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UNITED STATES COMMERCIAL POLICY

A PROGRAM FOR THE 1960'S

SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

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UNITED STATES COMMERCIAL POLICY

A PROGRAM FOR THE 1960'S

By

PETER B. KENEN

Associate Professor of Economics,
Columbia University

LETTERS OF TRANSMITTAL

NOVEMBER 30, 1961.

To the Members of the Joint Economic Committee:

Transmitted herewith for use of the Joint Economic Committee and other Members of the Congress is a study paper prepared for the Subcommittee on Foreign Economic Policy, titled "United States Commercial Policy: A Program for the 1960's."

It is hoped that this paper will be especially useful to the members of the subcommittee and to the witnesses who will be testifying before the subcommittee beginning next week.

WRIGHT PATMAN,
Chairman, Joint Economic Committee.

NOVEMBER 30, 1961.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a study paper titled "U.S. Commercial Policy: A Program for the 1960's," which has been prepared by Peter B. Kenen.

Dr. Kenen is associate professor of economics at Columbia University and codirector of the university workshop in international economics. He has served as a consultant to the Treasury and the Council of Economic Advisers, and was a member of President Kennedy's preinaugural task force on foreign economic policy. He is author of "Giant Among Nations," a study of the U.S. foreign economic policy, and of "British Monetary Policy and the Balance of Payments," his doctoral dissertation which was awarded the David A. Wells prize at Harvard in 1958. He is also coauthor of a textbook on monetary economics, "Money, Debt, and Economic Activities."

I believe this study paper will be helpful to the subcommittee in its present study and considerations of foreign economic policy.

Sincerely,

HALE BOGGS,
Chairman, Subcommittee on Foreign Economic Policy.

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UNITED STATES COMMERCIAL POLICY

A PROGRAM FOR THE 1960's

SUMMARY

For too many years, the administration, the Congress, and the public have lived with misconceptions about tariffs. These misconceptions threaten to cripple our foreign economic policy at the very time when it must be most agile.

The administration and a majority of the Congress have fought to prolong the life of the Trade Agreements Act although, as written, that legislation can have little more than symbolic value. They have consoled themselves, however, with the belief that tariffs do not matter as other trade barriers supervene, and that the President would find it hard to use additional bargaining power as other countries cannot give us truly reciprocal concessions. These convictions are now obsolete, if ever fully valid. Tariffs matter very much, not only for the flow of trade, but also for the flow of long-term capital and the location of industries. The other industrial countries, moreover, have much to offer us; they have, indeed, the power to hurt us and may inadvertently do so while pursuing aims we heartily applaud. The less developed countries, by contrast, need growing markets in the industrial West, yet can ill afford to buy them by the traditional methods of bargaining.

The advocates of a liberal trade policy also err in the conviction that tariffs can be cut significantly without doing injury to domestic industry. Yet injury to the cautious and inefficient is the price we must pay for the gains from trade. The gains from trade derive from the modernization of lagging industries and from the reallocation of resources to effect sophisticated specialization. This, too, is often forgotten, as when supporters of the Trade Agreements Act defend it as an aid to exports. Exports can never be more valuable to the Nation than the imports they can buy. The Nation gains from trade because it can obtain some things it could otherwise consume only at a greater sacrifice in effort and opportunity.

These are simple propositions, but call for major changes in U.S. commercial policy. The President must have more power to negotiate tariff reductions and must be freed of the injunction to avoid any injury to an American producer. By the same token, those who are injured must have relief, but only when their hurt can be measured by counting idle men and machines and only as relief from injury promotes a more efficient pattern of production. Those who are injured should be helped to do their jobs better or to do different jobs than heretofore. Import adjustment assistance must replace the tariff increase as the means of discharging the Nation's debt to those who

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are hurt by a change in policy. It should be added that the policy change that creates this debt is not the reduction in duties that may lie ahead, but the change in the ground rules governing trade policy; an adequate trade policy must must do injury, hurting those who could hitherto count on protection.

If the advocates of liberal trade policies have erred, the opponents have erred more seriously. Like those who believed the world flat because they could not see enough of it to detect its curvature, they believe that all things can be made more cheaply overseas, for having only seen those that are. In truth, the United States can compete with the lowest wage of low-wage countries because its productivity is high and because it enjoys inexpensive access to vital raw materials.

The opponents of liberal trade policies are also moved by a misplaced concern that tariff cuts would greatly increase unemployment. Without doubt, jobs would be obliterated in import-competing industries. But the adjustment required to take up the slack would be very small indeed. Fewer than two workers in a thousand would lose their jobs to a billion-dollar increase in imports. Far more than two, by contrast, lose their jobs to the normal changes in taste and technology that occur every year.

Finally, the opponents of a liberal policy are moved by concern about the balance of payments. There has, of course, been a deterioration in the U.S. payments position since the middle of 1961, and this from a position far from satisfactory. But an increase of tariffs would not help the balance of payments, being very apt to provoke retaliation. Even a tariff standstill, moreover, would invite difficulties, as the United States would then be powerless to bid away foreign tariffs. It would have to stand passive as domestic industry sought to vault foreign trade barriers by investing overseas, and replaced export income with a (smaller) stream of profits. Tariff reductions, by contrast, could actually aid the balance of payments. Today, we invite American business to retreat in the face of foreign competition by holding out the hope, however remote, of higher tariffs or quotas. A firm commitment to liberal policies, even if injurious to some companies, would provoke a new and better response. American industry can cope with import competition; the automobile industry proved it and gave us a better car in the process. Other industries must be made to do so, thereby to recapture home and foreign markets with lasting benefit to the balance of payments.

If, of course, the payments deficit endures, for 3 or 4 more years, we may be forced to act drastically. Even then, however, the United States should shun import restrictions. If, indeed, a reform of international monetary arrangements can be accomplished in the next few years to insulate them from key exchange rate changes, the United States should even prefer to devalue the dollar than to disrupt world trade by closing its doors to foreign producers.

I. Backgrounds

A. THE SCOPE OF COMMERCIAL POLICY

A nation's foreign trade responds to all of its economic policies. Monetary and fiscal policies, affecting output, employment and aggregate demand, will affect import demand and influence the supply of

exports. Tax policy, affecting domestic investment, will guide productivity growth, altering the terms on which domestic business can compete in home and foreign markets. Some policies, however, are expressly designed to affect foreign trade. They have a *differential* impact on the domestic demand for foreign goods and services, and on the foreign demand for domestic goods and services. These are called commercial policies. They include tariff legislation, the rules governing the government's procurement of goods abroad, those governing the entry of foreign farm products, and those relating to foreign shippers and airlines that service the U.S. market.

This paper argues that the United States must reexamine its commercial policy, especially its tariff policy. The Congress has studied tariff policy on several occasions since the Second World War. Whenever the Trade Agreements Act has approached expiration and the administration has requested renewal, congressional committees have held detailed hearings, looking carefully into the impact of foreign trade and tariffs on domestic business. Now, however, the United States needs to reappraise its tariff rates and practice more thoroughly and from a different viewpoint than before.

B. THE TACIT COMPROMISE ON TARIFF POLICY

The periodic legislative battles over renewal of the Trade Agreements Act have become an honored ritual. On each occasion, the administration and its supporters in the Congress have asked for an extension of the President's authority to reduce tariff rates, or for a small increase in that authority. On each occasion, the administration has been opposed by a parade of witnesses who have appeared before congressional committees to demand increased tariff protection for particular industries and to denounce the Trade Agreements Act as the source of every problem that business can encounter. After vigorous combat, the administration has purchased a small addition to its bargaining power by agreeing to amendments restricting the President's use of his authority and providing redress for injury caused by import competition. Each side has emerged from the periodic confrontation with less than it desired, yet convinced that it had won a victory.

The advocates of a liberal trade policy have found comfort in the argument that tariff policy is not the most important dimension of foreign economic policy. Much more, they have said, can be done to strengthen the world economy by financial measures, especially foreign economic aid. In any case, they have said, tariffs are not the major barrier to foreign trade; limitations on the convertibility of key foreign currencies, quantitative import restrictions, and regional payments arrangements have nullified the foreign tariff concessions already won by the United States, and foreign countries lack the strength to capture U.S. markets.

The opponents of liberal trade policies have consoled themselves with the belief that the restrictions on Presidential bargaining power and the measures providing for redress of injury protect domestic business from foreign competition. The peril-point provision circumscribes the President's authority as he enters into tariff bargaining; the escape clause and national security amendment provide ways to

undo the damage that may be done if peril points are set too low or unforeseen developments alter the terms on which foreign firms compete in the American market.

The recent legislative battles over trade policy have been fought from prepared positions, and each side has claimed a victory because it has not been overrun.

C. THE DEADLOCK IN TARIFF BARGAINING

The current stalemate on tariff policy has been reflected in tariff bargaining. During the first 20 years of the trade agreements program, the U.S. tariff fell sharply. The bilateral negotiations before the Second World War and the multilateral bargaining after the war cut in half the average ad valorem equivalent of U.S. duties. The reductions were spread across the whole tariff schedule:

TABLE 1.—*Tariff reductions since 1934, by commodity class*

[Duties collected as a percentage of 1952 dutiable imports]

Commodity class	1934	1945	1953
All dutiable imports	24.4	17.9	12.2
Chemicals, oils, and paints	25.1	20.0	12.4
Earthenware and glassware	40.6	36.7	24.7
Metals and metal products	23.7	18.9	12.1
Wood and wood products	10.9	7.5	4.7
Sugar, molasses, and products	25.8	13.5	9.4
Tobacco and tobacco products	45.6	34.7	20.3
Agricultural products	16.2	12.5	9.4
Spirits, wines, and other beverages	81.4	41.6	23.1
Cotton products	36.8	30.0	21.8
Flax, hemp, jute, and products	12.2	9.0	5.2
Wool and wool products	36.7	30.2	22.4
Silk products	58.8	52.7	31.0
Synthetic-fiber textile products	32.8	31.0	17.7
Pulp, paper, and books	20.4	15.2	9.4
Sundries	31.8	26.5	19.1

NOTE.—These estimates understate tariff levels in 1934 (and, therefore, understate the reduction since 1934) because they are based on 1952 imports. The ratio of duties collected in 1934 to 1934 imports would be higher than the ratio shown here because 1934 prices were lower than 1952 prices.

Source: U.S. Tariff Commission, "Effect of Trade Agreement Concessions on United States Tariff Levels," 1954.

Some of the decline described by the table above must be attributed to the increase in commodity prices during and after the Second World War. Many U.S. tariff rates are *specific*, not *ad valorem;* they are levied in cents per pound, dollars per ton, and so forth. The percentage equivalent of these specific duties must decline when prices rise. Some of the decline may also be ascribed to changes in the composition of U.S. imports. But the bulk of the overall decline has been due to the very large reduction in tariff rates resulting from bargaining with other governments.

It is always difficult to determine the extent to which tariff rate reductions have actually affected the level and pattern of imports. It is worth noting, however, that dutiable imports have risen more rapidly than free-list imports in virtually every commodity class:

TABLE 2.—*The growth of dutiable imports in relation to total imports, 1931–35 through 1956–60*

[Dutiable imports as a percentage of total imports]

Commodity class	Average of annual data					
	1931–35	1936–40	1941–45	1946–50	1951–55	1956–60
Total imports	37.6	39.5	34.0	41.6	44.6	56.9
Crude materials	22.6	22.3	32.2	36.6	40.3	45.6
Crude foodstuffs	16.8	25.4	23.6	16.6	12.8	14.3
Manufactured foodstuffs [1]	69.4	78.7	67.5	84.4	85.9	87.8
Semimanufactures	31.8	33.9	29.8	44.1	48.3	59.1
Finished manufactures	55.5	56.4	30.2	47.7	55.9	69.1

[1] Includes beverages.

