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A NEW LOOK AT
FOREIGN ECONOMIC POLICY
IN LIGHT OF THE COLD WAR AND THE EXTENSION
OF THE COMMON MARKET IN EUROPE

SUBCOMMITTEE ON FOREIGN ECONOMIC POLICY
OF THE
JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

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A NEW LOOK AT FOREIGN ECONOMIC POLICY

By
CHRISTIAN A. HERTER
and
WILLIAM L. CLAYTON

LETTER OF TRANSMITTAL

WASHINGTON, D.C.,
October 23, 1961.

HON. HALE BOGGS,
*Chairman, Subcommittee on Foreign Economic Policy,
Joint Economic Committee,
Congress of the United States.*

DEAR MR. BOGGS: In response to your request that we prepare for the Subcommittee on Foreign Economic Policy of the Joint Economic Committee of the Congress a statement of our views as to the course which the United States should pursue with respect to foreign economic policy, we are happy to send you such a statement herewith.

We have made this statement as brief as possible on the understanding that your subcommittee is having other studies made which deal in greater detail with some of the aspects of this problem.

We would be glad to discuss our views with you at any time, if you should so desire.

Respectfully,

/s/ WILLIAM L. CLAYTON.

/s/ CHRISTIAN A. HERTER.

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A New Look at Foreign Economic Policy

Twenty-seven years ago, with enactment of the Trade Agreements Act, the United States committed itself to a liberal foreign economic policy. That basic commitment has been renewed in eleven extensions of the act, but with restrictive amendments. Next year it must be renewed again. But "renewal" is a deceptive word if it suggests that what has been done eleven times in the past quarter century will suffice another time. It will not.

The time has come for the United States to take a giant step.

Two developments since the end of World War II pose the inscapable challenge and the one hope of answering it. The challenge is the cold war, in which the Soviet Union aims to divide the free industrial nations and at the same time win the underdeveloped countries of the world to communism.

The answer lies in the second development, the European Common Market. The nations of the free world must work together, as the Common Market "six" are doing already. In our experience we have found no international issues more divisive than economic issues. We assume that there will be no hot war. We are thinking in terms of winning the cold one.

Here is the situation:

There are 3 billion people in the world. About one-third live under Communist rule. One-sixth live in the major free industrial lands. The rest, who are one-half of the total, live in the poorer, less developed countries—the uncommitted or, as we prefer to call them, the "contested."

The 1 billion under communism live in a huge and relatively self-contained land mass with enormous natural resources. All of their foreign trade and most of their domestic trade is conducted by the state. Their governments are totalitarian.

The one-half billion in the major industrial countries—the West plus Japan and Australia—live under stable popular governments. They possess preponderant economic power in the world community. This is a point of critical importance for the purpose we have under consideration. Eighteen percent of the world's population commands two-thirds of its industrial capacity. It is our firm conviction that the way in which this preponderant power is used will be a major factor in determining the issues and the outcome of the cold war.

The 1½ billion people of the contested areas occupy one-half of the land surface of the earth, principally in the Tropics and farther south. They have vast natural resources of their own, but many of their people are hungry. Hunger and political instability go hand in hand.

The Communists are concentrating their subversive efforts principally on these poorer, underdeveloped countries. Soviet political and military pressures against these countries have been continuous since the end of World War II. In the 1950's the economic dimension was added.

Khrushchev fixed the terms of the cold war, in its economic aspect, in his declaration to the Twentieth Party Congress in 1956:

* * * from the fact that we advocate peaceful competition with capitalism one should under no circumstances conclude that the struggle against the bourgeois ideology and against the remnants of capitalism will be relaxed by our people; our task consists in a continuous attack on the bourgeois ideology and the unmasking of its antisocial and reactionary character.

The declaration of Soviet economic hostilities against the non-Soviet world has been made. The immediate objective in this war is the control of the contested countries, more than three score and ten in number. The ultimate objective is the control of the world. The struggle will be relentless, irreconcilable, merciless. The West need expect no quarter from the enemy. If Western determination is less than the Soviet bloc's, eventual Soviet triumph is assured.

In all of the contested countries, particularly those just now emerging from colonialism, the Russians have organized groups of native Communists who preach to the people, over and over again, that the best and quickest way to raise their level of living is by the Communist system. And who can say that people who have always been slaves to hunger will not put food before freedom?

In forming policies to meet the situation described, three significant facts of current life must be kept in mind:

1. *The increasing interdependence of nations.* Domestic economic policy can no longer be made without regard to possible external effects, nor can existing external conditions be ignored when domestic policy is being shaped. This country has known for years that it is not an isolated political system. It must realize that that is no less true of the body economic.

This is particularly the case for the United States because it possesses preponderant economic power in the Western community. If the United States domestic policy is damaging to Western unity, the West is diminished in the cold war. The

same may be said of the domestic policy of any of the principal allies.

