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The Long-Run Effect of Development and Industrialization Abroad on the United States *

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I. Historical Attitudes of Industrial Countries toward Industrialization Abroad.

"Is Export of Machinery Economic Suicide?" This succinct question was the title of a little tract published at the beginning of the century by one of the lone free trade economists of Imperial Germany. 1/ The tract ably answered the question in the negative, but its publication was symptomatic of the widespread alarm that was felt at the time in Germany about the industrialization of new areas of the world and about the "suicidal", though, in the meantime, highly profitable help in this process extended by the older industrial countries.

In truth, the technically more advanced countries have been

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* Prepared by Albert O. Hirschman.

1/ Heinrich Dietzel, Ist Maschinenausfuhr volkswirtschaftlicher Selbstmord? (Berlin, 1907).

remarkably inconsistent in their attitude toward the less advanced countries ever since the rise of manufacturing: they have alternatively and often simultaneously helped, feared, and attempted to block, the efforts of these countries to acquire industrial techniques and equipment. The most consistent attempt at blocking was made during the mercantilist period when all manufacturing nations issued prohibitions against the exports of machinery and the emigration of skilled artisans; these regulations could not be enforced with the coming of the industrial age and evasions became so widespread that they either fell into disuse or were formally repealed as happened in England a century ago.1/ But while England did nothing to prevent the spreading of industrial methods to other nations that marked the second half of the nineteenth century, this development did not fail to arouse many misgivings. No less an economist than Stanley Jevons warned in 1865

1/ "The export of machines was prohibited because it was feared that this would help a competing industry in another country. One of the first examples of this was the export prohibition, ... against stocking frames in England (1695/96), followed by a similar measure in France in 1724. About this time there was also a considerable fine in France on the export of textile implements in general. In various other ways, too, every possible obstacle was placed in the way of this export. At the beginning of the 1720's, Jonas Alstromer, the most enthusiastic protagonist of manufactures in Sweden in the 18th century, experienced the greatest of difficulties in smuggling from France and Holland the equipment which he needed for the formation of the Alingsas textile works. In England it was not until a somewhat later date (1750 and 1774) that the export of various textile machines and instruments was forbidden and there soon followed similar prohibitions against the export of iron-producing machinery (1781). Once this policy had been set going it was elaborated on all sides and pursued for a considerable time. In England, the country where an independent machine industry originated, the prohibition against its export was not abandoned in effect before 1825, while officially it persisted until 1843." Eli F. Heckscher, Mercantilism (London, 1934), Vol. II p. 147.

that the emigration toward the United States would "develop, or rather complete, abroad systems of iron and coal industry in direct competition with ours". 1/

The rapid rise of German and American industry benefited the British economy in many respects, but at the same time alarmed British opinion; an extensive literature grew up toward the end of the century describing in particular the disastrous dangers of the German trade rivalry. 2/

But the fears of the Industrialization of undeveloped countries found their most outspoken expression in Germany itself; with remarkably bad taste, that country had hardly joined the small band of industrialized countries when it was already intent on slamming the door behind it in the face of any additional newcomers. German foreign economic policy before both World Wars I and II actually contains several instances of direct

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1/ Stanley Jevons, The Coal Question, Third Edition Revised, (London 1906) p. 424. See also the interesting quotation from Torrens provided by J. Viner in "The Prospects for Foreign Trade in the Post-War World", Transactions of the Manchester Statistical Society (1946) reprinted in Readings in the Theory of International Trade (Philadelphia 1949) p. 520. It is possible that some classical economists adopted the pessimistic view as a result of their habit of reasoning in terms of the two-country, two-commodity model of foreign trade. Another reason for their preoccupation was the way in which the law of Diminishing Returns was expected to operate in reducing the profitability of agriculture in the food-exporting countries. But this source of alleged danger for the international division of labor between industrial and agricultural countries has in general played a far less important role in the discussion than the industrialization argument. The latter argument would be strengthened by the existence of diminishing returns in agriculture, but does not depend on it.

