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**National Power
and the Structure
of Foreign Trade**

By

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CHAPTER I

*Economic Thought on the Relationship
Between Foreign Trade and
National Power*

BECAUSE OF an enduring liberal tradition, the conflict of social purposes which has been popularized by Goering's blunt statement of the choice to be made between guns and butter surprised great numbers of people in the democratic countries. Often-heard phrases, like the perversion of normal economic activities or the diversion of national wealth from its true economic purposes, indicate that in spite of the experience of the First World War the pursuit of power was still largely considered as a subordinate or exceptional aim of economic policy.

True it is that ever since Max Weber economists have had some doubts about the meaningfulness of the term economic when applied to ends and not to means. Nevertheless, academic discussion has sought mainly to determine which of the possible and sometimes conflicting definitions of welfare should be adopted as an objective of policy and what means would be most suitable to the kind of welfare desired.¹

It is not surprising therefore that at first sight the pursuit of so different an objective as national power should have been deemed irreconcilable with the pursuit of any type of welfare. The alternative between guns and butter became, in academic language, the opposition between two economic systems, the economics of welfare and the economics of power.²

If the proposal to make the power of the state a primary aim of

¹ With respect to monetary policy, this self-imposed limitation of academic discussion has been pointed out recently by H. S. Ellis, "The Problem of Exchange Systems in the Post-War World," *The American Economic Review*, Supplement, Vol. XXXII (March, 1942), pp. 195-196.

² For a criticism of this terminology, see below, pp. 78 f.

economic policy was a shock to many contemporary minds, it nevertheless formed the basis and even the *raison d'être* of earlier schools of economic thought, Machiavelli to the contrary notwithstanding. Perhaps Machiavelli's discounting of the connection between economics and politics might be explained by his desire to establish still better the complete autonomy of political science which he had separated so emphatically from its traditional metaphysical and ethical framework. But soon after him, writers on economic subjects were to point out the excellent use to which external and internal economic relations might be put by a state anxious to increase its power.

The policies advocated by the Mercantilists were to a large extent inspired by the double objective of increasing the wealth and the power of their own particular country. The reference by Bacon of a possible conflict between these two aims of economic policy seems to have been the one exception in a vast literature.* In general, the aim of increased national power at the expense of rival states, on the one hand, and the aim of increased wealth, on the other, were brought into complete harmony by the balance of trade doctrine, which led the Mercantilists to assume that in its external economic relations a nation can increase its wealth only by decreasing the wealth of other nations. The instrument of the shift was thought to be a balance of payments leading to an influx of gold and silver. An increase in the stock of precious metals would contribute indeed to the power of the state either directly by the accumulation of treasure or indirectly by enriching the country, which would thus be in a better position to contribute to the power of the state by taxes and services. The connection established by the Mercantilists between wealth and national power may therefore be put in the form of a perfect syllogism:

Major premise: An increase of wealth of any country is an increase of its absolute power, and vice versa.

Minor premise: An increase of wealth of any country, if brought about by foreign trade, is necessarily a loss of wealth for other countries.

* Speaking of the Navigation Laws, Bacon said it was the "ancient policy of this estate" to bow "from considerations of plenty to considerations of power."—Quoted from Bacon's *History of the Reign of King Henry the Seventh*, in E. F. Heckscher, *Mercantilism*, Vol. II (London, 1935), p. 16. Cf. also the discussion on the place of

Conclusion: An increase of wealth through foreign trade leads to an increase of power relative to that of other countries—precisely the political aim of Mercantilist policy. Within the Mercantilist conception of wealth, a conflict between the wealth and power aims of the state is well-nigh unthinkable.

Adam Smith's best-known statement on our subject is, of course, that "defence is of much more importance than opulence."⁴ If attention, however, is given only to this famous formula, his thought is easily seen in a false perspective. Before Smith, Hume had elaborately discussed in his *Essay on Commerce* the relationship between the "greatness of a state" and the "happiness of its subjects." He had reached the conclusion that "in the common course of human affairs" the two are in complete harmony, but he mentioned the possibility of exceptions to the rule.⁵ Adam Smith's endorsement of "defence" in place of "opulence" is to be regarded as precisely such an exception. The Navigation Laws were indeed the only governmental interference with economic life in England to escape his criticism. In general, Adam Smith seems not to be concerned about the probability of a conflict between welfare and power. In one of his definitions of political economy, he states that "the great object of the political economy of every country is to increase the riches and the power of that country."⁶ Although his emphasis with respect to these two aims is different from that of the Mercantilists, he declares expressly in his chapter on "The Expence of Defence": "In modern war the great expence of fire arms gives an evident advantage to the nation which can best afford this expence and consequently to an opulent and civilized over a poor and barbarous nation." Thus, Adam Smith upheld the major premise of the Mercantilist syllogism even though wealth had not the same meaning for him as it had for the mercantilists.

It was the minor premise which crumbled under the weight of Adam Smith's proof that the gain of one nation is not necessarily the loss of another, but that, on the contrary, trade always benefits all participating nations. Therefore, the conclusion concerning the

power considerations in Mercantilist doctrines in Jacob Viner's review of Heckscher's work, in *Economic History Review*, Vol. II (1935), p. 100, and Heckscher's reply, *op. cit.*, Vol. VII (1936), p. 481.

⁴ Adam Smith, *Wealth of Nations*, Modern Library ed. (New York, 1937), p. 431.

⁵ David Hume, *Essays and Treatises on Several Subjects*, Vol. I (Edinburgh, 1800), pp. 271-282.

⁶ Smith, *op. cit.*, p. 352.

⁷ Smith, *op. cit.*, p. 669.

relative power of the country after the increase of wealth by foreign trade was no longer certain.⁹

This argument is at the root of the intellectual opposition of welfare and power which has been so well expressed by Mr. Hawtrey:

So long as welfare is the end, different communities may coöperate happily together. Jealousy there may be and disputes as to how the material means of welfare should be shared. But there is no inherent divergence of aim in the pursuit of welfare. Power, on the other hand, is relative. The gain of one country is necessarily loss to others, its loss is gain to them. Conflict is the essence of the pursuit of power.⁹

Although the free trade argument is not logically conclusive from the point of view of a policy the main objective of which is *relative* power, it has not been exposed to much attack on this score. The main argument of the protectionists against free trade has long been directed to the supposed dangers inherent in excessive specialization. The inability under free trade conditions to develop national resources which would contribute to the economic and military power of the state and the apprehension of being cut off from essential supplies during an emergency have again and again proved two essential supports of protectionist and autarkic policy.

It would, of course, be a drastic oversimplification to view the conflict between protection and free trade as merely a struggle between the welfare and the power motives of commercial policy. If this were so, the antagonists in the field of foreign trade policy would have been talking entirely at cross-purposes. An examination of the reasons given for free trade or protection shows that both theories, never afraid of proving too much, have claimed:

- 1) that they are to be recommended on purely economic grounds;
- 2) that they lead to international peace;
- 3) that they are best fitted to prepare a country for war.

The numerous and often conflicting arguments advanced on either side made possible the charge of hypocrisy, with which the protectionists have been especially fond of taxing the free traders.

⁹ Indeed, immediately after having proved that nations derive a mutual benefit from foreign trade, Adam Smith points to an instance in which welfare may be increased to the detriment of the power position of the country: "The wealth of a neighboring nation, however, though dangerous in war and politics, is certainly advantageous in trade."—Smith, *op cit.*, p. 461.

⁹ R. G. Hawtrey, *The Economic Aspects of Sovereignty* (London, 1930), p. 27.

We are not concerned here with the economic arguments.¹⁰ As to the noneconomic arguments for protectionism, it is historically interesting to note that they have not always been concerned with the conservation of certain social groups or with war preparedness. Lack of sympathy with foreign trade, because it might involve the nation in foreign entanglements, is a characteristic feature of American isolationism; an early and radical exponent of this idea was Fichte, who proposed his *Closed Commercial State* because he was convinced that commerce led inevitably to war. His ideal is a polyphonic humanity in which each nation, having closed its frontiers, achieves the full expression of its individuality.¹¹

Among the noneconomic arguments for free trade, the main contention was of course that trade would prove a "bond of friendship between nations." When derided as utopians or accused of lack of patriotism, however, free traders have usually fallen back upon the argument that foreign trade enriches a country and thus helps its defense. This argument, which goes back to Adam Smith, has been repeated in defense of free trade ever since his day, especially in times of actual or impending war.¹² It is definitely linked with the somewhat outmoded theories stressing the *potentiel de guerre* as the main factor of war preparedness.

In addition, free traders have tried to belittle the danger of dependence pointed out by their adversaries. Thus, in the course of the Parliamentary Debates on the Corn Laws, Macaulay found an interesting counterargument to the charge of dependence arising out of free trade: "Next to independence, and indeed, amounting to practically the same thing," he argued, "is a very wide dependence, a dependence on the whole world, on every state and climate."¹³

The mention of climate is particularly revealing for the state of

¹⁰ For a systematic analysis, see Gottfried Haberler, *The Theory of International Trade* (New York, 1937), pp. 221-295.

¹¹ J. G. Fichte, *Sämmtliche Werke*, Vol. III (Berlin, 1845), pp. 467-469, 483, 512.

¹² Cf. Ludwig V. Mises, "Vom Ziele der Handelspolitik," *Archiv für Sozialwissenschaft*, Vol. XLII (1916), p. 576; Lionel Robbins, "The Fundamental Reasons for Increased Protectionism," in *The Improvement of Commercial Relations Between Nations* (Paris, 1936), p. 27; also, Stefan Possony, *Tomorrow's War, Its Planning, Management and Cost* (London, 1938), pp. 147 f., 201; Wilhelm Röpke, *International Economic Disintegration* (London, 1942), pp. 101 f.

¹³ Hansard (3d ser.), LX, 469, quoted in *Commerce and Industry*, ed. by William Page (London, 1919), p. 131. As we shall see later (on p. 73), the essence of this argument goes back to Adam Smith.

discussion which prevailed at that time—the advent of Great Britain's free trade policy. The connection between the potato famine in Ireland and the repeal of the Corn Laws in 1846 is well known. It was obvious that free trade, by extending the area of commerce, would lessen the dependence on weather and therefore the dangers of famine. This argument has been one of the main weapons of free traders ever since Adam Smith's discussion of the Corn Laws. Fichte felt the weight of the argument so much that in a special section of his *Closed Commercial State* he tried to show how, in the absence of foreign trade, the danger of famine could be obviated by the piling up of stocks in good years.¹⁴ But for centuries wars and famines had been considered as two very similar and God-sent scourges of mankind. Only exceptional pessimists could imagine that a trend of development which pointed to the elimination of the danger of famine would not check, but would increase the dangers of war.¹⁵

It was, however, somewhat paradoxical to argue that the increased reliance of Great Britain on the outside world for her wheat supply would actually decrease her dependence in the event of war or of crop failure. Such an argument clearly presupposes either freedom of the seas or a mighty British fleet. Consequently, it has often been argued on the Continent that free trade was the "right" policy for England, but not for other countries. Macaulay's argument in favor of a greater geographical dispersion of commercial relations, however, has the great merit of pointing to the possibility of lessening the dependence created by foreign trade by modifying the distribution of that trade.

This idea could come to its full fruition only after commercial policy had been provided with the weapons necessary to influence the geographical distribution of foreign trade. As long as the most-favored-nation clause was prevalent in commercial treaties and trade was regulated mostly by tariffs, governments had relatively little influence upon the geographical course of trade, or, at any rate, were not fully conscious of possessing this influence. In the

¹⁴ Fichte, *op. cit.*, pp. 428-431. How, in a world of surpluses, this argument has fallen into oblivion has been pointed out recently by Röpke, *op. cit.*, p. 143.

¹⁵ An example of this kind of pessimism is given by a passage of Flaubert's correspondence: "The great collective (public) works, like the construction of the Suez Canal, might well be, in another form, adumbrations and preparations of these monstrous conflicts which we cannot conceive!"—*Correspondance*, Vol. IV (Paris, 1895), p. 29.

interest of their power policy, they tried to strike a rough balance between the economic and possible military advantages of foreign trade on the one side and its dangers on the other.

This is the policy actually advocated in a study by Herbert Wergo, a German economist writing before the advent of Hitler on the alternative virtues of free trade and protectionism in promoting the power policy of the state.¹⁶ According to Wergo, free trade and protectionism should not be considered as mutually exclusive policies. Both can be of service to the state. The practical outcome of such a theory would be the division of the national economy into two parts, a protected one, considered as "essential," and a free part, the aim of which would be to secure a cheap and plentiful supply of "nonessential" goods. Actually, this was the policy pursued by most states even before the outbreak of the First World War.

All these policies proposed by free traders, protectionists, or eclectics as being conducive to more *economic* power have the common characteristic that they do not necessarily lead to an increase in *relative* power, which is, after all, the only objective that matters. It is true that the danger of a nation's falling behind other nations because of the lack of a proper policy was often pointed out. But if all nations pursued the "right" policy—whatever this was held to be—protectionists and free traders alike could have no reasonable hope of a change in the balance of economic power in favor of any particular country. In other words, the contribution of commercial policy to the power of the state was thought of more as a necessary condition for the successful forging of the weapons than as one of the weapons making power supremacy possible.

This position was a natural one for the free traders whose whole case rested on the demonstration of the mutual benefit accruing from commercial intercourse to the various countries trading together. But the protectionists had their eyes fixed exclusively upon the dependence incurred through foreign trade by their respective national economies. Thus, they overlooked the fact that the dependence created by trade, like the benefit derived from it, has a double aspect.¹⁷

¹⁶ Herbert Wergo, *Freihandel und Schutzzoll als Mittel staatlicher Machtentfaltung*, Probleme der Weltwirtschaft, Vol. 45 (Jena, 1928).

¹⁷ In international investments exactly the opposite neglect has been prevalent, i.e., only the influence acquired through investments in other countries has generally been

This double aspect—the fact that dependence of country A on country B implies at the same time dependence of B on A—had on the contrary been seized upon by the internationalists who saw in it the basis for their hope that trade would create national or at least strong sectional interests opposed to war.²⁰ To convey this idea they used the terms mutual dependence, interdependence, inextricable network of markets, etc. This line of thought has a long history which can be traced back to Montesquieu.²¹ Its best-known exponents are Cobden and Sir Norman Angell, although the latter's outlook is far less optimistic than that of Cobden, because Sir Norman no longer takes it for granted that man will always eventually perceive and follow his real interests.

In his famous eulogy of international trade, John Stuart Mill adhered to the view that commerce caused mutual dependence and would thereby constitute a force for peace.²² But by his contributions to economic theory he undermined at the same time these very hopes. The necessary basis for the idea that the interdependence created by trade would or should lead to a peaceful collaboration between nations, is, indeed, the belief that the dependence of A on B is roughly the same as the dependence of B on A. Mill was one of the first to show that the material benefit derived from international trade is not necessarily divided equally between the various trading nations.²³ Ever since Mill's time Anglo-Saxon economists

given consideration. Staley has pointed out that by investing abroad a nation also becomes more or less dependent upon the country in which it invests. He writes: "Objectively, one can think of respects in which American policy becomes subject to influences from Europe as a result of capital investments in Europe, as well as of ways in which European policy becomes subject to influences from America—in fact in the realm of foreign policy and as between advanced countries, there is strong reason for believing that the borrowing nation has more leverage on the policies of the creditor nation than vice versa."—Eugene Staley, *War and the Private Investor* (New York, 1935), p. 406.

²⁰ This argument is distinct from, though related to, the idea that commerce, bringing about the very enrichment which is the aim or pretext of most wars, would render war unnecessary. (See below, pp. 28 f.)

²¹ "The natural effect of commerce is to bring about peace. Two nations which trade together, render themselves reciprocally dependent: if the one has an interest in buying the other has an interest in selling; and all unions are based upon mutual needs."—Montesquieu, *De l'Esprit des Lois*, Book XX, Chap. II, in *Œuvres*, Vol. I (Amsterdam and Leipzig), p. 446.

²² "It is commerce which is rapidly rendering war obsolete, by strengthening and multiplying the personal interests which are in natural opposition to it."—John Stuart Mill, *Principles of Political Economy*, 7th ed. (London, 1929), p. 582.

²³ J. S. Mill, *Essays on Some Unsettled Questions of Political Economy*, Essay I (London, 1844), pp. 1–46.

have given much thought to the ways in which the terms of trade might be altered by changing conditions or by adopting policies favorable to one nation. Bastable later showed how, under the hypothesis of trade between two socialist states, the theory of bilateral monopoly would become applicable.²⁴ The country with superior bargaining power might, on this basis, be able to obtain the whole gain from trade. Similar situations were found to prevail when trade takes place between two countries of different size or with different degrees of specialization.²⁵ Preoccupation with questions of this type has even led Edgeworth to affirm that "the principal characteristic peculiar to international trade is, I think, the possibility of a nation benefiting itself by a tax on exports and imports."²⁶

Thus, although the reasoning of the Mercantilist balance of trade theory had been decisively discredited by the criticism of Hume and Adam Smith, some of its main conclusions were rehabilitated, not as a certainty, but as a possibility by the theory of the terms of trade: It was shown that international trade might work to the exclusive or disproportionate benefit of one or a few of the trading nations.

