V. TRADE -- AN ELEMENT OF PROGRESS

by Eber Eldridge

As the service club seated itself for the annual banquet, two gentlemen in adjacent seats observed their table service with mild concern. One man having two knives and no fork anticipated difficulty with the T-bone steak about to be served. The other, having two forks and no knife, was silently considering the same difficulty. Each man noted the other's predicament, and the solution was obvious. A knife was exchanged for a fork, and both gave full attention to the T-bone steak.

The two gentlemen illustrate the basic principle of trade, domestic or worldwide. This principle is that the result of a satisfactory trade is a net gain for both parties. This basic principle is often overlooked in the complexities of tariffs, embargoes, trade agreements, currency exchange, balance of payments, etc.

United States Domestic Trade

The most convincing illustration of this principle is United States internal trade policies. When the United States was young, many farmers were self-sufficient. They tried to produce their own food, clothing, home furniture and recreation.

The result was low productivity per worker. As this country developed, farmers began to specialize. The corn, cotton, and wheat belts developed. By producing the product they could produce most efficiently and trading this for other goods and services, more total goods and services could be produced in the United States. Therefore, each individual earned a higher real income and a higher level of living. The farmer's per man productivity increased. In 1820, he produced enough to feed three people; in 1960 he fed 25.

Through the process of specialization and trade, the farmer's productivity increased. Labor was released from production of food for production of other items which increased our level of living. Specialization, efficient use of resources, and exchange of final product have helped make the United States a country with the highest level of living in the world. The internal trade within the United States best illustrates the principle that both parties gain with satisfactory trade.

United States Foreign Trade

Principle of Comparative Advantage. Resources such as land, labor or machines are not easily transferred between nations. For maximum total output,
the nation that has the resources to produce any products most efficiently should specialize in these products. However, some countries are not the most efficient in production of all commodities; they should produce those things in which they are least inefficient. This is known as the principle of comparative advantage.

To take a nonagricultural example, suppose an excellent lawyer is also a very fast typist. He can hire a secretary who knows nothing about law but who can type at a moderate rate. Even though the lawyer can type faster, he would be foolish not to hire the typist and spend all his time on law. The secretary is at a disadvantage in both law and typing, but since she can't practice law at all, her comparative advantage is in typing. The lawyer has an absolute advantage in the practice of law, and it requires greater education, background, and yields more (in terms of dollars) than typing; his output obviously will be greater if he specializes in law. By this specialization, the output (law cases and typing) will be greater than if the lawyer handled both.

The same principle holds in the field of agriculture. The United States might produce 100 units of pork or 80 units of milk with a given set of resources. Denmark might produce 50 units of pork and 72 units of milk with the same resources. Denmark has an absolute disadvantage in both products, but it has a comparative advantage in production of milk. The United States has an absolute advantage in both products. It has a comparative advantage in pork because it is here that the resource productivity is greatest. Suppose three resource units are available in each region. If one and one-half resource units are used for both milk and pork in the two countries, the total product will be 225 units of pork (150 U.S. and 75 Denmark) and 228 units of milk (120 U.S. and 108 Denmark). If the two nations use the same resources but specialize with the United States producing pork, where it has a comparative advantage, and Denmark producing milk, where it has a comparative advantage, the total product from the two regions will include 300 units of pork and 216 units of milk. Therefore, specialization in trade would provide a higher real income to both countries. In the first case, the United States put out 270 units (150 + 120) compared with 300 units by specializing; Denmark put out 193 units (75 + 108) compared with 216 when it specialized. 2/

Economic Advantages. United States foreign trade permits more economical use of the country's resources by promoting specialization of production. Taking the economy as a whole, we enjoy higher real wage levels and living standards with foreign trade than would be possible if we relied solely on supplies and markets within our borders.

The economic advantage of foreign trade is very clear when we buy abroad things which we don't produce at all at home -- coffee, bananas, and tin, for example. To provide substitutes for these imports within our own borders would entail most uneconomical use of our resources. At the same time, we would lose the advantage

of obtaining these imports by exporting in exchange the things which we produce with relatively greater efficiency than anyone else -- automobiles and almost all consumer hard goods, for example.