It is ironic that the United States should continue to erect barriers against the nations whose raw materials it, in fact, must have. Despite its domestic resources it must import many of the

raw materials essential to its industry. So far as we know the only major mineral the United States has in exportable surplus is coal. The Automobile Manufacturers Association lists 38 imports necessary to the production of motor vehicles. The telephone companies list 20 imports from many lands—in Asia, Africa, and South America—which are essential to their industry.

The domestic agricultural policy of the United States is the base of its import quota system. If it continues to support farm prices above world levels, obviously it will continue to have a restrictive quota system.

On a broader scale, the lesson of unbalanced international payments is there for all to see. Few even dreamed so recently as 5 years ago that there would be talk of American costs, interest rates, and taxes in the same breath with gold and "hot money."

2. *The new role of technology.* We are impressed by a statement of Dr. Guy Suits, of the General Electric Laboratories:

Growth (in science and technology) has been so rapid that 90 percent of all the scientists who ever lived must be alive today. Science and technological change had almost no impact on the outcome of World War I, while it was a major factor in World War II * * * Lord Keynes didn't recognize technological innovation as a factor in the economy 20 years ago, yet today it assumes major proportions.

Technological change has been a determining factor in the conflicts of the past two decades. It would be folly to suppose that it will be a smaller force in the future.

We have been impressed also by a statement of Gerard Piel, publisher of the *Scientific American*, in his brief paper, *Consumers of Abundance*. Dr. Piel observed, and we feel correctly, that "the advance of technology has begun to outstrip our capacity for social invention." He noted particularly that in the past several years "despite a steady rise in gross national product, unemployment has been rising."

In effect, while abundance has been definitely achieved in the West by the advance of technology, Western institutions are no longer able to keep abreast of the rapid change. In many sectors

of Western opinion, automation has taken on the aspect of a serious menace, although it is an indispensable factor in military security, competitive parity in the world economy, and the ultimate relief of Western man from the stultifying effects of repetitive labor.

3. *The population eruption.* A score or more of the countries in the contested areas are now growing at a Malthusian rate; i.e., their populations are doubling every 25 years. In this connection, we would like to quote from the preface to Prof. Philip M. Hauser's distinguished volume, *Population Perspectives*:

The revolutionary changes in population size, composition and distribution during the modern era, and especially during the course of this century, have precipitated problems which are among the most serious confronting the contemporary world.

The United States has been aware of the effects of population change right at home. The rapid migration of the rural population to the cities in the wake of an irresistible technological advance in agriculture has had grave effects on the urban areas. "Exploding cities" are a matter of concern. The situation may become much worse as the increasing younger generations disperse into the suburbs.

The explosion of cities in the United States comes at a time when Japan, in contrast, has achieved a historic measure of population restraint. An authoritative view of the effects of this unprecedented development must await careful and extended inquiry, but there is no escape from the conclusion that it has had very favorable effects on economic developments in Japan.

Our main concern in the population explosion is with the contested countries. These populations are growing at a rate double that of the Western community, but they possess only a negligible fraction of the economic resources of the West. In these circumstances of unprecedented proliferation, the daily struggle for food and space among populations already undernourished cannot fail to become more bitter. This is our concern.

Overt social conflict is a commonplace affair in the Malthusian world. It is a kind of conflict upon which the agents of world communism feed and upon which the fate of unstable governments often rests. In the contested countries of the world, the average income of hundreds of millions of people is about \$100 per year, as against about \$2,500 in the United States. Most of these people have gained their political

freedom since the end of World War II. While they intend to retain that freedom, they are even more determined to raise their level of living, with more to eat, more to wear, and better houses in which to live.

The gap between the developed and the less developed countries hits close to home in the case of Latin America. Frank Tannenbaum, professor of Latin American history at Columbia University, says in a recent article entitled *The United States and Latin America—The Sins of the Fathers*:

Stated simply, the task we face in Latin America can be put in a single question. What can the United States do to help bridge the gap that lies between a \$2,500 average annual income in North America and the \$200 average income in Latin America? * * * The difference in income is so wide that, until it is narrowed, we cannot expect the people of those countries to identify themselves with our aspirations, projects, or policies.

Let us look at some of the things that the United States has done which have the effect of curtailing the markets for Latin American products, thus reducing their income and widening the gap between the rich and poor countries. At the behest of politically powerful minority groups in this country the Government has instituted import quotas on lead, zinc, and petroleum. For many years there have been import quotas on sugar and other agricultural commodities. There is an export subsidy on the export of our cotton. All of these things are produced in Latin America.

So long as there is great disparity in living standards between the industrial and the contested countries, today's rapidly shrinking world will not be a peaceful place in which to live. The economic gap between the two groups of countries is now widening. The gap must be narrowed. Otherwise, permanent world peace is an illusion. The gap can be narrowed while raising the living standards of both groups.