It need not surprise us that the obvious power implications of these findings for the political dependence arising from trade, somewhat neglected by English economists, have been seized upon by their German colleagues. Thus, Max Sering wrote as early as 1900: "It has been wrongly contended that in the economic intercourse of nations the dependence is always a mutual one, that always equal values are exchanged. As between private persons, there exist between national economies relations of exploitation and of subjection."²⁷ But Sering, engaged in giving plausible reasons for the building of a German fleet, did not pay much attention to the economic conditions and techniques which would lead to such an unequal distribution of the mutual dependence arising from trade.

²⁴ C. F. Bastable, *The Theory of International Trade*, 4th ed. (London, 1903), pp. 25–29; see also criticism by F. Y. Edgeworth, "The Theory of International Values," *Economic Journal*, Vol. IV (1894), p. 622.

²⁵ Cf. J. S. Nicholson, *Principles of Political Economy* (London, 1897), pp. 309–311; see also Haberler, *op. cit.*, pp. 148–149.

²⁶ F. Y. Edgeworth, *Papers Relating to Political Economy*, Vol. II (London, 1925), p. 19.

²⁷ Max Sering, "Die Handelspolitik der Grossmächte und die Kriegsflotte," in *Handels- und Machtpolitik*, Vol. II (Stuttgart, 1900), p. 31.

of exports the problem created by an interruption of trade will be the more difficult, (1) the smaller the mobility of resources within the country, (2) the more the economic activities leading to exports have been concentrated in certain lines of production or in certain regions.

The mobility of resources includes the possibility of diverting capital goods to new purposes (i.e., their more or less "specific" character), the geographical mobility of the factors of production, and, above all, the ability of labor to turn to new tasks. The inherent advantage with respect to all these aspects of the mobility of resources lies overwhelmingly with the great manufacturing and trading countries as opposed to countries in which agriculture or mining predominates. Here again the prevention of industrialization would be the aim of a power trying to make the adjustment problem appear insoluble to the countries with which it trades.²¹

The second factor having a definite bearing upon the relative ease of adjustment after an interruption of trade is the extent to which production for export is concentrated in certain products or in certain regions. If most of the exports are made up of one particular product, there is very little probability that any great part of it can be consumed at home if the foreign outlet fails; if the exports all come from certain specialized regions within the country, there will be "distressed areas" and a need for large-scale relief and resettlement. It is highly unlikely that the pattern of the economic activities devoted to exports will follow closely the distribution of general economic activity among geographical regions and lines of production. But the discrepancy of the two patterns may be more or less pronounced, and, accordingly, the contribution of exports to dependence upon foreign trade will be large or small.

This subject is directly linked with the vested interests created by trade: a greater concern with the maintenance and expansion of trade in certain quarters than in the country as a whole. The actual going volume of trade, indeed, produces its own vested interests,

²¹ We are considering the mobility of resources only so far as it influences the distribution of power created by foreign trade. Of course the mobility of resources has an extremely important *direct* bearing upon political and economic power. This aspect has been pointed out very clearly by Mr. Hawtrey, *op. cit.*, pp. 83-92. For a good discussion of the various factors influencing the mobility of resources within an industrialized country with special reference to the trade cycle, see C. M. Wright, *Economic Adaptation to a Changing World Market*, Chapter V (Copenhagen, 1939).

Adjustment effects arise because of time & effort of moving from one production pattern to another. If trade is abruptly stopped, some production pattern will

just as does the limitation of trade through protection; and the history of commercial policy offers convincing evidence that the protectionists would have been still more successful than they have been if they had had to contend only with the opposition of the "consumers at large."

If conditions are such that the possible loss from a stoppage of trade would fall with special weight upon certain groups within the country, these groups are likely to form a sort of "commercial fifth column." Aside from the purely commercial groups, such as import and export companies, the influence of which is generally meager, the vested interests will consist of the producers for export and of the industries using imported raw materials. If exports are concentrated in some region or some industry, not only will the difficulty of adjustment in the case of loss of these exports weigh upon the decisions of the government, but these regions or industries will exert a powerful influence in favor of a "friendly" attitude toward the state to the imports of which they owe their existence. Creation of potential adjustment difficulties and of vested interests is thus the twofold result of a commercial policy which aims at an intensive specialization of the trading partner's economy and which tries to prevent the diversification of the partner's exports with respect to regions and to products. In the social pattern of each country there exist certain powerful groups the support of which is particularly valuable to a *foreign* country in its power policy; the foreign country will therefore try to establish commercial relations especially with these groups, in order that their voices will be raised in its favor.

THE INFLUENCE EFFECT OF FOREIGN TRADE (SECTION 2)

We must now drop a simplifying assumption under which we have worked hitherto and allow for the possibility of alternative markets or sources of supply. A country menaced with an interruption of trade with a given country has the alternative of diverting its trade to a third country; by so doing it evades more or less completely the damaging consequences of the stoppage of its trade with one particular country. The stoppage or the threat of it would thus lose all its force. In order to prevent this, the country wishing to conserve the influence derived from foreign trade in the real world of many nations must therefore take some precautions. The prin-

continuous but welfare will drop. Over time prod pattern can be adjusted to this or these situation.

Only scattered thoughts on this subject can be found in the subsequent literature. We shall attempt here a systematic exposition of the question of why and how foreign trade might become or might consciously and efficiently be used as an instrument of national power policy. The main contributions in this field have been practical ones, the German trade offensive in southeastern Europe being the outstanding and most recent example. We believe that by a theoretical analysis we may arrive at a fundamental diagnosis and ultimate cure of the ills which under the names of "economic penetration" and "bloodless invasion" have repeatedly afflicted recent history.

*Relation of commerce, military trade & national power
 mercantilists Adam Smith, J.S. Mill & others
 there has not been much systematic analysis of this topic*

Foreign Trade As an Instrument of National Power

IN THIS WORK the term *national power* is used in the sense of power of coercion which one nation may bring to bear upon other nations, the method of coercion being military or "peaceful." In trying to expand its power a nation must take account of many factors—historical, political, military, psychological, and economic. Among the economic determinants of power, foreign trade plays an important part. In order to analyze the way in which foreign trade contributes to a certain distribution of power among the various nations, it must be isolated temporarily from the other determinants; for the purpose of our inquiry these other determinants may be impounded in a vast *ceteris paribus* upon which, for the sake of rendering our analysis more realistic, we shall have to draw from time to time.

It will then be our aim to understand why and how relationships of dependence, of influence, and even of domination can arise out of trade relations. We are not concerned with the opposite line of causation which also exists and which may even have had a greater historical importance: the question of how a given distribution of power influences trade relations. It will, however, be well for the reader to remember that frequently the adoption of certain economic policies leading to greater power for a given nation is possible only if there exists an initial power disequilibrium in favor of that nation.

Colonial trade often gives us the opportunity of observing this type of cumulative effect. An initial power supremacy enables the imperial power to shape the direction and composition of the colony's trade, and the trade relations which are thus established in turn strengthen markedly the original power position held by the imperial power.

imperial power

THE TWO EFFECTS OF FOREIGN TRADE

Foreign trade has two main effects upon the power position of a country. The first effect is certain to be positive: By providing a more plentiful supply of goods or by replacing goods wanted less by goods wanted more (from the power standpoint), foreign trade enhances the potential military force of a country. This we may call the *supply effect* of foreign trade. It not only serves to strengthen the war machine of a country, but it uses the threat of war as a weapon of diplomacy. Although we have seen that free traders have advised statesmen to rely on the supply effect of foreign trade, protectionists have warned them of the dangers of its cessation during war, which, they say, is precisely when it will be most needed. But this danger might be lessened and the supply effect safeguarded:

- 1) by securing control of the oceanic trade routes;
- 2) by a policy of extensive preventive accumulation of stock piles in times of peace;
- 3) by redirecting trade toward those countries from which the danger of being cut off is minimized.

The attempt to trade more with neighboring, friendly, or subject countries is largely inspired by this consideration, and it has been one of the most powerful motive forces behind the policies of regionalism and empire trade.

All these points are obvious and hardly need further elaboration. As far as the supply effect is concerned, foreign trade serves as a means of increasing the efficiency of the military pressure which one country might bring to bear upon other countries. But, just as war or the threat of war can be considered in turn as a means of obtaining a certain result, so the supply effect of foreign trade is an indirect instrument of power, the direct instrument being war or the threat of war. In its final result, therefore, the supply effect of foreign trade requires at least the possibility of war.

The second effect of foreign trade from the power standpoint is that it may become a direct source of power. It has often been hopefully pointed out that commerce, considered as a means of obtaining a share in the wealth of another country, can supersede war.¹ But

¹ This idea, which points to trade as an "economic equivalent to war," appears, for example, in the following characteristic passage from the famous anti-Napoleon tract

commerce can become an alternative to war also—and this leads to a less optimistic outlook—by providing a method of coercion of its own in the relations between sovereign nations. Economic warfare can take the place of bombardments, economic pressure that of saber rattling. It can indeed be shown that even if war could be eliminated, foreign trade would lead to relationships of dependence and influence between nations. Let us call this the *influence effect* of foreign trade, and, because of its importance, give the greater part of this chapter to its analysis.

The terms dependence and influence have hitherto been used indiscriminately to describe the situation which seems invariably to arise out of the trade relations between two sovereign states. But why does such a situation arise at all? In other words, what is the root cause of the political or power aspect of international economic relations? To answer this question we must concede that the explanation of the great power held in the past by Great Britain was the fact that she possessed strategic bases, such as Gibraltar, Suez, and Singapore. The possession of these bases had two consequences: First, it guaranteed the security of British trade; second, as a welcome by-product, it enabled Great Britain to cut off the trade of other countries passing through these points, be it trade with Great Britain or trade between two other countries. This second consequence gave her considerable direct power over, and influence in, other countries, in that they were always exposed to the potential threat of a sudden stoppage of their trade at Britain's will.

But every sovereign nation has some influence of this kind, since through the control of its frontiers and the power over its citizens it can at any time interrupt *its own export and import trade*, which is at the same time the import and export trade of some other countries. The stoppage of this trade obliges the other countries to find

of Benjamin Constant: "War and commerce are but two different means of arriving at the same aim which is to possess what is desired. Trade is nothing but a homage paid to the strength of the possessor by him who aspires to the possession; it is an attempt to obtain by mutual agreement that which one does not hope any longer to obtain by violence. The idea of commerce would never occur to a man who would always be the strongest. It is experience, proving to him that war, i.e., the use of his force against the force of others, is exposed to various resistances and various failures, which makes him have recourse to commerce, that is, to a means more subtle and better fitted to induce the interest of others to consent to what is his own interest."—*De l'Esprit de Conquête et de l'Usurpation dans leurs rapports avec la Civilisation Européenne*, Part I, Chap. II.

alternative markets and sources of supply and, should this prove impossible, it forces upon them economic adjustments and lasting impoverishment. True, the stoppage of trade will also do harm to the economy of the country taking the initiative in bringing about the stoppage, but this is not unlike the harm an aggressive country can do to itself in making war on another. A country trying to make the most out of its strategic position with respect to its own trade will try precisely to create conditions which make the interruption of trade of much graver concern to its trading partners than to itself. Tariff wars and interruptions of trade rarely occur, but the awareness of their possibility is sufficient to test the influence of the stronger country and to shape the policy of the weaker.

That economic pressure upon a country consists mainly of the threat of severance and ultimately of actual interruption of external economic relations with that country was clearly recognized by Article 16 of the Covenant of the League of Nations. The intention of Article 16 was to coördinate and combine the power positions which the various member states of the League had acquired in the aggressor country by entertaining commercial and financial relations with it.

Thus, the power to interrupt commercial or financial relations with any country, considered as an attribute of national sovereignty, is the root cause of the influence or power position which a country acquires in other countries, just as it is the root cause of the "dependence on trade." It should be noted that the only condition for the emergence of these political aspects of trade relations is that of unfettered national sovereignties. It has often been pointed out that central regulation by separate sovereign units leads to a dangerous "politicalization" of trade.³ Undoubtedly the identification of every private interest with national interest and prestige may add a heavy strain on international relations. But state regulation by no means *creates* the political aspects of international economic relations (as the term politicalization seems to imply). It merely emphasizes them or makes them more apparent and exploitable. For the political or power implications of trade to exist and to make them-

³ J. B. Condliffe, *The Reconstruction of World Trade* (New York, 1940), p. 56; Lionel Robbins, *Economic Planning and International Order* (London, 1937), pp. 90 f.; Sir Arthur Salter, "The Future of Economic Nationalism," *Foreign Affairs*, Vol. X (October, 1932), p. 18; Eugene Staley, *World Economy in Transition* (New York, 1939), p. 178.

selves felt, it is not essential that the state should exercise positive action, i.e., organize and direct trade centrally; the negative right of veto on trade with which *every* sovereign state is invested is quite sufficient.⁴ We shall now examine the conditions making this right of veto or the power to interrupt trade an effective weapon in the struggle for power. To bring these conditions about will obviously be the goal of a nation using foreign trade as an instrument of power policy.⁴

THE INFLUENCE EFFECT OF FOREIGN TRADE (SECTION 1)

What we have called the influence effect of foreign trade derives from the fact that the trade conducted between country A, on the one hand, and countries B, C, D, etc., on the other, is worth *something* to B, C, D, etc., and that they would therefore consent to grant A certain advantages—military, political, economic—in order to retain the possibility of trading with A. If A wants to increase its hold on B, C, D, etc., it must create a situation in which these countries would do *anything* in order to retain their foreign trade with A. Such a situation arises when it is extremely difficult and onerous for these countries:

- 1) to dispense entirely with the trade they conduct with A, or
- 2) to replace A as a market and a source of supply with other countries.

The principles of a power policy relying on the influence effect of foreign trade are in their essence extremely simple: *They are all designed to bring about this "ideal" situation.*

⁴ The powers of the state with respect to foreign trade conducted by private enterprise may be compared to the powers of a labor union which, though refraining from collective bargaining, would have the power to call a strike and to determine its length. It will probably be granted that, in this case, most of the effects of combination would still obtain.

⁴ Since the power position of a country will be of importance in its commercial negotiations, the inquiry which follows gives incidentally an analysis of what is commonly called bargaining power. This term, however, for three distinct reasons, is inadequate for our purposes. First, the achieving of tariff and similar concessions is only one of the many uses to which the political power arising from foreign trade might be put; cf., in this connection, Hans Staudinger, "The Future of Totalitarian Barter Trade," *Social Research*, Vol. VII (November, 1940), p. 426. In the second place, bargaining power in commercial negotiations is traditionally associated with a certain position of the trade balance between the two countries in negotiation, a view which will be explained and criticized below (pp. 32 f.). Third, the term bargaining power has a definite meaning in the theory of bilateral monopoly which is markedly different from the meaning which it would assume in our analysis. This difference and its implications are shown on pages 45-46 of this chapter.

Our analysis of these principles is divided into two parts. In the first, it is assumed that the countries which are the objects of the power policy have no possibility of shifting their trade with A to each other or to third countries, whereas country A remains free to trade with whatever country it desires. Given this assumption, which will be dropped in the second part of our analysis, we have to pay attention only to the first characteristic of the "ideal" situation.

The difficulty for country B, C, D, etc., of dispensing with the trade conducted with A seems to depend on three main factors:

- 1) The total net gain to B, C, D, etc., of their trade with A;
- 2) The length and the painfulness of the adjustment process which A may impose upon B, C, D, etc., by interrupting trade;
- 3) The strength of the vested interests which A has created by its trade within the economies of B, C, D, etc.

GAIN FROM TRADE AND DEPENDENCE ON TRADE

The influence which country A acquires in country B by foreign trade depends in the first place upon the total gain which B derives from that trade; the total gain from trade for any country is indeed nothing but another expression for the total impoverishment which would be inflicted upon it by a stoppage of trade. In this sense the classical concept, gain from trade, and the power concept, dependence on trade, now being studied are seen to be merely two aspects of the same phenomenon, and this connection can serve as a modern application of the ancient saying *fortuna est servitus*.

The whole theory of the gain from trade and its distribution therefore becomes relevant to our subject. The gain from trade has been defined by Marshall in the following terms: "The direct gain which a country derives from her foreign trade is the excess of the value to her of the things which she imports over the value to her of the things which she could have made for herself with the capital and labour devoted to producing the things which she exported in exchange for them." This definition brings out clearly that the gain from trade cannot be measured either by comparing the satisfaction derived from the consumption of the imports with the satisfaction which could be derived from the consumption at home of the exports or by comparing the hypothetical domestic cost of the imported com-

* Alfred Marshall, *Money, Credit and Commerce* (London, 1923), pp. 109-110.

modities with their actual cost.⁶ If a country was shut off from trade it would normally neither continue to produce the goods formerly exported nor try to produce at home all the goods formerly imported, but, given the reduced resources, an adjustment would take place toward the production of the goods most desired.

Professor Viner has elaborated an even more complex concept of the gain from trade. He has shown that differences in satisfaction between the trade and the no-trade situation might occur not only through a different composition of the goods to be consumed in the two situations, but also because of differences in the occupational pattern or in the general balance between work and leisure in the country concerned.⁷

Provided we keep in mind the qualification arising from these considerations, Marshall's definition still gives a good account of the value of trade to a country or, in other words, of that part of a country's well-being which it is in the power of its trading partners to take away.

