you consider this presumption as a restraint on the country's behavior, then our adherence to any trade agreement, the GATT or any other kind of trade agreement, is a restraint on our behavior, no different from any other restraint imposed by any international agreement.

The OTC has three purposes. One is to facilitate the administration of the GATT. This does not imply any additional restraint which does not exist in the GATT.

Its two other purposes are very general. They consist mostly of the right to make trade proposals to member governments, and the proposals will presumably have more dignity than if the OTC did not exist, but they have no binding force on the governments unless the governments accept them. The OTC proposes to collect statistics, facilitate discussions, and help settle disputes. This is in essence what the OTC proposal is.

If my description of the OTC sounded as if it tended to belittle the organization, I have created a misimpression. The OTC has a symbolic importance which must not be overlooked. If the United States accepts membership in the OTC nothing very much will happen. However, if the United States refuses acceptance of the OTC, it will have all sorts of repercussions, because the failure to adhere to the OTC will be interpreted, and I think rightly, by most other countries as a gage of the balance of power within the United States.

As far as foreign countries are concerned, the principal question is: Is the United States tariff still regarded, as it was in 1926 or 1927, as exclusively a domestic matter, or is it something which the United States at least is willing to talk about to other countries? This is the real test of the OTC. If the Congress decides not to ratify the OTC, the interpretation placed on it will be that the Congress regards the

American tariff and American trade policy as exclusively a domestic matter, not properly the subject for international discussion.

Senator FLANDERS. I would like to get your point of view more clearly on that, Dr. Vernon. Is not our active participation in GATT the answer to that?

Dr. VERNON. Is not our active participation in GATT the answer to this?

Senator FLANDERS. Hasn't that been answered by our participation in GATT?

Dr. VERNON. Yes, of course. But the OTC, since its principal purpose is only to facilitate the operation of the GATT, becomes in a sense indistinguishable from our participation in the GATT. One has to bear in mind the congressional assertions with respect to the GATT. The Congress has never told the United States not to participate in the GATT, but it has gone as far short of that as it is possible to go without forcing the United States out of the GATT.

There has been 4 or 5 occasions in which the Congress has enacted a clause which says, in effect, "The passage of this legislation—whatever the legislation may be—shall not be construed to signify either approval or disapproval of an executive agreement known as the General Agreement on Tariffs and Trade."

Senator FLANDERS. You, of course, understand the reasons back of that, when the Constitution specifically reserves to the Congress the imposition of duties. The feeling in the Congress is that the Congress has gone pretty far toward relinquishing its powers in permitting the President to enter into these general-trade agreements.

The evidence of the thinness of the top rail of the fence on which the whole GATT thing is proceeding lies in the very careful definition which the State Department has found it necessary to explain with regard to the relationship of the Executive to GATT. I don't know whether I can put it in the precise terms, or not. The President does not resign his authority to GATT. GATT is supposed to be an extension of the President's authority granted him by the Congress. Congress could not give him permission to resign his authority.

That perhaps explains more or less the way in which the State Department has explained the matter to the Senate committee, but it is a matter that really is not simply explained. The Congress is desirous of making it clear that it retains its authority. It has given the President in this legislation the authority not to turn over his authority but to exercise it in a particular way.

Dr. VERNON. Well, sir, I don't for a moment pretend to be able to explain the actions of the Congress in any better and more accurate way than you yourself can do. All I can testify to is the impact of this provision upon foreign opinion. Now, as far as foreign governments are concerned, the Congress in effect has said to the President, and perhaps quite properly, "The GATT is your concern. As far as we are concerned, we are not expressing either support or resistance to it."

Now, suppose that the Congress then follows up by saying "Not only is the GATT your concern, but we propose not to authorize you to participate in an organization to administer the GATT. You find a way of administering the GATT without an organization," or "Withdraw from the GATT if you like. We haven't asked you to join it in the first place."

In circumstances of that sort, I think it would be a reasonable interpretation, I would certainly interpret it if I were a representative of a foreign government, as constituting, in effect, a declaration on the part of the Congress that there are no international organizations in which the Congress thinks it is appropriate for the United States to engage in discussions of its trade policy. I would have to govern my future activity on the basis of that long-run assumption.

Dr. SHELDON. Thank you very much, Dr. Vernon.

I have a question of Dr. MacEachron. You discussed for us some of the difficulties for the United States in trying to expand trade with countries which use state trading as their principal means of doing business.

Could you just briefly point up some of the difficulties for any normal country trying to run its own affairs through state trading? There are disadvantages for the state-trading country, too. What are some of the problems that are associated with trying to manipulate trade in that manner?

Dr. MACEACHRON. Are you speaking now, Dr. Sheldon, of the non-Soviet countries that have used state-trading devices?

Dr. SHELDON. Yes.

Dr. MACEACHRON. I think probably the best thing I can do is just refer very briefly to the experience the British had in certain fields with state-trading devices, and the experience I think can be said to be pretty bad.

The organization of a government entity is not, I think, a particularly good one for the purpose of deciding how much people need or want or are willing to buy of certain things. Instead of having a regular market, where the particular commodity is bought and sold, so that there is a way of judging how much should be brought into the country, and a sharing of the risks among a large group of private entrepreneurs, each of whom is staking his own money on a gamble that people will buy what he wants to bring in, instead of that you have a single decision. Instead of many decisions you have a decision of a group of men which may or may not be the right one. If it is the wrong one the whole country suffers. They either do not have enough of the product, or have more than they want and have wasted their resources by buying something nobody wants. Usually in the state operation it is necessarily a single, or at least a few large contracts instead of many small ones, so that it is much less flexible. The flow of goods cannot be adapted quickly to changing market conditions, and I think that that probably is all I need say on this point. It has not been successful, and countries have gotten away from it as soon as they could.

Dr. SHELDON. My question was prompted by experiences in Japan during the period of the American occupation. Those of us who were involved in those operations I think have come away with a feeling that there were very strong disadvantages, even though such measures may have been required at the time. You have touched on most of those points. We would learn of materials available at favorable prices in world markets, but by the time necessary concurrences had been arranged by the many agencies involved those opportunities usually had disappeared.

That kind of rigidity, the having to make plans, say, a year in advance, was always a problem in running trade efficiently. When we did leap into the market inevitably we had some effect on world prices, too. If you order things by the shipload or by many shiploads, it boosts prices. I am glad that you helped to bring out some of those points. Thank you very much.

Mr. BOLLING. I would like to pursue one thing that perhaps does not belong properly here today, but it has been mentioned.

I received an impression from what everybody said—not from what any single witness said, although I believe that Dr. MacEachron started the ball rolling, at least. This is the impression: While there might not be so severe a short-range impact on the United States if we reversed our approach toward furtherance of international trade cooperation, there would be inevitably a very severe long-range impact. And I had the impression that one of the implications would be the establishment of a trading bloc in Western Europe which would have a very substantial political drift toward neutralism.

I wanted to follow up on that particular point: Was there some mention of the effect this would have in the Far East? The implication that I sensed, although it was not stated, was that this might in economic terms have a further political effect.

Did I understand you correctly, or not?

Dr. MACEACHRON. You are getting a long way into the future. I think that is certainly a possibility. I think that any system that was set up that seemed to exclude the major nations of Asia would have very bad political effects which would be more important than the economic effects. I think it would tend to drive them into neutralism and what happened beyond that is anybody's guess.

I think neutralism is bad enough, but I am willing to stop there.

Dr. VERNON. I would subscribe to Dr. MacEachron's conclusion and your summary.

May I add this about European customs unions, a very brief comment: I can conceive of circumstances in which a European customs union could be set up in a fashion which would have both benign political and economic consequences. This would be in a situation, for example, in which the level of restrictions they imposed against the rest of the world was low and in which they were not driven to the arrangement by United States intransigence but voluntarily adopted this course. That is different from the kind of situation we envisage today.

Mr. BOLLING. I am interested primarily in the specific thought in mind of the United States shifting away its tendency toward trade liberalization.

Senator FLANDERS. It is going to be difficult for me to see how a European customs union would unfavorably affect Japan, say Japan would simply be dealing with a larger group in somewhat the same way that it now deals with the United States. I don't see why that necessarily means exclusion.

Mr. BOLLING. My first assumption, however, was that the United States tendency toward furthering international trade cooperation would be reversed, and that was the basis on which I was approaching this particular problem.

Senator FLANDERS. Tomorrow I am going to raise the question again if whether it isn't in the interest of the United States and the world that regionalism be practiced, not as a principle, which is accepted as a principle, but as the logical solution to the Japanese trade problem.

Dr. MacEachron. Senator Flanders, I would like to say a word or two on that point. Insofar as you get increased trade between Japan and these other nations of Asia that resulted from a natural desire on the part of the other Asian nations to buy Japanese goods, and in turn Japan buying from them, there would be no objection to it, and I think it would be desirable just as expansion of world trade anywhere is desirable. But if this regionalism were to be fostered by deliberate effort to exclude the trade of other nations from the region, or to discriminate against the trade of other nations, then I think you would be fostering something that is uneconomic, and I think would have harmful effects, harmful economic and political effects on the rest of the world.

Senator Flanders. One of the things I want to know is whether there are any trade restrictions now which seem to prevent what seems to me to be a very natural, normal flow of trade. What is it that makes it necessary for Burma to sell its rice in the Soviet area? What is it? I don't know what it is. I don't think it is tariff restrictions of any sort. It is something else.

Dr. Vernon. That could be. I am speculating here, but I suspect my speculation may have a basis in fact. You could have here the basic difficulty which capitalistic, particularly democratic countries have when they face a monolith like the Soviet bloc. The Soviets may be offering a better price, and a better price based not only on the utility of the rice to them, but the utility of the political influence to them.

Senator Flanders. And how are they going to pay the price? What is the medium of exchange?

Dr. Vernon. It could be goods given to the Burmese at better prices than the Burmese could get in the world market, or it could actually be an addition of sterling or gold to the Burmese reserves.

Senator Flanders. I think they wear blouses in Burma.

Mr. Bolling. Dr. Friedman?

Senator Flanders. I don't believe they can get blouses as cheap in the Soviet area as they can in Japan.

Dr. Friedman. Mr. Chairman, I am not quite sure of the facts on this one, but I would suggest that any discussion on this point might well analyze the total rice production of southeast Asia to see if it can be sold in large part or in toto to Japan. I think you have the problem in many of these cases that the world distribution of resources doesn't seem to follow a regional pattern. You may have one part of the world which becomes the rice bowl, not only, for example, for the Yangtze Valley or for China, but it becomes the rice bowl for a large number of countries outside of the area.

Senator Flanders. Burma, Siam and in the old days, Indochina, were all rice surplus countries. Indochina, of course, has been changed.

Dr. Friedman. I am not saying they couldn't sell it to Japan. I don't know. If I may get away from this particular case to a general case, we have the problem that the large industrial nations of the world really have an export capacity that usually goes beyond the needs of a particular area. That is, it may be that a particular industry can satisfy its requirements by being able to export to an area, but when you look at the total export pattern of the country, frequently other industries just can't hope to find the necessary markets in a particular area. Thus I think your investigation on economic lines should at least include an analysis as to what are the export requirements for industrial countries that are members of any potential region and also what are the export requirements of the other side, that is your raw material producers, to see to what extent they match. I think in your matching process you might come across some interesting problems of surpluses and deficits of various commodities.

Mr. BOLLING. I have another point that might more properly belong tomorrow afternoon, but which interests me very much. I have the impression that there are a large number of people, not only in the United States but in other countries of the so-called free world, who have a feeling that economic factors determine whether there will or will not be trade with the Soviet Empire, as Dr. MacEachron called it. My own view has been that based on very limited experience and knowledge of history with other totalitarianisms that economic factors quite often are very minor in economic transactions with totalitarian blocs; that the political factors that Dr. MacEachron mentioned are obviously the real factors involved in the decision making. It occurs to me that those who say that the Soviet will not be able to pay for this or that item of trade ignore the fact that the Soviet Uioin, at least in a military line, has demonstrated a capacity to come up with a very advanced level of product. I suppose that the atomic and hydrogen weapons are as advanced as anything is, and I presume that clearly a conglomeration that can manufacture advanced long-range bombers is capable of producing consumer goods, if the decision is made.

Now, would I find that all of you agree that a totalitarian state may base its trade entirely on politics and very little on economics?

Dr. VERNON. I am inclined to agree with your diagnosis, with certain restraints. The Soviet Union was clearly looking for machine tools, and transportation equipment in Western Europe, for reasons which could be said to be economic. The reason that an economist has difficulty in distinguishing economic from political considerations in the Soviet Union is that he can't think of economics as divorced from a price system, a system in which the market creates prices. Of course, the value that the Soviet Union places on different goods has little to do with open market prices. In other words, if she is anxious, awfully anxious to have a machine tool, she may put a dreadfully high price on it, not because in market terms it would have that price, but because this is a way of getting more machine tools produced. So that you start with the fundamental difficulty which is that you can't easily talk in economic concepts when you are talking about a totalitarian state, at least not in the concept in which an economist schooled in competitive market system is trained to think.

Mr. BOLLING. I thank you.

Dr. FRIEDMAN. That is a pretty good answer.

Mr. BOLLING. Are there any further questions?

We thank you all for your contribution and your presence. It has been a very constructive and helpful discussion.

With that, the subcommittee will recess until this afternoon at 2 o'clock in this same room, when the subject will be International Investment and Development.

(Whereupon, at 12:18 p. m., the subcommittee recessed until 2 p. m., the same day.)

AFTERNOON SESSION

The subcommittee met at 2 p. m., the Honorable Richard Bolling, chairman of the subcommittee, presiding.

Also present: Grover W. Ensley, staff director, and Charles S. Sheldon II, staff economist.

Mr. BOLLING. The subcommittee will be in order.

The subject for this afternoon represents a logical continuation of the discussions of this morning. We heard reports on the problems of international cooperation in trade and payments. Recognizing that an important reason for trade is to spur economic development, we turn to that subject this afternoon. Whether relying on private or public funds, international capital investment is an important element in raising living standards of all countries. Even the largest at some stage have relied on outside help, including the United States. The aspirations of the underdeveloped countries of the free world are viewed sympathetically by the United States, for their progress is important to world peace and prosperity.

Our first speaker is Dr. John H. Adler, of the International Bank for Reconstruction and Development. Author of several books on financial subjects, he also has served in foreign assignments in such developing areas as Central America and Nigeria. Until recently he was assistant to the Director of the World Bank's economic staff, and is now on the staff of the Economic Development Institute. Dr. Adler is going to discuss the Place of International Investment in the United States Economic Outlook.

Dr. Adler.

STATEMENT OF DR. JOHN H. ADLER, INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Dr. ADLER. Mr. Chairman, I want to start out by saying that I am speaking not on behalf or as a representative of the International Bank. What I have to say is a summary of my own thoughts on the subject of foreign investment and does not necessarily reflect the thoughts of the management of the bank.

In the statement that I have submitted to your committee I have tried to sift the facts from the folklore and fiction of foreign investment. I have tried to suggest what the actual and potential dimensions of foreign investment are and to show how it fits into the framework of the American economy on the one hand and the world economy on the other.

The investment of American capital abroad, the setting up of enterprises under American ownership and management in foreign countries, and the making of loans to foreign governments has been hailed on occasions as a cure-all for the so-called dollar shortage, now deceased, and for the underdevelopment of many parts of the world. On the other hand, some have considered it an actual, or at least a potential, threat to our economy. They charge that the production abroad of things that we produce at home and export ruins our export markets; or, as it is sometimes put, that we should not export jobs instead of goods.

They also claim that the development abroad of resources for the American market threatens the level of American employment; besides, it is charged, it weakens our national security.

As far as foreign loans are concerned, both private and public, some foreign countries seem to come dangerously close to the position that their economic advancement depends solely on our willingness to lend them large sums of money, while the opposition uses phrases like "down the drain" or "Operation Rathole" to indicate what they think about foreign lending.

These and similar statements, divergent as they are, have one thing in common: I think they exaggerate the importance of American foreign investment and the good and evil it can do. To be sure, foreign investment is an important part of the international transactions of the United States and it is important in more than one way. But it must be looked at in the context of all of our economic and financial relations with the rest of the world, and of the American economy itself.

Total private foreign investment at present amounts to about $25 billion. This is equivalent to 2½ percent of our reproducible national wealth. If we add to that Government loans outstanding, the proportion rises to something like 4 percent.

These are not small proportions, but they are much smaller, for instance, than the value of business inventories in the United States, or even that of military and naval installations. The relationship between the flow of foreign and domestic investment is similar. In the last 5 years, American long-term private capital outflows of all kinds averaged under $1 billion, compared with private domestic investment of around $50 billion. This, again, gives a proportion of 2 percent. The percentage figure becomes somewhat smaller if Government loans to foreign countries are included in foreign investment and if public construction is included in domestic investment.

These indications of relative orders of magnitude show that in the aggregate American foreign investment is not a major factor bearing on the level of employment and income in this country, although its significance as a source of supply for the American market is considerable. In the statement which I have submitted, I have a good deal more to say on this point.

Returns from foreign investment, which run in the order of magnitude of $1.7 billion per year, likewise are very minor items in the flow of American income. They amount to less than 10 percent of all corporate profits, and much less than 1 percent of total income.

The main reason for the small role that foreign investment plays in the American economy is that this country still contains within its own borders a wealth of underdeveloped resources, and there are so many domestic opportunities for the use of savings that there is little need to go abroad. There is a host of minor causes why the volume of American investment is kept down: inconvertibility, exchange restrictions, risks of war and civil unrest, the unfriendly attitude of foreign authorities, unfavorable tax treatment, both at home and in the host country, and, particularly in the case of portfolio investment, the experience during the 1930's when a good deal of the foreign loans went into default.

But even if all these obstacles to foreign investment could be eliminated, there would remain the competing attraction of domestic investment opportunities that normally win out—because domestic investment is inherently less risky and less costly in terms of enterpreneurial and organizational efforts, and the higher returns on foreign investment do not fully compensate for these factors.

I think several conclusions can be drawn from these observations. In the first place, it is patently unrealistic to expect that American private foreign investment will ever become a catalytic force in the world economy as important as British foreign investment in the last quarter of the last century and in the first decade and a half in this century.

The British experience undoubtedly was unique and therefore the comparison is not really appropriate and may be considered somewhat unfavorable, but I think it is revealing to measure the American foreign investment performance, which now has lasted for about 40 years, against that of Great Britain and the 40 years prior to 1914.

Professor Cairncross, who testified before your committee last week, has estimated that by the time of the outbreak of the First World War, about one-third of all accumulated British-owned wealth had taken the form of private foreign investment. In American terms of 1955 this would mean something like $400 billion compared with the figure of $25 billion which I gave a while ago.

On the average, about 40 percent of British savings was invested overseas every year. The present-day American equivalent would be a private capital outflow of $20 billion annually. This is more than the total Marshall plan aid for the entire period of its existence. Actually, our capital outflows for private direct investment run around $200 million. In the few years immediately preceding the First World War, one-tenth of the British national income consisted of returns on overseas investment. The comparable American figure is half of 1 percent.

Clearly, the role of American foreign investment is bound to be more modest than that of British overseas investment in the Victorian era. But this does not mean that it has no role to play. I think it can make a substantial contribution to the capital formation of underdeveloped countries, and it can materially help to increase their production and living standards. If the development of underdeveloped countries is indeed one of the major objectives of American foreign economic policy, one of the ways to carry out this policy is to encourage a freer flow of American capital abroad.

At the same time, it must be realized that the encouragement of private capital movements, or loans by the Government, or Government guaranties, cannot and should not take the place of a liberal trade policy. As mentioned before, a large proportion of American foreign investment is oriented toward the American market. This type of investment will not expand if it cannot be reasonably certain that its product will not be discriminated against by tariffs or quantitative restrictions. Other American capital likewise will continue to be reluctant to go abroad if the transfer of earnings is jeopardized by American trade policies restricting imports, thus not permitting foreign countries to earn enough dollars for the service of their foreign debts.

I think it is abundantly clear that American foreign investment is in the interest of foreign countries as well as of the United States. This has been recognized and emphasized in numerous policy pronouncements of our Government. For many years, an increased flow of American private investment has been considered a major objective of our foreign economic policy, and on many occasions Government spokesmen, responding to pressures of foreign countries, particularly the underdeveloped countries of the world, for Government loans and grants for economic development, have pointed out that these countries should rely, in the first instance, on the flow of private capital.

This policy means that American capital must be actively encouraged to seek investment opportunities abroad, and that foreign governments must be persuaded to permit the entry of American capital on acceptable terms.

Notwithstanding the respectable expansion of direct investment since the end of the war from $7 billion to something like $17 billion now, in neither direction has the policy been wholly successful. American capital has not really shown a growing and general willingness to go to underdeveloped countries. When it has gone it has been in quest of special resources, such as oil or ores, and only occasionally has it sought to exploit new or expanding market opportunities; the oil companies have gone in for oil refining and the distribution of petroleum products, and there has been expansion of investment in general merchandising.

Nor, with a few exceptions, have foreign countries changed their attitude of reluctance, sometimes even hostility, toward American investment.

Foreign countries generally are aware, it is true, of the benefits that they can derive from foreign-owned enterprises, and many of them have welcomed American capital in official declarations. But their legislation, and even more their administrative actions, frequently are not in accord with these declarations. Management and control must be shared with local interests, the number of alien employees is limited, the transfer of earnings, and the repatriation of capital is restricted or subject to discriminatory exchange rates, and there are no firm assurances against nationalization. A number of countries explicitly prohibit the entry of private capital into basic industries such as public utilities, and into the exploitation of mineral resources. In some instances these obstacles to American direct investment prove insurmountable, being based on political convictions that cannot be argued or bargained away. In others, burdensome conditions are imposed with the intention of keeping the largest possible share of the foreign companies' profits in the host country. The imposition of such conditions is frequently based on a misinterpretation by foreign countries of official American policy pronouncements as implying that American capital is eager, or even compelled, to go abroad.

As we know, this is not the case. With business opportunities beckoning at home and in a few countries genuinely friendly to foreign capital, American companies see no need to make concessions and to take what they consider to be undue risks. True, foreign investment has been in the last 10 years good business for American firms that have gone abroad. The rates of return for American investment outside of Canada have run at 16½ percent on the average for the postwar years, compared to something like 10½ to 11 percent in this country, but these high rates of return on American foreign investment are not a measure of the attractiveness of foreign countries to American business. To the contrary, the wide spread between American returns on domestic investment and returns on foreign investment is an indication of the reluctance of American capital to venture abroad, and of the high risk premium that is necessary to make foreign operations inviting.

Various proposals have been advanced to encourage the flow of American capital. A bill now pending before Congress provides for an extension of the 14-percent allowance on the corporate income tax for Western Hemisphere trade corporations to countries outside the hemisphere and for the taxation of foreign branch profits on the basis applicable to earnings of subsidiaries, that is to say, only after the profits have been transferred home. The Secretary of the Treasury has also indicated his willingness to accept for inclusion in tax treaties a provision under which special tax privileges given American investment under foreign industrial promotion laws will no longer be undone by limiting tax credits to the amount of foreign taxes actually paid. These measures undoubtedly would have some favorable effects, but it is not likely that they will lead to a sudden spurt of private foreign investment.

The concern which the Government has shown for private direct investment has, unintentionally to be sure, directed attention away from the fact that portfolio investment, except in Canada and in bonds of the International Bank, which are foreign bonds from the point of view of the American economy, has actually declined in the postwar period. Between 1946 and 1954 total new issues of foreign bonds, again excluding Canada, amounted to less than $300 million. The outflow of new money was offset by the redemption of outstanding securities, and by sales to foreign purchasers of outstanding foreign issues.

At the end of the war almost one-half of all foreign issues were in default. By now only 7 percent of all issues still are in default.

There has been a revival of interest in portfolio investment and issues of $70 million have been successfully floated in the last 12 months. Still, a revival of the market for foreign securities in proportions even remotely approximating those of the twenties is most unlikely, quite aside from the question whether indiscriminate portfolio lending would be really desirable. But there can be little question that portfolio investment could be considerably expanded through the modification of State statutes under which institutional investors, such as insurance companies, savings banks, and trust funds are now severely limited in their ability to purchase foreign securities.

Underdeveloped countries have pointed out, with a good deal of justification, that the apparent heavy reliance of the United States Government on private direct investment as a means of assisting economic development meets their needs to a limited extent only. Direct investment, though useful and desirable, does not provide capital for roads, ports, irrigation works, agricultural credit facilities, schools, or hospitals. Many countries also consider such public utilities as railroads and power in the public domain and therefore unsuitable for direct investment financing. They therefore seek loan capital, private and public.

To a considerable extent, these requirements for loan funds have been met by the operations of the International Bank, in addition to the grants and credits extended by the United States Government, in part through the lending activities of the Export-Import Bank. The IBRD has made 136 loans totaling $2.4 billion to 40 countries; this is much more than total American portfolio investment outstanding, exclusive of Canada.

Most of the loans assist in the financing of development programs and projects in underdeveloped countries. Total disbursements have amounted to the equivalent of $1.8 billion, $1.5 billion of which were made in dollars. Thus the IBRD and the Export-Import Bank, which has a portfolio of $4½ billion, partly however, in short- and medium-term loans, are the only major sources of loan capital available to foreign countries, and thus effectively supplement the direct flow of private loan funds.

I think the operations of the International Bank are significant from another point, too, namely its close cooperation with private investors. With growing frequency the bank sells portions of its loans out of its portfolio to private investors, and on two occasions so far it has made loans to foreign countries jointly with private investors.

The International Finance Corporation, which is expected to begin operations within a few months, will cooperate with private capital to even a greater extent, since all its financing will be made in association with private investors.

Occasionally in recent years the charge has been made that there is an inherent conflict between public and private capital movements, and that the flow of private capital will not significantly expand as long as Government funds, or funds of international institutions, are available for lending and investment abroad, largely because foreign countries prefer loan capital to equity investment and are unwilling to accommodate direct investment, if they can get loan money.

There seems to be little substance to this charge. In all but marginal cases the uses to which loan capital and direct investment are being put are different and supplement each other; loan funds are not a substitute for direct investment and vice versa. There is a place and room for both in an expanding world economy, and as the cases of Canada and to a lesser extent Australia, South Africa, and Mexico show, countries with the largest inflow of loan funds also are the most desirable host countries for direct investment.

Mr. Bolling. Thank you.

(The statement of Dr. Adler is as follows:)

The Place of International Investment in the United States Economic Outlook

Statement made by John H. Adler

In order to appraise the place of international investment in the economic outlook of the United States, I should like to establish first the orders of magnitude involved. At the end of 1954, the value of long-term foreign investment, both private and public, was $39.6 billion. Of this total, $15.2 billion was the amount of long-term loans owed to the Federal Government and Government agencies, particularly to the Export-Import Bank; the remainder, or $24.4 billion, represented privately held assets. Long-term foreign investment has grown rapidly in the postwar years; more than half of the total was built up in the last 8 years. This rapid rise, at a rate of $2.8 million a year, was due in the first instance to an expansion of Government claims, arising out of various loans and credit arrangements in the immediate postwar years, and in connection with the various aid programs. Aside from World War I debts of $11.3 billion, which are not included in the preceding (or subsequent) figures, Government claims on foreign countries were insignificant before 1939; at the end of 1946 they amounted to $5 billion, and by 1948 to $12.9 billion.[1] Since then, the growth of Government claims on foreign countries has slowed down and in 1954 a small decline took place. But because of the congressional mandate of this year's foreign-aid legislation that foreign assistance "shall emphasize loans rather than credits wherever possible," and of undisbursed loan authorizations of the Export-Import Bank, a resumption of public loans to foreign countries on a larger scale than in recent years is not unlikely.

Private long-term investment has grown more slowly; still, it almost doubled between 1946 and 1954. The bulk of the increase is accounted for by the expansion of direct investment, which rose from $7.2 billion to $17.7 billion, an increase of 146 percent. Portfolio investment (both in foreign dollar bonds and in securities payable in foreign currencies) and other investment, consisting of long-term banking and commercial claims, increased only by $1.6 billion, from a market value of $5 billion to $6.6 billion.

These figures, impressively large as they are, are somewhat deceptive. In the first place, they include investments in Canada which though technically and legally foreign are more properly treated as a category sui generis since from an economic, financial, and institutional point of view they are virtually akin to domestic investment. Investment in Canada accounts for $5.9 billion, or one-third of total direct investment, and for $3.3 billion, or two-thirds of the portfolio investment. American investment in Canada also constitutes about one-third of the growth in American direct investment abroad, and more than one-half of the rise in portfolio holdings. Secondly, another $500 million of portfolio investment consists of American holdings of International Bank bonds. Thus, if portfolio investment in Canada and IBRD bond holdings are excluded from total portfolio investment, there was actually a slight decline, from $1.3 billion to $1.2 billion, between 1946 and 1954 in all other American portfolio investments despite a considerable increase in the market prices of those securities, and the validation of various issues previously in default.

Thirdly, the growth in foreign direct investment (the total of which, excluding American interests in Canada, comes to $11.8 billion) has only in part been brought about by an outflow of new American capital. Almost exactly one-half of the growth has been due to the reinvestment of earnings. New direct investment capital has added only $3.6 billion to the increase of direct investment (outside Canada) of $7.1 billion.[2] The data conceal, however, much greater and much more complex movements of direct investment capital into and out of the United States. Between 1951 and 1953, for instance, gross outflows of direct investment capital (again outside Canada) amounted to $2.3 billion; this was in part offset, however, by a backflow of $1.1 billion. These movements of capital in both directions, as well as the reinvestment of earnings, of course affect the composition of direct investment by region and industry. But they are not surprising if one realizes that American direct investment is spread over 2,000 business units in Canada and another 6,000 foreign corporations and branches in the rest of the world.

There is one further difficulty involved in the interpretation of the statistics on foreign investment. The only figures available on the American direct investment position give book values, which in many instances bear little resemblance to the market or the replacement values of the assets. In general, the book value understates the market value of investment, particularly in such industries as mining and petroleum where rapid writeoffs are common practice. Moreover, because of the general upward movement of prices in the postwar

[1] The figures on Government claims include the cash subscriptions to the International Monetary Fund ($2,750 million) and the International Bank for Reconstruction and Development ($635 million).

[2] Other changes in total assets, such as valuation adjustments due to changes in exchange rates appear to be relatively minor because they are already taken into account in the computation of earnings.

years, the older the investment the greater the discrepancy between book and market values is likely to be. Moreover there is the problem of valuing in dollars assets denominated in foreign currencies. This may result at times in an overvaluation of the investment, at others in an undervaluation. On balance, it seems reasonable to consider American-owned foreign assets as undervalued by perhaps as much as one-third in the aggregate, and by more in the case of some industries.

The published data, based on book values, show that more than one-third of total direct investment (outside Canada) consists of foreign holdings of American oil companies in the form of oil wells, oil refineries, tankers, pipelines, and distribution facilities; one-tenth is investment in mining, including smelting, and another tenth investment in public utilities. Manufacturing (aside from oil refining and smelting) accounts for over one-fourth, and trade, agriculture, banking and finance, and other for the remainder of direct investment.

The composition of investment is also reflected in its geographic breakdown. The heavy concentration of foreign investment in the exploitation of mineral resources and their processing and distribution accounts for the fact that more than 60 percent of all direct investment is concentrated in Latin America and dependent territories in the Western Hemisphere, and in the Middle East. the bulk of investment in Europe which accounts for another 22 percent of the total outside Canada consists of American interests in manufacturing enterprises. But American-controlled manufacturing companies are also important in Brazil, Argentina, Mexico, and Australia. The most important host countries for American direct investment, besides Canada, are Venezuela ($1.4 billion), the United Kingdom ($12 billion), Brazil ($1 billion), Cuba ($700 million), Chile ($600 million), and Mexico ($500 million).

In the postwar years, foreign direct investment has been good business from the point of view of the American owners. Average net earnings after foreign taxes for the period as a whole come to $2.2 billion annually, of which $440 million originated in Canada. This is equivalent to 10.5 percent of the book value of Canadian investment, and to 16.5 percent for investment in the rest of the world. Earnings varied considerably among industries and host countries. They came to 22 percent for petroleum investment outside Canada, to 16 percent in manufacturing, to 12 percent in mining and smelting, but to less than 3 percent in public utilities.[3] The last figure suggests that private investment of this sort no longer pays, partly because utility rates have lagged behind cost and have not been adjusted to lowered rates of exchange, and partly because of an unfriendly attitude of foreign authorities toward foreign-owned utilities.

With this single exception, rates of return after taxes have been good by any standard even if allowing for the undervaluation of assets (which in many instances, particularly in petroleum and mining, is likely to be offset by charging off as current cost, exploration and similar charges thus bringing down the true rate of return). An estimate prepared by the Department of Commerce for 1950, seems to indicate that the bulk of United States foreign investment is not liable to the Federal corporate income tax because of tax credits granted for foreign tax payments.[4] The report of the President's Materials Policy Commission on the other hand, gives a 1950 figure of $385 million as the net United States tax revenue on income from foreign investment; but this figure is probably too high. In any case, because of subsequent revisions of the Revenue Code and increases in foreign taxes for which credit can be taken on the United States tax liability, American taxes on income from foreign investment appear to have declined in recent years relative to the amounts received, as well as in absolute terms.

Taking this into account, it is abundantly clear that the rate of earnings of direct foreign investment compares favorably with the rates of return of domestic corporations which in the postwar years averaged 11 percent of net assets after taxes.[5] This is true for aggregate foreign investment, as well as for individual industrial groups. Earnings of oil companies from domestic operations for instance, appear to have been of the order of 10 or 11 percent in the postwar period, compared with 22 percent earnings on foreign operations; domestic earn-

[3] For manufacturing, mining and smelting, and public utilities, the figures relate to the period 1949 to 1954; comparable figures for earlier years are not available.

[4] Direct Private Foreign Investment of the United States, Census of 1950. Government Printing Office, 1953, p. 29.

[5] For 3,444 major United States corporations. First National City Bank, New York, Monthly Letter. Returns include earnings of foreign subsidiaries; therefore the rate of earnings from domestic activities alone would be somewhat smaller than 11 percent.

ings of the metal mining and smelting industries have been around 10 percent in this country (abroad, 12 percent); earnings of all manufacturing industries came to 12.5 percent of net assets (abroad, 16 percent).[6] The only major exception to this conclusion is American foreign investment in public utilities the rate of return on which is much smaller than on domestic utilities.

The rates of earnings of direct foreign investment do not appear, however, to be out of line with returns on investment prevailing in most of the host countries. An exact comparison of earnings of American-controlled subsidiaries and branches with those of locally owned enterprises is difficult because data on rates of returns prevailing in foreign countries, particularly in underdeveloped countries, are fragmentary and because frequently American-controlled enterprises operate in industries where there are no domestic firms. But on the basis of whatever evidence there is, it is apparent that the rates of return on American investment are not higher, and are in many instances lower than those in comparable industries in most, if not all, underdeveloped countries.

Moreover, the rate of earnings on direct foreign investment in the postwar years has been largely a reflection of the prosperous condition of the world economy as a whole in that period, and more specifically of the favorable prices commanded in the world market by crude and semimanufactured materials and fuels, the production of which make up the bulk of our direct foreign investment. If commodity prices were to recede from the high levels prevailing through most of the postwar period, returns on foreign investment would decline rather sharply.

Earnings on portfolio and "other" investment abroad have been much smaller than earnings on direct investment. Dividend and interest payments under this heading averaged somewhat over $200 million in the last 5 years; of this amount $135 million are accounted for by payments from Canada and from the International Bank. Interest payments on Government loans rose from $109 million in 1950 to $272 million in 1954.

Earnings on all forms of private foreign investment came to an average of $2.4 billion in the last 5 years. This is a sizable figure but, nevertheless, foreign investment is not a major source of income to the American economy. In the last 5 years, it has been equivalent to only 14 percent of corporate profits after taxes and, if only that income from foreign subsidiaries which is actually transferred to the United States is considered, the percentage figure falls to 10 percent.[7] In any event, income on earnings on American foreign investment are but a fraction of 1 percent of the national income. Interest receipts from abroad of the Federal Government were of course also very small in comparison with total Government receipts.

Earnings on foreign investment are, however, of considerable importance for some industries. The petroleum industry, for instance, derives one-third of total income from its foreign activities, and foreign earnings are also an important component of the income of the mining industry.

To assess the true importance of foreign investment for the American economy we must next look at the products of American-controlled enterprises abroad and at their significance for American industry. According to estimates of the Department of Commerce for the years 1950 and 1952, commodities produced abroad by American-controlled enterprises represented at least 25 and 21 percent, respectively, of total imports. Shipments from American enterprises accounted (in 1952) for 95 percent of total imports of crude oil, 90 percent of nickel and aluminum or bauxite imports, 85 percent of copper imports, 75 percent of paper-base stocks, 70 percent of oil products, 55 percent of lead and iron ore, 40 percent of chrome, and 35 percent of newsprint imports. Almost one-third of all imports from Canada and from Latin America came from American-investment companies. Many of the imports produced by American enterprises are either not produced in this country, or they are produced in quantities substantially below domestic requirements. Several of them are classified as "strategic." Thus, from this point of view there cannot be any doubt of the importance of American foreign investment for the functioning of the American economy and for the country's security.

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[6] The estimate for earnings on domestic operations has been derived from data on total earnings; in the case of the oil industry total earnings have been adjusted to take account of foreign earnings. The figures for domestic and foreign earnings are not strictly comparable, however, since they do not cover the same range of operations, and are computed on a different basis.

[7] Under our tax legislation, retained earnings of subsidiaries are not considered income (and therefore not liable to corporate income taxes). Branch profits, on the other hand, are considered income, whether they are transferred or not.

There are indications that the volume of our imports from American enterprises is growing. The supply of iron ore from sources developed by American interests is being greatly expanded and the same is true of manganese and titanium. To some extent, this is a reflection of the fact that domestic supplies are becoming scarcer and, therefore, more expensive. It is for that reason that the President's Materials Policy Commission recommeded, 3 years ago, that the Government should assist American industry in the expansion of its foreign operations through investment treaties and special "resource agreements" with foreign countries, and that tax legislation should be modified so as to accord foreign investment more favorable treatment.

The importance of American foreign investment as a source of supply of American imports also throws considerable light on the relation between the supply of dollars available to foreign countries and the "cost" of foreign investment to foreign countries. As mentioned before, reinvestment of earnings of foreign subsidiaries of American companies accounts for about half of American direct investment in the postwar period. These undistributed profits of subsidiaries came to 35 percent of total earnings. Income actually transferred from subsidiaries and profits accruing from branch operations fluctuated between $1.3 billion and $1.7 billion in the last 5 years, of which investment in Canada accounts for from $200 million to $300 million. To these amounts must be added dividend and interest payments on portfolio and "other" private investment and interest-payments on Government loans, or another $300 million to $500 million per year. These are large amounts compared with the annual dollar earnings on current account of foreign countries (which moved from $12.1 billion to $16.4 billion between 1950 and 1954) since they appear to "use up" more than one-eighth of the yearly dollar supply of the rest of the world and thus curtail American exports, or the availability of American supplies to foreign countries, by the same proportion. The speciousness of this line of reasoning should be clear: American foreign investment is in the aggregate a net dollar earner for the rest of the world. Only if the obviously unrealistic assumption were made that these imports would also be forthcoming if foreign rather than American capital had developed these resources could there be any validity to the argument.

The argument may be more pertinent in the case of those countries in which the productive activities of American-controlled enterprises serve local requirements rather than the United States market. But even in these instances it may be argued that American investment is dollar saving since it produces goods which otherwise would have to be imported from the United States. This is particularly true of investment in manufacturing, since American-controlled manufacturing establishments abroad, almost without exception, produce American-type goods usually under the brand names used in this country. This is not deny that some types of American foreign investment, particularly in public utilities and portfolio investment, and government loans result in a net dollar cost to recipient countries; but this amounts to only a fraction of total income payments on foreign investment, and to an even smaller proportion of annual dolar earnings of foreign countries of current account.

The fact that foreign investment is an important source of American import supplies, however, brings out another point: The growth of American foreign investment depends, and will in the future depend, on the level of effective American import demand. If demand is curtailed by the imposition of tariffs or quotas, or by so-called voluntary restrictions, foreign investment, in whatever form, is discouraged at least to the same but probably to a greater extent.

American foreign investment benefits not only the American economy; it is also a major source of income and employment in the host countries. It pays more than $1.5 billion in foreign income taxes, and perhaps as much as another billion in other taxes, royalties, and other levies. Its total output may be of the order of $15 billion. But its indirect contributions to the economic growth of the rest of the world are much greater than its contribution to output. It supplements the formation of capital in the host countries; this is particularly important in underdeveloped areas where savings are low. It brings modern techniques of production and new methods of management and business organization to foreign countries, and it assists in the development of new skills. It helps to raise productivity and income levels and thus may favorably affect the rate of local capital formation.

Thus it is abundantly clear that American foreign investment is in the interest of foreign countries as well as of the United States. This has been recognized and emphasized in numerous policy pronouncements of our Government. For many years, an increased flow of American private investment has been considered a major objective of our foreign economic policy, and on many occasions Government spokesmen, responding to pressures of foreign countries, particularly the underdeveloped countries of the world, for Government loans and grants for economic development, have pointed out that these countries should rely, in the first instance, on the flow of private capital.

This policy means that American capital must be actively encouraged to seek investment opportunities abroad, and that foreign governments must be persuaded to permit the entry of American capital on acceptable terms. Notwithstanding the respectable expansion of direct investment since the end of the war, in neither direction has the policy been wholly successful. American capital has not really shown a growing and general willingness to go to underdeveloped countries; when it has gone it has been in quest of special resources (e. g., oil, ores), and only occasionally has it sought to exploit new or expanding market opportunities (oil refineries, distribution of petroleum products and general merchandising). Nor, with a few exceptions, have foreign countries changed their attitude of reluctance, sometimes even hostility toward American investment.

Foreign countries generally are aware, it is true, of the benefits that they can derive from foreign-owned enterprises, and many of them have welcomed American capital in official declarations. But their legislation, and even more their administrative actions, frequently are not in accord with these declarations: Management and control must be shared with local interests, the number of alien employees is limited, the transfer of earnings and the repatriation of capital is restricted or subject to discriminatory exchange rates, and there are no firm assurances against nationalization. A number of countries explicitly prohibit the entry of private capital, or of foreign capital, into "basic" industries, such as public utilities, and into the exploitation of mineral resources. In some instances these obstacles to American direct investment prove insurmountable, being based on political convictions that cannot be argued or bargained away. In other, burdensome conditions are imposed with the intention of keeping the largest possible share of the foreign companies' profits in the host country. The imposition of such conditions is frequently based on a misinterpretation of official American policy pronouncements which, in the view of foreign countries, imply that American capital is eager, or even compelled, to go abroad.

Obviously this is not the case. With business opportunities beckoning at home and in a few countries genuinely friendly to foreign capital, American companies see no need to make concessions and to take what they consider to be undue risks. The high rates of return on American foreign investment cannot be taken as a measure of the attractiveness of foreign countries to American business. On the contrary, the wide spread between returns on foreign and domestic investment is an indication of the reluctance of American capital to venture abroad and of the high risk premium that is necessary to make foreign operations inviting.

Various proposals have been advanced to encourage the flow of American capital. A bill now pending before Congress provides for an extension of the 14-percent allowance on the corporate income tax for Western Hemisphere trade corporations to countries outside the hemisphere and for the taxation of foreign branch profits on the basis applicable to earnings of subsidiaries, i. e., only after the profits have been transferred home. The Secretary of the Treasury has also indicated his willingness to accept for inclusion in tax treaties a provision under which special tax privileges given American investment under foreign industrial promotion laws will no longer be undone by limiting tax credits to the amount of foreign taxes actually paid. These measures undoubtedly would have some favorable effects but it is not likely that they will lead to a sudden spurt of private foreign investment.

The concern which the Government has shown for private direct investment has (unintentionally, to be sure) directed attention away from the fact, previously mentioned, that portfolio investment, except in Canada and in bonds of the International Bank, has actually declined in the postwar period. Between the end of 1946 and 1954 total new issues of foreign bonds, again excluding Canada and the IBRD, amounted to less than $300 million, only a fraction of the value of issues floated every year between 1919 and 1930. And even this small total is deceptive since it includes close to $200 million of bonds of the State of Israel which cannot be considered to have been issued on a commercial basis.

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The outflow of new money was offset to the extent of $244 million by the redemption of outstanding securities and by sales to foreign purchasers of outstanding foreign issues worth $400 million. Thus the portfolio of American investors in securities of foreign countries other than Canada would have declined by much more than the $100 million mentioned before had it not been for the validation of issues of foreign countries, particularly of Germany and Japan, and the rise in the market value of a number of other issues in connection with the resumption of debt service on them.

As a matter of fact the sad picture that foreign bond issues presented in the thirties has completely changed. According to a study prepared by the IBRD 45 percent of all publicly held bonds issued in the United States by foreign governments, states, and municipalities of countries other than Canada and Russia and the satellite countries were in default at the end of 1945. By now, less than 7 percent remain defaulted. There has been a revival of interest in portfolio investment and issues of $70 million have been successfully floated in the last 12 months. Still a revival of the market for foreign securities in proportions even remotely approximating those of the twenties is most unlikely—quite aside from the question whether indiscriminate portfolio lending would be really desirable. But there can be little question that portfolio investment could be considerably expanded through the modification of State statutes under which institutional investors such as insurance companies, savings banks, and trust funds are severely limited in their ability to purchase foreign securities. It is highly improbable, however, that portfolio funds would go to underdeveloped countries where they are most needed.

Underdeveloped countries have pointed out with a good deal of justification that the apparent heavy reliance of the United States Government on private direct investment as a means of assisting economic development meets their needs to a limited extent only. Direct investment though useful and desirable does not provide capital for roads, ports, irrigation works, agricultural credit facilities, schools, or hospitals. Many countries also consider such public utilities as railroads and power in the public domain and therefore unsuitable for direct investment financing. They therefore seek loan capital, private and public.

To a considerable extent these requirements for loan funds have been met by the operations of the International Bank—in addition to the grants and credits extended by the United States Government, in part through the lending activities of the Export-Import Bank. The IBRD has made 136 loans totaling $2.4 billion to 40 countries. Most of the loans assist in the financing of development programs and projects in underdeveloped countries. Total disbursements have amounted to $1.8 billion, $1.5 billion of which were made in United States dollars. The International Bank and the Export-Import Bank, which between July 1945 and June 1955 made loan disbursements totaling $4.5 billion,[8] are the only major sources of loan capital available to foreign countries and thus effectively supplement the direct flow of private loan funds.

The operations of the IBRD are significant also from another point of view. In addition to the initial capital subscriptions of the United States Government and of the other 57 member governments the bank obtains funds for its loan operations through the sale of bonds to private investors. It has sold $850 million worth of its own bonds; as mentioned before, $500 million of them are held by American investors. In addition, the bank also sells portions of its loan portfolio to private investors, in recent years almost uniformly without its guaranty. Thus it functions as a channel through which private funds flow abroad. In its loan operations the bank cooperates closely with the private investment market. Recently two public bond issues were coordinated with IBRD loans to the same borrowers. The International Finance Corporation which is expected to begin operations within a few months will cooperate with private capital to even a greater extent since its charter requires that all its financing be made in association with private investors.

Occasionally in recent years the charge has been made that there is an inherent conflict between public and private capital movements and that the flow of private capital will not significantly expand as long as Government funds, or funds of international institutions, are available for lending and investment abroad, largely because foreign countries prefer loan capital to equity investment and are unwilling to accommodate direct investment if they can get loan money. There seems to be little substance to this charge. In all but marginal

[8] Including some medium and short-term loans.

cases the uses to which loan capital and direct investment are being put are different and supplement each other; loan funds are not a substitute for direct investment and vice versa. There is a place and room for both in an expanding world economy, and as the cases of Canada and to a lesser extent Australia, South Africa, and Mexico show, countries with the largest inflow of loan funds also are the most desirable host countries for direct investment.

How does all this affect the formulation of our economic policies and in particular our foreign economic policy?

Total private foreign investment is at present equivalent to about 2.5 percent of our reproducible national wealth; if Government loans and credits are included the total rises to something like 4 percent. These proportions are not negligible but they are much smaller for instance than the value of business inventories or of military and naval installations. The relationship between the flow of foreign and domestic investment is similar. In the last 5 years American long-term private capital outflows of all kinds averaged under $1 billion compared with private domestic investments of around $50 billion; this again gives a proportion of 2 percent. The percentage figure becomes somewhat smaller if Government loans to foreign countries and public construction are also taken into account.

These indications of relative orders of magnitude show that in the aggregate American foreign investment is not a major factor bearing on the level of employment and income in this country although its significance as a source of supply for the American market is considerable. (As pointed out before, returns from foreign investment likewise are very minor items in the flow of American income.) The main reason for the small role that foreign investment plays in the American economy is that this country still contains within its own borders a wealth of underdeveloped resources and there are so many domestic opportunities for the use of savings that there is little need to go abroad. There is a host of minor causes why the volume of American investment is kept down: Inconvertibility, exchange restrictions, risks of war and civil unrest, the unfriendly attitude of foreign authorities, unfavorable tax treatment, and particularly in the case of portfolio investment, the disappointing experience of the thirties. But even if all these obstacles to foreign investment could be eliminated there would remain the competing attraction of domestic investment opportunities that normally win out because domestic investment is inherently less risky and less costly in terms of enterpreneurial and organizational efforts and the higher returns on foreign investment do not fully compensate for these factors.

Several conclusions can be drawn from these observations. In the first place it is patently unrealistic to expect that American private foreign investment will ever become a catalytic force in the world economy of the importance that British foreign investment had in the last quarter of the last century and first 14 years of this century. The British experience undoubtedly was unique and therefore the comparison is not really appropriate. But it is revealing to measure the American foreign investment performance which has now lasted for about 40 years against that of Great Britain in the 40 years prior to 1914. Professor Cairncross has estimated that by the time of the outbreak of the First World War about one-third of all accumulated British-owned wealth had taken the form of private foreign investment; in American terms of 1955 this would mean something like $300 billion compared with an actual $25 billion. On the average about 40 percent of British savings was invested overseas every year. The present-day American equivalent would be a private capital outflow of $20 billion annually against an average of $800 million in the last 10 years. In the few years immediately preceding the First World War, one-tenth of the British national income consisted of returns on overseas investment; the comparable American figure is about half of 1 percent.

Clearly, the role of American foreign investment is bound to be more modest than that of British overseas investment in the Victorian era. But this does not mean that it has no role to play. It can make a substantial contribution to the capital formation of underdeveloped countries, and it can materially help to increase their production and living standards. If the development of underdeveloped countries is indeed one of the major objectives of American foreign economic policy, one of the ways to carry out this policy is to encourage a freer flow of American capital abroad.

At the same time, it must be realized that the encouragement of private capital movements, or loans by the Government, or Government guaranties, cannot and should not take the place of a liberal trade policy. As mentioned before, a large proportion of American foreign investment is oriented toward the American market. This type of investment will not expand if it cannot be reasonably certain that its product will not be discriminated against by tariffs or quantitative restrictions. Other American capital likewise will continue to be reluctant to go abroad if the transfer of earnings is jeopardized by American-trade policies restricting imports.

Mr. BOLLING. Our second speaker is Prof. Roy Blough, of Columbia University. He has built a very distinguished record both in academic life and in Government. He is the author of several books in the field of economics. To most of us he is remembered best as a former member of the President's Council of Economic Advisers. More recently he held the important post of principal director of the Department of Economic Affairs of the United Nations.

Dr. Blough is going to discuss the consequences for the United States of investment abroad to aid economic development.

Professor Blough.

STATEMENT OF DR. ROY BLOUGH, PROFESSOR OF INTERNATIONAL BUSINESS, COLUMBIA UNIVERSITY

Dr. BLOUGH. Mr. Chairman, I have reduced my introductory comments to a short statement which is in your hands, and, with your permission, I should like to read this statement and perhaps add a few comments as I go along.

Investment moving abroad from the United States to aid the economic development of less developed countries may take several different forms. Among these are portfolio investment by private investors, direct investment by business, Government loans and grants, and loans and grants by international organizations of funds supplied by private investors and governments. Investment as thus broadly defined may finance a wide range of development-promoting activities, including provision of plant and equipment and various kinds of technical aid. The major objective of public and international investment abroad is to aid economic development; financial return is incidental, although often necessary to the success of the investment. The major objective of private investment abroad is to make profit; economic development is a highly important byproduct. Except as otherwise indicated, my remarks are intended to relate to investment which aids economic development, regardless of source. The forms and institutions of investment are not part of my assigned subject.

The consequences for the United States of investment abroad to aid economic development may be divided into three groups: First, those consequences that occur when the investment is made; second, those that occur as the economic development takes place, and, third, those that occur when income is received or investment is repatriated by the United States investor.

1. CONSEQUENCES WHEN THE INVESTMENT IS MADE

When an investment is made abroad dollars are either spent in the United States directly by the investor or are placed in the hands of persons abroad for expenditure. In either case the dollars are spent on United States goods or services. Some of the dollars may be used to bolster foreign-exchange reserves that are insufficient for orderly trade, but this is a minor and passing phase. Part of the dollars will be spent on goods and services from the United States that are directly related to the investment project, such as plant, equipment, and personnel. Part of the dollars will be spent on other exports from the United States. The investment made abroad often will finance both the expenditures that have to be made in foreign exchange to bring in capital equipment, technical aid, and so forth, from the outside, and the expenditures that are made in local currency, which leaves a foreign-exchange balance available to be spent on other goods. Moreover, the investment may be not tied to the United States as a source of supply. Businesses in which the investments are made may wish to buy capital equipment in Europe, for example. The European countries thus acquire dollars to spend on whatever they want to buy from this country.

Investment abroad thus creates demand for the export industries of the United States over and above the demand that is financed by our imports. Investment abroad is a way of escaping, at least temporarily, from the foundation truth that the amount we sell to other countries cannot exceed the amount we buy from other countries.

Just as in the case of other expenditures for goods and services, an enlargement of exports increases the demand for the products of other industries, and this stimulation flows through the whole economy. Investment abroad thus has the same general effect at the time it takes place as domestic investment. If it is added to domestic investment in a period of full employment or inflationary pressure, it will divert resources from the economy and add to the inflationary pressure. If it is added to domestic investment when recession or underemployment threatens, investment abroad will help sustain a high level of business activity and employment.

