CHAPTER VII

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# RADICAL CHANGES IN INTERNATIONAL TRADE

IF THE Second World War has taught us anything it is that if our way of life is to survive the United States must have the understanding and courage to take the economic leadership of the world. One has but to look back at the period between the great wars to realize that the United States has been in the driver's seat since 1920, but that it has acted upon the notion that the world's economic machine could be run with the brakes on and the ignition off. Tariffs are, as they have been for decades, the brakes. Other things are needed to keep the engine going—of course—oil, pistons, cylinders, mechanical parts. But it is the tariffs that have kept our national industrial machine at low speed and, indeed, they almost brought it to a halt in the early 1930's.

The world trade situation which the United States now faces in its present high estate has been profoundly affected by three radical changes in international business which occurred in the interwar years. They are: the abandonment of the gold standard, the metamorphosis of the United States from an importing country into a great exporting one and the outstanding creditor nation of the world, and thirdly, the emergence of Socialist, Fascist and Capitalist governments as interferers in, or dominators of, their traffic with other nations. The change-over of the United States from a debtor to a creditor nation was directly due to the First World War. Besides the large war loans made by our Government to its Allies, speculative private loans between

1919 and 1929 amounted to $7,500,000,000, which is more than the total issues floated elsewhere during that period. By 1929 we had built up foreign investments to a size equal to that which it had taken England a century to acquire overseas. What provision did we make for the effective repayment to us of these staggering debts? Why, we increased and enlarged our tariffs in 1921, 1922, and 1930, as if determined to make repayment as difficult as possible. We made no attempt to regulate the private investments, or to make sure that the money was put into productive foreign enterprises. Anyone with a proposal, however visionary, was permitted to work it off on the gullible American public during the 1920's.

Germany, for example, was over-run with high-pressure American salesmen, who not only encouraged individuals, municipalities and States to ask for money from us, but begged them to do so—with much resultant loss to American investors. Then, in 1928 we abandoned this policy so that, after a decade of reckless selling of goods and lending of savings, we stopped handing out money, again increased our tariffs and reduced our purchasing of other countries' goods by two-thirds, with a resultant decrease in the world's dollar supply of about $5,000,000,000. This compelled other countries to set up internal and external controls over their economies and finances, their exports and imports, in order to readjust themselves to this violent change of policy by the world's largest importer of private products, largest exporter (16 per cent in 1929 of the world's total), and the greatest loaner of funds. Automatic monetary adjustments, such as the gold standard, were removed and in addition to currency controls, more tariffs, quotas and embargoes were established in order to prevent the draining off of gold and foreign exchange needed to fortify shaky internal economies. Bilateral trade agreements were negotiated to obtain goods without the use of exchange and then, again, more and more government control.

If it is true, as has been stated in the most comprehensive analysis of the recent role of the United States in the world economy, that: "A world economic structure organized on the basis of equal treatment and with large scope for free enterprise cannot be maintained in the face of such reductions in the supply of dollars as have occurred in our international transactions in the past,"[1] then it is vital to review our interwar policies in order to understand the need for a change now in our international economic procedures. There were varied causes for the fluctuation in our domestic prosperity and in the volume of our foreign trade during those years under consideration. Although these two factors —domestic prosperity and volume of foreign trade—show a definite relationship, the causes of the depression of the early 1920's differed in various aspects from the reasons for the crash in 1929 and the conditions of the 1930's subsequent to the great shock at the beginning of that decade.

Although outwardly the period after the First World War seemed marked by world-wide economic expansion, rising incomes and greatly increased international transactions, there were, nonetheless, many danger signals. Thus, prices of basic commodities in which economies of whole countries were tied up, were subject to violent changes. For example, the price of crude rubber varied from four cents to a dollar a pound and the prices of wheat, cotton, jute, copper, lead, zinc, tin, coffee and sugar all were subject to sudden and drastic cost alterations. As these were major items in international trade, it was bound to show signs of these periodic strains. Although the general expansion seemed to indicate the "successful operation of a balancing

[1] See "The United States and the World Economy" published by the United States Department of Commerce (1943).

mechanism relating the various items to prices inherent in the economic period,"[2] it was in fact sustained primarily by the outpouring of American capital for investment abroad which was so poorly planned and uncontrolled as to weaken rather than to strengthen the structure of international trade. Our own American weakness during the years of 1922 to 1929 was due to the highly unstable factor of our long-term loans upon which the rest of the world depended for a satisfactory balance between the supply and the use of dollars.