The first conclusion which could be drawn from the connection which we have established between gain from trade and dependence on trade is that in order to increase its influence in other nations, nation A should simply bring about an expansion of its foreign trade. In accordance with a general presumption established by theory, a voluntary increase of trade on the part of A's trading partners is indeed indicative of an increase of their gains from trade and, hence, of their dependence on A. But this reasoning overlooks the fact that in this way the influence which the other nations hold in country A would also be increased. Some countries might be able to neglect this consideration because of their geographical position, their military power, or other noneconomic elements. But, in general, a country embarking on a power policy will have fixed for the amount of its trade relations with foreign countries a certain maximum limit which it will think unsafe to exceed.⁸

⁶ The latter error was attributed by Malthus to Ricardo. Cf. Jacob Viner, *Studies in the Theory of International Trade* (New York, 1937), p. 528.

⁷ Viner, *op. cit.*, pp. 519 ff.

⁸ It remains true that complete autarky can hardly be considered as an element of an intelligent power policy. And if the nations which have proclaimed autarky as their ultimate goal have remained far off the mark, this may be due not only to the economic difficulties which they have experienced in trying to dispense with foreign trade, but also because they have found it politically inexpedient to do without trade relations.

If we take account of this objection, another method might be proposed: country A, seeking to increase its influence in country B, might have an interest in altering the terms of trade in B's favor. Here, then, it would seem, we have an ideal instance of the opposition between a policy trying to maximize national income and a policy setting out to maximize national power.

This statement, however, needs qualification and elaboration. In the first place, the functional relationship between gain from trade and dependence on trade points to a potential clash, not only between national income or welfare and power, but also between the two different types of power policy, the one relying mostly on the supply effect of foreign trade and the other relying upon the influence effect. It is indeed clear that a policy using foreign trade as its instrument may sometimes have to choose between better terms of trade, i.e., more plentiful supply of needed materials for a given quantity of home products, on the one hand, and more influence on the trading partner, on the other.

But is there an inevitable conflict between national welfare and national power, or, within a power policy, between the supply effect and the influence effect of foreign trade? This is a necessary conclusion only if we accept the common conception that a given amount of trade results in a fixed total gain to be distributed between the trading countries according to some ratio determined by the terms of trade. An increase of the gain of A can then only be procured at the cost of a decrease of the gain of B. This view, however, should be suspect if only because of its resemblance to the cruder Mercantilist idea that A's gain is B's loss.

Actually we have here to clear up a terminological confusion which is at the root of the whole matter. What is commonly called total gain from trade is by no means, as one might expect, the sum of the gains from trade as defined by Marshall for the individual participating countries. The term total gain, as used generally, is rather to be understood as the physical surplus of goods made possible by the international division of labor. This physical surplus is indeed fixed under given cost and demand conditions. It might be called the total objective gain from trade. But a moment's reflection should show that although this objective gain might be wholly nonexistent (as in the absence of any international specialization

following the opening up of trade), a substantial *subjective* gain as defined by Marshall might still accrue to the various countries, provided only that they do not produce the same range of commodities.*

If, therefore, an objective gain from trade in the form of a physical surplus of goods is not even a necessary condition for the emergence of a subjective gain from trade, the existence of a close relationship between the distribution of the objective and the subjective gains as between the countries trading together may be legitimately doubted. The theory of the terms of trade has succeeded in showing how the objective gain is distributed and how its distribution can be affected by changes in tastes and techniques or by commercial policies. It has generally been thought that the terms of trade give a broad indication of the gain from trade; and in spite of its many limitations pointed out by Professor Viner,¹⁰ this method of approach still seems fruitful if one is interested mainly in knowing when a country increases or decreases the gain from its trade with another specified country, as this can under static conditions—i.e., with tastes and techniques constant—occur only through a movement of the terms of trade in its favor. But the method fails us decisively if we are interested, not in the increments of the subjective gain from trade, but in its total amount for any given situation. It is indeed not possible to assert that the respective extents of the subjective gains from trade correspond to the division of the objective gain without assuming for the two countries a similarity of tastes and of the levels of satisfaction prior to trade—in other words, without assuming the whole problem away. In the absence of such assumptions there is no reason whatsoever why a country should not obtain a smaller part of the physical surplus of goods obtained by international specialization whilst deriving a larger increase in satisfaction from trade than its trading partner.¹¹

* Even under the very simplest classical assumptions of two commodities of similar importance, two countries of similar size, constant costs, absence of transport costs, and similar tastes in the two countries, it can be shown that further specialization after the opening up of trade, as required by the principle of comparative cost, is not a prerequisite for the existence of some subjective increase in satisfaction from trade. Cf. diagrammatical exposition of this case on pages 49–52 of this chapter.

¹⁰ Viner, *op. cit.*, pp. 555–582.

¹¹ The belief that the position of the terms of trade gives a clue to the respective extent of the subjective gains from trade has been much strengthened by the often-quoted case of two countries of unequal size trading in two commodities. In this hypothesis the larger country specializes only partly, its pre-trade ratio of exchange

The inquiry into the factors which determine the amount of the subjective gain from trade has to be made directly. It has been undertaken with the help of diagrammatical illustrations by the neoclassical writers, Edgeworth¹² and, in particular, Marshall.¹³ Marshall's conclusion, which is unaffected by two errors in his method,¹⁴ is that "the surplus (of country G) is the greater, the more urgent is G's demand for a small amount of E's goods and the more of them she can receive without any great movement of the rate of interchange in her favor." In other words, with a given volume of trade the subjective gain is smallest if the supply-demand schedule of a country maintains a high elasticity throughout its relevant part; whereas the gain would be largest if a country's demand, after having been very elastic for small amounts of the other country's goods, becomes inelastic in its later (and relevant) stages.¹⁵

between the two commodities remains unchanged and the whole physical surplus of production due to specialization accrues to the smaller country whilst the supply in goods of the larger country remains unchanged. But so far from being an illustration of the general correspondence between the position of the terms of trade and the extent of the subjective gains, this is actually the only case in which the correspondence holds—a quite paradoxical case—as trade leads neither to an increase in quantity nor to a change in composition of the goods consumed in one of the trading countries.

¹² F. Y. Edgeworth, "On the Application of Mathematics to Political Economy," *Journal of the Royal Statistical Society*, Vol. LII (1889), pp. 558-560. Edgeworth reproduces in the main the "beautiful reasoning" of Auspitz and Lieben, *Untersuchungen über die Theorie der Preise* (Leipzig, 1889), pp. 413-415. In a later work, "The Theory of International Values," *Economic Journal*, Vol. IV (1894), Edgeworth deals essentially with the increments in the gain from trade, not with the total amount; cf. Viner, *op. cit.*, p. 576 and footnote 3.

¹³ Marshall, *op. cit.*, Appendix J, pp. 338-340.

¹⁴ As pointed out with respect to the algebraic illustration by Allyn A. Young, "Marshall on Consumer's Surplus in International Trade," *Quarterly Journal of Economics*, Vol. XXXIX (1924), pp. 144-150, and with respect to the diagrammatical exposition by Viner, *op. cit.*, pp. 570-575. Viner also shows that the more general objection of Allyn A. Young against the whole concept of Marshall's "surplus" in international trade (which is nothing but another expression for the subjective gain from trade) does not hold.

¹⁵ In this context elasticity means the response of the imported quantity to a change in the terms of trade. Although it is not identical with the ordinary concept of demand elasticity, it is related to it. Cf. T. O. Yntema, *A Mathematical Reformulation of the General Theory of International Trade* (Chicago, 1932), pp. 52-56. Professor Kindleberger has shown the inconsistent use made by various economists of the term urgent demand and has proposed the terms flexible and inflexible demand instead of not urgent and urgent demand; cf. C. P. Kindleberger, "Flexibility of Demand in International Trade Theory," *Quarterly Journal of Economics*, Vol. LI (February, 1937), pp. 352-361. He, however, as our quotation shows, is incorrect in contending that Marshall did not use the term urgent demand; paying attention only to the ordinary Marshallian price elasticity. Professor Kindleberger does not realize that Marshall's elasticity concepts, as developed in connection with his foreign trade curves, can take care of the various situ-

This statement may seem surprising, as a country which finds itself in the latter situation is generally said to be in an inferior strategic position and to be exposed to a manipulation of the terms of trade against it. Actually, however, this is only another aspect of the same situation: A country which gains much from the exchange of its home produce against imports may be maneuvered more easily into concessions according to the rate of interchange than a country for which trade is only barely profitable under existing conditions.

We have mentioned above the possibility that a country, though obtaining a smaller objective gain from trade, may still enjoy a greater subjective gain; it is now seen that this situation is not necessarily an oddity, but may, on the contrary, be considered as probably true.¹⁶

These theoretical considerations are directly relevant to the two-fold object of a power policy by foreign trade which we have described. Country A may possibly increase the gain from trade and therefore the dependence of its trading partners either by a change

ations which arise in international trade and are denoted by the terms urgent or inflexible. It remains true that these special terms are useful in shortening the description of the shape of a Marshallian demand-supply curve which is at first extremely responsive to favorable changes in the terms of trade and becomes inelastic for further changes in these terms. The conflicting interpretations of the term urgent demand derive from the fact that the various writers have considered different stretches of the same supply-demand curve. Professor Kindleberger rightly shows the connection between the concept of urgency of demand and that of income elasticity. The two, however, are not identical, since income elasticity means responsiveness of the demand of a commodity to income increases, whereas the elasticity of the Marshallian curve means responsiveness of demand of a commodity to a favorable change of its rate of exchange for another commodity.

¹⁶ It seems that J. S. Mill had this situation in mind when he wrote in his *Essays on Some Unsettled Questions*: "If the question be now asked, which of the countries of the world gains most by foreign commerce, the following will be the answer. If by gain be meant advantage, in the most enlarged sense, that country will generally gain the most, which stands most in need of foreign commodities. But if by gain be meant saving of labor and capital in obtaining the commodities which the country desires to have, whatever they may be; the country will gain, not in proportion to its own need of foreign articles, but to the need which foreigners have of the articles which itself produces."—J. S. Mill, *op. cit.*, p. 44; cf. also p. 46. Mill has not reproduced this passage in the *Principles* where he has elaborated only the second concept of gain; indeed, the first one hardly fits in with his value theory. Jevons obviously ignored Mill's earlier writings when, as exposed in the *Principles*, he attacked the concept of gain in the following terms: "So far as Mill's statement (about the distribution of the gain from trade) from being fundamentally correct that I believe the truth lies in the opposite direction. As a general rule, the greatness of the price which a country is willing and able to pay for the production of other countries measures or at least manifests, the greatness of the benefit which it derives from such imports."—Stanley Jevons, *The Theory of Political Economy*, 4th ed. (London, 1911), p. 145.

in the composition of trade or by a change in partners without having to submit to more unfavorable terms of trade. To resolve in this way the conflict between the supply effect and the influence effect of foreign trade which at first seemed inevitable, A has to seek trading partners with an "urgent" demand for its export goods.

In the first place, A will therefore turn to countries which have no possibilities of themselves producing the commodities country A exports. A second and more general case, which has been pointed out by Marshall, is the trade with "poor countries," that is, countries with low real incomes before the opening up of trade. Marshall has applied to this case the "law of the diminishing marginal utility of income" in the following terms: "The rich country can with little effort supply a poor country with implements for agriculture or the chase which doubled the effectiveness of her labor, and which she could not make for herself; while the rich country could without great trouble make for herself most of the things which she purchased from the poor nation or at all events could get fairly good substitutes for them. A stoppage of the trade would therefore generally cause much more real loss to the poor than to the rich nation."¹⁷

A nation pursuing a power policy may be assumed to export industrial goods and to import mainly those articles for which it has either no substitutes at home or only poor and expensive ones. It must be prepared to incur a certain dependence on foreign countries in order to obtain these articles—or, in our terminology, in order to profit from the supply effect of foreign trade. Its problem is there-

¹⁷ Marshall, *op. cit.*, p. 168. It will be noted that, for Marshall, the case of a rich country trading with a poor country and the case of a country having a monopoly in some article trading with another country having no such monopoly are somewhat intertwined. A conclusion similar to that of Marshall follows from Edgeworth's comment on his own assumption in the analysis of foreign trade that "the hedonic worth of money is the same in both countries"; he conceded indeed that "when we know that one party is much better off than another, the assumption may be illegitimate."—"The Theory of International Values," *Economic Journal*, Vol. IV (1894), p. 436. That the comparison of utilities between two collective groups, such as countries, is less rather than more hazardous than intrapersonal comparisons of utility has been shown by a recent contribution (L. G. Melville, "Economic Welfare," *Economic Journal*, Vol. XLIX [September, 1939], pp. 552-553). The possible exceptions to the case which have been pointed out by Marshall are not likely to arise from the difference in the "capacity for enjoyment" of the citizens of the two countries, but rather from the difference in the effect of foreign trade upon the distribution of income in the two countries. If, indeed, the goods imported into the relatively poor country add mainly to the enjoyment of its wealthier classes, whereas the contrary happens in the relatively rich country, the effect described by Marshall may well be neutralized.—I am indebted to Dr. Fellner for this point.

fore how to induce a maximum dependence of foreign countries, given a fixed dependence of its own. In solving this problem it can avail itself of our findings by determining what to export and by choosing the countries from which to import.¹⁸ It can see to it, first, that it possesses a monopolistic position in its export articles by directing trade to those countries which are relatively poorly suited to produce these or similar articles. In our case this means the agricultural countries; and the prevention of industrialization or even the removal of already existing industries is an important part of a policy of trying to preserve or to increase the influence acquired in these countries by an industrial nation.

In the second place, the nation conducting a power policy has an interest in diverting its trade to poor countries in which the marginal utility of income is high. Thus, if nation A, embarking on a power policy, has had a certain amount of trade with group B of other rich industrial nations, it might of course try to enlarge its influence in these countries by granting them better terms of trade. But this would interfere with its own production and, in addition, these countries might not value very highly the additional supplies coming from A. If, on the other hand, the nation diverts its trade to group C of poor and agricultural countries from which it can receive the same supplies, the gain from trade obtained by group C will exceed what group B's gain had been, and consequently A's influence in group C will be much greater than it was in group B. Although the real costs of the supplies may be higher in group C than in group B, A will then have little difficulty in manipulating the terms of trade in such a way that she gives no more of her home produce in exchange for her imports than formerly.

Renewed attention has been given recently to the analysis of ex-

¹⁸ We assume here, as stated in the beginning of this section (p. 17), that only the country conducting a power policy is at liberty to choose its trading partners, whereas the latter have no option but to trade with that country. This assumption will be dropped below. Here we also disregard the fact that the power-seeking nation may prefer to obtain a small influence in a neighboring state rather than a large one in a distant country. In a sense, our analysis considers every country as an equally interesting object of a power policy. Total influence is for us the sum of the influences secured in the individual countries, whereas actually every influence should be weighted according to strategic or other considerations. But this means only that the role played by the economic determinants of power must eventually be combined with and be qualified by the other determinants. The reader must judge whether the results reached by our analysis warrant the admittedly artificial isolation of the economic factor.

ploitation, both with respect to the factor of production in the domestic economy and to that of one country by another in international economic relations. For the latter subject it has been shown what conditions and what policies are required for a country to turn the terms of trade in its favor. At the outset this type of inquiry seems to be the exact opposite of our analysis of the influence effect, which depends on the gain from trade of the trading partners. The possibility of a conflict between the policy of maximization of national income, on the one hand, and the policy of securing the greatest position of influence with the trading partners, on the other, certainly deserves to be pointed out. But our subsequent analysis has shown that these two types of policies are not necessarily alternatives. The successful pursuit of the one policy may even condition the emergence of the other. The ability to manipulate the terms of trade in one's favor depends, indeed, on the gain from trade derived by the trading partners, and the policies we have described are directed precisely to increase this gain. The monopolistic exploitation of a trading partner can then be considered as one of the uses to which the power secured through the influence effect may be put. We are here concerned only with the methods and conditions leading to this power, not with its possible uses which may be the reaping of advantages of any kind—military and political, as well as economic.

ADJUSTMENT DIFFICULTIES AND VESTED INTERESTS

The threat of an interruption of trade—the ever-present characteristic of commerce between sovereign states—has two main effects upon the economy of the country the trade of which is interrupted: It impoverishes this country and also imposes a process of adjustment, since, when imports are no longer forthcoming, the goods formerly exported will no longer be consumed in the home market. Marshall's definition of the gain from trade: the excess of utility of the imports over the utility of the goods produced by the resources otherwise devoted to exports if there were no imports—compares the utilities of two nonsimultaneous sets of goods and thus obviously includes a time element. The immediate loss from the stoppage of trade is much greater than the ultimate loss after resources have been fully reallocated. The classical theory of international trade

was aware of this distinction;¹⁹ but it concentrated upon the ultimate loss and considered the time elapsing from interruption of trade to reallocation of resources within the country as a short-run period. Modern theory insists that this is not necessarily true; and even if it were true, our analysis would have to take into account the fact that harassed statesmen generally have a short-run view. Given a certain ultimate loss, the influence which one country exercises upon another through foreign trade is therefore likely to be larger the greater the immediate loss which it can inflict by a stoppage of trade.