Historically, investment abroad, in the inclusive sense in which I am using the term, has helped sustain and promote the United States economy at various times, beginning with the period of the First World War. There have also been times when it has added to our inflationary pressures, especially during and since World War II. Whether investment abroad will be needed to support the domestic economy in the future is a matter on which there are wide differences of opinion, and which I shall not attempt to explore here.

The idea that investment abroad might be increased or decreased in such a manner as to help substantially to offset short-run economic fluctuations in the United States may at first sight seem attractive. Unfortunately, as of the present time at least, it is not realistic. Private investment in recent years has not been large enough for variations in its volume to have much of an impact on the domestic economy. Moreover, the same economic forces that reduce private investment at home may operate to reduce it abroad as well. Even if interest in overseas investment opportunities were stimulated by a decline in domestic business activity, some lapse of time would likely take place before the stimulation affected the volume of investment, so that the timing of the investment might prove to be perverse. The volume of public investment abroad, as distinguished from private investment, could be more readily controlled, but it could hardly be turned on or off on a short-run basis, and if it were the effects on the stability of the economies of the recipient countries might be unfortunate.

Much of United States private investment abroad takes the form of reinvestment of earnings. If such investment involves an expansion of plant or equipment, the demand for United States capital goods abroad may be increased. However, since reinvestment does not add to the supply of dollars abroad, any increase in the export of capital goods resulting from such reinvestment of earnings will be at the expense of other exports. There is thus not likely to be any net stimulation of the United States economy as a whole.

2. CONSEQUENCES OF ECONOMIC DEVELOPMENT

It has often been pointed out that the rapid economic development of less-developed countries is a requisite for the political stability of those countries and for the peace and security of the world. It is not that economic development would insure political stability and world peace. The point is rather that it will be difficult, perhaps impossible, to achieve and maintain political stability and world peace in the absence of rising per capita levels of production and consumption in the less-developed countries. Our competition with the Soviet Union for the minds and hearts of men seems destined to be carried on, at least in part, in the field of economic development.

United States investment abroad can help speed up economic development. It can also greatly strengthen the cultural and commercial ties of the underdeveloped countries with the United States. A United States businessman who has both a firm grip on democratic principles and a sympathetic understanding of the aspirations of underdeveloped countries can be an ambassador of good will and an instrument for promoting abroad our principles of economy and government.

The importance to us of the economic development of underdeveloped countries carried out under friendly influences and by democratic means is great enough to determine our policy toward investment abroad. That is, unless it appeared that such investment would have a very adverse effect on the United States economy, the political stability and national security aspect would undoubtedly be the dominating one.

Also to be considered, however, is the economic impact on the United States of such economic development. Most of the discernible results are favorable to the United States economy. Economic development in a country means the establishment of new industries, the expansion of old ones, and a general increase of productivity. Based on past experience it is clear that a rising level of income in a developing country is accompanied by an increasing demand for imported manufactured goods. This can be demonstrated by an examination of statistics of countries at various stages of development and at various levels of national income.

The precise effect on United States exports of the rising demand for imports in the developing country depends on the pattern of development. Some United States industries are likely to experience a shrinkage in the demand for their products in some countries because of the establishment and growth of the same industries in those countries. This shrinkage would be offset for the United States as a whole by an increase in the exports of other industries. Indeed, the total volume of exports may be expected to expand, provided the developing countries can secure the necessary dollars.

Part of the process of development would be a growth in the industries producing minerals, agricultural raw materials, and other goods used in the United States. If we are prepared to buy enough of these goods, the developing countries will have the dollars to buy more of our exports. Obviously, despite the desire of those countries for our goods, they cannot buy them if we are unwilling to accept their goods in payment. Economic development resulting from United States investment abroad will thus lead to an increase in our total exports only if we are prepared to accept increased imports.

A less vital but significant point is that the economic development of underdeveloped countries makes a contribution to world economic stability. In most underdeveloped countries the commercial segment of the economy is highly concentrated in the production of one or a very few export commodities. As a result, the economies of these countries are highly vulnerable to changes in the demand for their products by the industrialized countries. Fluctuations in such demand lead not only to serious economic disturbances in the underdeveloped countries, but also to large fluctuations in their demands for the products of the industrialized countries. The development of more diversified economies would contribute to stability within the underdeveloped countries and in their commercial relations with other countries.

3. CONSEQUENCES OF COLLECTING INCOME AND REPATRIATING INVESTMENT

When the investment abroad begins yielding a return and that return is brought home, the effect is to increase the income of the domestic economy. If this income is to be received in the United States, the paying country must find ways to increase its supply of dollars. In the absence of Government loans, grants, and new private investment, an equivalent increase must take place in the dollars spent by United States consumers and industries on imports of goods and services. Otherwise exports will fall or the investors will not receive the income from their investments. Such imports do not operate to reduce the demand for domestic production as a whole, since additional spending power has been added to enlarge the domestic demand. Certain specific industries, however, undoubtedly will face greater competition. This may pose no problem if the United States desires to buy very large amounts of noncompeting goods and services. Otherwise, it will need to be prepared to permit the entrance of more goods competing with our own industries, since only in this way can other countries earn the foreign exchange required for the transfer of dividends and the repatriation of capital investment.

It is conceivable that the outflow of investment from the United States could for many years exceed the inflow of earnings and the repatriation of investments. The foreign exchange problems of the countries from which earnings and investment were to be transferred would thus be largely solved by the new investments. The United States Government presumably could bring about this result through its own investment operations regardless of the action of United States private investors and businesses abroad. Unless, however, the

Government is prepared to underwrite a permanent outflow of investment of sufficient amount, it must be prepared sooner or later to solve the international trade problem which is inherent in its position as a creditor nation.

Mr. BOLLING. Thank you, Dr. Blough.

Our final witness today is Mr. Robert R. Nathan, who heads the consulting firm of the same name. Mr. Nathan has had an extremely broad career in Government, both in the regular agencies and with the war emergency organizations, before he went into military service. He is very well known as a writer on economic matters in this country. What may not be as well known to the general public is the vast accumulation of foreign development and investment experience he has managed in recent years. His organization has done important advisory work in such countries as France, Korea, Burma, Israel, and Puerto Rico. Mr. Nathan is going to discuss the selection of forms and institutions for making foreign investments.

Mr. Nathan.

STATEMENT OF ROBERT R. NATHAN, ROBERT R. NATHAN ASSOCIATES, INC.

Mr. NATHAN. Thank you, Mr. Chairman.

Instead of reading my statement, I would like to just briefly summarize it, and in the interest of brevity perhaps even be a little dogmatic in some of my conclusions.

(The complete statement of Mr. Nathan is as follows:)

STATEMENT OF ROBERT R. NATHAN, PRESIDENT, ROBERT R. NATHAN ASSOCIATES, INC.

Mr. Chairman and members of the committee, my name is Robert R. Nathan. I am president of Robert R. Nathan Associates, consulting economists. Among other assignments which have particular relevance to the subject matter of this hearing, we have served for the past 4 years as consultants to the Government of the Union of Burma; for a year and a half we were employed by the United Nations Korean Reconstruction Agency in developing a plan for the rehabilitation of the Republic of Korea; in 1946 we assisted the Government of France in the development of its rehabilitation plan; we have advised the Government of Puerto Rico on varied matters; and we have worked for the Government of Israel.

Because of my experience abroad and more importantly, because of the great significance of our foreign economic policies to peace and freedom in the world, this opportunity to appear before your committee is deeply appreciated.

Before addressing myself to the immediate subject proposed, namely, the selection of forms and institutions for making foreign investments, may I first make a few remarks with respect to the magnitude of the foreign investment problem and also the subject of technical assistance.

With respect to the magnitude of the flow of financial and material resources from the United States to the rest of the free world, it is my strong conviction that the United States has not fully faced the challenge before us. The Marshall plan represented our first major effort to meet the needs of an unbalanced world economy. That program was highly successful in helping the countries of Western Europe to rehabilitate themselves from the ravages of wartime destruction. It was an undertaking daring in concept and dramatic in scope. It was successful. Today the beneficiary nations of the Marshall plan are able to stand on their own feet economically. While the threat of communism has by no means disappeared in Western Europe, the economic environment is now such as to afford far more favorable prospects of resisting Communist aggression and Communist subversion than was true immediately after World War II.

The challenge of meeting the problem of underdevelopment in many nations of the world is much different from that of rehabilitating war-torn economies. It is different in magnitude. It is certainly different in duration. It calls for a different approach in relating technology to needs for capital. It poses different ideological problems.

Unfortunately, it seems that in our foreign economic policy too often we try to deal with the matter of development as if it were the same as rehabilitation. The two are not the same and we must soon accept this fact. It is time for the United States to take a new look at the economic challenge which faces us and the free world and to develop concepts and programs geared to the realities of the undeveloped and underdeveloped countries instead of continuing with an approach which was appropriate for the purposes of rehabilitation, but has serious deficiencies for development.

This is a large subject and somewhat beyond the particular matter to which I am to address myself today. Nonetheless, I believe emphatically that a proper framework of understanding is essential if specific programs and policies are to serve effectively. I would therefore urge increased attention be devoted to this matter of basic objectives. Perhaps this committee cannot give concentrated attention to a study of our overall economic assistance effort, but I do believe that some group in the Congress must take the time to undertake such a basic reappraisal.

May I also comment briefly on the matter of technical assistance. The conception of point 4, namely, the program for making available to the balance of the free world more and more of the know-how which has made possible the tremendous economic growth of this country, was an admirable one. More and more it is obvious that the most important, single determinant of the economic development of a country is the ability and talent and know-how of its people. There are many nations rich in natural resources, but poor in living standards. There are other nations with very limited natural resources, whose citizens enjoy high incomes and high standards of living.

Unless the experience of the more industrialized countries is somehow transmitted or somehow made available to the underdeveloped countries in much larger degree than heretofore, the disparity between the have and have-not nations of the world will grow. This disparity is a continuous source of misunderstanding and tension between nations. It is my conviction that prospects for peace and international understanding are brightened as the disparity is narrowed and dimmed whenever the widening disparity embitters the people and governments of underdeveloped countries and alienates them from the free world. Therefore, I believe it is in the interests of the industrialized countries to do more and more to help accelerate the development of those countries many of whose people live in poverty and degradation almost beyond the imagination of the more fortunate people of America and Europe.

We must step up the flow of modern technicians into the areas of need. This can be done through the efforts of our own Government, through private institutions, through greater support of the United Nations Technical Assistance Administration, and through business enterprises. We must concentrate on quality in our technical-assistance activities. We must help bring more and more technicians from abroad to our country for training. The need is great and the problem is becoming increasingly challenging because of the direction in which the Communist world is moving in this field. Here too there is danger that through misconception of the problem we may defeat our own purposes. Though we may find it convenient in legislation and administration to distinguish sharply between technical assistance and material assistance, in fact there is no sharp line of demarcation between them. Material assistance to underdeveloped countries through loans, grants, and investments will not accomplish its purpose unless there is the know-how to use it productively. Sometimes we must export this along with the loans, grants, and investments. Similarly, it is rare that technical assistance can be put to productive use unless there are the material means of making it effective. Technical assistance in improving health conditions requires drugs, medicines, and laboratories. Technical assistance in improving agriculture requires implements, seeds, and experiment stations. Technical assistance in industrial production requires equipment and material. Technical assistance should not be considered a bargain basement variety of economic aid. Without necessary material to make it effective, it is like providing a country with expert dietetic advice without enough to eat. In fact, technical assistance without financial assistance may in many instances do more harm than good, because it is dangerous to raise hopes and make plans which cannot be implemented and fulfilled.

Here too, the subject is a complex one and I have merely posed the issue. What is needed is a thorough reappraisal of our activities in the field of technical assistance and the development of a program adequate in scope, wise in conception and dynamic in implementation.

Now I shall turn to the subject of forms and institutions for making foreign investments. I should like to deal with this matter from three points of view. First, there is the flow of funds and resources through public channels. Second, there is the part to be played by private investments. Finally, there is the matter of relating public and private activities in the area of foreign investment.

With respect to the role of governments, particularly the Government of the United States, it is my feeling that the undeveloped and underdeveloped countries of the world are not nearly as much interested in grants as they are in the adequate accessibility of loans essential for accelerating their industrialization and development programs. Nor do I believe that most of the underdeveloped countries of the world are nearly as interested in military aid from the United States as they are concerned with economic assistance. In fact, I believe that we have done a disservice to the cause of freedom, democracy, and peace in the world by concentrating so heavily in recent years on military assistance and so lightly on economic assistance. It would seem that the results would have been far better had we granted more economic assistance to countries even if the realities of the military situation had required that such aid had been associated with agreements with friendly nations to undertake defense expenditures from their own resources.

Public funds for foreign investment are now available from a limited number of instruments. Bilaterally, the United States makes available funds for development through the International Cooperation Administration, the Export-Import Bank and the loan of proceeds from the sale of surplus American commodities. In addition, there are the loans from the International Bank for Reconstruction and Development. There is the Colombo plan sponsored by the British Commonwealth of Nations. There are other efforts, mostly small in scope.

When we add up the present activities of the United States and other individual countries and international institutions, the magnitude, to me, is woefully inadequate to meet the capital requirements of those nations whose internal resources are insufficient to permit rapid development and expansion. Expert estimates differ on the amounts needed for investment, and I am not prepared to say how much is needed, but certainly these needs can be fully met by the most advanced countries. There is no question whatsoever in my mind that the amounts now available are far less than the underdeveloped countries of the free world need and can use productively.

There are a great many undeveloped countries that know quite well where they want to go, but whose programs continue primarily on paper because there aren't the resources to do the job. I am confident that, given a much enlarged technical assistance program, the effective use of foreign capital by undeveloped and underdeveloped countries could be doubled or tripled in the next 2 or 3 years.

The magnitude of the requirements of the less developed countries is by no means so large as to fall outside the capacity of the industrialized nations to fulfill these needs. We here in the United States, with our national production approaching an annual rate of $400 billion a year, could well afford to lend an extra 1 or 2 or 3 billion dollars a year so desperately needed by less fortunate, friendly nations. In fact, it isn't a question of whether we can afford to make more loans available for development abroad, but rather can we afford not to do so.

In helping make up some of the deficiency in investment capital needed by the underdeveloped countries, those who could provide the necessary means must not set their loan standards so high as to preclude fulfilling the need. The deficiency of capital is great for all kinds of projects varying from roads and harbors and public buildings to irrigation and power and railroad facilities as well as capital for industries with which a sizable element of risk must be associated.

I believe that by making loans primarily on a project-by-project basis, the lending nations and institutions have been inclined to set criteria which are too strict. We must recognize that somewhere along the line public loans as well as private investment have to bear an element of risk. No one should approve or condone irresponsibility in lending public funds which will or might be used for foolish undertakings. On the other hand, too often loans from governmental institutions have been predicated on standards which are appropriate for private banks but too severe for purposes of national development. Too often the lenders are adamant in requiring documentation which will almost prove conclusively that each project will be certain to be profitable and successful. Surely loans should not be made from any sources on projects very likely to be failures. However, not all economic undertakings can be successful. The history of growth of the American economy is one of successes and failures, not just successes. It is true that most projects which failed were privately financed, but by no means all publicly financed projects have succeeded.

If we are going to insist that borrowing nations make no mistakes and that their development programs move ahead in only the most logical and rational order of priority, we are asking the impossible and we are going to retard their development. Mistakes will be inevitable. Local circumstances frequently necessitate significant deviations from adhering to logical priorities. Perfectly balanced development cannot be expected. I believe that not enough public loan capital is being made available even for the soundest programs, let alone for worthwhile projects which have some element of risk but which should be undertaken.

One step which ought to be considered is the making of sizable loans to countries for general development purposes rather than for specific projects. Most public lending institutions today make funds available only for selected undertakings. There is no vehicle or channel whereby a country can secure a sizable loan for general development. If every Federal or State or local government's borrowing in the United States were required to refer only to specific development projects, our pace of economic progress would very likely be slowed down. I do not mean to imply that public lending institutions should not review the development plans of the borrowing country, but composite loans rather than project loans certainly have an important place in a program which is designed to accelerate and facilitate the industrialization and economic expansion of underdeveloped countries.

I am convinced that new mechanisms and new institutions are needed. Perhaps the SUNFED (Special United Nations Fund for Economic Development) may not be the answer but it certainly affords an opportunity for an international instrument to go beyond the scope of the International Bank for Reconstruction and Development. We should support SUNFED. We in the United States ought to reactivate the Export-Import Bank or set up some other institution or institutions or enlarge the scope of activities of the International Cooperation Administration so as to greatly expand the flow of funds to capital-deficient areas.

Clearly the distinction between grants and loans must be understood, and loans should be made only where there is the expectation that they will be repaid. However, we should be realistic in recognizing the fact that soundness of an individual loan does not preclude the continuance of a debt structure. There is such a process as refunding. Our Federal Government has a debt of about $275 billion. No one has any doubt that each holder of United States Government bonds will be repaid when his bond matures. But no one has any illusion that when our present outstanding Federal Government bonds mature, they will all be paid off fully from current proceeds and that the Government will be debt free. Most of the present obligations of the Federal Government will be refunded when they become due.

Certainly there are differences between internal debts and external debts. But there is nothing inherently wicked about refunding of external debts. As a matter of fact debt creation is generally accepted as an essential and inherent feature of economic development. That is true for individual companies and for governments. There is no reason why it should not be true in terms of the external financial relations of one country to other countries. I believe that too often public loans are predicated on the principle that the foreign country must be able to fully liquidate its obligations out of current earnings, with no thought being given to the normal process of refunding.

Actually as countires develop, their borrowing capacity and their credit worthiness grow. A nation which may today provide economic justification for a $100 million loan, if it uses its resources reasonably efficiently, may well have a sound borrowing capacity of several hundred million dollars by the time the $100 million loan matures. This has certainly been true of our own businesses and our own country. I believe that if we will recognize this principle, then loans will be granted on a basis more realistically related to needs and opportunities.

In summary, the need persists for far larger sources of loan funds from public institutions; the lending criteria have been too severe to truly facilitate economic expansion in the undeveloped countries; composite as well as project-by-project loans are required; new institutions and mechanisms are needed both by countries which have the capacity to make loans and by international institutions; and finally, broader concepts and clearer perspectives are needed with respect to evaluating the foreign capacity of countries in need of foreign investment funds.

With respect to private sources and channels of foreign investments, every effort needs to be made to expand the flow of investment funds from the United States to countries abroad. This is a principle on which there can and should be no fundamental disagreement. Yet there are many problems involved in private foreign investment which must be taken into serious account in developing programs for this expansion.

First, let me risk the criticism of the American business community by saying that in general it is my impression that the daring and imagination and risk assumption which are associated with the American businessman in his operations within the United States are hardly characteristic of his role as a foreign investor. For a variety of reasons the American investor is not generally a foreign investor. If we look at the figures on private foreign investment published by the Government and if we deduct from the totals the investments made in oil and mineral exploration and the amounts invested in Canada, the residual foreign investment is distressingly small indeed. I do not mean to imply at all that foreign investment in oil and mineral development are not useful for the underdeveloped countries but far greater is the need for investment in fabricating industries. The revenue derived by foreign countries from oil and mineral explorations can provide an important source for development purposes. But not all countries have these oil and mineral resources; and even those which do, often need more capital and generally would benefit greatly with more of the management and know-how usually associated with American private investment in industry.

I might present a few figures which may be of interest. In the 9 years from the beginning of 1946 to the end of 1954 direct investment outflows from the United States to foreign countries aggregated about $6 billion. Of this total, petroleum, mining, and smelting accounted for roughly two-thirds. If we add investments in Canada, other than in petroleum and mining, only one-quarter of the direct investment made by American capital went outside of Canada to activitis other than petroleum and minerals.

Our Government has taken steps to provide incentives for American investors to employ their resources abroad. The guaranty provisions with respect to convertibility and expropriation are certainly steps in the right direction. Taxation inducements have not been without merit. Whether we have exhausted all reasonable possibilities for private incentives is doubtful. Therefore, continued study of the experience of existing American investors abroad and of prospective investors is worth undertaking because it might well point the direction for providing additional advantages to such investors.

Our Government as well as American businessmen have been busy trying to get foreign countries to liberalize their own investment terms so as to make for a more favorable environment for foreign investors. We must realize that profit returns in the United States in a great many industries are exceedingly attractive today, and it certainly is not easy for foreign countries to compete with such profit prospects. They must offer the prospects for even greater profits because the risks are greater. In the development of enterprises which will substantially increase their exports or substantially replace their imports, the countries perhaps can afford to allow very handsome profits to foreign investors. However, it is not easy to provide the environment for very big profits to a foreign investor when the country is already short of foreign exchange and when the project will not help greatly in the solution of the foreign-exchange problem.

We sometimes fail to recognize that foreign governments face difficult problems if they undertake to provide greater incentives to foreign investors than to their own investors. Huge profits are not always politically defensible in recently liberated countries where generations of colonialism have created a state of mind that does not distinguish clearly between capitalism and colonialism, judging both to be exploitative. Many underdeveloped countries believe in nationalization of basic industries and are hesitant to allow private capital to control such basic industries, least of all foreign private capital. We in America do not share such ideological tendencies, but we cannot ignore them or quickly change them. Presumably we believe that other countries are free to make their decisions democratically for themselves without interference or pressure from us. But one might say that if a nation believes in nationalization of its basic industries, it should not expect private investment. There is logic for such a position, but if such countries need foreign capital and if Communist nations are willing to participate in fulfilling such needs, we are hurting our best interests by failing or refusing to be helpful.

Difficulties more often stem from the fact that private investors shy away from any investment in a country which has nationalized some of its industries. This problem poses a serious challenge to our Government as well as to our industrial, financial leaders. We just cannot expect free countries whose economic ideologies vary from ours to change their basic concepts and conform to the United States pattern in the hope that private investment will be forthcoming. In a way, there is a vicious circle involved. The less foreign investment, the more tendency toward nationalization, and this in turn precludes or narrows opportunities for private investment. I emphasize the fact that this is not a simple problem, because too often in the past some of our Government and business leaders have stated irresponsibly and without adequate thought that the problem of providing capital abroad is one exclusively for private solution.

We must also recognize that many of the underdeveloped countries have recently become free from long periods of severe exploitation. What the American investor regards, and often properly, as reasonable incentives, looks like an extreme degree of exploitation to poor countries which have recently become independent. There is certainly not a clear line between attractive incentives on the one hand and exploitation on the other. This is especially true when, coupled with high profits, provisions are requested for special tax exemption. This then begins to look like exploitation not only of the country's workers and its natural resources, but of its financial resources as well.

All these problems are not posed for the purpose of concluding that private foreign investment is hopeless as a means of accelerating the development of the less advanced countries. Quite the contrary—they are presented with the thought that a recognition of problems is a prerequisite to solution. In other words, we must understand that private investment has not played a sufficiently large role, and that there are serious impediments which we must try to overcome.

Private investment is important not only because it brings private capital; but it normally brings knowledge and responsibility for management and training. It is very important to provide the undeveloped countries with both know-how and capital. A combination of public capital plus management contracts would perhaps be the next most desirable substitute for a combination of private capital and private management. If American industry cannot be induced to undertake more foreign investment, then operating companies should be more willing to undertake management contracts, particularly where they do not provide capital, but receive adequate compensation, including perhaps profit participation.

There is a very basic relationship between public investment and private investment. Just as those who are inclined to completely ignore the role of private investment are in error, so I believe that those who seem to think that the entire solution lies in private investment are completely unrealistic. Recognizing the desirability and importance of private investment, it is my conviction that public investment at this stage must play a more important role than private investment and must, in a sense, lay the groundwork for private investment. Our Government, directly and through international institutions, should increase and facilitate the flow of public funds to help build up those prerequisite foundations for economic development—educational and health facilities, and power facilities, highways and harbors, and railroads and basic industries—to the end that the economic environment of the underdeveloped countries will be improved and will thereby become more attractive to prospective private investors.

We are inclined to take for granted—because they are so deeply imbedded in our society—these prerequisites on which the productivity of a society rests, such as a healthy, literate population and working force; a network of transport and communications; land reclamation and irrigation; basic power sources; distribution facilities through active and accessible markets. We are inclined to forget that these have been built up in our own country over many decades and at enormous cost, often by public capital directly or through generous incentives to private capital. Often these forms of investment do not yield an immediate and direct form of return. For this reason, among others, they may not be suitable investments for private capital, but they are necessary before there can be private investment on a large scale. This is the necessary role of foreign public capital, government-to-government or through international organizations.

In other words, the more intelligent and more constructive the job of increasing the flow of public capital, the more likely will be an increased flow of private capital in the years to come. Not only does this seem logical as a time sequence, but equally important, the Government can do much more in magnitude and speedily to step up the flow of capital abroad by direct action than it can through assisting private investors. Therefore, without neglecting private investment and indeed striving to stimulate it in the meantime, the Government should now reappraise our whole foreign economic policy with respect to the foreign flow of public capital and give it the emphasis and support which it needs.

Before closing, may I make one final point. I should like to offer a challenge to the leaders of American industry, particularly to the larger companies which have the resources and the know-how to help spread the prosperity of America to other countries which are still free and which want to remain free. We are all against communism, but it isn't enough to be merely vocal in this opposition. Those who have the technical ability and the financial capacity to carry the fight for freedom under a condition of competitive coexistence ought to see clearly the need to use these financial and technical resources to demonstrate that a free economy can help the underdeveloped countries far more than can the Communist powers. American industry has not done enough in this economic fight against communism; it has not used any significant portion of its resources for this great purpose. If only a little of the time and talent and money spent for nonessential purposes by big business were devoted to sending more of their technicians abroad, to helping foreign enterprises increase their productivity, to providing equipment for some industries in underdeveloped countries, the prospects for winning the fight against communism would be much brighter. The money and the talent needed is insignificant compared with the money and the talent our industrial leaders have at their disposal. I hope that the great ingenuity and ability of American business leadership as demonstrated by the growth of business in the United States, will somehow be directed toward this most serious problem of the middle of the 20th century.

Mr. NATHAN. Before talking about forms of investments, I would like to take a moment or two to talk about the magnitude of the flow of capital from the United States abroad, and also the problem of technical assistance.

Insofar as our general economic public aid program is concerned, it seems to me that we have not really adapted our thinking and policies and programs to the needs of underdeveloped and undeveloped countries. When we started the Marshall plan in 1948 to help in the rehabilitation of the countries of Western Europe, we undertook a very desirable and commendable program. I believe we faced that problem in its proper perspective in terms of magnitude. The policies adopted were appropriate. However, it seems to me that as the success of that program was achieved and communism was halted in its movement ahead in Western Europe, we have moved on to this problem of underdeveloped and undeveloped countries without taking the time to reappraise the program and to determine whether the requirements and needs for a program for undeveloped countries were different from a rehabilitation program for Western Europe.

I feel we have continued with the same kind of concepts and the same kind of approaches which in many ways are not appropriate for the new problem.

Just one illustration: I believe that the duration of the problem faced under the Marshall plan was obviously a limited one. The job was to rehabilitate the countries which were war-torn. The problem facing the underdeveloped and developed countries of the world are much more far-reaching in terms of their duration, and probably over time will call for a larger magnitude of flow of capital from the United States and from the other developed countries.

Also I think the whole relationship between loans and grants needs to be reappraised from the point of view of helping the underdeveloped and developed countries, as compared with or contrasted with assistance to the countries which needed to be rehabilitated from the ravages of war.

So I would like to suggest, Mr. Chairman, just generally—this being a big subject and being outside of the scope of our topic this afternoon—that we ought to spend a great deal of time thinking about this fundamental problem of the undeveloped and underdeveloped countries, and of our relationship to that problem.

I would like to say a word or two about the problem of technical assistance. It seems to be that the flow of capital must be considered in close relationship with the flow of know-how. My own experiences in traveling around the world and working with various countries has convinced me more than ever that the principal determinant of progress and economic development in a country is the capacity and experience and talent and training of its people. We find countries in the world with fabulous amounts of natural resources, yet with very low living standards; we find other countries with very limited natural resources but very high standards of living.

The differences can be explained primarily in terms of what we in America have come to call know-how. If we are going to help the less fortunate countries of the world to expand their capacity and their facilities and their production and their living standards rapidly, then we must insure a sizable flow of that know-how from the United States. Also other developed and industrialized countries should likewise feel it incumbent on them to assure an outward flow of know-how across their borders.

We must concern ourselves with the numbers and also with the quality of the people that are made available. We must also be certain that there is a two-way flow, that our technicians go abroad and our trainers go abroad, and that people from foreign countries come here in increasing numbers and get the kind of training they need.

Now, of course, just as capital without know-how can be wasted, so technical assistance without capital may be harmful, because we will certainly raise the hopes and aspirations and plans of undeveloped and underdeveloped countries by sending them only technicians. If capital is not available to go along with the planners and engineers the results can be even worse than had we not provided technical assistance.

With respect to the specific subject which I have been asked to discuss, forms of investment, I would like to break the subject down into three parts, and deal first with public investment, then with private investment, and then with the relationship between the two.

First, in the area of public investment, my personal experience and observations lead me to feel that most of the undeveloped and underdeveloped countries of the world are not nearly as interested in grants from the United States as are other developed countries, as they are in loans. They primarily want to have accessible to them an adequate supply of loan funds which will help them accelerate their development. I feel that except for very limited welfare purposes, the need for grants is not very great, but the need for loans is much larger than the supply of loans available today through public institutions.

Secondly, I feel the undeveloped and underdeveloped countries are far more interested in economic assistance in the form of loans than they are in military assistance. I believe that the emphasis on military assistance in our foreign aid programs in recent years has been a disservice to us and to the recipient countries.

I believe, in some measure, we have undertaken to increase the military portion of our total assistance for internal political purposes here in the United States. Some people seem to feel that it is easier to sell the idea of appropriations for military assistance than for economic aid, and therefore sometimes even economic assistance has been promoted under the label of military assistance.

On the other hand, the fact that we have been inclined to give more foreign military assistance and less foreign economic assistance has, in the eyes of many neutral nations, made it appear that we are more interested in war or defense than we are in the welfare and economic progress of the countries we are aiding.

With respect to the availability of public funds, they come today through two general categories of channels. One is the direct loan from one country to another, such as made by the United States through the International Cooperation Administration and the Export-Import Bank, and by other countries that are lending abroad. The other channel is the multilateral one which involves participation by many countries, and is principally through the International Bank for Rehabilitation and Development.

I feel that in the world political scene today, if a larger flow of funds could be made available through institutions such as the International Bank, it might have better economic consequences than loans from one country to another. This is in some measure true because the neutral nations in particular would prefer not to be beholden to any individual country. In my judgment, they would prefer to borrow from some institution in which there was participation by a great many countries, rather than one country.

As far as the size of public loans is concerned, I strongly believe the total amount of loans made by the International Bank, by the Export-Import Bank, and by the International Cooperation Administration, and through the Columbo plan, and every other public facility, has been totally inadequate relative to the needs of borrowing countries.

Today there are a great many countries which are ready with intelligent plans and with technicians, or ready to hire technicians, where projects are being held back and where development programs are lagging, primarily because the amount of capital available for development is wholly inadequate.

Also, I feel that the lending institutions on the whole tend to be too strict in their standards. In part this results from the fact that most loans made today by public institutions are project-by-project loans, and not overall-development loans.

Generally, I think there is a tendency for the World Bank, and, to some degree, of United States public lending institutions, to apply criteria which would be appropriate for a private investment bank or a private commercial bank, but, in my judgment, are not appropriate for general development purposes.

If we are going to undertake to lend funds for development abroad, with the idea that every project must practically prove itself to be a successful project in advance, then we are going to hold up development. America was not built only on the basis of successful projects. The history of the American economy is one of development through failures and successes, and not just successes. Yet in considering foreign loans we sometimes are inclined to think that the order of priorities of projects and the decision to undertake certain projects should be determined after the most thorough and careful scrutiny to a point where literally no mistakes could be made. I do not believe that is realistic. If we only studied our own experience and realized how we grew and how we learned, then I think we would be a little more tolerant of those who would like to borrow.

While loans should never be made for projects which are obviously uneconomical, and this is a question of degree, I do believe that we must recognize that people do learn by mistakes. We have learned by mistakes ourselves, both in the Government and in private activities here in this country. We cannot attempt successfully to avoid mistakes on the part of those who would like to borrow from us. I would very much like to urge that in this matter of project loans, we loosen up a little bit on the criteria, and that we also undertake overall-development loans to countries as well as project-by-project loans.

For these purposes, perhaps, the International Bank may not serve the requirements fully. If so, then other institutions and devices should be developed. For instance, the special U. N. fund for economic development, called SUNFED, has been proposed and has been pushed by a great many members of the U. N. I regret to say the United States has not been an effective supporter of SUNFED. We should support SUNFED and other institutions which will try through experimentation and through new efforts to fill the gaps that are so important today and so serious and so sizable.

There is one other aspect of foreign public lending, and a highly important one, which distresses me very much. On so many loans the borrowing country is asked to prove, almost prove, that the capacity to repay is assured. We seem to have forgotten that there is such a process as refunding. Why, here in the United States we have a public debt of something like $275 billion, and almost all of us, or most of the people in this country, own some of those securities. Each of us who happens to have a Government bond has no doubt that the bond will be repaid to the holder when the maturity date arrives. On the other hand, I don't believe any of us has an illusion that in the future when the bonds outstanding today are paid the United States Government will be without debt. That is obviously not going to be true.

The process of refunding by governments and by business institutions takes place all the time. I don't see anything sinful about the concept of refunding being applied to nations. Yet when loans are made to countries, the requirement is made that there be practically complete proof and demonstration that each project will be self-liquidating and that the debt will be paid off. This seems to me to be completely unrealistic. A country may have a borrowing capacity today, let us say, for a $50-million loan from the World Bank, as an illustration. Well, the World Bank would like to be sure, and should be sure, that it will be able to get that $50 million in, say, 15 years, when the loan is due. But at the end of 15 years that country may have a borrowing capacity of two or three hundred million dollars by the very fact of this loan, by the very fact that this $50-million loan has made possible a rise in its national income, an increase in its trade, an increase in its ability to export, and an increase in its ability to meet its requirements from its own production. We ought to think of this borrowing capacity in the future as these countries develop and not just try to be certain that on each loan there will be assured repayment. We should not forget about the possibility of additional borrowing.

Thus, in general, I would say, on the public side, we should emphasize loans more than grants, we should emphasize economic assistance more than military assistance, we should try to increase the variety and number of organizations lending through the U. N. and through other multilateral devices. We should make available much larger amounts of funds through public institutions. We should modify our standards somewhat, or at least have different criteria for different institutions. We should make overall development loans as well as project-by-project loans. Finally, we should recognize that the borrowing capacity of the countries in the future may be greater than at present, and that there is such a procedure or process as refunding, and that this has international applications just as well as national applications.

Now, as far as private investment is concerned, I feel that private investment should make a very important contribution and play a most significant role in the flow of capital abroad.

The progress to date has been most disturbing. Dr. Adler has presented some figures. I, too, looked at some of the data on total new and reinvested earnings abroad made during the 9 years from 1946 through 1954. In those 9 years, the flow of United States private capital, new investment and reinvested earnings, was about $11 billion. Of that $11 billion, approximately half was new investment, and half was reinvested earnings, but of the $11 billion, at least two-thirds is accounted for by investments in oil and minerals, and in Canada. That means that in the 9 years from 1946 through 1954, American foreign private investment new and reinvested, was about $3½ billion, or roughly an average of $400 million a year.

I don't mean to discredit or question the importance of oil and mineral investments. I think they are very important. They make available increased funds to countries which could not otherwise exploit their own resources. That, in turn, helps them to develop.

However, the most helpful investment, I believe, is industrial investment, investment in industrial activities other than in oil and minerals. In that area, the amount of private investment, I think, could be properly characterized as insignificant, and of a very discouraging magnitude.

Now, the problem is as Dr. Blough said, that private investment is made for the purpose of profits, and, as Dr. Blough said, too, a private investor does want a larger return when he makes an investment abroad than when he invests here in the United States. It is perfectly understandable. There are problems of language, convertibility, climate, living conditions for management, and everything else. It is natural that the American investor would seek a higher return abroad than here.

On the other hand, this raises very serious questions for us. I would like to emphasize these questions because many people have been inclined to say that the whole solution to foreign economic development rests with private investment. While I agree that the role of private investment is important, it seems to me that a serious mistake is made in saying the whole solution rests therein. Let us take an illustration. Here in the United States the rate of return on investment is quite high now. Not all corporations are as fortunate as General Motors and have ratios of income before taxes to total net worth which are well over 50 percent, or after taxes something like 30 percent, but, generally, the rate of return to investment is quite good here in the United States.

If the American investor seeks a much higher rate of return abroad, and that is perfectly understandable, then the rate which he expects from a foreign country becomes very confused in the minds of people there with a term called "exploitation," and it isn't easy to draw a line between exploitation and reasonable profit returns. That poses a really serious question because in many countries in the world, especially those which have recently become independent, the rate of return to local investors is not always as high as here in the United States. When you combine this fact with the need for a higher rate abroad than prevails here in the United States in order to induce Americans to invest abroad, it is clear why many countries are faced with the problem of whether to allow a differential in the rate of profit to the foreign investors as compared with the rate of profit to their domestic investors. In countries that have recently become independent and have a rather strong nationalistic feeling, that is a tough question for the officials to answer.

Another problem in many countries recently liberated is a confusion between colonialism and capitalism. Perhaps we in America have not done enough to dispel that illusion or dispel that confusion, because it really is confusion, but, unfortunately, too many of those newly independent countries still think of capitalism and colonialism as being the same.

As a result of that, it was often socialistic leaders or leaders of the Socialist movement who captured or were able to lead the country into independence in order to get control there. These people believe in a degree of nationalization of basic industries. I don't believe the solution to their problems lies in nationalism. However, that has been their direction. They had to move in that direction to some degrees because they don't have much entrepreneurial talent. In many newly independent countries, when the colonial powers moved out they took management with them, because the business leaders generally came from the colonial country. Consequently, these newly independent countries that want to develop believed they can develop only through nationalized industry. When a foreign investor comes along, the first thing he wants that country to do is stop nationalizing all industry, not just his own industry. He isn't just satisfied with a guaranty that his investment won't be nationalized; he is concerned very much with the whole general process. Can we expect those countries to change their basic conceptions and approach?

Perhaps there isn't any possibility in these countries for private investment. Nevertheless, I do believe we should not let ourselves be lulled into the belief that the solution of this problem of inadequate capital in the underdeveloped and undeveloped countries lies exclusively in the private investment area.

I also feel that we should do everything possible to increase the incentives for investors abroad. I would personally be very happy to see the United States Government lower its taxes on foreign investors. In other words, let us as a rich country bear the burden of providing some of these incentives rather than expect the recipient or host country to be the one to bear the entire cost of bringing in foreign investment.

The reason I feel we should do everything possible to induce private capital to go abroad, even though we should recognize that the difficulties are very great, is that so frequently private capital brings with it know-how, and that is what these countries need along with capital. If we can get American business to go abroad in increasing numbers, and to undertake productive investment, with management from the United States, then I think we can and will make a major contribution toward the expansion of economic activities in many of the underdeveloped countries of the world.

The American business community, with its tremendous financial and manpower resources, has not faced up to the challenge that is provided. I admit that this is a rather difficult matter, because it is true and proper that private enterprise will invest where it sees profits. On the other hand, we do have an ideological conflict in the world today, and, as I see it, the Communists are moving in rather aggressively in terms of technicians, and also in terms of capital.

On this front I do not believe they can compete with the United States. I think that when one looks at our national income compared to that of the Communists, when one looks at our training and skills and know-how compared with what is to be offered by them, it seems to me that American enterprise and the United States Government could win hands down in this competitive battle, if we are willing to face the challenge.

Even if the profits are not as great as one normally would regard as essential for private investment, I would hope that because of this difficult ideological conflict in which we find ourselves the American business community would direct a little larger portion of its manpower and capital resources to this problem of helping undeveloped countries to develop. Maybe the answer lies in very special tax incentives to be provided by the United States Government under which we would allow business corporations to write off against their profits some large percentage of the cost of a new plant put up abroad to serve the local population or the local government. I am certain there are various devices and techniques that can be found.

I am convinced that the talents of the American business community, if intensively devoted and directed toward this problem, could come up with some answers and results which would be most helpful and would assist the undeveloped countries to develop much more rapidly.

Now, if American private capital is not willing to go abroad in larger measure, I would hope that one other thing might develop, and that is an increase in public loans from the United States, or through the International Bank, or through other institutions, and then, coupled with that, an increase in management contracts by American industries now in operation. I happen to be a consultant myself, and I am not going to say anything against consulting engineers or any other consultants, but when it comes to running enterprises in foreign countries they need operating experience. Therefore, I would hope American corporations would be willing to send first-rate management teams abroad, under contract for a fixed fee, or profit participation, or something of that nature, and really try to do a job in helping those people to become better able to help themselves. Sometimes industries aren't willing to do that because they are afraid of competition from abroad.

I was very interested in hearing Dr. Adler say that the biggest markets come with the developed countries, not with the undeveloped countries; and also Dr. Blough say that when you study the history and statistics of various countries you find that as a country expands its economic activity and economically progresses it becomes a bigger market rather than a smaller market.

I would hope that industry in our country would realize that we can expand our markets by helping other countries develop. We should not be fearful of competition.

One other point, and that is the relation between public and private investment. It seems to me that if we are going to increase the flow of capital from the United States abroad, public investment must come first. I don't mean to say that private investment should not be encouraged, but I think we ought to realize that until the roads, the railroads, the basic utilities, the harbors, the transportation facilities are developed in many countries, private investmant may be hesitant, or more hesitant, about going in. Therefore, in terms of timing, I believe that public investment must come first.

I would hope that in facing this problem we would try to make available far larger resources for public investment, and to do so emphatically during the next few years. Then, I believe, the chances for private investment increasing will be enhanced. I still have doubts, however, whether private investment can solve the whole problem for a long time ahead.

Thank you.

Mr. Bolling. Thank you, Mr. Nathan.

At this point we like to allow some time for the various witnesses to comment further if they desire on the statements of other witnesses, or make additional comments in relation to what they have already said.

Dr. Adler. Mr. Chairman, it is quite easy for me to comment on the statements made by Dr. Blough and Mr. Nathan, because I find myself largely in agreement with what both of them had to say, although I would take exception to some of the remarks of Mr. Nathan on particular points, certainly as far as the International Bank is concerned. However, I shall not comment specifically on that, because I do not think it would be appropriate in my position to go on record one way or the other.

But to take just a few of the points, of the statements of both Dr. Blough and Mr. Nathan, I certainly agree with Dr. Blough's emphasis on the fact that international lending is not, or, more generally, international capital movements are not a sound or useful anticyclical device. It is obviously true, and I think the experience of the bank bears this out, that a long time elapses between the signing of a loan and the drawing down of the funds for purchases in the United States or anywhere else, and, therefore, such stimulating effects as foreign loans would have certainly will come much too late if we are sliding into a business recession.

I also agree with Dr. Blough's emphasis, on the importance of trade policy in relation to the outflow of American capital and I have something to say on that in my own statement; only if foreign countries—and this pertains to government as well as to private investment—have a chance, and a fair and continuous chance to earn enough dollars, can we be sure that they will repay us. A good deal of lending operations will depend and does depend on the reasonable assurance that American investors, and the American Government, will be repaid.

It has been claimed on many occasions that private investment really doesn't raise so much of a problem of repayment, and, on the face of it, there is really not much we have to worry about. If you assume for the moment that the American balance of payments is in equilibrium now, in other words, that the supply of dollars is just about adequate to take care of the foreign requirements for American goods, and if you further assume that we can expect a regular growth of American imports of goods and services of something like 3 percent per annum in line with our growth of national income, then we find that our imports go up by something like 400 to 450 million dollars a year.

Now, this $450 million a year, of course, would go a long way to serve debts, newly contracted, by foreign countries in this country, and to serve American foreign investment. This is particularly true because—this is how the argument usually goes—when economic activity in the world at large goes down the profits on direct investment also go down and, therefore, the demand for dollars to pay dividends also declines. Unfortunately, I think this is not true because what happens is that at the time when the foreign investment becomes less profitable, American private investors also choose to reinvest less, with the result that they will try to transfer back at least as large an amount as they transferred back when they retained a good deal of their earnings abroad for reinvestment.

Thus, what is really more important than anything else as a prerequisite for a substantial outflow of private capital is an American domestic economic policy which will avoid severe disruptions in our growth of income, and particularly major depressions, which affect not only us but also foreign countries.

Now, on the other hand, I am not worried about the problem of repatriation of investment. This is a fear which shows up in many discussions, in many articles written on the subject. If foreign investment is a permanent outlet for American savings, as I think it should be it is in the nature of the thing—then we do not need to expect repatriation of investment, just as we don't expect, as a matter of course, that the American steel industry will repay is debtors at one time or another. As a matter of fact, both equity and debt of an American industry, which is growing, are likely to rise continuously over time, and by the same token I would not expect substantial repatriations on foreign investment. This does not mean, of course, that certain countries or particular industries will not or should not attempt to repatriate their earnings. What matters really, in effect, is the overall dollar supply available not only to service foreign debts but also to purchase goods and services in the United States, and as long as that level stays high the problem of repatriation should not pose great difficulties.

As to Mr. Nathan's statement, I very much agree with what he had to say about the fact that we still really don't know enough about the problems and processes of economic development. I think we should constantly scrutinize our own ideas and those of other countries, as to what can be done to speed up economic develpment and what method should be chosen to assist underdeveloped countries, if, as our Government has indicated on many occasions, the economic development of undeveloped countries is desirable from the United States point of view not only from a general humanitarian standpoint, but also from the standpoint of our own self-interest.

I also fully agree with him about the need to expand technical assistance, but one must not jump from the statement that more technical assistance is desirable to the conclusion that this can be done overnight. Certainly, we have now several thousand people on the payroll of the technical assistance programs of this country, but we run up against the fact that perhaps we don't have enough suitable experts, and that means not only technically suitable but also suitable in their general outlook, in their attitudes toward foreign countries and foreigners, to go out into the field and do a good job. I think the records are full of cases where our technical assistance has backfired because we tried to do the wrong thing in the wrong place, or because we rubbed the people the wrong way.

Still, I think technical assistance is important and should get as much support as is possible from our Government, and from private organizations.

This brings me to another point. There was at least implied in Mr. Nathan's statement that the most important thing that can be done to assist the development of underdeveloped countries is to provide them with larger amounts of money, private or public, preferably on conditions less stringent than those imposed at the present time by the bank or by other entities, and certainly by private investment.

I think there is, of course, need for financial assistance to underdeveloped countries, but I am not sure whether you can really do the trick with financial assistance alone. Just as he indicated that technical assistance alone will not do the trick, I do not think financial assistance alone will do it either.

There are cases, I think, where you find that all the social overhead capital, as it is called—the roads and ports—are in reasonably good shape, but what is necessary is an expansion of agricultural credit, or the introduction of a well-working, well-functioning agricultural extension service. This is largely not a question of money but a question of organization, of training the people, of bringing the right people into it, of giving to the right people the right kind of training so that they can do the job. This is nothing that can be done overnight; certainly it can be speeded up, but it cannot be done as fast as, under certain circumstances, financial resources could become available.

The last point which I want to make is that I don't think that the distinction between project lending and program lending is really a very major issue. In the case of the bank, we have lent in many instances to countries first for one project, then for another, and finally we discovered, and they discovered, what we have done is help to finance the whole program. After all, a program consists of a lot of individual projects, and, as a matter of practice, you really don't have a program unless you also have reasonably well-developed, well-worked-up projects, and whether we pick up the chits for one project, or for another, it does not matter as long as we made a significant contribution to the program as a whole.

Finally, and in the same connection, we have never claimed that the credit worthiness of a country, or the country's absorptive capacity for foreign loans, both from the bank and other sources, is determined once and for all. In many instances we have gone cautiously into a country because we did not know how it would be able to make effective use of our funds, but gradually the countries have proved that they can handle foreign funds and can manage their own affairs to such an extent that they have become automatically more credit worthy. There is no reason to expect that this constant reappraisal of credit worthiness—and, I hope, a determination of the constant expansion of the credit basis—will not continue.

Moreover, the bank itself has never claimed a monopoly in the field of public lending, and if, as some people think, institutions other than the bank are necessary—certainly for loans for which standards other than those of the bank would apply—I don't think can have any particular quarrel with Mr. Nathan on this proposition.

Mr. BOLLING. Thank you.

Dr. Blough.

Dr. BLOUGH. Mr. Chairman, I am in substantial agreement with what the other two speakers have been saying. Dr. Adler's statistics and other facts place the problem in perspective, and his theoretical and policy positions impress me as being sound.

I was interested in his comment about whether the repatriation of private investment would present a problem. In my own comments I endeavored to point out that government cannot count on what private investors will want to do, or not want to do, but must be prepared for whatever action they may take.

If they should want to repatriate their investments, due to developments abroad, then I think Dr. Adler and I are in agreement that a considerable problem would be raised. As I recall, he said that he was not worried about the problem of repatriation. As long as the dollar supply is high, I believe the chances are good that his view will prove to be correct.

It is like a man with money in the bank. As long as he knows he can get it out he does not want it, but if he is afraid he cannot get it out then he wants it. Keeping the dollar supply of other countries high involves the commercial policy of the United States. We cannot get away from the need for a liberal and stable commercial policy on the part of the United States if we are to avoid the problems which might arise from more or less mass attempts at repatriation.

Turning to Mr. Nathan's comments, he mentioned the desirability of using international agencies for loans, and other financing. I think that is something which will bear emphasis. It is easy to understand the reasons why many people think the United States Government should keep complete control over the funds it devotes to international loans and aid, and I need not go into those reasons.

I would suggest, however, that as far as the purpose of making friends is concerned, we cannot buy reliable friends and we may, instead, make enemies when we administer funds on a bilateral basis. As far as achieving economic development is concerned, we are more likely to achieve it if we channel the funds through some international agency since, as Mr. Nathan has pointed out. This procedure is much more acceptable to many underdeveloped countries having strong nationalistic sentiments.

This problem is not an easy one to solve. Mr. Nathan mentioned the proposal for SUNFED, which was actively under consideration and development by the U N. while I was with that organization. In my judgment, there are certain problems about the administration of the funds that would be distributed through SUNFED which have not yet been successfully solved, and until they are solved we may have misgivings about the operation of the fund; aside from that particular point I find myself in agreement with Mr. Nathan in regretting the United States position toward this proposed organization.

As to the need for loans rather than grants, which he mentioned, I would suggest that at least some countries prefer loans to grants, because they do not like the position before the world in which receiving grants, places them; nevertheless, if the loans must be repaid in dollars or other hard currency, I have some doubts as to the capacity of underdeveloped countries to absorb a large increase of loans of that character.

Loans might be made that could be serviced and repaid in local currency or other soft currency. It is not clear what can be done with repayments in such currencies. Perhaps they can be reloaned to the same country or even other countries for economic development. But an agency like the International Bank cannot be expected to make loans repayable in soft currencies, since its new funds come from the private market, and private investors will insist on being repaid in the currency they supply, not in inconvertible currency.

If the United States Government and other governments were prepared to supply funds to some international institution for making loans so that it would not be necessary to go to the private market, then a considerably softer policy could be followed. If, for example, something like the SUNFED were developed, which would make loans repayable in local currencies, or other available currencies, then perhaps we would have the type of situation which Mr. Nathan has in mind; namely, considerably more funds available to underdeveloped countries on terms which are less rigorous than at present. I think the apparent rigor of the present terms is very largely a result of the anticipation of foreign exchange problems which countries would face when they had to service their debts.

On the subject of private investment, and the rates of profit, I think Mr. Nathan has put his finger on quite an important point. The attitudes of the underdeveloped countries are not always consistent. Rates of return on domestic investment are high in these countries. Even the interest rates in many of these countries run up to 15 or 20 percent a year, perhaps more, especially if there is a substantial inflationary movement. When these governments begin to think in terms of a reasonable rate of return on investment from abroad, however, their reasonable rates tend to approximate our reasonable rates for public utilities, so that whereas a return might have to be 15, 20, 25 percent to be attractive, the governments might think in terms of 8 percent, or something like that, as a reasonable rate.

The governments face difficult political problems, of course, but the question remains: How can you get a rate of return which is really attractive to private investment, considering all the facts, which at the same time is not looked upon as being exploitative by the underdeveloped countries? In this connection the use of joint ventures involving both capital from the United States and local capital may deserve greater consideration. One of the reasons given by underdeveloped countries for preferring public investment to private investment is the lower rates of income that are required.

On the subject of incentives, I am more doubtful than Mr. Nathan appears to be about the use of tax relief as an incentive. This matter, however, is coming up before another subcommittee, and I shall refer only briefly here to my doubts about it. The cost of the incentives in revenue loss would be large, since benefits would have to be given, I believe, to all of the investment outstanding, including that in Canada and in oil and minerals, to which he referred, which makes up the larger part of the total and which is doing very well without incentive. On the other hand, the obstacles to investment other than taxation are generally so great that I wonder whether tax incentives would really have a large impact on the amount of investment.

I would like to emphasize the point made by Mr. Nathan on management. In recent months I have talked with a great many businessmen who are engaged in investment and other operations abroad. They have unanimously expressed the view that management is a large, perhaps the largest factor in this whole picture; that without sound management capital is not going to be effectively used. How do you get sound management? A good deal is being done, but a whole lot more will have to be done. The management contract, which Mr. Nathan mentioned has had some success. There are other methods that also have proved helpful. I will not go into details, but I would like to stress the point that the improvement in these countries of management and technical services in general is an important part of the investment problem.

As to public and private investment, I do not see any conflict between them and I agree with Mr. Nathan that public investment often is a necessary condition for sound private investment. If the water is not clean, if there is no electric power, if there are no roads, if malaria is widespread, if public education is lacking, the situation is not one which private business is likely to find attractive. To get improvements in these fields requires types of investment other than private investment, and probably investment which does not have to be serviced and repaid in dollars, so that while public grants may not be necessary the loans will need to be of a somewhat different character than we usually think about.

Thank you, Mr. Chairman.

Mr. BOLLING. Thank you, Dr. Blough.

Mr. Nathan.

Mr. NATHAN. Just one or two comments, Mr. Chairman.