Despite the fact that in accordance with the recommendation of the Genoa conference in 1922 there was a return to the gold exchange system and that gold became "more universally than ever before the foundation of the credit structure throughout the world",[3] production of gold had made only a partial recovery in 1923 and remained practically stationary up to 1929. (The industrial demand for gold absorbed 25 per cent of production during this period.) The exchange breakdown was started by France in 1928 when it refused to take any payments except gold for its excess exports and repatriated capital. This, added to the large American excess of exports, plus the reduction by two-thirds of the dollars poured out by us into the world stream for purchases of goods and services, and our sudden shutting down of our lending program in 1928, placed an intolerable burden upon international exchange reserves. The French gold imports aggravated deflation in the rest of the world. Hence, in London the pressure became so unbearable that the gold parity of the pound was abandoned, and those countries which kept their balances in England followed suit and tied their currencies to the pound, thus creating the "sterling area." By then, of course, the depression had spread like a prairie fire throughout the world.

[2] *Ibid.*

[3] "International Currency Experience," League of Nations (1944).

From then on, the economies of the various nations were subjected to every type of internal and external control to try to ameliorate the general collapse—"the whole mechanism of international intercourse was jammed and fractured."[4] Throughout the 1930's trade ceased to be the business of individuals in almost all parts of the world and governments were compelled, or thought themselves compelled, to assume more and more of the responsibilities of conducting business and trade through import prohibitions, export subsidies, quotas, barter agreements and exchange controls. It is this pattern, still rigidly in control of international exchanges, that must be altered if we are to achieve a world at peace. In reviewing the tragic record of the 1920's, the Department of Commerce insists that the conclusion which "emerges most emphatically . . . . is the fundamental importance of maintaining a more stable and ample flow of dollars in transactions with other countries."

In 1933, as if to make the world situation worse, President Roosevelt, after calling together the London World Economic Conference, ended the whole gathering when it was about to produce a plan for international stabilization of currency. This was because the American Government refused to commit the United States to the stabilization of the dollar, and the President's demand that the Conference deal with more fundamental matters, notably the tariff. This the Conference tried to do. It was, however, again thwarted by the President, who let it be known that the United States would not agree to any plan which would jeopardize his program of raising prices and inducing domestic prosperity in this way. On July 27, 1933, the Conference came to a disgraceful and useless end. Within a year the United States followed the bad example of other

[4] "Transition From War to Peace Economy," League of Nations (1943).

leading nations and "adopted the mechanism for currency warfare. . . ."

The rise of the Soviets, of the Hitler regime in Germany, and the totalitarian trend in Japan, confronted the other nations with the appearance upon the world's markets of three which were not only wholly controlling their foreign trade, but using it as a means of propaganda and for the ideological and military conquest of their rivals, as well as for economic progress. Thus the German Government looked upon its overseas business not alone as an opportunity for those of its citizens who sought to exchange goods with other countries in order to provide needed materials or luxuries for their countrymen, but as a means of rearming Germany and preparing it for the military struggle to come. Nazi leaders and financiers of the Schacht type found additional reasons for totalitarian control of their foreign trade in the reparations burden imposed by the Treaty of Versailles, which, even when subsequently modified, compelled Germany to export without compensation—without the normal repayments of imported goods. Actually, when Germany did send goods as reparations the recipients not only found it difficult to accept them and adjust them to their own economic situation, but also faced the unbalancing of their own trade position. Thus, an irregular economic element and a disturbing political color were added by the reparations to the trade of the nations concerned.