Source: U.S. Department of Commerce, Bureau of the Census, "Statistical Abstract of the United States," 1961.

A part of this more rapid increase in dutiable imports may also be due to changes in the pattern of demand and in foreign supplies. The sharp changes during the war years would seem to have been of this type. But the statistical record is at least consistent with what one would predict after reducing tariff rates.

The decline in U.S. tariff rates and increase of dutiable imports is all the more striking because it describes a marked departure from well-established patterns. After each of the previous major wars in American history, there has been an increase in U.S. tariffs. During the Civil War, for example, additional taxes were levied on domestic and imported goods; when the war ended, the domestic imposts were allowed to lapse or were repealed, leaving a higher protective tariff than before. Similarly, in the decade after the First World War, there were two substantial increases in the U.S. tariff; the Fordney-McCumber tariff (1922) and Smoot-Hawley tariff (1930) raised U.S. duties to the highest levels in history.

The advocates of a liberal trade policy may also draw comfort from the tabulation of escape-clause cases:

TABLE. 3—*Escape-clause cases considered by the Tariff Commission, 1947 through October 1961*

Disposition	*Number*
Investigations instituted by the Commission	129
Cases dismissed at applicant's request	9
Cases terminated without formal finding	9
Cases pending before the Commission	2
Investigations completed by the Commission	109
Dismissed after preliminary inquiry (no report issued)	14
Commission decided against relief	55
Commission recommended relief	32
Commission evenly divided	8
Cases considered by the President	40
President invoked the escape clause	13
President declined to invoke the escape clause	23
President requested additional information	4

Source: U.S. Tariff Commission.

This record is inflated by the perennial applications; there have been no fewer than four hearings on spring clothespins and three hearings on wood screws, ground-fish fillets, and bicycles. When the record is revised to exclude duplication, it comes out this way:

TABLE 4.—*Commodities involved in escape-clause proceedings, 1947 through October 1961* [1]

Commodity and disposition	*Number*
Textiles, apparel, and related products	20
No relief recommended (knit berets; silk woven fabrics; stencil silk; wool gloves; rabbit fur; cotton pillowcases; jute fabrics; wool felts; calf and kip leather; mink skins; leather gloves; plastic raincoats; rayon acetate fiber)	13
Relief recommended but not granted [2] (screen-printed silk scarves; velveteens; carpets and rugs [3])	3
Relief recommended and granted (women's fur felt hats; hatters' fur; flax toweling; typewriter ribbon cloth)	4
Metals, metal products, and other manufacturers	38
No relief recommended (aluminum; motorcycles; cotton-carding machinery; metal watch bracelets; axes; zinc sheet; typewriters; barbed wire; cast-iron soil pipe fittings; iron ore; household china; woodwind instruments; rosaries; hardwood plywood; rolled glass)	15
Relief recommended but not granted [2] (woodscrews; scissors and shears; straight pins; umbrella frames; hand-blown glassware; binding twine; hard fiber cord and twine; tobacco pipes; violins; para-aminosalicylic acid; lighter flints; tartaric acid; cream of tartar; baseball and softball gloves; [3] ceramic mosaic tile; [3] sheet glass [3])	16
Relief recommended and granted (watches; lead and zinc; bicycles; safety pins; spring clothespins; stainless steel flatware; clinical thermometers)	7
Agricultural products and processed foodstuffs	21
No relief recommended (marrons; whisky and spirits; hops; narcissus bulbs; beef and veal; bluemold cheese; glace cherries; bonito and tuna; mustard seed; ground chickory; coconuts; glue of animal origin; red fescue seed; lamb and mutton; horseradish; cantaloup; watermelon)	17
Relief recommended but not granted [2] (garlic; ground bass fish)	2
Relief recommended and granted (dried figs; alsike clover seed)	2
Other products	9
No relief recommended (crude petroleum and petroleum products; sponges; reeds; pregnant mares' urine; chalk whiting; barium chloride; ultramarine blue; procaine)	8
Relief recommended but not granted [2] (fluorspar)	1
All products	88
No relief recommended	53
Relief recommended but not granted [2]	22
Relief recommended and granted	13

[1] Based on the 109 cases completed by the Tariff Commission.
[2] Including instances in which the Tariff Commission was evenly divided.
[3] Referred to the Tariff Commission for additional information.

Source: Based on data provided by the U.S. Tariff Commission.

Thus, of 88 industries seeking relief under the escape clause, fewer than half were deemed to be injured, and tariffs were raised or quotas imposed in only 13 instances.

The record of petitions under the national security amendment is very similar:

TABLE 5.—*Commodities involved in national security amendment cases, through May 1961* [1]

Commodity and disposition	*Number*
Total number of products involved	22
Petitions pending (cordage and twine; [1] military rifles; transistors; textiles)	4
Petitions withdrawn or inactive (dental burs; tungsten; analytical balances; wooden boats; photographic shutters; stencil silk; clinical thermometers; fine-mesh wire cloth; wool felt)	9
Petitions refused (heavy electric power equipment; electric steam turbines; cobalt; fluorspar; wool knit gloves; clocks; jeweled watches; wool textiles)	8
Petitions accepted (crude oil and products)	1

[1] Application previously refused.

Source: Office of Civil and Defense Mobilization.

Yet the totals presented in the tables conceal some important trends. In the first 10 months of 1961, there were 18 petitions for escape-clause action, as compared with an annual average of 10 in 1957–60. In seven of these cases, moreover, the Tariff Commission found evidence of injury, whereas it had averaged only three such findings in the 4 preceding years.

What is more important, there have been no major reductions in the U.S. tariff during the last decade, and the ratio of duty collected to total dutiable imports has been remarkably steady for the past several years.

TABLE 6.—*The average rate of duty on dutiable imports, 1931 through 1960*

[In percent]

Year	*Ratio of duties to dutiable imports*
1931–35 (average)	50.02
1936–40 (average)	37.87
1941–45 (average)	32.13
1946–50 (average)	16.03
1951	12.26
1952	12.69
1953	12.03
1954	11.57
1955	11.95
1956	11.30
1957	10.79
1958	11.09
1959	11.47
1960	12.12

NOTE.—These data are not strictly comparable to the figures in table 1, above. These are based upon the current year's imports, not on a base year's imports. The ratios in this table, then, are more apt to fluctuate on account of small changes in the composition of imports and in import prices.

Source: U.S. Department of Commerce, Bureau of the Census.

The explicit peril-point limitations on Presidential discretion and the additional limitations implied by the escape clause have worked to tie the hands of the American negotiators. As Prof. Don Humphrey put it some years ago:

> These rules of procedure are so restrictive that negotiating teams cannot press their demands upon the other country first and then consider what can be offered in return, as is the customary technique of bargaining. The maxi-

mum concession permitted by law is known to all in advance, as is the escape-clause policy.[1]

He might even have put the point more strongly. With a peril point fixed beneath each tariff rate, the maximum concession permitted by law, small in itself, may yet be larger than that which the U.S. team can actually offer in negotiation.

D. THE NEW CHALLENGE TO TRADE POLICY

The United States has adhered to a liberal trade policy for the last three decades, but is in danger of retrogression. This country, moreover, cannot be satisfied to stand still, even if this were possible. The premises on which trade policy have hitherto been formulated are no longer valid. To say today, as a decade ago, that tariffs do not matter would be disastrous self-deception. The events of the last few years present a new challenge to U.S. commercial policy. They make tariffs matter very much indeed.

1. *The return to convertibility*

During the 1950's and especially at the end of 1958, there were dramatic changes in the international monetary regime. The major European countries made their currencies convertible, at least for foreigners, thereby removing any justification for discrimination against U.S. exports. Once francs, marks, and pounds sterling could be freely used to purchase U.S. dollars there could be no reason for any country to prefer purchasing European goods (so as to conserve dollar receipts) and no reason to prefer earning dollars by export sales to the United States. After the restoration of convertibility, therefore, many countries dismantled their quantitative trade restrictions and withdrew discriminatory rules. This change brought into play all of the tariff reductions negotiated earlier. It also gave every country an incentive and opportunity to reduce tariff barriers through new negotiations.

The recovery of Western Europe which made possible its return to convertibility has itself posed a new opportunity for U.S. commercial policy. The reconstruction of European industry has empowered our trading partners to penetrate American markets and thereby to take full advantage of the tariff concessions they win from us. They shall henceforth value highly new U.S. tariff concessions and will undoubtedly be prepared to grant significant reciprocal benefits to U.S. industry.

2. *The formation of the Common Market*

The creation of the European Economic Community (EEC), or Common Market, has been even more important in undermining the premises upon which the United States has based its commercial policies. The economic unification of the six high-income European industrial countries will create a mass market for the manufactured goods and farm products that bulk large in U.S. output and exports. It can provide American business with unparalleled export opportunities. Yet formation of the Common Market also poses a double difficulty for American business. First, the six member countries

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[1] Don Humphrey, "American Imports," the Twentieth Century Fund, 1955.

of the EEC will eliminate every barrier to trade between them. Each will thereby obtain ready access to the markets of the other member countries. In effect, if not in intent, then, the EEC discriminates against nonmember countries, including the United States. Second, the common external tariff of the EEC may be more restrictive than its separate national predecessors. The common external tariff will be based on an arithmetic average of the duties formerly imposed by member countries. Under this procedure, therefore, the common tariff rate for any one product will be higher than it was in some parts of Europe, and lower than in others. The changes, however, may not cancel out in any meaningful way. The lowering of a French tariff from 30 to 20 percent may not compensate for the raising of a Dutch tariff from 10 to 20 percent, as the 20 percent common tariff may be sufficiently high to exclude all U.S. exports of the product in question, whereas the 10 percent Dutch duty may not have barred U.S. goods from the Netherlands. Negotiations now in progress at Geneva to reconcile the EEC tariff with the General Agreement on Tariffs and Trade (GATT) may help to mitigate this increase in the restrictiveness of European tariffs. Yet a further reduction in the external tariff of the EEC may have to be purchased by subsequent reciprocal bargaining.

There is already ample evidence that the Common Market will furnish vast new business opportunities to firms that reside within its tariff wall, but may punish those that stay outside. There has been a stunning upsurge in U.S. private direct investment in Western Europe. The American companies concerned are not, to be sure, entirely motivated by fear of the EEC tariff. The remarkable growth rate of Europe's economy is itself an important attraction to capital, and European costs are often lower than U.S. costs. One should nevertheless heed this investment boom as evidence that the EEC can drastically alter trade patterns.

The formation of the Common Market has one more important implication for U.S. commercial policy. In the past, the United States has had difficulty negotiating reciprocal tariff concessions because few other countries had markets large enough to provide genuine reciprocity. The reduction of a U.S. duty granted the foreigner easier access to the huge American market. The foreign government's own concession, by contrast, could only grant U.S. business access to a small market. The creation of the Common Market changes this situation, as the United States can now negotiate for tariff reductions that will grant large opportunities to American business. The six EEC countries have a combined population of about 170 million and a gross regional product exceeding $180 billion. They account for almost one-quarter of world imports. With the accession of the United Kingdom, the EEC will be even more important. Its population will exceed 220 million and its gross regional product will exceed $245 billion. It will account for more than a third of world imports.