First, about this problem of suitable experts that Dr. Adler raised. I think the problem does not stem from the fact that there are not enough suitable experts in the United States. I think it stems from the fact that there has not been an adequate effort to interest capable leadership in this country and capable technicians and capable managers to go abroad. The problem of recruitment is very, very difficult here in the United States, and I find it rather distressing that more Americans with talent and with ability do not realize that in this ideological conflict there is a responsibility to go abroad and help. In the recruitment efforts of our firm we find too many people who are concerned about, as Dr. Blough says, whether there is malaria, whether you ever see a snake, or whether the water runs hot and cold, what the temperature is like, and things of that nature. I feel strongly that unless a sufficient number of people in the United States wake up to the fact that there are ideological conflicts and competition going on in many uncommitted parts of the world, and face up to this fact, the democracies of the West are going to be in serious trouble.

I have no doubt that we have enough people and, properly selected and oriented, we have enough that are suitable for overseas work. We have so many technicians and so much management as compared with the rest of the world that a slight dilution, and I mean slight in terms of numbers of what we have available, would not hurt us at all, and would be tremendously helpful abroad.

Now, the problem raised by Dr. Blough, where he talked about loans and grants and the problem of repayment in dollars, is a very important one. It is true that many of the undeveloped and underdeveloped countries of the world do not find ready markets for their goods here in the United States. Where they produce basic minerals and things of that nature they can earn dollars, but if they happen to be agricultural countries in face of our surpluses, they don't find much of a market here in the United States, and, therefore, their prospects for earning dollars are rather remote. If they have to borrow in dollars and repay in dollars that creates a real problem because where are they going to earn the dollars to make the repayment?

I believe that if the United States realizes that in this era of competitive coexistence, we have a possibility of keeping neutral countries neutral, or perhaps trying to get them more oriented to the West, then we should try to face up to this issue by perhaps holding some foreign currency, or making available convertibility.

I, myself, don't happen to believe very strongly in gold reserves. I am not so sure that foreign currencies would be much less valuable than our gold stock in Fort Knox. I am not suggesting that we build a big vault to pile up foreign currencies but I think we could undertake devices and techniques which would help in this problem of convertibility. We could take repayment of loans in soft currencies, though not necessarily the currency of the borrower, because most borrowers can earn some currencies abroad. By sticking to the approach of requiring repayment in dollars when the loan is in dollars, we are making it difficult for borrowers to get the resources they need.

Perhaps we could lend them funds and allow them to spend the funds abroad and not require that most of the funds made available by us be spent in the United States. I am sure there other techniques that we can develop.

There is one other problem of a longer run nature that relates to the refunding matter I raised before. If an underdeveloped country borrows today fairly heavily to develop, and it does develop, and the obligations become due over the years, if that country is to repay its obligations, and not incur new obligations along the way, then it must develop a favorable balance of trade. It must export more than it imports. That means it may have less available for development in the future.

Of course, in the process of development it has built up national income, its ability to save and to provide for capital formation. But a country that once gets bitten by the bug of development does not like to slow down at a later date. It likes to go ahead at a more accelerated pace. That is why I believe we must look forward to a continued rise in debt among nations, just as we do internally. I know that poses difficulties in an external situation as compared with an internal situation, but if we want to be realistic about helping these countries truly develop, and help accelerate that pace over a period of years, over a period of decades, then I believe we must look forward to a larger and larger debt and to an increased requirement for capital funds. Otherwise, we are not going to be able to achieve the results we desire.

One final word, and I not only do not expect, but I almost request no rejoinder from Dr. Adler because he is not here for the World Bank today.

I would say that the World Bank within the scope of its operations has done an excellent job. It has made available funds for about \$2½ billion. All I am saying is that amount is not nearly enough from international institutions relative to what is needed and relative to what is required for development in the world among the underdeveloped countries. If, as I believe is probably correct, the world bank feels constrained from different types of loans because of the nature of its sources of funds, then I believe that other institutions ought to be developed, and we should not be hesitant about supporting SUNFED.

If that isn't adequate, let us try other methods. We are in a tough ideological conflict, and we should not necessarily stick to only one or two methods. We should be willing and desirable to experiment and try to meet these needs.

Mr. Bolling. Thank you, Mr. Nathan.

Are there any further comments from the members of the panel, or shall we proceed to questions?

Dr. Ensley?

Dr. Ensley. Thank you, Mr. Chairman.

Dr. Adler, one observes the benefits— housing and living standards generally, to the average citizen of Venezuela of substantial private United States investments in oil and, more recently, ore.

How can the benefits of this type of cooperation, between Venezuela and private United States capital be brought home to the other countries of South America who in many cases are sitting on vast resources, mineral and oil and other resources? There might be leaks and other shortcomings in carrying out of the program but nevertheless generally it has worked pretty well apparently.

Dr. ADLER. Mr. Chairman, Dr. Ensley raises a question to which I think there is no simple answer. I for one do not claim that I have an answer to it.

Let me try to go about it by saying this first: One of the things which we frequently overlook when we look at the low level of living in many underdeveloped countries—I am not thinking so much about Latin America as, say, about the countries in southeast Asia—is the fact that in the last 8 or 10 years, since the end of the war, most, if not all, of those countries have actually made very substantial progress. There is noticeable improvement in the living standards, and this is in itself a rather encouraging sign, because it makes it possible to build on that background of advancement rather than stagnation.

It may be the fact that a country like Brazil, which is in the situation that you mentioned, has had a very substantial rise in aggregate and per capita income which has made the country reluctant to go one step further and rely heavily on private investment where it is attracted, and certainly in the case of oil resources or mineral resources, American capital has shown a good deal of inclination to go abroad.

Maybe necessity itself will become a teacher, if the rate of growth without the development of these resources slows down. But I think educational propaganda, to point out how well the Canadians are doing by getting American financial cooperation in the form of direct investment, or how well the Venezuelans are doing, may be misinterpreted as a new form of dollar imperialism and what not. As a matter of fact, in terms of our making friends, I am not sure whether the plugging of private investment, as the only method of improving the lot of these people, does not lend itself to misinterpretation.

On the other hand, objective studies by a United Nations expert committee of the benefits derived in various countries from foreign investment, the sort of diligent and exact investigation which the National Planning Association has made in the case of 1 or 2 American firms, could swing public opinion, at least informed public opinion, to a point where these emotional blocks of nationalism, or tradition, of Spanish law, under which all resources under the soil originally belong to the king, or to the people, can be gradually overcome.

Dr. ENSLEY. Thank you.

Professor Blough has answered the question I had for him with respect to tax treatment of income earned abroad. I might say, Mr. Chairman, that Dr. Blough is scheduled to be one of the witnesses before our Subcommittee on Tax Policy a month from now, and he has already submitted his paper which is in the 1,000-page compendium of papers to be published tomorrow morning. I think this reference to the forthcoming tax hearings at this point worthwhile.

I have a question for Mr. Nathan. Yesterday afternoon, Dr. Gale Johnson of the University of Chicago commented on the possibility of using some of our surplus food and fiber as part of an investment program in southeast Asia relieving some of the working population from the never-ending struggle to get food, permitting them to use the time to build schools, roads, and other community works. What do you think of that as a possibility?

Mr. NATHAN. There are two phases of that. First, from the point of view of the positive results, I think, generally, it is a very desirable approach and we are attempting that under our Public Law 480 program. We are today selling United States surplus foods to countries which need these products. We are taking payment in local currency, and then lending back a substantial portion of that local currency for local development projects. It is a very useful method of trying to provide additional capital for projects, because the problem is not always one of foreign exchange.

In many, many instances, there are serious deficiencies in the supply of local capital for development purposes, and the foreign countries are not able to develop tax systems which can drain away enough local currencies for development, so that in serving this purpose the Public Law 480 program is very good. On the other hand, I would say that it poses problems which are very serious and which sometimes offset the benefits. One such problem is the problem of taking away markets from underdeveloped countries, which markets are very essential for them. An illustration is the case of Burma, where our firm is now employed. Burma has a tremendous surplus of rice. It has a huge carryover of rice. The United States was not an exporter of rice in any significant measure before World War II, but because the lines of communication were destroyed in the Orient, the United States increased its production of rice and today is the third largest exporter of rice in the world. Burma has this huge carryover which it is not able to sell, mostly because of the increased rice production in the last 2 or 3 years, particularly in normally rice-importing countries. However, the prospects look more favorable for the next year.

The United States has undertaken to provide rice under this 480 program to Japan, and I understand to the Philippines, and may be in the process of doing the same to Indonesia. Those countries happen to be natural markets for Burmese rice. It is not easy to make friends by taking away the markets which are so essential of countries which are friendly, or which are neutral. The problem is therefore one of trying to make arrangements for the disposition of these surpluses so as to minimize the interference with normal trade. That is easier said than done.

I think, however, that there are ways it can be done and it may require us to engage in multilateral trade arrangements, whereby we do provide a certain amount of our surplus goods to certain countries on the condition that those countries will increase consumption by so much per capita, by such and such amounts, rather than displace imports from other countries. Or we could offset the adverse impact on countries which are competing suppliers by making available loans or capital to those countries. Or we might even undertake efforts toward price stabilization of various basic commodities where we have surpluses.

I think the 480 program is commendable, but I believe that a great many careful considerations must be given to this problem of not competing with those who are also suppliers.

Dr. Ensley. Your reference to the surplus rice in Burma raises another question that if Senator Flanders were able to be here this afternoon I am sure he would ask, and that is the possibilities of a growing trade, which he feels is a natural trade, between Burma and Japan, industrial goods from Japan going to Burma.

What is the outlook for that development?

Mr. NATHAN. The outlook for that development is quite favorable. Within the last 12 months, Burma signed a reparations agreement with Japan whereby Japan would provide $20 million worth of goods and services a year to Burma, plus $5 million per year for joint ventures. The probabilities are that Burma will buy substantial quantities of capital goods from Japan under that arrangement, and also in exchange for rice. I think that same possibility exists and will extend to many other countries of Southeast Asia.

The problem is one of providing these countries or helping these countries obtain the financial resources needed to buy increased quantities from Japan. I believe that by our aggressive lending operations in many countries in Southeast Asia, which permit them to use some of those funds for purchases in Japan, we can in essence kill two birds with one stone—help these countries develop and also help Japan get on a sound footing.

Dr. ENSLEY. Is the surplus of rice in Burma resulting in East-West trade in rice, and if so, what is Burma getting in return for its shipments of rice?

Mr. NATHAN. Burma was faced with tremendous surplus of rice which it was not able to sell and many of the Eastern European countries came in under barter arrangements and have bought in aggregate several hundred thousand tons. Purchasing missions from Burma are now in those countries seeing what they can get. They are rather hopeful they will get the kind of goods they need.

Dr. ENSLEY. Industrial?

Mr. NATHAN. Industrial and some consumer goods, because Burma is a big importer of consumer goods. That Eastern European trade in some measure may be attributable to Burma's rice problem. The way we are disposing of our rice has not helped Burma's rice problem, nor has it in wheat because in some countries in Asia, short of foreign exchange they have taken American wheat and that has tended to displace rice in the diet of the people there; not that our purpose was to displace rice, because I think those people in the Orient prefer rice, but it is an interesting illustration of the way in which sometimes our surplus dispositions don't help us at all.

Dr. ENSLEY. That is all. Thank you.

Mr. BOLLING. I take it this relates to the conclusion that sometimes the easy way is not the effective way.

Mr. NATHAN. Very much so.

Mr. BOLLING. Dr. Sheldon.

Dr. SHELDON. Professor Blough, when resort is made to tied loans, that is supposed to ease the problem of capital transfer between countries. You made some reference to tied loans in your talk, and the United States on occasion has resorted to this device in connection with extension of foreign aid, too.

I wonder if you feel this is something which should be encouraged as a policy, or whether there are some pretty strong disadvantages to tied loans?

Dr. BLOUGH. I think there are strong disadvantages to tied loans from the viewpoint of foreign economic policy. If the purpose of the loan is to stimulate an export of certain goods, for example, capital equipment from the United States, then, of course, it is necessary to tie the loan to the purchase of goods in the United States. As I pointed out before, this is in effect discriminating among exporters since our total exports are limited by the available dollar supply. Tieing a loan increases a particular kind of export at the expense of other kinds of exports.

Now, suppose we made that loan without tieing it to the purchase of United States goods. The country receiving the loan might throw its purchases open to competitive bidding and buy the goods from the United Kingdom or from France or from Japan or from West Germany. Thus, the capital equipment would be bought from those countries instead of from the United States. But those dollars would not be lost. The idea that such dollars do not come back to the United States in payment for exports is a great mistake. Aside from the building up of foreign exchange reserves, which I mentioned in my earlier statement, those dollars will come home shortly to purchase other goods from us, perhaps capital equipment, perhaps other manufactures, perhaps agricultural products. The dollars may go through one or more transactions before they come back, but this helps the development of multilateral trade.

In short, if the Government has decided to stimulate a certain kind of export at the expense of other exports, tieing the loan is a logical and effective way of doing it, but if the purpose of a loan is to promote economic development, which is what we are talking about today, and if the United States Government does not seek to play favorites among its exporters, it should not tie its loans. That is the conclusion I would reach.

Dr. SHELDON. Thank you very much.

Mr. Nathan, you pointed out at one stage of your talk that it was perhaps more important to develop whole programs than have many separate projects in economic development, and there was a rejoinder from Dr. Adler, that the World Bank ended up with programs by the time it counted up all of its projects. I think perhaps there is still one question on which you might comment.

Even if a large number of projects constitute a program, haven't we the choice of scattering these projects throughout a country, or perhaps taking a small region or a limited region of the country and concentrating our efforts in that region in the interest of showing how a broad-scale attack on economic development can bring results in that localized setting? Would you comment on that?

Mr. NATHAN. First, I would say I certainly agree that the program is an aggregate of projects. It is not something completely distinct from specific undertakings. With respect to your particular point, Dr. Sheldon, it is not easy to go into a country and to undertake a type of loan which is primarily regional in nature because a country usually desires to develop its economy, either generally across the country at the same time, or it may have political reasons for concentrating on one particular area, rather than on one which the World Bank might find much more justifiable from an economic point of view, and after all, politics are important here as well as elsewhere, and we should give them a little leeway, too. But I think it would be difficult to try to sell a country on merely supporting a regional effort, although if the country were receptive I think it would be an excellent idea from the point of view, as you say, of demonstrating what our capital assistance was able to do.

Coming back to the general provision, however, I have a feeling that when a lending institution concentrates on projects, that there are dfficulties imposed on a borrowing country in terms of trying to gear these projects to the program it desires, in trying to maintain the kind of order of priorities that it wants to follow, and in terms of allocating the resources which it desires as compared with the desirability of the lending institution. Often there are rather intuitive bases for decisions within a country which work out better than pure economic rationalization. I have a feeling that instead of going into a country like India and making loans for this project and that project, which may, over a period of years—I don't know—may have added up to two or three hundred million dollars on the part of the bank—that it might be that better results could be achieved by a development loan to that country for $300 million, subject, of course, to a review of its program and a decision whether the program generally makes sense. But once it is decided that the program has a reasonable basis, then the total funds should be made available and the country allowed to go ahead on its own. I don't think that is a complete substitute for a project-by-project basis, but I would like to see the World Bank proceed on its project-by-project approach and then something like SUNFED or some other institution come along which would have substantial resources that would be able to make them on a development loan basis.

Dr. SHELDON. Thank you very much.

Dr. Adler, do you have anything to add to that?

Dr. ADLER. On the last point, I think I only can repeat that this is largely a matter of degree. Let me just add that for the dozen countries or so where the bank has sent survey missions, surveying development potentials and development opportunities for the economy as a whole, the mission has always come up with a development program indicating where the general lines of priority would lie and along what lines the economy as a whole should develop. In other words, the bank is not at all adverse to the concept of development program. It must be realized, however, that partly because of its statutory requirements under which the bank can finance only the foreign exchange cost of projects or programs, except in exceptional circumstances, it is never the sole financier of a development program or even a project.

Thus, the bank likes to see programs worked out; the program itself helps in many instances to develop and produce such development projects. What particular part of the program it finances within the framework of the development program is perhaps not immaterial, but at least of lesser importance, because the bank likes to see the financing for the program as a whole secured by internal credit operations, or by taxation.

Dr. SHELDON. Thank you very much.

We did have one other question. SUNFED has come up for mention on the part of a number of you. I wondered whether one of you for the record would give us a very quick picture of its principal features. Perhaps Dr. Blough would be the one to do it.

Dr. BLOUGH. SUNFED is a word made up of initials which, spelled out, are Special United Nations Fund for Economic Development. The word "Special" was included in this term in part because the rest of the initials make a word that would be rather poor from the public relations viewpoint.

The General Assembly, I think in its 1951 session, passed a resolution over strong United States objection, adopting in principle the idea of a fund to make grants and long-term, low-interest loans for economic development. This fund was to be within the United Nations, with contributions by member governments.

The Assembly asked the Economic and Social Council to study the question. The Economic and Social Council requested the Secretary General to set up an expert committee. This so-called Committee of Nine met for several weeks in late 1952 or early 1953. The United States member of that committee was Mr. Wayne Chatfield Taylor, and there were eight other distinguished gentlemen from industrialized and underdeveloped countries scattered throughout the world. This committee developed an organizational proposal and plan for the fund.

Its report was taken under advisement by the Economic and Social Council, and further resolutions were adopted by the Council and the General Assembly. The matter has been kept alive but no final action taken because of the opposition of the United States and certain other countries.

In 1953, President Eisenhower added a substantial element to this picture by saying in a speech, that when the United States made savings as a result of international disarmament agreement, part of such savings should be spent through an international agency to promote economic development.

It has been the position of the United States Government that until such savings are realized, the United States has no money available to contribute through SUNFED.

In the meantime there has been another committee, and several more reports. The matter is moving closer to action, as far as other countries are concerned. The Netherlands and certain other European countries have come out for SUNFED. The United States is still against it and I see no hope for a fund of any considerable size being set up against United States opposition.

According to present ideas, SUNFED would be attached either to the United Nations or to the bank or to both. It would have a board of directors which would be empowered to allocate the funds. It was to have a capital of $250 million, as a minimum, and it was hoped that this amount would be only the beginning.

I am afraid this has been a rather discursive discussion.

Dr. SHELDON. That has been very helpful. Thank you.

Mr. BOLLING. It might be appropriate to say there would be more likelihood of a reduction in armament if there are more activities in a field such as this than if there are not.

With that I think, gentlemen, that I will thank you all for your presence and your very valuable contribution. We appreciate the time that you have given us.

The subcommittee will now adjourn until tomorrow morning at 10 o'clock in this same room when our subject will be Regionalism as an Alternative to Multilateral World Trade.

(Whereupon, at 4:08 p. m., the subcommittee adjourned until Wednesday, November 16, 1955, at 10 a. m.)

FOREIGN ECONOMIC POLICY

WEDNESDAY, NOVEMBER 16, 1955

Congress of the United States,
Subcommittee on Foreign Economic Policy of the
Joint Committee on the Economic Report,
Washington, D. C.

The subcommittee met at 10 a. m., the Honorable Richard Bolling, chairman of the subcommittee, presiding.

Present: Senator Ralph E. Flanders.

Also present: Grover W. Ensley, staff director, and Charles S. Sheldon II, staff economist.

Mr. Bolling. The subcommittee will be in order.

On the preceding days of these hearings, a succession of witnesses has established the general merits of increased trade based on comparative advantage and currency convertibility. This case has been qualified by those who are concerned by the dislocations which may afflict some segments of the domestic economy as a result of trade.

Our witnesses yesterday went a step further in this study to emphasize that we live in a world in which cooperation in trade must be considered if trade warfare is to be minimized and if international investment is to play its traditional role in economic development.

Today we move on to the next step, to consider more explicitly how economics and politics must combine in the making of our foreign economic policy.

At a number of points in the hearings there has been brief discussion of regional trade blocs as an alternative to an immediate attempt to restore worldwide multilateral trade. This morning we are going to consider the possibilities in greater detail, and we hope it will be possible to bring out enough information to reach conclusions on this important subject.

During the course of the year, a distinguished study group sponsored jointly by the Woodrow Wilson Foundation and the National Planning Association produced an important book, The Political Economy of American Foreign Policy. It is a book which has had a mixed reception. We cannot hope to review all of its major points in these hearings. But we have invited one of its coauthors, Mr. H. van B. Cleveland, to outline and defend one of the points offered by the study group, a plan for regional trade encouragement. Mr. Cleveland is on the staff of the Committee for Economic Development, and is a veteran of service with the Department of State, the Office of Strategic Services, the Foreign Economic Administration, and was Deputy Director of the European Program Division of the ECA.

Mr. Cleveland.

STATEMENT OF H. VAN B. CLEVELAND, THE COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. CLEVELAND. Thank you, Mr. Chairman.

May I say that the views that I express this morning are not my employer's but my own.

Our subject this morning, as the chairman pointed out, is regional trading blocs and how they can help break down barriers to international trade. And the central question which I believe is in the subcommittee's mind is whether a regional approach to trade liberalization and currency convertibility is, or is not, more practical and effective than a global approach.

Over the last 10 years there has been a good opportunity to compare the effectiveness of these two approaches. My judgment is that a regional approach to trade liberalization, based on the sterling area and the European Payments Union, has proved to be more effective than global multilateralism. And this is the case I would like to argue very briefly this morning.

Eleven years ago, at Bretton Woods, N. H., a plan was laid down for freeing international trade and making currencies convertible which is still the official goal of American policy.

This plan recognized that, in order to remove import quotas and exchange controls among a group of countries, an international monetary mechanism had to be created to regulate monetary conditions within the countries, so that no serious balance-of-payments troubles among them would arise. Otherwise, the countries would refuse to remove their controls for fear that they would be subjected to large and unpredictable losses of foreign exchange, or to excessive deflationary or inflationary pressures from abroad. This is what the gold standard mechanism did for the whole trading world in the 19th century.

The Bretton Woods planners knew that, in order to work, the new international monetary mechanism had to be largely free to operate without interference from national governments. In the 19th century the gold standard mechanism was free to work according to its own rules and mechanics. Governments did not interfere with it because it would have been unheard of to do so, and because its workings were accepted throughout the trading world as impersonal economic forces to which private interests and public authorities were alike accustomed to conform.

The Bretton Woods planners knew they could not conjure up the gold standard out of the past. So they tried to substitute for its impersonal and automatic workings a pledge by national governments to each other to regulate their monetary policies so as to keep international payments in balance. In effect, national governments were to pledge themselves to act as if the gold standard mechanism were still in full operation. They were to respond to a balance-of-payments deficit and an outflow of gold by restricting bank credit and other deflationary action, just as if their banking system were still tied securely to the international gold standard.

It was hoped, in this way, to make it possible for all countries to remove their import quotas and exchange controls, at least on noncapital transactions, and thus to reestablish global multilateral trade and currency convertibility. It was hoped to restore for the whole world—or at least for the non-Communist world—a universal and nondiscriminatory trading system, something like that which had prevailed in the 19th century.

But these hopes have been disappointed. What trade liberalization has occurred has been along regional, not universal, lines. And the countries participating in it discriminate against the United States. The trade of Japan and most of the underdeveloped countries is still tightly controlled by import quotas, exchange controls, and bilateral agreements. Only within the dollar area—North America and northern Latin America—are trade and payments conducted more or less according to the Bretton Woods blueprint.

In short, the Bretton Woods plan envisaged a universal and nondiscriminatory trading system. But the actual world trading system excludes large parts of the free world. It has marked regional features, and it involves important elements of discrimination.

Why has the actual pattern of world trading relations diverged so sharply from the official American blueprint?

The weakness of the Bretton Woods plan was its central assumption, the assumption that most national governments could and would adhere to pledges to act as if the international gold standard had been restored.

Consider for a moment what this pledge involves. Today most national governments are held responsible by their electorates and by powerful interest groups to use their monetary power to assure domestic full employment and economic growth. Governments are not, generally speaking, at liberty to subordinate these objectives to the objective of keeping their international payments in balance, as they were in the 19th century. Yet, to carry out the Bretton Woods pledge, governments would have to give priority to the objective of balance-of-payments equilibrium over domestic economic objectives, whenever there was a conflict.

For a few countries there is no real conflict between domestic employment and economic growth and balance-of-payments equilibrium—the United States for example. The size and the relative self-sufficiency of the American economy, and the competitive power of American exports, mean that the Treasury and the Federal Reserve Board do not have to worry about the condition of our balance of payments. The United States does not have to impose import quotas in order to protect our gold reserves from, let us say, the effects of deflation in Europe. But for most other countries this is not true, and particularly for Britain and the industrial countries of Western Europe.

It is, therefore, very difficult for most countries to remove import quotas and exchange controls. In practice, it has proved to be possible mainly on a regional basis, particularly within the sterling area and the European Payments Union grouping, and I think it is not difficult to see why—that is, to see why this has proved to be possible on a regional rather than on a more universal basis.

In the first place, the countries of Western Europe and the sterling area have a strong, common, reciprocal interest in expanding their trade with each other. For historical reasons, their economies are highly interdependent. Their future growth and health depends on how rapidly their trade with each other expands.

This common interest does not include most of the independent underdeveloped countries, which, for nationalistic reasons, want to reduce their economic dependence on Europe. Nor does it include the United States, at least on the same basis, whose domestic market is very hard for European industry to penetrate and whose exports offer competition too stiff for many European producers.

Second, the members of the sterling area and of the European Payments Union have enough sense of responsibility to each other that they are willing to take mutual pledges of trade liberalization seriously. The Western European governments are even willing to consult regularly with each other in the Organization for European Economic Cooperation about their domestic economic policies with a view to preventing serious balance-of-payments difficulties from arising, difficulties which would lead to the breakdown of trade liberalization.

This sense of mutual responsibility and ability to cooperate are due in part to a common economic interest in expanding trade. But more fundamentally they reflect the fact that both the sterling area and Western Europe are historical communities. That is, these groupings have a real sense of unity which is the product of a long common history and of common values. In the sterling area the United Kingdom provides an important element of leadership.

I do not mean to minimize the serious conflicts of economic and political interest within these groupings. Nevertheless, the members of the sterling area and the European Payments Union have a feeling of unity which does not exist, to the same degree, between them and most other countries. And this feeling seems to be one reason why these regional groupings are able to maintain a high degree of freedom of trade and payments among their members.

Why do these groupings have to discriminate against the dollar? Or, to put it another way, why cannot the United States be included in the sterling area and the European Payments Union?

The main reason is, of course, the dollar problem—that is, the tendency of the West European countries and the sterling area to be chronically, or recurrently, shorter of dollars than they are of each other's currencies. As long as this condition lasts, the countries of Western Europe and the sterling area cannot liberalize their imports from the United States to the same degree as from each other. Nor can they make their currencies as convertible with the dollar as they are among themselves. As long as they have a dollar shortage it is not possible for them to remove all discrimination again the dollar without doing themselves more economic harm than good.

In order to "go convertible" and remove their quotas on dollar imports, Britain and some of the continental countries would have to take rather drastic internal deflationary action. I doubt if this action would be politically possible for them to take. If taken, it would probably lead to economic stagnation like that in Britain, France, and several other European countries in 1952 and 1953.

Moreover, there would be danger of repeating the experience of 1947, when a premature attempt to move toward sterling convertibility led to a great intensification of trade restrictions among the West European countries.

This reasoning is valid, of course, only if Western Europe's and the sterling area's dollar shortage is, in fact, a chronic phenomenon. The dollar shortage is much less acute than it was a few years ago. But there are strong reasons for thinking that Britain and some of the continental countries will have a chronic, or at least a recurrent, shortage of dollars for a good many years ahead.

I cannot go into all the reasons why I think that, but I will give two of them:

One reason is that so large a part of Western Europe's current earnings of dollars consists of extraordinary United States Government expenditures, mainly military expenditures. Continuation of these expenditures at the present level is, at best, uncertain. If they should be drastically cut, Europe and the sterling area would again find themselves with an acute shortage of dollars.

Another reason for thinking the dollar problem is here to stay is the recurrent inflation in the United Kingdom. If the British economy has a tendency to be periodically more inflated than the American economy, as it apparently has, convertibility and the end of discrimination are not in sight. For sterling convertibility is the key to general convertibility and nondiscrimination.

To summarize, trade liberalization in the postwar world has taken a regional form because it is only among the nations of Western Europe and the sterling area that there is sufficient economic interdependence, coupled with a sufficient sense of community and mutual responsibility. The pattern involves discrimination against the dollar because the more dynamic, competitively powerful and self-sufficient American economy cannot be fitted into the pattern, in a manner consistent with Western Europe's economic health, unless Western Europe is shielded to some extent from American economic power.

Implicit in this whole argument is a political premise which I should like, in conclusion, to make explicit.

The United States has helped to build and maintain the European Payments Union and the sterling area for political rather than economic reasons. These regional groupings serve our national interests because they contribute to the economic health of our western allies. The United States Government has been willing to acquiesce in the discrimination against our exports involved because these regional groupings seem to contribute to the strength and solidarity of the free world. This political gain outweighs, in my opinion, the economic cost of discrimination to the United States.

Without this political consideration, I would find it difficult to argue that it is in our interest to support regional trading blocs from which the United States is excluded. But given our profound interest in Britain and Western Europe, I believe we should continue to support the sterling area and the European Payments Union for as long as they contribute to Britain's and Western Europe's economic growth and health.

Mr. Bolling. Thank you, Mr. Cleveland.

As many of you are aware, the report of the study group has brought dissent as well as praise. Senator Douglas of this subcommittee is one who has disagreed with some of its conclusions. I regret that other business has made it impossible for him to be with us today, but he will be reading the transcript.

We have invited Prof. Gottfried Haberler, of Harvard University, to present an analysis of flaws in a regional approach to trading problems. Dr. Haberler was recognized as a world authority on trade even while he was in Europe, and served as a expert on such matters for the League of Nations. Since that time, he has spent nearly 20 years at Harvard, continuing his writing, and advising the Federal Reserve Board and International Monetary Fund.

Professor Haberler.

STATEMENT OF DR. GOTTFRIED HABERLER, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Dr. Haberler. Thank you, Mr. Chairman.

It has been a constant quip that if you have 3 economists together you will get at least 4 answers to the questions which you ask them. I don't think it will be that bad this morning as far as I can see. There are only two answers because I am almost entirely agreeing with Professor Kindleberger's memo and I shall cut my remarks on problems with which he deals shortly. I have some disagreement, I must say, with Mr. Van Cleveland, but let me state my position in nonpolemical form.

It has been the traditional policy of the United States to stress multilateral trade and nondiscrimination. Multilateral trade means that each country buys where it can get its imports cheapest, and sells where it can get the highest price. I don't think anybody would deny that under this arrangement gains from trade will be maximized for all participants. Closely connected with the principle of multilateralism is the principle of nondiscrimination, each country treats imports from any source alike and in the field of tariff policies that means that imports from any country of the same commodities pay the same duty.

Now, the principles of mutilateralism and nondiscrimination have been implemented by including into trade treaties most-favored-nation clauses, and I might say that this principle to include most-favored-nation clauses, that is to stipulate that each of two contracting parties will treat the other party not less favorably than the most-favored nation, that this policy has a long tradition and has been followed by Republican as well as by Democratic administrations. Such clauses have been inserted in all trade agreements of the United States before and after the inception of the reciprocal trade agreement policy.

It is clear—on that there is no dispute—that regional blocs violate the principle of nondiscrimination because they discriminate against outsiders in favor of insiders. The United States always looked with disfavor at such violations. For instance, British Commonwealth tariff preferences were looked upon with disfavor and steps were taken to eliminate them.

On the other hand, there have been always exceptions to the principle of nondiscrimination. The United States always took the position that customs unions are a legitimate exception to the principle of nondiscrimination, and has not only suffered, but also encouraged and applauded the formation of customs unions.

The United States has been criticized for that position. It has been pointed out that there is a contradiction if you are against a preferential tariff regime under which the countries grouped under such a regime grant each other discounts on duties. Then if the preferential tariff regimes are bad because they imply discrimination, then the customs union should be worse because the customs union implies a higher degree of discrimination. Under a customs union duties between the members of the union are not only reduced, but eliminated altogether. Hence, the customs union in a sense implies a higher degree of discrimination. It can be shown, however, that there is no contradiction involved; that this traditional position of the United States, this traditional attitude with respect to customs unions and preferenial regimes is perfectly justified on economic as well as on political grounds.

Customs unions have a great advantage over preferential regimes. Customs unions do away with all redtape by eliminating all trade barriers between the countries concerned, all redtape of customs procedure, all that is eliminated, and a large free-trade area is thereby created.

The preferential regimes, on the other hand, like the British Commonwealth preference, do not only not reduce redtape, they actually increase it, because if you tax imports differently according to the country of origin, you have to ascertain where the commodity comes from. And that is now not always easy. Suppose country A imports raw materials and semifinished goods from B, and exports the finished products to C, where it has preferential position. Then some rules have to be laid down, how much value added in A makes the commodity a product of A, which has the preferential position in B.

Practice has shown that this additional redtape can be rather disturbing. But there is another reason why customs unions are much better, and are really in a different category than preferential regimes. The customs union is a once-for-all across-the-board elimination of trade barriers, and, therefore, it is likely to be stable and not subject to frequent change. On the other hand, preferential regimes, in the nature of the case, are selective. Preferential regimes are selective in the sense that the commodities and the degree of preference is different, according to different commodities, and it is a priori plausible, and experience has borne that out, that because they are selective they are less favorable because there is a natural tendency to reduce trade barriers only for those commodities which do not actively compete with domestic production.

In other words, the reduction of duties under preferential regimes is "trade diverting." Each country lets enough in from the preferred areas to shut out imports from cheap sources from the outside but not more. Suppose we had a European preferential regime—and that applies to some extent to EPU, and the reduction in quota restrictions within the European market, to which Mr. Van Cleveland has referred; in that case, European countries will import, say, more expensive wheat from France or from Turkey in place of cheap wheat from the United States or from Canada. This is trade diversion. It is something which does not help the consumer in the importing countries in Europe. They have to pay just as much as before. The Government loses revenue, because revenues are less if the duties are reduced and the domestic producer is not hurt. This is nice for the domestic producer, but by the same token such partial reduction and selective and preferential reduction in duty doesn't do any good to the community. It is a sham reduction and, therefore, on economic grounds not only useless, but positively damaging.

I do not say that actually all preferential tariff reductions are of that kind and I do not say that all removals of trade barriers under the customs-union regime are of the other kind, but there is not the slightest doubt that under the preferential regime the majority of duty reductions are of that kind, trade diverting rather than trade creating, while under the regime of the customs union you get the trade-creating as well as the trade-diverting reductions.

I summarize this part of my paper by saying that the traditional American policy of favoring customs unions while objecting to preferential tariff arrangement is perfectly justified on economic grounds—not only from the point of view of the United States, but also from the point of view of the countries which enter into such arrangement.

Unfortunately, customs unions are very rare occurrences. In modern times I can think only of Benelux, the customs union between Belgium, Netherlands, and Luxembourg. There is no other case on record. If you go further back in history you will find the German zollverein in the 19th century under which Germany was unified, economically speaking. I might mention that under modern conditions, when we have countries that have exchange controls and many other interferences with trade, state trade monopolies, and so forth, that there the mere customs union doesn't mean very much. In that case, we should speak of an economic union, economic unification, or integration, which implies not only unification of the customs tariff, but also the unification and integration with respect to other phases of economic policy.

Now, there are two reasons—two sets of reasons why this type of regional integration, customs union or economic union, is so hard to achieve. It is in fact harder to achieve than the global kind of trade liberalization under the operation of the most-favored-nation clause. First, any economic union or customs union which is not of the trade-diverting kind steps on just as many special interests as global liberalization of trade. If the customs union means anything, if it increases trade between the members of the union, and does not just divert trade from cheap sources from the outside to expensive forces inside the union, then somebody is going to be hurt. The industries in each country which now face stronger competition from the other members, over and above the degree, which is sufficient to shut out cheap imports from the outside, these industries will be hurt. Hence, economic integration and regional liberalization of trade, to the extent that it really creates trade, runs into exactly the same difficulties as global universal liberalization of trade under the operation of the most-favored-nation principle.

This is one reason, and the second reason is that over and above these unavoidable difficulties, a customs union or economic union or regional liberalization of trade runs into the difficulty, that it requires agreement between the members on a common policy vis-a-vis the outside world. Under the customs union, the members of the unions must agree on a common tariff, and under a system of full economic union they must agree on other phases of economic policy as well. So beside stepping on as many toes as the universal or most-favored-nation principle, the regional solutions have this difficulty, that it requires a close political cooperation and agreement on all these things, on which it is very hard to agree. Hence, I say that as a rule, the regional liberalization of trade is harder to achieve than a global multilateral nondiscriminatory liberalization of trade.

There are, of course, occasionally political forces which make it possible to overcome these difficulties. When the German zollverein was founded in the 19th century, the national enthusiasms swept away all of the economic difficulties and if the time comes for East and West Germany to be reunited, that will cause certain economic dislocations, but in that case we can be sure again that economic enthusiasm will simply override the economic difficulties, and I admit that in the case of European trade liberalization under EPU during the postwar period it was also possible to some extent to overcome these difficulties.

Now, in view of all that, let me ask the question, What should American policy be? To my mind, the American policy cannot be to prevent any foreign countries from entering into a customs union, or into an economic unification. If two or more countries want to get for themselves the same advantages which the United States derives from the fact that it has a large free-trade area, by doing away with internal barriers, the United States could not in good grace object to that; even though American interests, and I mean real American interest, not only special interests, will be hurt. If the rest of the world, or part of the rest of the world sets up such a discriminatory system, American interests may be hurt and the American interests as a whole, not only special interests offset by benefits to somebody else, but nevertheless I think the United States could not very well object if other countries wanted to do that.

On the other hand, I think it would be a great mistake for the United States to encourage other countries to enter into such discriminatory trading blocs because these trading blocs are likely to be trade diverting, rather than trade creating. That is, they would do no good to the countries concerned, while hurting at the same time the United States, and I think that is an important point which ought to be remembered: While hurting, at the same time other countries, apart from the United States. Take the European case, internal European unification and discrimination against the outside hurts not only the United States, but it also hurts a number of other countries which are not in such a good position as the United States to afford that. Let me mention Canada, Latin America, and especially Japan. Japan is an extremely important country. I will say a word about it in a minute, and any regional arrangement, say, within the sterling area or within Europe hurts Japan and they can afford it much less than the United States.

I think it would be much better for us to follow our traditional policy of general nondiscrimination, and to encourage other countries to go in the same direction. I do not deny that in Europe the policy of regional trade liberalization under EPU, the European Payments Union, and so forth, has had some success—perhaps great success, and that has implied discrimination against the United States, Japan, and other countries, but here my judgment is a little different from that of Mr. Cleveland. I think we can be very happy that the degree of discrimination in Europe against the United States, or against Canada and other dollar countries, has been greatly reduced. Imports from the United States are treated much more liberally now than they were 5 years ago. Many special restrictions on dollar imports have been reduced and eliminated. On the other hand, discrimination against Japan is still very strong in many parts of the world.

On the whole, the Europeans went forward in the direction of eliminating discrimination on their own initiative. Most Europeans regard the present arrangement as temporary, a way toward freer nondiscriminatory trade, more multilateral trade, and I think we should encourage them to go on in that direction.

Since they have gone pretty far in that direction, without encouragement on our part, I think they would go even faster if we gave some encouragement. For instance, because of the recent extension of the reciprocal trade agreement policy we could offer certain reduction in import duties on our part, if they went ahead, removing discrimination against us and against Japan, Canada, and other non-European countries.

On the question of regional trading blocs in other parts of the world, I am not going to say much because Professor Kindleberger covers that ground.

Let me just say that I entirely agree with him that the conditions for regional tariff arrangements and other regional trading blocs in other parts of the world are much less favorable in Europe. The Middle East—just think of Israel and Egypt. It seems unthinkable to put them in the same bloc. Similar political and economic cleavages exist there, in Latin America and exist in the Far East. I entirely agree with Professor Kindleberger, that whatever merit there was in European arrangement, there is none in the Far East, Middle East, or Latin America.

Let me say a word about Japan. Here again I can be brief because Professor Kindleberger covers that case. I entirely agree with him about that. It seems to me the Japanese problem is one of the most pressing ones. Japanese trade interests are worldwide. They do not fit into any regional arrangement. The problem must be solved on a global basis. Fortunately, progress has been made. Japanese exports to the United States, as well as to Europe, have increased, and have, of course, stepped on the toes of special American and British interests. But that cannot be helped unless we want Japan to seek trade outlets in China and Russia and to cease buying cotton and coal from us. We should continue to induce other countries to accord most-favored-nation treatment to Japan, and any idea of an Asian regional bloc to take care of the Japanese problem is just useless. That simply means passing the buck to somebody else.

Let me briefly summarize. I reach the conclusion that the regional approach to problems of world trade and payments is economically and politically unsound, and I say that great progress has been made in the direction of multilateral, global freer trade—not free trade, but freer trade—and, as Dr. Bernstein has pointed out the other day, many currencies have become near convertible, and that there is a good chance that full convertibility of the major currencies will be achieved in the near future. Therefore, I think it would be really too bad if the United States at that time, when success is in sight, if, at that time, we should drop our traditional policy and go in for regional arrangements.

If I say that global multilateral arrangement is better, it does, of course, not follow that every economic problem has to be solved literally on a global basis, that economic negotiations must be carried on by means of monster conferences, with every country in the world participating. That does not follow. It is the supreme virtue of the system of the most-favored-nation clause that you can have multilateral trade and at the same time bilateral negotiations or negotiations in manageable small groups. Moreover, it does not follow that there are not many special problems, ranging from fisheries, transportation, exchange of electric power, nuclear research, and so forth, which can best be solved by small groups of interested countries.

Professor Kindleberger has more to say on that problem, so that I will just say that these problems exist; for these special problems regional or very frequently bilateral arrangements are all that is needed, and that is compatible with the general principle of multilateralism and nondiscrimination.

I think that is all I have to say.

(The complete statement of Dr. Haberler is as follows:)

DEFECTS IN THE CONCEPT OF REGIONALISM TO SOLVE TRADING PROBLEMS

Statement by Gottfried Haberler to the Subcommittee on Foreign Economic Policy of the Joint Committee on the Economic Report

MULTILATERALISM, NONDISCRIMINATION, AND THE MOST-FAVORED-NATIONS CLAUSE

American foreign economic policy has always favored the principle of multilateral trade and nondiscrimination. Under the principles of multilateral trade, each country will buy its imports in the cheapest market and send its exports where it can get most for them. This evidently will maximize gains from trade for all participants.

This is closely related to the principle of nondiscrimination. In the area of tariff policy, nondiscrimination means that imports of any commodity should be taxed irrespective of where it comes from. These principles have been implemented by inserting so-called most-favored-nation clauses into all American trade agreements before and after the inception of the reciprocal trade-agreement policy in 1934. Under this clause no country can treat imports from the United States less favorable than imports from any other country.

MOST-FAVORED-NATION PRINCIPLE AND REGIONAL BLOCS

Regional trading blocs violate the most-favored-nation principle because they do precisely what the most-favored-nation clause forbids; under a regional trade arrangement imports into any member country from any other member country are treated more favorably than imports from the outside. Outsiders are discriminated in favor of insiders. The United States always looked with disfavor upon any such discriminatory arrangements—for example, upon the British Commonwealth preferences, a regime under which members of the British Commonwealth accord each other lower duties than are charged on imports from non-British countries.

EXCEPTIONS TO THE RULE OF NONDISCRIMINATION

Apart from such exceptions which were only suffered, there have always been others which were not only accepted as perfectly legitimate, but were even applauded or encouraged. The most important exception of this kind is the customs union.

CUSTOMS UNIONS VERSUS PREFERENTIAL TARIFF ARRANGEMENTS

By a complete customs union we mean an arrangement whereby two or more countries eliminate tariff and other trade barriers between themselves entirely, and agree on a common tariff against the outside. A customs union constitutes a higher degree of discrimination against outsiders than a preferential tariff regime, because under the customs union imports from other members are entirely duty free as compared with imports from the outside; while under the preferential tariff regime, imports from other members pay only less (usually 20 or 30 percent less) than imports from outside.

(Incomplete customs unions are customs unions under which imports from other members are not entirely duty free, but pay substantially reduced duties. Hence the difference between an incomplete customs union and a preferential regime is only one of degree.)

American official policy has been often criticized or even ridiculed for (*a*) approving and encouraging customs unions and (*b*) condemning tariff preferences. If tariff preferences are bad because they imply discrimination, then a customs union should be worse because it implies a higher degree of discrimination. A 10-percent preference is bad, a 50-percent preference is worse, a 90-percent preference still worse, but once it reaches 100 percent, as in the case of the customs union, the vice turns into a supreme virtue. Many economists and foreign negotiators at international conferences found it difficult to resist the temptation to point out this apparent contradiction. It can be shown, that a good case can be made on economic and political grounds for differentiating between customs unions and preferential tariff regimes.

ADVANTAGES OF CUSTOMS UNIONS OVER PREFERENTIAL TARIFF REGIMES

A customs union does away with all customs redtape, simplifies customs procedures, and creates a large free-trade area between the members of the union. It is a general, once-for-all, across-the-board elimination of barriers, and therefore likely to be definitive and stable. On the other hand, a preferential tariff regime, as for example the one existing between the members of the British Commonwealth, is in its nature selective. It does not do away with redtape, but rather makes it worse, because differential tariff treatment makes it necessary to ascertain the origin of imports. (Suppose country A imports raw materials and semifinished goods from B, and sells the finished product to C where it enjoys preferential treatment. How large must the value added in A be in order to be treated preferentially?)

Because preferences are not across-the-board, but selective, there is a strong tendency in each country to grant preferences only for those commodities, and to such an extent that the larger imports from the preferred area shut out cheaper imports from the outside and do not result in a net increase in total imports. In other words, preferences divert trade from cheaper to more expensive sources of supply, but do not create a larger volume of trade. They are likely to be trade diverting, while a customs union will always be to some extent, possibly to a large extent, trade creating. To give an example, under such a regime European wheat-importing countries will import less cheap wheat from the United States or Canada and more expensive wheat from France or Turkey. Such trade diversions are in the interest of high-cost producers in preferred areas, but they do not benefit the consumer in the importing area, and they reduce government revenue in the importing country. Moreover, they do not hurt the competing producers in the importing country. This is, of course, the reason why selective duty reductions under preferential tariff regimes are rarely allowed to be trade creating. They are, in most cases, not steps in the direction of freer trade, but on the contrary are steps away from it; they make for a less favorable allocation of the world's productive resources because imports do not come from the cheapest sources available.

To summarize, the traditional American policy of favoring customs unions while objecting to preferential tariff arrangements is perfectly justified on economic grounds.

CUSTOMS UNIONS RARE AND UNLIKELY

Customs unions are very rare occurrences. The only modern example is Benelux, the union between Belgium, the Netherlands, and Luxembourg. It might also be mentioned that for those countries that have rigid exchange control, import quotas, state trading monopolies, and generally highly regimented and planned economies, a mere customs union would not accomplish very much. In order really to achieve the benefits of a larger economic area they would have to modify not only their tariffs but also do away with exchange control (payments restrictions) and quotas. In that case, we may speak of economic unions and economic unification or integration.

There are two sets of reasons why customs unions and economic unions are so difficult to achieve. First, they face the same difficulties as free trade or freer trade. Since customs unions like free trade (although to a lesser extent) create trade and lead to a greater volume of international exchange of goods and services, they cannot help but hurt special interests. After formulation of a customs union in each country, export industries will have to expand while those industries in which other members of the group have a large comparative advantage will suffer. (There will always be a third group where larger imports from other members of the union will only shut out imports from the outside without increasing the total volume of trade. This trade diversion will not hurt any special interests, but by the same token, not benefit the community.) To the extent then that a customs union creates trade, it runs into exactly the same kind of difficulties and may in the short run be exactly as painful to special interests as freer trade in general.

Secondly, however, a customs union, economic union, or any regional trading bloc runs into a second type of difficulty over and above those which it shares with generally freer trade: it requires agreement on a common tariff, and in the case of economic unions, agreement on a common policy with respect to payments restrictions and possibly other phases of monetary and economic policy.

It follows from this that usually a customs union or economic union, or a regional trading arrangement that really does any good and constitutes a step toward freer trade between the countries concerned (and is not confined to useless and uneconomic trade trade diversion) is even harder to achieve than a general nondiscriminatory reduction of trade barriers through the operation of the most-favored-nation clause. This is so because the regional solution, to the extent that it does any good at all, while stepping on as many toes of special interests as the nondiscriminatory, multilateral solution, requires in addition agreement on a common tariff and common economic policies which the multilateral solution does not.

There are, of course, occasionally special political forces powerful enough to overcome these difficulties. The German Zollverein is a case in point. Another one is Benelux. When the time comes for reunification of East and West Germany we may be sure that economic difficulties will be swept away by national enthusiasm. But I doubt whether there is anywhere in the world a comparable situation.

WHAT SHOULD BE AMERICAN POLICY?

In view of all this, what should be the attitude of American policy? If any two or more countries really want to create a large free-trade area in order to enjoy the same economic advantages which the United States derives from its large market, the United States could not, in good grace, object, although the creation of such a large trading bloc may—but by no means necessarily will—imply damage to American interests (not only damage to some special interests offset by benefits to others but net damage to the United States as a whole.)

On the other hand, it would be unwise for us to press other countries into discriminatory trading blocs. They are likely to be trade diverting instead of being trade creating. And let us not forget one thing: If, for example, we encourage Europe and the sterling area to adopt or persist in such policies, it will not only hurt us (without doing the European much good except in the unlikely case that they really proceed close to complete unification), but will also hurt other countries which can afford it much less than we because foreign trade for them is more important for them than for the United States. Japan, other Asian countries, and Latin American countries, for example, would be hurt by an exclusive regional trading bloc in Europe.

It will be much better for all concerned if we follow our traditional policy of general nondiscrimination and general lowering of tariffs and other trade barriers. Similarly, in the area of international payments the principle of general free convertibility as laid down in the charter for the International Monetary Fund should continue to guide United States foreign economic policy. In the trade area, as well as in the payments area, great progress has been made. It would be a pity to give up or to deemphasize the multilateral approach now when final success is near.

I would not deny that in Europe the policy of regional trade liberalization (implying though it does discrimination against the United States, Canada, Latin America, Japan, and others) has had some success, and has gone beyond trade diversion, creating additional trade between the European countries.

Fortunately, however, the discrimination against the United States, Canada, Latin America, has become progressively less severe because restrictions on imports from dollar countries have been reduced and currencies have become more freely convertible. (Discrimination against Japan is, however, still strong in many parts of the world.) This is to be welcomed not only from our point of view, but also from the European standpoint.

Since the European seem to be eager, on the whole, to go forward in this direction, it would be a mistake on our part to try to put the clock back. We should not induce them to increase discrimination against us, Latin America, Japan, etc., by making exclusive regional trade arrangements among themselves. What we should do is to encourage them to go forward on the way toward nondiscriminatory freer trade. Tariff concessions under the extended reciprocal trade agreement policy would be a suitable measure of encouragement. Since European countries have reduced discrimination against us on their own initiative, with little or no encouragement on our part, they surely would move faster in that direction if they did receive some encouragement.

In other parts of the world where there has been some talk of regional trade groupings, conditions are much less favorable than in Europe. This is true of the Far East, of Latin America, and the Middle East. Compared with Europe, countries in those regions are much less homogeneous, less disciplined financially, and there exist sharper political cleavages than in Europe. All this makes regional trade arrangements practically unworkable.

ECONOMIC PROBLEM OF JAPAN NOT AMENABLE TO REGIONAL SOLUTION

To make the Japanese economy viable and stable is one of the most pressing problems. Japanese trade interests are worldwide. They do not fit into any regional arrangement. The problem must be solved on a global basis. Fortunately, progress has already been made. Japanese exports to this country as well as to other parts of the world have increased sharply. This creates difficulties to American as well as British competitors of Japanese products. But that cannot be helped unless we want her to seek trade outlets in China and Russia, and to cease buying cotton and coal from us. We should continue to try to induce other countries to accord most-favored-nation treatment to Japan. But an Asian regional bloc is politically unworkable, economically unsound, and would not solve the Japanese economic problem.

REGIONAL APPROACH TO OTHER THAN TRADE AND PAYMENTS PROBLEMS

While I thus reach the conclusion that the regional approach to the problem of world trade and payments is economically and politically unsound, it does by no means follow that every economic problem must be solved on a literally global basis or by means of monster conferences. On the contrary, it is the supreme virtue of the most-favored-nation principle that trade negotiations can be bilateral or restricted to manageable groups without giving up the benefits of multilateral exchange.

Moreover, there are many special problems—fisheries, transportation, exchange of electric power, nuclear research, etc.—which can best be solved by a small group of interested countries. But these groups will usually not be the same; they will vary and overlap according to the nature of the problem.

Mr. Bolling. Our final witness this morning is Prof. Charles P. Kindleberger of the Massachusetts Institute of Technology. He has had wide experience in both the economic and political areas of international relations. In the Department of State, he was Chief of the Division of German and Austrian Affairs. He has been on the staff of the Bank of International Settlements, and the Federal Reserve Board. His writings include work in international trade theory, the dollar shortage problem, and international capital movements. Dr. Kindleberger is going to help us assess the merits of various regional trading blocs, including ones for Latin America and the Far East.

Professor Kindleberger.

STATEMENT OF DR. CHARLES P. KINDLEBERGER, PROFESSOR OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Dr. KINDLEBERGER. Thank you, Mr. Chairman.

I am going I think, to agree with Mr. Cleveland that the regional approach has been very useful to trade payments in Europe, agree with Professor Haberler that it should not be elevated to a principle and simply suggest that what will suffice as an ad hoc arrangement useful in particular circumstances should not be generalized. Economists have the weakness, I am afraid, of taking some device that works well in one minor context, or even major context, and saying we will apply this everywhere. My view would be that the regional approach should not be applied in Japan, and should not be applied in Asia, despite its undoubted successes in Europe.

It should also not be applied in Latin America. A regional approach is necessary in the nature of many problems. Professor Haberler mentioned inland transport and fisheries. Many heavy commodities move very little in transoceanic trade. Coal does to a certain extent. It is one of the rare exceptions, but there are others—electric power, rail transport, inland transport, which clearly fall in local areas. The success that Europe has had on a regional basis is, I think, not a result of the regional approach as such, elevated into a high principle, nor is it to my mind a function entirely of the moral community which has been so stressed by the Woodrow Wilson study group, which Mr. Cleveland participated in. It seems to me it is a function of structure. This has been mentioned already, but in my paper I cite some numbers to support this view. European countries on the whole buy half their exports and imports from each other. This has been going on for a long time. If you take Western Europe, aside from Britain, the figure is much higher. Britain, of course, has extended trade with the sterling area. Its position in Europe is very ambiguous, because it is partly in Europe and partly out of Europe. Britain will agree to no regional solution which is solely European. Britain has to have solutions to her trade problems straddled between the sterling area, on the one hand, and Europe, on the other.