For a country cut off from foreign trade the most urgent problem is to produce at home or to find substitutes for goods which were formerly imported and to find new employment for the factors of production formerly employed in export industries. The first problem is definitely connected with the ultimate loss from the interruption of trade, whereas the second is a short-run problem. Nevertheless, the "danger of losing a market" if political conditions deteriorate makes for as much concern as the danger of losing supplies. According to classical theory the active side of the gain from trade derives only from the imports, and the exports are set as a passive item against them. Modern theory, on the other hand, has presented an analysis which, within the framework of a national policy aiming at full employment, considers exports as an incentive to employment and national income, and imports as "leakages" which to a certain degree prevent the working of this incentive.²⁰ The classical and the modern approaches are of course based on quite different assumptions, and each is valuable in its own field for the explanation of some relevant economic facts. The modern approach, with its emphasis on immobility, overhead costs, and incomplete use of resources, leads to an understanding of why the common belief that the real benefit arising from trade lies in exports rather than imports is more than a mere "popular fallacy."

Obviously, the difficulties arising out of a cessation of exports will be greater the greater the exports (and consequently the imports); and the short-run problem is thus intimately connected with the extent of the long-run gain from trade. But with a given quantity

¹⁹ Ricardo, in his *Principles of Political Economy*, states it thus at the beginning of the chapter on "Sudden Changes in the Channels of Trade."

²⁰ For a discussion of the "Foreign Trade Multiplier," see Gottfried Haberler, *Prosperity and Depression*, 3d ed. (Geneva, 1942), pp. 461-473, and literature quoted in that work.

ciples which we have formulated for power policy through the instrumentality of foreign trade retain their full validity. They were aimed at rendering it difficult for the other countries to *dispense* with foreign trade; but if we wish these principles to be effective in the real world, they must be supplemented by measures which make it difficult for other countries to *shift* the trade conducted with them by the nation trying to increase its power by foreign trade.

Any switching of trade would, of course, be rendered impossible by a monopoly of trade imposed by one nation upon another. In the old colonial system a colony was not permitted to turn to other buyers or sellers, even though the mother country had no obligation at all to provide the colony with goods or to buy from it. Under modern conditions subtler methods must be devised in order to arrive at similar results. A country may still hope to create conditions in which the diversion of trade to a third country will be much more difficult for its partner than for itself.²¹

In a very general way the difficulty of substituting country A as a market or supply source for country B may be said to depend not only on the absolute amount of A's trade with B, but also on the importance of this trade relatively to B's total trade. If, for instance, a country loses 5 per cent of its export trade, it should be able to find additional outlets in the markets which account normally for 95 per cent of its exports and where a sales organization for its products is likely to exist already. Similarly, if the country loses a relatively small fraction of its import trade, it is probable not only that its economic activity is not based to an undue degree upon these supplies, but also that other countries will be able and eager to make up for them. The greater the percentage of exports and imports involved in a dominant market, the more difficult it will be to provide substitute markets and sources of supply.

If a nation with an absolutely large volume of trade imports from, or exports to, a small trading nation, the trade they conduct together will inevitably result in a much higher percentage for the small than for the large trading nation. German-Bulgarian trade in 1938, for example, represented 52 and 59 per cent of Bulgarian imports and exports, respectively, but only 1.5 and 1.1 per cent of

²¹ How important this problem is even in simple commercial bargaining is repeatedly brought out by N. F. Hall, "Trade Diversion—An Australian Interlude," *Economica*, Vol. V, new series (February, 1938).

the German imports and exports. These figures indicate that although the same absolute amount is involved, it will be much more difficult for Bulgaria to shift her trade with Germany to other countries than it will be for Germany to replace Bulgaria as a selling market and a source of supplies.²² In the real world of many sovereign states it will therefore be an elementary principle of the power policy of a state to *direct its trade away from the large to the smaller trading states*. This principle must then be added to the one established above, viz., that trade should be directed toward the poorer countries. The two are by no means contradictory, as there are many states which are both poor and small.

Similarly, it will be an elementary defensive principle of the smaller trading countries not to have too large a share of their trade with any single great trading country, so that the integration of their economies with those of the great countries (for which no reciprocal integration is forthcoming) may be kept at a minimum compatible with their economic well-being. The idea that dependence can be diminished by distributing the trade among many countries has been clearly enunciated by Macaulay. These two principles, the one offensive for the large countries, the other defensive for the small countries, gave rise to the first two inquiries of our statistical section.

A more specific policy by which a country could try to prevent its trading partners from diverting their trade to other countries would consist in the creation of monopolistic or monopsonistic conditions with regard to certain products.²³

With respect to exports, country A may try to change the structure of country B's economy so as to make it highly and artificially complementary to A's own economy. First, A may encourage the production of products having but little demand in other countries. This amounts to the creation of what might be called "exclusive complementarity" between the economy of country B and country A.

Furthermore, country B may have a comparative advantage in the production of a certain commodity with respect to country A, but not with respect to countries C, D, E, etc. If by some preferential

²² Not only is it more difficult for Bulgaria than for Germany to shift trade, but it is also harder for Bulgaria to *dispense* entirely with the trade conducted with Germany, because this trade is much more "essential" to her. This is, however, not a consequence of her comparative smallness, but of factors pointed out in section 1 of this chapter.

²³ Cf. H. K. Heuser, *The Control of International Trade* (London, 1939), pp. 250-251.

① *Not power is enhanced by trading of smaller countries that have large share of their trade w/ large countries*

treatment, A induced B to produce this commodity for export, A becomes B's only market, and the dependence of B upon A thus created may be well worth to A the economic cost involved in not buying in the cheapest market. In general, any attempt to drive the prices of exports from trading partners above world prices, whether by the direct encouragement of production contrary to the comparative cost principle or by general monetary manipulations, will fit in with the policy of increasing their dependence.

The paying of a higher price is only the most obvious way of rendering more arduous the diversion of a trading partner's exports to third markets. The offer of some special advantage relating to the conditions of the contract other than the price works toward the same effect. Firms often reward loyalty on the part of their customers by rebates and other devices.²⁵ The economies of regularity and the considerations of risk which explain this practice play an even greater role in foreign trade; with prices uniform, exports will therefore be directed preferably to those countries which are able and willing to guarantee stable prices for a prolonged period.

With respect to imports, the substitution of the imported products from any country will be more difficult in the absence of a natural monopoly the more highly differentiated are the products. Such products tend to create fixed consumption habits and production techniques, and difficulties arise when these products have to be replaced by similar but not identical products from other countries. Hence, it is generally easier for an industrial country to change the source of its supply of foodstuffs and raw materials than it is for a country producing foodstuffs or raw materials to change its traditional supplier of industrial goods.²⁶

Under conditions of incomplete use of resources, however, it will generally be much easier to switch imports than exports, all countries being ready to sell and none ready to buy. This fact has indeed tended to dominate the whole discussion of the determinants of bargaining power between two trading countries. It was held that superior bargaining power is *always* on the side of the country having a passive trade balance with its trading partner. In other words,

²⁵ Cf. W. A. Lewis, "Notes on the Economics of Loyalty," *Economica*, Vol. IX, new series (November, 1942), pp. 333-348.

²⁶ Cf. R. F. Harrod's distinction of A, B, and C goods in his *International Economics*, new ed. (London, 1939), pp. 60 ff.

- ③ Trade w/ poor countr ^{which have great need for your exports} that have adjust diffc
 ④ Force art of complementarity of B's output
 on B's market.
 ⑤ Bilateral trade can turn B's dependence
 on A into unilateral dependence

the difficulty of shifting imports was entirely discounted, whereas in assessing the difficulty of shifting exports no account was taken of the various factors enumerated above. It was thought that the country having the greater absolute volume of exports would automatically experience the greater difficulties of diversion and thereby find itself in an inferior bargaining position.²⁷ This is, of course, far too great a simplification; but the fact remains that an intelligent power policy must take account of the greater difficulty which is generally experienced in diverting exports.

Let us suppose then that country A buys a percentage of B's exports sufficiently large to render a substitution of these exports well-nigh impossible for B. Is there any means of extending this impossibility to the switching of B's imports as well? We see immediately that the policy of bilateralism is perfectly fitted to take care of this problem. Indeed, under conditions of bilateralism, a real impossibility of switching exports induces a *technical* impossibility of switching imports. In this way the device of bilateralism is seen to be an important link in the policies by which the aim of maximum power through foreign trade may be attained.

In all our analysis we have spoken exclusively of direct import and export trade. *Transit trade* plays a special and somewhat contradictory role when we try to answer the question: Should a country, from the point of view of power policy, aim at a large transit trade? On the one hand it would seem that transit trade can always be replaced by direct trade and that therefore the country handling the transit trade is in a rather weak position. But if the replacement of the transit trade is impracticable for geographical, technical, or contractual reasons, transit trade is immediately seen to be an ideal means of increasing power by trade. Indeed, the economy of the country handling this trade is only superficially affected by the trade; whereas it acquires the influence normally deriving from exports and imports both in the country of origin and the country of final destination of the transit commodities. In other words, pro-

²⁷ Relatively early the German economist Dietzel attacked this view: "In respect to the question of the strength of the (bargaining) position, it does not matter so much which one of the two nations waging a tariff war buys more from the other; it matters more which of the two nations can better do without the market of the other, and is able in the case of loss of this market, to sell nearly as much elsewhere."—Karl Dietzel, *Der deutsch-amerikanische Handelsvertrag und das Phantom der amerikanischen Industriekonkurrenz* (Berlin, 1905), p. 20.

on x from B

vided only that its services are indispensable, the country handling the transit trade acquires from that trade a twofold influence and at the same time evades almost entirely any dependence of its own economy.

AN ILLUSTRATION: GERMAN TRADING METHODS UNDER NATIONAL SOCIALISM

The conditions or policies which have been described as being conducive to increased national power by means of foreign trade can be summarized by the following synoptical table:

Principles of a Power Policy Using Foreign Trade as Its Instrument

I. Policies relying on the *supply effect* of foreign trade and trying to insure its working even in times of war.

- A. Concentrate imports on goods needed for the war machine.
- B. Accumulate large stocks of strategic materials.
- C. Redirect trade to neighboring politically friendly or subject nations.
- D. Secure control of the oceanic trade routes.

II. Policies relying on the *influence effect* of foreign trade.

A. Policies designed to make it more difficult for the trading partner to *dispense entirely* with the trade.

1. Increase the trading partners' gain from trade (without impairing the supply effect).
 - a. Develop exports in articles enjoying a monopolistic position in other countries and direct trade to such countries.
 - b. Direct trade toward poorer countries.
2. Increase the trading partners' adjustment difficulties in case of stoppage of trade.
 - a. Trade with countries with little mobility of resources.
 - b. Induce a wide discrepancy between the pattern of production for exports and the pattern of production for home consumption.
3. Create vested interests and tie the interests of existing powerful groups to the trade.

B. Policies designed to make it difficult for the trading partners to *shift* trade to each other or to third countries.

1. In general: Direct trade toward the small trading countries.

2. With respect to the exports of the trading partners:
 - a. Import products for which there is little demand in other countries.
 - b. Drive prices of the export products of the trading partners above world prices:
 - i. By fostering high-cost production.
 - ii. By monetary manipulations.
 - c. Grant to the trading partners' exports advantages not relating to the price of their products.
3. With respect to the imports of the trading partners:
 - a. Export highly differentiated goods creating consumption and production habits.
 - b. Develop trade on a bilateral basis.
4. Develop transit trade.

Practically all the outstanding features of German foreign economic policy since 1933 can be subsumed under this scheme. This does not mean, as will be explained below, that Germany has consciously worked out such a master plan. Keeping this in mind from the outset, we shall show very briefly the correspondence in each point between German policies and the general principles of a power policy through foreign trade which we have established. We shall list the German policies in the order indicated by the synoptical table and refer back to it each time by its own symbols. In our account of German policies, we rely on numerous studies of German trading methods to which the reader may turn for full information.²

² Antonin Basch, *The New Economic Warfare*, Chapter I (New York, 1941); H. M. Bratter, "Foreign Exchange Control in Latin America," *Foreign Policy Reports* (February 15, 1939); J. B. Condliffe, *The Reconstruction of World Trade* (New York, 1940), pp. 256-262, 291-294, 323-324; "Germany's Trade Offensive," *The Economist* (London, November 5, 1938); Paul Einzig, *Bloodless Invasion* (London, 1938); Howard S. Ellis, *Exchange Control in Central Europe* (Cambridge, Mass., 1941); A. G. B. Fisher, "The German Trade Drive in South-Eastern Europe," *International Affairs*, Vol. XVIII (March-April, 1939); Margaret S. Gordon, *Barriers to World Trade*, Part IV (New York, 1941); H. C. Hillmann, "Analysis of Germany's Foreign Trade and the War," *Economica*, new series, Vol. VII (February, 1940); *Europe's Trade* (League of Nations, Geneva, 1941); Fritz Meyer, "Devisenbewirtschaftung als neue Währungsform," *Weltwirtschaftliches Archiv*, Vol. XLIX (May, 1939); von Mickwitz, "The Economic Structure of Capital Exports to South-Eastern Europe," Mimeographed for the International Studies Conference (Bergen, 1939); Douglas Miller, "You Can't Do Business With Hitler" (New York, 1941); Mark Mitnitzky, "Germany's Trade Monopoly in Eastern Europe," *Social Research*, Vol. VI (February, 1939); *South-Eastern Europe* (Royal Institute of International Affairs, London, 1939); *South-Eastern Europe* (Royal Institute of International Affairs, London, December, 1940). (this is a separate and distinct work from the previous same-named publication); Hans Staudinger, "The Future of Totalitarian Barter Trade," *Social Research*, Vol. VII (November, 1940).

Summary of
mechanisms to
enhance power
from
trade

Little need be said concerning the policies relating to the supply effect of foreign trade. Germany considered her exports a means of obtaining in exchange certain imports deemed essential for her purposes (I A.); she accumulated large stocks of strategic materials (I B.); and she directed her trade toward countries from which she hoped not to be cut off in the case of war (I C.). The two latter policies, coupled with the autarkic program, were considered as a substitute for the control of the oceanic trade routes (I D.) which Germany could not hope to achieve.

Let us now turn to the influence effect. Germany's attempt to concentrate on exports of finished products, on the one hand, and on exports to agricultural countries, on the other, had obviously the result of giving her exports a quasi-monopolistic position so far as the productive system of her trading partners was concerned (II A.1.a.). In addition, to maintain this position, it was one of the great principles of German foreign economic policy to prevent the industrialization of her agricultural trading partners. Particular insistence on this point has been noted in all the commercial negotiations of Germany with her southeastern neighbors and even, to some degree and some success, with Italy.

The policy of trading with agricultural countries and, furthermore, of preventing the establishment of industries in these countries is indeed prompted, not only by the consideration just mentioned, but also by the fact that agricultural countries have generally but little mobility of resources (II A.2.a.), and that manufactured products, being highly differentiated, are often difficult to replace immediately by similar products from other countries (II B.3.a.). Here we have an example of the above-mentioned cumulative effect of power. Germany could never have hampered or prevented the industrialization of the Danubian countries if she had not had an initial political and economic ascendancy over them, and the prevention of industrialization in turn served to enhance or to maintain Germany's initial power position.

The modification of the structure of German trade can also be interpreted as a shift of trade from the relatively rich to the relatively poor countries (II A.1.b.). In order to give a statistical illustration, we have computed the shares in German trade for the eleven countries which, according to the thesis expounded by Colin Clark,

are "richer" than Germany in the sense that real income per head of the employed population is higher.*

Looking at the percentages of the single countries, one notices that, with the exception of Eire, Denmark, and Sweden, an all-round decrease from 1929 to 1938 is evident. For Denmark and Sweden the incentive of regionalism may have outweighed other considerations. The trade with Eire is relatively insignificant.

The policy of trading with countries having but little mobility of resources (II A.2.a.) has already been commented upon. Germany has also induced the southeastern countries to use still more resources in the production of certain crops (oil seeds, fiber plants)

SHARES HELD BY ELEVEN COUNTRIES "RICHER" THAN GERMANY
IN TOTAL GERMAN IMPORT AND EXPORT TRADE*

Year	Imports per cent	Exports per cent
1929	41.9	49.0
1932	39.1	48.9
1937	29.9	38.6
1938	31.3	37.1

* In 1938 Austria is excluded from the foreign trade statistics. In order to make the figures for the other years comparable to those of 1938, Austria has been excluded throughout, i.e., the figures are percentages of the total German trade minus Austrian trade. The figures have been computed from German sources (*Statistisches Jahrbuch für das Deutsche Reich and Wirtschaft und Statistik*).

and mineral resources which would practically be exported in their entirety (II A.2.b.). By offering a stable market for the agricultural surplus production of these countries, she tied landowners and peasants, the most powerful social groups in these countries, to her own interests (II A.3.).

Coming to the policies rendering a diversion of trade more difficult for the trading partners, we shall show in Chapter V how Germany concentrated her trade on the relatively small trading countries (II B.1.). The fostering of special products such as oil seeds and fiber plants is also an example of the creation of exports for which there would be little demand in other countries (II B.2.a.). Germany's encouragement of cultivation of cotton in Brazil, Tur-

* Colin Clark, *The Conditions of Economic Progress* (London, 1940), p. 41. The eleven countries are, in the order indicated by the author: United States, Canada, New Zealand, Great Britain, Switzerland, Australia, Holland, Eire, France, Denmark, Sweden. The margin of error of such calculations is admittedly very wide, but, over a short range of years, a computation such as we give on this page may serve our purposes.