2/ See Ross J. S. Hoffmann, Great Britain and the German Trade Rivalry, 1875-1914 (Philadelphia, 1933).

attempts at preventing industrialization of other countries. 1/

With the possible exception of their own colonies it proved, however, generally impossible for the older industrial countries to prevent the spread of industrialization to other countries and, once this was clear, every industrial country wished for its own manufacturers to capture the profitable market in capital goods that was the consequence of world-wide industrialization. Nevertheless, opinion in the industrial countries always remained apprehensive about the ultimate outcome of the process. The effect in the interwar period of the Japanese trade expansion on specific old established industries such as the British cotton mills seemed to justify the pessimistic forecasts about the eventual doom of the older industrial countries who had allowed their secrets to be copied.

II. The United States Attitude.

Among the many expressions of these gloomy views, one voice is almost consistently absent: that of the United States. 2/ Indeed, once this country turned its attention to the problem, it was in order to foster the development

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1/ For German policy prior to World War I see J. Viner, Dumping: A Problem of International Trade (Chicago, 1924). p. 52. Literature on Germany's Foreign economic policies before World War II in this respect is too voluminous to be quoted here.

2/ There has been one recent exception: During the Congressional debate on the bill vesting in the Export-Import Bank the power to guarantee private capital invested abroad against certain risks peculiar to foreign investment, the opposition used the argument that foreign investment would create competition for domestic industry through the use of cheap foreign labor. (See the speech by Rep. Wolcott, Congressional Record, July 11, 1950, p. 10031 f.) Other examples of such arguments can probably be found, but there has never existed in this country anything approaching the national anxiety, fostered by leaders of public opinion, that has been characteristic of some European countries.

of undeveloped countries through the promotion of the International Bank for Reconstruction and Development, through the development loans of the Export-Import Bank, and finally through the elaboration of the Point Four Program. It is of considerable interest to analyze the probable reasons for the apparen absence of concern in the United States over any untoward effect of foreign development and industrialization on the U. S. economy. For, in the course of this analysis, we will not only discover why we have been traditionally exempt of a fear that has afflicted most other industrial countries, but we will also find out whether we have any reasons to change our traditional outlook on this problem.

Possibly the most important reasons for our lack of concern about industrialization abroad is the composition of our exports. In contrast with a country such as the United Kingdom, our exports of manufactures consist typically of articles that are geared either to increases in production (machine tools and other capital goods), or to high and expanding levels of income (automobiles and other consumers' durables). For this reason, our exports are not only not endangered by industrialization and development abroad, but on the contrary stand to gain considerably from expanding production and rising incomes in other parts of the world. This is in marked contrast with those industrial countries whose exports were mainly based on such goods as textiles, hardware, glassware, etc., the production of which is usually among the first undertaken by newly industrializing countries. Moreover, the United States also exports substantial quantities of industrial raw materials, such as cotton, petroleum, sulphur, etc. and these exports therefore are likely to gain directly from an expansion of manufacturing abroad.

The industrial countries of Europe, in particular England and Germany, viewed with concern and alarm the building of foreign industries not only because of the prospective competition for their own export industries; there was the additional fear that, once the foreign markets were lost, they would not have any countervalue to offer for the foodstuffs and raw materials on whose massive imports they had come to rely for the sustenance and employment of their people. Actually, the "fear of becoming a predominantly industrial state", often voiced in Germany during the period of rapid industrialization toward the end of the 19th century, had in part its roots in this vision of a country that finds itself suddenly deprived of the essential supplies because it can no longer market its manufactures abroad. Such apprehensions gave considerable impetus to the German policies of agricultural protection and of colonialism.

In the United States, such fears could never become very oppressive: for the dependence of our economy on foreign supplies has always been quantitatively and qualitatively of a much smaller order than that of the Western European industrial countries. There would be no starvation in the United States even if we were to be cut off overnight from our foreign sources of supply as a result of industrialization abroad.