Other countries like Germany, however, sold, say, 75 percent of their exports to Europe and bought only 50 percent of their imports in Europe. In the twenties, they occupied a peculiar position in which they had to have multilateral trade, one in which any attempt to impose the bilateral balance, which the EPU does in principle, would impose a burden on them. It is fortunate, I think, that Germany's participation in EPU happened to coincide with a very considerable expansion in armament and capital equipment demand in Europe and a cutting down of their requirements for raw materials overseas, so that they were able to come more nearly into balance.

Let me make this point more clear, if I can: The European Payments Union was a great success in reversing the spiraling decline in trade, which had taken place in Europe. Each country in Europe had been attempting to cut down its imports from its European partners in order to acquire dollars to spend in the United States. This particular process was self-cumulative. The great benefit of the European Payments Union is that it meant that there was a discouragement to try to export to a maximum in Europe and encouragement to import which left these countries in a much better position to expand trade in nonessential goods. If we elevate this very convenient ad hoc device into a principle, it implies that each country in Europe is going to have balanced trade in Europe, that is, its exports and imports in Europe must be balanced, and exports and imports outside of Europe must be balanced. This would make it difficult for those countries such as Germany, which by the structure of their trade typically sold more in Europe and bought more outside. The fact of the matter is however, that if you throw the sterling area into the European bloc, you obviate a lot of this. We tend to think of the European bloc as a regional one, whereas if you take note of the fact that the dependent overseas areas of Belgium and France, and the colonial parts of the sterling area and the dominions are part of it, it really is a world trading bloc, without the heavy preponderantly regional impact which is implied.

I would say first that the success of the regional approach in Europe is undoubted but that this view must be qualified since the approach is not as regional as it appears. Second, I would like to indicate that the liberalization movement in Europe has not gone so far as we tend to think it has, since it has applied almost entirely to quotas. There has been almost no reduction in tariffs. There are many commodities such as automobiles and bicycles, where the European markets remain sharply divided. You will see only French automobiles in France, only German automobiles in Germany, and only British automobiles in Britain. It is only in a very few markets which produce none of their own automobiles, like Switzerland, Belgium, and Denmark, that you will see cars of all three countries, and an occasional American car as well being driven on the streets. This is a long way from a customs union.

Let me go on to say, however, that the structure of trade of Latin America and of the Far East is just altogether different from that in Europe. The southern group of countries in Latin America, like Argentina, Uruguay, Paraguay, have more than half their exports go to Europe, and another substantial bloc of their exports come to North America. Their trade with each other, or the trade with all other countries in the world beside United States and Europe, which includes their trade with each other, has gradually risen from 10 percent in 1913 to 15 percent today. This is altogether different from the 50 to 75 percent of trade in the regional bloc, which takes place in Europe.

The same would be almost equally true of two other groups of countries; Brazil, Colombia, Cuba, Ecuador, are more nearly balanced between Europe and the United States but have only 14 percent of their trade with all other countries. And finally Chile, Mexico, Peru, and Bolivia, the mining countries, have as much as 18 percent with all others, including themselves.

Again, these countries don't import much from each other. They import from the United States and from Europe. There isn't any basic regional trading bloc in which they give great preference to each other there, in my judgment.

If you move over to Asia, the same thing is true, but to a less degree. Here the exports of the countries of a certain group of selected Asian countries, India, Pakistan, Ceylon, Indonesia, Thailand, Philippines, and Hong Kong, is 35 percent in Asia, but it is 20 percent with the United States and 30 percent with Europe. This is not quite as sharp a case as in the case of Latin America. It still raises very considerable questions as to whether they have enough trade with each other to warrant the creation of a special trading bloc in the area.

One of the preferences which we have allowed in principle—and this was worked out in the defunct draft charter to the International Trade Organization, was that where countries were engaged in a program of economic development they should be allowed to discriminate in favor of each other in particular commodities.

Suppose a country engaged in economic development was planning to start a steel mill. If its neighbors wanted to give it free preference in this field, that is, to make imports of steel from this country free, we would regard this as an appropriate exception to the most-favored-nation clause in the sense which the executive branch agreed to but the Congress never agreed in the draft charter of the International Trade Organization.

This was an exception, very much sought after by the Arab League, in particular, and by underdeveloped countries in general, but it has remained almost entirely a dead letter. The Arab League, itself, happens to be an area in which each country has its own oil refinery. It is a small oil refinery, it is an uneconomic oil refinery, but each one has its own. The planning of this kind of investment has not taken place there at all. I know of no other cases where this particular exception has been used.

Senator FLANDERS. Excuse me a moment.

What are those two countries with small oil refineries?

Dr. KINDLEBERGER. I say, almost every one, Syria, Lebanon, Saudi Arabia has a big one, Iraq a big one, Iran a little one. All of these countries are unwilling to use say the big Abadan refinery, but insist on having their small uneconomic refineries.

My view would be that while economically one can justify this exception to the most-favored-nation clause, politically, it may be almost impossible to get agreement. Each country is perfectly willing to accept preferences in other markets for its own product, but when it comes time to give a preference in its own market to its neighboring countries on a regional basis, it finds it extremely difficult to find something which it hadn't really prepared to go into itself all along, so that I am afraid I find difficulty in thinking this is a very fruitful way to proceed.

Certainly Latin America is still interested in this view. The Asian countries which are represented in the Economic Commission for Asia and the Far East, talk as if they had hoped to make progress in this line, but steps that seem to be taken appear to be backward steps, rather than forward steps.

Now, let me take a moment to talk about the Japanese case, because this is one which is very troublesome and pressing today. The Japanese are very much interested in what a regional approach may do. The Japanese put forward in the Economic Commission for Asia and the Far East a plan for an Asian Payments Union. The details of this particular plan are not known to me. The only reference I have seen to it in the American press is the mention in a story from Manila that it has been abandoned. It seems clear however, that what they wanted was not really the equivalent of the EPU as we know it in

Europe, but a way to bail themselves out of frozen balances which they have in certain countries of that area. This would mean that the other countries would be treated not in a self-balancing mechanism where one month they would have a surplus, one month a deficit, the way most countries in Europe have worked out, but as the persistent debtor countries were; Turkey, you will recall, was a persistent debtor in the European Payments Union, and its deficits in Europe were covered by grants of the United States of America.

Greece was another such persistent debtor. For the first couple of years, before its magnificent recovery, Austria was also a persistent debtor. In all these cases the United States was obliged to find some means outside the Payments Union to finance the surpluses of other countries of Europe with these presistent debtors.

This is what Japan wanted, obviously; not a self-balancing mechanism, but a way in which they could get convertibility for frozen Indonesian currency or frozen Burmese currency, to give examples. One of the difficulties in this trade is that they haven't made reparations settlements with all these countries yet. The Burmese reparations settlement has just been concluded, and it is hoped that Burmese trade with Japan will expand, and particularly that it will expand its exports to Japan. Up until recently the Burmese have been holding back quite naturally because they thought possibly their reparations settlements would be better if they had a big debt which they owed Japan. The Indonesian reparation settlement is disturbing to Indonesian-Japanese trade in this same way.

At the single conference last May the United States put forth a proposal which said that $200 million voted by Congress in the form of aid would be given to these areas if they could agree on a method of dividing it.

Now, here, again, I am not fully aware of what happened from my reading of the American press. I gather that the Japanese were very anxious that some arrangement would be made. They had the view that the way this could be used would be much like the offshore purchases by which certain grants of aid to Europe by the United States were made. You will recall that Canada, for example, benefited from the fact that aid was made available to England to pay its debts in Canada, or to pay for current imports from Canada. The expression was coined in the State Department, about which there is still some debate, that the dollars did twice the work. They helped Britain and helped Canada. Some people think that is rather a Madison Avenue way of expressing it, but, in any event, it was used.

The Japanese, of course, would like very much that we would, say, give aid to India, which would then spend the dollars in Japan, and this would help Japan balance its payments.

The difficulty was, however, that $200 million seemed to be not enough to take care of all the needs of these areas, and that when it came time to divide it they could not agree. They simply did not have the basis for it politically—the basis which Mr. Cleveland mentioned did exist in Europe. I think I ought to say that one of the major acts of effective cooperation in Europe was its willingness, politically, its capacity to agree to divide aid. The smaller countries in Asia, as the others have said "We don't want to be told that we have to give up a share of American aid for the greater Asian good";

they were rather skeptical that India and Japan would get the most of it.

Congress has since cut that $200 million down to $100 million. This is a case where it has cost these countries to disagree, but the fact of the matter was they could not agree, and were not able to adopt a regional solution to this.

The other point I want to make is that the Woodrow Wilson study group suggested that the regional approach to Japan, balance payments problem, was to include Japan in Atlantic Trade and Payments Committee. I have a hard time seeing that Japan touches the Atlantic in any way, and I have a hard time seeing that it shares the traditions and history of the Atlantic community. This of course, wasn't their reason for putting it in this area. What they really said was that the political importance of a solution to the Japanese economic problem, and the great difficulties of solving it, mean that we have to solve it on a nondiscriminatory basis. This would argue to me for a multilateral approach rather than a regional approach, and to say that the regional approach to Japan's problem is followed by tucking it into a European group seems to me to be wrong. I am afraid that some people in the United States who think of a regional approach to Japan's problem really are very much worried about Japanese imports to this country. They rather hope this problem can be solved somewhere else, we do not have to worry about it, push it under the rug, let the Asians handle this problem and adopt the regional approach.

I think this is a remedy we cannot in conscience adopt. It is not true that Japan's problems arise from the Chinese blockade. The development of Red China would seem to me to be such that even if there were no blockade Japan would not be able to trade on traditional lines with China because the goods would be used by China rather than available to Japan. Japan must buy more from the United States in the way of coal, it must buy cotton from the United States, and its problem must be solved, it seems to me, on a universal basis. I think the United States is perfectly right in insisting in the General Agreement on Tariffs and Trade for most-favored-nation treatment of Japan, and to push the British and the Belgians and the Dutch to give her most-favored-nation treatment.

At the same time, I think in approaching the Asian problems of economic development we should be more ready to allow countries whom we are aiding in the East to spend dollars in Japan.

I was out of the country at the time when the big furor occurred about the International Bank loan to India to buy locomotives, in which it turned out that dollars were being lent to India to buy locomotives from Japan. I do not know exactly where all the opposition came from, to what extent it came from the Congress as well as from the press, but I do know that it ended up with a new loan, or that loan was canceled and a new loan was made, and some of the dollars were spent on higher cost locomotives from the United States, as well as less expensive locomotives from Japan.

I would argue in this case that there are things which we are doing in the region which can be used to help solve the Japanese problem, but I do not regard this as an exclusively regional approach. This seems to me to be an ad hoc approach, and that in general what one would say, that every possible means, country by country, regional and multilateral, should be adopted here.

What one must be careful about, it seems to me, is elevating a regional, a practical regional device, into a theoretical system, which commits us to a kind of foreign policy which in many situations is unworkable.

Mr. BOLLING. Thank you.

(Dr. Kindleberger's complete statement is as follows:)

THE REGIONAL APPROACH TO UNITED STATES ECONOMIC FOREIGN POLICY

Statement of Charles P. Kindleberger, professor of economics, Massachusetts Institute of Technology

With the adoption of the Economic Cooperation Act of 1948, the Congress of the United States moved some distance away from the multilateral approach to economic foreign policy of the United States, embodied in the Bretton Woods Agreement and in the policies of the executive branch of the Government up to that time, and toward a regional program. It is sometimes now suggested that the regional approach be adopted generally by this country for foreign economic problems, in place of a multilateral one, and that, in particular, the difficult issues in Southeast Asia of trade and payments on the one hand, and economic development on the other, be treated regionally. In the writer's view, the question of regionalism and multilateralism cannot be sharply opposed as clear-cut alternatives. A regional approach is appropriate to some problems, but not to others; again, the same problem can be solved on a regional basis in some parts of the world, but not in others; and, finally, some problems, such as economic development, require a whole battery of approaches, country-by-country, regional and global at the same time. The most effective regional approach anywhere is one which leads ultimately to a multilateral solution, i. e., in which the regional trappings of the solution are headed for discard. Moreover, in many areas, the regional approach is a blind alley, certain to produce confusion, frustration, and setback. In particular, the attempt to solve the trade and payments problems of Japan in a regional setting, or of promoting Asian and Latin American development along exclusively regional lines, would seem to be misguided.

REGIONAL APPROACH EFFECTIVE IN MANY AD HOC PROBLEMS

It is a misreading of history to believe that the regional approach to foreign economic issues began with the introduction of the European recovery program, or even the Anglo-American Financial Agreement of 1946. A wide variety of problems of United States economic foreign policy have been, are, and will be settled with a small group of countries located in a region. Defense problems are largely local in character in Europe, the Middle East, among the American states, or in Southeast Asia, and with them is the economic issue of sharing the burdents of defense. But a variety of ecoonmic questions have a preponderantly regional basis, usually because of physical restrictions on the transportability of goods and services or other spatial limitation of demand or supply. Inland transport, the fisheries of the Great Lakes, the allocation of coal in Europe or of rice in Southeast Asia, plant quarantine in the British West Indies, are all problems which are important within, and of little interest beyond limited areas. Occasionally, a problem is preponderantly regional, but has significant implications for one or more countries as a considerable distance, which explains the participation of the United States in European, Latin American, and Asian economic bodies. Apart from the general interest in the area's well-being, it may be, for example, that part of the coal being allocated in London and Geneva and of rice in Singapore is of United States origin.

SUCCESS OF REGIONAL APPROACH TO PROBLEM OF EUROPEAN RECONSTRUCTION, AND ESPECIALLY TRADE AND PAYMENTS

The widest development of regional institutions has been in Western Europe, where success has been achieved in cooperation for economic reconstruction. A considerable number of international economic institutions has been developed: the Economic Commission for Europe (ECE), which was created in 1947 out of the ad hoc reconstruction organs, such as the European Coal Organization

(ECO), European Central Inland Transport Organization (ECITO), and the Emergency Economic Committee for Europe (EECE); the Organization for European Economic Cooperation (OEEC), established to administer the European Recovery Program under the Economic Cooperation Act of 1948; the European Payments Union (EPU), created to effect a multilateralization of payments among the OEEC countries; the European Coal and Steel Community (ECSC), which was organized as a supranational body to direct the coal and steel industries of six European countries etc. More, these organizations have been successful. The ECE, with a representation including Eastern as well as Western Europe, has perhaps had only limited achievement in intergovernmental decision making. But the OEEC has divided United States aid to European economic recovery, reduced barriers to trade within Europe, corrected, through EPU and its predecessor schemes, a tendency for intra-European payments to contract as the separate countries all sought to earn dollars from each other. In addition, the OEEC, the managing board of the EPU, and the Bank for International Settlements have provided a mechanism for a certain amount of coordination of monetary and fiscal policies among European countries. The ECSC has made a start of increasing intra-European trade in coal and steel by eliminating price and transport rates, discrimination within the area, and moving toward an equalization of taxes.

EXTENT OF EUROPEAN SUCCESS WITH REGIONAL APPROACH

These successes are impressive, but they have their limits. The most difficult task which the OEEC attempted was that of dividing United States aid, since this involved the greatest submission of national sovereignties to the common interest. The inherent difficulty of such division was enhanced by the perverseness of the incentives involved: the countries which recovered the most received the least aid, while those which were most ineffective in recovery thereby enlarged their claim for help. After two painful annual divisions, the OEEC chose to apply the percentages of aid in the previous year to whatever annual aid might be forthcoming from the United States.

The OEEC has produced no common investment plans, such as are now being advocated for underdeveloped areas, except in the oil-refining industry where too much capacity has been built for Western Europe's short-term needs. It has not succeeded in its original ambitious plan for creating a Western European customs union, and even the partial customs unions, such as those between France and Italy, or among the Scandinavian countries and the United Kingdom, have been abandoned, except for Benelux. This last heroic attempt to carry out a wartime promise is still unfulfilled. Even if it should be realized after the obstacles of disparate monetary and fiscal policies, differences in taxation and the stubborn comparative inefficiency of the Belgian farmer as compared to the Dutch have successively been settled, there may well be a question whether the results justify the investment of so much expert and political effort.

Trade liberalization in Europe, now being reextended from 75 to 90 percent, after recent setbacks, has been an important contribution to European recovery. It remains, however, short of an internal free-trade ideal. What is liberalized, of course, is quota restriction, not tariffs, and, even if all quotas are eliminated in, say, automobiles or bicycles, the high tariff barriers which limit European competition in automobile exports to a few small markets like Switzerland, the Low Countries, and Scandinavian would remain. Moreover, liberalization has made no substantial progress in agriculture, where, in Europe as in the United States, tariffs are generally believed to require the support of quantitative restrictions.

Western Europe's success in regulating its payments, though negative, is impressive. Immediately after the war, each country of Europe attempted to earn dollars from its neighbors by restricting imports whilst expanding exports. The EPU and its predecessor organizations built back this trade to higher levels than before by limiting the amount of dollars which could be earned in intra-European trade, and restoring the incentives to trade.

If a country exports more to the EPU region than it imports from it, it must extend credit to EPU, which is a penalty. Thus there is inherent in the organization of EPU encouragement to countries to balance their trade within the area. If its trade within the region is balanced, and overall trade balance is achieved by a country, this means that the country must have balanced trade outside the region. Any necessity to balance separately within and without the region is contrary to the principles of multilateral trade. Germany, for example, in 1913 sold 76 percent of its exports to European countries, but bought only 55 of its imports from the Continent. In 1928, the percentages were 66 for exports, and 47 for imports. Prior to the depression, the world's multilateral trading system made it possible for some countries to earn surpluses on trade in Europe to pay for deficits in trade outside, whereas other countries, such as the United Kingdom and the Netherlands in this early period, had deficits in Europe and surpluses in trade with overseas areas.

The theory underlying a regional payments scheme is thus opposed to the widest possible world specialization and exchange. In the case of EPU, this theoretical weakness was in practice limited since EPU was strictly not a regional payments scheme at all. The payments scheme included the sterling area as a whole, rather than simply the United Kingdom and also the dependent overseas territories of other European countries. It was possible to earn sterling, French francs, and guilders by exports to EPU countries and use them for imports from overseas. Nonetheless, each country and its currency area was expected to earn outside Europe, or acquire as aid, the currencies it needed for imports from North and Latin America and other overseas currencies such as the yen.

It is still early to evaluate the ECSC as an instrument of regional economic policy. It has met every test thus far, but it may be said that the severe ones are still ahead. A critical period will be faced when the time comes to expose Belgian coal and Italian steel to European competition. Another would be posed by the necessity to redirect the community's investment resources in response to changes in the monetary, fiscal, wage or exchange policies of a member.

It is difficult to decide how much Europe is prepared to build on the example of the ECSC. The European Defense Community, which followed logically as a supranational example from it, was abandoned by France, the land of its intellectual parentage. New proposals are forthcoming regularly for further functional integration in power, transport, and most recently atomic energy. Iron, steel, power, and transport clearly lend themselves to regional treatment because of their great weight which limits intercontinental trade in these commodities to small proportions of total trade. But European countries seem likely to weigh the national advantage and disadvantages inherent in any proposal carefully, and since any scheme must have net disadvantages for some country, the prospects for large-scale expansion of functional integration seem dim.

BASIS FOR REGIONAL APPROACH IN EUROPE

Before examining the extent to which the regional approach is applicable in other parts of the world, it may be well to examine its basis in Europe. Much has been made in recent writing, particularly in W. Y. Elliott, ed., The Political Economy of American Foreign Policy (New York, Holt, 1955), to which Mr. Cleveland contributed, of the "moral basis of community," which underlies a regional approach. This factor, on which I want to comment again later, may play a role, but surely the structure of the economies, which is key here, is not necessarily regional in character. Parenthetically it may be added that the sterling-area system, the discriminatory features of which the United States has continuously opposed, is based partly on a moral community between the Dominions and Britain, partly on political ties between Britain and the colonies, and partly on the structure of trade. The arguments which the Elliott study group use would justify the increase of preferences under the Ottawa system, which it is the purpose of United States commercial policy to eliminate. And here moral community is unrelated to regional location.

The important thing about the regional approach to Europe is that the countries of Europe are so deeply involved in each other's economic affairs. Table I shows the extent of this interdependence. More than half of Europe's trade is internal. In addition, the dependence of the smaller countries on European trade is greater than that of the larger. The United Kingdom's position vis-a-vis Europe has always been ambivalent, and in 1950 only 30 percent of exports and 28 percent of imports, respectively, were directed to and bought from Europe. The table also underlines the point already made that many countries of Europe have in the past exported more to Europe than they have bought.

This relationship can be expressed in another way. Frequent attention has been drawn to the fact that much of European income is derived from exports and spent on imports, in contrast to the United States where foreign trade is very small in relation to national income. It is true that the percentage of exports to national income is much higher in the separate countries of Europe than the 5 percent figure in the United States. But if trade of European countries with each other is eliminated, the percentage of "foreign" trade to national income is sharply reduced, as table 2 shows. Scarcity of data limit the estimates to the eight countries of "Industrial Europe." If it were possible to extend it to include agricultural parts of Europe, such as Eire and Denmark, the ratio of exports overseas to income would be somewhat further reduced.

APPLICABILITY OF REGIONAL POLICIES ELSEWHERE

The same basis of intense regional trade exists neither in Latin America nor in Asia. In Latin America, some countries export more to Europe, some more to the United States, but in no group of countries is trade with any other part of the world, including Latin America, of great importance. This is indicated in table 3, where, unfortunately, the most accessible source has given the data for exports and imports on dissimilar bases.

Asian trade is somewhat less strongly oriented overseas, as table 4 indicates. Here roughly a third of exports and imports go to and come from the region. But half of exports and imports go to and come from the United States and Europe. The trade problems of the area are largely world, not regional problems.

TABLE 1.—*Percentages of European exports and imports in intra-European and overseas trade*

Country	Year	Intra-European trade		Overseas trade	
		Exports	Imports	Exports	Imports
United Kingdom, Germany, France	1913	52	41	48	59
	1928	52	42	48	53
	1938	49	37	51	63
	1950	42	35	58	65
Italy, Belgium-Luxembourg, Netherlands, Switzerland, Sweden.	1913	71	59	29	41
	1928	69	61	31	39
	1938	66	63	34	37
	1950	66	55	34	45
All other European countries, excluding U. S. S. R.	1913	80	70	20	30
	1928	86	76	14	24
	1938	84	75	16	25
	1950	65	59	35	41
Total, Europe	1913	60	49	[1] 40	[2] 51
	1928	63	54	[1] 37	[2] 46
	1938	61	50	[1] 39	[2] 50
	1950	53	56	[1] 47	[2] 44

[1] Of which exports to:

	U. S. S. R.	United States	Canada	Latin American Republics	Overseas sterling area	Dependent overseas territories	Other overseas countries
1913	4	6	2	8	11	4	6
1928	2	6	2	6	11	4	5
1938	2	5	2	7	11	5	7
1950	4	6	2	7	15	8	5

[2] Of which imports from:

	U. S. S. R.	United States	Canada	Latin American Republics	Overseas sterling area	Dependent overseas territories	Other overseas countries
1913	7	14	2	9	11	3	4
1928	2	13	3	10	10	4	4
1938	2	11	4	8	13	7	5
1950	4	11	3	7	15	8	6

Source: Ingvar Svennilson, Growth and Stagnation in the European Economy, United Nations, Geneva, 1954, tables 49–52, pp. 171–177.

TABLE 2.—*Industrial European ratios of exports to national products, selected years*

[In percent. In real terms, i. e., exports and national product both deflated by price series based on 1913 as 100]

Year	United Kingdom	Germany	France	Italy	Netherlands	Belgium	Sweden	Switzerland	Industrial Europe
1913	22	20	20	13	50	55	24	46	12
1928	15	17	26	18	33	61	19	21	11
1938	8	8	10	14	26	37	15	14	7
1952	16	15	19	15	45	38	17	18	11

Source: Calculated by the writer from trade returns and a wide variety of sources for price series and national income.

I have not seen an announcement of the proposal to create an Asian Payments Union, on the analogy with the European Payments Union, and no details of the proposed scheme have come to my attention. It is not surprising, however, to read in the press of its abandonment.[1] The EPU pattern fits Asia badly: there is neither the basis of a vigorous area trade nor the pattern of its decline. India, Pakistan, Burma, Ceylon, and Malaya belong to the sterling area. The Philippines has its special relations to the dollar area, and Indonesia its particular arrangements with the Dutch payments system. Japan has had special payments problems largely in dollars, but partly in sterling, but its payments problems within the area have often reflected mere inability to collect from countries with overall deficits. It would be possible for the United States to assist Japan by converting these frozen surpluses into dollars. Similarly, Britain could be of assistance by agreeing to make the sterling in these accounts convertible, or the Netherlands, by accepting Indonesian currency in exchange for dollars or sterling. But this is not a regional payments scheme. It is financing from the outside to unfreeze bilateral balances. And like much else that is useful in foreign economic policy, it costs money.

The question of systematic removal of quotas within the region hardly arises, since intra-area trade is held down not by quota restrictions, but by lack of supply. This is not true in all cases, as for example, textiles and recently rice in Asia. In the main, however, trade liberalization on an area basis applies only to Europe.

TABLE 3.—*Percentage distribution of Latin American trade by destination and origin*

EXPORTS

Country	Year	United States	Europe	All other
Argentina, Uruguay, Paraguay	1913	5	85	10
	1928	8	79	13
	1937	13	77	10
	1949	13	62	15
Brazil, Colombia, Cuba, Ecuador	1913	48	43	9
	1928	58	30	12
	1937	52	36	12
	1949	59	27	14
Chile, Mexico, Peru, Bolivia	1913	43	53	4
	1923	46	40	14
	1937	35	42	23
	1949	60	22	18
Venezuela [1]				

[1] Data not comparable.

[1] Sterling Trade Urged in Manila, New York Times, September 24, 1955.

TABLE 3.—*Percentage distribution of Latin American trade by destination and origin*—Continued

IMPORTS

Country	Year	United States	Europe	All other
Argentina, Brazil, Chile, Peru, Uruguay	1913	16	74	10
	1928	27	56	17
	1949	33	41	23
Colombia, Cuba, Mexico, Venezuela	1913	49	39	12
	1928	58	32	10
	1949	80	11	9
Total	1913	23	66	11
	1928	36	49	15
	1949	51	29	20

Source: United Nations: A Study of Trade Between Latin America and Europe, Geneva, January 1953, pp. 18, 45.

TABLE 4.—*Percentage distribution of trade of selected Asian countries,*[1] *by destination and origin*

EXPORTS

Year	United States	Europe	Japan	Other ECAFE[2]	Other
1928	19	36	6	30	9
1938	18	40	6	23	13
1952	20	28	6	29	17
IMPORTS					
1928	9	43	6	36	6
1938	12	40	9	30	9
1952	19	31	9	25	16

[1] India, Pakistan, Ceylon, Burma, Malaya, Indonesia, Indochina, Thailand, Philippines, Hong Kong.
[2] Countries members of the Economic Commission for Asia and the Far East.

Source: Calculated from appendix, table I, United Nations, A Study of Trade Between Asia and Europe, Geneva, November 1953, p. 127.

The proposal is frequently put forward that regional preferences should be permitted in particular products in which one or more countries in a region are getting an industry started. Under the draft charter of the International Trade Organization, which has been rejected, preferences for countries engaged in development were an exception to most-favored-nation treatment, along with customs union. Similar exceptions have been urged recently by the Economic Commission for Latin America (ECLA) in a United Nations study of International Cooperation in a Latin American Development Policy (New York, 1954). The rationale for these proposals is that separate national markets are too small to enable an individual country to operate a new industry at an efficient scale of output. If it were able to sell without tariff interference in the markets of several neighboring countries, all of which were protected along with its home market against competition from industrialized countries, its chances of success would be increased, as would those of the other countries in other lines on which it had granted preferences.

Whatever the economic merits of the case, there seems little likelihood of its getting an adequate test because of its political weakness. All developing countries are prepared to accept concessions in the markets of their neighbors; few are willing to give up rights in their own markets in exchange. In the Arab League, which fought hard for this exception to the principle of nondiscrimination in the conferences which drafted the provision of the charter of the International Trade Organization, each country now has its own small and relatively inefficient oil-refining industry. Rather than specializing Pakistan in jute and India in burlap, both countries after partition expanded investments in the missing stage of production to have an integrated industry within their borders. Developing countries as a rule have limited capacities to enter industry. In principle, they will be willing to give up their potential entry into several lines, in order to get assured markets in one; in practice, this calls for a longer view of the future than they are able to bring to bear.

This inability of developing countries to agree was dramatically illustrated last May at Simla, where a group of Asian countries failed to produce a recommendation as to how to divide $200 millions of aid offered by the United States, and therefore were unable to obtain it. The reasons for this disagreement are not entirely clear. For some purposes proposed at the conference, such as financing capital-equipment imports, commodity stabilization, or seasonal imbalances in Asian payments, the amount was too small. But for other ends, it was impossible to reach agreement. The press reported that Japan was eager to devise arrangements to share this fund, she would probably have been one of the principal beneficiaries—and India somewhat less so. The smaller nations, however, expressed fears that regional cooperation might involve "being told our needs must be subordinate to the greater Asian good. We are too far behind for that sort of thing." [2]

Finally, there has long been a strong demand for regional arrangements to assist in the provision of capital for economic development. In this hemisphere, there has been many proposals for an inter-American bank, to supplement the Export-Import Bank and the International Bank for Reconstruction and Development. In Southeast Asia, there is the Colombo plan, a loose-knit arrangement under which a number of countries starting with the members of the British Commonwealth in the area, but since extended to independent developing countries, locally and far-off potential contributors of aid, such as the United States and Canada, meet annually and discuss national plans for development. There is no central plan, nor any system for the provision of capital, which is all bilaterally arranged. There is, however, a very successful Colombo technical cooperation scheme, to parallel and supplement the bilateral technical-assistance scheme of the United States and the multilateral arrangements in this area of the United Nations.

I see no reason to bar or favor any approach to the provision of economic assistance to developing countries. To insist on the regional approach seems unnecessary, nor is there any reason to exclude it, to the extent that it can be helpful. There is point in emphasizing now the requirements of one area, such as Asia or the Middle East, and now the problems of another, but all avenues of assistance should be used—bilateral, regional, and multilateral. It does seem strained, however, to set up a series of regional development organizations, as the study group under the chairmanship of Professor Elliott recommends, and then to note that the regional economic-development group for Southeast Asia should include the members of the sterling area, the United States, the potential creditor countries of Europe, especially West Germany and France, so as to encompass within one group the industrial capital-exporting countries and the underdeveloped, primary-producing, capital-importing countries (op. cit., p. 259). If the sterling area, Western Europe and the United States are all included, the regional appproach would seem somewhat lost to view. I see no way in which this approach differs from a universal one with sectional subdivisions, such as the regional commissions under the Economic and Social Council of the United Nations, or the Europe-Africa-Australia, Western Hemisphere, and Asia-Middle East operating departments of the International Bank for Reconstruction and Development.

THE SPECIAL PROBLEM OF JAPAN

One of the more obdurate problems in trade reconstruction has been presented by Japan. Cut off from her large-scale trade with China, partly perhaps by blockade, but mainly by the unavailability of supplies of her normal imports from the area, feared by a number of countries of Southeast Asia which she once pressed into a greater East Asian coprosperity sphere, she has presented the problem until recently of a country with pressing needs for raw materials, but lacking markets. In recent months Japanese exports have been climbing rapidly, much of the increase taking place in the United States markets to the distress of textile and clothing manufactures. Proponents of regional cooperation, as will be understood, have sought to find regional means of solving this problem.

Not all regional solutions for the Japanese trade problem are identical. The study group headed by Prof. William Y. Elliott recommends that Japan be included in an Atlantic (and Pacific?) Trade and Payments Committee. This would be formed by the addition of the United States and Canada as full members to the existing OEEC. The proposals urge the broad basis of moral com-

[2] New York Times, May 13, 1955.

munity in the west as the basis for the Atlantic trade and payments group, but then justify Japanese membership in view of its unique foreign trade and payments problems and its military and political importance to the West (op. cit., p. 273).

The other approach is to include Japan in a regional arrangement in Asia, in which Japan exports manufactured articles, and especially capital equipment, to Southeast Asia and buys the primary products of the region. Press reports indicate that the Under Secretary of State, Mr. Herbert Hoover, Jr., and the International Cooperation Administrator, Mr. John B. Hollister, have urged a solution along these lines in their recent trip to Asian countries (e. g. Dulles Aide Sees Japan's Premier, New York Times, October 5, 1955).

I confess that I see no necessity to include Japan in any exclusive regional grouping, and would agree with both schools that Japan's talents and needs, cut off from China to the extent that they must be, should be employed to serve both West and East. Any assistance to economic development in Asia should contain provision to contribute to the solution of Japan's problems. At the same time we should go forward with reducing barriers to Japanese exports in Europe and in this country. It may be painful for certain industries in the United States to permit Japanese imports, but we can hardly cut them off, and insist on selling cotton and coal to that country, or remitting profits from United States industry there. Nor can we urge in the General Agreements on Tariffs and Trade, as the Department of State has done simultaneously with its representations in the East, that other countries, including Britain, Belgium, and the Netherlands, reverse their refusal under an escape clause to withhold most-favored-nation treatment from Japan, unless we ourselves treat Japan on this basis.

Japan's relations to the rest of Southeast Asia before World War II were like the relations of England, the Netherlands, and France to the other countries in Europe. A preponderance of Japanese exports and imports went to and came from Asia, as table 5 shows. Trade with Europe was small; trade with the United States, large primarily because of raw cotton among imports and silk, a declining export. But many of Japan's import requirements must be met in dollars—coal, steelmaking materials, cotton, and petroleum products—and there is no indication thus far that Japan can earn sufficient surpluses in southeast Asia to pay the United States and Europe for its imports from these areas, or that these surpluses, where they are earned, would be in acceptable exchange, such as convertible sterling or dollars acquired by these areas in trade with the West by loans. Thus far Japan has been enabled to meet its dollar requirements by disbursements of the United States Army and unofficial purchases of occupation troops. Since the close of the Korean war these have declined considerably. It will be remembered, moreover, that vigorous protest was raised in this country, I believe by the Congress as well as by the press, when the International Bank proposed to lend India dollars to be spent on locomotive equipment from Japan.

TABLE 5.—*Percentage distribution of Japan's foreign trade, by destination and origin*

Country	Exports			Imports		
	1923	1938	1953	1928	1938	1953
China (including Manchuria and Hong Kong)	28	46	5	21	24	2
India, Burma, Ceylon	7	7	6	13	8	5
Southeast Asia	6	7	33	9	9	20
Subtotal	41	60	44	43	41	27
United States	42	16	18	28	34	31
Europe	8	10	8	17	13	7
Other	9	14	30	12	12	35

In short, the Japanese trade and payments problem is a harsh one, given the presence of so many persons tightly packed in a limited area with limited resources. It is made worse by the difficulties of trade with China. It would be convenient for the United States to reduce its responsibilities in this matter, and its share of the reallocation of resources, by regarding the problem as a regional one to be solved elsewhere. The clearest indication, however, that it is a universal one, is that it can be regarded as an Asian or as an Atlantic problem. The case sharply illustrates the limitations of the regional approach. Japanese exports of producers' goods can be usefully sold in underdeveloped countries in Africa, Latin America, in fact all over the world, and not solely in Asia; this will mean Japanese competition in United States, British, and West German export markets. Moreover, producers' goods like ships and consumers' goods in the field of textiles, clothing, optical goods, etc., must be expected in the United States domestic market. The fact that Japan's trade is now balanced overall means that any considerable further expansion in exports is likely to have an inflationary impact, raise costs, and correct itself. Competition in some lines may push further, to be sure, and it is possible that Japan would run an export surplus for a considerable period of time, like Western Germany, to build up foreign exchange. In the Japanese case, however, this seems unlikely. But a sound development of Japanese trade would see a considerable development in both exports and imports, the latter of which is held down to a cruelly low level. In this expansion, it seems inevitable that Japanese exports to the United States must grow more than Japanese imports from this country.

PARTICIPATION IN REGIONAL GROUPINGS

The interest of the United States in Europe, the Middle East, the Western Hemisphere and Asia, together with the possibility that the regional solution to Japanese trade and payments problems may run in Atlantic or Pacific terms, suggests the difficulties of arranging country memberships in a regional approach to world economic policy. The problem is presented clearly in Europe. Membership in NATO, OEEC, EPU, ECSC, ECE is by no means consistent.

If the United States has an interest in participating in all major regional groupings, so will other creditor countries, and other major export countries. What about countries like Turkey which are located in one region, but have strong trade ties to others? What about intercontinental competition in primary products, as in wheat, tin, copper, cocoa?

In my judgment, the proposal to constitute an Atlantic Trade and Payments Committee of Western Europe, Canada, Japan and the United States, based on some "moral community" of western civilization, which is not shared by Latin America and Asia is dangerous as well as misguided. The notion that Japan with its very different traditions partakes of western culture is simply absurd. But to line up all the creditor and manufacturing countries in one bloc is to widen the gulf, apparent on a number of issues in the United Nations, between the "imperial" and "colonial" powers. United States interests are by no means identical with those of any other power, though they run somewhat closer perhaps with Canada, and with the United Kingdom than with other countries. But in many respects, they are close to other countries.

CONCLUSION

In practical terms, many problems of economic foreign policy present themselves for solution in regional terms. This is more true in Europe than elsewhere. In particular, the regional approach to trade and payments problems which has been fruitful in Europe is applicable neither in Latin America nor in Asia. While regional measures may expedite the solution of particular problems, there is no warrant for a decision on the part of the United States to adopt in principle a regional approach to problems of foreign economic policy.

Mr. BOLLING. At this time we always allow time for members of the panel and witnesses to comment on the statements made by the other witnesses.

Mr. Cleveland, shall I start with you?

Mr. CLEVELAND. Yes. Thank you, Mr. Chairman.

I think, as seems frequently to happen in gatherings of this kind, the differences melt down rather quickly. Perhaps that is because we are all reasonbale men, or perhaps simply because we are under a certain pressure to agree.

First of all, I agree wholly that regionalism is not a principle which can be applied abstractly and rigidly to every situation. In fact, I don't like the term "regionalism." It is a very inaccurate word. When we speak of Europe and the sterling area as a "region", we distort the meaning of the word, at least in its geographic sense. My view is simply that trading blocs which are less than universal seem to be a workable solution in the case of Europe and the sterling area for the problem of eliminating trade and payments quotas among these countries—that is, for making currencies convertible within the group. And I take it that both Dr. Kindleberger and Dr. Haberler agree, broadly speaking, that the European Payments Union and the sterling area have been useful in that respect.

Perhaps there is a difference between us, at least between myself and Dr. Haberler, in his feeling about the future of these groupings. My own guess is that the necessity for these arrangements, the sterling area and EPU, will continue for the indefinite future. His guess, I take it, is that the dollar shortage is tending to disappear, and that the need for discrimination against the dollar by the sterling area and the EPU on balance of payments grounds, at least, will evaporate in due course.

I wish I thought that. I don't.

There is also perhaps a little difference among us on the question of Japan. I must say I find that, of all the world's trading problems, Japan's is the most baffling. It seems to me obvious that what Japan needs is exactly the sort of thing that Western Europe and Britain have. That is, Japan needs a big trading area to operate in. If that trading area could be the whole world it would be great, but it seems to me that for the same reason that Britain and some of the continental countries need a degree of discrimination in order to protect themselves from the dollar problem, Japan, whose dollar problem is a great deal worse than that of any European country, probably needs the same kind of trading area to work in. Unfortunately, I don't see any real possibility of giving Japan that kind of a trading area.

There isn't, as Dr. Kindleberger said, the basis in political affinity and historical community, between Japan and the West to get the British, for example, to make any significant sacrifices in order to give the Japanese trading opportunities in the sterling area. It is just too difficult politically for a British Government to do.

On the other hand, I do not see any prospect of solving the Japanese problem within an Asiatic grouping. There just isn't the "economic space" in non-Communist Asia, and even if there were I think an Asian trading bloc led by Japan would raise very serious political problems for the United States. We should not forget the coprosperity sphere. Finally, I do not see any prospect of the Japanese problem being solved on the basis of trade with the United States. There aren't sufficient markets here for Japanese manufactured goods, even if the tariff were greatly reduced. And the tariff isn't going to be reduced that much.

So, as I say, I find Japan's trading problem a baffling dilemma. I suspect that the ad hoc solution of it will be continued United States extraordinary financial support of one kind or another, for the indefinite future—for as long as it is in our political interest to supply it.

Mr. Bolling. Dr. Haberler.

Dr. Haberler. If I may make a couple of remarks, I think the difference is one of optimism and pessimism. Professor Kindleberger and I agree that in Europe our policy was extremely successful, and it had this discriminatory feature, and I think Mr. Van Cleveland should be proud of that. He was one of the people among the administrators who engineered and supervised this policy, and I think he did really better there than he now admits because Europe is in a very good position, and is close to convertibility, and the dollar shortage, as far as Europe, has very largely disappeared.

Let me mention a figure which I read in Dr. Bernstein's testimony here before this subcommittee. Since 1950 the free world outside the United States, has added $10 billion to its stock of gold and dollars—$10 billion. Now, what kind of a dollar shortage is that, where in 5 years you add $10 billion? If the dollar shortage still exists it is anyhow on the way out.

I agree with Mr. Cleveland that full employment is a must, or near full employment, approximate full employment is a must nowadays in most countries, but I fail to see why that should be incompatible with multilateralism.

The Japanese problem is a difficult one. We all agree on that. And Mr. Cleveland says it would be nice if they had a trading area, an exclusive trading area, but he admits there is no such thing. Where should it be except, say, the Soviet bloc, and that we don't want, so the trading area for Japan should be the world, and, as I said, progress has been made, and Japanese exports have increased. Look to Germany. Germany was cut in half and lost all its eastern trade, and German exports are now larger than the exports of all of Germany before the war.

I don't see why it should not be possible for Japan to move also in that direction, and, in fact, they have gone in that direction, so I am much more optimistic in these respects. But I am a little more pessimistic in one respect, namely, the future of the sterling bloc. Don't forget, the sterling bloc consists of the independent countries, Australia, New Zealand, and so forth, Great Britain, and of colonial countries, British Malaya, Gold Coast, and it happens that the colonial countries were the ones who earned most dollars, while the independent sterling area, Australia, and New Zealand, spent more dollars than they earned.

The colonial countries, British Malaya and the Gold Coast, have been the large dollar earners for the sterling bloc, really on a very large scale, something like half a billion pound sterling over a few years. But these countries are nearing independence. I think it is just a matter of years that they will become semi-independent. They may remain, of course, in the British Commonwealth of Nations, but it is doubtful whether they will go on earning dollars for the Australians to spend, so I am a little less optimistic with respect to the future of the sterling area.

Mr. Cleveland, in effect, says:

> In order to go convertible, drastic deflationary action would be necessary and would probably lead to economic stagnation like that in Britain, France, and several other European countries in 1953 and 1954.

I think Mr. Cleveland is much too pessimistic here. There was no economic stagnation in Great Britain or France or any other European country in these years, certainly not in 1954, and currencies of these countries are near convertibility anyhow.

As Dr. Bernstein pointed out in his testimony, sterling is de facto convertible. At a slight discount of 1 percent you can convert sterling into dollars, and the same is true of all the major European currencies.

The German mark, the Dutch guilder, the Belgian franc, and even the French franc—exchange control is so leaky anyhow that you can take out as much money as you like, so legally, or illegally, all of these currencies are very close to convertibility, and I do not see why it should not be possible to make the last step and to convert this illegal or de facto convertibility into a full-fledged legal convertibility.

In view of all that I think we should not support regional blocs which would only hurt the countries which enter into these blocs. We should stick to our traditional policy, which just now is beginning to bear fruit.

Mr. BOLLING. Thank you.

Dr. Kindleberger.

Dr. KINDLEBERGER. My previous remarks had a practical tinge, and since this is, I take it, a kind of a seminar, I will retreat a little bit and make a couple of academic points, one on the dollar shortage and what its prospects are, and one on customs unions, addressing myself in the first place to Mr. Cleveland's remarks about dollar shortage, and then to Dr. Haberler's remarks about customs unions.

With respect to the dollar shortage, I find myself in an embarrassing position since 5 years ago I published a work on the subject, and I do not know quite how much I am committed to the views I had then. There is an echo effect, you know, which lingers on here, and you have some hesitation about disowning an intellectual child.

But I think I would say that I recognize the existence of persistent relative tendency to inflation in Europe, and in underdeveloped countries. When I say "relative inflation," I mean relative to the United States. In a world depression I think the United States would go deeper in depression, although it might not go very deep in the present situation. In a period of inflation I am clear that other countries inflate more than we do. This seems to me to put a consistent strain on balance of payments always in one direction.

There is this much to the dollar shortage view; in other words, I have a hard time seeing, although some people are beginning to contemplate the view, that we would at any time inflate much more than other countries. Any inflation in this country gets communicated to them through an increase in their exports.

Mr. BOLLING. Would you support that statement a little more with more detail?

Dr. KINDLEBERGER. Yes. Suppose we take the Korean boom of 1950 when we had a very sizable inflation of prices here. Other countries had a more sizable inflation. Our prices rose 15 percent. British rose 25, French rose 50. That is the kind of thing I had in mind.

Mr. BOLLING. On the downside?

Dr. KINDLEBERGER. On the downside if our prices came down 10 percent theirs might come down 2 percent. This would always work out in favor of our exports against theirs, and they might always have to keep some kind of controls, if only standby controls in being. They have to be ready to face this. They don't have to be ready particularly to face the problem of a big import surplus in the United States.

There is that much to it. At the same time I would say this: That the United States happens to be much more eager for defense expenditures at home and abroad than they are, and this is a big factor on the other side; that the United States is prepared, seems to be prepared today, and more eager to take a bigger share of the cost in France, the cost of equipping armies all over the world, a bigger share of bases in Africa, and the other places. This is working the other way. The net effect of this in the last 5 years has been that it has piled up reserves of gold and dollars in other countries, coupled with continued relaxation but existence of discrimination against the dollar.

I do not know whether this is a dollar-shortage view or not. It is a little of both, with two major factors working. I think it is very difficult to predict the outcome of these opposing forces.

Now, a word on customs union: Professor Haberler emphasizes, I think quite rightly, the political support which you find for customs union, but I think it is well to point out that in many cases an area within the customs union loses from it, and I would like to give historical examples which he didn't cite.

One is the South in the period up to the Civil War when it was part of the customs union in the North and was penalized by that. How large a role this economic cause had on the War Between the States I am not enough of a historian to speak to. The other case is one in which he addressed you but in somewhat different context, and that is Germany.

The impressive thing is that the division of Germany in two after World War II did not hurt Western Germany. The Germans were convinced that if they lost their breadbasket in Eastern Germany they would starve to death. This proved to be far from the case.

Professor Gerschenkron of Harvard's considered view is that Western Germany paid Eastern Germany a very heavy price in customs union, in the same way the South might have been said to pay the North in the United States. This is a very academic point, but it qualifies my enthusiasm for customs unions, which may be very considerably trade diverting, and where one party of the customs union may pay quite a heavy price. In Germany the fact that Western Germany had paid a heavy price is seen by the fact that they gained from this economic schism.

Mr. BOLLING. Are there further comments from the members of the panel of witnesses?

If not, Senator Flanders?

Senator FLANDERS. I take it that none of the three of you are supporting or even considering the creation of regional blocs, regional trade blocs, as a matter of principle. The only way any of you are willing to look at it at all is in specific cases.

That is right, isn't it?

Mr. CLEVELAND. Yes, sir.

Senator FLANDERS. There is no principle involved that any of you are willing to consider.

Now, starting with Mr. Cleveland, whom I did not have the opportunity of hearing, but whose testimony I have run over very rapidly, on page 4 you speak of, beginning with the first full paragraph of the European Payments Union grouping.

Mr. Chairman, I find myself repeating what I have at the other sessions, because the same thing has come up.

I was rash enough to make a statement before a group of Government officials, businessmen, and journalists from the NATO countries that I thought that Western Europe could do more for itself by a customs union than the United States could possibly do for it. In other words, it could establish its own mass market, and get the economic benefits of a mass market.

Now, I would like your reaction to that point of view.

Mr. CLEVELAND. Senator Flanders, I think I agree with you, but I think I would go further and say this: That a customs union in present circumstances in Western Europe would not have—well, it would have certainly a good deal of effect if it were really a solid customs union, that is, permanent, regarded by producers and buyers in all countries as something that would last. It would certainly have a very important effect on creating trade within Europe.

I think anyone would agree with that. I think almost any economist would agree with that.

Senator FLANDERS. I take it that such a union should include a uniform tariff policy with regard to the goods coming in from the outside?

Mr. CLEVELAND. That would certainly be necessary. Otherwise trade would pursue rather distorted channels. That is, for obvious reasons. If Germany had a low tariff, and France a high tariff on American imports, France would import American goods via Germany.

Senator FLANDERS. One of the interesting points that came out in the debate was that everybody there agreed that it was a grand thing, that they must be working toward it, but the difficulties in the way were defined in such a way that it seemed to me they were almost identical with the difficulties which American business and labor feels in freeing our flow of trade with Western Europe, and I called their attention to that fact and asked if they would have a little sympathy with us on that count.

Now, I want to get one thing clear in my mind, certainly for the record: Our reciprocal trade treaties have resulted in a very great decrease, on a statistical basis at least, from the Smoot-Hawley bill. When these reciprocal trade treaties go into effect, reducing our duties for this, that, and the other thing, and they are made under the most-favored-nations clause, do these favored nations themselves accept that rate and that cut between themselves?

Mr. CLEVELAND. I think I will pass that question to the expert, Senator, if I may.

Dr. HABERLER. The most favored——

Senator FLANDERS. We reduce the tariff on many goods to be imported into this country, we reduce the rate by 5 percent, we will say, as we are doing under the new law yearly for a limited period.

Now, do those nations, themselves, as between each other, become bound to give similar reductions, or is this really just between us and them but not with them and each other?

Dr. HABERLER. There are bilateral agreements between any pairs. If we make such a deal we reduce tariffs on certain imports, and that is then generalized to all imports from countries to which we accord most-favored-nation treatment, and if some of the other countries make bilateral treaties among themselves they reduce tariffs which by virtue of the most-favored-nation clause is then extended to imports from the United States.

Senator FLANDERS. If we grant a 5-percent advantage to Italy, and to Great Britain, for the same product, that does not mean that that advantage goes, or that change goes to Italy and Great Britain in their transactions with each other?

Dr. HABERLER. No.

Senator FLANDERS. In other words, we have a multilateral set of bilateral agreements.

Dr. HABERLER. Yes.

Senator FLANDERS. And so far as moving toward free trade in the world, it is channeled only through us, and not for the rest of the world?

Dr. KINDLEBERGER. I think it is fair to say that in exchange for the concessions we make to Italy they make concessions to us which they generalize to England.

Senator FLANDERS. They will generalize their concessions to us through everyone?

Dr. KINDLEBERGER. That is right.

Senator FLANDERS. One of the questions we are raising is whether we are really bargaining, and how tightly and closely we are bargaining on these things, and how great the advantages are we really will get.

That is going to be brought out, I am sure, in our report.

Well, then, the only universality comes in the bargaining of other members with each other. That, again, is because of the most-favored-nation clause. That clause comes into effect, and so to that extent it becomes universal. It affects all the members alike.

Now, one point was raised here yesterday, I think it was, as against the European customs union, and that was that it would tend to become a political bloc, as well as a customs bloc, and that it might tend toward neutralism.

That was a new idea to me, and, of course, it is outside of the economic aspect of the thing. I wonder, Mr. Cleveland, whether you would fear that result?

Mr. CLEVELAND. Let me answer it this way, Senator Flanders: The question really is—the question you have to ask is, Would a regional European bloc, which was, let us say, on the way toward some kind of really close unification, have a greater tendency to neutralism than the present divided Europe?

That seems to me the relevant question, and my answer to that is "No." It seems to me that weak, divided countries, unable, really, to have any sense of playing a part in the world, feeling too weak, feeling overshadowed by American and Russian power, are much more likely to be neutralist in sentiment than a coalescing group of countries, which, if they achieved any degree of unity would be a real force in the world.

Such a group seems to me much more likely to be able to take a positive attitude toward foreign policy, and since it is a group which is on the whole friendly by tradition and interest with us, it would seem to me that such a group would more likely be a valuable ally and a strong one than a group of separate and rather demoralized nations.

Senator FLANDERS. On the last page of your testimony, next to the last paragraph, speaking of your European payments unions and the sterling area, you say:

The United States has been willing to acquiesce in the discrimination against our exports involved because these regional groupings seem to contribute to the strength and solidarity of the free world.

I take it that you would extend that observation to a western European customs union, when, as, and if it were formed?

Mr. CLEVELAND. I would, indeed, sir.

Senator FLANDERS. In what does the discriminatory feature consist, in a group of nations which has agreed to trade freely with each other, and how does that discriminate against the United States?

Mr. CLEVELAND. I think in my opinion it is not a good use of the word "discrimination," but, technically, if a group of countries free that trade between themselves, in any degree, more than they free it with outside countries, then they are, technically speaking, discriminating.

Senator FLANDERS. Isn't the existence of the customs union between the 48 States a menace to the rest of the world?

Mr. CLEVELAND. Indeed, it is. The existence of any nation is a discrimination.

Senator FLANDERS. Will you explain that?

Mr. CLEVELAND. I think it is what you say, Senator Flanders. It illustrates the inadequacy of the idea of discrimination. Anything you do for one country, and not for others, is discrimination, and obviously, you cannot say that it is bad just because you are not doing it for everybody. I think the difficulty is in using the word "discrimination" to cover two different situations.

If a group of countries gets together and raises its tariff against the rest of the world without lowering its internal tariffs, tariffs with each other, that seems to me clearly undesirable.

If a group of countries get together and sharply reduces their tariffs among themselves, that also is technically discrimination, but it seems to me that it is subject to quite different judgment than the other case.