The Germans began restricting foreign payments under Chancellor Bruening because of the economic crisis of 1931. When Hitler came in, Schacht practically stopped service on all Germany's foreign bond issues, except those of the Government itself. The interest on its own bonds held in this country it religiously paid down to its declaration of war after Pearl Harbor. The only other American-owned bonds on which interest was paid were those of the North German Lloyd whose ships were libelled whenever they entered American ports if the interest was not in hand. The withholding of all payments due to foreigners by private German businesses or municipalities naturally gravely affected all American and other foreign creditors and added no little to the difficulties. So did the German effort to obtain the foreign materials they needed by deliberate attempts at direct barter. One of these was the effort to force the United States into a barter arrangement to deliver cotton to the Reich. The German financiers figured that the United States would be so worried by the size of their surplus cotton stocks as to jump at any chance to dispose of some of it. They miscalculated, for the United States kept up its cotton production by subsidizing its growers and storing the surplus. The Nazis, however, engaged in direct bartering with many other nations as part of their master plan to tie the economies of these nations to Germany's, so that they might be dependent upon her, and she would thus eventually obtain control of their economic life. Their attempts at barter and their other manipulations of international trade compelled the Nazis more and more to turn to the extraordinarily varied and ingenious, though inevitably fatal, juggling with their own currency.

Well before the restriction of German payments to foreigners, it was clear that any lack of balance in trading accounts could not be liquidated by shipments of gold because the surpluses and deficits were too vast. This was of special importance to the United States then undergoing its transformation into a great creditor nation. It soon was impossible for either the United States or England to collect the balances owed them by foreign countries in the form of additional imports, or of cash payments, or of imports of gold. They were, therefore, compelled to resort to the renewal of the noncollectable short-term loans or the funding of such loans into long-term obligations, a radical change which did not produce happy results. When the great financial crash came, the Germans were charged with having resorted to these loans in order to cheat their foreign creditors and to offset reparations. The truth is that these loans were generally justifiable and were amply secured by mortgages on private industries and upon State and municipal utilities, with adequate interest and amortization charges, but as a whole there were too many of them. When the Hitler regime exercised the theretofore unused power of the State to interfere with the due service of loans to private individuals in foreign lands, payment of the interest and amortization charges ceased at once. Under Dr. Schacht's malign leadership, the plan used to deprive foreign creditors of their money was to compel German private debtors to pay their debts into a special fund in the Reichsbank which, Dr. Schacht pretended, would in due course be transferred to the American and other foreign creditors, but this due course never came.[5]

Italy presented another set of circumstances and problems in the international field in the between-wars period. The differences can be accounted for by various historical, geographic and economic causes. The roles of both Germany and Italy in international trade had always differed, and Germany was, of course, far ahead of Italy in industrialization. It was not until December, 1934, that a decree was issued ordering all Italian exporters to sell to the National Foreign Exchange Institute all the foreign exchange received and all the foreign credits granted to them in payment of their

[5] It is an interesting illustration of the character of Hjalmar Schacht that when the loans were made and he was serving the Weimar Republic as the head of the Reichsbank he approved and sponsored them and then, in the same capacity under Hitler, he to all intents and purposes repudiated them.

exports.[6] In the early months of 1935, the importation of coal, coke, tin, nickel and copper was placed under a special government monopoly. The curtailment of exports did not increase, of course, the actual wealth of that country which depended upon large imports for many necessary materials and commodities; rather it served to avoid increasing trade deficits. Indeed, Italy was one of the last to follow the general trend of import restrictions because of its dependence upon certain essential imports. In 1931 France adopted a rigid system of import limitations and quotas to which Italy replied in kind, but by 1932 the two nations entered into a reciprocity agreement. By the end of that catastrophic year, Italo-French trade had declined almost 50 per cent as compared with 1931.