There are other less tangible factors that are equally important in explaining the United States attitude toward foreign development.

After all, the differences in foreign trade structure between Germany and the United States, important as they are, are not so great as to explain why Germany should have been generally alarmed and the United States largely unconcerned by industrialization abroad. For if the United States had good reasons for its attitude, the German fears were largely unfounded. Even some contemporaries pointed out, statistics in hand, that industrial countries usually are each other's best customers. The truth is that German writers took a certain delight in showing that the industrial countries were digging their own grave through the export of machinery and industrial techniques. This propensity for discovering apocalyptic historical vistas has been a general trait of German historical and sociological writing since the 19th century. It can, e.g. also be found in the familiar Marxist analysis which showed how capitalism was preparing its own destruction through the creation of a proletariat and how competition was destined for extinction because of the way in which the competitive struggle led to monopoly. These numerous prophecies of doom do not teach us so much about the real nature of industrialism, capitalism, and competition as about the state of mind of their intellectual authors, ill at ease in the industrial age, and therefore inordinately fertile in finding proofs for its inevitable dissolution.

The fundamental reason why these theories have never gained much credence or influence in the United States is to be found in the absence of the many conflicts and strains - deeply embedded in history - that in Germany and many other European countries resulted in a widespread intellectual hostility toward industrial capitalism. In this country, any difficulties accompanying our economic development were generally interpreted as difficulties of growth, remedies for which could readily be found from case to case, rather than as deep-seated cracks fated to bring about the collapse of our whole economic structure.

Instead of casting an uneasy eye toward the industrial advances of other countries we have always believed in the possibilities of further economic and technological progress and in our ability to maintain industrial leadership. Moreover, our economic history testifies abundantly to the benefits of vigorous industrial expansion; and a theory maintaining that any further extension of industrialism, be it within or without our borders, is disastrous or even dangerous, is *prima facie* suspect to us.

These historical and psychological reasons are at least as important as the purely economic ones in explaining why we not only have *practiced* foreign economic and industrial development, but why, unlike other industrial nations, we have generally not been alarmed by this practice and have lately taken the lead in advocating it as a matter of public policy.

III. The Arguments and the Facts.

In the preceding paragraphs we have already had occasion to mention some of the arguments that have been used in demonstrating either the dangers or the benefits of foreign industrialization and development for the older industrial countries. We shall now review the controversy in a more systematic fashion.

The market-destroying effects. - It is easy enough to understand how industrialization of new areas can be harmful for the established industrial countries. Certainly the local refining of ores and canning of food will take work away from the refineries and canneries of the countries that previously imported materials and foodstuffs in their raw state. No doubt, the setting up of cotton mills in the developing countries reduces the market of the old established cotton industries. It is also possible that the country with the newly established industries may eventually compete successfully with the older industrial countries in third markets and we cannot even exclude the possibility that it may do so in the market of the very country that originally supplied it with finished goods as well as with the capital necessary for industrialization. Is it not natural enough then to cast the industrializing country in the role of the snake reared and nursed at the bosom of the older industrial countries?

The strength of this argument lies in its simplicity and directness. In this, it has a striking affinity to the early arguments against the introduction of labor saving machinery. The counter-arguments are very similar in both cases: It is shown first that the harmful direct effects described above are more than compensated by a number of beneficial indirect effects. Secondly it is argued that the incriminated process is already underway, that it cannot be halted, and that therefore it is far better to lead it into beneficial or at least innocuous channels rather than futilely to oppose and bemoan it.

<u>The market-creating effects</u>. - The first market-creating rather than market-destroying effect of industrialization (here again the analogy with the argument for the introduction of labor-saving machinery is obvious) relates to the demand for capital goods in the newly industrializing country. This demand clearly has been for some time of the greatest importance for the continued vitality of the exports of older industrial countries. Nevertheless, in itself the new demand for, say, textile machinery cannot lastingly compensate for the loss of old markets for finished textiles.1/

1/ A. J. Brown, Industrialization and Trade (London 1943) pp.36-39

The second and more powerful market-creating effect of industrialization rests on its income-generating aspects. It is easily shown how for many countries a soundly conceived process of industrialization is a necessary component of any development that would lift these countries to higher levels of real income. These increases in income will result in higher demands for all kinds of goods, including imports. In this fashion new markets will be created all around and in the end the older industrial countries will find that they can export new varieties of manufactures in far greater quantities than previously.