There is less obvious, but nonetheless real, economic advantage in foreign trade when we buy abroad things which we do produce in some quantities at home -- things like pottery, fine woolens, and hats. We could, if we wanted, meet all our requirements for these imports from home production. The cost would not be nearly as great as that involved in trying to grow coffee or bananas in the United States. But there would be a cost which would be reflected in higher prices (and less demand) and lower wages, i.e., a less economic use of resources. Again we would lose the advantage of selling, to pay for these imported items, goods which we produce at home with greater comparative efficiency.

In general, when an import competes successfully on its own merits in our domestic market, foreign trade offers an economic advantage by promoting a more efficient use of our resources. All trading nations benefit in this way from an expanding world trade.

Many sectors of American manufacturing and agriculture sell a large part of their output abroad. One-fourth to one-half the production of cotton, tobacco, and wheat is exported. In all, farm products representing about 25 to 30 percent of the value of farm marketings are highly dependent on export markets. A large part of the output of some manufactured goods also is exported. In a recent year, exports included 30 percent of the output of earth-grading machinery, 23 percent of tractor production, 22 percent of textile machinery production, 22 percent of the sewing machine output, 19 percent of typewriter output, 17 percent of printing machinery, 16 percent of trucks and buses, 13 percent of refrigerators, 13 percent of diesel engines, and 12 percent of agricultural machinery. This country exported chemicals and pharmaceuticals in large volume -- 38 percent of DDT, 26 percent of penicillin, 11 percent of dyes, colors, stains, for example. Nine percent of cotton textile print cloth and a large volume of iron and steel products were exported.3/

Importance of Trade to Nations

The economies of most other countries in the world, particularly the western European nations, are considerably more dependent than the United States on foreign trade. For example, Britain’s imports are equal to about 22 percent of its gross national product compared with 3 percent for the United States. The corresponding figure for Holland is 38 percent; for Belgium, 30 percent; West Germany, 13 percent; Italy, 14 percent; Japan, 10 percent; and France, seven percent. Because of this dependency on foreign trade, the future economic

growth and health of many countries depend in considerable part on whether they have sufficient opportunity to expand trade with each other and with us.

Although trade is only a small percentage of the United States gross national product, it is large in terms of world figures. The United States is the world's largest exporter of farm products. In the fiscal year 1959, the United States supplied 17 percent of the world's export volume in commodities like those produced in the United States. The output of 41 million acres (one acre of eight) of cropland moved abroad.

Agricultural shipments in 1959 filled 800,000 freight cars or 3,200 cargo ships. In moving them, an average of nine ships a day weighed anchor.

The United States is the world's second largest agricultural importer. United States imports have accounted for about one-sixth of the world's agricultural imports in recent years. The United States has been running slightly behind the United Kingdom, the world's number one importer of agricultural commodities.

The agricultural share of United States imports is much smaller now than in the past. In 1914-18, agricultural imports of $1.5 billion averaged 61 percent of total imports of $2.5 billion. As United States industry expanded after World War I, nonagricultural imports increased more than agricultural imports. In the past three years, agricultural commodities have averaged 30 percent of total United States imports. Agricultural imports amounting to $4 billion in the fiscal year 1959 were 29 percent of total United States imports of $13.9 billion.

Over the years, two-fifths of agricultural imports have supplemented the output of United States agriculture. These items are somewhat similar to or interchangeable with domestic products. In 1958-59, supplementary imports increased to one-half of total agricultural imports due to expanded purchases of cattle and meats. Other supplementary commodities are cane sugar, fruits, vegetables, vegetable oils, oil-bearing materials, tobacco, apparel wool, grains, and cotton.

Historically, about three-fifths of agricultural imports have been complementary to United States production -- items not produced in commercial volume in the United States. However, in 1958-59, complementary products declined to about one-half the total. The major complementary commodities are coffee, crude natural rubber, cocoa beans, carpet wool, bananas, tea, spices, and cordage fiber.