As for the Soviets, their government not only monopolizes exports and imports, but owns and controls the Russian ships which carry them, which again introduces an unprecedented element into the international trade situation. Since compensation for this ocean carriage or for railroad transportation within Russia, and the prices of all exports, are controlled by the government, it is obvious that it can easily underbid foreign competitors, other things being equal. As its vast balance sheet comprises the entire business and commerce of the country, it is not of great importance if its steamships show annual losses; they can be offset by profits in a hundred other directions. Indeed, it may almost be treated as just a matter of bookkeeping. Moreover, its trade monopoly enables it to keep its exports and imports in perfect balance without incurring debts or amassing trade balances abroad. As a League of Nations publication put it in 1943:

[6] William G. Welk, "Fascist Economic Policy—An Analysis of Italy's Economic Experiment," Harvard Economic Studies, no. 62 (1938), Harvard University Press.

> Countries committed to comprehensive economic planning on a national scale, involving direct intervention in the processes of the market, and State control of the allocation of at least a major part of the national supply of productive resources for production, must find some way of controlling foreign trade so that their plan shall not be subject to continuous disruption through unanticipated fluctuation in the prices and/or quantities of particular categories of imports and exports resulting from external factors beyond their control.[7]

The role of Great Britain in international trade also changed a good deal in the interwar years, notably in the creation of the "sterling area," a group of nations elsewhere cited.[8] A fact that is not generally recognized is that many countries nominally on gold had actually been "on sterling" for a long time. The commercial ties between these countries were strengthened by the Ottawa system of imperial preference in 1932 and subsequent trade agreements between the United Kingdom and countries such as Denmark, Sweden and the Argentine. In the Fall of 1939, after war began, many non-British countries gave up their alliance with the pound, thus reducing the sterling area practically to the British Commonwealth, excepting Canada. However, it was "wartime exchange control [that] transformed the sterling area into a more coherent organization and gave it a more precise and formal status."[9] In the sense that London

[7] "Trade Relations Between Free-Market and Controlled Economies," League of Nations Publication; Economic, Financial and Transit Department (Geneva, 1943).

[8] These countries consisted of the British Commonwealth of Nations with the exception of Canada whose currency took a middle course between the pound and the United States dollar, a few non-British countries, such as Portugal, the Scandinavian countries which joined it in 1933, and Iran and Latvia in 1936, etc. Several other countries which long kept their official exchange rates fixed in sterling were not, however, regarded as members of the sterling bloc: for example, the Argentine and Japan.

[9] "Trade Relations. . . . ," *cit. supra.*

has always been a convenient location for these countries to keep their liquid assets it is likely to continue to be such a storehouse.

Still another new and startling factor in the world's economic problems has been the wholesale giving of American products to Allied countries under Lend-Lease and the UNRRA. Even where it is pretended that these Lend-Lease donations are loans, it is plain that the vast majority of them will not be paid, that payments will not be asked and that these wartime transactions will rank as the most extensive giving in all history. That these donations have chiefly been munitions, means of transportation, food and necessary raw material, must not hide the fact that they, too, have played their part in throwing world traffic out of gear, precisely as has the disappearance of such exporting nations as Japan and Germany, and the temporary suspension or reduction of the exporting activities of France, Italy, Hungary and other countries. Again, as in the case of Canada and the United States, there has been a temporary setting aside of tariffs, or overlooking of tariff barriers where tariffs have not collapsed with the cessation of international trade.

Can there be world-wide low tariffs or free trade without international currency stabilization? This question is frequently raised, especially since the voting by Congress of the Bretton Woods proposal. The answer is—yes. The removal of trade barriers should be the all-important first step and it is not dependent upon the status of a given currency or currencies. Indeed, nations frequently manipulate their currencies in order to hinder freedom of trade and make importations difficult. That stabilization of currency would help enormously by ending a frequent source of trade handicaps, is plain. Even those who hold to the belief that stabilization of foreign exchanges is absolutely requisite for an expanded world trade admit that an essential requirement of stabilization would be a reduction in the number of trade barriers and of high tariffs. In other words, we can reduce the tariffs without requiring a fixed international money standard and stabilized exchanges, but we cannot have stabilization unless there is a lowering of customs duties.[10]