These arguments are valid enough and they are made even more convincing by the statistical evidence that has been accumulated in their support.

<u>The statistical evidence</u>. - The statistical material has brought out the following facts:

(1) Not only do imports of all kinds show a universal tendency to rise with per capital income, 1/ but imports of manufactured goods have generally increased in countries progressing along the road of industrialization. The increase in imports of manufactures generally lagged behind the increase in local manufacturing, but it is worthy of note that imports of manufactures generally showed a tendency to rise most in countries where a rapid process of industrialization took place.

1/ With respect to the United States, for instance, it has recently been calculated that, from 1936 to 1940, "the people of the well-developed areas bought from the United States, on the average, $5.80 worth of goods per person per annum. The people of the intermediate areas bought, on the average, only $1.25 worth and those of the underdeveloped areas only 70 cents worth." Department of State, <u>Point Four</u>, Washington 1950, p. 10.

This relationship is illustrated by the following table taken from the League of Nations report on Industrialization and Foreign Trade 1/

	Manufacturing	Imports of Manufactures
	1926/29 as percentage of 1891/95	
Japan	1,932	628
Finland	583	473
United States	436	230
Sweden	405	480
Italy	394	189
Germany	279	185
France	260	127
United Kingdom and Ireland	143	195

(2) World trade is not by any means confined to the exchange of manufactures against foodstuffs and raw materials. This "traditional type of interchange" in fact, amounts to only about one-third of total world trade; the remaining two-thirds consist of the exchange of some foodstuffs and raw materials against other foodstuffs and raw materials on the one hand, and, on the other, of the exchange of some manufactures against other manufactures. It has been shown that approximately one-half of the manufactures entering world trade are exchanged against other manufactures, and only the other half against foodstuffs and raw materials. 2/ In a more detailed way, it has been shown that many countries "export and import what are apparently the same commodities" whereas in fact they are only broadly similar but differ in quality, price, design, and in other respects. 3/

1/ Princeton 1945, p. 93.

2/ A. O. Hirschman, National Power and the Structure of Foreign Trade, (Berkeley, 1945) pp. 117 - 157.

3/ H. Frankel, "The Industrialization of Agricultural Countries", Economic Journal, June - Sept. 1943, pp. 188 - 201.

These statistical findings show only that on balance industrial countries have nothing to fear, and much to gain, from the industrialization of other countries. Naturally they do not and cannot show that there will be no harm to any industry or firm. It is clear that industrialization will mean smaller markets and more competition for some industries of the old industrial countries.

In order to maximize the net gain to be derived by the industrial countries from the industrialization of underdeveloped countries, the old industrial countries must strive to fulfill three conditions:

(1) The exports of these countries should specialize as much as possible in such lines as are likely to be benefited, rather than hurt, by industrialization abroad. These lines are capital goods and such consumers' goods whose production is rather complex and whose consumption is sensitive to rises in income.

(2) These countries must actively develop new and improved processes and products so as to maintain their trade position with as little disturbance as possible.

(3) Finally, these countries must maintain a sufficient degree of mobility and adaptability in their economy so as to be able to shift resources away from those branches which are threatened by foreign industrialization.1/

It is quite evident that among all industrial countries it is the United States which comes nearest to fulfilling all three of these conditions.

1/ See in particular, Eugene Staley, World Economic Development (Montreal 1944) pp. 159 ff.

IV. The "Magic" of Industrialization.

So far we have only given the reasons for which the industrialized countries should not fear development and industrialization abroad. There are, in addition, powerful reasons why they should promote it so as to be able to influence it in the right direction.