The countries of the Common Market have already evinced a willingness to bargain for tariff reductions. When it became apparent that outsiders feared the loss of major export markets in continental Europe, the EEC countries offered a 20-percent reduction in their prospective external tariff, provided other governments could offer

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equivalent concessions. The current GATT negotiations have been concerned with the implementation of this offer. Press reports, however, indicate that the 20-percent reduction in the EEC tariff will not become fully effective because the outsiders, especially the United States, cannot or will not make equivalent concessions.

3. The problems of the less developed countries

It is the declared objective of U.S. policy to help the less developed countries toward decent living standards and a viable basis for participation in the world economy. Our foreign economic aid, however, cannot be fully effective unless the less developed countries have adequate opportunities to trade with the industrial countries. Their own markets are limited by poverty. They can most effectively develop by fostering new export industries to serve the world market and thereby secure the foreign-exchange receipts they need for the purchase of caiptal equipment and consumers' goods. The less developed countries, however, cannot export unless the wealthier nations of the West—the United States, Canada, and Western Europe—are prepared to buy from them. The West must offer growing markets for the raw materials presently produced and exported by Asia, Africa, and Latin America, and also for the manufactured goods that the less developed countries hope to export in the years ahead. The United States and Europe cannot expect to obtain fully reciprocal tariff concessions from the less developed countries, but must not therefore be deterred from granting them concessions. Nor can we shrink from this obligation because the domestic producers involved are those that have already been exposed to intense foreign competition. The United States has recently imposed import restrictions on lead and zinc and the domestic textile industry has expressed serious concern about import competition and been promised special consideration. Yet, the countries that need U.S. concessions will want lower duties on nonferrous metals and cotton textiles.

The problems of the less developed countries, especially of Latin America, have been compounded by the formation of the European Common Market. The EEC countries have offered special tariff preferences to certain of the less developed countries (notably those that were formerly French colonies) and is apt to extend preferential treatment to the Commonwealth countries if Britain accedes to the Treaty of Rome. The remaining countries in Africa, Asia, and Latin America may therefore be seriously injured by the radical tariff changes in Europe. They will be injured by an overall increase in the restrictiveness of European tariffs—the unintended but inevitable consequence of the principle on which the EEC tariff is to be constructed. They will also be injured if some of the less developed countries receive special tariff treatment in Western Europe.

E. THE NEED FOR RADICAL REFORM

In his address to the National Foreign Trade Convention, the Under Secretary of State gave a vigorous description of the present situation:

> I have been aware of a measure of agreement rarely found in these esoteric circles—agreement on the fact that we are coming to the close of a familiar era in our world trading relations and entering another that is not familiar at all.
>
> Some see this new phase as filled with opportunity and challenge. Some, on the other hand, are apprehensive. But few question the proposition that pervasive change will be the dominant characteristic of the years that lie ahead.

There is, in truth, reason for excitement and for apprehension. The proper cause for apprehension, however, lies at home, not in the outside world. The United States is ill equipped to exploit its opportunities and to overcome its handicaps. This country adheres to a strategy formulated 30 years ago and follows tactics that would doom even the most cautious strategy, let alone the bold one we should adopt. The United States must reform its commercial policies. It must recast its strategy and devise new tactics.

II. The Strategy of Trade Liberalization

A. An Open Atlantic Community

The trends in European commercial policy described above could easily fragment the free world. Although the prospects for British accession to the Treaty of Rome are brighter now than ever before, there are as yet many high hurdles to be cleared before Western Europe itself can become a single economic community. British accession, moreover, may raise new problems, as the differences that presently separate Britain from the EEC countries could conceivably be resolved by raising new common barriers against the outside world. In any case, a Europe united into one trading area would still be separate from the United States, Canada, Japan, and the less developed countries. This division, if perpetuated, could jeopardize the cohesion and power of the free nations. The Western World need not be linked by bonds as strong as those being forged by the EEC countries; but it must develop commercial ties sufficiently powerful to constitute a lasting pledge of loyalty and strength toward common aims and action.

Some would seek this unity by creating a full-fledged Atlantic customs union or free-trade area—by uniting Europe, the United States, and Canada in a new common market. This possibility, however appealing, poses a danger of its own. It would fence off the industrial center of the non-Communist world, proclaiming a formal division of the free nations. It would segregate the affluent from the poor, the old from the new. A full customs union, furthermore, would be as difficult of attainment as it would be dangerous. It would encounter justifiable opposition from Europeans who believe that the EEC has as its raison d'être the permanent political unification of Europe. An extension of the Rome Treaty to embrace the United States and Canada would dilute those provisions of the treaty which seek to cement the European countries into perpetual confederation.

There is but one way to forge an Atlantic community consistent with its members' obligations to the outside world. The industrial nations should join in a general, substantial, and nondiscriminatory reduction of external trade barriers. The vital aims of Atlantic policy can best be advanced by fashioning an *open* Atlantic community—by exposing each constituent country and trading area to the stimulus of competition from every other part of the community and to competition from the outside.

B. THE GAINS FROM LIBERALIZATION

A dismantling of trade barriers within the Atlantic community and vis-a-vis the other non-Communist countries would serve several of the urgent objectives of Western policy:

It would make for greater cohesion within the Atlantic community, thereby facilitating closer cooperation in strategic, political, and economic policy.

It would promote a more efficient allocation of resources within the community, thereby enlarging the community's capacity to bear the great burdens it must assume.

It would accelerate economic growth within the community, thereby enhancing the appeal of liberal institutions in the emerging nations.

It would directly aid the less developed countries by providing them with more ample markets, thereby promoting more rapid economic growth in the poverty-stricken nations.

1. *Cohesion within the Atlantic community*

The architects of the Treaty of Rome that established the EEC justified the separation of "the Six" from the rest of Europe by a common external tariff as a prerequisite to political unification. This is a cogent and proper contention, but it has a valid converse. The separation of the EEC countries from the rest of the Atlantic community may *weaken* the impulse to cooperation as between the EEC and other countries. Furthermore, the discrimination against outside countries that is inherent in the EEC arrangements will inevitably injure outside countries. This injury may exacerbate economic rivalry and could engender retaliation, tariff warfare, and other forms of economic combat. Thus there have been occasional reports that some European countries are reluctant to join in the effort to coordinate foreign-aid programs and to redistribute aid burdens; they ask, first, satisfaction for the injury they may suffer as a consequence of tariff discrimination.

The creation of an open Atlantic community by a substantial reduction in tariffs and other trade barriers could reduce the discrimination inherent in the emerging regional arrangements and would not generate new discrimination against the less developed countries. It would foster recognition of economic interdependence, leading to political cohesion and the strengthening of institutions like the OECD, which are needed to resolve common problems and direct collective action.

The unification of the Atlantic community as the low-tariff center of the non-Communist world would not preclude the perfection of regional arrangements inside the community. It would not erase the economic boundaries marked out by the Treaty of Rome; it would not slow the progress of Western Europe toward full political and economic union. There is no inherent conflict between the creation of the Common Market, or of a broader European group, and the establishment of an Atlantic community in which economic and political ties would be much stronger than they are at present, even if not as strong as those of the EEC.

2. Resource allocation within the Atlantic community

The classical case for freer trade, now more than a century old, has not been impaired by history or by the evolution of economic analysis. The case for low tariffs is as strong as ever. A nation with limited resources—manpower, capital, and land—must make the most efficient use of its resources to promote the welfare of its citizens. It should specialize in those tasks and processes that it is best equipped to undertake and should allow its neighbors to undertake those that it is ill equipped to accomplish. A nation rich in land and poor in capital, compared to other countries, ought not to seek self-sufficiency in manufactured goods; it should instead specialize in farming and should fulfill its need for manufactures by selling farm products on the world market to import industrial products. A nation that is rich in capital and industrial skill should not seek self-sufficiency in farm products; it should offer the manufactured goods in which it has a "comparative advantage" in exchange for foodstuffs and natural fibers.

The transition to intensified international specialization will be painful for those who are engaged in the lines of production that will be scaled down. But they can be compensated for their losses at a cost to the community smaller than it would have to maintain them in comparatively inefficient occupations. Tariffs are a subsidy to inefficiency—a means of continuously transferring a part of the national income to industries that cannot cope with competition from abroad.

A reduction of tariffs throughout the Atlantic community would promote a more efficient allocation of manpower, capital, and labor, raising living standards throughout the community. It would also enhance the productivity of resources in their present uses. An intensification of competition would force the modernization of old plants and improvements in product design like the compact car, a blessing already bestowed by import competition. Finally, tariff reduction would help to dissolve business rigidities in every member country—rigidities that afflict the American economy as severely as Western Europe. Freer trade would enlarge markets and facilitate the adoption of mass-market methods of production.

All of these are the benefits that Europeans claim for the Common Market. The same gains would accrue to a broader aggregation of industrial countries, and a number of U.S. industries would benefit substantially. The Commerce Department has cited, among others, the industries producing tractors, aircraft, trucks, and buses, construction and mining equipment, and metal cutting machine tools.

3. Growth within the Atlantic Community

While the reallocation of resources and rationalization of production that would accompany a reduction of trade barriers could bring a once-over increase in standards of living, it could also foster steady economic growth. As in the Common Market, reallocation and rationalization would be accompanied by additional investment in export capacity and in the modernization of existing plant. This would provide a stimulus to the capital-goods industries in all of the industrial countries, raising employment and income. Increased income, in turn, could enlarge spending on all kinds of goods and services, sparking a general advance in production. The unprecedented Euro-

pean boom of recent years and the flow of American capital to Europe owe much to the expectations of rapid economic growth that have been generated by Europe's progress toward economic union. Business has been expanding capacity to capture new export opportunities and has been diversifying its production to cope with the increase of competition that must accompany the reduction of intra-European trade barriers. Tariff reduction over a broader area—in Western Europe, Canada, Japan, and the United States—would have similar effects, creating new investment opportunities throughout the Atlantic community.

4. Atlantic trade policy and the less developed countries

The creation of an open Atlantic community would redound to the benefit of the less developed countries and would improve Western relations with those countries. By raising the rate of growth in the Atlantic community, it would foster a new respect for liberal economic institutions, improving the prospects for sustained growth in the low-income countries. In the eyes of the uncommitted nations, rapid growth has become the preeminent symbol of social efficiency. Hence, rapid Western economic growth would invite the widespread imitation of methods that have brought us prosperity and enconomic power. The United States and Europe would also be able to accelerate the growth of the less developed countries. During the 19th century, economic growth proceeded from the world's industrial center (especially from Great Britain) to the periphery of underdeveloped areas, notably to the regions of recent settlement in North America. More recently, the industrial center has abdicated its catalytic function, partly because the center itself has been fragmented by trade restrictions. The developed countries of the West can help to foster economic growth in low-income areas by grants, loans, and direct private investment, but can contribute even more by providing an expanding market for the raw materials and light manufactures exported by the less developed countries. The prices of raw materials are exceedingly sensitive to business fluctuations in the industrial countries and, in the longer run, to Atlantic commercial policies. More rapid growth at the industrial center of the free world would help to stabilize those prices, while a permanent and substantial reduction of import barriers, by providing larger markets for the exports of the less developed countries, might deflect the low-income countries from the ill-considered efforts at a rapid massive industrialization they have too often launched as a defensive response to Western economic instability and import barriers.