Summary of German trade

key, and Greece, and her exploitation of low-grade mineral resources in Rumania and Yugoslavia can be shown to be contrary to the comparative cost principle (II B.2.b.i.). In general, Germany supported the agricultural economies of southeastern Europe without insisting upon the adjustments necessary to render them competitive on a world level. This had the effect of adding to basic cost disequilibria a monetary disequilibrium which drove the price system of these countries upward by the device of overvaluation of the reichsmark (II B.2.b.ii.). In this connection it must also be recalled that Germany has not only paid prices higher than those which could be had in the world market, but that trade with Germany offered to the southeastern countries another substantial advantage over trade with other countries: Germany had promised to these countries conditions of stability in both price and volume of their exports (II B.2.c.).⁸⁰

With respect to imports which create consumption and production habits (II B.3.a.), we have already mentioned the general advantage of industrial countries in comparison with agricultural countries. The export of armaments to the Balkan countries, extensively practiced by Germany, is an item very much to the point, since a retraining of personnel is a necessary accompaniment of any improved style or variety of arms. In addition, once the main weapons had been accepted from Germany, the importing countries had to rely on her for ammunition and spare and repair parts. Bilateralism (II B.3.b.) has not only been the most evident new principle introduced by Germany into trade relations, but it has also had exactly the same function which we have attributed to it in our exposition: forcing the countries selling a substantial share of their exports to Germany to grant Germany a similarly dominating position in their imports. Finally, Germany has made the most sustained efforts to increase the amount of transit trade which she traditionally handled as a result of her geographical position (II B.4.). She tried to sell to the world the Balkan products, and to the Balkans she attempted to sell such "colonial" products as coffee, cocoa, etc.

⁸⁰ There is nothing paradoxical about the fact that the power of the state to interrupt trade may be made into a more effective weapon by granting to its trading partners certain advantages, e.g., of security—for a time. The security, indeed, is revokable; and the power of the state granting security in trade relations is precisely born of the desire of its trading partners to prevent the loss of this security. Here again *fortuna est servitus*.

The correspondence between German policies and the principles of a power policy carried on through foreign trade, which we have deduced from simple premises, will now have become clear. Just as these principles were originally derived by us from the single postulate of maximum power, German policies can be understood as a coherent whole by reference to this postulate.

Only future research into the proceedings of the inner councils of Nazi leaders will show how far their plans for economic conquest were actually laid down in advance. It seems probable, however, that the amazing coherence of German policies was due only in part to detailed planning springing from economic analysis and that an important role was left to experimentation in the elaboration of actual policies. But if we assume only that in every decision of commercial policy the political power standpoint was given due consideration, the coherence of German policies need not surprise us, for, in every case, this power, so far as it is based on foreign trade at all, goes back in the last analysis either to the strength which foreign trade lends to the German war machine (supply effect) or to Germany's power to menace her trading partners with a stoppage of trade (influence effect). It is therefore only natural that by examining in a general way the processes through which these two sources of power through foreign trade could be best developed, we should at the same time have described the actual policies of a state which had made power the primary object of its actions in every field.

It will have been noted that a single policy such as the prevention of industrialization realized simultaneously several distinct features of the power policy outlined in different parts of the present analysis. Similarly, we have seen how an apparent conflict between the supply effect and the influence effect of foreign trade could find a solution. Furthermore, a shift of trade toward the poorer countries will often be found to implement the other principle of power policy which impels a country to divert its trade toward the smaller trading countries. All these instances tend to show that there is a real danger of attributing too much cleverness to German policy by supposing a motive behind certain effects of policy which, though welcome, may not have been actually aimed at.

Economists have often dwelt upon situations in which a policy is self-defeating, i.e., leads to certain unforeseen repercussions which

foil the aim at which the policy was originally directed. It is, however, equally possible that a policy has unforeseen effects which reinforce rather than destroy the result which the policy had tried to bring about. It may well be—here again only future documents will give us an even approximate knowledge—that in German trading methods we are confronted by precisely such a situation. This would detract somewhat from our opinion of the thoroughness and the astuteness of the Nazis, but it would also raise in our minds a question of grave importance: Are the conditions in the actual world such as to make the pursuit of power a relatively easy task?

Undoubtedly, conflicts between the policies implementing the different principles of a power policy with foreign trade as an instrument are conceivable and do occur; but they seem to be less important than the situations in which it is possible to realize concurrently several power objectives by a single policy.

Finally, it must be remembered that the conditions which we have described as leading to power relationships are not necessarily brought about by any conscious policy at all. Indeed, the initial impetus to German policies in the 'thirties was given even before Hitler's advent to power, not by political motives, but by the economic fact that Germany, a debtor country with a weak currency, found herself attracted to the central and southeastern European countries which were in a similar position. The important point is that power elements and disequilibria are potentially inherent in such "harmless" trade relations as have always taken place, e.g., between big and small, rich and poor, agricultural and industrial countries—relations which could be fully in accord with the principles taught by the theory of international trade. Political power may only be latent in such commercial relations. But so long as war remains a possibility and so long as the sovereign nation can interrupt trade with any country at its own will, the contest for more national power permeates trade relations, and foreign trade provides an opportunity for power which it will be tempting to seize.

NOTES ON THE THEORY OF INTERNATIONAL TRADE

The following remarks serve to elaborate for the technical reader certain questions in the theory of international trade connected with the analysis given in the preceding pages.

EQUILIBRIUM IN INTERNATIONAL TRADE UNDER VARYING ASSUMPTIONS IN THE INSTITUTIONAL FRAMEWORK^a

For our purpose it is useful to distinguish between three types of trade organization *within* a given country:

- a) Competitive conditions and absence of any state intervention;
- b) Competitive conditions and possibility of unilateral state intervention, e.g., imposition of tariffs;
- c) State monopoly of foreign trade.

If we contemplate trade between two states, trade may be carried on under any one of six possible combinations. But only four of these, which might be called aa, bb, cc, and ab, need be analyzed. If we assume that the trade is in two commodities, the apparatus of the Marshallian foreign trade curves, together with the theory of bilateral monopoly developed by Edgeworth, Pigou, and Bowley,^b permit us to illustrate these cases by a simple diagrammatical device.

In figure 1 the abscissa measures the amounts of a commodity produced by country X, and the ordinate the amounts of another commodity produced by country Y. OQ_1 is the indifference curve of X, showing the bargains which would leave X as badly off as if it did not trade at all. Let us call this curve, with Professor Viner,^c the *no-gain-from-trade curve*. To this curve, correspond other indifference curves which will cut the Y ordinate (the dotted curves in our figure). A similar indifference map exists for Y, and OQ_2 is Y's no-gain-from-trade curve. The locus of the points at which any two indifference curves of these two systems are tangential to each other is the curve Q_1Q_2 , which is called the contract curve in the theory of bilateral monopoly. The curve OP_1P is a Marshallian supply-demand curve, i.e., the locus of the points at which straight lines drawn in any direction from the origin and indicating a certain position of the terms of trade touch the indifference curves of Y. The

^a A very interesting article by Tibor de Scitovsky, "A Reconsideration of the Theory of Tariffs," *Review of Economic Studies*, Vol. IX (Summer, 1942), has come to my notice after the above notes had been written. De Scitovsky's main contribution is an elucidation of the precise meaning of community-indifference curves; but he also gives (*ibid.*, pp. 102-105) a comparison of trade under barter agreements and of trade when tariffs are the main weapon of commercial policy, which has much in common with the analysis presented here.

^b Cf. bibliography given by Gerhard Tintner, "Note on the Problem of Bilateral Monopoly," *Journal of Political Economy*, Vol. XLVII (April, 1939), p. 263.

^c Viner, *op. cit.*, p. 576.

curve OP_2P is the corresponding locus for X. The supply-demand curve of Y (OP_1P) touches an indifference curve of X at the point P_1 , and similarly the supply-demand curve of X (OP_2P) touches an indifference curve of Y at P_2 . We can now proceed to the analysis of the various cases.

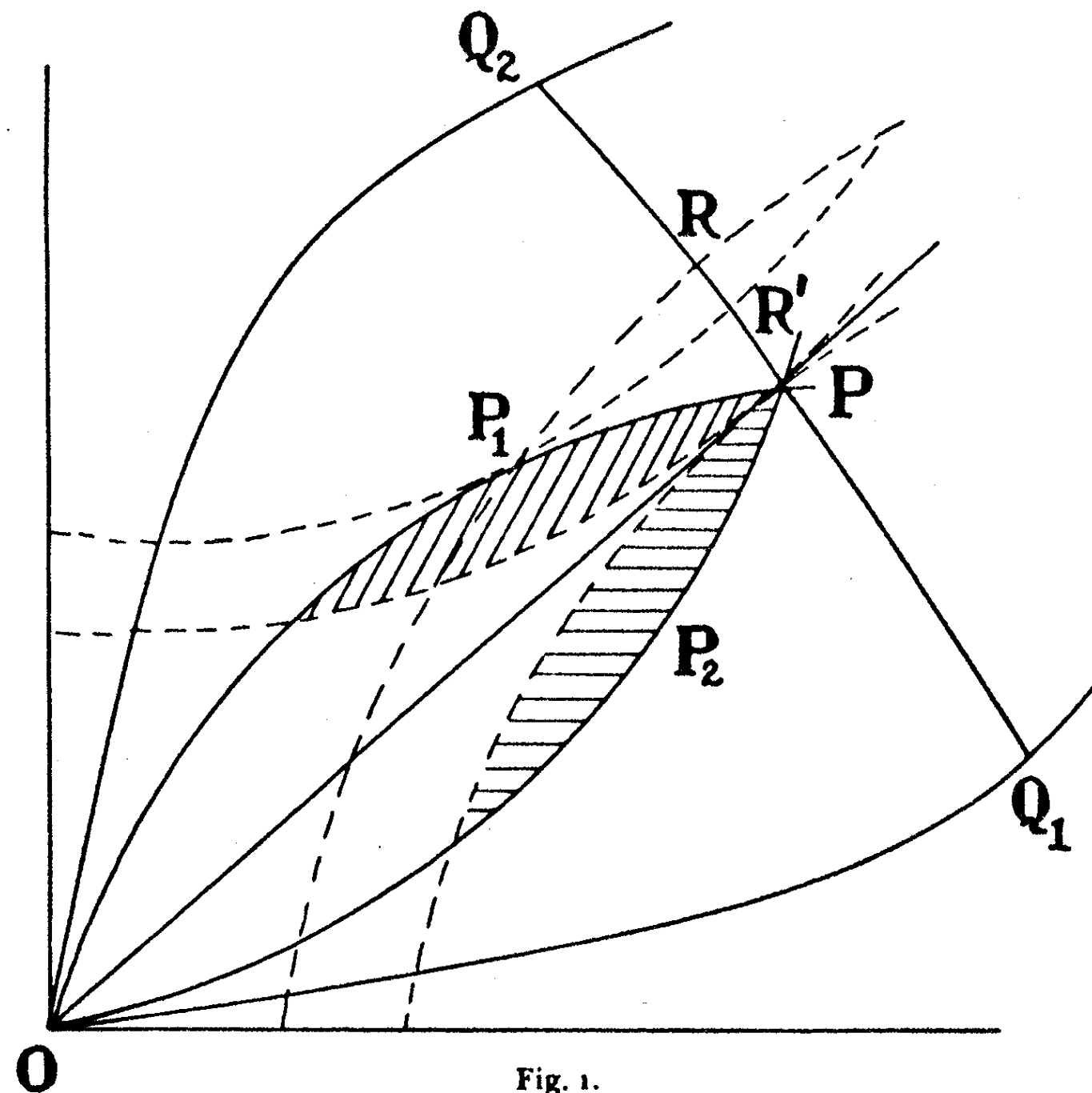


Fig. 1.

Case aa (classical case of perfect competition): Every party considers the terms of trade as a datum and moves along its supply-demand curve until the quantity offered is equal to the quantity demanded. Determinate equilibrium is established at P. It can be proved that P lies on the contract curve.

Case cc (classical case of bilateral monopoly): The terms of trade lose their regulatory function and two monopolists drive a bargain which will lie somewhere on the contract curve. This curve is, indeed, the locus for all bargains which, with a given satisfaction from trade of the one partner, maximize the satisfaction of the other. Which particular point will be arrived at by the two countries trading together depends on "bargaining power."

Case ab (foreign trade between two countries, each of which has a competitive trading system, but only one, say X, enjoying tariff autonomy, which is an attribute of sovereignty): In this case the terms of trade lose their regulatory function for country X, but not for Y. Like any monopolist, country X can aim at evaluating the demand curve of its trading partner and at finding out the point most advantageous from its own standpoint.* This point is P_1 , at which, as we said before, an indifference curve of X touches the supply-demand curve of Y. By imposing a duty upon its goods, X will be able to shift its demand curve so that it cuts Y's demand curve at precisely this point. It is not possible here to compare the total utility obtained at P and that obtained at P_1 by the two trading countries taken together. All one can say is that at P_1 , X is better off and Y worse off than at P. But by drawing the indifference curves going through P_1 until they cut the contract curve at R and at R' , we see that there is a stretch, RR' , on the contract curve, each point of which offers to both parties more satisfaction than either can obtain at P_1 .

Case bb:† If both countries have full economic sovereignty whilst retaining their competitive trading system, they may both try to influence the terms of trade by the imposition of tariffs. In other words, so far as the absence of the parametric function of price for the country as a whole is concerned, the position is very similar to case cc, in which the theory of bilateral monopoly became applicable. Obviously, with any given system of tariff rates, equilibrium is again determinate. But although tariff rates have the same economic effect as transport costs, the usual procedure of simply including tariffs among the data of international economic equilibrium seems illegitimate, the reasons for which we will presently point out.

The history of commercial negotiations gives abundant proof that tariffs are the manifestation of bargaining power under conditions of private trading. If tariffs are considered as data, bargaining power should in all cases be treated in the same way, and equilib-

* This has been recently recalled by Nicholas Kaldor, "A Note on Tariffs and the Terms of Trade," *Economica*, Vol. VII, new series (November, 1940), pp. 379-380.

† Cf., in connection with the following section, the article of A. C. Pigou, "Equilibrium under Bilateral Monopoly," *Economic Journal*, Vol. XVIII (1908), pp. 205 ff. Although our approach has much in common with Pigou's analysis, Pigou was not interested in the applications of the theory of bilateral monopoly to international trade, but rather to wage theory.

rium under conditions of bilateral monopoly would be perfectly determinate. If, on the other hand, tariffs are not treated as data, equilibrium in our case is just as indeterminate as it was in case cc. In other words, even with entirely competitive markets, the institution of national economic sovereignty implants elements of monopoly and indeterminateness in the trading system.

This indeterminateness is, however, different in kind from that which we have analyzed under cc. Every country can influence the terms of trade by the imposition of tariffs. But once this has been done, the market is left to adjust itself to the new conditions. The price and the terms of trade remain objective data for the traders, and therefore the equilibrium positions all lie on the possible intersections of the supply and demand curves as modified by government intervention. Since an imposition of a duty on exports or a subsidy on imports may be considered unlikely, the Marshallian curves will shift nearer to each other. We obtain thus a surface of indeterminateness, OP_2PP_1 , bounded by the two original curves of case aa. Any point lying on the surface, including the point of origin, may be the outcome of successive impositions of tariffs. The shaded area indicates the possible position at which one of the two trading partners will be better off than at the free trade position P. At all other points of the surface both countries would be worse off than they were before they started to impose tariffs and to retaliate. What we pointed out for point P_1 in connection with case ab holds here generally also. For every point of the surface OP_2PP_1 (with the exception of P) there exists a segment on the contract curve every point of which yields to both countries a higher amount of satisfaction. The imposition of tariffs is therefore seen to be a rather inefficient weapon for a country desiring to obtain an increase in satisfaction from a movement of the terms of trade in its favor. It seems a significant confirmation of the foregoing analysis that countries which have had a foreign economic policy which considers exports as a means to obtain imports (and not imports as a necessary evil to secure export markets) have generally reverted from a tariff policy to a policy of direct bargaining.

There exists, then, a difference between a policy relying on autonomous tariffs and a policy of direct state trading. But this difference is far from being as fundamental as has often been believed. Auton-

omous tariff policy, we have shown, introduces into the international market elements of indeterminateness which differ from such elements under bilateral monopoly mainly in the fact that they lead to a range of possibilities which, from the standpoint of the satisfaction of both countries, is much inferior to the range offered by bargaining of two countries each with a foreign trade monopoly. In addition, our analysis shows that, by supposing international trade to result in determinate equilibrium, the theory of international trade assumes, not only perfect competition, but also the absence of economic sovereignty.

A NOTE ON BARGAINING POWER

In the theory of bilateral monopoly the term bargaining power has a definite technical meaning. It denotes the forces which, with given indifference systems of the two monopolists, make for equilibrium at one rather than another point on the contract curve. The components of bargaining power in this sense are somewhat vague; they are generally believed to be bargaining skill, information on the indifference system of the partner, deception of the partner about one's own indifference system, and simple force, which, however, is limited by the shape of the partner's no-gain-from-trade curve. Indeed, it is not possible for either of the monopolists to exploit the other in the sense that by exchange the one is made to be less well off than he was before the exchange took place. It is not even possible to draw from the location of the equilibrium point on the contract curve any conclusion for a comparison of the advantages derived by the two monopolists from the exchange. If, for instance, the exchange takes place at the center of the contract curve, we could say that the advantages derived by both monopolists are equal only if we assume: (1) that the indifference systems of the two monopolists are identical, and (2) that the two no-gain-from-trade curves express equal levels of satisfaction for both monopolists.