Senator FLANDERS. It seems to me that, offhand, to just simply change the unit rather than the introduction of a new factor, as to what the resulting duties come to be in the union, is a matter of serious importance to the rest of the world, and what would happen to the reciprocal trade treaties I don't know; do you?

Mr. CLEVELAND. I am not an expert on reciprocal trade treaties.

Mr. BOLLING. Dr. Haberler would like to comment.

Senator FLANDERS. Dr. Haberler is next, anyway.

Dr. HABERLER. Any tariff discriminates against outsiders in favor of insiders, but that is accepted. If the American tariff discriminates against outside producers, from that it does not follow that you should go on and have further discriminations between different outsiders, such as preferential tariff arrangements provide, and especially not if these discriminatory tariff reductions are only trade diverting. The customs union is a little different because, with certain exceptions, which Professor Kindleberger mentioned, it introduces trade-diverting and trade-creating tariff reductions, and so we can say, at least for larger countries on balance, it would lead to a larger area and to a larger inside market, and to also possibly to a larger trade with the outside.

So a customs union does not necessarily hurt an outsider. Europe would develop tremendously if she had a customs union. In the end, the United States and other outsiders may benefit rather than be hurt.

If I may be permitted to say just one more word, the European customs union is, I think, a very academic question. I think there is not the slightest chance that there will be one.

Senator FLANDERS. After listening to its proponents, I came to the same conclusion, and I was led inevitably to think of the objections raised in this country against having a customs union of our own with Western Europe.

Now, on the top of page 3, Dr. Haberler, you make the same statement which I think you have cleared up:

> A customs union should be worse because it implies a higher degree of discrimination—

but as I have listened to your explanation just now I think that that is a different kind of a discrimination from some other tariff discriminations.

Now, on the foot of page 5 you say that:

> Usually a customs union or economic union or regional trading arrangement that really does any good and constitutes a step toward freer trade between the countries concerned, and is not confined to useless and uneconomic trade diversion is even harder to achieve than a general nondiscriminatory reduction of trade barriers through the operation of the most-favored-nation clause.

I want to come back to the question of the Japanese finding their markets in southeastern Asia. I do not know whether that is a question of a customs union or not. Maybe it isn't a question of a customs union, but it is a regional development, and it has long seemed to me to be a natural.

Of course, it was the theoretical basis of Japan's endeavor to conquer eastern Asia on the plea of the greater east Asian coprosperity sphere, but that involved holding the iron and coal resources of Manchuria which, I think, as I have listened to you gentlemen, it is agreed that is now completely within the regional setup of the Soviet Union, and will remain for an indefinite period unavailable to Japan, but are there not advantages in examining the barriers between trade for food from the food surplus countries of southeastern Asia and for manufactured goods, particularly of the consumer type made in Japan, and see what the barriers are to the free flow of those two types of goods.

I doubt if there are tariff barriers. I do not know what they are, but there is a regional development which seems to me to be perfectly natural, and which we should do everything we can to bring it about.

The first requirement of man is for food, and there are food surpluses in southeast Asia, even though Indochina is out of it now and Indochina used to be a food-surplus country, as far as rice is concerned, but Burma and Siam still are.

I think we must make endeavors to establish regional trade on a somewhat broader aspect than simply the tariff aspects of it.

One thing I noted in Mr. Nathan's testimony yesterday was that the people of Burma or the Government of Burma was interested in exchanges with Japan for consumer goods and industrial equipment. That raises another question which I raised yesterday. Yesterday I put it in too grandiose a form. I suggested that the enemy of free trade was autarky, and perhaps autarky was getting the upper hand. Let us not use the word "autarky"; that means something too big, too integrated, and too definite. But when we say that every country in the world is trying to industrialize itself, isn't that directly contrary to free-trade theory, which is that the world shall specialize itself and is not that idea gaining ground as against our efforts toward free trade?

Dr. HABERLER. Senator, if I may say one word on these two problems, first, Japan is being discriminated against, so you can do a lot for her by eliminating that discrimination against her, which is the opposite of a customs union, or something like that between Japan and these countries. She is discriminated against in the British countries, and probably also in southeast Asian countries. If we try to eliminate that I think we help both sides. Some of the British colonial countries can import cheap Japanese textiles instead of being forced to buy more expensive British textiles. It is better for them, and it is better for the Japanese. Of course, it steps on the toes of Lancashire in England, but that probably cannot be helped, so what is needed, I think, is less discrimination against Japan and we need not go all the way and introduce discrimination in favor of her.

As to the other question which you raised, industrialization, I should say it depends on the method. It is quite natural for countries to industrialize. Industrialization comes into conflict with international trade, with freer trade only, if highly protectionist methods are used for industrialization. That, unfortunately, is being done in many countries. Many backward countries industrialize by highly protectionist methods and introduce industries which are not suited for them, so I would say industrialization as such is not in conflict with free trade, but too hasty and misguided industrialization is.

Senator FLANDERS. It may be their industrialization is not to be protected by duties but by low wage rates, and in that case, free trade remains but trade itself would tend to diminish.

Dr. HABERLER. There are countries that have industrialized and increased trade at the same time. Take Australia. Australia is a highly industrialized country but has a large trade in nonindustrial products. She remained an exporter of wool and other agricultural products, despite her industrialization.

Senator FLANDERS. You make the outright statement at the foot of page 8:

> The Asian regional bloc is politically unworkable, economically unsound, and would not solve the Japanese economic problem.

I wonder if you wouldn't just make that a little more conditional and not quite so strong. If we think of Japan and the southeast Asian bloc as primarily regions whose resources and whose activities and whose products complement each other, why do we have to say that such a bloc is politically unworkable, economically unsound, and would not solve? Can't we say would not completely solve the Japanese economic problem? Have we suggested any political elements to it, and is it economically unsound for regions whose needs complement each other and whose products complement each other to get together?

I thought that was as uncompromising a statement as could possibly be made, and I hope that you would be willing to dilute it just a little.

Dr. HABERLER. I may tone down my statement by saying that a regional bloc would not solve the Japanese problem, but it might help a little. On the other hand, the decision whether 2 regions, 2 countries or regions are really complementary I would leave to the test of the market. If these southeastern countries do not discriminate against the Japanese, then the Japanese can show whether they really can supply them cheaper than we or the British. I would put it to the test of the market, and that you do by eliminating discrimination and, if possible, eliminating tariffs altogether. A priori it is very often difficult to say what will happen or should happen. I would leave that to the forces of the market, to supply and demand, and would not interfere by discrimination one way or the other.

Senator FLANDERS. I am interested in finding out, and I don't expect to delay this by making this inquiry here, but to find out what there is, if anything, that blocks the test of the market in this area, which, it seems to me, belongs together economically.

One other thing with regard to Japan: In view of the fact that we have a regional grouping under the Soviet organization, extending into and through China, regionalism, of course, to that extent becomes a factor to be reckoned with rather than a theory to be discussed.

Since that effective regionalism will probably deny access to Japan on almost any terms its coal and iron source in Manchuria, is it not necessary for Japan to reorient itself in its future planning more toward consumer goods and rather less toward capital goods involving iron and steel?

Dr. HABERLER. More toward consumer goods rather than——

Senator FLANDERS. Than toward heavy capital goods, such as shipbuilding, for example, rails, locomotives. Isn't that becoming an artificial, to an extent, an artificial industry in Japan, not having its source, its old source in Manchuria?

Dr. HABERLER. I am not enough familiar with the Japanese economy, but they have done quite well in the past in producing capital goods. Again, I think this is a question I would put to the test of the market. Let them try out whatever they think they can do. Let's have as much competition as possible.

Senator FLANDERS. The test of the market seems to be that they are having difficulty in getting their raw materials, and difficulty in consequence in getting orders.

Dr. HABERLER. I read recently that they are the second largest shipbuilding nation in the world, ranking immediately after Great Britain. They seem to be doing quite well in that field. Of course, they are saddled with the textile industry, which is probably not very good. That is something that they share with the British.

Dr. KINDLEBERGER. If I may comment on that, Senator, it seems to me that it makes very little difference from a physical point of view whether the coal and iron ore, scrap steel, leave this hemisphere or Europe, let's say, and go to Japan and are there made up into locomotives or whether locomotives leave this country or Europe and go to southeast Asia. From the physical point of view it is true that the ultimate natural constituents of the locomotive come from the United

States, or from Europe, but the economist is not permitted to think in these natural terms. He has got to put a price on things before he can discuss it.

Senator FLANDERS. I think the test of the market, as Dr. Haberler suggested, the test of the market is the criteria. I would only hope that we did not try to assist or support development in Japan which turned out not to meet the test of the market.

There is just one other thing: Do any of you have information as to whether there is any oil, crude or refined, in the southeastern Asia region, including, of course, Indonesia, which can be bought other than with pounds and dollars? While that region is rich in oil, the Japanese must find pounds or dollars with which to buy it. That cramps their style a little bit.

Now, Dr. Kindleberger, I find a statement not quite so rigid as Dr. Haberler's, but to the same effect, on the foot of your first page:

In particular, the attempt to solve the trade and payments problems of Japan in a regional setting, or of promoting Asian and Latin American development along exclusively regional lines would seem to be misguided.

It would not, however, be misguided on our part to assist in freeing anything that could be freed. I am not speaking about tariffs in that region, but anything that—well, there are evidently currency problems involved.

Dr. KINDLEBERGER. These problems, as I understand it, sir, are to a very considerable extent the sterling problem. The Japanese would like to sell to Malaya for transferable sterling. They have to sell for sterling—inconvertible sterling. In the same way they would like to be allowed to convert their rupiah, which they get from export trade surplus in Indonesia into guilders, but their trade agreement with Indonesia prevents them from doing so. The convertibility which I would regard as a multilateral approach would go a long way toward helping the Japanese currency problem.

Senator FLANDERS. You wouldn't object to our doing anything we could to assist in that convertibility?

Dr. KINDLEBERGER. By no means; no.

Senator FLANDERS. As you can see, I am somewhat obsessed by this Japanese situation, because I do not feel at all happy, particularly over the present and prospective inroads of the Japanese textile industry on our own garment and textile production. Maybe I ought to feel happy, but I do not.

I might say that it seemed to me that there was, up until the First World War, a natural regional relationship between Great Britain and southeastern South America, below Brazil. That is, with Paraguay, Uruguay, and the Argentine. They raised food for Great Britain; Great Britain furnished them with manufacturers, but there, again, that trade has suffered from many causes, but in part suffered from the industrialization particularly of the Argentine, some of which was forced and uneconomic.

Here, again, at the foot of page 12, Dr. Kindleberger, you say:

The other approach is to include Japan in a regional arrangement in Asia, in which Japan exports manufactured articles, and especially capital equipment, to southeast Asia and buys the primary products of the region.

Why "especially capital equipment"? Because that ultimately limits that place as her market.

Dr. KINDLEBERGER. I would say, sir, the textile industry all over the world is suffering from the fact that it is the easiest industry for developing countries to get into. We are faced with the position where empire preference means that India is selling textiles in the British market whereas it used to go the other way. More than this, textiles are a peculiarly footloose industry in the terms of what is called location theory. You can raise wool in Australia, ship it to England to be scoured and put into tops, and woven, and then made into cloth and sent back to Australia, and the transport cost, 7,000 miles across the ocean twice, is not particularly relevant to the final cost of the article. The textiles are an article which can peculiarly go all over the world. The transport cost barrier is not particularly significant. If countries can enter this industry easily, and can ship goods almost anywhere, it seems to me that Japan, while it got its start in economic development in this industry, is going to find itself like Britain, and I am afraid like the United States, shifting out of this into other industries. This would seem to me to be the position faced by Japan. Japan is at the moment doing extremely well in constructing ships, as Professor Haberler pointed out, ships which are bought in very large quantities by the United States, by the way, although they often fly other flags.

Senator FLANDERS. You said in building ships?

Dr. KINDLEBERGER. Yes, sir.

Senator FLANDERS. You say the ships what?

Dr. KINDLEBERGER. Often fly other flags. They are bought frequently by United States interests, although they often fly other flags.

More than that, they are selling heavy capital equipment, like locomotives, all over eastern Asia. India is buying its railroad equipment from Japan and this seems to me to be sort of the line that this development is going to take.

Senator FLANDERS. Really what I was raising questions about was the furnishing—whether it is to Japan's interest to furnish production machinery to a market which she might want to hold.

Dr. KINDLEBERGER. This, of course, is an issue, the debate on which goes back to the 17th century. The question was asked, Is it economic suicide to export machinery? And in the case of the United States, I think we have agreed that you do export machinery, then as the undeveloped countries get into your old line of business and you find that you move on into new lines. The only salvation is in changing.

Senator FLANDERS. Our safeguard is our great domestic market.

Dr. KINDLEBERGER. And also our capacity to evolve and to change.

Senator FLANDERS. I am not sure that the British in the long run, with the export of British textile machinery during the last years of the last century and the early years of this, haven't multiplied British difficulties. I think they have.

Dr. KINDLEBERGER. It would seem to me it is perfectly clear that they had no chance at all of monopolizing machinery and keeping other countries from learning how to make textiles.

Senator FLANDERS. I think we might have stepped in with some exports ourselves.

Well, Mr. Chairman, I think that is all I have on my mind. On the top of page 15, sir, you say:

The case sharply illustrates the limitations of the regional approach. Japanese exports of producers' goods can be usefully sold in underdeveloped countries in Africa, Latin America, in fact all over the world.

But can they not particularly—producer goods, yes, that is right, producers' goods. That is true. So far as consumer goods are concerned, they can best be sold in the developed countries, with high-wage levels.

If I may, Mr. Chairman, I would like to refer to one other thing to which I have referred each time, I think, and that is, I think the American manufacturer is not particularly intrigued with a notion of our tariff as a wall. If it is a wall, it has been getting lower and lower. It is true that some of it has many high spots in it and some low spots have broken glass bottles set in cement on the top, but still it is a wall which has been going lower and is no longer on an overall statistical basis one of the high tariff walls of the world.

I wonder if a better description, a better figure would not be that we live here in America on a plateau of high wages, prices, and profits, and there are other plateaus about us of lower prices, wages, and profits, and we have to raise the question within ourselves as to the balance of internal profit to be derived from providing ladders from the lower plateaus of lower wages to our higher plateau of wages, prices, and profits. Does that, as you visualize that figure, appeal to you at all?

Dr. KINDLEBERGER. Not to an international trade economist; no, sir, it does not.

Senator FLANDERS. I didn't think it would. I have tried to picture it just the same.

Dr. KINDLEBERGER. We have a very low level of capital cost in this country. If you take a country like Italy, for example, which pays 15 to 25 percent a year for its capital, you would see that they could be outraged at the cheap capital we have in this country, which is driving their capitalists out of business in a great many areas. If you think only in terms of high costs, high profits, and high wages, you will find it impossible for the United States to export anything. We probably export too much.

Senator FLANDERS. You want to put in low-interest rates into that picture?

Dr. KINDELBERGER. I certainly do; yes, sir.

Senator FLANDERS. I am afraid that if I am to be at all realistic I shall have to do so.

Mr. BOLLING. Dr. Sheldon?

Dr. SHELDON. Mr. Chairman, I should like to comment on some questions which Senator Flanders raised with regard to Japanese trade.

The concern that he shows for consumer goods versus capital equipment is a very real problem, and one which has been recognized for a long time. During the period of the American occupation in Japan, we were very much concerned with that same problem, too. There were many people on the economic staff who wanted to push exports of Japanese consumer goods in places like southeast Asia, but we found that during that period, at least, that we were faced with a practical problem. We could sell machinery, we could sell capital equipment, but we just had no markets of the size which were required to dispose of Japanese capacity to turn out textiles.

The point has already been made, that underdeveloped countries want to establish their own textile industries. There are other lighter industries which they are interested in trying to establish, too. So whether it was economic or not we had two choices: Having limited and inadequate trade out of Japan, or doing what we could to sell whatever the market would take, and the market happened to want in many parts of the world Japanese machinery, ships, locomotives, etc. So whatever that might mean for the long run, the practical problem during the occupation period was to sell what we could, and that meant capital goods.

I have another question about southeast Asian trade with Japan. Perhaps Professor Kindleberger might make some additional comment on this point. It has been touched on briefly already. We recognize that Japan does have frozen balances in places like Indonesia. We know that they would like to be able to convert that currency. There isn't a very good way to do it. Just what is the reason? Isn't the reason simply that they do not have available right now commodities of the kind that Japan requires in sufficient volume to match Japan's ability to supply these countries such as Indonesia and Burma?

Dr. KINDLEBERGER. I must preface my remarks by saying I am no expert in this area at all, but my understanding is that Indonesia has been going through several periods of inflation. One of the reasons Japan finds it so easy to sell there is there is a strong demand for goods which doesn't really represent a long run, to put it in quotes, "natural Indonesian-Japanese trade," but represents a particularly accentuated inflationary position right now. It is Indonesian overall inflation which makes its balance of payments quite out of balance, and which gives it the necessity to put on controls. It is perfectly clear that nobody is going to enter into reciprocal arrangements with Indonesia until they get their own house in order. I know little about this. The situation changed rapidly last year twice, I think, and I am not sure of the result.

Dr. SHELDON. I am sure the reparations problem is an additional element of uncertainty in that situation.

I would like to comment on one other point which Senator Flanders raised. He was inquiring of the panel whether or not there is any oil available in southeast Asia that can be purchased for soft currencies. I might suggest that there is one way it can be obtained and that is for the southeast Asian countries to nationalize western investments in that part of the world, capital improvements which were possible only with western know-how and savings. I am not sure that very many people in this country, or oil companies in particular, would be very happy over this solution to providing a soft currency source for that oil purchase.

Senator FLANDERS. May I follow up on that question just a minute? I think it was Dr. Haberler who mentioned the fact that oil refineries, small oil refineries, were in existence in Iraq and Lebanon and Syria and other places. How do they pay for their oil and can they sell their oil for hard currency so as to pay for the oil in hard currency? Was it you, Dr. Haberler, who mentioned that?

Dr. KINDLBERGER. It was I. My understanding is that these are countries which have, say, a pipeline going through them, or have some other relationship with oil companies, of a contractual sort. It is one of the clauses of the concession, or the pipeline agreement, let's say, that they require the company to erect at the company's expense a small refinery, not for exporting but for their own domestic requirements. What they actually do, of course, is to cut down the foreign exchange cost of their domestic requirements by paying for them at crude oil rather than finished-products prices.

Senator FLANDERS. By the way, I have a constituent who is so concerned for the economy of the South that he would like to have me go on a campaign to make paper out of cotton, and knowing of the tremendous demand for paper in the United States, I think it is worth considering.

Dr. KINDLEBERGER. What they are trying to do is to cut down their cost to them of their petroleum products, and since they have crude oil in the country already, they see or they visualize that this has no additional transport cost.

Senator FLANDERS. The oil companies probably would not have considered their having a refinery which made products available for export.

Dr. KINDLEBERGER. It makes no sense to have a 20 or 30 thousand barrel a day refinery.

Senator FLANDERS. There is nothing in that to help the Japanese and Indonesians.

Dr. KINDLEBERGER. I think it should be added some of these countries have been selling to Japan for inconvertible yen, with which they are expanding their own investment in refineries and tank cars and other things in Japan so that not all the oil bought thus far has been paid for in dollars and sterling. A lot of it has been paid for with domestic investments.

Mr. BOLLING. I would like to pursue one thing about which I queried you, Dr. Kindleberger, a little earlier. You spoke of the fact that we inflate more slowly and other countries deflate more slowly. I would like to explore the reasons for that.

Dr. KINDLEBERGER. This I should label as a theory. This is by no means established or by no means agreed. Some people think dollar shortage to the extent that this tendency exists is due to the greater innovational powers of the United States. My own view would be it relates to this point I have just made, and which you ask about. The reason, I think, for it lies in the structure of savings and investment in the United States, on the one hand, and in underdeveloped, and, let's call them, mature countries, Western Europe, as the other; but I don't think any simple explanation will do it. The United States is the richest country in the world and economists tend to believe that a rich man has an easier time saving than a poor man, so that our savings tend to be high relative to our total income, and in absolute amounts.

More than this, while our investment opportunities may at one time be larger and at other times smaller, depending upon the business cycle, there is something to be said for the point that if other countries are anxious to employ any new technique that we devise, like nuclear energy, or electronic devices, and to put it into effect as soon as it is really established as a going concern, then their tendency to invest is as high as ours. Particularly this is true in underdeveloped countries with a big backlog of requirements for investment, merely to catch up. This means that their current level of investment plus their backlog gives them more tendency to invest than we have, since we have more tendency to save this would give us in most modern income analyses a relative tendency to deflation and them a relative tendency to inflation. This is not to say other countries are inflated or we deflated at any given time. The tendencies are relative to one another. I would say this is by no means a universal and complete explanation of all the balance-of-payments difficulties that you want to get into.

Germany certainly has a tendency to save as high or higher than the United States, and Switzerland as well, but in the case of, say, Britain or France, for one reason or another—I think they differ in these two cases, they tend to stay more inflationary than we do. And when we are positively inflated they are more inflated, and when they are positively not inflated, we are relatively deflated.

Mr. CLEVELAND. Could I make a comment on that, Mr. Chairman?

Mr. BOLLING. Certainly.

Mr. CLEVELAND. This is not going to be a very technically satisfactory comment, but maybe it will mean something.

It seems to me, generally speaking, a country whose national income is growing rapidly, and which is the richest country in the world, the United States, people tend to be on the whole somewhat more satisfied with the incomes they are getting than in the country where the national income is growing more slowly, and it is a poorer country and, therefore, has the rich country as a kind of model, as a standard for consumption.

I think that as between the United States and Great Britain, for example, the fact that our production, our national income, is growing more rapidly than that of Great Britain and the fact that we are the richer of the two countries, that is a real effect in keeping the British economy in a state of somewhat greater inflation than ourselves, because if people are demanding rising money incomes in forms of wages and otherwise, and if they feel pinched in their incomes, they save less, and that tends to produce a somewhat more inflationary condition than in a country where people are by and large somewhat more satisfied with their incomes, and tending to save a higher proportion of them.

I think that is a pretty kind of a hydraulic, if you will, comparison, but to me, at least, it seems to explain at least the fact that sterling tends to be short, or, rather, that dollars tend to be short in Britain, and Britain tends to be more inflated than the United States.

Senator FLANDERS. Mr. Chairman, may I ask a question to get a point clearly in mind?

Mr. BOLLING. Surely.

Senator FLANDERS. I thought I understood you up to this point, but I may have missed it, that taking the present situation in Great Britain and the United States, both of which appear to be susceptible to inflation, perhaps, that in Great Britain, with less prosperity, the individual less prosperous, there is less tendency to saving, and so do I understand your point to be that there is less tendency for savings to go into new investment, which can produce more goods to meet the demands of the market? Is that point involved?

Mr. CLEVELAND. That was not the point I was making, but I think that is true. My point is the man or the wage earner, who is less satisfied with what he is getting, exerts more pressure through his union for higher wages; that is my point.

Senator FLANDERS. That I think is obvious.

Mr. CLEVELAND. That is obvious, and I think it is a major element in explaining why it is that Britain has a periodic tendency to be more inflated than the United States.

Senator FLANDERS. I might say I had a conversation with a leading British economist, and he felt quite hopeless with regard to the British endeavor to control inflation, but did not feel that the United States was going to have the same difficulty, and largely on the basis that you have just stated.

There is also perhaps that basis, the basis of the increase in capital required to increase production as one of the safeguards against inflation.

Dr. HABERLER. May I say just one word on this question? I think it is very important to emphasize the inflationary factor. If we can reach agreement on the statement that the dollar shortage can be explained in terms of the greater inflationary pressures in many foreign countries, we shall have gone a long way toward an explanation of the dollar shortage. I think all the reasons which have been given for believing that certain foreign countries are subject to greater inflationary pressures than the United States are good reasons. But still we should not accept inflation as inevitable. There are always good reasons for spending more than you have. There are excellent reasons for that in the United States—there is tremendous expansion of consumer credit which the Europeans have not had yet. They are getting into that now. But it is the task of monetary policy to resist inflation. In some countries anti-inflationary policy is more successful than in others. There are poor countries who do not get into inflation and there are rich countries who get into inflation, but if a country gets into inflation, then it has simply to do something about its exchange rate, and if it were true that these countries inflate all the time more than we do, then the consequence will be that continuously or periodically they would have to devalue their currencies. But I think it is not that bad except in a very few countries.

Take the British case. They had some inflationary periods. Recently they went through one, but it looks very much as if they are going to put their house in order again. There are quite a few other countries who have done so. There is nothing inevitable, I should say, about these inflationary pressures that cannot be resisted.

Dr. KINDLEBERGER. It may not be inevitable. The question is for a betting man, which odds would he pick? I would guess that, in general but with exceptions, that other countries would be more likely to inflate relative to the United States than vice versa.

Dr. HABERLER. If that is true, they should correct it.

Mr. CLEVELAND. It is a question of between "is" and "ought."

Senator FLANDERS. I have no further questions, Mr. Chairman.

Mr. BOLLING. With that we certainly thank you for your time. Your contribution has been a great one.

The subcommittee will now recess until this afternoon at 2 o'clock in this same room when the subject will be East-West trade policy.

(Whereupon, at 12:20 p. m., a recess was taken until 2 p. m. of the same day.)

AFTERNOON SESSION

(The subcommittee met at 2 p. m., Hon. Richard Bolling (chairman of the subcommittee) presiding. Present: Senator Ralph E. Flanders. Also present: Grover W. Ensley, staff director; and Charles S. Sheldon II, staff economist.)

Mr. Bolling. The subcommittee will be in order.

Undoubtedly the biggest element of uncertainty which affects all international trade is the issue of war and peace. When war is not upon us, we nonetheless feel its potentiality in the making of trade policy. We have seen how national-defense requirements have been offered as one important argument in favor of trade restrictions to protect home industry. Also, we have had described the importance of international investment and close trading relations with the free world in order to stem the tide of communism and to give hope for progress. Trade policy, then, as it is affected by world strategic considerations, has both negative and positive elements.

But we must move beyond these generalizations to discuss directly and openly one of the big political-economic issues of trade policy. What rules are to govern our conduct of trade with the Soviet Union, the European satellites, Red China, and Communist Asia?

We could find no more distinguished private citizen with direct experience in dealing with the Soviet authorities on trade matters than Maj. Gen. William H. Draper, Jr. General Draper is one of those men on whom his country has had to call for many times the normal share of public service. Although he has moved to the pleasant surroundings of Mexico City, he has responded once again to accept our invitation to appear this afternoon. His duties have ranged from such a hot spot at home of being the chairman of the Long Island Transit Authority to military and diplomatic service abroad. He has been the Chief of the Economic Division of the Control Council for Germany, the Economic Adviser to EUCOM, and Under Secretary of the Department of the Army. He served during a part of the Korean war period as the Special Representative of the President in Europe with the rank of Ambassador.

General Draper, we are happy to have you with us to discuss the problems of East-West trade.

STATEMENT OF MAJ. GEN. WILLIAM H. DRAPER, JR., CHAIRMAN OF THE BOARD, MEXICAN LIGHT & POWER CO., LTD., MEXICO

General Draper. Thank you, Mr. Chairman.

Mr. Chairman and members of the committee, my first contact with East-West trade was in early July 1945. Germany had recently surrendered. I flew to Berlin with my British colleague, Sir Percy Mills, to negotiate with the Russians for the feeding of the 2½ million Germans in the sectors of Berlin that we and the British were to take over on July 15.

General Sokolovsky, now Marshal Sokolovsky and Chief of Staff of the Russian Army, gave an elaborate luncheon to celebrate the first meeting of the Allied Kommandatura. Vodka, beer, wine, and champagne flowed freely. After dozens of toasts, perhaps designed to soften up the Western negotiators, we got down to brass tacks. We found the Russian idea of feeding our sectors meant our bringing in the food, 2,000 tons a day, as a gift. And so it was arranged, cattle to come from Bavaria, flour and sugar from our Army stocks, potatoes and coal for power production from the British zone, with nothing in return. We had made what now might be considerd a typical East-West trade.

Since we needed time to get the supply trains rolling, the Russians agreed to advance the food and coal for an extra week, to be returned later. But difficulties developed. On the takeover day, July 15, Gen. Floyd Parks, our commander in Berlin, telephoned me in Frankfort to say the Russians weren't living up to their part of the bargain, they would not lend us the food until our supplies arrived. President Truman was arriving in Berlin that day for the Potsdam Conference, with the pleasant prospect that all feeding might come to a sudden halt in the new British and American sectors. Finally, however, it was settled amicably and the food made available, against our written agreement on behalf of the United States Government, probably a completely illegal agreement, to repay the food loan in either gold or food.

My next experience was also typical. At Potsdam the Russians, British, and ourselves agreed to treat Germany as an economic entity, and to make the cost of needed imports for the whole of Germany a first charge against exports from all of Germany. In other words, the proceeds of exports from all zones of Germany would be used first to pay for food and other needed imports. This seemed logical and in accordance with good international trading practices, and was so agreed at the highest level, by Stalin, Churchill, and Truman.

But when we tried to get the Russians to implement this agreement on exports and imports they delayed during many months of tedious four-power meetings, and finally refused point blank. Reparations to Russia came first with them. As reparations, they were shipping out everything they could lay their hands on, including even the railroad tracks on which we were bringing in our supplies. We were held up for 4 or 5 days and almost ran out of food, and found they were lifting the tracks. So no proceeds of exports from the Russian zone ever became available to pay for imports at all. While they were steadily funneling off German assets to the East, the American taxpayer was footing the bill for huge food imports from the West.

So General Clay stepped in and arbitrarily halted reparation shipments from our zone to Russia, with a consequent deterioration in East-West trade.

Then in 1948 our Russian friends refused to join us in the proposed currency reform for all of Germany. They became furious when we went ahead with this necessary program in Western Germany, and deliberately broke the agreement they had made in 1945 to allow 16 supply trains to come into Berlin from the Western zones each day. They blockaded Berlin, and tried to starve out our sectors and to stop what little East-West trade had developed.

Seven years have gone by since the airlift fed Berlin and kept our flag flying there. The obstacles to East-West trade are not now physical, but I fear, from reports of the four-power negotiations closing today in Geneva, that the Russian purpose has changed very little. Apparently any real volume of East-West trade is only possible on

Russia's own terms. Her terms unfortunately are too high now, as in the past.

The United Nations declared Communist China and North Korea the aggressors in the Korean war, and called for economic sanctions. In late 1951 Congress passed the Battle Act to deny arms, ammunition, and other strategic goods to the Soviet bloc. The Battle Act controls became operative in January 1952. That same month I began my duties in Paris as United States Special Representative in Europe. So I saw at first hand the negotiations in the Coordinating Committee of the 14 NATO nations, called COCOM, to determine the strategic items to be controlled.

At the Lisbon Conference in February 1952, NATO agreed on the military buildup necessary to prevent aggression in Europe; in COCOM that same spring economic controls were adopted to slow down the military and economic strengthening of the Soviet bloc. COCOM was dealing with the trade of sovereign nations at a time when British gold and dollar reserves were at their low point and still dwindling, and when France was in economic crisis. Despite this, agreement to prohibit trade in strategic items was reached under pressure of the Korean war and the threat of similar aggression in Europe.

The famous Danish tanker case threatened trouble. An oil tanker was obviously a strategic item. Denmark had contracted to build two tankers before the Battle Act controls were imposed and felt that it must make good its contract and deliver the tankers. President Truman wisely decided that to deny Denmark further economic or military aid, as he could have done under the law, would have been detrimental to the security of the United States. When the second tanker came along President Eisenhower made the same decision, on the basis of Denmark's prior commitment and of our security interests.

This case illustrates very well both the negative and the positive approach to the security problem we faced then, and still face, in a somewhat different form. Denying strategic items to the Soviet bloc is the negative approach. Maintaining unity among our allies and building up their strength is the positive approach. Both are necessary, but the economic and military power of the free world and its cohesive unity, as two Presidents decided in the tanker case, is vastly more important.

However, I assume that all here will agree, despite Mr. Molotov's recent outbursts at Geneva, that we and our allies must continue to deny arms, atomic materials, and other strategic warmaking potential items to the Soviet bloc so long as the risk of aggression remains. As our Secretary of State has so well said, these controls are a consequence and not a cause of tensions.

What, then, are the problems and possibilities of peaceful East-West trade? At present the free world's annual exports and imports total more than $160 billion, and are still climbing to new records. Of this, not quite $4 billion, or less than 2½ percent, is with the Soviet bloc. Could there not be a massive increase in the exchange of goods between the East and the West, perhaps comparable to the $60 billion increase in the free world's total trade since the Berlin blockage 7 years ago? Certainly it would seem to me as a private citizen that a large increase in East-West trade is possible to the advantage of both if the two sides really wanted to trade together and actively encouraged such trading activities.

Two weeks ago at Geneva, Mr. Dulles stated the official United States Government position. He said:

> The Western nations have sought to widen the multilateral base of their trade and to increase the extent to which each of them shares in the international division of labor. Trade in peaceful goods between the members of the non-Communist world has risen to an unprecedented level. The same opportunities have been and are now offered by the Western nations to the Soviet-bloc nations.

Then he asked:

> Is the Soviet Union now prepared to expand its exports sufficiently to make possible a much higher level of trade with the West? If so, what goods will be available? If the U. S. S. R. believes that serious obstacles to peaceful trade exist on the Western side, we want to know what they are.

Under the directive from the summit, the foreign ministers were considering only peaceful trade. Nevertheless, Mr. Molotov completely disregarded the offer made and the questions raised by Secretary Dulles, failed to consider ways of increasing Soviet exports and imports, and instead made violent attacks on our refusal to sell strategic war-producing items. As the New York Times' headline put it yesterday "Molotov Reveals the Iron Curtain Is Here To Stay."

Why is it that the total East-West trade between nearly 1 billion inhabitants of the Soviet bloc and more than 1½ billion inhabitants of the free world is less than the foreign trade of Holland with a total population equal to that of New York City?

The answer, I believe, is very simple. For 10 years Russia has been molding and integrating its European satellites and Communist China into a military, political, economic, and trading bloc. It has deliberately planned that this Soviet bloc shall be self-sufficient, and have as little contact and as little dependence on the outside world as possible. State trading has kept its exports and imports under strict economic and political control.

Also, the bloc's historic exports of food and raw materials have been less available for shipments outside the bloc, less food for export, because food and agriculture have been sacrificed for the sake of rapid industrialization, less raw materials, since many of them are needed for the industrial buildup itself.

Last year the value of food imported by the Soviet bloc was about three-quarters of the total value of the food exported by the bloc countries. From the Russian point of view, this is a dangerous trend indeed, and perhaps explains the emergency increase in the Russian area planted to corn this year. If Soviet bloc agriculture remains backward we may well see a net import of food by the bloc.

We here in the United States also have a farm problem. It is the problem of surpluses, of annual crops beyond our capacity to eat or to sell.

The Russians have their farm problem, one of deficits, annual crops that are less than planned or needed; deficits which they cannot eat.

With all its political implications and difficulties, I still prefer the American type of farm problem.

Someday, incidentally, if Russian agriculture continues its deficits, the Russians may badly want part of our food surplus. That could really stimulate normal East-West trade. There is now no bar against private sales of food to the Russian bloc, but I see no advantage to us in continuing the present legislative prohibition against sales to the bloc by our Government of surplus commodities. Our stocks of surplus food might well become a good trading medium for legitimate East-West trade.

It is difficult for private traders to deal with a state monopoly; a state monopoly that establishes trade offices in other countries but permits none in its own; a state monopoly that buys a piece of machinery, gives no patent protection, and may copy it and compete for sales in third markets; a state monopoly which gives or withholds orders on political as well as economic grounds and offers little real opportunity or incentive for building up a continuing year-by-year business.

I will sum up the picture as I see it as a private citizen, with no responsibility and no special knowledge. Peaceful trade, if genuinely carried on by both East and West as a normal exchange of goods for the benefit of both sides, could increase steadily, develop human contacts and understanding, and perhaps have some part in bridging the gulf that now separates our two worlds. Hopes have been rising here and abroad during the past year that Moscow might welcome such a development. The Western Powers have now clearly stated their desire to encourage growing trade between the blocs, subject only to necessary restrictions on warmaking equipment. Unfortunately, it has now been made painfully clear that despite the beneficent smiles and kind words that were exhibited at the summit, the Russians really don't want more East-West trade. We will simply have to wait until some day perchance they get a change of heart.

In the meantime, economic sanctions and controls, the negative factor to which I referred earlier, are becoming of relatively less importance. The Soviet bloc industrialization has been proceeding apace, and the bloc is now more self-sufficient than before. Economic sanctions were obviously more effective during the hot war in Korea than during the cold war that has followed, although sanctions are still being applied with greater severity to Communist China than to the Soviet European bloc. There can always be honest differences of opinion here and among our allies as to what items are strategic. The list was chipped away last year; it will probably be again. We can well afford to reach compromise solutions in this area in order to maintain the unity of our alliance. The positive approach is still the vital one for us.

Foreign trade is of far greater importance to our partner nations than to us and it is quite natural that they are continually seeking new or expanded markets. If an expansion in East-West trade is to be denied them, they will look even more eagerly to alternative markets, particularly our great market here. I respectively suggest that in the interest of the positive approach, of greater solidarity among our allies, and of our own long-range economic interests, we could well continue along the path our Government has been blazing, and gradually reduce still further our own trade and tariff barriers.

Mr. BOLLING. Thank you, General Draper.

The negotiations at Geneva, according to newspaper accounts, seem to have come to an inconclusive end. It is probably a difficult period to answer in precise detail what United States policy on East-West trade is going to be in the months ahead. Our interest is not to pry out what must still be secret, but rather to consider longer run principles, and also the kinds of problems which are and will be associated with the administration of controls on East-West trade.

The man who can give the most authoritative answers on Government surveillance of trade and on enforcement of rules is the Deputy Director of the International Cooperation Administration for Mutual Defense Assistance Control, the MDAC. Vice Adm. Walter S. DeLany occupies that post. Admiral DeLany's seagoing career extended from Vera Cruz before World War I through the great battles of the Second World War. Duty as operations officers of CinCPac, and of the Chief of Naval Operations Staff has been followed by international experience with NATO. Since assuming his post with the Foreign Operations Administration, now renamed the International Cooperation Administration, he has been involved in the day-to-day operations of East-West trade controls and in the negotiations for these controls which we must carry on with our allies. We are pleased, Admiral DeLany, to have you here this afternoon to discuss problems of East-West trade.

STATEMENT OF VICE ADM. WALTER S. DeLANY, UNITED STATES NAVY (RETIRED), DEPUTY DIRECTOR (FOR MUTUAL DEFENSE ASSISTANCE CONTROL), INTERNATIONAL COOPERATION ADMINISTRATION

Admiral DELANY. Thank you, Mr. Chairman.

It seems especially timely to discuss the development of international rules governing the shipment of strategic materials in East-West trade because of recent efforts to equate security controls with the low level of East-West trade. In actual fact the items controlled are very few indeed in comparison with the wide range of commodities the Soviet Union and her European satellites could buy from the free world if they had the desire and the means of payment.

In any discussion of strategic trade controls it is well to remember that they came into being by an act of Congress as a result of the threatening gestures and tensions created by the U. S. S. R. Trade controls were imposed by the free world as one security measure against those threats. The controls on trade in strategic material is intended to deny or limit shipments of goods which will significantly contribute to the bloc's war potential. They do not apply to trade in peaceful goods.

In the face of those threats, the policy on East-West trade has been based on these principles:

1. The free nations should not furnish a potential aggressor with goods which directly and materially aid its war industry and military buildup.
2. Security export controls should be applied on a selective basis except in the case of military aggression when a policy of complete embargo would be in order.
3. Mutual security can best be advanced by the continued increase in the political, economic, and military strength and cohesion of the free nations.

While controls are limited, selective and flexible against the European Soviet bloc, they are far more comprehensive against Communist China and North Korea who have been declared aggressors by the United Nations. Against these regimes the United States embargoes all exports, prohibits all imports, and prohibits our ships or aircraft from calling at their ports or carrying commodities destined to them. We block all of their assets within our jurisdiction and exercise financial controls aimed at depriving them of dollar exchange.

The controls of the other free-world nations are also more inclusive against mainland China and North Korea, although they do not generally match the total embargo imposed by the United States. About 45 countries support the selective embargo resolution adopted by the United Nations in 1951 which applies specifically to arms, ammunition, and implements of war. Half of these 45 countries apply an embargo on other strategic goods as well, and practically all the leading maritime nations have adopted controls on shipping of varying degrees but of less severity than United States controls on shipping.

As you can see, the very essence and heart of these controls is their dependence upon the cooperation of our principal allies. Relatively few items can be controlled by one country. Trade controls pose important economic, financial, and political problems in the countries cooperating with us. Foreign trade is a far greater factor to the economic well-being of those other countries than to the United States. It is well to remember that when we discuss trade controls with the participating countries we are talking about their trade. We must always respect their sovereign rights to deal with their own problems as they see them within their own national interests and the security of the free world.

Trade is not a gift to either party. Shipments to the bloc must be paid for in Soviet goods or gold which the free-world nations can use in their own economies. The Soviet Union has, in fact, recently begun to sell gold again and appears to be trying to utilize credit arrangements more widely.

Now, I would like to discuss the administration of these complex controls in the United States and internationally.

As you know, one of the principal parts of our legislative framework for the control of trade is the Mutual Defense Assistance Control Act of 1951, usually known as the Battle Act. It is administered by the Director of the International Cooperation Administration.

In addition, there is the Export Control Act, which is administered by the Department of Commerce; the Trading With the Enemy Act, administered by the Treasury Department; the Atomic Energy Act, administered by the Atomic Energy Commission; and the Munitions Control Act, which is administered by the Department of State. All activities under these legislative mandates are coordinated by the Secretary of State insofar as they affect foreign policy.

The Mutual Defense Assistance Control Act, which has no termination date, reinforces the international system of voluntary trade controls which were already in existence before the act became fully operative in January 1952. Among other things, the statute provides that United States aid should go only to countries that cooperate in the control of strategic goods. It has been administered as intended by Congress, with awareness of other countries' problems, the need

EDAC STRUCTURE

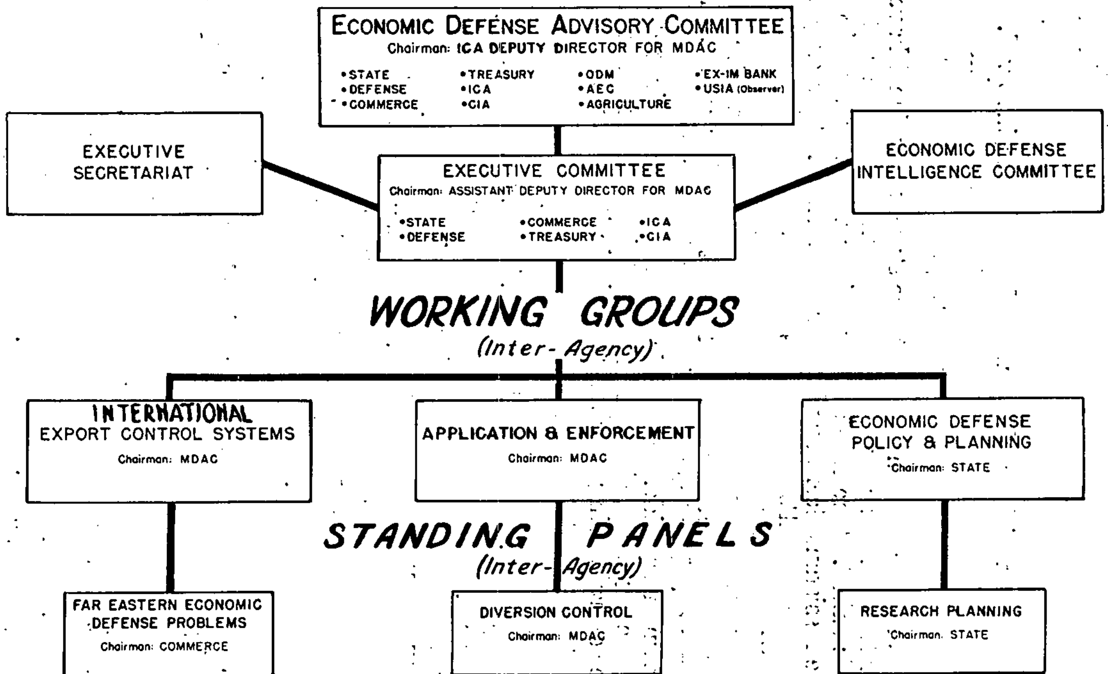


CHART 1

for building up free world strength and unity, as well as to impede the military buildup of the Sino-Soviet bloc.

The problems innate in security controls cut across so many responsibilities here in Washington that, of necessity, the Mutual Defense Assistance Control Act is administered with the advice of an Economic Defense Advisory Committee which has 10 Government agencies represented. Each brings the particular point of view of his agency to bear on the complexities of these controls.

The committee mobilizes all the resources of the United States Government which can help with the problems involved. Meetings of the executive committee are held at very frequent intervals to discuss new facets of those problems. Working groups are constantly in action delving into the perplexities involved in each new decision.

As you will see from the chart, the structure which I have outlined shows the membership within the different components of the EDAC, as it is called. The top-level committee with membership as shown at the Assistant Secretary level is represented. The executive committee, which is the smaller group, with membership as shown, is the working committee of the organization. It is supported by three working groups, one for international control, one for application enforcement, and then the policy and planning group. EDAC is also supported by the economic defense intelligence committee, which is shown at the side. EDAC is a completely coordinated committee with the agencies of the Government interested in this East-West trade control having memberships within its structure.

Now, as relates to the International Organization for Security Controls, an organization which has its headquarters in Paris, 15 major industrial nations carrying on 60 percent of the free world's trade are members of this informal organization which is called the consultative group. Their ministerial representatives meet when necessary to discuss economic defense policy and to agree on changes.

Actual day-to-day coordination of the international security controls rests upon two committees: the Coordinating Committee, known as COCOM, which concerns itself with trade controls against the European Soviet bloc, and the China Committee, known as CHINCOM, concerned with the special problem of control over trade with Communist China.

I should emphasize that the consultative group, if I may again refer to the chart, the yellow tabs show the country memberships. The big blue center circle shows the consultative group, which corresponds normally in function to the high level section of EDAC. On the left is the Coordinating Committee, which has the same membership as shown in the yellow blocks and handles trade controls toward the European block. On the right is the China Committee, again with the same country membership which handles controls toward Communist China. The consultative group is chaired by a Frenchman, the Coordinating Committee and the China Committee are chaired by an Italian. There is a joint secretariat which provides year-round services to the organization. The United States is represented by a permanent delegate in both COCOM and CHINCOM, and the consultative group and that organization is part of USRO in Paris.

INTERNATIONAL ORGANIZATION *for* STRATEGIC TRADE CONTROLS

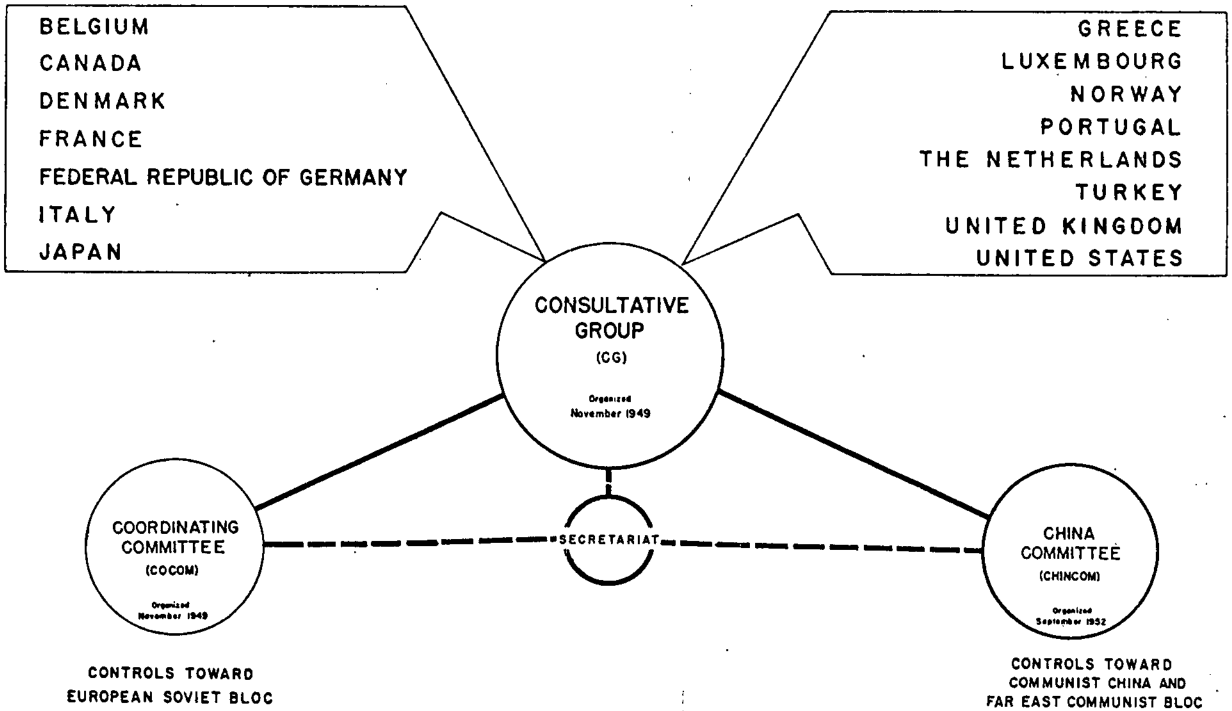


CHART 2

I should like to emphasize, however, that the consultative group has been in existence voluntarily since 1949, several years before enactment of the Battle Act by Congress.

Despite the traditional trade rivalries among these participating countries and their constant search for new markets abroad, the governments have voluntarily reached agreement on uniform lists of commodities to be denied the Sino-Soviet bloc. They have agreed that they will not ship to the Soviet bloc in Europe any arms, ammunition, or implements of war, atomic energy materials, and about 170 other items which would make a contribution to the warmaking potential of the bloc.

In addition to these items which are embargoed to the bloc, certain other items of somewhat less strategic importance are denied to the European Soviet block after a certain agreed quantity has been shipped. Still other goods are listed for "surveillance" so that shipments can be restricted promptly if agreement is reached to do so. About 90 items fall into these 2 categories. As to Communist China, there are no quantitative or surveillance controls. Commodities in all of the categories I have just described are embargoed, plus a number of other items.

Perhaps I can best illustrate how the functions of the American and international organization interlock by describing the activities which resulted in a revision of these control lists in August 1954. At that time, economic conditions in the free world had improved considerably, a buyer's market emerged, and pressures for increased exports rapidly developed. Certain of the controlled items had decreased in importance because of changes in technology and science, or because new evidence had been received as to the use being made of the item by the bloc. There was also the need for gearing the international program for a long-haul concept. The threat of war appeared less immediate than it had been when the control lists were first prepared.

The executive branch of our Government, in November 1953, approved an economic defense policy which, although still requiring continued controls, took cognizance of the changed conditions by placing controls on a more selective basis. This policy, I should emphasize, applied only to the European Soviet bloc. No change was made in the China controls.

The various agencies in the Economic Defense Advisory Committee systematically examined each of the then 400 items which were under embargo, quantitative control, or surveillance. The other participating countries which had come to the same conclusions about the need for an overhaul also reviewed the lists and reached their own views.

In March 1954, a trilateral conference involving the United Kingdom, France, and the United States agreed on criteria for determining the status of each item under consideration. Soon afterward COCOM in Paris began a detailed review of these items. As a result of these negotiations, agreement was reached generally on new and shorter lists. Certain items on which agreement could not be achieved were left in their previous status of control. As of now, 226 items are embargoed to the European bloc.

In addition to a review of the lists, agreement was reached on a substantial tightening of the machinery of controls. Transaction controls were tightened among the 16 COCOM countries to prohibit the sale of embargoed goods to any part of the Sino-Soviet bloc by residents of free world countries regardless of the source of the goods. More effective controls over transit trade were introduced by the COCOM nations to prevent the diversion to the bloc of embargoed items ostensibly bound from one free world country to another.

Thus, while there were differences of opinion, the unity and voluntary cooperation of the 15 nations continued.

The foregoing relates to what is known as the international lists of items under control to the bloc. The Battle Act requires that the Administrator, after full and complete consideration of the views of the Departments of State, Defense, and Commerce, the International Cooperation Administration, and other appropriate agencies, shall also determine and list the items which come within separate provisions of the act.

We therefore have, in addition to the international lists of items, the lists to which the Battle Act relates. We have a list known as title I, category A, which contains atomic energy and munitions items.

By the provisions of the act, if an aid-receiving country ships them to the bloc, this aid must be terminated. No such items have been shipped.

We have the list known as title I, category B, which contains items of primary strategic significance. This is the same as the international embargo list.

If an aid-receiving country knowingly and willingly ships any of these items to the bloc, the President, after receiving advice from the administrator of the act, and after taking into account the contribution of such country to the mutual security of the free world, the importance of such assistance to the Uited States, and the importance of imports received, may direct the continuance of aid to a country where unusual circumstances indicate that the cessation of aid would clearly be detrimental to the security of the United States.

There have been shipments of these items by aid-recipient countries. About 75 percent of the dollar value of such shipments were made under an accepted interpretation of prior commitments; that is, commitments for shipment made before publication of the Battle Act lists. No aid has been terminated incident to such shipments.

Finally, there is a list known as title II which contains items of lesser strategic significance. The items on this list are the same as those on the international lists II and III. The act provides that aid to a recipient country shall be terminated when the President determines that it is not effectively cooperating with the United States pursuant to this title of the act, or is failing to furnish the United States information sufficient for the President to determine that the recipient country is effectively cooperating. No aid has been terminated under the provisions of this title of the act.

The unity of action of the free world and its determination to retard the war-potential buildup of the Sino-Soviet bloc become even more important when we realize the extent of the effort being made to destroy security controls. Each of the countries, including the United States, has been constantly subjected to propaganda which blames export controls for the low level of Soviet trade. This propaganda invariably presents the U. S. S. R. as a potential connucopia of profitable trade if only the free world nations will drop their strategic trade controls. A study of the facts, however, shows that this horn of plenty has unfortunately been little more than a loudspeaker.