C. THE VITAL CHANGE IN PREMISES

All of the gains that could accrue to an open Atlantic community derive, in the end, from a single basic change in the premises underlying tariff policy. The Congress and administration must come to realize that it is far better to buy than to sell.

The trade agreements program was built upon the premise that U.S. commercial policy should seek to increase U.S. export sales. This premise had validity when the program was started. The trade agreements program was born in the depths of the great depression. It was an imaginative response to domestic unemployment, standing

in sharp contrast to the approach taken by those governments that sought to create jobs by restricting imports. While others adopted "beggar my neighbor" remedies for unemployment, the United States charted a course to enrich itself and its neighbors.

We must never forget, however, that the greatest gains of trade are those that derive from a nation's capacity to import, not from the enlargement of its exports. The individual works to buy what he needs from other people. He seeks a high wage, not as an end in itself, but as a means of purchasing the necessities of life and, in the lucky instance, its luxuries. An individual could survive by producing food, clothing, and shelter with his own hands, but clearly benefits by concentrating on those tasks he does best and leaving to others those he would do badly. A nation should similarly work to earn what it needs for its sustenance, selling abroad to buy abroad and specializing in those tasks to which its resources and skills are best adapted. It is this principle of "comparative advantage" that was taught by the great economists, Adam Smith, David Ricardo, and John Stuart Mill. It is learned, if not always understood, by every undergraduate who studies economics, and is supported by every empirical investigation of trade patterns.

In a well-known study of British and American exports,[2] Sir Donald MacDougall has shown that the U.S. exports those products in which it enjoys the highest productivity, and Britain those in which she has a similar advantage. U.S. output per worker is, on the average, about twice as high as British output per worker. The United States, however, does not export every product in which U.S. productivity is absolutely greater than United Kingdom productivity. Rather, the United States exports those in which its productivity is *more than double* United Kingdom productivity (i.e., higher than average U.S. productivity) whereas Britain exports those in which United Kingdom productivity is more than one-half United States productivity. In another study,[3] Donald B. Keesing has shown that the United States has its greatest advantage in those products requiring highly skilled labor, being well endowed with skills, whereas other countries, notably Japan and India, export those that require relatively large amounts of unskilled labor, being poor in skills.

A new commercial strategy, then, should pursue to the advantages that derive from enlarged opportunities for international specialization. The United States must look to the state of its export trade, being concerned with its balance of payments, but should nevertheless pursue a grand design rather than the accountant's course. It should appraise tariff negotiations according to the measure in which they enlarge opportunities for trade, not by debiting every additional import dollar generated against the extra export dollars won from a foreign country.

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[2] G. D. A. MacDougall, "British and American Exports," Economic Journal, 1951.
[3] Donald B. Keesing, "Labor Skills and the Factor Content of International Trade," unpublished doctoral dissertation, Harvard University, 1961.

III. The Tactics of Trade Liberalization

A. THE NEED FOR NEW BARGAINING AUTHORITY

To accomplish a sweeping reduction of trade barriers, the United States must modify its approach to tariff bargaining. The President must be empowered to make larger reductions in the U.S. tariff and to make a different kind of concession than he has negotiated in the past.

In some instances, the U.S. negotiators will want to exchange concessions on a rate-by-rate basis, as in the past. It is the individual tariff rate, after all, that bars trade in a particular commodity, not an average of rates or class of rates. Even in these instances, however, the United States will have to make larger reductions than are possible now. It will also have to transfer items to the free list by removing some duties completely. This may be the only was in which the United States will be able to expand trade significantly within the Atlantic community and create new trading opportunities for the less developed countries, as some individual rates, though seemingly low, may virtually prohibit imports. In other instances the United States will have to make agreements reducing whole classes of tariff rates according to a prearranged schedule and toward an agreed level. The separate countries and multicountry trading blocs may emerge from this new kind of bargaining with different tariff schedules; they need not undertake to fashion identical rate structures. But each participating entity must agree to reduce all of its tariffs by amounts sufficient to stimulate trade and must undertake to simplify tariff schedules so that the complexity of rates, as distinct from the level of rates, shall cease to be an independent barrier to trade. There are several ways in which these overall reductions might be arranged:

1. Percentage reductions

Each government might undertake to reduce all of its duties by some agreed percentage—a third, a half, or two-thirds—within a 10-year period, or might agree to reduce rates on one class of products by a half, rates on another by a third, and rates on yet another by three-quarters. The percentage reduction might not be the same for each nation, as some countries have already lowered their duties substantially and, therefore, start with low rates. Similarly, different rate reductions might be planned for each product class by each country, as the initial structure of rates will not be the same from country to country and the final structure need not be the same. But each country's schedule of rate reductions should be worked out in consultation with other governments to assure an acceptable degree of reciprocity.

2. Tariff-rate ceilings

Each government might undertake to reduce all of its duties to an agreed absolute ceiling—15, 10, or 5 percent ad valorem—within a fixed number of years. The negotiators would then have to fix the set of ceilings and undertake to reduce each tariff rate to the nearest ceiling: rates above 15 percent would be reduced to 15; rates below 15, to 10; and rates below 10 to 5 or to zero. Again, the governments would not have to apply the same ceiling to all commodity classes. But they would have to submit their plans for approval to assure reciprocity.

3. Tariff-rate averages

Each country might accept a target-level tariff average for each commodity class—preferably an unweighted average—and might undertake to bring that average into being by reducing the separate rates that comprise the average (without raising any other rate). The target average could be identical for each country without forcing an excessive uniformity in rate structure, as the separate rates entering into each country's average would differ widely.

One could devise other schemes for rate reduction, or could combine those described above. Thus, the governments might set target tariff-rate averages, but might also agree to reduce every rate now above an agreed ceiling. Alternatively, they might combine target tariff averages with a commitment to reduce every rate by some uniform percentage in the process of realizing the agreed average.

Percentage rate reductions would seem to offer the simplest method for scaling down trade barriers, especially as they are the method used by the EEC, but might meet with powerful resistance in some countries because they would force a large absolute reduction of high tariff rates and thereby require a reallocation of resources so rapid as to cause great hardship for business and labor. The method of target averages might therefore be preferred, as it would allow each nation to lower some rates more slowly than others or to make deeper cuts in some parts of its rate schedule, balancing smaller cuts elsewhere.

Whatever the method chosen, however, the basic implication is unchanged. The President must enjoy greater authority and discretion than he has at any time in the history of the trade agreements program. The U.S. negotiators must have in reserve the power to take advantage of every liberal impulse manifest by other governments. Congress must authorize the President to reduce every individual rate by at least 50 percent, to enter into international agreements that envisage even larger phased reductions, and to transfer products onto the free list.

B. THE NEED TO DO INJURY

A grant of new authority will be in vain if, at the same time, the exercise of that authority is circumscribed by provisions of the kind that encumber the present Trade Agreements Act. From the birth of the present program, the State Department and White House have been obliged to promise that the United States would never knowingly cause injury to any American enterprise by granting tariff concessions to other countries, and that, in the event of inadvertent injury, would take remedial action. This pledge was prominent even in President Roosevelt's 1934 message to Congress proposing the trade agreements program; it was repeated again and again, as in 1945 by the State Department:

> A rumor has freely circulated that certain American industries have been singled out as inefficient industries and that if the additional authority provided for in the bill is granted the State Department will use such authority to trade off these inefficient industries for other industries which can compete in the world market. Nothing could be further from the truth than this. The State Department has never construed the Trade Agreements Act as a license to remake the industrial or agricultural pattern of America.

The no-injury rule was later enshrined in the escape clause and in the peril-point provision, and has become increasingly restrictive with

the passage of years. The present escape clause could be used to cancel any tariff concession that caused an increase of imports. This is because an increase of imports is regarded as a measure of injury, as well as a cause:

> In arriving at a determination * * * the Tariff Commission, without excluding other factors, shall take into consideration a downward trend of production, employment, prices, profits, or wages in the domestic industry concerned, or a decline in sales, *an increase in imports, either actual or relative to domestic production*, a higher or growing inventory, *or a decline in the proportion of the domestic market supplied by domestic producers.* [Italic supplied.]

The escape clause could even be invoked if there had been no absolute increase of imports, merely an increase in the share of the domestic market served by imports. If, therefore, domestic production and imports were both to fall, but imports by less than domestic production, U.S. companies could ask for additional tariffs. They may likewise appeal if domestic production increases but imports grow faster. This is indeed a strange sort of injury. Is an industry injured if imports claim a part of the market that did not exist before?

The definitions used in the present escape clause are also absurdly restrictive. The 1955 and 1958 Trade Agreements Extension Acts define the makers of a single product or the participants in a single stage of production as separate industries qualifying for relief. Thus, a company producing eight profitable items can petition for redress of injury if its sales of a ninth product start to decline or if imports of that ninth product increase relative to domestic production. Under this definition, the Tariff Commission has been asked to provide relief for the "industry" making "jeweled watches and watch movements containing 7 jewels or more but not more than 17 jewels, and parts thereof." The present law, finally, achieves the quintessence of absurdity when it instructs:

> Increased imports, either actual or relative, shall be considered as the cause or threat of serious injury * * *when the [Tariff] Commission finds that such increased imports have contributed substantially to causing or threatening serious injury to such industry.

Couple this mandate to a statement by the Chairman of the Tariff Commission:[4]

> When there are increased imports, and there has been a reduction of duty, I think it is fair to presume that the imports are, in part at least, due to the concession granted.

An increase of imports, then, can take place years after a tariff concession, but the concession can still be blamed for the increase. Imports, moreover, can be blamed for every difficulty encountered by American business. If tastes or technology change, depressing American production, but imports are not affected in equal measure, the Tariff Commission may be asked to recommend higher duties. In one instance, the Commission did recommend a higher tariff on briar pipes when prices and production were depressed by Army sales of post exchange inventories, not by imports, and has been asked to increase duties on hats and on fur products although these are really the victims of changing fashion.

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[4] House Ways and Means Committee, hearings, "Renewal of the Trade Agreements Acts" (85th Cong., 2d sess., 1958).

Wherever manifest, in the escape clause or the peril-point provision, the no-injury rule will prohibit a meaningful reduction of U.S. tariffs, immobilizing the United States at the threshold of opportunity. A meaningful tariff concession is one that grants to a foreign producer access to American markets. It must do injury by the present definition, as an increase of imports is itself adjudged injurious, and may do injury by more reasonable tests, idling men and machines.

No one, it should be said, could regard the amount of injury as a measure of success in tariff negotiations; no one seeks wantonly to obliterate jobs and to close down factories. The President, however, must be entitled to negotiate concessions that do genuine injury whenever these concessions would serve the broad economic and political interests of the United States and the free world. The closing of some factories and the loss of some jobs are prerequisite to resource reallocation. They are the first steps toward increased specialization within the world economy and the creation of new efficient tasks for the United States. To this end, legislation that replaces the Trade Agreements Act must be very different from its predecessor.

1. The peril-point provision

The peril-point provision must be eliminated. That provision ties the hands of U.S. negotiators. Admittedly, the law provides that the President may cut a tariff below the relevant peril point. But it must be evident that he cannot do this very often without seeming to infringe upon the spirit of his legislative mandate and thereby incur the wrath of the Congress. It must be equally evident to our trading partners that U.S. negotiators have fixed positions and cannot be induced to move further toward liberalization, no matter what concessions are offered by other governments.