It would therefore be incorrect to say that superior bargaining power enables one monopolist to gain more satisfaction than his partner; all we may affirm is that it enables him to increase his gain at the expense of that of his partner.

The term bargaining power is, however, used in contexts implying a different meaning. Thus, if we say that the bargaining power

of the entrepreneur is superior to that of the nonunionized worker—considered as an individual factor of production with some elasticity of substitution—we think not only of the differences in bargaining skill, cunning, information, etc., but mainly of the fact that the worker “needs” the entrepreneur more than the entrepreneur “needs” him. This, in turn, means that we are here implicitly comparing two utility gains or, at least, the levels of satisfaction of the two opponents if there is no contract. Similarly, if we say that adherence to a trade union enhances the bargaining power of the worker, we imply not only that the trade union has more information, skill in negotiation, etc., than the individual worker could possibly have, but also that the wage at which it would be a matter of indifference to the worker to be idle or to work is higher after than before his adherence to the union. We have here essentially a dynamic problem, since the indifference system of the worker is supposed to have shifted so as to form a *new contract curve* with the indifference system of the entrepreneur. Even if the bargaining skill of the two parties has remained the same, the wage will be higher under the new conditions because the range of possibilities offered by the new contract curve to the worker is better than the old one.*

In other words, there are two methods to better one's position: either by working toward a better point on a given contract curve, or by bringing about a new and more favorably situated contract curve. This latter aim may be realized, as in the familiar case of unionization, by shifting one's own indifference system, i.e., by enabling the worker, backed by the financial resources of the union, better to withstand an interruption of his employment. But it may also be realized by shifting the indifference system of one's partner by rendering it more difficult for him to dispense with the contract.

Thus, we see the connection between the theory of bilateral monopoly and our analysis of the influence-effect of foreign trade. The shifting of the indifference systems, however, has been considered until now only as a means toward the attainment of a better bargain.

* That changes in bargaining power in the traditional sense are much less important than changes in bargaining power which are the outcome of changes in indifference maps has been pointed out recently in connection with wage theory by J. T. Dunlop and Benjamin Higgins, “Bargaining Power and Market Structures,” *Journal of Political Economy*, Vol. L (February, 1942), pp. 4-5.

In our analysis the possibility of driving a better bargain was only incidental to the main aim, which consisted of tying the trading partner to a country using foreign trade for purposes of national power. We have shown how this may be accomplished:

- 1) with an unchanged indifference system of the trading partner, by making him better off, i.e., by granting him better terms of trade;
- 2) with an unchanged total level of satisfaction of the trading partner, by changing his indifference system so as to make him worse off in the eventuality of interruption of trade.”

Because we have seen that the first solution would conflict with the supply effect of foreign trade, we have therefore mainly dwelt upon the second solution. Our analysis has thus led us to drop two of the basic assumptions of the theory of bilateral monopoly:

- 1) that we are in the presence of fixed indifference systems;
- 2) “that the one exchanger is insulated from the other in the sense that his economic conduct is not influenced in any way by the satisfaction which he conceives to be obtained by his correspondent.””

But in our problem, A is vitally concerned about B's satisfaction, for, by such concern, B's dependence on A is increased and the increase of satisfaction of B is brought about mainly by a change of B's indifference system. The difficulty of shifting trade to a third country may readily be taken account of in the construction of these indifference systems. The no-gain-from-trade curve of B becomes then a *no-gain-from-trade-with-A* curve, i.e., expresses the various bargains at which it would barely pay B to shift its trade with A to a third country. This curve will generally express a higher level of satisfaction of B than the ordinary no-gain-from-trade curve, but will coincide with it if no substitution is possible.

All our analysis of the influence effect of foreign trade may then be summarized by the following principle: Given a certain gain from trade of A and a fixed indifference system of A, create conditions such as to maximize the difference in satisfaction between the

” In the first case, the trading partner arrives at a higher indifference curve and the level of satisfaction expressed by the no-gain-from-trade curve remains the same; in the second case, the trading partner remains at the same indifference curve, but the no-gain-from-trade curve expresses a lower level of satisfaction than before. In both cases, his gain from trade increases, either because he actually gains more by the trade or because he would stand to lose more from a stoppage of trade.

” Pigou, *op. cit.*, p. 207.

indifference curve which B actually reaches by trading with A and B's no-gain-from-trade-with-A curve.

As we shall later have occasion to point out (p. 79), an economic system guided by the objective of welfare must also provide for and organize the use of economic power. At present we see that the "economics of power" may use welfare analysis to great advantage. And moralists may well ponder over the fact that concern about the trading partner's satisfaction becomes relevant for economic analysis when it is considered as a step toward eventual domination.

A NOTE ON GAIN FROM TRADE

We shall be concerned here with the relation of the welfare gain to some objective measures or indicators of the gain from trade. Our first point will be to prove that under the simplest assumptions a subjective gain from trade is possible without any specialization upon opening of trade, i.e., without any increase of aggregate production of the two countries. Because it is possible to simplify the diagrammatical exposition, we shall now use the common indifference map. Under the assumption of similar tastes in the two countries, the diagram need represent only one system of indifference curves.* In accordance with other assumptions which have been seen to be implicit in classical theory,** we shall suppose in addition that the two products exchanged are of equal importance. This somewhat imprecise concept may be defined in the following way: The income elasticity for both commodities is unity throughout the indifference map and, if the terms of exchange are fixed so that a unit of the one commodity exchanges against one unit of the other commodity, then, whatever the real income, expenditure will be divided equally between the two commodities. These assumptions yield an indifference map which is entirely symmetrical with respect

* Cf., in particular, the models given by W. W. Leontief, "The Use of Indifference Curves in the Analysis of Foreign Trade," *Quarterly Journal of Economics*, Vol. XLVII (May, 1933), pp. 493-503. The objections to this method, as formulated by Professor Viner (*op. cit.*, pp. 521 ff.), could be taken account of partly by interpreting the indifference curves of the community so as to include in their shape, not only the satisfaction derived from the consumption of the commodities, but, in addition, the satisfaction derived from their production. As to the meaningfulness of the concept "community indifference curves," see Kaldor, *op. cit.*, pp. 377-378, and De Scitovsky, *op. cit.*, pp. 89-95.

** Cf. F. D. Graham, "The Theory of International Values Reexamined," *Quarterly Journal of Economics*, Vol. XXXVIII (November, 1923), pp. 56 ff.

to the two coördinates. Let us assume also that each of two countries of equal size has its own constant costs levels, but that these levels, as between the two, are different. For our purposes the concept "countries of equal size" means that country A can produce in complete specialization either x units of commodity a, or y units of b,

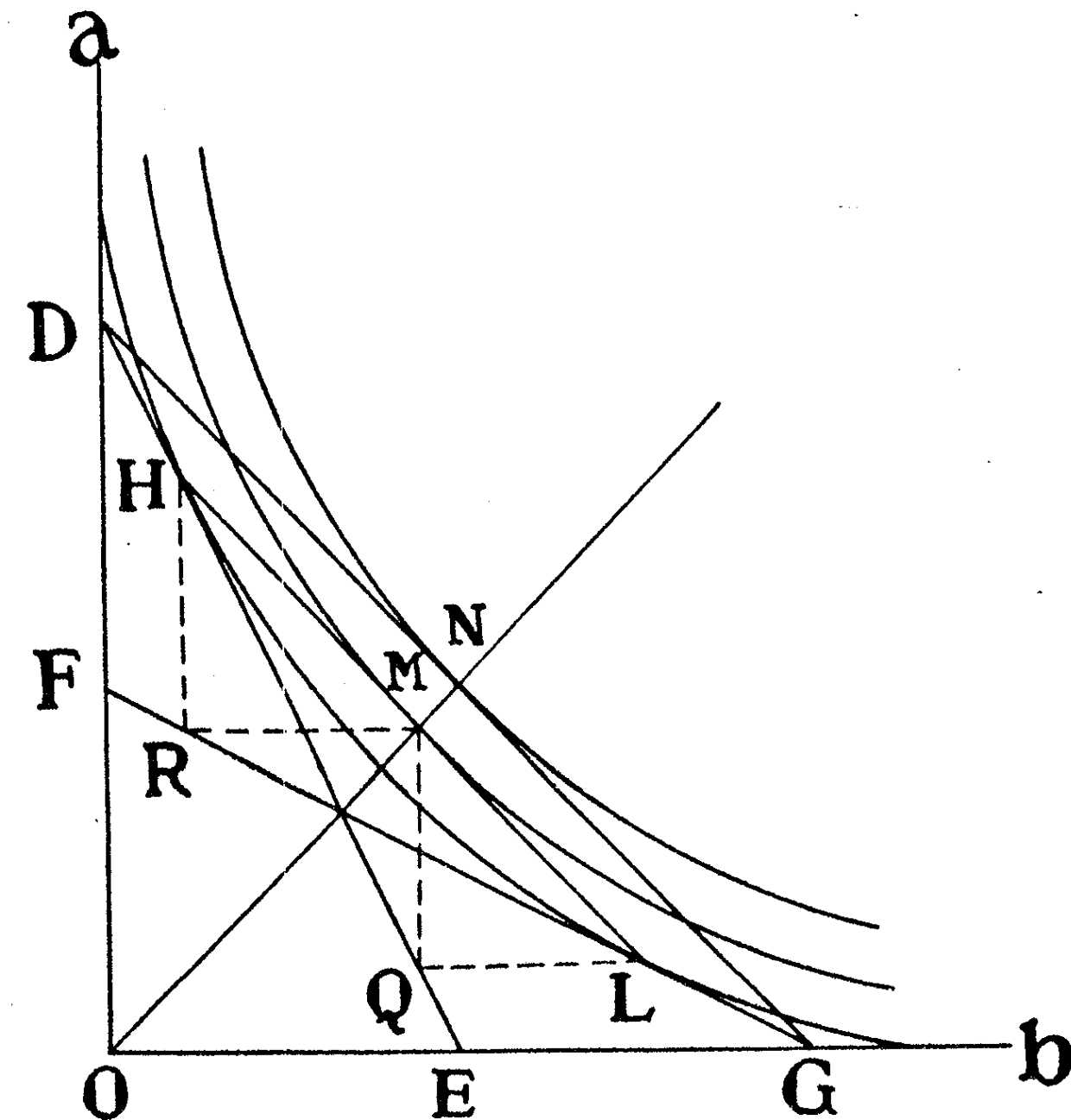


Fig. 2

whereas country B can produce y units of a, or x units of b. These assumptions are graphically presented in figure 2, in which the abscissa represents the amounts of commodity a, and the coördinate the amounts of commodity b. The curves are indifference curves common to both countries. DE is the substitution line of country A enjoying a comparative advantage in production of commodity a. FG is the substitution line of country B. They are straight lines because of our assumption of constant costs. Then, with no trade, the equilibrium for each country will be established at points H and L, at which an indifference curve touches the respective substitution lines. If trade now opens and specialization does not yet set in, both

countries can move to a point M lying on a higher indifference curve—country A by exchanging RH of a for RM of b, and country B by exchanging QL (= RM) of b for QM (= RH) of a. If A specializes in the production of a, and B in the production of b, they can of course get to a point N lying on a still higher indifference curve.

In our graph the two countries start from the same indifference curve, and by trade reach a higher indifference curve common to them (either at M or at N). The assumptions through which we have obtained an equal gain from trade for both countries are extremely rigid and unrealistic. It is sufficient to drop one of these assumptions in order to obtain different welfare-gains for both countries.

If the substitution lines of countries A and B are not DE and FG, but OD and OG (A can produce only commodity a, and B only commodity b), both countries will be, in the absence of trade, at a lower level of satisfaction than in our previous case. If trade opens, they will immediately move to point N without any further specialization being possible. The volume of trade will be the same as in our previous case after specialization had taken place, but the gain from trade will be greater, as the two countries have started from lower indifference curves. Generally, the gain from trade is thought to be intimately associated with international specialization. So far as more specialization permits a greater volume of trade, this association, at least as a presumption, is warranted. But it is often forgotten that specialization is, after all, only a *pis-aller*, i.e., a course which has to be taken if the diversity of products produced in the two countries does not permit a continued profitable exchange. A presumption exists, therefore, that *with a given volume of trade* the gain from trade is the greater the *less* specialization there has been after the opening up of trade. This does not contradict established theory in any way; in fact, it is mentioned only because the connection between specialization and gain from trade is ingrained in most minds in too rigid a manner.

Short-run and long-run gain from trade and the requirements of a comprehensive theory of the gain from trade will be our next concern. The gain from trade is always the difference in satisfaction between two situations in equilibrium, the one before opening of trade or after the stoppage of trade and the other when trade is in

full swing. The change in the productive structure of the country between the two points is expressed by a movement along the substitution curve. If, in figure 2, we consider the substitution line DE, and suppose that trade is suddenly interrupted, the country would revert from N to D and would then aim at point H. The short-run gain from trade is thus the difference in satisfaction between point N and point D, whereas the long-run gain from trade—the only gain which has hitherto received attention—is smaller, since it is indicated by the difference in satisfaction between point N and point H. If there is a sudden worsening of the terms of trade so that the productive structure cannot be adapted, a situation may therefore arise in which trade, while still yielding a short-run gain, results in a long-run loss. In this particular case, what is true in general about the abolition of protection holds for the stoppage of trade: It would result in immediate loss, but in ultimate benefit.

In the static theory of international trade, no account is taken of the time which is involved in changing the productive structure. The substitution curve is a long-run curve, i.e., its shape is not limited by any finite period of time, but only by the available techniques and factors of production. If we introduce time into our analysis, we see immediately that the shape of the substitution curve itself is changed. We will have two entirely different substitution curves according as we allow the period of two years or ten years for changes in the productive structure to take place.⁴ This means that we have no longer a single gain from trade nor a simple subdivision into short-run and long-run gains, but a whole array of *dated* gains from trade of which the long-run and the short-run gains are the two extreme items. But all those dated gains would still relate to a given degree of employment and of utilization of resources in general. We obtain a new family of substitution curves by considering this degree of employment as a variable.

To complicate matters further, the gains thus indexed by length of adjustment time and by degree of employment are subjective in two senses: (1) because they are related to the comparison of two levels of satisfaction, and (2) because one of these levels is necessarily the result of expectations. Because of this fact the gain from

⁴ Professor Haberler mentions the fact that the substitution curve will be more "bulged" the less the time allowed for. Cf. Haberler, *op cit.*, p. 179.

At a given volume of trade, gains from trade are less, the less the specialization.

trade loses its unity for a third time; indeed, there is not only a different gain from trade for every adjustment period and level of employment contemplated, but for every single case there may be different expectations of gains. Furthermore, these expectations relate, not only to the resources within a country and to their mobility, but also to the degree to which it will be possible to draw on the resources of other countries by means of loans, immigration, etc. A comprehensive theory of the gain from trade would thus take account of the time element, of the level of employment within the country, of all types of international economical relations, and would be largely built upon a theory of expectations.

Basic summary of the argument
 as pp 34-35. Supply effect related
 to goods needed for warfare.
 Influence effect related to relative
 opportunity cost of change in
 welfare loss and adjustment
 effects. Basically adjustment effects
 relate to the difficulty a country
 would have in moving to a
 new allocation of factors if
 trade were stopped, i.e. it is
 a function of time. The slower
 easier the adjustment & more quickly
 a country can move to a new pattern
 of production, the less the
 welfare losses resulting from breaking
 trading relations.

CHAPTER III

The Question of "Economic Aggression" During World War I

IN THE PRECEDING CHAPTER we have tried to show in detail why and how it is possible to turn foreign trade into an instrument of power, of pressure, and even of conquest. The Nazis have done nothing but exploit to the fullest possibilities *inherent* in foreign trade within the traditional framework of international economic relations. This is the general lesson which should emerge from the experience of economic penetration of such countries as Hungary, Bulgaria, Rumania, and other countries less successfully penetrated by "bloodless invasion." What are the conclusions which can be drawn from this experience when the present war will be won by the United Nations? Should we, because of its evil potentialities, try to limit international intercourse? Should special safeguard or boycott measures be erected against German trade once the war is over? Should we be content with prohibiting certain practices and technical devices, such as bilateral clearings, differential exchange rates, etc., which have been a prominent feature of German policies in the 'thirties? Or should we rather endeavor to build a new framework of international relations in which this use of foreign trade for purposes of national power would encounter more difficulties than hitherto? And how could this end be achieved?

Before attempting to give an answer to these momentous questions, we shall try to gain perspective by recalling how similar problems were recognized but not resolved during and after World War I.

The literature on the commercial and economic policies of Nazi Germany being rather voluminous, it is surprising not to find in it—so far as the author is aware—a single reference to the parallel and equally copious literature which was published before and during World War I. The accusations voiced against Germany at that time were in their substance very similar to those we hear today.

The intellectual level of the writings on this subject, however, compares rather unfavorably with the contemporary literature; this may be one of the reasons for which these books, like discreditable relatives, have been permitted to fall into oblivion. In addition, the *methods* by which Germany was said to achieve her end of economic conquest before World War I were different from those which she has used more recently.

