CHAPTER XIV

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THE "MENACE" OF CHEAP FOREIGN LABOR

"WILL not cheap or pauper foreign labor ruin us if we let down the tariff bars?" No question ever presented to the tariff reformer is more familiar, yet none is based on a greater fallacy or betrays more clearly the total lack of understanding of the basic principles of foreign trade on the part of those who ask it. Without doubt it has done better service for the protectionists than any other argument since the abandonment of the infant industry plea. Every variation of this cheap labor theme is now put forward, from the coolies of China to the low-wage slaves of Europe impoverished by war, or Europe's agricultural peons with their "threat" to our farmers. Thus the advocate of high tariffs has no more difficulty in finding a new cheap labor menace than the admiral or general has in providing a potential enemy to warrant larger and larger military and naval expenditures and universal military service. He asserts that our standard of living will sink far if the American workman is forced to compete with the laborer of the Orient living on a handful of rice a day, and paints a vivid picture of our being swamped with cheap toys, cheap light bulbs, cheap bicycles, cheap gadgets of all sorts, because of which the honest American workman will be unemployed or have his wages cut.

The best answer to this fallacious argument is that while we were putting on tariffs to protect our workers from the competition of low foreign wages, other countries were setting up tariffs to protect their workers against our ruinously low unit costs. Although the imposition of tariffs is not a proper remedy on either side, if we were going to accept a world system of tariffs, it would seem that justice—and logic—would be on the side of the action taken by other nations. Unit cost is, after all, the deciding factor in price competition, as opposed to the cost of labor. For example, both the radio and automobile industries in Great Britain pay lower wages than the same American industries, yet mass-production methods make the unit cost of these commodities lower in America, with the resultant competitive advantage for this country on world markets. To take another case, does the Chinese laborer who gets one dollar a day for producing a hundred nails by hand, undermine the wages of the American who gets ten dollars a day but produces a hundred thousand nails each day by machine? On domestic as well as world markets this means that the American can offer to sell ten thousand nails for one dollar with his greater machine-supported efficiency, while the Chinese laborer can only offer a hundred for the same price. Can there be any doubt as to which is likely to do the most business?

Surely no one can deny that when it comes to production and competition, the United States has done extraordinarily well, despite the fact that less than *10 per cent* of our workers are protected by tariffs. More than that, the truth stands out in contrast to most of the loose thinking as to protection, that our most highly protected industries are among those *that pay the lowest wages!* Again, the chief industries which are benefited by the trade agreements program are, on the whole, those paying better than average wages. The question therefore arises, are the industries which need the most tariff protection the least efficient? Are they industries with the least comparative advantage or with a less favorable combination of resources? Have not some once weak domestic industries so increased their overall efficiency in late years as to reduce their unit cost to the point where they are now practically invulnerable to competition? Again, low wages cannot compete with low unit costs achieved by efficient use of machinery, skilled labor and managerial ability.

One of the clearest illustrations of this is to be found in the history of the textile industry in India, where consistent efforts toward greater industrialization have long been made. Thus, in 1946 a textile machinery mission left India for Britain and the United States, not only in order to obtain more and new textile machinery, but also to discuss the possibility of India herself being able to undertake the manufacturing of textile equipment. If "cheap" labor gives such a competitive advantage it seems strange indeed that the leaders of Indian industry are so desperately anxious to buy costly machines. Can it be that they find competition in the world's markets difficult to meet because of their backward methods of production, in spite of the fact that they pay low wages? Well, the Indian manufacturers know from the experience of other nations that industrialization brings higher wages with it. Hence their desire to aid their near-starvation countrymen by bringing in up-to-date equipment and machinery, not only in the textile, but in other industries.

Curiously enough, in the past Indian mill-owners have sought to have the tariff raised on foreign cotton cloth, the reason being that protection was needed against the "unfair competition" of foreign goods made by the "cheap" labor of Japan![1] A tariff board on investigating these claims in 1923 found that the existing tariff was adequate and that cheap foreign labor was only one of the determining factors in the

[1]Nothing could be more amusing or enlightening than this episode, since Indian labor has so long been considered the most exploited in the world and the bane of many prosperous nations. Few would believe that it could have any rivalry in its economic misery. The chief complaint of the Indians was that the Japanese women worked on night shifts and the factories never stopped.

depression in the industry, and not even the most important. In fact the pathetic notion that hungry, ill-paid workers can offer serious competition to the products of well-paid laborers, who are healthy rather than hungry, and are equipped with modern, speedy and efficient machines, can quickly be dispelled by looking at the overall picture—and always holding in mind the fact that unit cost is the deciding factor in the bookkeeping of production.