2. The escape clause

The escape clause should not be suppressed, for it does embody one legitimate principle: American workers and employers who are injured by tariff concessions ought somehow to be aided by the Government. The Government does not have this obligation in respect of all economic changes—even those it has precipitated. To extend assistance in every case would quickly cripple an economy that relies upon competitive processes to spur enterprise and foster efficiency. When, however, producers are injured by an abrupt change in basic public policy, by a change in the ground rules, they deserve some measure of assistance, and a radical revision of the trade agreements program would constitute one such abrupt change. The enactment of legislation to permit large tariff reductions and thereby to encourage more efficient resource use would put the Nation's business on notice that it cannot expect to be shielded from import competition and that those who continue to produce things that can be made more cheaply abroad, or who use methods inferior to those used abroad, do so at their hazard.

If, however, the escape clause is to give effective expression to this principle, it must be rewritten from beginning to end.

First, it must fix limits to the time period within which producers may appeal for relief and for which aid will be offered. There must be a proximate temporal connection between a change in tariffs and the alleged injury if the Government is to accept responsibility for repairing that injury. It may, indeed, be argued, that a time limit

should be fixed in relation to the passage of the new trade legislation, not in relation to changes in particular tariff rates. It is the abrupt change in basic rules that fixes an obligation on the Government, not the change in particular duties. The Government is not obligated to aid those employers and workers who are injured by a change in the excise or income taxes: tax rate changes are a normal hazard of economic life. Similarly, the Government ought not to be obligated to aid those who are injured by a change in a tariff rate once it has given adequate notice that it will change duties. It should only aid those who are injured soon after the abandonment of the no-injury rule, for they will not have had time to protect themselves.

Second, the definition of injury must be revised. Injury must be defined to imply absolute hardship, not a mere reduction in one's share of the market, a decline in profits from peak levels, or a slower increase of wages than in other parts of the economy. Imports can only be said to have caused injury when they force an absolute reduction in output and, in consequence, the idling of men and machines. A firm cannot be said to have been injured if all of its men and machines can be put to work producing an alternative product. A worker cannot be said to have been injured even if he loses his job, provided that there are comparable alternative job opportunities available to him. In a sense, then, it is the community, not the worker or company, that should be entitled to petition for aid.

3. Adjustment assistance

Finally, the form of relief ought to be changed. At present, the Government responds to injury by restricting the offending import. It freezes the pattern of production and resource allocation. The Government should instead facilitate economic change. It should help to move resources out of the vulnerable industries or help to modernize those industries. When, therefore, an industry claims and proves injury by the tests suggested above, it should be provided with new opportunities, not given a new lease on its old life by higher tariffs.

An adequate adjustment assistance program should have several dimensions.

Assistance to employers should comprise long-term, low-interest loans for reequipment of diversification, and liberal tax amortization provisions to write off the equipment rendered idle by import competition. The same sort of assistance might be offered to firms proposing to locate in communities stricken by import competition and to firms already in those communities and willing to expand production.

Assistance to workers should comprise grants or loans for retraining and to defray moving expenses when new jobs cannot easily be created in the affected communities, extended employment benefits and, for older workers, lump-sum cash payments to compensate for the loss of seniority or lump-sum credits to provide early retirement benefits under the social security program.

It must again be stressed that these aids should only be available for a limited time, as the Government's obligation derives from the change in rules governing tariff negotiations—the abandonment of the no-injury principle—rather than from any future reduction in tariff rates.

4. "Market disruption" agreements

In some instances, the United States may wish to limit imports temporarily as an aid to injured industries, especially on those occasions when the increase of imports has been very rapid or confined to a narrow class of products affording intense competition for a few American firms and communities. These are the instances of "market disruption" recognized by the members of GATT and in the recent international agreement relating to cotton textiles. The cotton textiles agreement authorizes each importing country to request that the exporting countries restrain sales, and actually to limit imports if exporters do not comply.

Restrictions of this type, however, should not cut back trade, but only forestall a further rapid increase of imports. They should not be imposed at the mere threat of market disruption, but only when there has already been a rapid increase in imports. They should be temporary and subject to relaxation by prearranged schedule. Thus, an exporting government might be asked to restrain total shipments to present levels for 1 year, but should then be allowed to increase them by 10 percent in each succeeding year, and, after 4 or 5 years, should be allowed to remove any and all restrictions.

The cotton textiles agreement has several of these features, but lasts for only 1 year and does not provide for an automatic increase in export levels year after year.

A request to exporting countries that they limit sales cannot be justified unless there is also reason to assist the injured domestic industry. But such a request would not be proper in every instance justifying domestic measures. Market disruption agreements should not be invoked unless there has been an absolute increase of imports larger than in previous years, sufficient to idle resources in the import-competing industry, and, in the judgment of both importing and exporting governments, testifying to a permanent change in the direction or volume of trade. They should only be invoked to stretch out the process of adjustment, not to exempt the domestic industry from the need to adjust.

C. A NEW APPROACH TO RECIPROCITY

An increase of Presidential authority and the relaxation of existing restrictions on the use of that authority would equip the United States to guide commercial policies in the Atlantic community. The President, however, must exercise that authority differently than in the past. The United States must redesign its concept of reciprocity.

Because the present trade agreements program has export expansion as its aim and looks upon the concomitant increase of imports as a necessary evil, U.S. negotiators must always be concerned to get the better of a foolish bargain. Describing the 1956 GATT negotiations, a State Department pamphlet said:

> * * * United States concessions include to an exceptional degree concessions on relatively large trade items on which the duty is not a major factor in determining the level of imports and where the concession is far smaller than the value of the trade alone would indicate. * * * Our concession [on copper] consists only in agreement to reduce by 15 percent, in three annual installments, a two-cent-per-pound import tax which is now suspended by United States domestic law, and then only under favorable price conditions. * * * this concession may never become operative at all.

It is, of course, manifest nonsense to suppose that the United States can obtain meaningful tariff concessions from others by offering concessions like this. It is even more foolish to negotiate with a view to minimizing the increase of U.S. imports that must be exchanged for a given increase of exports. The gains from trade, it should be recalled, derive from specialization and, therefore, from importing what others can produce at lower cost.

Admittedly, some sort of reciprocity must be preserved, if only because governments seek to strike "fair" bargains as the measure of sovereign equality. The notion of reciprocity, however, should at least be made consonant with the objectives of tariff bargaining. Today, U.S. negotiators regard one concession as equivalent to another whenever the amounts of trade involved are approximately equal. This test is silly. It looks to the amount of trade existing before the tariff is reduced, so that a large reduction in a very restrictive tariff counts for very little, while a smaller reduction in an ineffectual tariff could count heavily. What should be studied is the amount of *additional* trade that will be generated by the tariff concessions. It is admittedly difficult to know by how much trade will increase if any one tariff is cut. But this difficulty does not justify the use of an irrelevant test.

Note, further, that one cannot balance off tariff reductions by looking at the size of the changes in duty. A country that has agreed to cut its tariffs in half, but that starts with an average tariff of 50 percent, may not be making as large a concession as one that has agreed to cut its duties by a third, but starts at an average of 15 percent. And a country that makes huge percentage cuts may not be making real concessions if it also limits imports by quota or employs valuation methods that make its low tariffs virtually prohibitive. The apparent tariff rate, moreover, may not fairly measure its protective effect. A country that imposes a 10-percent tariff on refined gasoline and allows crude oil to enter duty free is actually imposing a very high tariff on the *value added* by refining, for the tariff is applied to the full value of the gasoline but pertains to the value added by refining.

Finally, there will be instances in which adherence to any formal notion of reciprocity would obstruct U.S. policy. This will be especially true vis-a-vis the less developed countries, which cannot possibly grant tariff concessions equivalent to those we should give them. They believe that tariffs are needed to foster industrial development, and remind the United States that it relied heavily on tariffs in its own early years. While the "infant industries' argument" for protection can be abused, most authorities acknowledge that tariffs may sometimes give substantial aid to fledging industry. One might, of course, seek to apply a broader notion of reciprocity in respect of the less developed countries. The United States and other developed countries might offer to grant the developing countries unilateral tariff concessions so as to provide them with growing markets if, at the same time, the less developed countries would grant fair and equitable treatment to private foreign capital. The less developed countries are reluctant to negotiate tax treaties with the developed countries because those treaties do not offer meaningful reciprocity when one of the parties does not have business interests subject to the other's

jurisdiction. Yet tax treaties could guarantee to foreign capital a modicum of security from abusive tax practices, and may be required if U.S. capital is to flow into the less developed countries. An exchange of one-sided tariff concessions for one-sided tax treaties could provide genuine reciprocity, in the best interest of all concerned.

IV. Tariffs, Wages, and Employment

Thus far, this paper has been especially hard on the advocates of liberal trade policies, arguing that they have built their program on indefensible premises. The United States cannot reduce its tariffs without causing injury. It ought not to do so to stimulate exports, but rather to stimulate imports. It is now time to turn to the premises held by the other side—to the arguments for protection that have for so long held sway in the United States.

A. TARIFFS AND WAGES

Chief among these arguments is the contention that low foreign wage rates confer an "unfair" competitive advantage upon producers abroad.

It is, of course, true that most foreign hourly wage rates are below those prevailing in the United States, but this difference in wage rates does not argue for protection because it does not confer an "unfair" advantage on the foreign producer. It may not confer any advantage. Standing side by side with the "principle of comparative advantage" in every economics textbook is the similar and simple truth that high wages are the consequence of high productivity. The converse of this proposition is also true: Average wage rates are lower abroad because productivity is lower abroad. There is, indeed, a striking correlation between average national wage rates in manufacturing and average national output per capita:

Looking, then, at the national averages, the overall productivity differences tend to wash out the overall wage difference.

But even if this were not so, there would not necessarily be a case for tariffs to offset low foreign wages. An increase in the average wage rate would boost the average cost level in one country relative to that in another country. There is, however, another way of doing the same thing: to appreciate the first country's currency in terms of the second country's currency.[5] An overall wage-rate change is roughly equivalent to an exchange-rate change. This analogy has important implications. One ordinarily appraises an exchange rate by examining the balance of payments. If, at a given exchange rate, a country is running a deficit in its international transactions, one may argue that it should devalue its currency. In that same case, one could say that its average wage rate is too high. If, conversely, a country has a surplus in its balance of international payments, one may argue that it should appreciate its currency. In that same case, one could say that its average wage rate is too low. One cannot urge an increase of average wage rates unless one would be equally willing to urge an appreciation of the currency in relation to other currencies.