The leaders of the under-developed countries throughout the world have been caught by the magic of the words "Development" and "Industrialization". Whether or not they have studied the relevant correlations and scatter diagrams1/ they are fully aware that there exists an almost straight line relationship between per capita income and percentage of the population not absorbed in agriculture.

They are, if anything, overaware of this relationship: Industrialization, the creation of any industry whatsoever, is often held the only key to the escape from age-old poverty. Given this mentality two dangers have to be guarded against:

(1) Too much emphasis should not be placed on industrialization in development programs, and over rapid and uneconomic industrialization must be avoided. This double danger has been clearly recognized by the United States. In the Point Four Program, for instance, the accent is as much or more on teaching the undeveloped countries to do more efficiently the things they are already doing (in agriculture and small-scale industry) than on the setting up of entirely new industries.

(2) The second danger is that, in their haste to industrialize, the

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1/ For these, see Louis H. Bean, "International Industrialization and per Capita Income", Nat. Bur. of Econ. Research, Studies in Income and Wealth, Vol. VIII, 1946, pp. 121 - 144.

undeveloped countries will be tempted to adopt the totalitarian methods which, without doubt, have been highly successful in Russia. It is in this connection that the timely provision of technical and financial assistance from the older industrial countries, can be decisive in convincing the undeveloped countries that they do not need to buy economic progress at the exorbitant political and human cost which has been paid by the Russian people.

V. International Trade in an Industrialized World

In view of the predisposition of the United States in favor of development and industrialization, there is little need further to elaborate on our argument. On the contrary, a useful purpose may be served by concentrating attention on some of the problems raised by the process. The need for the industrial nations to preserve mobility and to encourage further technological progress as well as the dangers of unsound industrial development for non-industrial countries have already been pointed out. At the end of our short survey, we may perhaps speculate about the institutional changes required in a world where the prime determinants of international trade would no longer be differences in climate and natural resources and where there would no longer be just one or even a small group of nations that can claim being "the workshop of the world." Let us say from the outset that such is far from being the present condition of the world. An inspection of any table showing a few basic indexes of industrialization (horsepower per capita, etc.) reveal the huge disparity in industrial development among nations. It is even far from certain that this disparity has substantially decreased during the past generation or two. Nevertheless, if we advocate world-wide industrialization, we should look forward to a world economy where many of the presently underdeveloped countries will have become proficient in a number of industrial processes.

Such a development does not hold sinister implications for the future of international trade since there will certainly remain room for a profitable division of labor among nations. But it may be asked whether a division of labor based essentially on differences in skill and on the past history of industrial development is not likely to be more unstable than the simple and "natural" division of labor between industrial and agricultural nations. Countries with an established system of industry, with a good transportation system, with a pool of engineers and technically skilled workers can usually graft additional lines of output onto their existing industrial structure without too much difficulty. In every single instance the loss from the pre-existing international specializationis likely to be small although in the aggregate these losses may be quite considerable. For this reason, disintegration of the finely wrought international division of labor which we have in mind here, is dangerously likely as long as nations remain entirely free to pursue autonomous domestic economic policies, as long as sectional interests can push for special advantages under the cover of national interest, and as long as the special risks affecting international as opposed to internal trade have not been eliminated. 1/

One example may perhaps make clear this proposition. Slot machines are produced in the United States today exclusively in Chicago while Hollywood has a virtual monopoly on the production of movies. This division of labor is based more on historical accident than on any basic difference in the

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1/ D. H. Robertson diagnosed this danger in his article "The Future of International Trade", Economic Journal (1938) reprinted in Readings in the Theory of International Trade, Philadelphia 1943, pp. 505 - 506.