TRADE OF FREE WORLD WITH BLOC, 1947-1955

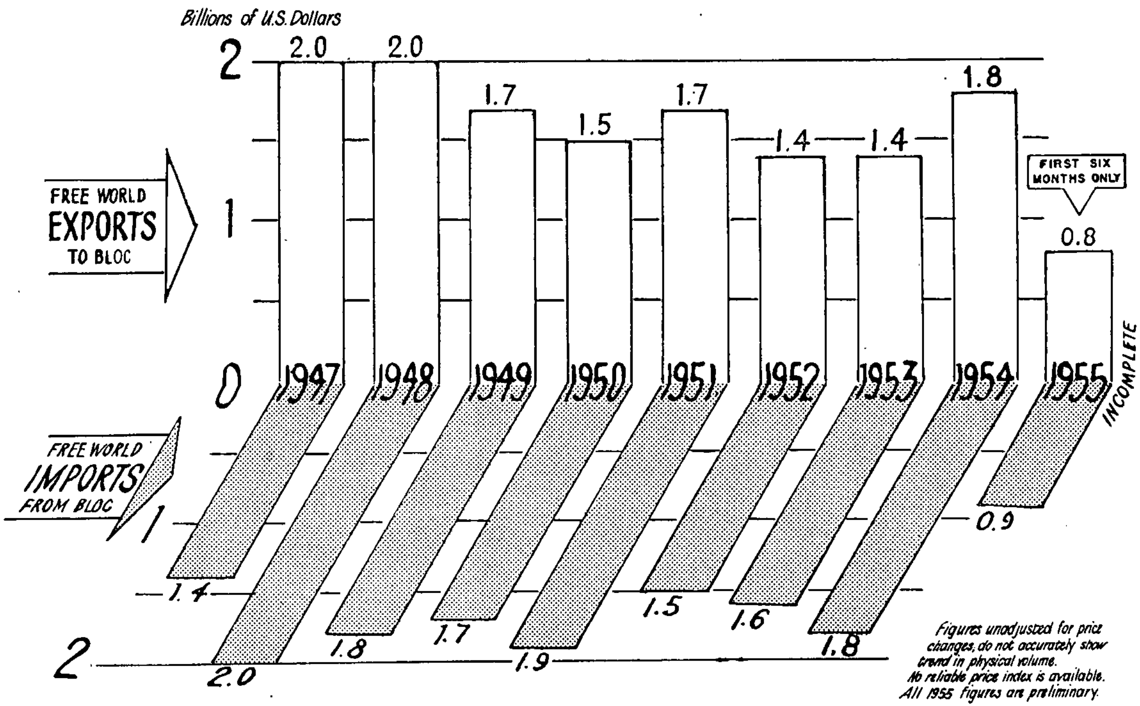
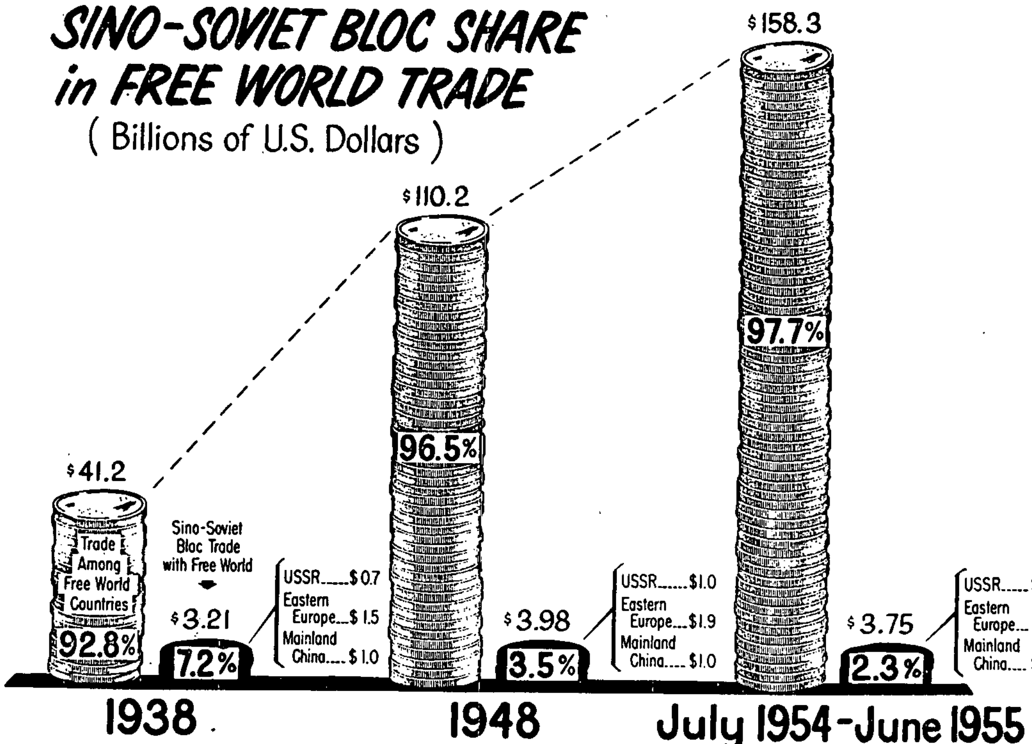


CHART 3



NOTE: Eastern Europe (Satellites): Albania, Bulgaria, Czechoslovakia, Hungary, Poland, Romania. East Germany is included in 1948 and 1954-1955 but not in 1938.

SOURCE: Dept of Commerce - Figures unadjusted for price changes.

CHART 4

It is our belief, based on very comprehensive and continuing studies, that a further reduction in strategic trade controls would have its effect primarily in the composition rather than the overall dollar value of East-West trade. We believe that any further reduction in the controls would result mainly in a change in the kinds of commodities imported by the bloc. The basic reasons for this are the Sino-Soviet bloc's lack of marketable exports with which to pay for the free world goods it needs and its strong desire to obtain complete independence from the need to import.

As you can see on chart 3, the trade of the free world with the entire Sino-Soviet bloc has been relatively low in volume. In 1947 and 1948, before international security controls became effective, trade with those areas of the world amounted to only about $2 billion in exports and somewhat less in imports. It may reach the same amount this year.

However, there has been a drastic drop in the Sino-Soviet bloc share of free world trade since World War II. In 1938, as you can see on chart 4, the countries now included within the bloc took for themselves 7.2 percent of that trade. In 1948, before the first international security controls on strategic goods became effective, that trade had already declined to 3.5 percent. In the year preceding June 30, 1955, the bloc share was only 2.3 percent.

The U. S. S. R. individually has always had a minor role in the field of foreign trade. Even in 1938 its proportion of world trade was only 1.6 percent. In 1948, when the Soviet Union still had ready access to anything for which it could pay, its share of free world trade declined to 0.9 percent. In the fiscal year 1954–55 the proportion declined again to a mere 0.6 percent.

The Eastern European countries in 1938, before they were forcibly joined to the bloc, were a considerably greater factor in world trade than the U. S. S. R. In that year they gained 3.4 percent of the world's foreign trade. In 1948, when the U. S. S. R. had completed its conquest of the area, the proportion of trade with the free world dropped to 1.7 percent. In the year 1954–55, after the principle of self-sufficiency and construction of a parallel market had been firmly established, their portion of free world trade had dropped to 1.3 percent.

In the midst of war in 1938 China had a larger share of the world's foreign trade than the U. S. S. R. It amounted to 2.2 percent. China's best customer then was the United States. Again in the midst of war, in 1948, with its economy thoroughly disrupted, the portion declined to 0.9 percent. In the year 1954–55, the share of Communist China's trade with the free world was only 0.4 percent.

It should be noted, also, that between 1938 and 1955 the free world's foreign trade skyrocketed from $41.2 billion to $158.3 billion annually.

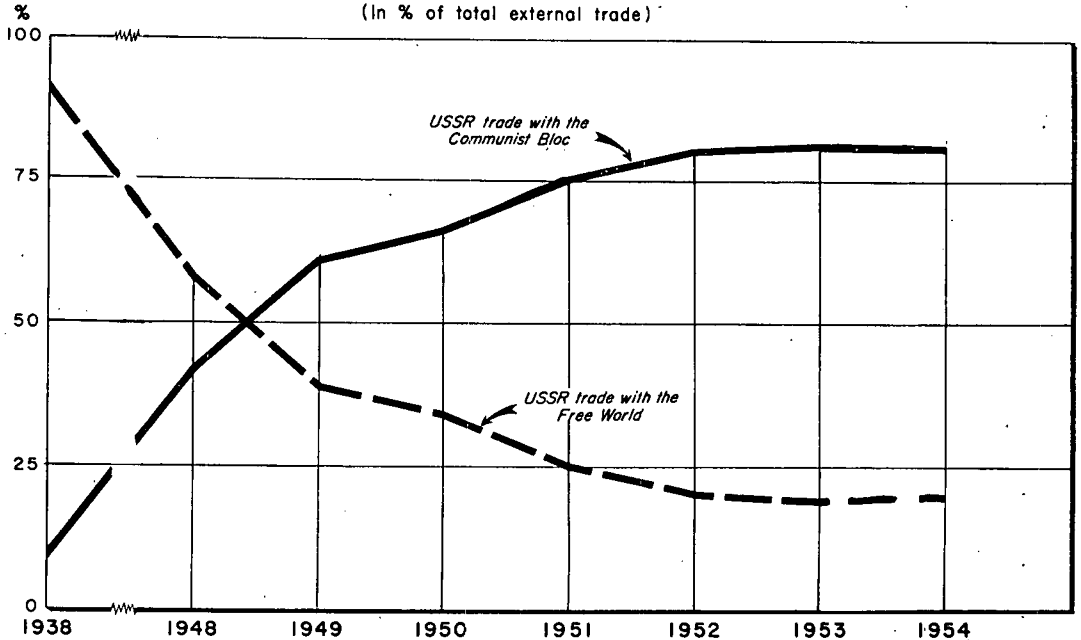
The trade of the Sino-Soviet bloc with the free world during the same period has never exceeded 3 to 4 billions.

In fact, during the year preceding July 1955, imports from the free world by the entire bloc were about $1 billion less than imports by the Netherlands.

The trade of the leading industrial nations of the free world, all members of COCOM, with the countries now composing the European Soviet bloc, has never returned to its prewar importance. In prewar days Eastern Europe was important particularly to the trade of Western Europe.

USSR TRADE WITH THE FREE WORLD AND WITHIN THE SINO-SOVIET BLOC*

(In % of total external trade)



* Sino-Soviet Bloc includes: USSR, European Satellites, Communist China. Does not include North Korea or Northern Vietnam.
Source: Trends in Economic Growth, Joint Committee on the Economic Report, 1955

CHART 5

The reason for this drop in importance of East-West trade can be traced directly to Soviet policy. An example of this can be seen on chart 5. This illustrates the Soviet drive toward autarchy within the bloc, to set up a market which has been described by Soviet leaders as isolated from and parallel to free world markets. The obvious aim is to make the entire Sino-Soviet bloc independent economically from the remainder of the world. As a result of this policy, the postwar expansion in U. S. S. R. foreign trade has occurrd almost exclusively with the countries comprising the Sino-Soviet bloc.

You will note in the chart the comparison between the free world trade and the intrabloc trade in the lower and upper curves. You can see how they spread.

Before 1940 the U. S. S. R. devoted less than 15 percent of its external trade to the areas now comprising the Eastern European satellites and Communist China. By 1954 the proportion had risen to 82 percent. Thus only 18 percent of the Soviet Union's foreign trade was available to free world merchants.

Conversely, the areas of the Eastern European satellites and Communist China gave 10 to 15 percent of their total foreign trade before 1940 to the U. S. S. R. Last year these countries as a group devoted 53 percent of their foreign trade resources to the U. S. S. R. and another 24 percent to trading with each other. Thus the satellites and Communist China limited their exchange of goods with the free world to 23 percent of their total.

We have seen no positive evidence that this policy of making the bloc self-sufficient has changed recently. The free world has been regarded by the bloc primarily as a source of equipment, technical knowledge, and commodities which are in short supply within the bloc.

There are many other factors which inhibit trade with the bloc. Among the most important, as I have said previously, is the lack of marketable exports with which to pay for the bloc's imports. The traditional exports of those countries have been products of the farm, forest, and mine. Yet many of these are now being imported as a result of the emphasis upon industrial production within the bloc. Petroleum from the U. S. S. R. and Rumania seems to have become a major export in 1954 to the free world. Some machinery has been shipped to underdeveloped countries as part of the Soviet drive to increase political contacts with those countries.

In addition, the Soviet market is a highly unreliable one for merchants. There is no certainty that a newly established production line, created to fill Soviet orders, will not be interrupted because of a change in Soviet demands. American businessmen have in the past seen their products purchased and used as prototypes for Soviet production although these products are protected by United States patents which the Soviet Union refuses to recognize. Soviet political decisions are reflected all too frequently in their own trade embargoes. There is no need to recount the Soviet action in Yugoslavia in 1948.

These are only a few of the difficulties which, because of Soviet policies, hinder trade with the free world. These difficulties in trading with the Soviet bloc have very little to do with the security controls. As I said earlier, the Soviets have available to them a vast and relatively untapped supermarket of peaceful goods which they can buy at will, provided, of course, they are willing to devote their resources to pay for these goods.

In summary, I would like to emphasize:

Strategic controls of a selective nature are important and necessary to deprive the bloc of the kinds of goods it needs to build up its war potential industry.

Strategic controls have been only a minor factor in causing the low volume of postwar East-West trade. This trade has always been low in relation to total world trade.

The bloc's own policies have had a great effect in limiting East-West trade.

If the bloc in Europe is in earnest about increasing trade in peaceful goods, it has more than ample opportunity to do so.

Mr. Bolling. Thank you, Admiral DeLany.

We always at this point in the proceedings inquire if the witnesses have been stimulated by the other witnesses' comments to make further comments of their own.

Would you have any further comments that resulted from what Admiral DeLany has said?

General Draper. I was stimulated, but not to speech.

Mr. Bolling. What about you, Admiral?

Admiral DeLany. No, sir; I have no comments.

Mr. Bolling. Senator Flanders, do you have some questions or comments?

Senator Flanders. I was not fortunate enough to be here when you read your paper, General Draper. I have gone through it hastily since.

On page 7, at the top of the page, "Our stocks of surplus food might well become a good trading medium for legitimate East-West trade."

I have marked two words there. First, the word "trading," and the other "legitimate." Now, as a trading medium, what would you expect them to offer us in return for the surplus grain, for instance?

General Draper. One of the exports that we have taken in the past in some quantities has been manganese. I don't know——

Senator Flanders. Manganese?

General Draper. Manganese ore.

Senator Flanders. We have, as I remember, found other sources so that we are not deficient in manganese supplies. Do you know whether these other sources cost us more than the manganese from Russia did previously?

General Draper. I believe that the manganese that is being offered by the Soviet in other markets is priced about the same as we now pay for manganese. I can conceive of their trying to undercut it, but so far as I know they have not done so.

Senator Flanders. Would you feel that from a trading proposition that they had a great reservoir either of goods or gold to back up a large-scale trading operation?

General Draper. No, sir; I do not. I do know there are gold resources, and when they did require imports in the last year or two they have paid their gold for quite a little of that. Just how big those stocks are, I don't know. Gold would be another trading medium that I should think we would take in return.

Senator Flanders. So far as you know are there any reasonably good estimates as to the available supply of Russian gold?

General Draper. I don't know of any such.

Senator FLANDERS. I underlined the word "trading," and the word "legitimate." What is your use of the word "legitimate"?

General DRAPER. As opposed to the type of trading that they are apparently trying to get us to agree to in strategic goods.

Senator FLANDERS. So far as existing regulations are concerned, are we free to export food grains?

General DRAPER. We are as private sales, sir, but as I understand it, the surplus commodity law now prohibits sales of such commodities, including food, to members of the Soviet bloc.

Senator FLANDERS. Yes. That is not an administrative restriction but a statutory restriction.

General DRAPER. That is my understanding, sir.

Senator FLANDERS. And do you feel that that statutory prescription is good or bad?

General DRAPER. I see no advantage in it. I would personally suggest it be repealed.

Senator FLANDERS. I assume that it is based on the idea that anything which helps the Soviet Government over its agricultural crisis is in the long run a strategic piece of strategic assistance. Do you suppose that is the reason?

General DRAPER. Certainly during the war, food was of a strategic item of the highest quality. I would assume that if we are interested, as our Secretary of State stated recently, in developing peaceful trade with the Soviet bloc, or willing to do so, at least, that food would come within that category. I remember that a year or so ago President Eisenhower offered food free, which is permitted under another provision of the law, to East Germany and some of the other satellite states when there was some famine condition there.

Senator FLANDERS. Yes.

General DRAPER. Food is also a political weapon.

Senator FLANDERS. I think it was as a political weapon that food was offered to the satellites.

General DRAPER. I think so.

Senator FLANDERS. As a matter of fact, I played a part in putting that into law, with the notion of its political effectiveness.

I am a little bit dubious about the wisdom of helping the Soviet Government over its comparative failure in the agricultural field by any large-scale trading in foodstuffs, though so far as trading is concerned I think we just agreed that they have comparatively little with which to trade.

General DRAPER. I would think, Senator, that if what I am suggesting here—which I do not really expect, namely, that the Soviet decided to try to develop trade with the West—I don't expect that. If they took measures in that direction, and we did similarly in peaceful goods, over a period of years the same phenomenon that has developed among the free nations could certainly happen. Perhaps not under the present Russian system—I don't know—but the creation of markets does develop products where people want to sell and want to find a market and exchange their goods to the advantage of both. I don't really expect it. It is a possibility, and if that developed, and they really needed food badly, we could trade as hard as we wanted with them.

Senator FLANDERS. That would mean setting that up as a permanent policy, abandonment of autarky.

General DRAPER. For it to develop; yes, sir.

Senator FLANDERS. You do not expect them to move in that direction?

General DRAPER. Not for the foreseeable future.

Senator FLANDERS. One other point on that question of use of our food surpluses:

Do you think that the other food-growing nations—taking Canada as an example—would have any reason to be disturbed at the effect on prices of the dumping, let us say, of surplus wheat in the Soviet Union, or in the Soviet area?

General DRAPER. I would presume that could be a matter of mutual discussion at such a time. Maybe we would do it jointly, but I do not suppose that dumping would really hurt Canada because, as far as I know, she is not selling very much there now.

Senator FLANDERS. I do not see how that would affect world prices, if dumped into that particular hopper.

General DRAPER. I should not think so, sir.

Senator FLANDERS. I might just say in comment, Mr. Chairman, that I am convinced that the Russian policy for the indefinite future is based on the idea of complete self-existence, self-support, autarky, and that anything that they proposed to do otherwise at any given time is a special case with special consideration, and cannot be depended on for long, as their long-range operation, and will be so much to the particular advantage of the Soviet Government that we might well view it with a skeptical eye.

I take it that you feel more or less similarly?

General DRAPER. I agree with every word of that, sir.

Senator FLANDERS. Thank you, sir.

Now, Admiral DeLany, I picked up a phrase here on page 3, the second paragraph:

> The Soviet Union has in fact recently begun to sell gold again and appears to be trying to utilize credit arrangements more widely.

Do you think there is any danger of any of the countries of the Western World granting very extensive, or long-time credits to the Soviet Government?

Admiral DELANY. I do not.

Senator FLANDERS. So that as a temptation to expanded trade between our European friends and Soviet Government, you doubt if the requirement for credit increases the temptation in any way?

Admiral DELANY. I think they are aware of the unreliability of the bloc, and I think that they are completely skeptical of any idea of extending long-term credits.

Senator FLANDERS. So that again it gets back to the question of what has Russia to pay with. To the extent that she has a gold supply, that is a valid item in the exchange; and, so far as your research and knowledge goes, can you give us any estimate as to the annual amount of receivable exports that she might offer for trade? That is, exports that would be attractive to the Western World—manganese was mentioned.

Admiral DeLany. Yes, sir. I think General Draper has referred to the fact, in answer to your question, that there are, generally speaking, ample supplies of that item in areas other than the Soviet bloc, but the potential does prevail for starting a price war. I do not know whether the American buyer would be attracted by that or not, but that possibility does prevail.

Senator Flanders. I did not get that.

Admiral DeLany. I said there are ample supplies of manganese outside of the bloc, and the possibility always prevails that the bloc could start a price war. Whether that would be attractive to free-world merchants, or whether they would accept that kind of an offer, or whether they would realize the potential danger in it, I cannot say. It isn't possible to predict.

Senator Flanders. In general, the price would be an administrative rather than a commercial matter?

Admiral DeLany. Yes, sir.

Senator Flanders. I am glad that in your judgment the holding out of large orders on credit terms will not be attractive to the members of the Western World.

Again, at the middle of page 9 you indicate the limitation of things to offer. You say that it is your belief, based on comprehensive and continuing studies, that a further reduction in strategic trade controls would have its effect primarily on the composition rather than the overall dollar value of East-West trade.

I take it that there again you meet the limitation of what they have to trade.

Admiral DeLany. Yes, sir. I mean to imply if you remove strategic controls you merely increase the size of the shopping list and give them more selectivity in their choice. I do not believe that they would spend more dollars, but I think they would be more selective in their purchases.

Senator Flanders. Yes. Perhaps that selectivity would not operate in a direction which we would particularly wish to encourage.

Admiral DeLany. Definitely not.

Senator Flanders. Mr. Chairman, this seems to be a love feast for everyone except the Soviet Government.

Mr. Bolling. Do you have any further contributions to the love feast?

Senator Flanders. No; I have not.

Mr. Bolling. Dr. Ensley, do you have some questions?

Dr. Ensley. Yes.

Mr. Chairman, you will recall that on Monday afternoon one of our witnesses was Dr. Gale Johnson, the distinguished agricultural economist from the University of Chicago, and one in the group that visited the Soviet farm regions last summer. We asked him his views with respect to whether or not the shipment of surplus goods to Russia might help break down the Iron Curtain and be a step toward peace, or whether or not he felt it would permit the Communists to use their resources for warmaking purposes and stockpiling. I would like to quote his reply and get your judgment on that, Admiral.

He said, "My own feeling would be that if I had to make a decision that I would embark upon such a program very, very slowly."

And then he went on to point out that it was his observation, from looking over the wheatlands in the Ukraine, that they were attempting frantically to build up their wheat production, primarily for state reserves.

Are these factors being considered in the discussions currently going on within the executive agencies?

Admiral DeLany. My own interpretaton of the whole agricultural problem is that it is not possible to predict what would happen if the laws of the United States were changed to permit the sale of surplus commodities to the bloc.

I think if for political reasons, if for divisive reasons or any reasons that you want to think of, it would become a policy of the bloc to import United States agricultural surpluses, then it would not be a matter of stockpiling or anything else. It would be within the political framework of their autarkic controls. I personally do not feel that you can predict that they will or will not buy our agricultural surpluses. It is hard for me to believe that they would intentionally do anything that might relieve, what shall we call it, the dilemma in which we find ourselves with agricultural surpluses.

I cannot imagine their being that gracious.

Dr. Ensley. Admiral, would you be in a position to tell us the status of discussions within the executive branch with respect to the advisability of shipping or trading some of our surpluses to Russia?

I gather from the press that there are discussions going on between the Departments of Agriculture and State, primarily.

Admiral DeLany. No, sir; I cannot comment on that. I am not familiar enough with the details of the discussions.

Dr. Ensley. Nothing has been resolved yet in the executive agencies?

Admiral DeLany. No, sir.

Dr. Ensley. Thank you very much.

Mr. Bolling. Dr. Sheldon?

Dr. Sheldon. It has been evident from some of the earlier discussions in these hearings that the Soviet Union is using trade as a weapon, and now that the military struggle, at least temporarily, seems to be at an end, the economic struggle is moving to the forefront, and I am sure that probably both of our witnesses today can supply us with current examples of that nature.

I am just wondering whether either one of you would take a try at this question: What can we do to counter this kind of Soviet activity? They are using trade as a weapon, offering technical aid and assistance to various parts of the world, not necessarily from any genuine interest in improving the welfare of other people, but to divide the free world. What kind of counteraction should we take that would be helpful?

Maybe, General, you could start.

General Draper. In a sense aren't they copying us? They are following in the path of economic assistance that we have been carrying on now since even before the Marshall plan. They are doing it obviously in those countries where they can get the most for the least—India, Afghanistan—talking about the dam in Egypt, and probably not intending to spend very much, but to make a lot of trouble.

I suppose our answer is to continue where it is politically and otherwise desirable to give assistance that is within our means, and is going to achieve its objective, or we think it will.

The International Bank, as I guess everyone knows, has been thinking about the dam in Egypt for a long time, and that is a tremendous project. I don't suppose that it justifies itself on the basis only of a loan, so that may be the case, or there may be other cases where our Government may or may not want to lend assistance. I would suppose that it would be necessary to analyze each case on its own merits, and the political importance of the area, and the country and the project, and then decide in a practical cold-blooded way the best thing to do about it, if anything.

Dr. SHELDON. I take it, then, your answer would be in terms of specific consideration of individual cases, rather than a blanket endorsement of a new program on a world scale, necessarily?

General DRAPER. I would so recommend.

Dr. SHELDON. Admiral, would you comment on that?

Admiral DELANY. My comment would be that our efforts should be directed toward trying to have the free world countries appreciate the effect of this divisive effort, and to direct our attention toward the retention of the unity, and the relative economic strength of a unified free world, vis-a-vis the Soviet bloc.

Senator FLANDERS. Dr. Sheldon, may I make a comment at this time?

Dr. SHELDON. Yes, sir.

Senator FLANDERS. With regard to the Soviet Government entering into this field of economic assistance, et cetera, we had testimony yesterday from Mr. Nathan with regard to what they were doing in Burma—exchanging, or receiving rice, and, as he said, in return for industrial and some consumer goods.

Also as we know they are making arrangements to build a steel plant in India.

There is not merely, perhaps, Admiral, the Western World to consider, there is also what is in effect the neutral world to consider, and we have to wonder how to counteract these movements in the neutral world, as counteract the attractiveness of East-West trade with the Western World.

Probably the same limitations on the amount of trading they can do in, say, Burma, or India, that come within the overall limitations of their economy; unless they have some worn-out steel mill that they are willing to ship to India. Whether that is the case I don't know.

General DRAPER. They may still have some they took out of Germany 10 years ago.

Senator FLANDERS. Yes. That might be the case.

By the way, I am quoting someone who ought to know, that the Indians paid the Soviet authorities some large sum of money—let us say just, for example, a million dollars, for drawing up a plan for this steel mill. It took them a year to get the plans drawn up, and when they showed them, it was discovered that they were old plans which had been drawn up for a Soviet steel mill, one of their own, and just new tracings made, and new blueprints with the Indian legends on it. The new blueprints were furnished, and the Russians obtained another million dollars with which to trade.

That may be true or it may not be. I do not know.

Dr. SHELDON. I do have another question which perhaps is naval in character and should go to Admiral DeLany.

In some of these postwar years Soviet merchant ships have been put into Western yards for major repairs and overhaul.

Admiral DELANY. Yes, sir.

Dr. SHELDON. Isn't it possible that this kind of activity in Western ports has freed repair yards and building ways in the Soviet Union, making possible naval construction which we would certainly not find very encouraging?

Admiral DELANY. Yes. I think that is entirely probable, but I should like to invite your attention to the fact that the repairs, et cetera, that are being done on the Soviet ships are completely in accord with the COCOM, or an internationally accepted practice, and that no nation has undertaken the overhaul of any kind of a ship that could be considered to be purely wholly strategic, nor have they done any structural work, construction, or anything for any type of ship of that kind. While the possibility does prevail, that the repair work in foreign yards does relieve the Russian situation for the maintenance of its own merchant fleet, and thereby provide ways and yards for construction and overhaul of combatant ships, I would just like to repeat undertaking that work within the free world ports, is completely within accepted and recognized practices of countries participating in our international trade control.

Dr. SHELDON. One of the arguments which is offered from time to time by people who want us to relax trade, at least with the satellite countries, is that more trade with satellites, particularly, might encourage Titoism. Then there is a counterargument this isn't so at all; all we would do is simply strengthen those economies and help the whole Soviet bloc.

How do we weigh these two counterarguments?

General DRAPER. Which way is Titoism going now?

Dr. SHELDON. That is another question.

General DRAPER. In the line of peaceful trade, I see no reason why—no reason against it with the satellites. I don't see much expectation that it is going to develop in any great scale. It is rather important to three of our allies—the Germans, the British, and the Japanese; the Japanese with respect to the East. In the case of those three I think the figures generally are about $200 million dollars a year that each of them are doing in trade with the Soviet bloc, or figures comparable to that, so that it is a reasonably important percentage of their total trade, although not, of course, anything like a majority of it, and I would think that kind of trade in peaceful goods with the satellites or with the Soviet is perfectly acceptable, and to the extent it grows and goes on, is probably somewhat useful in making contacts.

Dr. SHELDON. Thank you very much.

General DRAPER. It was said by Mr. Molotov—certainly Mr. Molotov didn't encourage contacts in his speech day before yesterday from that point of view.

Mr. BOLLING. There is a view in the minds, apparently, and on the lips of a very substantial number of well-intentioned people in this country that trade in and of itself may have a substantial effect on the lessening of tensions—trade with the bloc. Would you care to comment on that, General Draper?

General DRAPER. If it amounted to anything real or any sizable part of their trade or our trade, I can see that it might. If trade with the Soviet bloc and the free world approximated our relations, for example, in trade with the British or the French, or any other major country and the free world, those contacts are vital, are important. They make for friendship, for understanding, for knowledge, for travel, but the present level of Soviet bloc trade with the free world is so small that I cannot imagine it has any real importance, and in that respect, and so long as they adopt and continue to adopt the policies they have now, it never will grow very much, and until it does I do not see that it can have much importance.

Mr. BOLLING. This next question is related to the first one: If I understand what has been said here and what I have heard in other places, the economic goal of the Soviet bloc is self-sufficiency or autarky. If one then moves from that to the second point, that therefore if their economic goal is autarky, it follows that whatever efforts they make in the field of trade, whatever trade they actually do carry out, is motivated by political considerations rather than economic considerations. If that situation continues, then the answer to the first question is even firmer. If their trade is totally or nearly totally politically motivated, then there will be no impact on an improvement of relations and a lessening of tensions.

General DRAPER. If they carried out their political intent properly that would be absolutely true.

Mr. BOLLING. Well now, related to this again, do either of you doubt the ability of the bloc to produce goods and services which would be attractive to various nations interested in increasing their exports? That is, of course, if the bloc was sufficiently interested.

General DRAPER. I have no doubt. In Germany we had many, many trades. We reached a number of trade agreements with Czechoslovakia, Poland, Hungary, I think with Rumania, and that was in the period of collapse right after the end of the war when production was at a low ebb everywhere. Polish coal was a vital import to our side. Coal briquettes fom Eastern Germany were very much needed in Western Germany, grain from Rumania. The whole Soviet development of the satellites, however, has been in the direction of not increasing their exportable surplus, and certainly to the extent the free world has been developing, not to increase the supply even for themselves of consumer goods. So that I think it would take not only a change in their autarkic philosophy, but also a change in direction of their productive energy, to not stress to the degree they have the heavy industrial growths which were primarily in the beginning at least designed for a war base—probably still are—to have that trend more in the direction of consumer goods, which will probably be the things they could supply to the Western World, if they wanted to.

Mr. BOLLING. But if they made a policy decision——

General DRAPER. That is right.

Mr. BOLLING. If they made a policy decision, there is no doubt in your mind they could produce goods that would sell abroad.

General DRAPER. There isn't any question in my mind that they could produce goods that would find a market at a cheaper price in other parts of the Western World just as the Western World would find items that could be sold there if there were desire on both sides to develop that trade.

Mr. BOLLING. I am thinking perhaps primarily in terms of their ability to use trade as a political weapon to a much larger degree at a comparatively small diversion of their resources. It occurs to me that at some point they may do what other totalitarian nations have done in not too distant history. They may decide that they can make their greater gains in breaking up the free world, in dividing the free world, through the use of trade as an active instrument of policy rather than as more of a propaganda instrument of policy, as it has been in recent years, and that then leads me to my final question: Therefore, it seems to me obvious, and I doubt that either of you would disagree, that it is extremely important for this country not only to have the kind of policy with regard to trade that allows people who desire to trade in our markets, but also that we have the kind of policy which does not give to the bloc cheap opportunities to use trade as an instrument of policy. I take it that you would agree with that.

General DRAPER. Certainly.

Mr. BOLLING. Thank you very much. Are there further questions?

Senator FLANDERS. I have one observation to make, which I think is outside our frame of reference. Our frame of reference, I take it, relates largely to employment, production in this country. That is what the joint committee is set up on, so this is outside that frame of reference, but I want to make the observation that I think that in my judgment the statement that trade builds up or releases tensions and builds up international good will should not be accepted as a generality. It is strongly my belief that it was the trade war between Germany and Great Britain in what was practically a free-trade world which brought on World War I, so that we can't say that freedom of trade and peace necessarily go hand in hand. We have got to look at the conditions before saying that.

Mr. BOLLING. I have one more question that I would like to ask. What would be the positive international advantage to the United States or the free world of trading large quantities of food to the Soviet bloc, disregarding what they would pay for it?

General DRAPER. I can think of one internal advantage if the volumes were large.

Mr. BOLLING. International.

General DRAPER. It would depend entirely upon the circumstances, in my judgment, at the time, and what our thought about the Russian position was at that time. Certainly I would think that the food that the President gave in East Germany a year ago—there was nothing in return—had real political advantage.

Mr. BOLLING. I would agree with that.

Are there any further questions or comments? If not, gentlemen, we thank you very much for your time and your very important contribution to our hearings.

At this point I shall make a letter from William C. Foster, of New York, a part of the record.

(The letter referred to is as follows:)

OLIN MATHIESON CHEMICAL CORP.,
New York 22, N. Y., November 15, 1955.

Hon. RICHARD BOLLING,
Chairman, Subcommittee on Foreign Economic Policy of the Joint Committee on the Economic Report, Washington 25, D. C.

DEAR MR. BOLLING: You have requested that I submit my thoughts on the subject of "so-called East-West trade." I am happy for this opportunity. Possibly my comments may assist the committee in its deliberations concerning this complex subject.

My direct experience in the field extended from 1946 through 1951, and principally concerned Western Europe. My remarks therefore are based on that period and on that area. Conditions have changed substantially in the intervening years, but I am sure that the committee will make due allowances for those changes.

To meet their economic needs, the nations of Western Europe, prior to World War II, had traditionally depended on Russia, Poland, Czechoslovakia, and the Balkans for food, fuel, and, to a lesser degree, fibers. In turn, these states were a market for many of Western Europe's industrial and high-labor content products.

The dislocation resulting from the Second World War, the liquidation of the free Eastern independent states, the dictatorial control of trade and production in the Russian satellite states of the East, of course, completely disrupted this trade. The hostile and aggressive designs of the East made impossible even the best efforts of the West to establish normal trade during 1947 and 1948; this despite the full realization of the plight of the people in the subjugated satellites.

Faced with these realities, it became increasingly clear that the interests of the United States would best be served if we would (1) neither ship to the East goods having any strategic value nor condone such shipment by our allies; (2) recognize that in the absence of a normal Eastern market for food and fuel, Western Europe must obtain these essential commodities elsewhere; and (3) accept the fact that the only alternative source of such supplies was the dollar areas of the Western Hemisphere since Europe, due to its low levels of trade and production, was not capable of making substantial contributions.

The Marshall plan, through the instrumentalities of ECA, was the catalyst that stimulated the activity which led to the high level of production and trade and made economic recovery in Europe a reality.

I firmly believe that it was the dollars and the imaginative leadership supplied under the aegis of the Marshall plan that made it possible for Europe to live again despite the discontinuance of trade wth the totalitarian East.

The $15 billion of economic aid invested by the United States during that period in the recovery of Europe were moneys well spent. These funds made possible the preservation of democracy in Europe. Furthermore, these billions underpinned a European economy and made it possible for this area to enjoy a recovery without being compelled to sell to the East. In short, these were moneys that made a major contribution toward the maintenance of security and peace in the world.

No one, and certainly not I, could say for certain whether the East would or would not have attacked Europe during this period. I think, nevertheless, that one can without serious question assume that a weak Europe would have offered an easy target for Russia.

During those 5 critical years, the choice seemed to be a clear one. In simple terms, we had either to help the Western democratic nations or recognize the necessity of their trading with Eastern Europe. We had but one choice: to assist Europe and through that assistance eliminate or radically reduce the flow of strategic materials to the East. I believe we succeeded in achieving this objective.

Today, as a private citizen, and in the absence of firsthand information, I believe the situation to be not fundamentally different. Today we and our allies are militarily strong—far stronger than in those critical years. In our strength things are permissible which would have been foolhardy during 1946–51. Today I believe an increased flow of consumer goods—and, I repeat, consumer goods—from the East to the West would be mutually beneficial.

Again may I express the hope that these thoughts may be of use in your deliberations.

Respectfully yours,

William C. Foster.

Mr. Bolling. The subcommittee will now adjourn until tomorrow morning in this same room at 10 o'clock, when the subject will be economic policy alternatives.

General Draper. Thank you very much.

Admiral Delany. Thank you.

(Whereupon, at 3:28 p. m., the subcommittee adjourned, to reconvene at 10 a. m., Thursday, November 17, 1955.)

FOREIGN ECONOMIC POLICY

THURSDAY, NOVEMBER 17, 1955

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY OF THE
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The subcommittee met at 10 a. m., Hon. Richard Bolling (chairman of the subcommittee) presiding.

Present: Grover W. Ensley, staff director, and Charles S. Sheldon II, staff economist.

Mr. BOLLING. The subcommittee will be in order.

This is the final day of this series of hearings on foreign economic policy. A tremendous amount of ground has been covered. We appreciate that it will take time to assess completely all that has been presented, and our hope is that when the printed record is available that it will provide an important source material for further discussion.

This morning we have asked two distinguished economists to appear to discuss the major policy alternatives open to us, and the implications of these alternatives for the United States economy. In one sense we are completing the circle. On the first day, the message of the Department of State emphasized the importance of foreign economic policy as a part of foreign policy in general. That theme undoubtedly will reappear today, but also foreign economic policy as a part of economic policy in general will be emphasized.

I have tried to make the point that our policies are complex, sometimes confusing, and certainly compounded of many elements. Our goal has been to find a pattern to explain foreign economic policy and to chart a course for the future. Our guests this morning are going to help us in this process.

Dr. Howard S. Piquet is the senior specialist in international economics of the Legislative Reference Service of the Library of Congress. Professor Piquet has taught at several of our leading universities and presently is also on the staff of American University. He is well known as a writer on trade matters, with his last book receiving national attention. It is entitled "Aid, Trade, and the Tariff." Dr. Piquet has served in a number of agencies of our Government and with the United Nations. For many years he was the chief economist of the United States Tariff Commission. In addition to his regular advisory work for the Congress he served on the staff of the Randall Commission. For the joint committee he headed the special staff which wrote the study entitled "Trends in Economic Growth; a Comparison of the Western Powers and the Soviet Bloc."

Dr. Piquet, we are happy to have you with us to discuss "the major choices open to us in foreign economic policy and their implications for the structure of the economy."

STATEMENT OF DR. HOWARD S. PIQUET, SENIOR SPECIALIST IN INTERNATIONAL ECONOMICS, LEGISLATIVE REFERENCE SERVICE, LIBRARY OF CONGRESS

Dr. PIQUET. I suppose, Mr. Chairman, I might be called your home talent, since I am a member of the congressional establishment. What I say is not in any way to be interpreted as the official view of the Legislative Reference Service of the Library of Congress. I speak solely in my personal capacity.

Economic foreign policy constitutes an essential and major part of overall foreign policy and cannot be determined separately from it.

In turn, at the very center of economic foreign policy lies foreign trade policy, involving such thorny questions as the tariff, customs regulations, quotas, and clashing interests among groups within countries.

Currency convertibility, foreign investment, policies relating to raw materials, agricultural policies, monetary policies, and many other international economic questions are important, but they are all geared into foreign trade policy. Without a realistic foreign-trade policy not much can be done to solve them. Foreign trade, furthermore, is by far the largest item in the balance of international payments and foreign-trade policy is of tremendous psychological importance in international human relations.

Since economic foreign policy is closely intertwined with foreign policy it is doubtful whether it or any important phase of it, including foreign-trade policy, can ever be effectively determined scientifically according to an objective formula. Our long experience with cost equalization and the tariff tends to support this assertion.

Whether we consider economic foreign policy as a whole, or international trade policy, or any other aspect of international economic relations, the important thing is the attitude or set of preconceptions with which we approach the problem. It is to these various attitudes that I propose to address myself this morning. There would be little point in listing the many concrete policies and programs that have been suggested, for there seems to be about as many of them as there are experts in the field. Furthermore, members of the committee have heard many of them in the last few days.

Before analyzing attitudes, however, it would be well to clear away some of the intellectual underbrush that has accumulated in our path.

Mere attainment of equilibrium in the balance of international payments should not be the goal of economic foreign policy. Attainment of equilibrium in the day-to-day accounting sense would be relatively easy. In fact, technically speaking, the international accounts actually are in balance since the United States has been following foreign aid and allowing the international debits and credits to find its debits. Full accounting balance can be achieved by terminating foreign aid and allowing the international debits and credits to find their own balance in terms of diminished exports or increased imports, or both.

The kind of international economic balance in which we are really interested is not this narrow, accounting balance, but rather the balance, or better stated, viability between our economy and the economies of other countries at production and living levels that are tolerable in the light of political realities.

Had we not embarked upon economic foreign-aid programs 8 years ago we probably would have closed the so-called dollar gap. But we would not have closed the more serious gap between living standards here and in Western Europe. We could not afford to allow levels of living in Italy, France, the United Kingdom, and other countries of Western Europe to fall to the depths to which they would have fallen without assistance from us. Totalitarian dictatorships were waiting in the wings for the international drama to unfold in that direction.

In retrospect, it is clear that the reconstruction efforts typified by the Marshall plan played a major role in holding Western Europe in the family of free nations. It also seems clear that permanent foreign aid is not the real solution to the problem. The real question confronting us, therefore, is whether we are going to have either foreign aid or foreign trade at levels high enough to maintain international political stability and security in the free world.

The basic policy decision—and, in my opinion, it is one that has already been made—is whether we should continue along a path of international economic cooperation or whether we should follow the path leading to economic self-containment.

Americans have demonstrated their conviction that only through collective strength can the nations of the free world attain genuine security against aggression. In a succession of foreign-aid programs since the close of World War II they have given, or loaned, about $5 billion annually to assist the economic recovery of countries that were disrupted by war; for technical assistance to underdeveloped areas, and for direct and indirect military purposes. In addition, they have supported the United Nations and have played a leading role in establishing and supporting other international organizations.

In the following analysis it will be assumed that the United States is going to continue a policy of international cooperation rather than a policy of economic self-containment. Whether, within this framework, policy veers more toward the extreme of self-containment or toward the extreme of internationalism, remains to be decided.

Whatever economic foreign policy the United States pursues, within the framework of international economic cooperation, must necessarily be in terms of the following factors, or some combination of them:

1. Imports—merchandise and other current transactions—into the United States;
2. Exports—merchandise and other current transactions—from the United States;
3. Foreign investment in the form of either net increases in United States investments abroad—private or governmental loans—or further reduction of foreign investments in the United States;
4. Continuation of foreign aid—gifts—by the United States.

In the long run the solution must be in terms of items 1, 2, and 4. The outward movement of long-term capital necessitates eventual repayment and servicing in terms of imports. When new capital exports fail to keep pace with return payments, a point that is bound to be reached sooner or later, the lending country must become a net importer on current account. This was the sequence of events in Great Britain in the 19th century.

Continuing in the same framework, the United States can follow any one of three policies, as follows:

The first is to continue its foreign-aid programs and its present import policy, such as has been done since 1945. This policy would enable United States exporters to continue exporting at a high level. Long-continued aid, however, might result in intensifying ill will among its recipients at the same time that it imposes a long-continued, unpopular financial drain upon American taxpayers. Further, if such a policy were to be followed for an extended period, it might postpone indefinitely the balancing of the economy of the United States with those of recipient countries on a basis of full viability.

The second choice would involve the cutting down of foreign aid, together with a consequent curtailment of United States exports. Those who argue in favor of such a policy are impressed by the extent to which United States exports have expanded as a result of two world wars and assert that United States exporters have developed unjustifiable vested interests in their continuance. They believe that it would be desirable for the United States to curtail its exports and allow European countries to take over third-country markets, which they most probably would now have were it not for United States competition. Such a policy would necessitate adjustments in the United States economy similar, in a general way, to those that would be necessitated if imports were to be permitted to increase. The interest groups involved would be different, however, and the industries most immediately affected would be those that are geared to exports, such as automobiles, many machinery items, motion pictures, and other manufactured goods, together with such important agricultural staples as cotton, wheat, and tobacco. Some industries would find it difficult to contract production. In the case of agricultural products, contraction of exports would aggravate an already apparently insoluble surplus problem.

The third choice would be to curtail foreign aid, but while doing so to encourage imports. Such a policy would point in the direction of more, rather than less, foreign trade. It would lead, however, to intensified competition between imports and domestic production in certain lines and to economic adjustments in those cases where the effect of the imports would be to displace certain American producers.

It is important to weigh the effects of such adjustments upon the economy as a whole against the effects of adjustment to declining exports. Adjustment will be the easier to the extent that the phenomena in question have an expansive effect upon the economy as a whole and the more difficult to the extent that their effect is one of contraction.

For this reason, it would appear to be less risky to the American economy to take up the slack of declining foreign aid by a policy designed to increase imports than by one that would result in declining exports.

These three policy choices are not necessarily mutually exclusive. It might be possible simultaneously to cut off some foreign aid, to curtail certain exports, and to encourage certain imports. The stimulation of American investment abroad, of course, would be consistent with any of these policies and, if successful, would make easier of accomplishment any one, or any combination, of them.

It would be overoptimistic, however, to rely upon accelerated foreign investment, unaided by foreign-trade policy, to generate the increased imports needed to restore international economic viability to the national economies of the free world.

Probably most people would agree that the foreign trade policy of the United States since 1934 has been directed toward liberalized trade. That was the year in which the trade agreements program was initiated. Ever since, with ups and downs it is true, it has continued to constitute the hard core of the country's international trade policy.

Yet if one is put to it to define clearly what the administration and Congress mean by "liberalized" trade, one will find the task exceedingly difficult. Different people use the same term as a label for quite different concepts.

To some it means merely larger exports and larger imports. To those who look upon large and flourishing world trade as beneficial for its own sake this is a logical meaning. Most such persons would prefer, probably, that such trade be conducted with as much freedom as possible, but the essential thing is that there be abundant world trade. Trade concessions by all countries, on a reciprocal basis, are consistent with this view.

A second, and more penetrating, view is that not only should there be larger world trade in the aggregate, but the balance between imports into, and exports from, the dollar area should be altered in favor of larger imports. Such a change, it is maintained, is necessary to bring about balance in the international accounts. To this end adherents to this view are in favor of reducing tariffs and doing away with as many other trade barriers, quotas, licensing arrangements, and so forth, as possible. They are not wedded to the idea that for every concession granted to stimulate imports there should be a corresponding concession in favor of United States exports; that is, strict reciprocity.

Then, there are those who confine practically all of their attention upon tariff duties, as such. As long as statutory tariff rates are reduced, in trade agreements or otherwise, the more conducive will the environment be for increasing international trade. Those who think this way usually lay great stress upon the importance of nondiscrimination in international trade. To them such devices as import quotas, exchange controls, clearing agreements, licensing arrangements, and so forth, are evil, per se.

Finally, there are those who see in historical and philosophical perspective the original meaning of "liberalized" trade. They agree that a large and flourishing world trade is desirable and that it makes for prosperity and peace. They agree that imports should increase relative to exports but believe that such a circumstance would eventuate if trade were really to be liberalized. They favor the lowering of all tariffs and would most certainly work for the abolition of all bilateralism, as opposed to multilateralism, in world trade.

These are the heirs of the doctrines of the original classical political economists of the 19th century—Adam Smith, David Ricardo, and John Stuart Mill. These are the true free traders, using that term with caution and in its pure meaning. Thus used, it is not incorrect to apply the term to the more enthusiastic proponents of the trade agreements program, and quite correct to say that it summarizes the stated trade policy of the United States from 1934 to date.

The term "free trade," it should be observed, has a dual meaning, a fact which has led to considerable confusion in international trade and tariff debate.

In its broadest meaning, free trade signifies the absence of all tariffs and discrimination between foreign suppliers. No responsible Government official today would admit that he is a "free trader" in this sense.

In its purer meaning, free trade signifies merely the absence of discrimination between foreign suppliers, even though moderate tariffs applicable to all suppliers alike are imposed. Free trade, in this sense, has been the stated goal of United States trade policy since 1923, when the unconditional most-favored-nation policy was announced by Secretary of State Hughes.

In the 19th century the logic of a free trading world economy was compelling. Under pure competition as outlined by Adam Smith and his followers, the greatest economic good for the greatest number resulted when each country devoted its energies to lines of activity in which it had a comparative advantage. So well did this system work down to the outbreak of World War I that it came to be looked upon as a natural arrangement.

There are many in the liberal fold, as opposed to those who are in favor of economic self-containment, who are critical of the passive trade policy which was appropriate prior to World War I. Although, for the most part, they favor the establishment of a multilateral trading system eventually, they are critical of relying upon this approach for solutions to the problems that confront the country now. They think that today, after two world wars and profound industrial and economic changes, it is clear that the 19th century arrangement, instead of being an inevitable norm to which we can, should, and will return, appears for what it really was, a pleasant historical interlude.

Some of those in the liberal trade camp who are critical of policy which relies almost exclusively upon the reestablishment of a multilateral trading system, maintain that, laudable though such an objective is, it is ineffective as an instrument of policy to solve today's international economic problems.

As they see it, the foundations upon which the 19th century system of pure competition rested were neither natural nor permanent. The system was made possible, in their view, by the industrial conditions of the period and by the willingness of Great Britain to assume the responsibilities of leadership in the world economy. It was facilitated by maintenance of the gold standard, the convertibility of the pound sterling through the guardianship of a small group of men in London, the insularity of Great Britain, the nature of her industrial economy, and her willingness to enforce the Pax Britannica. The 19th century was the golden age, not only in that trade was relatively free within an integrated world economy based upon a free gold standard, but also because it was a century of world peace.

These critics hold that, instead of seeking to reestablish the world economy of the 19th century, the goal of United States policy should be to establish a functioning international economy in which negotiated arrangements are substituted for the automaticity of the old-world economy. This they would do through regional arrangements of various kinds—I don't mean geographical regional, but I mean regional in a functional sense, also, such as the Marshall plan, the OEEC, international conventions along the lines of those sponsored by the Internatioal Labor Orgaization.

In support of their position they emphasize the following points:

1. The great difference between the position of the United States in mid-20th century and the position of Great Britain in mid-19th century.

In the earlier period Britain's was the leading economy among many, no one of which was far ahead of the others in size and production. Today the United States is the dominant country in the free world, not because of positive political leadership, but because of its great wealth and productivity. In the 19th century the British economy was more dependent upon the economies of the rest of the world than they were upon it. The ratio of foreign trade to British national income, therefore, was high and the pound sterling circulated freely throughout the world.

Today other countries are much more dependent upon the United States economy than the United States is dependent upon them. With few exceptions, the United States is conscious neither of the need of importing merchandise from abroad nor of any compelling necessity to invest capital abroad. There is little reason to expect, therefore, that the dollar can play a role in the contemporary international economy similar to that played by the pound sterling in the 19th century. The likelihood is that the dollar will remain far too scarce to perform such a function.

2. The economic adjustment mechanism does not now work with the precision with which it worked even a half century ago.

Enterprise today is conducted on a much larger scale than previously. A relatively small number of companies dominate many important fields of production and economic adjustments tend to be man-made and administrative in contrast to adjustments brought about more or less automatically by the forces of the market. Production, furthermore, is now so highly specialized that overcapacity threatens in many lines.

In agriculture and labor, also, group action has very largely superseded individual action. Economic adjustments, instead of constituting an equilibrating process, are more aptly described today as the result of negotiation of one kind or another.

In addition to these economic and industrial changes per se is the increasing role played by the state. Governmental intervention in agricultural production and marketing, in population movements through immigration controls, in imposing barriers to international trade and in governmental response to the demands of powerful claimant groups, have made the 20th century far more complex than the 19th.

3. These difficulties are accentuated by differences between the United States and many other countries with regard to manufacturing psychology.

Many American factories produce consumer goods that will soon need to be replaced. Automobiles, radios, television sets, refrigerators, and consumers' mechanical goods generally are not intended to last for a long time. If they do not wear out they are soon rendered obsolete by rapid technological and design changes. With American industry operating on this basis and industries in many older countries operating along more traditional lines, stresses and strains are introduced between the two economies. American goods are so new and advanced in design and so low-priced that they are popular everywhere.

The strong demand for American goods drains other countries of their scarce dollars. Finding it difficult to sell enough of their own goods in the American market to provide dollars with which to buy the American goods that they would like to have, they resort to exchange restrictions and quantitative import controls in order to protect their gold and dollar reserves against "excessive" imports from the dollar area.

Some alternative policy choices:

1. As stated earlier in this paper, the basic choice is whether we shall continue along a path of international economic cooperation or whether we shall return to a policy of economic self-containment. This choice, I said above, the American people have already made. The question now is which policies to pursue within the framework of international cooperation.

2. One choice within this framework is to continue pressing forward the multilateral trade philosophy of the trade agreements program. Even though this program has been greatly weakened as an instrument for liberalizing trade (both for increasing imports and for freeing trade from its bilateral shackles) it is still recognizable as a trade-liberalizing instrument.

Since 1947 the Presidential power to reduce tariff duties has been greatly curtailed and the escape clause has been strengthened as a barrier to further tariff cuts.

It is interesting to observe that, since 1947, as the administration has pressed ever harder for multilateral tariff reductions (at Geneva, Annecy, Torquay, and again at Geneva) Congress has tightened the escape clause and grafted onto the Trade Agreements Act the doctrine that tariff reductions shall not cause, or threaten, injury to any domestic producing interest. As a consequence, there has been a temptation to reduce duties, as such, rather than to reduce them in order to increase imports.