There are other simple facts as to the nature of foreign trade which clearly expose the fallacy of this cheap foreign labor argument and eliminate this "menace." Let us take Japan as the most frequently cited prewar danger to America. If our market is going to be flooded with Japanese goods, obviously, American importers who buy these goods must be able to obtain yen with which to pay the Japanese because yen are the only money which is any good to them. Now we can obtain yen in one of three ways: We can exchange gold for yen; we can borrow yen; or we can earn yen by selling to Japan American goods (and also services, which we shall hereafter omit for simplicity's sake). This is sufficiently important to be stressed again and again. Of these three ways, however, it is clear that the first two are only temporary expedients. Although we have a lot of it at Fort Knox, the total amount of gold in the world is limited; and so is the amount which any one country is willing to lend to any other. Hence, in the long run, *the only way that we can get hold of yen is to exchange goods for them.*

This means that if the American market is flooded with Japanese goods, the Japanese market must also be flooded with American goods in order that we may obtain the yen to buy the goods which are flooding the American market. In other words, Americans are eager to buy Japanese products at cheaper rates than similar American goods; but we can pay for the cheaper Japanese goods only by getting the

Japanese to buy an equal value of American goods which are cheaper than similar Japanese products or are not made in Japan. Thus, in order for us to purchase Japanese products, American factories must do work of equal value and pay usual or higher wages to the workers who turn out the work. The average man finds it extremely difficult to realize that any great pile of Japanese goods on the wharves of San Francisco is coming into the United States only because another pile, perhaps smaller in bulk, but of equal value, is lying on the same wharves awaiting shipment to Japan in exchange for the Japanese goods piled nearby. Apart from gold and loans, there is no other way that trade can take place.

Hence, it is clear that foreign trade simply involves an exchange of one batch of goods for another batch of goods. In the old days when people gathered in a village square to swap cabbages for shoes, no one talked of their standard of living being reduced because more shoes or more cabbages were being produced. Yet foreign trade is in reality the same thing. Practically, over a period of time long enough to eliminate the temporary influences of borrowing and of gold movements, we can forget about yen and dollars and exchange rates and all the other complications of foreign trade, and recognize that foreign trade is a kind of barter. Hence, if Japan's flooding us with cheap toys should involve throwing out of work in our toy factories some American laborers, they will find work in our car or other factories producing the materials or cars with which we shall be flooding Japan. Otherwise we should not be able to sell more goods to the Japanese and thus obtain the yen needed to buy the Japanese toys and other products.

Almost a hundred years ago the great French economist, Frédéric Bastiat, explained the essential point about foreign trade thus:

Tell me, workmen! if a man should stand on the quay at Boulogne and say to every Englishman who landed, "If you give me those English boots, I will give you this French hat"; or, "If you give me that English horse, I will give you this French tilbury"; or ask him, "Will you exchange that machine made at Birmingham for this clock made at Paris?"; or, again, "Can you arrange to barter this Newcastle coal against this champagne wine?" tell me whether, assuming this man to make his proposals with discernment, anyone would be justified in saying that our *national labour,* taken in the aggregate, would suffer in consequence?

Would it make the slightest difference in this respect were twenty such offers to be made in place of one, or a million such barters to be effected in place of four, or were merchants and money to intervene, whereby such transactions would be greatly facilitated and multiplied?

Now, when one country buys from another wholesale to sell again in retail, or buys in retail to sell again in the lump, if we trace the transaction to its ultimate results we shall always find that *commerce* resolves itself into *barter, products for products, services for services.* If then, *barter* does no injury to *national labour,* since it implies as much *national labour given as foreign labour received,* it follows that a hundred thousand millions of such acts of barter would do as little injury as one.

But where would be the profit? you will ask. The profit consists in turning to most account the resources of each country, so that the amount of labour shall yield everywhere more satisfaction and well-being.[2]

Of course there would not be much of a case for foreign trade if it just meant that Mr. Smith of Grand Rapids moved from a toy factory there to a car factory in Detroit. Actually, by selling abroad we do a lot more than hold our own in production. Let us take the extreme case: Suppose that there is nothing the Japanese can produce that we cannot produce

[2]Frédéric Bastiat, *Essays on Political Economy,* Parts I and II, "Sophisms of Protection."

better and *cheaper*. Even then foreign trade would be desirable, for, compared with the Japanese, we should do certain things better than other things, so that it would be mutually advantageous for us to concentrate on the things which we could produce with the *greatest comparative advantage*, while the Japanese concentrated on the things which they can produce with the *least comparative disadvantage*. To take an extreme individual case, a business executive might conceivably be one-tenth better than his secretary as a typist, and ten times better as an executive. Under these circumstances the two as a team will be more productive and, therefore, will mutually benefit if the executive sticks to direction and management where his comparative advantage is ten times that of his secretary, and his secretary sticks to typing, where she is at a comparative disadvantage of only one-tenth.