When testifying before the Senate Committee on Finance in 1943, Secretary Hull replied in answer to a question whether he considered the completion of tariff treaties or reciprocal agreements feasible until there was a stabilization of international currency: "If we attain permanent monetary arrangements and permanent exchange stability before achieving economic rehabilitation, in ninety days the exchange and money situation would snap right back to where it is now."[11] It is believed that the International Monetary Fund and International Bank launched in 1946, but becoming active only in 1947, will stimulate international trade through stabilization and make up for the lack of a universal currency mechanism and the general instability arising from the changed status of gold. The idea is that if this vast fund of $8,800,000,000 enables nations to borrow from it what they need to settle their international trade balances, they will be above and beyond any temptation to devalue their currency in order to get more trade, or to restrict that trade for nationalist purposes. They are expected to walk up to the counter, state their wishes and obtain what they need up to 25 per cent of their quotas in the

[10] "In order that the future programs of monetary stabilization may succeed, it is highly important that the United States lower its tariff rates. . . . ."—Prof. Benjamin H. Beckhart, "Problems of Post-War Currency," in *Wanted—An Economic Union of Nations* (New York: Citizens Conference on International Economic Union, 1943).

[11] Senate Hearings on Reciprocal Trade Agreements, 73rd Congress, 2nd Session, pp. 13–14.

first twelve months, and not over twice their total individual quotas during a longer period.

The Fund can, however, waive this restriction and hand over more gold or dollars to any needy country if it can line up in its behalf 51 per cent of the votes of the members. As to the wisdom of all this, there are the sharpest differences of opinion. Thus there are those who view everything in terms of the gold standard, while others think that the latter is no longer to be considered. "Free Trade and the Gold Standard," says the London *Economist,* "are to international economics what international law and world government are to international politics—the obvious end of policy." It adds that neither of these ends can be achieved overnight. There are Englishmen, like the late Lord Keynes, who not only believe wholeheartedly in the international monetary pool, but claim to be its creators. On the other hand, there are other experts in England who believe that the Bretton Woods plan means financial disaster for their country: as in the case of the British loan, the experts are sharply divided.

Similarly, in this country there are extraordinary divergences as to the value and the safety—to us—of the Fund to which, while ostensibly contributing only 31 per cent of the total, namely, $2,750,000,000, actually we are advancing 77 per cent of the total lendable assets, gold and dollars. Foreign currencies will be paid in, but will not be disposable for gold, and dollars are the standard goods the Fund will have to offer. The pessimists fear that the demand for our dollars from the Fund may readily cause a dollar scarcity and a rise in prices which would seriously affect our international trade. The only remedy for this, they say, would be to end the scarcity by pouring in more and more dollars or, as John T. Flynn puts it, "if we do not, we must subject our external and internal economic arrangements to the will of our debtors. If we do not like this we can resign from the Fund and take a complete loss on our contribution and the odium of having welshed on our impossible commitments."[12] It is well to point out here that "the odium of having welshed on . . . . impossible commitments" was exactly what befell numerous nations after the First World War when they were unable to repay American loans because of our policy of selling goods and materials to them, but erecting tariff barriers against the goods and materials they wished to sell us, with which they desired to earn American dollars in an honorable manner. Incidentally we thus limited our own exports.

The main function of the International Monetary Fund to provide means to moderate strains on the exchange rate while the exchange markets are being gradually freed from the existing restrictions, has been described by J. B. Condliffe as "an important but modest function."[13] He points out justifiably that the most urgent need in the after-war period is for the creation of special, emergency, revolving funds to meet the first abnormal trading demand. It is not the purpose of this book to pass judgment upon these moot points, but only to show that these differences and problems exist, and that if tariff reform, or tariff obliteration are not to be taken up until the currencies are stabilized, there will be an indefinite postponement of what is the crying need of the hour, namely the freeing of trade in every direction.

[12] For the strongest American criticism of the International Monetary Fund proposal see Henry Hazlitt, "Free Trade or State Domination?" in *American Scholar* (winter issue, 1944–45), p. 9.

[13] J. B. Condliffe, "Exchange Stabilization," a study published by the Committee on International Economic Policy in co-operation with the Carnegie Endowment for International Peace.