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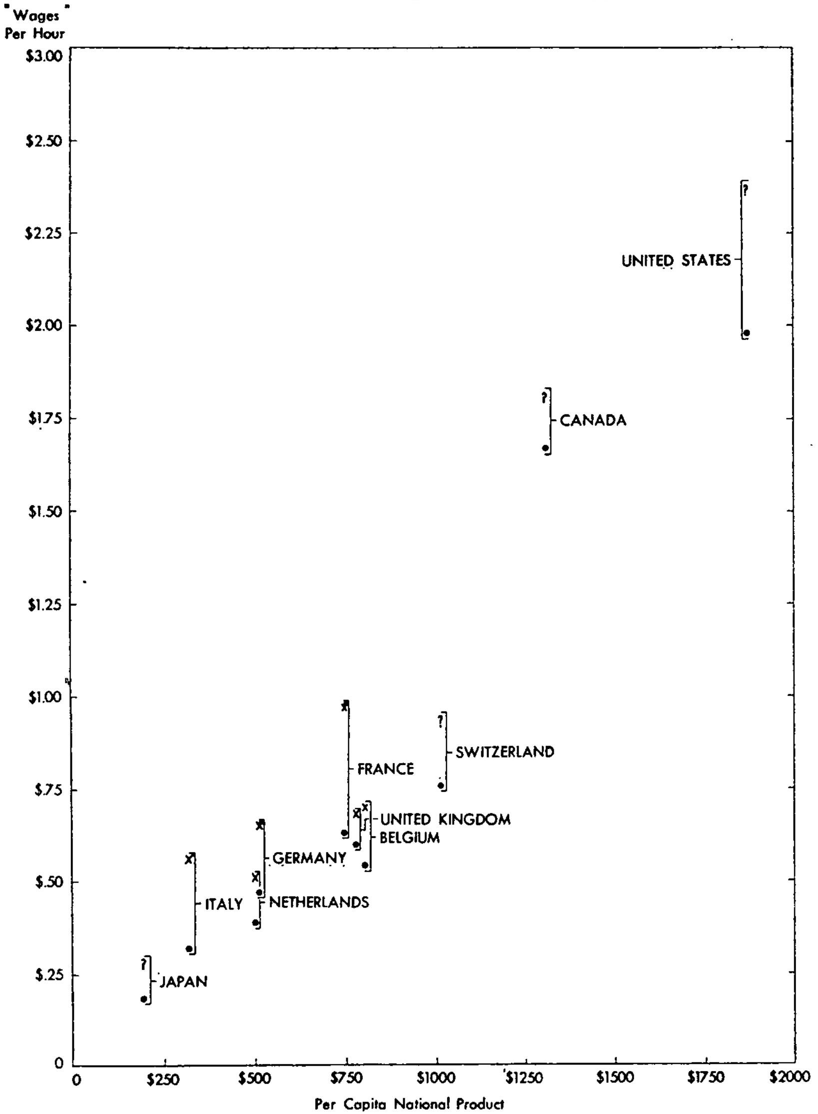
[5] Note, indeed, that the rate of exchange between the two currencies figures into the wage comparison itself. To compare Japanese and American wages one must first convert the Japanese wage into dollars, using the exchange rate.

CHART I



Now, the countries with the lowest average wage rates are not the ones that run surpluses in their international transactions. More often, they are in deficit with the outside world. Japan's balance of payments is stronger now than it was a few years back, but Japan's international position remains precarious. The low-wage countries, then, cannot afford to appreciate their currencies, and, therefore, cannot raise their wage rates faster than they increase productivity. By the same token, they cannot successfully confront a U.S. tariff barrier fashioned to offset their lower wage rates.

Note, finally, that while wage rates and labor costs are often lower abroad than in the United States, higher foreign nonwage costs often offset the wage cost differentials. In a recent study of manufacturing costs here and abroad, the National Industrial Conference Board found that "with substantial frequency * * * U.S. manufacturers were able to offset their labor disadvantage, relative to other countries, by means of savings in other cost sectors."[6] The Conference Board report contained this striking summary:

TABLE 7.—*Regional differences in all-industry average unit costs of manufacturing, U.S. firms at home and abroad*

[Excess (+) of foreign over domestic costs for comparable activities; data in cents per dollar of total U.S. unit costs]

Region	Type of cost					
	Labor	Materials	Overhead	Sales	Other	Total
Canada	−1	+11	0	0	0	+10
United Kingdom	−5	+3	−4	−7	−3	−16
Common Market	−6	+11	−4	−3	−1	−3
Latin America	−1	+19	+5	−3	+5	+25
Australia	+3	+14	−2	−1	+2	+16
All other	−6	+13	+3	−5	+4	+9
All areas	−2	+12	0	−3	+1	+8

NOTE.—These statistics and others cited later from the same study are based on costs encountered by American firms operating abroad and in the United States. These costs may or may not be typical of those encountered by foreign firms.

Source: National Industrial Conference Board, "Costs and Competition," 1961, p. 84.

Average labor costs were lower in all but one foreign area (Australia), but average total unit costs were lower in only two, and then, only slightly in the Common Market countries. The lower foreign labor costs were largely offset by higher materials costs and, significantly, higher selling costs. Note, in passing, that foreign wage costs were as low in the higher wage foreign areas (the Common Market countries and United Kingdom) as in the lowest wage foreign areas (Latin America and others). Note, too, that European wage rates have been rising much more rapidly than U.S. wage rates, so that the difference in labor costs is apt to narrow in the years ahead.

One may reply to this analysis by objecting that the relevant comparison is between particular wage rates—that when foreign and U.S. wage rates and wage costs are compared, industry by industry, substantial unfair wage-cost differentials emerge, and tariffs are needed to offset these. There are three related answers to this line of argument:

[6] National Industrial Conference Board, "Costs and Competition, 1961."

(*a*) Wage rate structures are strikingly similar from country to country. In the table that follows, the industries with lower than average wage rates abroad are those with lower than average wage rates in the United States:

TABLE 8.—*Wage rate structures, selected countries and industries, mid-1950's*

[Data as percentages of average wage in manufacturing]

Industry	United States	France	United Kingdom	Italy	Japan	Germany
Textile mill products	73	97	[1] 82	[2] 84	58	----------
Food and kindred products	92	87	----------	----------	90	79
Lumber and wood products	89	----------	----------	[3] 72	74	----------
Apparel and other finished textiles	78	94	[4] 77	----------	53	[4] 100
Stone, clay, and glass products	99	89	----------	----------	105	94
Flat glass and glassware	112	----------	[5] 107	106	----------	----------
Chemicals and allied products	107	[6] 90	103	109	126	102
Primary metals	119	81	[7] 117	134	153	[8] 134
Machinery (including electrical)	107	----------	[9] 108	106	[10] 110	[10] 113
Aircraft and automobiles	117	----------	[11] 129	138	----------	----------

[1] Woolens and worsteds only; corresponding U.S. figure: 79.
[2] Unweighted average of woolens and worsteds (88) and broadwoven fabrics (81); corresponding U.S. figure: 74.
[3] Includes furniture; corresponding U.S. figure: 88.
[4] Includes footwear; corresponding U.S. figure: 73.
[5] Flat glass only; corresponding U.S. figure: 139.
[6] Includes rubber products; corresponding U.S. figure: 108.
[7] Iron and steel tubes; corresponding U.S. figure (blast furnaces and steelworks): 128.
[8] Iron industry; corresponding U.S. figure (blast furnaces, steelworks, rolling mills and foundries): 122.
[9] Includes shipbuilding; corresponding U.S. figure: 108.
[10] Nonelectrical machinery only; corresponding U.S. figure: 112.
[11] Unweighted average of aircraft (123) and automobiles (135); corresponding U.S. figure: 117.

NOTE.—Industrial classifications are those pertaining to the United States; the foreign categories may differ slightly from their U.S. counterparts. For a detailed discussion of the data, consult the source listed below (pp. 777–779).
Source: House Ways and Means Committee, "Compendium of Papers on U.S. Foreign Trade Policy," 1957, pp. 768–771.

The dispersion of wage rates is wider in some countries than in the United States, but the several separate national arrays have similar characteristics. There are only three instances, above, in which wage rates are below average abroad and above average in the United States (stone, clay, and glass products, and chemicals, both in France), and two instances in which wage rates are average or above average abroad and below average in the United States (stone, clay, and glass products in Japan, and apparel in Germany).

One could perhaps contend that this international similarity in wage-rate structures is imposed by competition from the lowest wage countries—that some U.S. wage rates are below average because the industries involved must contend with competition from the below-average wage rates abroad. The available evidence, however, suggests that interindustry wage patterns mainly reflect the different skill mixtures used in each industry. Wage rates are relatively low in the textile and apparel trades because these industries use fewer highly skilled workers. They are, moreover, the most intensely competitive domestic industries, a fact that tends to limit the bargaining power of the labor unions involved.

(*b*) There is a further point made by Irving Kravis in his study of wage-rate structures and foreign trade,[7] that U.S. wages tend to be

[7] Irving B. Kravis, "Wages and Foreign Trade," Review of Economics and Statistics, 1955.

highest in the export industries rather than the import-competing industries. His observation has two interesting implications. One would expect the opposite result if, in fact, wage rates were the principal determinants of trade patterns; the low-wage U.S. industries would then have the greatest success in foreign markets. The converse being true, one must discount the role of wage rates per se, as a decisive influence on trade structure. Second, his data imply that the protected import-competing industries have not been able to offer high wages despite the preference given them by our tariff laws. In table 1, above, on tariff levels it will be noted that the several branches of the textile industry (cotton manufactures, wool and wool manufactures, and silk manufactures) enjoy the highest average tariff rates. In table 8, however, they come out with below-average wages. One can only conclude that the comparatively high tariffs protecting these industries have not been altogether successful in raising wage rates; rather, the tariffs have sustained those branches of American industry that can only provide relatively low-wage employment. To be sure, an increase in duties might raise wages above present levels in the industries hard hit by import competition. It is fairly certain, though, that prohibitive tariffs could not bring textile and apparel wages up to the present average of wage rates prevailing in U.S. industry, let alone cause them to rise above prevailing averages.

(*c*) It is, of course, true that some products are produced abroad more cheaply than in the United States and that wage-rate differences contribute to this result. But if there were no differences in production costs, there could be no trade at all. And the mirror image of lower foreign cost in some lines of production is, inevitably, lower domestic cost in other lines of output. We tend to forget this because we see foreign goods in the United States every day, but do not have the opportunity to see American goods abroad. As a matter of fact, the United States enjoys a broadly based advantage in many lines of output. This country, indeed, exports more to the low-wage countries like Japan than it imports from those countries. In manufacturing alone, moreover, U.S. costs are lower than foreign costs almost as often as they are higher. The NICB study cited above contains this summary:

TABLE 9.—*The distribution of products by region and total unit cost level relative to the United States*

[Percent of products manufactured in each region]

Region	Number of products studied	Percentage of products with costs—		
		Higher than in United States	Same as in United States	Lower than in United States
Canada	45	51	29	20
United Kingdom	31	13	13	74
Common Market	45	27	9	64
Latin America	62	58	11	31
Australia	19	68	11	21
All other	12	50	8	42
All areas	214	44	14	42

Source: National Industrial Conference Board, "Costs and Competition," 1961, pp. 208–212.

The results here are similar to those presented in table 7; the United Kingdom and Common Market countries are, in general, lower cost areas than the United States. But the global distribution is well balanced. And when one looks at manufacturing costs alone, rather than total unit costs, the picture changes to favor the United States:

TABLE 10.—*The distribution of products by region and plant cost level relative to the United States*

[Percent of products manufactured in each region]

Region	Number of products studied	Percentage of products with plant costs		
		Higher than in United States	Same as in United States	Lower than in United States
Canada	46	76	15	17
United Kingdom	33	27	18	55
Common Market	52	35	8	57
Latin America	66	67	8	26
Australia	18	72	6	22
All other	13	62	0	38
All areas	228	54	10	36

Source: Same as table 9.

Although fewer of the products studied were cheaper to manufacture in the United States than in the United Kingdom or Common Market countries, the balance is better than that which was struck inclusive of selling costs, and the global balance is decidedly favorable. High labor costs, then, do us less damage as an international competitor than the extravagant selling campaigns mounted in this country.[8]

B. TARIFFS AND EMPLOYMENT

During the last several years, the United States has suffered a gradual increase of unemployment, including long-term, hard-core unemployment. This development is the proper object of widespread concern in and out of Government. It has fostered a host of proposals. The best of these would accelerate economic growth, the worst would seek to hoard jobs by restricting imports.