On economic grounds there is much to be said for restoring the original trade agreements philosophy. But this would involve the repeal, or at least serious modification of the escape clause, and this seems out of the question politically. For, the fact is that throughout most of the 20 years since 1934 it has been possible to lower many duties without injuring anyone. This was possible because of the many excessively high duties provided for in the Tariff Act—excessively high, that is, in terms of the power to restrict imports. After 20 years of tariff-reducing activity there is not much "water" left in the tariff structure that can be wrung out without injuring domestic producers somewhere.

3. In the belief that tariffs should be reduced in order to increase imports, and not just for window-dressing purposes, it has been proposed (by Mr. David McDonald, as a member of the Randall Commission, and by several Senators and Members of the House in bills introduced in the last session of Congress) that a program of adjustment assistance be adopted to facilitate the economic adjustments in the home economy that would be necessitated in those few cases where

tariff reductions might cause some hardship. Such assistance would be modest in scope and would consist of increased allowances under the unemployment insurance law, assistance to distressed communities, assistance through the Small Business Administration to companies finding it necessary to adjust to new lines of production, et cetera.

Such a program would not be very costly for the simple reason that the displacement effects of tariff reduction would not be very great. The claim that has been made by certain interested parties to the effect that reduced tariffs would displace some 5 million workers is highly exaggerated. Competent estimates were made a few years ago showing that, even if all tariffs were to be suspended (assuming conditions of economic prosperity to prevail) imports would increase by not more than $1.8 billion and that not more than 200,000 jobs (i. e., man-years of work) would be displaced by the increased imports resulting from such suspension.

A 50-percent reduction of all tariffs obviously would have a much smaller displacement effect.

The effect of the adoption of Mr. McDonald's proposal would make it easier, in practice, to reduce duties in the national interest, since those in positions of responsibility would realize that innocent victims of increased imports would not be called upon to bear the ultimate burden. It would, by the same token, make it easier for the economy to adjust to lines of production more consistent with the natural aptitudes of the people and with environmental conditions.

The adoption of such a proposal would make it easier for the United States to implement its stated policy to reestablish a multilateral trading system.

4. Another proposal along the same line, but not as comprehensive as that for an adjustment-assistance program, would provide that imports be exempted from escape-clause action until imports amount to five (or possibly 10) percent of domestic production. This proposal has the advantage of being simple, but it has the disadvantage of applying a rigid rule that might not be suitable in all cases.

A variant of this proposal is that all tariff duties be suspended until imports reach a stated proportion of domestic production or consumption.

Either of these proposals would tend to stimulate imports. Some administrative difficulties would be encountered by virtue of the fact that statistics of production and consumption often are not obtainable.

5. An interesting proposal for stimulating imports from low-wage countries, such as Japan and Italy, was made in the last session of Congress by Senator Payne, of Maine. We face a dilemma in that these countries must export to the free world if they are to survive economically and still remain on our side in the world-power struggle. Yet, the products that now come from these low-wage countries are among the most troublesome of all imports.

The Senator proposed (in an amendment offered to H. R. 1) that the President be empowered to suspend tariff duties on imports of products not currently being imported in appreciable quantities from low-wage countries until such imports reach a specified (say 5 or 10 percent) amount of domestic production of each of those products. As long as imports remain below these levels the escape clause would be inoperative. Once imports reach the specified levels, the old rates of duty would be restored and the escape clause machinery would again be available to domestic producers.

This proposal is really an elaboration of the so-called tariff quota device which has been utilized successfully in trade agreements with regard to certain dairy and fish products. The selections of commodities obviously would not be a statistical job, because the imports don't come in, but rather would be a job to be undertaken cooperatively by American and foreign businessmen. Their task would be to divert imports away from lines that hit sensitive spots in the United States economy to lines in which the economy is strong.

6. Another question to which we should be giving attention is the adequacy of reciprocity itself. We often talk as though reciprocity in the lowering of trade barriers is the only conceivable way whereby we can bring about increased international trade and restore economic balance. As a matter of fact, pursuit of a policy of strict trade reciprocity would be a fairly certain way of seeing to it that we shall not attain international economic viability. The problem today is different from what it was 20 years ago. At that time we were in the midst of depression and economic stagnation and the problem was to increase both exports and imports. Today the problem is primarily to achieve balance between exports and imports at a high level and this means increasing imports relative to exports.

We should be thinking about whether we should supplement the power to negotiate foreign trade agreements with the power to reduce duties unilaterally.

The report of the Commission on Foreign Economic Policy recommend that the President be granted the power, unilaterally, to reduce duties in excess of 50 percent ad valorem to that level but Congress did not enact the proposal into law.

There would seem to be little reason why the concept of reciprocity should not be expanded beyond the field of international trade. Why should we not bargain on an across-the-board basis with other countries, giving limited trade concessions in our markets in exchange for concessions from other countries which we feel we need, whether they involve trade or something else? There would seem to be little reason, for example, why we should not utilize trade policy as a bargaining device to secure actions and commitments on the part of other countries which we deem necessary in the common defense. The objection that this might be construed as dollar diplomacy seems rather farfetched.

Much more could be said regarding the choices that lie before us in the field of economic foreign policy. We could examine the GATT and the OTC in the light of the attitudes to which I have referred. We could stress the need for more accurate official data regarding the effects of imports and exports on a much closer up basis than we now have (as Mr. McDonald, and others, have done). We could examine the large question of technical assistance to underdeveloped areas, and the popular subject of currency convertibility.

To do all of this would prolong the discussion unduly and would not add much as far as attitudes are concerned. I believe that what I have already said sets forth fairly clearly what might be called the paths of policy decisions that are open to us. Once the choice of the path to be followed is made the details will not be too difficult to work out.

Mr. BOLLING. Thank you, Dr. Piquet.

Our second participant is Prof. Theodore W. Schultz, chairman of the department of economics at the University of Chicago. Dr. Schultz is the author of many books concerned with trade and with agriculture. In the capacity of a consultant he has served our Government and been on foreign missions, including ones to India and Latin America. We have invited him to appear today not only for his obvious professional qualifications but because his colleagues in economics the country over have given him enthusiastic endorsement for his assignment to such an important spot on our program.

Professor Schultz, we are happy to have you with us, to discuss the economic consequences of choosing trade restrictions or trade freedom as a basis of American economic policy.

STATEMENT OF PROF. THEODORE SCHULTZ, CHAIRMAN, DEPARTMENT OF ECONOMICS, UNIVERSITY OF CHICAGO

Dr. SCHULTZ. Thank you, Mr. Chairman.

My text will be quite different from the very imposing one that you have just read. I had thought of building on the statements that preceded, in order not to repeat endlessly what may have been said. Well, this proved harder to do than one might think, because it was difficult for your staff to keep abreast, and while I did receive excellent summaries, I didn't get them until past midnight last night. As I read them, I realized that you had more hay down than I cared to put up. I did gain some impressions. Every once in a while you were fairly abstract, and I could see two or more angles dancing on the point of a particular pin, and doing it quite well.

So I really found myself putting aside what I had prepared and starting all over this morning, and if you will bear with me I am going to change my text. Perhaps I was looking for an escape clause for myself.

I shall take Latin America as a laboratory, as an area, and see if I can offer some insights on these economic issues that are on your agenda and you have talked about, to see how foreign economic policies work in practice.

I choose Latin America not because I believe in regionalism. I do not want to be in that position. Latin America is not our particular continent. I certainly want to stay free here of any economic imperialism from the side of the United States. Nor do I want to be endorsing a kind of Pan Americanism as against an international approach. Also I know a little about Latin America. That is the main reason I have taken it. I have invested the last 3 years largely in that part of the world, and I have some insights about most of those 20 countries, and I shall use their experience in what I am about to say.

Let me establish a little background. The Latin American countries, most of them, have really achieved a great deal of economic growth in spite of their economic instability. For example, Brazil, as you have seen recently, or Chile with her inflation, and then, too, there is a lot of political instability in some countries which certainly has had adverse implications for economic growth. But despite all this, there has been substantial economic growth in many parts of Latin America.

Now, second, there is a powerful underlying complementarity, economic complementarity, between Latin American countries and the economy of the United States.

This is true even for the Argentine, which many people think is an exception. This is true whether one looks at trade, or investments, or whether one looks at what their economic growth does to our national income. What I am really saying is, if they were to continue to grow during the next 10 years as they have the last 10, that growth in itself will increase our per capita national income. That is the nature of the complementarity. This is in terms of more products that we want, need in our economy, at a lower price, if you please, or at the same price, even though we buy larger quantities, and in other ways in which their economic activities are related to our economy.

Now, another reason for taking Latin America is, as you all know, there are many programs and policies of the United States that come into play in the field of economic foreign policy. Economic foreign policy is a very complex affair. It is trade, but it is also much more than trade today as your statements have revealed, and as your original agenda revealed.

As you all know, in the case of Latin America large quantities of United States funds, have been made available. United States business firms have been reinvesting large amounts in this area. There are the operations of the Export-Import Bank. There are United States dollars that have moved in via the International Bank. Most of these are from dollar loans in the New York market. Then there are all manner of private funds. I won't burden you with the figures, but they are in the billions of dollars and it is now one of the largest if you take it as the continent as a whole, and it rapidly will supersede Canada as an investment area drawing upon United States funds. Also, it is where United States technical assistance programs were first undertaken. You see it now as point 4. It started back with Nelson Rockefeller in the early forties; now ICA. There is the U. N., and the important Organization of American States. I shall come back to these because I consider them parts of our economic policy. Moreover, they are important when it comes to economic growth. Therefore, if their economic growth helps our per capita income, then these economic affairs are pretty well linked.

Also, there are many private efforts transferring useful knowledge from the United States to Latin America and these should not be lost sight of. These go beyond our public efforts, but public policy may favor or frown upon such private efforts. This is, I think, quite clear as soon as you see what I want to say. United States-supported religious groups are carrying on many programs. I do not have in mind their ideology or religious faith per se, but the work they do in agriculture, in health, and in education. They support more full-time (equivalent) people in these three fields than our entire point 4 program in Latin America. Ther are 1,600 projects supported by United States religious groups, Catholic and Protestant, in Latin America in agriculture, in health, and education. It is a large enterprise. The educational foundations—we may frown upon these foundations as a subcommittee of Congress has done, I fear, all too much so in recent years, and this could have serious adverse effects. The facts are, our foundations have remarkable achievements to their crdit in Latin

America. The Rockefeller Foundation and its corn program in Mexico has been exceedingly successful. It is a success story if you ever want to read one; the ACAR program in Brazil of Nelson Rockefeller, while not a foundation, because this program is more closely identified with Nelson Rockefeller as a private venture in agriculture in Brazil, using the old Farm Security technique of combining credit and extension work—is again one that has been highly successful.

The Kellogg Foundation also has been successful in its health work, as was the Rockefeller Foundation in health much earlier and now. There is the work of the universities. There was a lot of it long before the emergence of university contracts. Now you have university contracts under point 4 which are also important. I would stress, in addition, business as a carrier of useful knowledge to Latin America. Since I have been studying and concentrating on these developments with a group of six colleagues, let me reveal some conclusions. It is clear to us—there seems to be a lot of evidence to show—that the most important single channel for carrying new technology into Latin America is still business. It is larger than point 4, larger than universities, larger than foundations, despite the importance of each of the others. I do not want to minimize the importance of each of the others. Let's not underestimate, however, how much new knowledge useful to society in its economic effects is carried through what are normal business channels and this for Latin America.

Also, the United States purchases of many particular products are critical. They are the bulk of some Latin American products, which are the key products of a country—canned fish, Peru; coffee for Brazil and Colombia, and the list is long.

I want to call attention to one aspect of trade that you may not have considered. It was not in any of the summaries. This is what I would call our contribution to product price stability abroad. When Latin American countries are heavily dependent on the export of farm products or raw materials and when these move widely in price they become terribly concerned about such price fluctuations. We have not taken much account of their problem of price instability. But in one case we have, through our domestic policy, brought substantial price stability to a product of some importance to parts of Latin America, and this is cotton. The Mexican cotton producer has been operating with about as stable a price as the United States cotton producer because of our cotton price-support program. The Peruvian, Nicaraguan, and other cotton producers have benefited in terms of greater price stability.

We have overdone the level of price supports to our disadvantage, but if we had a price-stablization program for cotton, let's say it was 3 to 5 cents a pound below than what it is, and this would clear markets, then if we had such price supports, we would have not only equilibrium prices, but we would be bringing price stability to particular cotton producers; to Peruvians, Mexicans, and others. We should think about this and make it our policy where it would work at small cost to ourselves. It can make a major contribution in some cases. In the main, devices have been offered which appear to be all too expensive even where they would work. We have been well advised in not getting tangled up in them. I call attention to how well we have come off in cotton in making this kind of contribution.

On the Latin American side, there, also, are many programs and policies related to economic affairs.

In this area I would stress that they are committed to a "hurried industrialization." I shall say more about that in a minute. There have been some marked advances in agriculture, notably in Mexico, but these are the exception. There are indeed all too many different trade policies and foreign exchange controls—characteristic of Latin American countries.

What I have said thus far is that both from our side and from their side there is a whole array of economic policies and economic programs, which affect their economy and our own. We are involved; they are involved, and the two are interrelated.

Now, to make an appraisal—I want to make some observations which are in the nature of appraisal of this United States-Latin American area of economic policy. I shall make several assumptions. One, the economic growth of Latin American countries is to our interest. I have already said a few words on this. Two, Latin American economic policies are not independent of ours. I am going to make a lot of this point in terms of our choices. They can't change our policies, but we are a big factor in the choices they have, and in what they do, and if they have got a lot of bad economic policies it may in large part be in our hands to help improve them.

Now, I have to say a word or two about economic growth; namely, to achieve economic growth, three basic variables, each requiring capital and effort, must be brought into play, and these are increasing the stock of reproducible goods—plants, machines, steel mills, railroads, inventories, all that; two, improving the quality of people as productive agents; three, raising the level of the productive arts. A lot I have already said touches on all three of these.

Now, with this background, I shall turn to my observations on Latin America, which are in the nature of an appraisal. What I have in back of my mind is our effort and capital and their effort and capital that enter into these three variables—producible goods, increasing their stocks of these, effort and capital to improve the quality of people as productive agents, and to raise the level of the productive arts.

First, all too much emphasis is being placed upon increasing the stock of reproducible capital relative to the other two things. And, thus, there is a lack of balance. This is happening all over the world in poor countries. They are expecting too much and thinking too much in terms of capital and effort, in terms of things you can see—the plants, roads, railroads, and not putting enough capital and effort into bringing people up and to increasing the arts with which one produces.

We have, however, introduced an important corrective. Our point 4 program is actually a corrective to this overemphasis on capital for reproducible things. But the imbalance persists.

Mexico has come off better on this score than any other Latin American country. In Mexico 10 or 15 years ago—you see it in the records and accounts, in the first approaches of Nelson Rockefeller and the program we offered in the early 1940's—Mexico was already thinking of people they would need 10 years hence for their expected economic development. They anticipated needs and got technicians trained. This represented an improvement in the quality of human agents.

They have been pushing education at a very elementary level which is much needed because in many of these countries there still is vast illiteracy. Puerto Rico, about which we can take some satisfaction because of its close tie and connections to our own community, has a remarkable record over the last 15 years on this score—a balance of these three, in getting roughly the right amount of effort and capital, improving the quality of people, and raising the level of the arts, and not going off wholly on physical structures.

Second, industrialization, as such, in some Latin American countries has been given all too much emphasis in economic growth. Now I am playing industrialization off against agriculture, transportation, communication, and other reproducible capital, not against the human agent or the productive arts. It has led to serious factor disproportionality, and it has led to underrating, if you please, other sectors of the economy, thus bypassing other kinds of economic opportunity. We have had a hand in it, or at least we stood passively by again and again. This is a very sensitive area because Latin Americans feel just as soon as we say, "Don't industrialize so fast, you are doing it too rapidly for your own good," that we want to keep them out of the industrial field and want them to continue as producers of raw materials so we can buy them more cheaply. Then you are involved in national emotions. The plain fact is, however, that several of these countries today would be really much farther ahead had they undertaken their industrialization a little slower and had they brought up their agriculture, at the same time, developed transportation better, as for example in Mexico. Mexico has done a remarkable job in bringing up the cotton and wheat production, now corn production, vegetables and fruits, and it has built the necessary transportation along the way. It didn't get caught with a tremendous shortage of transport as did Brazil because of decisions made 10 years ago and longer.

I again point to Mexico as a country where a satisfactory balance has been achieved.

Third, there are the adverse consequences of inflation, the way foreign exchanges have been handled, and again also the underrating of agriculture, which turns in part on the belief that they are very vulnerable to large price fluctuations in this area, in the raw materials and agriculture. Again, here we enter upon the need for keeping our markets open, because very often our market is their primary market, and any discussions in Congress to raise tariffs immediately hit the front pages, immediately scare them in terms of believing that something adverse may be done to their market. You could ruin their whole fish industry by just a minor increase in import barriers to the American market; for example, in the case of canned fish which we now normally buy from Peru.

One observes in Latin America, that in several countries inflation has become chronic, and then the way they have tried to live with this inflation has given rise to very serious malallocations of resources. It isn't the inflation itself that does the harm—I will say a word on this in a moment—it is essentially what a country feels compelled to do in living with inflation that gives rise to distortion in resources use.

Today Chile is operating about 20 or 25 percent below its normal output simply because of the way it has been trying to live with its chronic inflation. If you go around in Chile and just assess the resources in agriculture, and in the shops in the cities, and so forth, you have rather a firm basis that if for a few years there was to be a stable price level, and expectations got adjusted, one would see that economy produce about 20 or 25 percent more than is now the case. There is that much slack in the economy, and the slack comes from the fact that there are price rigidities, price controls, and some factor prices, and product prices are held down, foreign exchanges are regulated, all sorts of devices are brought into play, and each distorts the economy a bit, and in Chile these distortions have become very serious.

It is high time that the United States not just stand by and say inflation is bad, because if their policies in some sense depend upon us, and if we have some say and can help in a remedial way in correcting this chronic inflation, it would help them immensely, and it would help us, too, again in some measurable economic sense, and, therefore, we need to bring our prestige, our insights, our resources to bear in efforts to get such chronic inflation in hand.

I cite Chile as an example. There are others. They are serious, and we need to act, bringing economic programs to bear.

The role of the two banks are clearly evident here.

Again, point 4, what we could do through ICA, and through ICA we are doing some things and I hope will make a real contribution to get better insights about this Chilean problem, and how to help them eliminate their chronic inflation.

The negotiations and the procedures are perhaps a detail, but what I am trying to say is, this is a matter of concern to us. It affects their welfare and thus, in turn, affects ours, and, therefore, chronic inflation needs to get on the agenda even if that inflation is not our own but is happening in Brazil, Chile, or elsewhere.

Fourth and lastly, I want to say that the optimum size of the market in many cases, and in many ways, is being impaired, and here I want to say a word about our own and a word about Latin American policies, foreign economic policies and programs, that are relevant.

I am not going to argue the case, why it is important to get as close as possible to the optimum size market. This is as old as Adam Smith, the division of labor it brings forth, the additional product that emerges, and that we can have more income and wealth as a result. I take this as a long received postulate; I build on it.

From our side any discussion in our Government on restricting trade, at once, the same day, becomes a destabilizing factor in the particular foreign country that would be affected. One cannot be in these countries very long while Congress is in session, and when such discussion gets on the agenda how at once this discussion appears on the front pages abroad and the belief grows that we are going to leave, for example, our reciprocal-trade programs behind, and go back to more protectionism.

There is, however, also a lot to be said about our record that is affirmative and at hearings like this one we should take cognizance of our achievements, for these have been really impressive.

We need to take credit, for it is a fact, that we have achieved a remarkable economic stability during the postwar period, and with it, growth. Our economic accomplishments in this regard have redounded to the benefit of many foreign countries. As we benefit from their growth and their economic stability they benefit mightily from ours.

Our trade barriers are lower for Latin America in the main than they are for many other parts of the world because many Latin American exports are tropical products, and there is vast complementarity. Argentina is perhaps an exception, but less so than is commonly held.

If I may go back to a comment of Dr. Piquet and read one other side of his coin, the statement—let me quote:

> If all tariffs were suspended, imports would increase by $1.8 billion, and these imports would replace about 200,000 full-time people in the economy.

This estimate in dollars and employment illustrates how close we are to free trade. We are closer than we think. If it wouldn't affect more than 200,000 workers—equivalent—we are really remarkably close to it.

His concept is a good definition of free trade, that is, suspending all tariffs and other trade barriers. Now, I am not endorsing those estimates. The figures may turn out to be much larger, but the only reason for my commenting on them is to make the point that we are closer to being a free trading economy than many critics on the outside appear to realize. We have come a long way. I, as an economist, would like to see us go the whole way, but let us not underrate the distance we have come.

This is especially true when you see the Latin American economic complex, because for most of their products our market is open. Just throw coffee back into the picture, and you see what I mean.

Now, on the negative side a lot of little things can be said. These little things are more important to the rest of the world than they are in Latin America, although in particular countries they represent serious difficulties. We are in dumping some agricultural products and we are getting worse at it rather than better. It is inevitable up to a point because of our stock situation, and we have got to work ourselves out of these excessive stocks, but the way we dispose of wheat abroad is obviously very adverse to the Argentine. It has adverse effects on her economy. It cannot help but be otherwise.

We talk about this with Canada because we are friendly with Canada; we talk less about it with the Argentine, but it is a sore point just the same.

In the thirties the Department of Agriculture was authorized to go into Latin America and help in research in agriculture, but not to do so whenever the product appears to be competitive to our economy.

This clause in there somewhere colors some executive and administrative decisions, whenever our point 4 programs get close to such competitive crops. We will help them in technical assistance, but it has to be on products that nobody in the United States produces. This puts us in an awkward position.

We are being extraordinarily shortsighted; it is an unfortunate position for the United States to take, one that is really inconsistent with our own long-run economic growth.

Turning more to Latin America market restricting policies, one observes tremendous hodge-podge of protectionism, dumping, subsidization, almost every conceivable measure that will impair markets, their own markets. Exchange controls lead in this direction, they become protectionism, one gets quotas in addition to tariffs, to impair markets. A particular rubber firm, for example, is given the entire market, it agrees to buy all the local rubber at a high price and then charges a monopoly price for the tires it sells in that country.

Now, I don't want to blanket all Latin American countries because there are some notable exceptions. Costa Rica and Peru, for example, are real exceptions, and still others; nevertheless, the generalization runs in the direction that I am implying.

My only reason for stressing these bad economic policies is that we have a lot of responsibility in this connection. What they do is, in a major sense, dependent on what we are prepared to do. They cannot influence our economic policies appreciably, but it is quite different the other way around. We can influence their economic programs and policies so that they do come off better in terms of their own economic growth, and this in turn would be to our advantage because it will raise our per capita incomes.

First, the economic growth and the economic stability of the other free countries serves our own national interest. I have been using the term "national interest" as measured by increases in our national per capital income.

Second, the foreign economic policies of many countries, as in most of those in Latin America, are substantially dependent upon our economic programs and policies. Thus these foreign economic policies are to a considerable extent, in the long run, a variable, subject to our influence, and for the good for both the foreign country and the United States.

Third, while we have done rather well in broadening our role in economic affairs abroad, point 4, economic aids, investments, and the larger scope now permitted foreign trade in our market, we have not had a clear conception of what is required for economic growth, and, therefore, have not been prepared to press for policies, both at home and abroad, which would bring about something close to an optimum rate of economic growth. In this respect we could, if we would, do much better, indeed.

Mr. Bolling. Thank you, Dr. Schultz.

Have either of you further comments that you would like to make specifically or not so specifically as a result of listening to the other's statement?

Dr. Piquet, would you like to add anything?

Dr. Piquet. On the question of the tariff, Professor Schultz made the statement that the United States is a low-tariff country, which is correct, I believe, but the implication is that we don't have trade barriers.

I think you would agree that there are many other barriers besides tariffs. I am thinking not only of customs regulations, but also the fact that even in the absence of any restrictions ours would be a pretty tough market to break for new products, particularly. I don't think you meant to give the impression that we do not have any other barriers, but just low tariffs.

Dr. Schultz. Lots of them.

Dr. Piquet. That is the only comment I have.

Mr. Bolling. Have you some questions, Dr. Ensley?

Dr. Ensley. I am particularly interested in Professor Schultz' discussion of Latin America, having traveled through those countries in the last few months myself.

I, too, have been impressed with the long-run effects of our technical assistance, in all of its forms—whether it is Government or private. In the countries of chronic inflation it would seem that following the most simple principles of the fiscal and monetary policy would reap great rewards. I gather that we have been making those principles known to them during recent years through our programs of one kind or another, and that there is increasing knowledge, in Chile in particular, and to quite an extent in, say, Paraguay, of the effects of inflation and how they might deal with the problem through fiscal and monetary measures. But our people are discouraged by the slowness with which these principles are applied by those two countries, and as you pointed out, I believe, it goes to deep-rooted economic and political problems, which are only reflected in the inflation.

I am just wondering if Dr. Shultz could pinpoint or indicate the process by which a country like Chile, which is experiencing inflation—I suppose close to a hundred percent a year?

Dr. SCHULTZ. Last year it did.

Dr. ENSLEY. And with production almost on a plateau, certainly in the last couple of years, can it get back into a position of growth and stability? What will happen if they do not; and what are the steps that they should go through in order to make a start?

Dr. SCHULTZ. I was in Chile last June. The budgets for Government receipts were running then at a rate of about 90 billion pesos, Government payments were running at a rate of about 140 billion pesos.

Dr. ENSLEY. They seem to have adopted every inflationary expenditure program from every country in the world.

Dr. SCHULTZ. You have already said most of the things that I could say. The first thing one needs to say is that we too have just within the last several years rediscovered central banking. Then, too, some western European countries have very recently gone back and made use of monetary controls, and, for us, therefore, to be preaching suddenly that, for example, Brazil and Chile should have used monetary controls all along, is just a bit out of taste.

But it is time that we do press for monetary controls and central banking in our economic relations with foreign governments. We aren't doing so as yet. There are parts of our Government, and also the United Nations, which are still, it seems to me, not aware of what monetary and fiscal policies can achieve in curbing inflation and in achieving economic stability.

When you get on the ground, for example in Chile, we have first-rate United States personnel who know something about this problem and they have dug underneath and are winning the confidence of Chileans. Accordingly the stage is set to really move ahead and improve existing economic policies.

Now, the time is ripe for something to happen, if we had some imagination in this, and I think it calls for a number of things, in the case of Chile, but for Chile it is a very serious political decision, and I don't want to go into this too deep, but there are tough political problems; the urban workers and their social security on the one hand, and large farmers on the other hand in a preferred position politically, and both gaining particular political ends which result in chronic inflation. Only Chileans can correct this situation through their democratic process.

Dr. ENSLEY. I was also impressed with the way in which our private capital, working with Government, say, in Venezuela, has resulted quite obviously in tremendous gains for the average citizen of Venezuela, in terms of housing, community facilities, and higher levels of living. While there may be some problems there, and perhaps all hasn't trickled down that should, nevertheless it is quite obvious that that arrangement of private United States investment and native cooperation has worked pretty well.

How can we show the other Latin American countries that have been very standoffish about our private capital—particularly in Brazil—that a development program will work to the benefit of the people?

Dr. SCHULTZ. Well, one can only say some rather obvious things. If we think in terms of a range, United States capital used in the service industries—Sears, Roebuck in Mexico and other Latin countries—or in manufacturing, is more easily accepted in a country despite the nationalisms of the country, and the closer one gets to the natural resources—oil or mining—the harder it is to operate satisfactorily given the strong nationalism of many countries.

I was reared in South Dakota and politically the Homestake gold mine was always a devil in politics come an election. I do not see why this was true, but they were taking gold out of the Black Hills and shipping it out, and one belief was the State gave up its gold and got nothing in return. Many people believed it to be true.

Men were employed, resources were used, paychecks were paid workers, and all, but none of this soaked into our political thinking at the time.

The fact is that oil and mining touch sensitive national nerves. We would be much better off if we could get out of all mining in Mexico and have our capital go in, as it is now going in, for manufacturing and services, where it operates easily and readily and gets off very well in relation to the nationalism of Mexicans.

When you hit oil you get the extreme right and the left combining as they do in Brazil, against any foreign capital to develop their oil resources. Despite the social awareness and social imagination at the executive level of large oil interests, for example in Venezuela, the oil companies are not out of the woods. It goes back again to the difficulties that arise out of views and attitudes of people toward taking their oil out into the world, or taking out their iron ore, something which you can see, which is not the case in a Sears-Roebuck kind of operation in a major service industry.

My guess is that what needs to be achieved in Venezuela—leaving aside the dictatorial nature of the government—is to try to correct the terrible dichotomy that exists. In the areas where people have benefited a great deal from oil, and then you have across the hills not far away primitive poverty of the worst sort one can find in Latin America. They exist side by side in Venezuela. This is dangerous, explosive.

Dr. ENSLEY. One more question with respect to Chile: When I was there in mid-July you had just left a few days earlier. You had just completed arrangements between your economics department at the University of Chicago and the Catholic University of Santiago.

It sounded like a very interesting type of point 4 program, and I wonder if you could tell us about it?

Dr. SCHULTZ. This effort to develop a research center is still in negotiation and planning stage. We have decided on our end, and I am now convinced wisely, that a good deal of time needs to be spent in thinking through the program between the two universities before one launches into a contract. One of my major criticisms of the university contracts is that too little effort goes into the work plans. Not enough energy and time has gone into really thinking through what is to be done in the program of the two universities, and, therefore, I justify the large amount of time and energy that has gone into this, and in the end I think we both will know each other, we will know what can be contributed on each side, and realize whether it is worth doing. What is contemplated, of course, is the development of workshops, which focus on three sets of problems: The inflation problem which we have been talking about; the agricultural problem, the whole failure of agriculture development; and, the other, general resource management, where both foreign and doméstic investments are involved, and their effects on the development of the Chilean economy.

These seem to be from our point of view, and theirs, the three critical focal points on which they would like to get to work, and we, too, feel it is worth while.

Dr. ENSLEY. Thank you.

Mr. BOLLING. Dr. Sheldon?

Dr. SHELDON. Dr. Piquet, I feel that your paper certainly has helped me in organizing thinking that is required for summarizing our results.

I do have one question. In discussing liberal trade in the classsical sense, there are many reasons why those doctrines are not in practical effect today. I wondered how much of the reason for this is a practical political one. For example, trying to win support for reduced duties is always difficult in a legislative body. Alternatively, how much of the reason is a matter of the basic institutional setting? Perhaps you have really answered this, in part, in your statement, but would you draw this distinction for us?

Dr. PIQUET. I am not so sure there is really a distinction there. Political activity inevitably takes place in an institutional setting. The dominant fact, it seems to me, in this whole field today, is that economic forces just do not adjust the way they are supposed to adjust, for many, many reasons only some of which are political. I think the answer to your question is that the second circumstance is more important than the first, although I wouldn't belittle the political difficulties, within any environment, of getting anything done. But economic forces simply do not adjust for some of the reasons that I gave in my paper, and there undoubtedly are many others that I overlooked.

Given enough time, there is a tendency toward equilibrium, if by no other way than by unemployment and death, but it is not a delicately balanced equilibrium.

Dr. SHELDON. Thank you very much.

Dr. Schultz, you made the comment that what we do in this country is going to be watched abroad, including countries of Latin America. Mr. Bolling has received a letter from Guatemala City which mentioned that these hearings are being reported by the local newspaper down there.

Dr. SCHULTZ. Yes.

Mr. BOLLING. I have a few very specific questions, and 1 or 2 very general ones.

The first specific question is rather a series of specific questions. They were sent to me in a letter by Senator Douglas, who, of course, is chairman of the full committee, and a member of the subcommittee.

In the letter he expressed his regrets that he could not be here, but asked that these questions be asked of one or more of the panels. I have asked them of one of the panels, and I would like to now ask this panel, and, more specifically, Dr. Piquet. The questions are as follows:

> The advocates of protection are urging that countries maintain and increase trade barriers because they say that the automatic price adjustments which formerly under the gold standard used to balance trade and settlements between countries are no longer operative now that most countries are off gold and have more or less successfully insulated their price levels from being affected by the quantities of gold which are within their borders.
>
> This argument is being advanced in both Great Britain and the United States and is one of the strongest forces making for protectionism at the present time.
>
> It raises the series of questions upon which not only I, but the country, desires light.
>
> 1. Under the old standard the automatic adjustment was that country (A) with a large excess of imports would export gold. This would curtail the money supply in (A) and lower its price level. At the same time the outward flow of gold into the rest of the world (B) would expand the money supply there and raise the price level. This increase in the price level in (B) and the fall in (A) would reduce exports from (B) into (A) and increase exports from (A) to (B). This process would go on until a balance of trade or, more properly of settlements, would be affected.
>
> Can anything like this process take place now with the countries off gold and, if so, how?

Dr. PIQUET. That is a big order.

What is called for is a discourse on the nature of the equilibrating process under gold, and in contrast under inconvertible paper. There is quite a literature on this subject.

I can, however, give a thumbnail answer to the question:

In the first place, under the free gold standard it is necessary to carry the analysis a bit further than is done in the Senator's question. Under free gold standard conditions the "par of exchange" was nothing more than the ratio of the weights of the gold content of the standard currencies in question. That is to say, the pound sterling was 4.866 plus times as heavy as the gold dollar, and the rates of exchange, the actual market rates of exchange, could depart from this parity only to the extent of the cost of shipping gold, which was roughly 2 cents a pound sterling. That meant that the maximum was $4.88 plus, and the minimum was $4.84 plus per pound sterling. Whenever the exchange rates, by virtue of excess debits or credits, one way or the other, hit one of these points, actual gold would be shipped. But, before this actually happened—and this is what the question does not point out—short-term capital movements would bring about balance. That is, long before, let us say, the excess of debits would force the rate up to 4.88, the short-term capital market would take care of the discrepancy. On top of this there was a third factor. In the major capitals of the world, particularly New York and London, there were arbitrage operators who, operating by telephone and with slide rules, were able to cash in on even very slight discrepancies in foreign exchange quotations.

The result was that foreign exchange was probably the most stable of all markets. This fact alone facilitated world trade since buyers and sellers knew precisely what they were giving, and what they were getting, for their merchandise.

Conversely, the fact that today foreign exchange moves all over the map acts as a retarding influence on world trade. I should say that it is just as important as tariffs in throttling world trade.

Today, the automatic gold mechanism is a thing of the past. There are still short-term capital markets but, because of international instability, they are not as important as they used to be as an equilibrating force.

Yet, even under conditions of inconvertible paper currencies, there are forces that operate toward the maintenance of equilibrium. They are very sluggish forces, however, and, because of this, exchange rates move all over the map, as I said before.

The questions that the Senator asks call for a description of these adjustment forces. The question is a theoretical one and the answer must necessarily be theoretical also. With regard to any particular country there are peculiar circumstances that would have to be taken into account. In all cases, however, the basic forces would operate.

Under paper standard conditions, the adjustment would tend to take place in the following manner:

Just as gold used to move internationally whenever exchange rates hit the so-called "gold points," so under paper standard conditions, commodities would tend to move in foreign trade once certain "price points" had been reached. That is to say, with regard to commodities that are transportable, exports will be stimulated when the exchange rate falls to a point sufficiently low to make it profitable to ship the goods. Thus, there is a cheese export point, a cotton textile export point, camera export points, et cetera. Certain commodities, such as cement and heavy structural steel, do not enter foreign trade because their shipping weights are too great relative to their values.

There is a long list of movable commodities, however, the shipment of which will be greatly influenced by exchange rates. Thus, when Great Britain devalued the pound sterling in 1949 it paid for persons in other countries to buy goods that they had not purchased in Britain before. At least, it paid them to do so in those cases where prices were lower to them by virtue of the fact that the pound sterling itself was depreciated in terms of their own currencies.

Thus, when devaluation occurs commodities begin to move in foreign trade that did not move before or which, if they had moved before, now move in greater volume.

As was shown in the price and trade statistics that were issued daily after the British devaluation in 1949, there were all sorts of effects upon prices and exports from Great Britain to the United States.

For instance, in the case of Scotch whisky, there was no change in price because there was tight control of the market in Great Britain. In the case of certain cotton textiles, on the other hand, there was a direct relationship between the decline in value of the pound, relative to the dollar, and the value of exports to this country.

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As these "points" are reached, as the exchange rate goes down, there will be then a tendency to buy more in the country whose currency is depreciating, until that fact alone generates more exports relative to the imports, and balance tends to be restored.

Now, if these forces worked as precisely as did the adjustments under the free gold standard, we wouldn't have many worries. The trouble is this is a sluggish sort of thing. These things are tendencies, only. They take time to work out, and before they do so the exchange has gone down pretty far. Even more important than the fact that the exchange has fallen is the factor of uncertainty itself. You don't know how far it is going, you don't know when it is going up again. The changes are so great that they make trade uncertain.

There is some literature on this subject and it may be that you would care to have a few references inserted in the record at this point.

(The references are:)

Taussig, Frank W., International Trade Under Depreciated Paper, Quarterly Journal of Economics, May 1917, page 380 and following pages.

Graham, Frank D., International Trade Under Depreciated Paper, the United States 1862–79, Quarterly Journal of Economics, February 1922, page 220 and following pages.

Graham, Frank D., The Theory of International Values, Princeton University Press, 1948.

Mr. Bolling. I wish you would submit something on that.

Another question:

Trace in precise detail what would happen if exchange rates were allowed to fluctuate, if country A found its industries were unable to compete in international trade with those of the rest of the world and its imports therefore rose and its exports either declined or could not equal its imports (other things being equal).

Is there a self-correcting process? If so, through what stages would it operate and what would be some of the consequences?

Dr. Piquet. I think I have answered that question in theory, at least.

Dr. Schultz. Mr. Chairman, this sounds like a good Ph. D. examination in any case.

Mr. Bolling. In this case I am not the professor. Senator Douglas is conducting this through us.

The next question:

Compare the relative advantages of fluctuating verses fixed exchange rates in terms of (*a*) effect on quantity of world trade, (*b*) trade of country in particular, (*c*) maintenance of rigid price and cartelization policies within a country, and (*d*) effect on wage structure, and so forth.

Dr. Piquet. I think I implied the answers to those questions in what I said before. If I could elaborate one point further: The basic thought to keep hold of all the time in this kind of discussion is the fact in every country there are two values of a currency to be kept in mind, the one internal and the other external. The two of them tend to keep together allowing for certain lags.

Mr. Bolling. And 4:

Does not the use of periodic devaluations of currency to correct trade of settlement deficiencies tend to create additional disadvantages? If so, what are they?

Dr. Piquet. Dr. Schultz, aren't you taking this examination, too?

Dr. Schultz. I am enjoying this, sir.

Mr. Bolling. He seems to be perfectly content.

Dr. SCHULTZ. It sounds like my colleague, Professor Douglas.

Dr. PIQUET. I didn't catch the last question. Will you repeat that, please?

Mr. BOLLING (reading):

> Does not the use of periodic devaluations of currency to correct trade or settlement deficiencies tend to create additional disadvantages? If so, what are they?

Dr. PIQUET. Of course, and it means currency warfare. When one country devalues, if it does it by itself, not in collusion or in conjunction with other countries, it precipitates similar action in other countries because each one is competitively devaluing its currency in order to increase its exports relative to its imports. That lesson was learned so well after the First World War, that this time, in 1949, when the British pound was devalued—even though it was not done through the auspices of the International Monetary Fund—it was done by Great Britain in collaboration with other countries outside the dollar area. Had they devalued the pound alone, what would have been gained by way of stimulating exports relative to other currencies would have been more or less offset by the fact that she would have had to pay more for the raw materials she bought with the cheapened pounds. In order to avoid that, therefore, she devalued the pound in conjunction with other countries who devalued their currencies and those countries that were selected for cooperation were countries that were supplying raw materials alternatively to the dollar area. The net effect of the devaluations in the fall of 1949, therefore, was to appreciate the value of the dollar, vis-a-vis the sterling area. The answer to the question, then, is that devaluation leads to competitive devaluation, and exchange warfare which ultimately means broad-scale economic warfare.

Mr. BOLLING. Now, I will stop speaking for Senator Douglas and ask you a few of my own.

I have had the impression throughout the hearings that in real, hard economic terms, that the present and future ability of the United States to reduce further its tariff is relatively insignificant, but that any apparent retrogression on the track that we have been following for the last 20 years has a psychological effect which was way out of proportion for the real economic effect.

A specific example, perhaps the most obvious, is the recent decision on bicycles, which insofar as I can make out has no real economic effect. It doesn't make the American bicycle competitive with the bicycles that are imported in money terms, and I doubt that it changes the consumer's attitude toward it. But this decision apparently had an almost catastrophic psychological effect in the minds of those who were trying to encourage their businessmen to penetrate what is at best a very difficult market, the American market.

Is that a fair summary of the situation, or is it an exaggeration?

Dr. SCHULTZ. No, you have not exaggerated. I would underscore what you have underscored, namely, where is our policy drifting? Are there signs that we are in the process of reversing a major policy? Bicycles may be viewed as a forerunner of a lot more escape clauses to come. If so, then we have retrogression. More important in the current picture are the quantitative controls, quotas, and all manner of devices to keep things out of our market because of other domestic policies. Agriculture is full of these; and then there is the counterpart, some elements of dumping, and these are serious. Naturally, Canadians are worried about what we are going to do and are doing in dumping our surplus wheat, sympathetic as they are in realizing we have got to work our way out of a tough surplus problem.

Mr. BOLLING. Certainly I would agree.

If the political situation in the United States is such that it is not possible, in the field of tariffs, to have continuing progress without offsetting the retrogression, as is possible under the escape clause and in other proceedings, might it not be better from a total point of view, taking into account the psychology, to strive for stability, rather than progress and retrogress?

Dr. SCHULTZ. A commitment that we will not for a long period reverse our major policy position would be very important. It would be of major importance to public entities and to private individuals in making their plans in other countries. Let's talk just about tariffs now.

Mr. BOLLING. That is what I want to talk about.

Dr. SCHULTZ. If we would just commit ourselves, if our public process could, which in some sense it cannot, that we will not change these tariffs around for 5 or 10 years and people could make investment plans abroad against such firm commitments, this would be, in my judgment, excessively important. They do not quite take us seriously yet that we are going to let these tariffs stand as they are.

Mr. BOLLING. In effect, you would agree?

Dr. SCHULTZ. Yes.

Mr. BOLLING. Now, I want to move from that very specific one, in which I intended to ignore the other restrictive devices and just limit it to tariffs, to say that the feeling I had from your statement, Dr. Schultz, was that you, although strictly limiting yourself as much as you could to economics, that what you were saying in effect was that foreign economic policy very obviously could not operate in a vacuum. The impression I received from your statement was that it was impossible to segregate pure economics, if there is such a thing, from all the other fields that are in effect covered by the social sciences.

Dr. SCHULTZ. The setting of my remarks was in what I call political economy, where politics and economics join, so I agree with your inferences.

Mr. BOLLING. The point being that you cannot, if you are dealing with an underdeveloped area, that you cannot approach the economic problems in anything like a vacuum. You have to consider all the social problems, and all of its political problems, at the same time.

Dr. SCHULTZ. Yes.

Mr. BOLLING. Now, there is one other question that I was curious about, and you may not be able to give the answer. You cite it in your discussion, that there had been a satisfactory balance between the development of capital goods, human agents, and the arts in Puerto Rico and Mexico.

First, I would like you to tell me a little more specifically what you mean by the arts, and then I would like you to tell me why you think there has been a better balance in Puerto Rico and Mexico, as contrasted with some other countries, if many others have had a very poor balance.

Dr. SCHULTZ. Answering your first question first, by the productive arts I have in mind the whole underlying useful knowledge that enters into, in this case, production. Narrowly we sometimes call this technology—chemistry of sugar, the technician who stands by to see that you get a little more sugar out of the cane as it goes through the presses and when it gets boiled. This is technology, and you get into the extraction of oils out of the various soybeans and others that you may have around, or the making of a flour out of corn in Mexico that will keep more than just overnight, which is still common.

Mr. BOLLING. What we call know-how.

Dr. SCHULTZ. Yes. This is our shorthand for it. Our level of the state of arts is relatively high. Unfortunately, what we have can't be taken directly and used in most poor countries. It is usually a long and difficult process to adapt it and make it useful. The Rockefeller Foundation had to spend years to take our knowledge about hybrid corn and corn breeding, and come up with new corn varieties, working with the Mexican Government, that were useful to Mexico. It took years. They had to first "produce" biologists who knew how to do these tricks and proceed to see whether they could do them. This takes time. Here we deal with the art of growing corn in Mexico. This is what I think I mean by the productive arts.

Now, why Mexico or Puerto Rico have come off better, I can only guess, and perhaps describe what happened. Along the way, 1 or 2 decades ago, there was a certain public awareness, both central and local, that these things were going to become important; that is, to have more people around who were skilled and trained, whether you think of these as foremen or as skilled workers or whether you think of these as rather high-powered technologists. Senor Robeles, of Mexico, one of the more distinguished men I know, head of the research department of the Bank of Mexico, way back, began to use some of the resources of the bank—this is a public agency, and other funds. Nelson Rockefeller helped, picking out many hundreds of carefully selected individuals to be trained in Mexico and in the United States, getting them ready for their industrial and economic development 10 years hence. They developed the so-called Armour laboratory in Mexico. The result, if you spent some time in Mexico today you find many able people at a lot of points who are ready for this industrialization.

Now, why they happened to enlarge on their overhead capital, in a much better way than was the case in other countries, why they built new roads, linking the economy, and why they got capital distributed widely rather than committing all of it in and around the capital city, why Mexico supported one development in northern Mexico and then other areas, and thus nurtured a decentralized pattern and in what I call overhead capital, power, roads, schools, I wish I knew, but it has happened. Those decisions were taken really quite a long while back. By comparison Brazil did not do nearly so well in this regard. Iron areas of Brazil are served by poor transport. As recently as a year ago it didn't have anything but a dirt road between Belo Horizonta and the capital city, about 300 miles away. By rail transportation it took 24 hours. Your train broke down every time one made this trip. I don't want to draw too adverse a contrast here, but the plain fact is that Mexico did come off much better. This is the point I want to make.

Mr. BOLLING. This boils down, if I understand it, boils down to that very rare quality in government or individuals, that their executives had vision, imagination and planning.

Dr. SCHULTZ. There was certainly a broad awareness of this at, I suspect, many points, because when one digs a little bit in Mexico, you get in Monterrey, you get it in Toreon, in outlying cities and towns, and apparently brewing for quite a long time, so it wasn't just at least the decade back. It wasn't just one individual. Essentially it was getting into the social and political climate, and importantly so.

Well, the record of Puerto Rico is easy to read, and it reads like a success story on this score. Many agencies in government, the university, all of them, started getting Puerto Ricans out and trained for the task of economic development at hand. Many people then said that they had so many in training that they couldn't employ them. Yet today such trained individuals in Puerto Rico are scarce; and leaders in Puerto Rico are afraid that Latin American countries will take too many of these trained people. They are short. They have to keep the training up, they are developing so fast.

Mr. BOLLING. This amounts to the fact that it may be more important to have an integrated program than no program at all. It may be important to have an integrated program than a good program which is partially approached.

Dr. SCHULTZ. Yes.

Mr. BOLLING. If you do not have an overall approach to the problem, you will get yourself in more and more trouble rather than less and less.

Dr. SCHULTZ. I don't want to be arguing for tight integration. I am arguing for a balance and an awareness that this is a very complex process, as it was in our society. I like the words "integration," or "coordination," provided we don't narrowly define how this is done. The cultural complex does it, the political process does it, and importantly the markets in the economy, and it gets done in still other ways.

Mr. BOLLING. Thank you very much.

Are there further questions? If not, with that, gentlemen, we thank you very much for your time and presence and your contribution, which was a very great one.

The subcommittee will recess until this afternoon, when the final session will be held.

(Whereupon, at 11:33 a. m., the subcommittee recessed until 2 p. m. the same day.

AFTERNOON SESSION

(The subcommittee met at 2 p. m., Hon. Richard Bolling (chairman of the subcommittee) presiding.

Also present: Grover W. Ensley, staff director, and Charles S. Sheldon II, staff economist.

Mr. BOLLING. The subcommittee will be in order.

The afternoon session represents the final summation of our hearings. The dean of international trade economists in the United States is undoubtedly Prof. Jacob Viner, of Princeton University. Professor Viner has taught at many of the great universities of the United States and Europe. Over the years he has been a special adviser to the United States Tariff Commission, the Secretary of the Treasury, and the Secretary of State. Every student of international trade has read one or more of his books on trade. These books have dealt with most of the topics of concern in these hearings, including the balance of payments, dumping, customs unions, relations of free markets with controlled economies, and the problems of economic development.

Dr. Viner has been working in our offices to review the testimony and written statements of all the earlier witnesses. We are honored to have him now appear to interpret the significance of this material. We have asked him to discuss the implications conveyed in these hearings, together with such policy recommendations as he might care to make.

Professor Viner.

STATEMENT OF DR. JACOB VINER, PROFESSOR OF ECONOMICS, PRINCETON UNIVERSITY

Dr. VINER. I was honored to receive this assignment. I am honored to be here, but I am also scared at the assignment and my opinion of my own judgment has gone down greatly in accepting it.

I have done the best I could to keep up with the flow of testimony and wisdom and information. I should explain that I have only a slight notion of what occurred this morning, so I am not quite up to the minute. Moreover, I will make my contribution, such as it is, a commentary more than a summary, and I will try to avoid debating with the participants.

In the first place, I recognize that they were operating under conditions of compulsory brevity and there is no more terrible restraint that can be put on an economist than compulsory brevity. I also believe that good economic analysis tends to run to words. The comments I make on the contributions will therefore in the main consist of filling in of gaps which may have been inadvertent or may have been due to time limitations, and of clarification and elaboration. I may, however, slip into argument upon occasion, if permitted.

I will emphasize issues of commercial policy proper largely because of limitations of time, but also because I think these issues predominated in the testimony.

A few preliminary remarks about special characteristics, distinctive characteristics, of American foreign trade, some of them perhaps unique characteristics, which I think ought to be borne in mind in applying general thinking to the American situation. In the first place, foreign trade is of relatively minor economic importance to the United States as compared to other countries. The nature of our economy and the way in which it operates from year to year are not dominated by the course of our foreign trade, as they are for many other countries.

Secondly, the United States operates, in technical terms, under almost universal absolute advantages in production. Even the things we import we can produce more efficiently, more effectively, in the main than the countries that sell them to us. There are, I think, only a limited range of exceptions. Tropical foods and tropical forest products and some minerals, I think, cover substantially the range of economically important things which Americans can't produce better, meaning at lower real cost, at lower cost in terms of input items, than can other countries. If many things are higher in money cost here, it is because the prices of the input items are higher here and not because the productivity, or the effectiveness in production of the input items are less here than in other countries. This is a special situation, obviously a situation which cannot be true for more than one country in the world.

Third, and this is also a unique situation, this country has no balance-of-payments worries. It doesnt worry about the effects of its internal policies or the effects of its commercial policy on the ratio of imports to exports, on its balance of payments surplus or deficit, on its gold reserves or other monetary reserves. It just leaves these effects out of account as not of major importance.

It is able to do that, and alone able to do that, for possibly also other reasons, but for three reasons that seem important to me: First, that in modern times, technical progress has been more rapid in the United States than abroad, with the result that competitively we have not been hard pressed in order to sell abroad as much as we wanted to or needed to in order to pay for what we wanted to import.

Secondly, inflation, while it has prevailed in this country, has prevailed at a slower rate than in other countries, with the result that this relative deflation, if you like, or relatively slower inflation, has on the whole put pressure on the balances of payments of other countries and has kept us from having balance-of-payments troubles.

Third, is the hoard of gold in Fort Knox. Many people ridicule that hoard, talk about it as if it might as well be nonexistent. Actually, it has exerted a tremendous influence on the nature of American foreign policy, and not only American economic foreign policy, since the early 1930's. No other country is in the position to weigh such things as participation in joint costly enterprises with other countries, like a war, or like foreign aid, or like the outflow of capital under private or Government auspices to other countries, without considering the impact on its reserves, on its gold stock and its international liquidity. We can consider major programs with the question of the impact on our balance of payments never being raised by anybody. It is just not in our consciousness. Fort Knox has been largely responsible for that. I don't want to exaggerate, but I think even our efficacy as an ally, as a partner and leader in the economic planning of the Great War, was greatly facilitated by the fact that the state of our balance of payments was one worry we did not have that other countries did very much have.

A fourth distinctive characteristic of American foreign trade is that, on the whole, foreign trade has been stabilizing for us cyclically, whereas for many other countries it has been a destabilizing factor. I could put it in another way; other countries have helped to dampen our cycle, whereas we have helped to endow them with a cycle and to intensify its amplitude. Some other countries move in the direction of autarky, or, at least, make gestures in that direction, on the ground that that is the only way in which they can maintain a stable economy. I am not presenting this as a forecast for the future, but in the past at least our economy would be less stable than it has been if it had not been for the fact that other countries by their relatively stable takings of our exports even during recessions have helped to stabilize our economy, or, at least, make it less unstable, than it would otherwise have been.

Fifth—and this, I think, may startle even my professional colleagues—this country is operating now under what I would call a genuinely floating exchange system, and is the only country in the world which is doing so.

I understand a genuinely floating exchange to be one in which nothing is done by the government concerned in the fiscal field, in the monetary-control field, at the national boundaries in terms of trade barriers, or through any type of exchange control, because of what happens to the average value of its national currency in terms of foreign currencies. There is no country in the world of which that is true except the United States.

Nobody can tell what the average exchange value of the dollar is going to be next year or next month. What we can know is that nothing will be done deliberately in this country to affect it, partly because nobody here seems to care. But things will be done abroad which will affect it, and some of these will be deliberate things. An exchange rate, of course, is a two-sided thing. While other countries may not be much concerned about what the average exchange value of the dollar is in terms of foreign currencies, they may be very much concerned as to what the value of the dollar is in terms of their own particular currencies, and they may do things to make that value something different from what it otherwise would be.

Finally, it has been a distinctive factor of our foreign trade during World War II and the postwar period that the combination of our political leadership in the free world and of our increased, our startlingly increased, economic predominance in the world makes our economic foreign policy necessarily a vital part of our foreign policy as a whole, and makes it absolutely urgent that we shall take carefully into account the outside impact of our major commercial policy decisions before we commit ourselves to them irrevocably.