distribution of natural or human resources. Nevertheless, it is presumably beneficial to both movie-goers and slot machine addicts and there is little prospect that Los Angeles will add the production of slot machines and Chicago that of movies thereby destroying these benefits. But would this still be the case if a national boundary line were drawn tomorrow along the water shed of the Rocky Mountains? Is it not likely that at one time or the other the West Coast State would then experience balance of payments difficulties with the Middle West State and would restrict the importation of such "non-essentials" as slot-machines? Would not then a profitable internal market be created in the West Coast State for the "domestic" production of such machines just as, in the absence of European imports during World War II, California was quick to build up a ceramics industry? And once such an industry had come into being would it not be likely to be protected by the West Coast State, to "safeguard employment" and for similar well-known reasons even after the balance of payments difficulties have long been overcome? Are we not then confirming, through a slightly more sophisticated route, the very thesis which we thought we had refuted, namely, that world-wide industrialization makes the future of international trade dark and hazardous indeed?

In answering this question we must first repeat that this danger is remote insofar as the undeveloped countries are concerned. It has taken on actuality only for the small, but important group of countries formed by the United States and Western Europe. Within this group we have indeed already experienced a substantial regression from the delicate integration that existed within it before the First World War or again in the twenties. But within this group also we are now witnessing the beginning of a major effort to reverse this process by changing the institutional framework within which the intertrade of the group operates. By creating closer forms of economic association, it is hoped that serious divergences of national economic policies can be avoided, that sectional interests can be held in check, and that the special risks affecting foreign trade can in general be reduced.

It remains to be seen to what extent this aim can be achieved through cooperation in the economic field alone. Closer forms of political association may be required to convert what is today international trade into the interregional trade of tomorrow. But, in any event, current efforts are encouraging evidence that we are not passive in the face of the dangers threatening fruitful specialization among advanced industrial countries.

Rather than dejectedly contemplating the operation of another dismal historical law, we are busily and, let us hope, successfully engaged in proving that the only historical laws are those which we ourselves accept and create.

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GERMANY'S FOREIGN TRADE -- AN OBJECT LESSON IN ECONOMIC SANITY

J. Herbert Furth

Economists who have become fascinated by controls -- and who will be called "controlists" for the sake of brevity -- are remarkable people: they have discovered the truth, and the truth has made them blind, blind to the arguments of their opponents -- who will be called "liberalists" 1/-- and blind to the facts they purport to analyze.

Liberalists believe that direct economic controls, though they may be unavoidable in emergencies, tend to hamper efficiency and economic progress. Controlists, on the contrary, believe that controls are "weapons which experience suggests are necessary in dealing with structural problems", and that a country struggling with such problems cannot throw them away without finding it difficult "to attain a high level of economic activity while maintaining monetary stability." So Germany, in a fit of pathological liberalism, abolished controls and saw its production rise within two years from 50 to 107 per cent of prewar. Whereupon the controlists sagely remark that it may be necessary for that country "to retreat from the liberal principles of economic policy hitherto followed." 2/

Controlists are particularly fond of applying their discoveries to international economic relations. Liberalists believe that the liberalization of international commercial policy tends in the long run not only to maximize the volume of imports and exports, but also to promote progress toward general equilibrium in the balance of trade. Controlists, on the contrary, believe that liberalization has a "negative rather than positive" effect upon the dollar balance of payments of non-dollar countries, and therefore leads to grave losses in reserves (ECE, op. cit., pages 105-107). So Germany, in another fit of criminal lunacy, liberalized its import policy, and true enough, immediately experienced a considerable rise in its trade deficit. 3/ The controlists were jubilant: they accused

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1/ The simpler word "liberal" cannot any longer be used in this connection: a prominent controlist insists that "the modern liberal ... may not differ greatly from the communist about the economic reforms which are necessary", but only about political views (B. S. Keirstead, The Theory of Economic Change, page 322); according to this definition, a "liberal" would be a radical controlist and thus the exact opposite of a liberalist.

2/ All these quotations from ECE, Economic Survey for Europe in 1949 (see this Review, July 18, 1950); ECE did not object to the rise in Germany's production as such, but to the fact that this rise did not fully absorb the extraordinary increase in the labor force which was due mainly to the inflow of refugees from the East.