If the United States increased tariffs it could actually generate more unemployment over the long run. An increase of tariffs, far from helping to restore full employment in the United States, could actually increase total unemployment over the long run. It would create a certain number of jobs in the import-competing industries, but would cost us vital jobs in the export industries. And the export industries are the more productive, with higher output per worker and, therefore, higher wage rates. An increase in tariffs, moreover, would be bound to provoke costly retaliation against U.S. exports. Nothing is more certain in international economic relations.

If the United States declined to reduce the tariffs, it would be powerless to cut away foreign tariffs, especially to pare down the restrictive external tariff being erected by the EEC. The forma-

[8] Note, in this connection, that foreign firms selling here must presumably incur the same high selling costs as domestic firms, while U.S. firms selling abroad can match the lower foreign selling costs. On this basis, the comparison of manufacturing costs (plant costs, above) may be the more relevant for assessing the competitive position of the United States.

tion of the EEC has already attracted U.S. capital to Europe, and more will follow in the years ahead unless tariff barriers come down throughout the non-Communist world. Now, an export of capital is not intrinsically injurious to the United States. When investment abroad is *additional to* investment in the United States, it enlarges the foreign demand for American goods at the same time that it sustains standards of living in the United States; it provides us with markets and with inexpensive products to complement our own output. When, however, investment abroad is *in lieu of* investment in the United States, it is costly of jobs in this country. When American firms close factories here to open new ones in other countries or build new ones abroad rather than building them at home, jobs and exports vanish. There is an absolute loss of jobs when companies close domestic facilities. There is a loss of potential employment, no less serious, when companies build facilities abroad rather than at home. But a movement of capital in response to new or existing trade barriers is precisely this sort of injurious investment. The companies that are moving to Europe because they fear exclusion from European markets when the EEC tariff comes into full effect are, whether they say so or not, investing abroad rather than at home. While quite properly defending their own positions, they are inadvertently adding to domestic unemployment. It would be unfair for this country to prohibit or penalize this type of foreign investment. It would be impossible to identify the firms that are migrating primarily because of tariff barriers. Even if one could, moreover, one should not penalize them for doing what they must to protect themselves. Instead of restricting investment, the United States should strive to reduce trade barriers, thereby to remove the obstacles business must otherwise vault.

A reduction of U.S. import barriers would adversely affect the industries directly involved. No one, no matter how enamored of liberal trade policies, would deny this. The job loss, moreover, could be heavily concentrated in certain communities and would sometimes be large relative to total employment in the import-competing industries. In an exhaustive analysis of imports and employment,[9] Salant and Vaccara have found that a small increase of imports would obliterate jobs more rapidly than workers normally leave them, sometimes forcing outright layoffs. In 14 of 72 industries studied, a $50 million increase of imports (at 1953 prices) would have this effect; in another 31 industries, a $200 million increase would do so. These industries, however, are not apt to prosper, even if protected. There is, in fact, every evidence that they are stagnant or declining—the victims of changing fashion and technology, or of resource exhaustion. According to Beatrice Vaccara:[10]

> An examination of the relationship between growth and import-competition reveals that import-competing industries have a greater tendency toward declining growth patterns than do manufacturing industries generally. Although import-competing industries are still predominantly rising industries as far as output is concerned, the relationship of rising to declining industries is only 2 to 1, as against 3 to 1 for all manufacturing industries. Furthermore, with regard to employment, the import-competing industries are predominantly de-

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[9] Walter S. Salant and Beatrice N. Vaccara, "Import Liberalization and Employment," The Brookings Institution, 1961.

[10] Beatrice N. Vaccara, "Employment and Output in Protected Manufacturing Industries." The Brookings Institution, 1960, pp. 41–43.

clining industries; 63 percent of the industries, employing 54 percent of the workers, have average annual declines and only 30 percent of the industries, employing 42 percent of the workers, have average annual increases.

Although one must be cautious about generalizing from a small number of cases, the data * * * indicate fairly clearly that among import-competing industries, the greater the degree of tariff protection the stronger the tendency toward declining output and employment * * *.

The maintenance of high tariffs, even an increase of tariffs, in respect of these industries would do nothing more than arrest their decline. Tariffs cannot help them greatly to expand, even to increase employment in the depressed towns and areas that are so often host to import-competing industries.

The additional job loss due to liberalization, moreover, would be very small in relation to total domestic employment or to total unemployment, and could be more than offset by the increase of jobs furnished by liberalization abroad. Salant and Vaccara estimate that—

a diversified increase of imports valued at a billion dollars at domestic ports in 1953 would cause a net decrease of 86,000 employees. (An import increase of this size would be approximately one-sixth of total dutiable imports in 1953 and probably about one-eleventh of those in 1959.)[11]

This net decrease, they point out, is one-eighth of 1 percent of total 1959 employment and one-twentieth of the smallest decrease in employment occurring in any recession since the Second World War. It would be a mere 8.6 percent of the annual increase in total employment required to provide jobs for our growing population.

Import liberalization, then, could work serious hardship upon those persons who are directly involved. But the economic adjustments that would be required to reabsorb those who are injured are very small, indeed, when compared to overall employment and the usual patterns of economic change.

To sum up: A standstill in U.S. commercial policy would not conserve jobs, nor would an increase of U.S. tariffs. A large-scale liberalization of Atlantic commercial policies, by contrast, would cause dislocation but no net loss of jobs. It could, in fact, increase the quantity of jobs if, as some predict, it would bring a larger increase of exports than of imports. It would certainly increase the quality of jobs by reallocating labor toward more efficient firms and industries.

The United States ought not to fear import liberalization. Instead, it should take its cue from Western Europe. The six EEC countries have undertaken to dismantle intra-European barriers, thereby exposing their own firms and workers to intense foreign competition. Some European businessmen have sought refuge against this competition by entering into restrictive business agreements. For the most part, however, European industry has responded vigorously. The EEC countries, in fact, have enjoyed the greatest economic expansion in recent history at the very time they were reducing tariffs; labor is scarce in Europe, not redundant. The reduction of tariffs, by encouraging reequipment and diversification, has created a new demand for workers, not thrown men out of work. Some firms and workers have been injured and more will be injured before the process is complete, but a growing economy can absorb those who are hurt,

[11] Salant and Vaccara, p. 263.

providing them with new and better opportunities. The same thing can happen here. The solution to our own unemployment problem does not lie in a retreat from competition. It is, instead, vigorously to promote domestic economic growth by all available methods—by monetary and fiscal policies, tax reform, and the intensification of competition, to which trade liberalization can itself contribute.

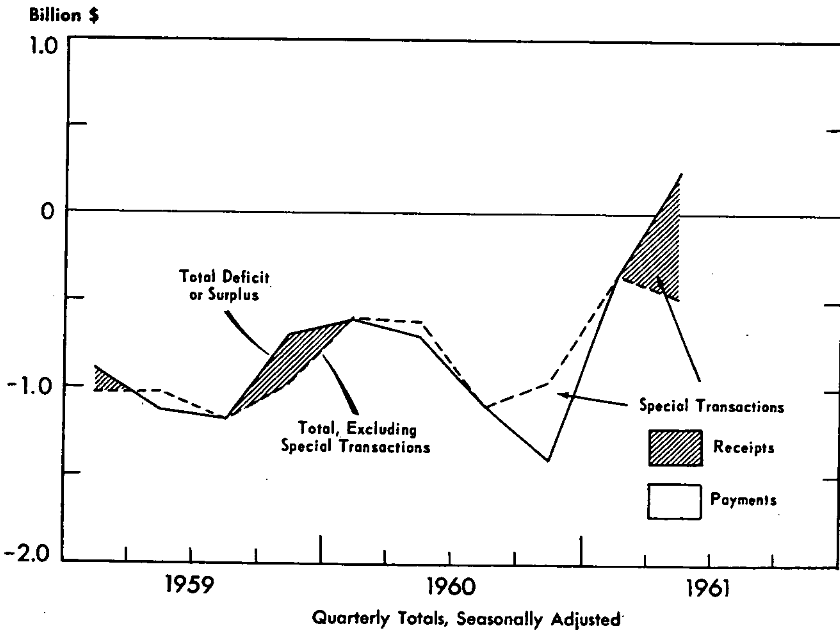
V. Tariffs and the U.S. Balance of Payments

A. Recent Developments

For the last 4 years, the United States has run large balance-of-payments deficits. This is not the place to analyze their cause or to review fully the measures taken by the previous and present administrations to combat them. But the balance-of-payments problem is apt to loom large in discussions of commercial policy and deserves brief discussion here.

During the first half of 1961, there was a striking improvement in the balance of payments.

Chart 2



The improvement, however, was largely due to special receipts (mainly advance repayments of foreign governmental debt) and to the cessation of the short-term capital outflow that attracted so much attention in the last quarter of 1960 and early months of 1961. There was an improvement in the so-called basic balance during the first quarter of 1961, but a deterioration in the second quarter, leaving the basic balance better than in 1960 and, therefore, better still than in 1959, but as yet in deficit:

TABLE 11.—*The U.S. balance of payments, seasonally adjusted, 1959–61*

[Millions of dollars]

Transaction	1959 quarterly average [1]	1960				1961	
		I	II	III	IV	I	II
U.S. payments	7,416	7,411	7,607	7,407	7,675	7,211	7,312
Merchandise imports	3,823	3,785	3,830	3,674	3,433	3,394	3,410
Military expenditure	777	767	756	798	727	759	748
Other services, pensions, etc.	1,481	1,571	1,651	1,609	1,574	1,578	1,604
Government grants and capital outflow	760	750	843	775	1,013	1,000	850
Private long-term capital	575	538	527	551	928	480	700
Direct investment	(343)	(344)	(260)	(406)	(684)	(512)	(353)
Portfolio investment	(232)	(194)	(267)	(145)	(244)	(−32)	(347)
U.S. receipts	6,368	6,914	7,069	7,041	7,107	7,444	7,237
Merchandise exports	4,071	4,650	4,837	4,927	4,995	5,054	4,751
Services	1,857	1,915	1,991	1,927	2,058	2,060	2,136
Repayments on U.S. Government loans [2]	262	168	148	170	145	131	102
Foreign capital other than liquid funds	177	181	93	17	−91	199	248
Basic deficit (−)	−1,048	−497	−538	−366	−568	+233	−75
Short-term private capital	−19	−156	−83	−534	−539	−559	−104
Special U.S. receipts [3]							724
Unrecorded transactions (net)	132	33	−142	−212	−327	−25	−296
Overall deficit	−935	−620	−763	−1,112	−1,434	−351	+249

[1] Excludes the U.S. subscription to the International Monetary Fund.
[2] Excluding the $724,000,000 listed as special receipts below.
[3] This definition of special transactions differs from that used by the Department of Commerce, as it excludes special payments; the latter, however, were small in 1960 and 1961, apart from the Ford Motor Co. purchase of minority interests in Britain.

Source: U.S. Department of Commerce, "Survey of Current Business," September 1961.

To make matters worse, the balance of unrecorded transactions has stayed negative for the past five quarters, after several years on the opposite side. In the first half of 1961, therefore, there was an overall average quarterly deficit of $300 million, and a $662 million quarterly deficit after accounting for the nonrepetitive debt repayments.