**Low Wages in Other Countries**

It is frequently argued that trade is impractical when wages of other

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countries are low. This argument does not seem compatible with the basic principle of trade that both parties must gain.

Wage levels in other countries are generally much lower than in the United States. For example, in 1951 the annual wages and social benefits paid by British industry to each employee averaged about 32 percent of what American industry paid; in Belgium the figure was 37 percent; West Germany and France, 29 percent; in Italy, 17 percent; Japan, 10 percent.5/

The fact that wages are lower in other countries does not mean that American products cannot compete on even or better-than-even terms with foreign products. The price at which a product can be profitably sold depends not on wage rates but on unit costs of production.

Unit cost of production, in turn, is determined by many factors in addition to wages -- the amount and character of capital investment that stands behind each worker, managerial skill, prices of raw materials and power, quality of labor, and volume of output. The combination of these elements largely determines productivity. In general, high productivity of United States industries accounts for the low cost of many American products.

It is the higher average productivity of this country that makes it possible for the average American worker to earn a higher wage than his counterpart in Europe. Conversely, the lower European wage level is conditioned by lower productivity in European industry. Many specific industries, of course, are exceptions to the general rule.

Productivity varies widely among individual American industries, while differences in wage rates tend to be less marked. For this reason, those American industries in which productivity is highest are likely to have the lowest unit costs and therefore the strongest competitive position both in the domestic market and overseas.

Our highly mechanized mass production industries are good examples of competitive advantage based on productivity. At home, the products of these industries have little to fear from foreign competition. Abroad, they have proved strongly competitive. In these industries, the combination of high capital investment per employee, relatively low raw material costs, American managerial skill and large-volume runs based on mass markets result in an efficiency so much greater than in other countries that our production can be sold profitably at prices fully competitive with foreign prices despite much higher wages prevailing here.

There is one other thing to be remembered. A country's wage level and its level of per capita income are closely related; its per capita income and per capita purchases of goods from the United States are related. Note

in table 17 how countries with higher per capita incomes buy more from the United States. Thus, if we reduce purchases of goods from some country because it has low wages, its per capita income level will fall and adversely affect its foreign market purchases.

Trade and National Security

Our trade policy affects the economic strength of other nations. Their economic strength affects their military strength and their political stability, in short, their value as Free World allies. Thus, our trade policy has a significant bearing on our own security. Our trade policy affects our ability to win allies and keep them. It has become, to our allies, an important symbol of our attitude toward their economic problems. What we do about trade has significant psychological and political effects in strengthening or weakening our alliances. Increased trade will help to strengthen the community of economic and political interests between our allies and ourselves and to increase their sense of solidarity with the United States.

In spite of our desire to strengthen and assist allies, we must recognize that free trade might expose some essential defense industry to damaging import competition. Tariffs which restrict trade can, to some extent, protect productive capacity essential to national defense. Exactly which industries are essential to national security and how much damage might result from tariff cuts cannot be easily determined.

Trade and "Infant" Industries

One argument against free trade is that it is damaging to infant industries. Protective tariffs which restrict trade are a form of subsidy for industry and a tax on consumers. Our tariffs give an indirect subsidy to domestic producers by raising the domestic price of competing imported products. Thus, the tariff allows some domestic output to be sold at higher prices in larger quantities than would be possible without tariff protection. At the same time, tariffs tax consumers of certain imported goods to discourage importation of these goods. It is often argued that protective tariffs are justified in protecting infant industries until they have an opportunity to build their volume and productive capacity to the point where they can compete with foreign industries. The United States gave tariff protection to the steel industry as an "infant industry" protection.

Use of Tariffs -- A Trade Restriction

Tariffs were imposed in this country at first largely as a means of raising revenue for the federal government. In the years before 1860, the American economy was still predominantly agricultural and tariffs were relatively low.
Table 17. Prosperity and trade.