For us at least, whatever may be the case for other countries, the tariff can no longer be said to be a domestic question. It is a world matter.

Now, following the lead of Dr. Triffin in his testimony, I would like to comment on the postwar economic performance of the United States as a member of a free-world community.

Dr. Triffin pointed out that that record was on the whole highly satisfactory. First, we maintained a high level of economic activity, and I agree with him that that was the most important contribution we could have made to the economic welfare of the world.

Secondly, we have been engaged since 1934 in a progressive liberalization of our trade barriers. I am perhaps on the pessimistic side as to really how far we have gone, as to how deep we have cut, in our tariff-rate reductions. I think a lot of it has been, whether intended so to be or not, window dressing. Nevertheless, we could have been moving in the other direction. If we had adhered to our historical tradition, we would have been moving in the other direction, particularly during the great depression of the thirties. As I see it, the most important contribution the United States has made in this particular area is not the reductions of trade barriers we have made, because I am not sure that we have really made very significant reductions, but the fact that we have reversed a tendency to move toward more severe trade restriction, merely avoiding evil can be of great virtue, however.

Third, Dr. Triffin credits us, rightly, I think, with cooperating effectively and loyally with international economic agencies such as the International Bank, the International Monetary Fund, the United Nations. Moreover, that also was a reversal of a past trend. You may remember there was a period, a silly period, in which we even refused to recognize formally the existence of the League of Nations. I remember once in 1933, when I happened to be teaching in Geneva, I was asked by the new Roosevelt administration, to attend on its behalf an important meeting of the Economic Committee of the League of Nations. I was coached very carefully as to just how far I could go to acknowledge that I was really sitting in as an American representative at a committee meeting of an organization really known as the League of Nations.

I would add to Dr. Triffin's list, what he undoubtedly would be glad to include, our startlingly generous and wide-reaching program of foreign economic aid. Nothing to parallel that had ever occurred in human history: in kind, yes, perhaps, but not in extent.

I turn to the question of the underlying principles which, as far as economic considerations are concerned should and in an ideal situation would govern a people in formulating its national economic foreign policy. Here I am going to follow the discussion and the contributions made in these hearings as I have read them in the transcript. I have paid close attention to questions asked so as to learn what it is that may be puzzling and what it is that is of special interest to the members of this committee. In large part I will restate what others have stated, and stated very well. I will try, however, to answer specific questions where some doubt may have been left in some minds by the trend of the hearings.

I will approach the problem from the point of view of this question: Why should we import at all?—making the question as fundamental as possible.

In the first place, there are things we must import or do without and some of these are things we want very badly. Obvious illustrations are things like bananas, cocoa, coffee, mahogany, tin, asbestos, that either we import or do without.

Secondly, there are things that we want and we could produce at home, but obviously only at terrific cost as compared to the cost to us of getting them from abroad in exchange for exports. I do not think there are very many such commodities of major importance. I think carpet wool is probably a case in point. Woodpulp and pulpwood are cases in point, but may not be 10 or 20 years from now, for with changed methods of forestry management in the United States and with the development of the wood resources of the South, it may be that while it would still be strongly in our interest to import them, the added burden of cost to us if we had to or chose to produce them ourselves might not be overwhelming.

Third, there are many things that we can produce at home at absolutely low real costs and often at lower real costs than those at which anybody is able to produce them abroad. (I am using "real costs" to mean the costs in terms of input items, in terms of labor-days, units of capital, amounts of raw materials consumed per unit in their production, et cetera), but where real costs of producing them would be much higher than the real costs of producing the exports with which we can buy them from abroad.

The criterion, for many economists at least, and what I think ought to be the economic criterion for any country as to what it imports and what it does not import, is, therefore, comparative cost. Stated in another way, a country, insofar as only economic considerations are involved, ought to import everything that it can get from abroad in exchange for exports which would cost it less to produce than the imports would cost to produce at home.

The concept of comparative advantage and comparative cost has come up repeatedly in these hearings and questions have been raised about it. It is a tricky concept, partly because it involves a double set of ratios. The trickiness is not so much the consequence of a real intellectual difficulty as of the fact that you have to deal simultaneously with three sets of ratios. You have to deal with the cost ratios at which different things can be produced in your country with the cost ratios at which the same things can be produced abroad, and finally with the cross ratios between these. It is hard to express clearly orally and extemporaneously just what is involved, although I insist that intellectually the problem is not too serious in the classroom, if a good teacher is leading one by the hand, with the aid of good arithmetical illustrations on the blackboard.

Nevertheless, even economists sometimes state the proposition too sweepingly, and perhaps not quite accurately. I have no doubt upon occasion been guilty of this myself. First, as to what actually governs the course of foreign trade in the sense of what determines what countries are actually exporting, and what they are actually importing in a given actual period of time. The question was asked in the course of these hearings as to whether it is true that comparative costs do determine the course of trade.

Well, comparative costs certainly cannot determine the course of trade completely and absolutely as long as you have trade barriers intended to stop them from determining it, and as long as these trade barriers have any effect whatsoever. Other factors than trade barriers can also prevent trade from conforming to comparative costs. Let me formulate the conditions required if international trade is to be completely in accord with comparative costs.

Firstly, it would have to be a free-trade world—no tariffs, no trade barriers, no subsidies on exports, nor on imports.

Secondly, the internal markets of each country would have to be competitive, so that commodity and factor prices would be flexible and would be determined by individual market forces.

Thirdly, resources would have to have substantial mobility interindustry, so that they could get out of an industry that was, or ought to be, in a decline and could move fairly quickly into an industry that was expanding or should expand.

Under those circumstances foreign trade would be wholly in conformity with comparative money costs, and it also would be wholly in conformity with comparative real costs, as I defined them, namely, comparative input costs per unit of output.

However, there are today important deviations from this pattern. Trade barriers obviously prevent the pattern of trade from conforming to the pattern of comparative cost. When the trade barriers are imposed by knowing and intelligent men, that is their intent and their consequence. This is especially true: The distortion of trade from comparative costs can be particularly great, and I would also say especially perverse, if these trade barriers are discriminatory according to source of import.

Next, if there are not genuinely competitive national markets in the economies you are concerned with, then you may have the phenomena of dumping prices, and these dumping prices may take the actual course of trade away from what it would be under comparative cost. Or you may have special export taxes, or export subsidies. You may have government price fixing, where the prices fixed by the government are available to foreign buyers. You may have government trading, and when a government trades, what principles it follows are something that you do not know while it is trading, are likely to get a distorted account of after the event, and in any case are likely to have no close resemblance to the principle of comparative cost.

Then you may have private cartels and monopolies, which have an impact on price structures, such that the course of trade is substantially different from what it would be if these markets were really competitive. Then you may have collective bargaining by trade unions and employers, or you may have other factors, which create serious immobility of factors of production from industry to industry, so that factors in production in some industries are locked in and cannot get out. I may say that if you find such situations, it may call for important qualification to the free-trade type of argument. Or you may have another situation in which the effect of the collective bargaining is not to lock workers in, as, say, through seniority rules, but to lock them out by setting wage rates so high that the employers cannot afford to hire them, and an artificially high money cost leads to uneconomic imports. This phenomenon occurs repeatedly. If anyone wanted concrete examples, I would direct him to study some of the Latin American countries, where trade unionism has moved in in its youth with some irresponsibility, and has tended to snuff out really promising new industries by just making it impossible for them to make a go of it.

For all these reasons—and I am sure I have omitted some other factors of a similar sort—actual trade today may in specific instances be in accord with comparative money costs but not in accord with comparative real costs, or it may be in accord with comparative real costs but not in accord with comparative money costs, or, if the government is the trader, it may not be in accord with either comparative money costs, comparative real costs, even comparative prices.

If you ask what is the present significance of all that, well, in the first place, the free-trade argument rests basically on all the assumptions I have made. If you depart from these assumptions, this does not necessarily mean that the reverse conclusions become applicable, and that state interference with foreign trade becomes economically sound. It does mean, however, that the general free-trade doctrine is no longer clearly applicable without further argument and without inspection of the special circumstances which prevail.

The practical question, and it is a question on which I think economists disagree among themselves, is as to whether these complicating factors are cumulatively of such importance that the general economic argument for specialization in accordance with comparative real costs ceases to be applicable to trade in accordance with actual prices—

which is the way the trade will in fact occur except when government steps in—and as to whether, therefore, either each case has to be treated ad hoc as a special case for which there are no general rules, or new kinds of general rules need to be discovered and applied.

One thing I am sure of is that a blind application of the free-trade doctrine would be a mistake of judgment, of policy, in the free world as it operates today. In this free world, it is possible to have more trade than is good for you, as well as to have restrictions on your trade that are economically costly. That point will come up later.

Let us assume, however, that after you have taken into account all these various considerations, you conclude that on strictly national economic grounds there is still a strong case for liberalizing American restrictions on imports. I think there has been a general consensus shown by the participants and the questioners in these hearings, and would be shown by the economics profession, at large, with respect to several important propositions. First, that in any program of trade barrier reductions gradualness should be treated as a virtue, as a requisite; that you should avoid shock. You should not move at such a pace as to produce a problem of need of major and rapid adjustment for any American industry. Secondly, that reciprocal reductions; that the balancing or at least the offsetting, in part, of our trade barrier reductions by trade barrier reductions abroad would, in general, but not universally, be more advantageous to us than unilateral reductions on our part. Third, that the reductions should be selective rather than across the board. Fourth, that merely token reductions are not worth the trouble involved in making them.

Let me make, now, some applications of this reasoning to questions that have arisen in the course of these hearings.

First, the alleged menace to our economy of low wages abroad, and the ancient low-wages-abroad argument of American protectionism. As has been pointed out in these hearings, in other countries that argument clearly does not hold. Some of the lowest wage countries in the world have some of the highest tariffs in the world. They cannot use the low-wage argument against anyone, and no country can use the low-wage argument against us. Nevertheless, at the present time the strength of the feeling abroad that their economies need protection against our competition is much stronger than the strength of the feeling in this country that we need protection against the outside world. Differences in wage levels cannot, therefore, be a comprehensive explanation of why foreign competition is commonly feared.

One thing more to remember is that foreign countries as a rule do not have low wages because they like low wages. They have them because that is all their workers can earn for their employers or themselves. In other words, they have low wages because their workers have low productivity. Low wages may mean high wages cost per unit of product, and very often does.

Foreign wages, moreover, are not perpetually low and guaranteed to remain low. In the argument now circulating, for instance, about the importation of cheap products from Japan, notably cheap blouses, if those blouses really were to pour in here by the tens of millions I am sure that the wages would not remain the same as they now are for those workers in Japan who make them. You do not have to have strong trade unions in order to have wages move somewhat in response to the worth of the laborer to his employer.

The question of "substandard" wages has been raised in these hearings. It is a moderate form of the argument that low wages abroad are a menace to the prosperity of American industry. The argument has been raised that a general national level of wages in a particular country which conforms to its general productivity, is not a menace to our economy, even if it is a low level, and that we should not, therefore, take special measures against it. But if the wages are "substandard," then, it is agreed, we should take special measures of protection.

I am not clear whether the ones who propose that are arguing in terms of American economic advantage, or of American humanitarian obligations to the exploited workers abroad.

On the question of American economic advantage, my first point would be that it does not make any difference to us why foreign wages are low, and it does not make any difference to us why foreign prices are low, provided the lowness of wage or price is stable, is not transitory. If, however, our hearts are really throbbing out of sympathy for these poor exploited laborers abroad, let me point out that the way in which to intensify their misery most effectively is to destroy the market that their product may be having in this country. What you may be doing if you put special import duties on products produced by foreign labor earning very low wages is further to reduce the wages they can earn by lowering the price net of duty that their employers can get by sale in this market. Or you may be putting them out of employment completely, so that out of your pity that their standard of living is so low you are making it impossible for them to live at all.

I turn now to the implications for American export policy of these considerations about why we should or should not, as the case may be, welcome imports into this country: The question as to what our export policy should be has been raised several times in the course of these hearings.

Here, I think, I may not sound much like an enthusiastic free trader. I would no more push exports artificially than I would push import restrictions artificially. I would regard exports as such as no better and no worse, no more and no less a matter of legitimate concern, than any other unit of trade, internal or external chosen at random.

The tariff and tariff policy normally, and in the long pull—not in the short run, not during a business cycle, but in the long run—affects the kind or quality of the employment of our labor and other resources, but does not affect the quantity of it. If unemployment were a problem for us it should be dealt with by fiscal and monetary policy, or possibly by other means. The tariff is not an appropriate instrument, for dealing with it, and particularly not for chronic or continuing unemployment.

I would agree that a recession would not be a good time for us to lower import barriers, even reciprocally. In general, it would be well for us to time our trade barrier liberalization so that it comes in times of prosperity. Adjustment to it is then easier, and it is less likely to have even short-run unemployment consequences.

I would also argue that it is just as unsound to promote exports artificially, as by subsidies, by organized dumping, or by tied-in loans where we lend abroad only on condition that they spend the proceeds of the loans in this country, as it would be to restrict imports artificially. The argument for lowering import barriers ought not to be, as it has often been, as it has steadily been in this country from the highest sources, that this is a way to promote our export trade.

It is not sensible for us to want, for national reasons, more exports than are necessary in order to pay for the goods that it is wise for us to import. Exports, from a national point of view, should be regarded as a mean to an end, the way to pay for imports, and not as an end in themselves.

There is no doubt in my mind that in the whole history of our trade agreements since 1934 we have conceded more than we have gotten in return in reductions of trade barriers. There has not been an even balance of concessions. In general, in the absence of special circumstances, I would aim at a balance of reciprocal concessions. But, in this period, and particularly in the postwar period, this lack of balance seems to me to have been in our interest, and very much in the interest of the world. Our exports have been as large as was good for us; in the immediate postwar period they were larger than was good for us from a strictly national point of view. We were shipping abroad steel which we could have put to good use here, shipping abroad things for which we had urgent use at home.

Moreover, I feel that on the whole the outside world has bought from us, since 1945, at least as much as it was in their interest, or in our interest, that they should buy from us, despite the fact that they did not lower their trade barriers as much as we did. That may not apply to particular countries. It may not apply to particular years. It is an overall judgment.

My major reason for coming to this conclusion is that while we were inflating at a formidable rate in this period, the outside world proved to be much more efficient inflators than we. Inflation tends to be an artificial stimulus to imports and a restraint on exports. Moreover, there was a pent-up shortage of goods, including producers' goods, abroad to a degree not existing here, so that they had a goods hunger instead of a sales hunger in those countries.

In any case, as we all know, they bought from us much more than they sold to us. The balance was made up in the main by gifts on our part. Nobody need now regret that we did not have a vigorous export promotion program, say, since 1945, and nobody need now regret that we did not have lower import trade barriers for the purpose of having had larger exports in that period.

There is today a widespread pattern of foreign-trade barriers discrimination against exports from the United States. Our trade agreements bargaining has not come anywhere close to eliminating this, especially in the quota and the exchange control field. Even today, however, and still more so as of 1946 or 1948 or 1950 or 1952, if you consider these discriminations against dollar goods in association with the overvaluation of foreign currencies, if you consider them in terms of the relatively greater inflation abroad which has not been compensated by or offset by exchange depreciation, it is by no means clear to me that foreign countries are buying less goods from the United States than they should buy, or would buy, under as liberal a trade policy as possible. So that, although I am and remain an unregenerate free trader in principle, I am so only in that framework of assumptions that I have earlier indicated. At the present time, while I think there are strong, overwhelmingly strong, arguments for further liberalization of this country's import barriers, the same thing does not hold for a number of other countries, because for a number of other countries import barriers are now an essential and urgent offset to an overvalued currency, or to an overinflationary situation.

My own preference would be that they should stop overvaluing their currencies, that they should stop inflating. But if you accept those as facts, then it is important for us as their friends that they shall not overimport as they would if these discriminatory trade barriers were not at work. However, the situation is changing, and changing to a more normal situation, and I would not recommend for the future that we show no concern as to whether other countries respond to our trade-barrier reductions in a similar way. I would scrutinize their circumstances, and I would ask any other country that wants to maintain discrimination against our trade to make out a strong case showing that there is an urgent need for it in order to maintain balance in its economy.

The question was raised by Senator Flanders—I am sorry he is not here to hear my answer, which I am sure he would not regard as completely satisfactory—as to what the United States economy would look like under complete free trade. I will add to the question just one elaboration, that the complete free trade was gradually attained, and would answer as follows: First, some industries we now have would not be here. We would have some new industries that otherwise would not be here. Many of our old industries would be expanded. Second, American productive resources, labor, and other input items in production, would be assigned more closely than they are today to the employments of greatest productivity, to the employments of greatest service to the national economy, of which they are potentially capable. Third, per capital national real income would be greater. Fourth, we would have less monopoly in this country. Fifth, taking them all in all, the changes would probably not be spectacular. They would be significant, but they would not make our economy look strikingly different from what it looks today.

These are all results which I would regard as gratifying. The only qualifications I would make is that I am, so far, at least, confining myself strictly to economic considerations, and, secondly, that our abandonment of protectionism was not too abrupt.

Now for some comments on specific technical points that came up in the hearings in connection with the way in which we operate our trade barriers.

Mr. Strackbein, in his testimony, argued that the escape clause was not exerting a significant restrictive effect on imports, on the ground that in cases where an impending application of the escape clause seemed imminent, the imports, instead of declining, had risen. I would reply that that is exactly the sort of effect I would expect. A threat of the imposition of an import barrier to have on the volume of imports. The threat of a new trade barrier stimulates imports; if stocks are available you try to get them in in advance of the application. I would also argue, and maybe this would be in agreement with Mr. Strackbein, although I think not, that you cannot throw much light, statistically, on the effect of the existence of the escape clause.

The argument that the escape clause is an important barrier to imports even if not applied, rests on what men would do if the escape clause were not there rather than on the visible things they do when the escape clause is present as a threat.

Here one must rely on human reason. I know some men do not like to be driven to this extreme length. You cannot derive a reliable answer from examination of the statistical record. But foreign businessmen have said, and its truth seems perfectly plausible to me, that they would regard themselves as fools if they were to make a major investment in such things as special designing for the American market, finding out what Americans want, establishing dealer contacts, setting up warehousing facilities, launching advertising campaigns, and expanding their own production facilities abroad in order to develop the Amercan market, as long as they faced an imminent threat that if they did succeed the American tariff would be raised against their products.

It seems to me perfectly sensible for a businessman to respond in just that way to the existence of that kind of a threat, the threat that if you are successful in your campaign it will be made impossible for you to continue it. If I were a businessman, I am sure that the escape clause would enter seriously into my consideration as to whether I should start a major investment directed toward expanding my sales in the American market.

I was interested in Dr. Humphrey's suggestions as to modifications of the escape clause. They were new to me, and I think they are deserving of serious consideration. He suggested that the application of the escape clause should not be available to the products of growing American industries and should not be available to single products, but only to industries as a whole.

I would qualify this slightly. I would recommend that application of the clause should not be available to a single product where the single product is predominantly one of a wide range of products produced by the same industry. Sometimes single products correspond to a single industry.

Dr. Humphrey also suggested that the outward mobility of the labor affected in the industry concerned should be taken into consideration before the escape clause is applied. I think that what he had in mind was that there is more of a case for giving the benefit of the escape clause to an industry whose labor is highly specialized to that industry, and therefore could not easily shift to another industry, than to give it to an industry whose labor is not specialized to that industry and has many other opportunities of employment.

These all seem to me sensible suggestions for limiting the application of the clause. I think they are deserving of examination.

The question of dumping came up. Perhaps a word or two would be appropriate on the logic of concern about imports that come in at dumping prices, meaning by dumping prices, prices for export which are lower than the prices which under otherwise similar circumstances are charged to home buyers. Cheapness of imports, as I have already had occasion to argue, is an advantage to the importing country, whatever its cause, if it is a stable cheapness, an enduring cheapness. A temporary cheapness may do a lot of damage to a domestic industry. It may throw it into insolvency, or drive workers out of the industry, while the cheapness to the consumer, because it is temporary, may be a meager offset. If the cheapness is fairly lasting, however, it is an advantage to the importing country, regardless of what its cause is. Knowing whether the cheapness is due to dumping would be significant only insofar as the existence of dumping might establish a presumption as to whether the cheapness was to be short-lived or permanent. Antidumping measures are legitimate only if, on careful consideration, they are found not to be interfering with permanently cheap imports.

It should be noted, also, that dumping prices are not necessarily cheap prices and very often are not cheap prices in any sense of the term. Let me give you an instance, of which there have been many historical examples. A European member of an international cartel has monopoly control of its own national market, and soaks its domestic customers. It sells for export at the same price as that at which the whole cartel sells, regardless of where the members are located. These prices may be even a little high as compared to American prices. Under the American law that is dumping, and under the American law the antidumping penalty can be applied.

Notice that in this case the dumping price is not cheap in any sense, except that it is lower than the domestic price of a monopoly that soaks outrageously its domestic customers. A lot of dumping prices are dumping prices of that sort, that is, are not low prices. Let me come closer home and give you another example. Our American wheat exports are dumped exports. We are selling them abroad at dumping prices, on my definition of the term which corresponds to the American legal definition of the term. In other words, the foreigner can buy American wheat at a lower price than the American can. I am not at all sure, and I do not know whether the experts are sure, that the American export prices for wheat are low prices in any real sense of the term. It may merely be that our domestic price is an especially high price. I strongly suspect that, in terms of world-market prices, except for the special giveaways, we are not really exporting wheat at especially cheap prices. We are simply not trying to get from foreigners the specially high price which a wheat buyer has to pay in this country as the result of special statutory measures designed to benefit the wheat producers.

It is important, therefore, that dumping duties should not be applied in a mechanical way and should not be applied at all except where a clear and genuine injury to an American industry would otherwise occur. The injury should be to an industry, and not to one little wing of a big American industry that may be highly prosperous.

Secondly, dumping duties should not be applied unless the benefit, if any, to American consumers from a cheap price is likely to be transitory, as judged by the nature of the prevailing circumstances. Here there is something new that needs to be watched; the application of the antidumping legislation has been shifted from the Treasury to the Federal Tariff Commission. That may have some significance. It may change the character of the administration of the antidumping law. On the whole, I think that the Treasury enforcement of it, and I have been studying that and watching it since the start of the legislation, has been extremely legalistic. That has both hurt us and benefited us. It has saved us from protectionist zeal. The officials who have enforced it have had no commercial policy intentions of their own; they have had an act of Congress to administer, and they have tried strictly to follow it to the letter. It was a fairly good act of Congress, as restrictive trade legislation goes, and, on the whole, I think we profited from the fact that the men who were administering it had no policy ideas of their own to promote. Maybe it is getting into the hands now of men who do have ideas, and these ideas may be protectionist. If such is the case, what they can do with that antidumping law will make the escape clause look like small potatoes. They can, if they wish, raise the effective tariff barriers more than all the negotiations in Geneva will be able to achieve in the other direction. Congress should have another look at the antidumping legislation, make up its mind what it really wants, and see to it that the act instructs the Tariff Commission accordingly.

I move on to another technical question on which I have a few general ideas. Although I do not want to masquerade as an expert, and that is the question of whether when a reduction in a tariff rate which in the judgment of Congress, or of the Executive, has been in the national interest, nevertheless results in injury to deserving Americans, those injured should be compensated in some manner.

What should be general policy here? One thing that I think we must keep in mind is that facing risks confidently, recognition that things will and should change and that some changes will have adverse effects, have been essential elements of the progressiveness, the adaptiveness of the representative American which have contributed to the attainment of the unexampled prosperity of the American economy. We must beware of pursuing the will-o'-the-wisp of universal economic security for every American industry or occupation or individual. In that path lies stagnation, if not worse.

Nevertheless, it has always been my belief that where a sudden change in policy by the Government results in serious disappointment of reasonable expectations, there is a case for careful consideration as to whether there ought to be some compensation. A decision ought to be based in part on the practicability, on the availability of a workable procedure for compensation.

What I am saying is that there is a case for disaster protection, where the disaster is to innocent and deserving citizens and is the result of a change in policy on the part of the Government of which it had given no or insufficient advance warning. It probably would be inexpedient, however, to try to work this out in special relationship to the tariff. It should be part of what I might label as "a general program for relief of undeserved distress," or rather "a general program for relief of undeserved distress resulting from a change of mind on the part of Congress." Otherwise, you might be creating an undesirable legal vested interest in the permanence of tariff protection, presumably, for every protected industry. Moreover, the practical difficulties of designing and administering a workable compensation scheme may be so great that it is not worthwhile trying to surmount them except for a wider area than that of tariff reduction. This might link up with distressed area policy, but I can't go into that now.

My next topic is the relationship of commercial policy to security and strategic interests. I will deal with it here from 2 points of view.

The economist with free-trade tendencies is likely to explain that, of course, he is abstracting from strategic or from security considerations, and to give the impression that if he were not so abstracting he would be making important concessions from his free-trade case. Although I do not pretend to have made a detailed study, or that I would be competent to make one, I strongly suspect that if you take our tariff as a whole, it is a drag on our national security, it is a negative security factor rather than a positive one. I know that over the years, when tariff hearings have been held, the generals have come over from the War Department to testify that tariff protection is urgent, that the United States will face defeat in the next war if jeweled watch movements, and so forth, are not made in this country. But nobody ever asks them to testify as to whether there is any way in which the fact that a certain industry is protected, weakens our economy from the point of view of being able to withstand a tough war.

As I see it, the ideal economic base for American military strength would be provided if our national economy had somewhat the following characteristics: It would be an economy which in peacetime produces and exports a surplus of commodities valuable in wartime, so that it has production facilities and skills for more than it wants in peacetime of those goods specially useful in wartime, whether they are munitions or civilian goods. Secondly, in peacetime trivial items from the security point of view, luxury items, even items whose consumption soften the race, it would import rather than manufacture at home, and in wartime it would do without them.

I am sure that our tariff, from a strategic point of view, applies promiscuous protection. Consideration as to whether domestic production of an item is important or not strategically does not enter except when the strategic argument can be used to support a restriction. When it cannot be used to support restriction, nobody appears to testify in the hearings that there can be a strong strategic argument against import restrictions on articles not useful in a wartime economy. Embroidery, lace, or fine gloves, costume jewelry, household furnishings, and these are the kind of products that are still bearing the really heavy duties, and these are the kind of products, I think, the duties on which are really restrictive of imports into the United States. They are all products which I think we ought to import in peacetime without restriction as far as strategic considerations are concerned, and to do without, if not then obtainable by import, in time of war.

I am all for a careful scrutiny of our commercial policy from the strategic point of view, but from the point of view both of what import barriers may add to our national strength—and there are undoubtedly some—and of what removal of import barriers may add to our national strength. There is also be considered the effect on the military strength of our military allies of our commercial policy. Our restrictions on their sales to us affect, of course, the strength of their national economies and their ability to support adequate military budgets. In any case, the one point I hope to have established here is that it should not be taken for granted that emphasis on security considerations would in the net lend any weight to the case against liberalization of American trade barriers.

Another topic that came up in these hearings, although more in the questioning perhaps than in the testimony, was the question of the pros and cons of regionalism. The discussion turned on whether regionalism is good or bad. I would mildly suggest that one could come to a more logical answer as to the merits of regionalism if it were made clear, as compared to what? There are some types of situation in the commercial-policy field I can think of that regionalism is worse than and there are others I think that regionalism is better than. We might have a look at the conceivable alternatives.

I suppose the most relevant one is, Is regionalism good or bad as compared to the status quo, on the assumption that its only attainable alternative is regionalism, or perhaps more regionalism than we already have?

Another possible comparison is between regionalism and nondiscriminatory lowering of trade barriers. Let me first compare regionalism with the status quo, and let me make clear that by regionalism here I mean discriminatory removal of trade barriers as among a restricted group of countries. Actually, regionalism has gotten to be a misnomer because it is applied, for instance, to the sterling area. Just what region both Australia and England are in at the same time I am not quite clear. It is really customs blocs, or tariff blocs, that are in issue. The proximity aspect is sometimes not there at all, and at other times it is just historical accident that it is present.

It is becoming widely accepted, as stating the issue fairly, at least from the liberal trade point of view, that a regional preferential arrangement, whether it takes the form of fractional preference or of a free-trade area or of a customs union, is better or worse, according as it is more trade creating than it is trade diverting.

Let me give you a hypothetical illustration of a trade-creating consequence and of a trade-diverting consequence of the establishment, say, of a customs union. Let's suppose that before the establishment of a customs union between Holland and Belgium, Holland produces steel at $200 a ton cost and Belgium produces it at $150 a ton; each has a high tariff and each supplies its domestic markets. With the establishment of the customs union, Holland is going to buy the Belgium steel at something like $150 a ton, and its own steel production will cease.

That is trade creating, and it is good in that sense from the point of view of liberal trade policy. It may not be as good as all-around free trade because it may be that England would be happy to supply steel at $100 a ton to Holland, but it is better that Holland shall buy it at $150 a ton from Belgium than that it shall produce it itself at $200 a ton. This would be one of the kinds of effects you would have from a customs union, and it would be a good effect. On the other hand, suppose that before the customs union Holland did not produce its own steel, but bought it from England at $100 a ton, and that the customs union has a $100-a-ton tariff on steel imported from outside. Holland will now buy steel from Belgium at $150 a ton free of duty. That is a trade-diverting consequence of the customs union. It is bad for Holland. It is probably bad for the two countries combined; it is certainly bad for the outside world. It clearly is very bad for England, which loses a good customer.

The question as to which effect is going to predominate is not a question that the theorist can answer without knowing the facts in each specific case, and the theorist often has neither special skill nor zeal for learning facts of this kind. Each case, I think, would need to be studied separately. There are certain general things, however, that

I think can be said. The larger the area—I don't mean merely in acreage, but economically—covered by the preferential arrangements, the more likely it is that the trade-creating will predominate over the trade-diverting effects.

Also the larger the extent to which, in the absence of the regional union, the countries would be moving in a parallel way to set up hothouse industries, the more, the better is likely to be the union; the least inefficient of the countries is going to do the providing with respect to each product, since there will be internal free trade. On the basis of such considerations, and of some other similar ones, I would argue that in general, for a European customs union, or a Western European customs union, whether it embraced England or not, there would be a strong presumption that it would be to the marked advantage of the area, and to the marked advantage of the world as a whole, although it might inflict some heavy blows on some excluded countries. On the other hand, I am very doubtful of the mutual advantage of Benelux, of the Holland-Belgium-Luxembourg customs union. I think it is not an accident that for 150 years there has been constant talk of and constant drafting of projects for customs unions, but almost no realization, except in the one case of the Prussian Zollverein, where the political drive, the nationalist drive, was really the thing that gave it strength, and where, instead of the economic union creating the political unity, it was the existence of the political unity, the sense of common nationality, which made it possible to establish the economic union.

Today one hears arguments by Americans which sound to me sentimental for economic union of areas, any areas. From 1944, on, this country was pressing hard on Western Europe, diplomatically and propagandawise, and possibly even in the administration of our foreign aid, to move in the direction of economic unification. I am not saying that regional economic unification is not good. Under some circumstances it is a great blessing economically and under other circumstances I say it can be a horrible curse, both economically and politically.

Economic union can be politically divisive within an area. I am not going to dig up the American Civil War again. But let me point out that economic union, customs union, internal free trade with a tariff or imports from outside, has been somewhat of a divisive factor in Canada, with the Prairie Provinces and the Maritime Provinces often dissatisfied, disgruntled, complaining. The country is in part politically divided because it is a protectionist country with internal free trade. The same thing is true of Western Australia vis-a-vis the Australian union; it has been a dissatisfied partner ever since the Australian Confederation was set up. The same thing was true of Norway and Sweden. They were hostile to each other when in economic and political union. They became real friends only after they separated. The same thing is true with the Union of South Africa; the union has intensified the frictions, multiplied the occasions for quarreling, intensified both the urgency and the difficulty of reaching common agreement between the Cape Province and Natal, on the one hand, and the Transvaal and the Orange Free State, on the other. Or to take perhaps the most important case in history, it is to me by no means clear that Austria and Hungary and Bohemia and Croatia would have been hostile to each other, would have been as ready to spring at each other's throats if they had not been brought into political union including customs union.

It has been said that strong fences make good neighbors. Some neighbors don't need fences, others do. I think removal of fences ought to be done with caution and with discrimination as to the nature of the circumstances. They ought not to be removed at random.

I would point out one additional factor, which should lead to caution in promoting regionalism, and that is it is liable to leave orphan areas in a very serious plight. The unincluded country, the stray country that doesn't belong to a big bloc, may then be in real trouble. The notable case today is Japan. Let me give you another case. If regionalism were to go much further than it has so far, we might have some little sick orphans right near us in Haiti and Santo Domingo if they were not included in one of the blocs. The great blocs would include countries able and determined to produce for themselves the things that Haiti and Santo Domingo could supply. They would have no export market. I do not stress the fact that European regionalism is historically and otherwise, largely a program to make permanent tariff discrimination against American exports respectable. I think it is better that we should not get excited about that, that that should not be the cause of our hostility, if there were to be hostility to European union. I think it has been nice, indeed, to see the enthusiasm with which Americans have been promoting programs which historically, going back to the 1870's, going back to the rise of the United States as an important exporter of agricultural products and later of manufactures, have had as a major economic objective organized discrimination against imports from the United States.

All that I am suggesting is that some of the Americans who have been promoting this have been a little naive. Let us say, however, that I am not arguing now that all cases of discrimination against dollar imports should be opposed by us under all circumstances. Let me make my position clear. In the period from 1945 on, through perhaps yesterday, Western Europe would either have had to cut down its rate of inflation so it didn't exceed ours, or to restrict dollar imports. The causes were many, and I haven't got time to examine them, but given the dollar shortage which prevailed, discrimination against dollar imports did not necessarily mean that they were buying less of our exports than we should have wanted them to buy or than it was good for them or for us that they should buy. I have already made this point, but it was perhaps worthwhile repeating it in a different direction.

Now let me say just a few words now on East-West trade.

Economically, it is not for us an important issue. East-West trade won't amount to much for us, regardless of what our policy is. In the first place, the Russians are a continental country, particularly if you include their orbit, and like us, therefore, their exports, even under liberal free market circumstances, would be a small proportion of their national income. In the second place, it is quite clear that they are committed to autarky as a national aim, if now not for themselves, at least for the countries within their orbit.

Secondly, I think there is a real danger that needs to be carefully watched and that is that Russia may use fake offers to buy abroad that may lure other countries into their embrace. I am not saying that we should match them by equivalent offers. We ought to watch carefully, however, lest an unnecessarily restrictive trade policy on our part is a factor making some countries highly responsive to Russian offers.

The Russians have since 1945 entered into a fairly substantial number of trade agreements with other countries, in which there is mutual agreement as to amounts to be bought and sold. The Russians, I understand, have rarely taken as much as they said they would, and often didn't make deliveries in return at anything like the scheduled rate. But if Russia should really embark on a more expansive trade policy, it might have serious consequences for our political relations with some countries.

Third, the issue is more important for some of our friends abroad than it is for us, because for them the orbit countries, the satellite countries at least, if not Russia itself, have been important markets. For them the Soviet countries are still significant sources of vital imports, as, for instance, Polish coal for the neighboring countries, and for them, East-West trade is more important, or seems potentially to be more important, than it is for us.

Therefore, if in the light of our strategic considerations we press on them the cutting off of trade which is valuable for them, I think we ought to recognize these circumstances and accept some obligation to make available to them an alternative market for their exports. What we have been doing instead, I am afraid, is to tell them that continued access to American foreign aid is contingent upon their conforming to our East-West trade rules. I do not think that is the way to use foreign aid. Whatever East-West trade does occur, I am sure, has been scrutinized by the Russians in a cynical, realistic, and probably able manner, and on a centralized basis. Russian policy is free from subjection to internal pressure, from group pressures, from pressures of persons who want exports or want profits. They are in a position to make clear-cut cold-war decisions. They are adequately security-conscious, or aggression-conscious, and if they permit any trade to occur, it must be because they have concluded that it is to their military advantage.

We are not in the same position. We are a democratic country. Congress must respond to pressures of many kinds, and not every individual is an informed statesman, alerted to the menaces latent in our foreign relations. The Communists are more unified, not only within Russia, but as a group, as a bloc, and therefore can reach a centralized, strategic decision more quickly and more unqualifiedly than the Western countries can. All the strikes, therefore, are against us before we start, if we engage in a game of trying to outwit them by relaxation of East-West trade barriers.

These are all the comments that I have time to make. I am aware of important omissions. My excuse must be that if I had had more time to prepare, I could perhaps have cut down without loss the time I spent on some of the issues I did talk about.

I have placed my emphasis as I said I would, where the presentations and the questioning in the course of the hearings seemed to show that there was most interest. I hope participants to whom I have not explicitly referred as well as those to whom I have referred will recognize that the fact that I don't comment, or don't comment at length on what they have said does not mean that I didn't value it highly, nor do I mean that I think that everything I have said is original. Most of what I have said is a reaction to, or a reflection upon, previous testimony, and much of it is directly borrowed, in substance if not in form, from the testimony of your earlier witnesses.

Mr. BOLLING. Thank you, Dr. Viner.

Dr. Ensley, do you have some questions?

Dr. ENSLEY. Mr. Chairman, I had a list of questions, but Professor Viner has commented on most all of them. I was interested in the point he made on the importance of timing reductions in trade barriers, doing so during periods of prosperity, and his point also that it would be proper for the Government to ease the hardship in those cases that arise from action in this field.

Professor Viner, would you differentiate between the effects that might result immediately from a lowering of a barrier, as against an effect that emerges, maybe 2 or 3 or 10 years after a barrier has been reduced? Is there any difference in the type of injury that would justify different government relief action?

Dr. VINER. It seems to me offhand that if the actual impact of increased foreign imports came 10 years after the trade barrier was reduced, nobody would be smart enough to be able convincingly to connect that increased import with that reduction of the trade barrier. A 10-year interval is sufficient to resist all the capacity for causal analysis that the economist has.

Dr. ENSLEY. Aren't some of the recent cases that have been brought up, as you say, of the escape clauses——

Dr. VINER. Ten years is a long time.

Dr. ENSLEY. Maybe not 10 years, but might they not result subsequent to the reduction of the barrier and make it rather difficult——

Dr. VINER. As I suggested, I wouldn't care very much what the cause of the distress was, provided that the victim was deserving. If he was an innocent American, whether worker, employer, or what, and was facing serious injury as a result of a change in government policy, or even as a result of some other kind of sudden change, I would approve of his being given some degree of disaster protection if a procedure could be worked out that doesn't cost more than the benefit it renders.

I find it hard, however, to picture a blow that takes 10 years before it becomes visible. If the injury is spread over 10 years, normal retirement would have taken care of the workers, particularly in this country where workers are extremely mobile. An American plant depreciates rapidly even without accelerated depreciation. If you have 10 years to depreciate it, you have little capital loss to bother about. It is for injury of quicker impact that we should seek a remedy. I am somewhat skeptical, however, as to the possibility of finding a suitable mechanics for it. I did refer earlier to "distress area" policies. We shouldn't care about areas as such. It is persons we should care about. I think we could go off on a seriously wrong path if we started to try to maintain the prosperity of particular sets of acres. In some instances it may very well be that the way in which you really can relieve human beings in economic difficulty is to take them out of an area which is no longer an economic area to live in. I am very much afraid that distress-area procedures are liable to lead, say, to keeping farmers in the cutover areas or up in the high hills when they ought to move to where they can earn a decent living.

The tariff impact, moreover, may not be an area impact. It may be, say, a worker impact, or a type of investment impact. The industry may not have been highly concentrated in a restricted area, or even if it was concentrated in a restricted area this may have been an important area with a wide range of industries, with the result that the area, as such, doesn't need relief. But the particular individuals, the highly trained workers, and possibly the owners themselves, may need relief, even though the area as such continues to be a prosperous one. Let us not start subsidizing deserts for the sake of the desert area, even if we decide to take care of the people within the distressed area whose trouble may be that they shouldn't have gone there in the first place.

Dr. ENSLEY. Your emphasis would be on the distressed individual, and irrespective of what made him distressed, whether it is an import, whether it is a technological change, automation, or whether it is change in the taste of the market, or what?

Dr. VINER. I wouldn't quite say "irrespective" of whatever it is that was the cause of the distress. I would introduce perhaps a moral note here. I did introduce it earlier. To be entitled to relief, the person should be deserving. I won't push that line of argument any further, however, at this time.

Secondly, the distress to be relieved should be due to a major disappointment with respect to reasonable expectations.

Third, it should have been the Government that had made those expectations reasonable and that now disappoints them.

Dr. ENSLEY. How about technological change?

Dr. VINER. You are pushing me out of the area, I believe, which is proper to these hearings. I am willing to think aloud, but I speak unprepared. Let me bring back again into the discussion my other proposition, that we beware of guaranteeing security to everyone against everything. At this stage all that I am prepared to say is that if a draft of a bill were available which presented a procedure which seemed at all acceptable, practicable, reasonable, equitable, for taking care of these undeserved disappointments of reasonable expectations due to Government action, it then would be time to look at it and see whether it could be carried further safely, so as to apply to distress not resulting from changes in Government policy.

We are already moving in this direction, of course. Old-age pensions, unemployment compensation, special subsidies to poorer States with respect to education, or roads, or health, are all illustrations of this movement. I think we are going to move further. Your committee is at this time pursuing a fundamental investigation in this area. I wish you good luck in this enterprise. I do not feel qualified, personally, to recommend what it is practicable under the circumstances to do without resulting in more harm than good.

Dr. ENSLEY. Thank you very much. This discussion ties in with our hearings that commence tomorrow, on low-income families, and the hearings that we concluded 2 or 3 weeks ago on automation. Thank you very much.

Mr. BOLLING. Dr. Sheldon?

Dr. SHELDON. In Dr. Piquet's study on Aid, Trade, and the Tariff, he measured as best one can some of the short-run effects of making tariff cuts and came up with some estimates on a number of jobs that might be involved.

Walter Salant, in these hearings, presented some rules of thumb which might be used with regard to tariff cuts, although the Salant paper before this group did not try to make an overall estimate. You will recall, though, he set some probable general limits.

Now, the statement has been made quite often that these low job displacement estimates may be all right for the short run, but if we were to consider the long-run consequences, the cost in jobs and dislocation would be very much greater. You have pointed out some of the advantages of mobility, and indicated we can adjust to these changes. Is there anything else that can be said as a more direct answer to these people who are worried about an even larger dislocation than the immediate short-run one?

Dr. VINER. The longer the period you take, the less will be the dislocation. There is nothing in the general character of a tariff either to increase or to decrease overall employment. Changes in tariffs cause changes in employment at the moment, but those are transitory. In the long run, whether we liberalize our tariff or whether we retrace our steps and start raising trade barriers it will not change the volume of employment in the United States. I would even go a little further. I still remember the occasion in which I angered a high Government official of like free trade tendency to mine when I told him that on the whole free trade would lower employment in the long run rather than raise it.

My argument was that free trade would raise the standard of living and people would take some of that higher standard in leisure. He still thought that I was playing into the hands of protectionists, who would agree with me that free trade would reduce the volume of employment. If you take the longer run, particularly in this country, I marvel at the extent of occupational mobility of labor. I am not a statistician but I do look at statistics, often, I fear, with great lack of confidence as to what their message is. But one of the things I do see is how high is the average number of apparently skilled occupations which the average American has had in his lifetime, and how little relationship there seems to be between the different occupations. I suspect that one explanation is that unlike, say, European countries, or unlike primitive tribes, we don't require very great skill of a typical worker. The great skill has been put into the planning of the plant, the design of the machine. The foreman has great skill, but the rank and file of the workers are basically unskilled. As a distinguished American engineer has said, I think with but little exaggeration, the secret of American prosperity has been that we have been able to get a high productivity out of unskilled workers.

It may be that their occupational mobility is due to the fact that the machine and plant layout and supervision quickly provides them with the necessary skill for a new task and that, therefore, they can shift readily from craft to craft. A wartime study of death notices of soldiers in German local newspapers disclosed that practically every one had as a civilian been a member of a highly skilled craft. He was a special kind of weaver, or carpenter, or toolmaker. I suppose he had been an apprentice for 6 years or more. We don't operate that way any more, I understand, and our procedures give us greater adaptability to change without sacrifice of productivity.

Moreover, our businessmen also have tremendous adaptability. They extend their range of products or contract it quickly and without severe strain. I wouldn't discount their ability to adjust in time to almost any change. Occupational immobility of the factors, therefore, should not be used as a strong argument against trade-policy liberalization in this country, whatever may be the case for England, or for Switzerland, or for any other country.

Dr. SHELDON. I thought your discussion of substandard wages, whether or not they should be of concern to us as imports come into the country, was very cogent. In justice to Mr. Seidman, who discussed that topic for us, I think that he did put emphasis on the importance of higher wages abroad as a means for improving our export markets.

Do you feel that this is seriously a factor in terms of our own well-being? Does this really make much difference in terms of export levels that we are likely to attain?

Dr. VINER. I would say that percentagewise we are a very fortunate country in this respect. Not very much that happens outside is of vital importance to our prosperity except as it bears on peace and war. I do think it is in our general interest that labor abroad earn high wages, and notice that I say, not "get," but "earn" high wages. Mechanical raising of their wages, if their earnings are not up to it, will cause trouble to those countries. I don't believe that mechanical raising of wages carries with it automatically increased productivity, although it may do a little in that way. The higher the level of income of the people of other countries, the better customers they are likely to be of ours, and the better products they are likely to supply us with, produced efficiently and therefore at lower cost to us. This is aside from other noneconomic considerations, which should make us sympathetically interested in the prosperity of other countries. But this does not in any way lead to the conclusion that because wages are low abroad we should raise our import duties on their products.

Mr. BOLLING. Dr. Viner, I would like to hear you discuss convertibility a little bit.

Dr. VINER. Well, may I ask you a question?

Mr. BOLLING. Of course.

Dr. VINER. Do you mean convertibility at a fixed rate of exchange, or convertibility at a floating rate or a flexible rate of exchange?

Mr. BOLLING. Both, I think, sir. You can, if you wish, if there is a relationship between some of those questions of Senator Douglas.

Dr. VINER. I have read Senator Douglas' questions. I found them very formidable.

I will read: "Trace in precise detail"—with the "precise detail" underlined—"what would happen if exchange rates were allowed to fluctuate," and so forth.

I think I am going to plead privilege. I am a senior professor now, almost a senile one, and I ask such questions, but I don't answer them.

Mr. BOLLING. Obviously, this is fair in relation to me. If it is fair to take that position in relation to Senator Douglas I don't know.

Dr. VINER. He has always been a good friend of mine, and I think he will forgive me.

I will answer in a general way, but I cannot answer with real precision. That is a sort of a question on which I would allow at least 45 minutes to a student writing fast, and I do not want to give you an answer that would be inferior in quality to the minimum that I would expect of him. To answer it properly I would have to start elaborating: If the situation is so and so then so and so, would be the result; if it is otherwise, then so and so would be the result. I would have to make distinctions and distinctions without end, I think you would not bear with me if I started out on that course.

Mr. BOLLING. I think this may conceivably be one of the purposes Senator Douglas had in mind, to make it clear that it isn't as simple as people said it was.

Dr. VINER. It is not simple, and it should not be made to appear as if it were simple. Everybody who is interested in the free market, in having a market-governed economy rather than a directly planned or Government-operated economy, likes exchange convertibility. It makes the exchange value of a currency a market phenomenon. It leaves the individual free to change what he has valuable into anything else that is valuable. Therefore, liberals now tend to be passionately devoted to exchange convertibility at flexible rates. They are sometimes so passionately devoted that they do not pause to make it clear whether they want convertibility even at the price of flexibility, or whether they want the flexibility as the end, or whether they want fixed rates of exchange. The trouble with Senator Douglas' questions, for me, talking sincerely and seriously here, is that I have to look at the specific concrete case of a particular country in a particular position before I can begin to answer these questions. I want to know is he asking this about the United States, or is he asking this about Belgium today, or France today, or England today, which are all in different situations, or Canada today. Each time I would first want to know something about the country, often more, indeed, than I actually know, before I would be ready to offer an answer.

As in the case of the gold standard, and you had a submission on the gold standard, it can be said of fixed rates of exchange that there have been worse human institutions. In some circumstances I would choose the gold standard, and fixed—or rigid—rates of exchange. I would also say this, that what we have substituted for the gold standard, and for the fixed exchange rate, has certainly not been working with magnificent success over the past 25 years. But I do think we are beginning to learn, and I do think we can now do better than a system of exchange rates frozen so rigidly that a country must be on the edge of disaster before it feels free or is free to move to change a rate that involves serious disequilibrium. I am definitely opposed, however, to multiple exchange rates. One of the pioneers in their invention and rationalization has presented a submission to you. I would have argued against the drift of much of his argument if I was sure I had it quite right. Even with respect to multiple exchange rates, however, for the period from 1945 to the present day, with first the recovery from war; secondly, the Korean episode, circumstances have been so special for so many countries, that I would not think I was talking either intelligently or honestly if I were to start laying down general statements as if they were equally applicable to the United States and to Haiti, or to Brazil and Britain, with reference to what sort of exchange systems they should have.

I do have preferences in the abstract. My preferences, stated quite frankly, would be for a system of on the whole stable exchange rates, plus a system of nationally stabilized price levels. However, I would not want exchange rates rigidly frozen through time. I would not want too strong a taboo about changing them, so that if one of them proved to be a disequilibrium rate to a serious extent for a country, it could not be changed without internal or external storm. I am not sure that what I have described as my ideal is not substantially in the spirit of the charter of the International Monetary Fund. I do not think it has been able to work in quite that way, but that has not been its fault. We have been living in a transition period—which I once defined as a period of transition, between one transition period and another one. We have not established that we could carry out the general principles of the Monetary Fund charter to the letter.

Fellow economists, to whom I had better listen carefully, do not agree with me in my cautious approach to exchange flexibility. My major misgiving about it is that the one major restraint that still remains, in perhaps 30, or 40, or even 50 countries of the world, against almost unlimited inflation, is the concern those countries have that their exchange rate shall not fall, or shall not fall far. This is almost the last brake on inflation in some of these countries. If you encourage those countries, as some economists are doing, to abandon any objective as to the exchange value of their currencies, and just to let their currencies float, I think you would be removing the last significant obstacle to completely unrestrained inflation for a long period for many of these countries.

I do not want to name countries, but I think I would be pretty safe in listing up to 30 countries in which the major brake now on inflation, operating on ministers of finance, on members of legislative bodies pressing for expenditures, on businessmen, on bankers, is the association of the dignity of the country, and the worthwhileness of the national currency, with its value in terms of the dollar or of gold. They all know this much, at least, that further inflation will lower the exchange value of their national currency. That is often the one thing which leads them to take the uncomfortable and unpleasant actions needed if inflation is not to proceed indefinitely.

For this reason, a lot of the current argument for flexible exchanges seems to me highly abstract even for the college campus, and highly dangerous outside the campus. This argument, if valid at all, is valid under assumptions which are not at all realistic and do not take into account the actual forces which determine the monetary and fiscal and commercial behavior of many countries.

There, but for the grace of God, go we too. There was a time when I was at the Treasury and often heard the Secretary of the Treasury boast that the dollar was the strongest currency in the world, I used to comment "That is not saying much." I would make the same comment today. I would urge today that we be very cautious before we remove any remaining brake on inflation.

Mr. Bolling. Dr. Viner, we are very grateful for your brilliant summary. This is the final meeting of the present series of hearings on foreign economic policy. Whether we have trodden new ground is perhaps too early to say. We are sure we have managed to bring together the considered opinions and current thinking of many of the men in America best qualified to interpret the problems of foreign economic policy. This has not been an attempt to review in specific detail the very real problems of individual domestic industries, exporters, and importers. Perhaps on a selective basis our future work, if it is continued, will give an opportunity to pursue some of the important subjects in greater detail than was possible this time. Analysis of the testimony collected will point the way to future study.

Our witnesses have managed to cover for us the major elements of trade policy viewed from the national point of view. The Employment Act of 1946 charges the Joint Committee on the Economic Report with responsibility not only for reporting on the main recommendations of the President's economic report to the Congress, but also for making continuing study of economic matters which bear on the subject of our economic stability and growth. This study very clearly is concerned with problems as viewed from the broad national interest. It is abundantly clear from these hearings that our foreign economic policy is important to our domestic stability, growth, and progress.

We want to pay tribute to the standing committees of both the Senate and House which must with patience and critical attention receive the vast mass of specific testimony so essential to the drafting of actual legislation in the foreign economic policy field. The field is so large that many committees have responsibilities for such activities. Perhaps we in the joint committee should feel relieved that we are in no way responsible for drafting legislation. It is our hope that both their members and their professional staffs will find something of value in the record of these hearings. We will feel our work has been in accordance with the responsibilities assigned us under the Employment Act of 1946 if we have provided that broader review of economic policy which must prevail if the individual laws and rules and regulations of our Government are to contribute uniformly to recognized national goals. We will welcome criticisms and suggestions from the legislative committees and other Members of the Congress.

It is our expectation that the Subcommittee on Foreign Economic Policy not only will issue in printed form these hearings, but also will offer a report of findings and recommendations. This will be done as soon as analysis of the information brought to our attention can be completed.

Without objection, letters, documents, statements, and other materials will be added to the record of these hearings where such information is directly pertinent and appropriate.

I want to thank all the men who have taken so generously of their time to prepare statements for us. We have appreciated the care with which certain newspapers and news services have followed these activities.

Before concluding the hearings, I want to say how gratified we have been to note the number of study groups in attendance. During the first week of the hearings there were a number of students from Dr. Viner's school, Princeton University, with us, and during this week I understand we have had a group from the School for Advanced International Studies of Johns Hopkins University. One of the most interesting and faithful of the study groups attending our hearings is a class of trainees of 17 different countries from the International Monetary Fund training program. These young men are economists with the central banks or similar government agencies in their own countries here to study the Monetary Fund and the problems with which it is concerned. This group is directed by Mr. J. C. Powelson, Assistant Chief of Training of the International Monetary Fund.

I also wish at this time to express my very real personal appreciation for another fine, workmanlike job of the kind we always count on from our staff, in organizing and conducting these hearings. I know the other members of the subcommittee join me in this, and in expressing our especial thanks to Charles Sheldon, the staff economist of the subcommittee, who has so ably carried the responsibility for all aspects of the subcommittee's operations.

The hearings and the subcommittee are now adjourned.

(Whereupon, at 3:50 p. m., the subcommittee adjourned.)

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