Most business men, of course, are not better typists than their secretaries. It may seem extreme—perhaps even silly—that a business man could ever be better as a typist; but it is no sillier or more extreme than to assume that any one country can produce *everything* better and cheaper than any other country. Differences in natural resources and climatic conditions mean that even such large areas as the United States and Russia lack many materials or agricultural products—or can only produce them at exorbitant costs. Bananas can be grown in hothouses, and most materials can be produced in the United States if price is no consideration; but, in practice at least, it is clear that many products must either be imported or done without.

Trade due to differences in climate and natural resources, however, is not the most important sort of international trade, as most trade is with industrial European countries possessing roughly the same climate, but less in the way of natural resources than we. Our trade with these areas represents in its essence an outstanding example of the specialization and division of labor which has been largely responsible for the increase in world production over the last two centuries. Almost no one doubts that it is desirable to have Detroit specialize in the production of automobiles, or the South specialize in growing cotton and in manufacturing cotton textiles; nor does any one question that it is mutually beneficial when the two areas exchange, in effect, cars for cotton textiles. It is also clear that the average standard of living in Detroit is considerably higher than it is in the South. It should be equally clear that the average standard of living in Detroit is not being ruined by cheap textiles from the South, nor is the standard of living in the South ruined by cheap cars from the North. Instead, both areas profit by concentrating on the mass production of the things they are best able to make and dividing between them the increase in total production resulting from this specialization and division of labor. But, exactly the same thing is true of trade between the United States and industrial Europe.

Furthermore, although the Northern laborer in the United States does not have to fear the competition of the low-wage laborer in the South, he has everything to gain from the latter's receiving better wages which can be achieved in one way though industrialization of the South. The greater the total production of wealth, which in turn becomes purchasing power, the higher the standard of living will be. Workers in the South will then have the means with which to buy goods manufactured in the North; the *potential* demand of the Southern wage-earner for all the consumer goods he has wanted to purchase but has been without the money to acquire, will then become *effective* demand in the marketplace. As is well known, goods and materials manufactured in different areas frequently vary in quality, but even if industrialization in the South should bring about certain similarities in the goods produced, the North would still not have to fear this competition. The increased consumption and prosperity resulting from buying and selling on a larger scale, the fact that the South will be a better customer than formerly, will all outweigh any detrimental factor. The same situation holds true on the international scale. As a matter of fact, the highly industrialized countries, even those whose climate and natural resources are most similar to our own, are the best customers for our manufactured goods.

The American consumer should never forget that, in addition to the prices we pay for goods and services, taxes are also a part of the cost of living. The difference between the regularly imposed taxes and the hidden ones that are concealed behind the tariff duties is obvious, however frequently overlooked. The consumer does not forget that he has paid or has got to pay his Federal and State income taxes. Always he hopes that he will receive from them direct or indirect benefits in scores of different ways such as education, social security, sanitation, safety, conservation of natural resources and many others. From the disguised tariff tax he pays he can be sure of getting nothing except the privilege of paying more for some of the necessities of life which he must have for himself and his family. As Congressman Rainey of Illinois remarked in the House of Representatives in 1906, tariffs are "a system of taxation . . . . exercised not for the purpose of raising revenue, not for the purpose of subserving any interest of the State," but to delegate "the taxing power to individuals and to private corporations to be exercised by them for their own personal and private benefit."

It was an English Prime Minister who said in Napoleonic days that it would be a dangerous experiment to levy a direct tax of 7 per cent. But, he added, "there is a method by which you can tax the last rag from the back and the last bite without causing a murmur against high taxes, and that is to tax a great many articles of daily use and necessity so indirectly that people will pay them and not know it; their grumbling will then be of hard times, but they will not know that the hard times are caused by taxation".[3] He was quite correct. It has been the ignorance of the plain citizen, and the failure of the tariff reformer to supply adequate leadership, which have kept the American consumer in such unawareness of the tariff's heavy levies upon his purse and prevented a popular revolt.

[3]See *Free Trade Broadside,* vol. 1 (July, 1906), p. 3.