3/ See G. Grimwood, Western Germany -- Liberalization of Trade; this Review, February 14, 1950.

the German authorities of "further distorting the picture of Germany's trade", and the German merchants of engaging in "an importing spree"; they called the process just another "sign of the rake's progress which is going on", and felt that the virtuous, controlist British "may be forgiven if they feel a certain amount of that typically German sentiment, Schadenfreude /joy at another's sorrow/." 1/

Controlists regarded the future of Germany's foreign trade with even greater gloom than they did current developments. Attempts to reduce Germany's trade deficit with the United States are "likely to be self-defeating" because they would reduce Germany's supply basis rather than increase its dollar earnings. "Attempts to gain greater export markets . . . in Western European countries are likely to be defeated by the prospective curtailment of Marshall aid", and by the increase in Germany's cost of production due to devaluation; moreover, the competition for the "limited markets" of Western Europe "will be fought out largely with the weapons of multiple prices, multiple exchange rates, or successive devaluations." Finally, "attempts to create considerably larger German exports to the new development areas . . . could only succeed if large credits were made available." Not enough that Germany thus could not possibly expand its exports, it also must raise its imports so that it would have a "presently foreseeable trade deficit of $2,000 million." 2/

These forecasts should take their place alongside with the famous predictions of postwar unemployment in the United States. Once again, history was kinder to the liberalists than to the controlists. In the second quarter of 1949, Germany had imports of $581 million and exports of $285 million, leaving a trade deficit of $296 million; in the same period in 1950, imports were about $525 million, exports $422 million, and the trade deficit about $103 million. The annual rate of the "presently foreseeable trade deficit" is thus about one-fifth of the predicted figure, and the progress seems to have been made by a pilgrim rather than a rake.

The situation is even more promising if the regional distribution of Germany's foreign trade is considered. As long as convertibility of currencies is the exception rather than the rule, progress toward overall equilibrium would mean little if it were accompanied by an increase in

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1/ All these quotations from the London Economist, January 21, 1950; the Economist, a source of joy and comfort to the liberalist in matters of domestic policies, is strictly controlist in its views on foreign trade.
2/ All these quotations from H. Mendershausen, Fitting Germany into a Network of World Trade; paper read at the annual meeting of the American Economic Association, New York, December 27, 1949.

regional disequilibria. Germany, however, has reduced regional as well as overall disequilibria. A comparison of data for 1949 -- which do not differ much from four times the figures for the second quarter -- with the annual rate of those for the second quarter of 1950 (see Table 1) shows a reduction in Germany's trade deficit with the United States from $775 million to about $310 million; with the rest of the Western hemisphere from nearly $135 million to about $90 million; and with the ERP countries plus the non-participating sterling area -- which under EPU should be considered a common region for purposes of international payments -- from $65 million to about $55 million. Trade with the rest of the world changed from a deficit of $140 million to a surplus of about $40 million.

This progress was achieved without any "reduction of Germany's supply basis" and without the use of "multiple prices, multiple exchange rates, or successive devaluations." The liberalization of trade with the ERP countries resulted indeed in a sharp increase in imports from these countries, but mainly at the expense of "unrequited" imports from the United States. At the same time liberalization stimulated exports to these countries, and in consequence neither Germany nor the other ERP countries (including the entire sterling area) lost any reserves nor were they subject to a "negative rather than positive effect" upon their dollar balance of payments. While the annual rate of Germany's total trade volume (exports plus imports) increased by 13 per cent between 1949 and the second quarter of 1950, the volume of Germany's trade with the other ERP countries (including the entire sterling area) rose by 35 per cent.