The following features of German trade attracted most attention in the days before the First World War:

- 1) The rapid expansion of German exports, both absolutely and relatively, to other countries;
- 2) The scientific methods by which this expansion was achieved—in particular, the systematic study of the needs and habits of foreign consumers;
- 3) Unfair competition and, in particular, the dumping of some German exports. Contrary to this, the selling of potash abroad at prices higher than the home price;
- 4) The attempt by Germany, in connection with the dumping, to prevent industrialization in other countries and to destroy competitive industries which had already been established;
- 5) The export of German capital, business enterprises, and of managerial and scientific personnel;
- 6) German methods of financial control over foreign enterprises.

The first two points were discussed as early as the 1890's in England and France and were mooted in an intensely alarmist literature of which E. E. Williams' *Made in Germany* was the most celebrated specimen.¹ Although this literature often adopts such military figures of speech as "conquest" or "capture" of foreign markets, the danger against which it seeks to mobilize is not generally the economic or political dependence of the countries exposed to the German "trade offensive" but the lagging of British or French exports in these countries. Foreign and, in particular, export trade is viewed as an end in itself and not as a means to political penetration and economic subjugation.²

¹ For a detailed description and bibliography of the English writings, see Ross J. S. Hoffmann, *Great Britain and the German Trade Rivalry 1875-1914* (Philadelphia, 1933). The French are represented by Marcel Schwob, *Le Danger Allemand* (Paris, 1898); Georges Blondel, *L'essor industriel et commercial du peuple allemand* (Paris, 1898); Maurice Lair, *L'impérialisme allemand* (Paris, 1902).

² It is interesting to note that the same factual background, i.e., the rapid advance of German foreign trade, provided the subject of great anxiety, not only for England

Only at a later stage was Germany accused of consciously using her foreign economic relations as an instrument of domination. So much was still made of the German trading methods, the personal contact, the thorough study of consumers' needs, the ability of her representatives abroad to learn foreign languages, etc., that one often wonders whether the authors' purposes were one of praise for or denunciation of Germany.³ But the emphasis shifted from these aspects of German commercial policy to the other points (3 to 6) enumerated above. The frequent dumping of German goods abroad was not seen as an instance of differential price policy practiced by a discriminating monopoly. It was supposed that dumping served a policy bent upon destroying competition in the foreign market so as to secure a monopolistic position for the German exporters and to enable them later to raise their price. This claim bears a striking similarity to the recent accusations against Germany according to which she has bought supplies at artificially high prices in other countries in order to secure there a monopsonistic position and to be able later to *lower* the prices—either directly or by manipulation of exchange rates.

No detailed study seems to exist about the question of how far German dumping before World War I was actuated by so-called "predatory" motives. According to Professor Viner, who, after the war, rendered a balanced judgment on the matter, German dumping has received far more attention than it deserves. He contends that all nations have engaged in dumping at one time or another, and, in general, he looks upon the accusations leveled against Germany on this account with some skepticism.⁴ He states, however, that "there is general agreement that before 1914 export dumping was more widespread and was more systematically practised in Germany than in any other country,"⁵ and "it is even probable that predatory motives were a more important factor in German dumping than in the dumping of other countries." In particular, a "well substantiated and important instance of dumping with a deliberate

and France, fearful of German competition, but also for Germany, apprehensive of her increasing dependence on foreign countries. (See below, pp. 146 ff.)

³ See, e.g., P. P. Gourvitch, *How Germany Does Business* (New York, 1917). This little book gives some interesting examples of the German trading methods in Russia.

⁴ Jacob Viner, *Dumping: A Problem of International Trade* (Chicago, 1924), p. 52.

⁵ *Ibid.*, p. 51.

intent of crushing the domestic industry in the market dumped on is to be recorded against the Stahlwerksverband in its export policy with respect to Italy."⁶

Of course, as soon as one interprets dumping as an attempt to secure a monopolistic position in the market of a foreign country, the suspicion of an "ultra-economic" motive of domination follows almost automatically.

Another feature in German external economic policies which led to this suspicion was the export of German enterprises and scientific personnel and the penetration of German capital into foreign enterprise. The most vigorous book on this subject was published in Italy by G. Preziosi under the impressive title, *Germany Poised to Conquer Italy*.⁷ The ownership and operation by a group of German bankers of the Banca Commerciale Italiana provided the central point of this book, which was widely read and aroused much interest at the time. It pictured with a good deal of exaggeration, but the more vividly, the disastrous consequences of the control by Germany of Italy's most important commercial bank, which, on the pattern of German banks, carried on an extensive financing business. According to Preziosi, Germany did her best to prevent the industrialization of Italy and, where this was impossible, she sought to obtain by financial devices the control of Italy's key industries—textile, metallurgical, and shipping. In addition, the Banca Commerciale, which had "its arms in Italy but its head in Berlin,"⁸ favored German trade by all kinds of stratagems and invested Italian savings abroad in enterprises controlled by Germany. Preziosi accuses the Germans of industrial espionage and the Banca Commerciale of stopping credit facilities to firms which show an anti-German attitude. He points out cases of open or veiled political corruption and suspects the hand of Germany in industrial strikes, employing for all these activities of the Banca Commerciale the familiar term, "the Trojan Horse."

In general, Preziosi has this to say about German methods: Pan-Germanism acts everywhere applying always the same rational and well studied procedure, which consists in the foundation of one or sev-

⁶ *Ibid.*, p. 64. Bibliography concerning this case of dumping is given there.

⁷ Giovanni Preziosi, *La Germania alla conquista dell'Italia* (Florence, 1914), introduction by Maffeo Pantaleoni, the well-known economist; I am referring to the second, the 1916, edition.

⁸ *Ibid.*, p. 11.

eral banks, in the capture thereby of the credit system, of savings, trade, industry, and the merchant marine, and in the creation of a dense network of interests and customers—with the result of rendering other nations subservient to Germany.⁹

If Preziosi wrote the most sensational book on the methods of German economic penetration before the First World War, the most detailed and authoritative statement on the same subject is that of the French historian Henri Hauser.¹⁰ His book, written in 1915, is wholly dedicated to the proposition that "economic war, conquest of markets,—words applied to Germany—are not at all metaphors. More than ever we have the feeling that Germany made war in the midst of peace with the instruments of peace. Dumping, export subsidies, import certificates, measures with respect to emigration, etc., all these various methods were used not as normal methods of economic activity, but as means to suffocate, to crush, and to terrorize Germany's adversaries."¹¹

Having described these methods in detail with special emphasis on dumping and on the export of capital as practiced by Germany, he concludes: "By this concentration of all its energies, by this unity of direction, economic Germany has become a power at least as formidable as military Germany and of the same order: a power of domination and of conquest."¹²

It would be easy to add to these quotations examples from other authors.¹³ It is not our task here to examine how much truth there was in the accusations of Preziosi, Hauser, and others, and how far the foreign economic policies of Imperial Germany had been centrally and systematically planned in advance with the "ultra-

⁹ *Ibid.*, p. 35.

¹⁰ Henri Hauser, *Les méthodes allemandes d'expansion économique* (Paris, 1915), (English translation, *Germany's Commercial Grip on the World* [New York, 1917]).

¹¹ *Ibid.*, 8th ed. (Paris, 1919), p. 4.

¹² *Ibid.*, pp. 258–259.

¹³ E.g., Maurice Millioud, *The Ruling Caste and Frenzied Trade in Germany*, translated from the French (Boston, 1916); Henri Lichtenberger and Paul Petit, *L'impérialisme économique allemand* (Paris, 1918); Siegfried Herzog, *The Future of German Industrial Exports* (New York, 1918); also see below, p. 60. For factual surveys, cf. U. S. Bureau of Foreign and Domestic Commerce, *German Foreign Trade Organization* (Washington, 1917), and *German Trade and the War* (Washington, 1918). An interesting study in national self-criticism, which tries to explain the reasons for world-wide suspicion and hatred against Germany in general and German trade in particular, was given by the philosopher, Max Scheler, *Die Ursachen des Deutschen Hasses* (Leipzig, 1917).

economic" aim of domination and eventual conquest. In the main, these writings were tracts which added the economic aspect to the literature on Germany's diplomatic preparations for war. They give only one side of the picture, forgetting that foreign trade and export of capital implied also a dependence of Germany on other nations; in general they were entirely lacking in systematic analysis of the connection between national power and international economic relations.

This much is certain: The possibility of using external economic relations for purposes of power policy was clearly recognized; whatever its objective foundation in economic history or theoretical analysis, it had become a very strong subjective reality. For many persons it turned into an obsession, people always being prone to believe both that they are being maneuvered by hidden forces and that the worst has been prevented just at the last moment. Thus, Briand, then French Prime Minister, declared at the opening of the Paris Economic Conference of the Allies in 1916: "The war has opened our eyes to the peril; it has abundantly demonstrated the economic slavery into which the enemy sought to drag us; we must recognize that . . . our adversaries came very near to success."¹⁶ Similarly, Mr. Hughes, Australian Prime Minister, issued a statement after the conference in which he said: "Some Allies were before the War so completely enmeshed in the toils of Germany that they had lost all but the shadow of their nationality, and even now they are obsessed with the fear that peace will find them again in the grip of the enemy."¹⁷ It was indeed at this very conference that the anxieties of a possible renewal of "silent economic penetration" after the war found an official expression of far-reaching importance. Anxieties of this sort had been intensified during the war by German projects for Mitteleuropa and by persistent reports that German warehouses were overflowing with goods intended for a trade offensive immediately upon the cessation of hostilities.

Let us now inquire how political leaders and economists reacted to the discovery that foreign economic relations could be, had been, and probably would again be used as an instrument of national power policy. How was the danger to be averted? In other words,

¹⁶ *Le Temps*, June 15, 1916.

¹⁷ *Times* (London), June 21, 1916.

how did the experience affect thinking on postwar economic reconstruction and thus postwar economic policy?

In the main, it is possible to distinguish two schools of thought. The writers who had aroused the public to the danger of "silent economic penetration" were ardent advocates of preparing defensive or offensive weapons from the arsenal of economic nationalism. Aligned against them were the defenders of the virtues of free trade who ignored or denied the danger to which their adversaries had pointed.

It was only too easy to exploit the possibility of "economic aggression" by sovereign nations as an argument against free commercial intercourse. The demand for increased protection seemed to be much more compelling and much less oriented toward mere vested interests if the evil portrayed by the protectionist was economic aggression and penetration rather than foreign competition. The necessity of revision of accepted thinking on free trade and protection in favor of the latter was emphasized by Hauser, who declared that "no theory can prevail over the facts."¹⁸ The same note was struck by Briand in his already-quoted speech at the Paris Economic Conference: "You will be less attentive to the traditional theoretical doctrines and to old customs than to the new realities which are imposing themselves upon us. If it is proved that old errors have almost permitted our enemies to establish an irretrievable tyranny over the productive forces of the world, you will abandon these errors and enter new roads." And the *London Times* was in happy agreement with "the truth that the economic situation arising out of the war and the problems attending it cannot be dealt with by muttering any shibboleth."¹⁷

The universal endorsement of "realism," as against theories and abstractions considered as "shibboleth," is an aspect of what Benda was to describe after the First World War as the intellectual victory of Germany.¹⁸ This victory went even so far that some of the very authors who denounced German commercial methods had nothing better to propose than to use these methods on behalf of their own countries and for the very aims for which Germany had used them.

¹⁸ Hauser, *op. cit.* p. iv.

¹⁷ *Times* (London), June 23, 1916, editorial.

¹⁸ Julien Benda, *La trahison des clercs* (Paris, 1927), p. 72.

Thus, Preziosi wanted to build up strong Italian industries so that they may "in their own time practice dumping, turning against the Germans their own favorite weapons."¹⁰ Similarly, he wished to free the Banca Commerciale from German influence because "the banking system has to be one of the most powerful instruments which the state has at its disposal in order to direct international policy according to its own aims."¹¹ Thus, it is not surprising to be informed by the *Enciclopedia Italiana* that Preziosi early joined the Fascist party and had an important part in the elaboration of its economic program before the march on Rome.

In a more balanced fashion, Hauser made a distinction in his final chapter between "what we shall not imitate from Germany" and "what we shall have to imitate." This shows rather significantly the way in which the whole problem was raised. But in spite of his moderate position—he rejected the more aggressive German methods, such as dumping, and did not favor a complete boycott of Germany after the war's end—he advocated an "economic offensive" even after the war as the only possible answer to German methods.¹²

These instances suffice to show the general features of a current of thought which received its practical expression and official consecration at the Paris Economic Conference. This was, significantly, the only Allied conference during the war at which problems of postwar economic reconstruction were under consideration. A short survey of its resolutions and its influence upon later events seems therefore to be warranted.¹³

The resolutions adopted by six Allied nations—England, France, Italy, Russia, Belgium, Japan—fell into three parts: measures for the war period; measures for the transition period after the war; and permanent measures. The aim of the conference is clearly stated in the preamble to the resolutions:

The representatives of the Allied governments . . . declare that, after forcing upon them the military contest in spite of all the efforts to avoid the conflict, the Empires of Central Europe are today preparing, in concert with their allies, for a contest on the economic plane, which will not

¹⁰ Preziosi, *op. cit.*, p. 43.

¹¹ Preziosi, *op. cit.*, p. 58.

¹² Hauser, *op. cit.*, p. ix.

¹³ For a history of the genesis of the conference, see Etienne Clémentel, *La France et la Politique Economique Interalliée* (Paris-New Haven, 1931), pp. 74-78.

only survive the reestablishment of peace, but will at that moment attain its full scope and intensity.

They cannot therefore conceal from themselves that the agreements which are being prepared for this purpose between their enemies have the obvious object of establishing the domination of the latter over the production and the markets of the whole world and of imposing on other countries an intolerable yoke.

In the face of so great a peril, the representatives of the Allied governments consider that it has become their duty, on grounds of necessary and legitimate defense, to adopt and realize from now onward all the measures requisite on the one hand to secure for themselves and for the whole of the markets of neutral countries full economic independence and respect for sound commercial practice and, on the other hand, to facilitate the organization on a permanent basis of their economic alliance.¹⁴

In this preamble the spirit which dominated the conference becomes clear. The economic sovereignty, even of the defeated enemy, is not questioned, and it is supposed that economic war will continue after the end of military war. Under this assumption the main preoccupation of the Allies became "economic defense," which is very often indistinguishable from economic warfare.¹⁵

We are interested here in the resolutions of the conference only so far as they deal with the transition period or with the permanent arrangements after the war. These sections, reproduced in Appendix B, should be read in their entirety. Indeed, they make familiar reading.

One after another we find enumerated all the fundamental policies of refined economic nationalism with which we have become so well acquainted in the period between the two wars—restricted access to raw materials and resources, preferential treatments and discriminations, restrictions on the activities of aliens, antidumping legislation, differential transport rates, autarky, not only with respect to key industries, but on a practically universal scale by means

¹⁴ Quoted from H. W. V. Temperley, *A History of the Peace Conference of Paris*, Vol. V (London, 1921), p. 367.

¹⁵ *Le Temps* had a somewhat lukewarm attitude toward the conference and showed the absurdity of this position even from a nationalistic point of view. "We think that the main economic task of the Conference is not to elaborate this modest reply to a project which is assumed to be already realized, but on the contrary by all means to prevent the realization of this project and the formation of this Mitteleuropa, although some persons apparently would like to confine themselves to preparing a shield against its blows."—*Le Temps*, June 15, 1916.

of subsidies, tariffs, prohibitions, etc. Even a cursory view of this amazing Pandora's box raises doubts whether these measures were devised for defense only.

The Paris Resolutions were to be considered as a basic program. Each of the Allies promised to work out its own program in terms of national policies. Each, furthermore, was to be informed of the program decisions of the other. The agreement had not been reached easily. The French and English delegations met with some resistance from the Russian and Italian delegations. Before the war the two latter countries had relied heavily on the German market and viewed with some apprehension the possibilities of German reprisals. The Russian delegates opposed the period of five years which had been proposed by the English delegation as the minimum period during which Germany was to be excluded from most-favored-nation treatment; Russia obtained the much vaguer wording "for a number of years to be fixed by mutual agreement."¹⁸

The Russian government, however, was mainly fearful lest too intimate an understanding with the Allies on postwar economic policy might, by the establishment of conventional tariffs, restrict Russia's contemplated full use of economic sovereignty. This is evident from the governmental instruction to the delegates, which underlined "the necessity of a thorough-going, unhindered development of our productive forces and organization on as large a scale as will be practicable of our vast natural resources. . . . In order to avoid the enslavement of our industry by foreign enterprises and to make it absolutely independent we must, as a just measure, create autonomous tariffs, where the tariff on goods is not fixed by agreement with individual countries but is established by legislative chambers in accordance with the needs of the country, leaving us complete freedom to alter the tariffs in order to protect whatever branch of national industry may need it."¹⁹ As we see, such opposition as existed within the conference against the Anglo-French proposals was motivated by the fear that the prospected policy did not go far enough in the direction of economic nationalism. What Russia really objected to was not discrimination against Germany

¹⁸ Baron Boris E. Nolde, *Russia in the Economic War* (New Haven, 1928), pp. 167-168.

¹⁹ Quoted in Nolde, *op. cit.*, p. 163.

as much as it was postwar economic collaboration between Germany and Russia's wartime Allies.

Although less evident on the surface, a similar tendency was noticeable in Great Britain, where the emphasis shifted slowly from Allied economic solidarity against the enemy to British protection against the foreigner and to the problem of imperial supply.²⁰

One of the driving spirits behind the British delegation was, indeed, W. A. S. Hewins, a prominent tariff reformer and imperialist.²¹ Seeing in the Paris Resolutions a powerful lever for eventually achieving tariff protection and imperial preference, he attributed to them an enormous and beneficial importance; this, in spite of the harmful effects felt from them in the midst of the war.