<table>
<thead>
<tr>
<th>Country</th>
<th>Per capita income[^]/</th>
<th>Per capita purchases of United States goods[^]/</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>$1,899</td>
<td>$235.00</td>
</tr>
<tr>
<td>Switzerland</td>
<td>1,400</td>
<td>46.07</td>
</tr>
<tr>
<td>Belgium-Luxembourg</td>
<td>1,200</td>
<td>43.98</td>
</tr>
<tr>
<td>France</td>
<td>1,104</td>
<td>13.27</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1,199</td>
<td>21.00</td>
</tr>
<tr>
<td>West Germany</td>
<td>989</td>
<td>19.00</td>
</tr>
<tr>
<td>Netherlands</td>
<td>836</td>
<td>50.00</td>
</tr>
<tr>
<td>Italy</td>
<td>515</td>
<td>13.86</td>
</tr>
<tr>
<td>Japan</td>
<td>307</td>
<td>14.00</td>
</tr>
<tr>
<td>Ghana</td>
<td>169</td>
<td>2.12</td>
</tr>
<tr>
<td>Egypt</td>
<td>136</td>
<td>1.67</td>
</tr>
<tr>
<td>Iran</td>
<td>134</td>
<td>4.10</td>
</tr>
<tr>
<td>Thailand</td>
<td>92</td>
<td>3.24</td>
</tr>
<tr>
<td>India</td>
<td>68</td>
<td>1.10</td>
</tr>
<tr>
<td>Indonesia</td>
<td>65</td>
<td>1.28</td>
</tr>
<tr>
<td>Pakistan</td>
<td>65</td>
<td>1.32</td>
</tr>
<tr>
<td>Burma</td>
<td>56</td>
<td>0.37</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>47</td>
<td>0.33</td>
</tr>
</tbody>
</table>

[^]: 1957 figures.

Between 1860 and World War I, the tariff became a major protective device for the host of new industries being born in community after community in the United States. These industrial communities grew up in the face of powerful competition from well established industries in Europe. It was in the national interest to give them substantial tariff protection in their formative years. Often they retained it long after their formative years.

World War I added a new dimension to American tariff policy. The war found the United States cut off from traditional supplies and many important materials -- notably essential chemicals and pharmaceuticals from Germany. Partly to eliminate this dependence on foreign supplies, Congress increased tariffs further in the 1920's.

The Smoot-Hawley Tariff in 1930 raised tariffs to the highest point in our history. In 1934 a retreat from protection began with the enactment of the Trade Agreements Act. For the first time since before the Civil War, those who believed that freer trade policies would strengthen rather than weaken American industry saw their views reflected in tariff legislation. This act introduced many new principles -- notably the principle of reciprocity whereby the United States bargains concessions in its own tariff for tariff concessions abroad. Again, however, a domestic issue -- the aim of increasing domestic employment by getting other countries to lower their tariffs on our exports -- probably decided Congress in favor of lower tariffs.

World War II, for the first time, broadened the scope of tariff policy considerations beyond the domestic economy. The size and competitive strength of the American economy in the wake of World War II made the country inevitably a major factor in international trade. At the same time there was growing awareness of interdependence of America's security with that of the rest of the Free World.

Today, what the United States does with its tariffs has a bearing on the economic and military security, both of this country and of its friends abroad. It has a bearing on the foreign policy of this country and of other Free World countries.

Since the tariff has become a foreign policy issue as well as a domestic issue, the trend toward lower tariffs which started in 1934 has continued. Post-war tariff agreements negotiated at Geneva, Annecy and elsewhere have resulted in many rates well below the 1930 levels.

Today's debate is concerned with whether we should continue the trend, stop or perhaps even reverse it.

Not only do tariffs restrict imports, but they also inhibit the growth of American exports. Because our typical industrial and agricultural exports are the products of some of the most efficient producers in the world, other countries are anxious to buy more from us. But they are limited in their dollar earnings. Increasing the effective demand for United States exports depends upon increasing
the supply of dollars abroad. The main way of doing this is by increasing United States imports. Trade is a two way proposition. While some dollars spent abroad may at times go into other country's reserves, the vast demand for American products abroad assures that most dollars spent in other countries will come back here in the form of increased orders for United States exports.

\footnote{This can also be done by increasing American investment abroad and by increasing expenditures abroad by American tourists or by foreign aid. However, foreign claims against our gold supply are a major concern of the United States.}