In the fall of 1949 and the winter 1949/50, Germany signed "liberalized" trade agreements with eight ERP countries, including Austria, Belgium-Luxembourg, Denmark, France, the Netherlands, Norway, Sweden, and Switzerland. The annual rate of trade with these countries, including their dependent overseas territories (see Table 2), rose between 1949 and the second quarter of 1950 by about 36 per cent and Germany's surplus with these countries dropped from $65 million to about $35 million. In relation to the other ERP countries Germany liberalized its import controls unilaterally, following the recommendation of the Organization for European Economic Cooperation. The annual rate of trade with these countries (including the entire sterling area) rose by 33 per cent and Germany's deficit with these countries dropped from $131 million to $90 million. Whether bilateral or unilateral, liberalization has thus brought forth an increased volume as well as a better balance of trade.

Liberalists should be less willing than controlists to predict the future on the basis of scanty evidence. However, if political conditions- which at present overshadow all problems of economics and finance - permit a continuation of the trend that was visible during the first half of 1950, Germany's trade deficit with the world outside of the Weatern hemisphere would probably soon be converted into a surplus, and its deficit with the Western hemisphere would be substantially reduced. For the time being, there would thus remain a "hard core" deficit with the United States, amounting perhaps to some $250 million annually; this deficit would approximately correspond to the rise in cereal imports made necessary by the elimination of Germany's prewar sources of supply in Eastern Europe, and especially in the former Eastern provinces of the Reich. The sum would be less than 1 per cent of Germany's present national output, and about 7 per cent of Germany's present total foreign trade. Nevertheless, the gap might be difficult to close without the use of government grants or credits as long as the restoration of world-wide multilateral trade remains the pious hope of a few liberalists. However, the rapidity with which Germany has cut in half last year's dollar deficit, might indicate that even such a cautious statement could turn out to have been unduly pessimistic.

Table 1

Germany's Foreign Trade, 1949 - 1950
(Millions of dollars)

Area	1949			1950 (1st quarter) 1/			1950 (2nd quarter) 1/		
	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance
United States	47	822	- 775	48	476	- 428	56	364	- 308
Canada	6	21	- 15	4	12	- 8	8	4	+ 4
Latin America	32	150	- 118	78	104	- 26	100	196	- 96
Total West. Hemisph.	85	993	- 908	130	592	- 462	164	564	- 400
ERP non-sterl. area	785	770	+ 15	980	1,180	- 200	1,138	992	+ 146
ERP sterling area	128	118	+ 10	108	160	- 52	100	164	- 64
Non-ERP sterling area	36	126	- 90	44	204	- 160	56	192	- 136
Total ERP & sterl.area	949	1,014	- 65	1,132	1,544	- 412	1,294	1,348	- 54
Eastern Europe	61	107	- 46	108	92	+ 16	142	84	+ 58
Other Countries	28	122	- 94	56	140	- 84	88	104	- 16
Total Rest of world	89	299	- 140	164	232	- 68	230	188	+ 42
Grand total	1,123	2,236	-1,113	1,426	2,368	- 942	1,688	2,100	- 412

1/ Annual rate

Table 2

Germany's Foreign Trade with Selected ERP Countries, 1949-1950
(Millions of dollars)

Country	1949			1950 (1st quarter) 1/			1950 (2nd quarter) 1/		
	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance
Austria	65	14	+ 51	72	24	+ 48	64	32	+ 32
Belgium-Lux.	118	128	- 10	124	92	+ 32	144	60	+ 84
Belgian D.O.T.	2	20	- 18	*	20	- 20	4	12	- 8
Denmark	17	47	- 30	40	108	- 68	60	72	- 12
France	217	73	+144	168	116	+ 52	172	152	+ 20
French D.O.T.	3	24	- 21	4	76	- 72	4	72	- 68
Netherlands	104	112	- 8	220	288	- 68	264	256	+ 8
Netherlands D.O.t.	8	29	- 21	*	4	- 4	*	*	*
Norway	20	31	- 11	24	40	- 16	24	44	- 20
Sweden	68	85	- 17	92	140	- 48	84	108	- 24
Switzerland	71	64	+ 7	80	92	- 12	92	68	+ 24
Total	693	627	+ 66	824	1,000	-176	912	876	+ 36

1/ Annual rate

* Negligible