The resolutions, indeed, lent substance to the German claim that England had engineered and entered the war out of jealousy for German trade;²² and Lloyd George himself pointed out later to Hewins that they had prolonged the war by drawing the German people closer together, impressed by the fear of economic strangulation after the war.²³ Again, the resolutions caused strong misgivings in neutral countries and, in particular, momentarily estranged the United States. Thus we read in Baker's *Woodrow Wilson, Life and Letters*:

When confidential telegrams brought reports of the agreements being negotiated at the Paris Economic Conference, June 14th to June 17th, the State Department became exceedingly apprehensive. The more Lansing thought about the matter, the more positive he was that the Allies were deliberately making encroachments upon the rights of neutrals under the guise of measures against Germany. He warned the President June 23 that the results of the Paris pacts might be "very far-reaching on the commerce and trade of the whole world after the war is over." "The drastic measures of the Allies purpose to prevent as far as possible the rebuilding of industries and commerce (of the Central Powers) after the war . . . the knowledge of this intention to continue the war industrially . . . will cause the Central Powers to hesitate in taking steps toward a restoration of peace. . . . In view of these possibilities would it not be

²⁰ W. K. Hancock, *Survey of British Commonwealth Affairs*, Vol. II, Part I (London, 1940), p. 96.

²¹ Hancock, *op. cit.*, p. 138; W. A. S. Hewins, *The Apologia of an Imperialist* (mostly in diary form), Vol. II (London, 1929), *passim*.

²² Alfred Marshall, "National Taxation after the War," in *After-War Problems*, ed. by W. W. Dawson (London, 1917), p. 344.

²³ Hewins, *op. cit.*, p. 132-133.

well to consider the advisability of holding a Congress of Neutrals to . . . determine upon ways and means to relieve the present situation and to provide for the future . . . the best way to fight combination is combination?"

The same fears cropped out in a Senate resolution . . . inquiring of the President what was the "character, form and full purpose of this new action by the Allies."¹

The Paris Resolutions were submitted in England in July, 1916, "for special reference" to a newly appointed "Committee on Commercial and Industrial Policy After the War." The chairman of this committee was Lord Balfour of Burleigh, and Mr. Hewins was one of its members. The committee's final report is dated December 3, 1917, i.e., eight months after the entry of the United States into the war. At that time the world-wide extension of the Entente, together with the *letter* of the Paris Resolutions which, after all, had foreseen a postwar economic alliance between the Entente countries, could have led to the planning of a strong nucleus for future international economic collaboration. But it was the nationalistic and restrictionist *spirit* of the Paris Conference which prevailed. In spite of a number of qualifications the emphasis of the Balfour Committee's report is on imperial preference, postwar restrictions of trade with former enemy countries, protection of essential industries, protection against dumping and "sweated goods," control of economic activities exercised by aliens, and, finally, the rejection of the decimal system in weights, measures, and coinage!

Only three months earlier, President Wilson had already foreshadowed his own program of postwar economic reconstruction in the American reply to the Pope's offer of mediation:

Responsible statesmen must now everywhere see, if they never saw before, that no peace can rest securely upon political or economic restrictions meant to benefit some nations and cripple or embarrass others, upon vindictive action of any sort, or any kind of revenge or deliberate injury. . . . Punitive damages, the dismemberment of empires; the establishment of selfish and exclusive economic leagues we deem inexpedient and, in the end, worse than futile, no proper basis for a peace of any kind, least of all for an enduring peace.²

¹ Ray Stannard Baker, *Woodrow Wilson, Life and Letters*, Vol. VI (New York, 1937), pp. 229-230.

² *New York Times*, August 29, 1917. In the original draft of his reply, the President had used the word "childish" instead of "inexpedient." In deference to Allied senti-

In addition to his position on grounds of principle, Wilson repeatedly pointed out how impolitic it was to menace Germany with punitive measures against her trade after the war, since such threats would inevitably stiffen the German spirit of resistance.³

Thus, a clear-cut opposition is obvious between the spirit of the Paris Resolutions and the Balfour Committee's report, on the one hand, and the policy of the American President, on the other.⁴ This opposition remained unresolved and was brought into the open one year later at Versailles.

The kernel of the economic reconstruction after the First World War should have been the third of Wilson's Fourteen Points, which called for "the removal, so far as possible, of all economic barriers and the establishment of an equality of trade conditions among all the nations consenting to the peace, and associating themselves for its maintenance." But two months before the Armistice, Clémentel, the French wartime Minister of Commerce, who in 1915 had initiated the Paris Economic Conference, addressed a detailed letter to Clémenceau and Wilson outlining the French program of postwar economic organization.⁵ This program was directly inspired by the Paris Resolutions, being an ardent plea for close postwar economic collaboration among the Allies and for discriminating measures and safeguards against Germany.

Actually, Allyn A. Young, with his firsthand knowledge as the Economic Adviser to the American Peace Commission, was later to describe the third of Wilson's Fourteen Points and the Paris Resolutions as the two conflicting fountainheads of the economic

ment and upon the advice of Colonel House, he substituted the latter term. Cf. Charles Seymour, *The Intimate Papers of Colonel House*, Vol. III (New York, 1928) p. 164.

³ Cf., e.g., Baker, *op. cit.*, Vol. VII, pp. 341-342.

⁴ American opinion and policy, however, was not free from the influences which had shaped the Paris Resolutions. A publication of the Bureau of Foreign and Domestic Commerce on *German Trade and the War* (Washington, 1918) quotes approvingly in its conclusion a speech by an Italian industrialist, from which we extract the following characteristic passage: "The German people, feeling the bitter lesson of their defeat, will renounce, let us hope, for a long time, their mad ideas of reconquest or of revenge, but it will be necessary in every way for us to make haste in defense against their methods of economic invasion."—*Op. cit.*, p. 153. Cf. also the introduction, by Herbert Hoover, Vernon Kellogg, and Frederick C. Walcott, in the book by Siegfried Herzog quoted above. The most violent book on the German economic menace known to the present writer was written *after the end of the war* by an American journalist, Stanley Frost, under the title, *Germany's New War Against America* (New York, 1919).

⁵ Clémentel, *op. cit.*, pp. 337-348.

sections of the treaty.¹⁰ The real nature of the compromise is, however, visible in articles 264 and 265, which impose most-favored-nation treatment upon Germany without stipulating anything with respect to the commercial policy of the Allies. According to the Paris Resolutions, the Allies should have refused most-favored-nation treatment to Germany "for a number of years," whereas, according to Wilson's Third Point, they should obviously have granted her "equality of trading conditions." The silence concerning the commercial policy of the Allies meant that there was no open contradiction between the treaty and Wilson's Third Point, but that in practice the door was open for the application of the Paris Resolutions. It was also in the spirit of the Paris Conference to act as if the political independence of the restored or newly created nations could be nothing but a "sham independence" unless supplemented by full "economic independence," which not only meant full economic sovereignty but even implied efforts to be self-sufficient with regard to all essential economic activities.

The system proposed by Wilson was based upon the relatively liberal policies—reducing trade barriers and supporting nondiscrimination—to be conducted independently by the various nations retaining, in all other respects, their full economic sovereignty. But the Paris Resolutions had outlined a restrictionist and discriminating policy which was to be implemented by an enduring association of the Allied powers even after the war. Between these two poles, the economic groundwork laid at Versailles and the commercial and economic policies worked out during the pre-1939 peace years, a compromise of the worst kind was evolved, combining as it did the principle of full economic sovereignty and the practices of restriction and discrimination.

With that refined instinct which can only be created by passionate partisanship, Hewins detected the intrinsic weakness of the Wilsonian position as early as 1917. Commenting on Wilson's reply to the Pope's offer of mediation, Hewins asserted what was to become

¹⁰ Allyn A. Young, "The Economic Settlement," in *What Really Happened at Paris*, ed. by Colonel E. M. House (New York, 1921), pp. 309-317; cf. also the same author on "Commercial Policy in German, Austrian, Hungarian and Bulgarian Treaties," in *A History of the Peace Conference of Paris*, ed. by H. W. V. Temperley, Vol. V (London, 1921), p. 65, and Bernard M. Baruch, *The Making of the Reparation and the Economic Sections of the Treaty* (New York, 1930), p. 82.

the standard argument against American commercial policy: "In effect Wilson invites the Powers to adopt a policy of international free trade to protect the isolation of the U. S. A."¹¹ Since that time much has been said about the failure of the United States after 1918 to adjust the structure of its foreign trade to its new position as a creditor nation. And it is certainly true that the United States, constituting an immense and highly protected economic empire, was in an unfavorable position to combat "the establishment of selfish and exclusive economic leagues." Wilson himself, when pressed to comment on the third of his Fourteen Points, interpreted it in a limited sense by saying that he insisted only upon the policy of non-discrimination. He declined to make any reference whatever to the "removal, as far as possible, of all economic barriers."¹²

The unwillingness of the United States to make a contribution to the rehabilitation of international economic relations by tariff reductions or, at least, by an agreement to stabilize existing tariffs, however, can be considered as only one reason for the utopian flavor and the eventual defeat of Wilson's policy. An even more important factor contributing to the weakness of the American—or rather, Wilsonian—position has been pointed out more recently. This was the premature breaking up of the agencies of Allied economic collaboration which had been created for war purposes but which could have been turned to the tasks of relief and reconstruction.¹³

A third element which made for the victory of economic nationalism in the period between the two wars was an insufficient appreciation of the very earnest motives which had led to the adoption of the Paris Resolutions. In describing these motives in detail, we have seen how events before 1914, how German plans for Mitteleuropa during the war, and how a body of writings on these subjects had imbued public and statesmen alike with the fear that external economic relations might be used as instruments of power policy. Not only Germany, which had gone through the experience of Allied

¹¹ Hewins, *op. cit.*, Vol. II, p. 165.

¹² Baker, *op. cit.*, Vol. VIII, pp. 503-504, 524-525. Cf., also, Seymour, *op. cit.*, Vol. IV, pp. 193-194.

¹³ Cf. J. B. Condliffe, *Agenda for a Post-War World* (New York, 1942), pp. 58 f., and E. H. Carr, *Conditions of Peace* (New York, 1942), pp. 249 f. For detailed reference, see Henry B. Brodie and Karl W. Kapp, "The Breakdown of Inter-Allied Economic Collaboration in 1919," in National Planning Association, *United States' Cooperation with British Nations*, Planning Pamphlets, No. 6 (August, 1941).

After 1918
Wilson's policy
was to protect
the isolation of
the U.S.A.
by international
free trade.

economic blockade, but all nations had become conscious and afraid of the possibilities of economic domination. This consciousness and this fear—carefully nourished and exploited by a host of sectional interests—were to determine their external economic policy just as their internal policy was vitally affected by the Russian Revolution, which had rendered the middle classes the world over conscious and fearful of social revolution.

A considerable amount of opposition to the Paris Resolutions was evident in all the Allied countries, particularly in England and the United States; but this opposition, although fully aware of the dangerous economic and political consequences involved, generally ignored or denied the problem which the Paris Resolutions had at least attempted to solve. Let us summarize briefly this section of opinion, which formed the ideological background of President Wilson's position.

The Paris Resolutions were generally interpreted by their opponents as a wartime offensive of the protectionists; critical appraisal was often restricted to a mere restatement of the merits of free trade, of the most-favored-nation clause, and of the open-door principle.⁴⁰

At the times it was touched upon, the idea that the state could use commercial relations for ends of national power was entirely dismissed. As early as 1904 William Smart struck this note in a book directed against the tariff reformers: "All the nonsense one hears about dumping as a 'national conspiracy' is derived from the fallacious idea which thinks of another nation as an industrial unit."⁴¹ Still more outspoken was J. A. Hobson, who devoted a booklet to the refutation of the thesis adopted at the Paris Economic Conference.⁴² In the chapter entitled "How to Meet Trade Aggression," he writes:

The German State had a powerful secret service in many foreign countries, and may have utilized branches of German firms abroad as sources of political information. The widespread employment of German clerks in foreign commercial houses has undoubtedly given German firms a fuller knowledge of the business conditions of their foreign com-

⁴⁰ *The Economist* of July 8, 1916, p. 55, reproduced in full a letter of protest by liberal peers and Members of Parliament. For a general review of the opposition in various countries, cf. E. M. Friedmann, *International Commerce and Reconstruction* (New York, 1920), pp. 108-116.

⁴¹ William Smart, *The Return to Protection* (London, 1904), p. 161, quoted in Viner, *Dumping, etc.*, *op. cit.*, p. 61.

⁴² J. A. Hobson, *The New Protectionism* (New York, 1916).

petitors than commercial firms in England possess. But all these arts and practices are nothing else than an intelligent seizure of legitimate business opportunities. . . . The notion that all this expanding trade and finance have been the cat's-paw of the aggressive German state is baseless. . . . The suggestion that German traders, bankers, colonists, are merely advance agents of the German state is one of those impositions upon credulity which would not have been possible in any other atmosphere than that of war.⁴³

This startling statement was written when several international crises and wars leading up to the First World War had occurred, crises in which, as future research was to show, trade and finance had often been more the instruments than the determinants of diplomacy.⁴⁴

Even Professor Cannan, who had so clear a view of the necessities of effective international government, saw in the "new protectionism" "nothing but the old protectionism utilizing the ill-feeling created by the war and its unchivalrous incidents."⁴⁵

Of prominent free trade economists at the time of the First World War, Edgeworth alone seems to have recognized the existence and the importance of the problem. This may be an outcome of his close contact with Continental thinking, on the one hand, and of his pre-occupation with the theory of the terms of trade, on the other.⁴⁶

He clearly recognized and, to some extent, defended "the motives of those free traders who took part in the Conference of Paris. The danger which they had in view was not the bogey of the common protectionist, not the action of normally competing merchants, but 'dumping' or some other form of 'penetration' engineered and subsidized by a hostile government acting in monopolistic fashion, like a trust when it 'freezes out' its rivals."⁴⁷ It should be noted that Edgeworth pleaded here only for a better appraisal of the motives of those responsible for the Paris Resolutions, not for the resolutions themselves. He was far from agreeing with them, but he recognized

⁴³ Hobson, *op. cit.*, pp. 78-79.

⁴⁴ Cf. Eugene Staley, *War and the Private Investor* (New York, 1935), *passim*.

⁴⁵ In the review of Mr. Hobson's book reprinted in *An Economist's Protest* (London, 1927), p. 89. Cf. also his blunt statement: "Of all the discreditable tomfooleries of which we have been the victims, the 'war on German trade' was the most idiotic."—*Ibid.*, p. 63.

⁴⁶ See above, p. 11.

⁴⁷ F. Y. Edgeworth, *Papers Relating to Political Economy*, Vol. III (London, 1925), p. 225.

clearly the reality of the question raised by him in a not unfavorable review of Preziosi's book: "How are we to define the arts and aims to which the odious character of 'conquest' is properly attributable from a 'penetration' which is really peaceful and conducive to the increase of the world's wealth and the survival of the economically fit?"⁴

Edgeworth thus stands between the two groups which our analysis of World War I discussions on postwar economic policy has revealed. Between those who ignore the danger of external economic relations becoming an instrument of national power aims and those who see the danger but try to remedy it by the defensive and offensive weapons of economic nationalism, a place should indeed be left to those who, faced with the danger, refuse to follow the policy either of the ostrich or of Gribouille.

⁴ *Ibid.*, Vol. III, p. 203.

During & before WWI thinking on
 the political impact of trade was dominated
 by two groups: liberals who regarded
 the state that trade was an instrument
 of public power because traders were
 seen as independent actors not
 agents of the state; others who
 saw foreign trade as directly intimately
 related to foreign policy. Both felt
 the only way a country could
 cope with this was by adopting
 an aggressive economic policy of its
 own. Few thought of how to
 create structures that would
 manage the field well to which
 trading relations could be put.

Problems of Reconstruction

BOTH OUR THEORETICAL and historical analyses—supplemented in Part II by statistical evidence—permit certain conclusions which can be made available for the current discussion on postwar reconstruction.

The situation with which we are confronted today and which will have to be met after the end of the war is in many ways similar to that which resulted during and after World War I. As at the Paris Economic Conference of 1916 and subsequently at Versailles, the fear of "economic aggression" and the prevention of its recurrence will be a major preoccupation of our future peacemakers.

We shall examine three possible attempts to solve the question: (1) the imposition of certain restraints upon the commercial and economic policy of Germany and her allies; (2) universal free trade; and (3) the abolition of discriminating practices and the restriction of state intervention. The appraisal of these proposals will lead up to the principle which, in my opinion, should guide the reconstruction of international economic relations.

The disarmament of Germany, Italy, and Japan will certainly have to include an economic disarmament which will prevent the use of the productive powers of these countries for aggressive purposes. A distinction should, however, be made in this respect between the economic basis of military aggression and economic aggression proper. Although the task of securely preventing at the source any future rearmament of the Axis countries is admittedly a difficult one, it is not without prospect of a reasonable solution. The crucial importance of gasoline as a raw material, of the airplane as a weapon, and of the machine-tool industry as the industrial basis of modern warfare points to the possibility that a tight control in a few strategic points within a country's economy might paralyze its power to prepare for war without impairing its capacity to produce for the purposes of civilian consumption.