Third-quarter data are not available as of this writing, but preliminary indications are disturbing. The November issue of Economic Indicators puts the overall third-quarter deficit at a full $850 million, ascribing the increase to a very sharp rise in imports of goods and services. Preliminary data also augur ill for the rest of the year; the gold outflow totaled some $400 mililon in October and the first 3 weeks of November. Some observers predict a further deterioration in the early months of 1962.

B. THE NEED FOR ADDITIONAL ACTION

This pessimistic account does not condemn the action taken to date. The Government's effort to limit its own oversea spending has succeeded, if published data are any indication; while total foreign-aid spending has risen in recent quarters, the dollar outlay on the balance of payments has stayed very steady. Merchandise exports have kept on rising, if not because of the Government's efforts, at least not despite them. And there has as yet been no evidence of renewed speculation against dollar, even though the gold stock has begun to fall again, the administration's assurances anent the dollar price of gold and its new foreign-exchange policies have helped to calm the nerves, if not to end the deficit.

New measures, however, are needed, not only to curb the present deficit, but also to cope with the costs of the Berlin crisis, soon to appear on the balance of payments. It is not yet time to make radical changes in financial policy, but surely the time to make further alterations in the policies that influence oversea spending by Americans and foreign spending here.

1. It may be time to place new restrictions on the oversea residence of service dependents—not, perhaps, to bring home the families of servicemen now abroad, but certainly to discourage travel by the families of men newly sent abroad. This can be done without issuing outright prohibitions. The Government should announce that it will no longer provide free schooling for the children of servicemen or, at least, will only maintain schools at a few centers in Europe and Asia.

2. It is surely time to press for a further redistribution of military and economic burdens. A small change has already occurred, especially in respect of the German share, but a larger change is still warranted. At the very least, the European members of NATO should pay for all construction on the European Continent, including all the costs of missile sites.

3. It is also time to insist that the Atlantic countries running payment surpluses untie more of their economic aid, and that they provide temporary relief to partners afflicted by deficits. A nation's total aid effort should not be geared to the state of its balance of payments; national income per capita remains the best single test of a nation's capacity to aid others. The United States can ask, however, that the balance of payments be made the criterion for timing aid efforts. Using the Development Assistance Committee of the OECD, the United States, Britain, France, Germany, and other interested countries should confer on aid commitments for the next 5 years, each pledging a total effort commensurate with its capacity. Each of the countries, however, should be allowed to space out some of its outlay according to the condition of its international balance of payments. A country in deficit should be allowed to postpone a third of its annual outlay and to make up this deficiency during the balance of the 5-year period. A country enjoying a payment surplus should be required to step up aid outlays so as to offset the decline in the deficit countries' contributions. A prepayment of aid commitments by the surplus countries might not always offset deferments by deficit countries, but would usually come close to evening the total flow. It would, of

course, be difficult to force the pace of negotiation on this issue with so many other complex problems pending, but action must be taken soon to avert more serious difficulties.

4. Congress should approve the changes in taxation of foreign-source income proposed by the administration. These proposals have been misunderstood in the business community. Witnesses before the Ways and Means Committee charged the Treasury with the view that foreign investment always harms the balance of payments. This, however, was not its view. It merely argued that the deferral of U.S. tax liability artificially stimulates new investment and discourages the repatriation of income. These tendencies assuredly injure the balance of payments, even if only for the time being. They may also be detrimental in the long run, by encouraging a capital outflow of the kind described earlier in this paper—investment abroad in lieu of investment at home, which substitutes a stream of profit for a larger stream of export revenue. The Congress may not want to adopt the first proposal made by the President—the current taxation of income to subsidiaries, whether or not repatriated—but surely should adopt the "tax haven" bill subsequently circulated by the Treasury. It is in tax havens (or "profit sanctuaries," as the business community prefers to call them) that the worst abuses can occur and the largest advantage may accrue to the footloose firm that seeks primarily to reduce its taxes.

5. The administration should further enlarge its arsenal of weapons for combating speculation against the dollar and should take additional steps to bolster foreign and domestic confidence. It should request, and Congress should approve, elimination of the 25-percent gold cover requirement that backs Federal Reserve notes and deposits, so as to place all of our large gold holdings in direct support of our international position. It should hasten to detail the arrangements worked out at Vienna to provide the International Monetary Fund with additional convertible currencies and, recent reverses notwithstanding, press the view that these currencies should be automatically available.

6. The administration should again review the several proposals for reform of international financial arrangements. These proposals are not directed to improvement of the U.S. balance of payments, but may have to be adopted in order that the United States shall have sufficient freedom in its own financial policies.

C. THE ROLE OF TARIFF REDUCTIONS

The United States should also press for an early reduction of trade barriers, especially European barriers to the import of farm products and, in the process, should reduce its own tariffs. This last proposal, most relevant here, sounds paradoxical, for tariffs are usually thought to defend the balance of payments. In present circumstances, however, a tariff reduction could do more good than no change at all and would certainly do more good than a tariff increase.

A reduction of U.S. tariffs designed to secure reductions in tariffs abroad would, of course, increase U.S. imports. Yet it would also open the major foreign markets to American goods and diminish the incentive for American firms to invest in Europe for production there

instead of the United States.[12] Tariff reduction, then, could enlarge our net receipts on current account while slowing the outflow of capital that has contributed substantially to our deficit. The very adoption of liberal tariff legislation, moreover, may weigh decisively in the balance of considerations that must soon determine the course to be taken by the EEC in its agricultural policy. A restrictive European farm price-support policy could jeopardize an important source of export revenue for the United States. A liberal European policy could conceivably resolve our payments problem.

Present U.S. trade policy may actually be adding to the payments problem, because the procedures for relieving injury hold out hope of additional tariff protection. Firms afflicted by import competition may sometimes cut output to maintain profit margins, instead of cutting prices to meet foreign competition; they may count on additional protection to maintain their share of the American market. Thus it was that the manufacturers of heavy electrical equipment sought to obtain extra protection against import competition. It must now be clear, however, that the companies concerned were actually trying to protect oversized profits, that had been generated by collusive arrangements and that were in jeopardy because of foreign competition. Their petitions under the escape clause and national security amendment argued that the foreigner had lower costs and that a buy-American policy in respect of electrical generators would strengthen the Nation's defenses. In short, the companies ran the gamut of familiar arguments. In truth, however, they were seeking protection against competition itself, not just against imports. If the United States ceases to promise tariff protection to firms afflicted by import competition, American manufacturers will be forced to compete for the home market and for markets abroad, and to abandon pricing policies that exploit the consumer and the taxpayer and damage the balance of payments.

D. IF THE DEFICIT SHOULD LAST

The measures described above, including tariff reduction, may suffice to end the U.S. deficit. They will be helped by the increase of prices abroad, especially in parts of Europe, and could be reinforced by additional European exchange rate changes. If, however, these measures do not end the deficit, the United States may be forced to choose among difficult and painful measures. The United States could crack down on domestic spending, thereby achieving external balance at the price of internal stagnation. It could drastically restrict spending abroad. It could devalue the dollar.

The choice among these measures is never easy, and, it should be emphasized, the necessity for making such a choice is neither near nor certain. If such a choice becomes necessary, however, the United States should choose devaluation rather than deflation or import restrictions.

Deflation would mean a stagnation of output and, with a growing population, a steady increase in unemployment. It would, therefore,

[12] It may be argued, moreover, that an early reduction of tariffs would bring a faster increase of exports than of imports; there is excess capacity in the U.S. economy, but (as yet) little slack in Europe. American producers could therefore exploit their opportunities faster than their European rivals.

mean an increase of tensions at home that could cause the Nation to turn inward, away from its urgent responsibilities toward the outside world.

Exchange control is superficially attractive and, in limited form, is sanctioned by the articles of agreement of the IMF. It is nevertheless impossible to restrict capital movements without also regulating other international transactions. Capital transfers can too easily be disguised as merchandise or service purchases to be regulated without close scrutiny of all transactions.

Some, of course, would say that comprehensive exchange control is the most promising solution for a desperate payments problem. One must again demur, however, as the economy would soon drown in a sea of paper, while the controls would inevitably discriminate against one or another of our trading partners.

Tariffs or import quotas also have their advocates as a remedy for payments problems. Indeed, these were the preferred remedy in the 1930's with disastrous consequences for world trade. Tariffs spawn retaliation, even if used for the least obnoxious reason. The imposition of a tariff is always regarded as a hostile act, if not by foreign governments, surely by business and the press. Tariffs, moreover, are just as damaging when imposed to defend the dollar as when used to subsidize the inefficient industry.

Of all the extreme remedies, should one become necessary, devaluation could alone correct the balance of payments without doing irreparable damage to world trade and to the Western Alliance. The United State could not resort to devaluation without first obtaining changes in international monetary arrangements. Under the present arrangements, a devaluation of the dollar might touch off widespread disorder, demolishing the framework within which trade and payments take place. But once the monetary constitution had been amended, along the lines proposed by several specialists, the United States would be free to control its deficit by an exchange rate change. To be sure, devaluation invites retaliation, just like a tariff or quota, but other countries are less apt to accept the invitation. The impact of devaluation is spread across the whole of the outside world, not narrowly concentrated on particular countries or industries; it does not foster the same political reactions. In any case, devaluation is widely accepted as a legitimate recourse for nations presently in deficit.

VI. Other Aspects of Commercial Policy

This paper has focused on the tariff problem because, in the next few months, the administration and Congress must hammer out a policy to replace the Trade Agreements Act. There are, however, other important dimensions of commercial policy deserving urgent attention. At present, the U.S. Government justifiably gives preference to domestic suppliers in its own procurement of goods and services in order to minimize the balance-of-payments costs of its operations. Over the long run, however, the buy-American restrictions now in force in respect of foreign aid and defense procurement should be abandoned and the analogous cargo preference rules should be modified. Concessions of this sort may be more important over the long-run than some of the tariff reductions the United States may be

willing and able to offer in the next few years. Government purchases of goods and services bulk large in the national product and, potentially, in our foreign trade. The elimination or modification of the buy-American rules might be promised in exchange for European tariff concessions. What is more important, a modification of these restrictions would intensify competition along that important boundary at which government comes into contact with business. This increase of competition, domestic and foreign, would reduce the risk that the public may be exploited by collusive bidding and would help to reduce the built-in tendencies toward concentration fostered by Government procurement. Because the Government buys in large quantities, its activities inevitably prefer the large firm over the small and, what is worse, make the large firms larger still. Increased competition, while it would not aid smaller U.S. businesses, would at least dilute some of the additional advantages large firms obtain by supplying Government needs.

Other restrictions on foreign trade, notably the import quotas on farm products, should also be eliminated, but these changes in commercial policy would require prior changes in domestic policy.

VII. Conclusion

The Western World has changed radically in the last decade. The United States is now one of several powerful countries in the democratic camp. It may rightfully require of others that they share the burdens of common defense and aid the less developed countries. At the same time, however, the United States must set an example by its own policies. In the 1960's, as in the 1940's, it must guide the democratic nations toward new strength by the exercise of imaginative leadership. Tariff policy has a part to play in this process. A radical revision by the trade agreements program would empower the United States to lead the Atlantic community toward closer economic cooperation. It could forge new powerful links between the advanced and less developed countries, to mutual benefit. Above all, it could strengthen the American economy, banishing smugness and routine by challenging the cautious and inefficient. A nation that owes so much of its own wealth to the free play of competition should be willing to embrace an extention of that principle, not cower behind barriers to trade.