But time is running out.

Almost precisely 99 years ago, on December 1, 1862, Abraham Lincoln said in a message to Congress:

The dogmas of the quiet past are inadequate to the stormy present. The occasion is piled high with difficulty, and we must rise with the occasion * * * we must think anew and act anew. We must disenthrall ourselves and then we shall save our country.

The Trade Agreements Act as it stands today is hopelessly inadequate to meet conditions as they are and as we can see them developing.

The last renewal of the act, in 1958, was hailed for its long term. Four years is the longest that any renewal has run. But it was less meaningful than it appeared to be. The negotiating authority vested in the President was small, and when the American negotiators prepared to do the actual negotiating at this year's session of the General Agreement on Tariffs and Trade in Geneva, they found themselves hamstrung by the law's protective clauses.

At this juncture we see only one course to consider as the Reciprocal Trade Agreements Act presents itself for action next year.

If the act were allowed to expire, this would be a clear victory for protectionism. The symbol of our liberalism would be gone. The President's negotiating authority would be gone. But the protectionist clauses of the act would remain, for they are permanent law.

The challenges of the times demand a substantial broadening and reshaping of the act for another term of several years. This approach recognizes the limitations of the act as now written, and recognizes that the United States needs an enormously stronger hand than it has if it is to meet the competitive challenge that is built into the Common Market. But we hope that this would not mean a postponement of reckoning with the greater question we must face.

We believe that the United States must form a trade partnership with the European Common Market and take the leadership in further expanding a free world economic community.

As a minimum step in that direction, the Trade Agreements Act must give the President authority to negotiate tariff reduction across the board in place of his present authority to negotiate item by item. Our allies in Europe are no longer dealing in item-by-item terms, and we must adapt our negotiating authority accordingly.

It is frequently suggested that there be a Federal program to aid industries and workers, and even whole communities, injured by competing imports, to help them adjust to new ways of economic activity. We believe that the dislocations of labor or capital as a result of increased imports can be adjusted better by the affected parties than by the Government, but we would support a public program for extreme cases.

We note that the government-aid adjustment program of the Common Market itself has had relatively little use. Actually, in this country it is hard to find an industry whose troubles can be traced to imports alone, and we suspect that too liberal an adjustment assist-

ance program would be more of a temptation to inertia than a stimulus to innovation.

More than any broadening or reshaping of the existing law, however, we believe that the most hopeful vehicle for strengthening the West and thus for defeating Khrushchev in the cold war is to be found in the example of the Common Market. The object of a common market is to enlarge the number of consumers within a free trade area. The United States was formed into a common market when the Thirteen Colonies were welded into one nation by adoption of the Constitution.

For many years Europe has dreamed of a United States of Europe. Now they have made a beginning. Unfortunately only six countries joined in the initial effort. Seven others formed instead the European Free Trade Association, thus creating a rival organization and a serious breach in a vital area.

The recent decision of Britain and other Western European countries to open negotiations for joining the Common Market "Six" gives promise that one of the elements of Western disunity soon will be eliminated. So long as Western Europe is divided by the "Six" and the "Seven" there is not only a lack of economic unity, there is great danger that this will lead to grave political differences. The *New York Times* has referred to Britain's announcement as a turning point in history. Indeed it is. The Common Market ushers in an age of new competition, new ideas, and new initiative.

But the happy prospect of healing Western European differences still leaves the two sides of the Atlantic with a gap in economic policies that is getting wider, not narrower, all the time. On the one hand, Western Europe, for centuries divided into many separate economic and political compartments, is attempting now the elimination of her internal trade barriers and their customs houses so that her 325 million people and their goods can move freely from one country to another. On the other hand, the United States is in reverse. It takes too frequent refuge in protectionist devices. But even if this country stood still it would be drifting backwards because it would not be keeping pace with Europe's determined move forward.

At the close of World War II the United States embarked upon a policy designed to bring about a great expansion in the world economy. There resulted the GATT and later the Marshall Plan, with the Organization for European Economic Cooperation to implement it. OEEC, now the larger Organization for Economic Cooperation and

Development, was organized at the request of the United States by countries recipient of Marshall Plan aid. It is perhaps not too much to say that it was the father of the Common Market. (It is interesting now to recall that the American proposal for an OEEC caused the Russians to walk out of the first international Marshall Plan meeting in 1947, and to force Poland and Czechoslovakia to withdraw their tentative acceptance of Marshall Plan aid. The Soviet Union realized then that such a group might one day become an effective roadblock to Communist ambitions.)

If the United States is to continue to meet its responsibilities of Western leadership in preserving the freedom of the Western World, it must again, as in 1947, put the national and international interest ahead of the short-term, special interest of its politically powerful minority groups. It cannot be repeated too often that communism is waging war against the West—relentlessly, craftily, cunningly. The West will lose this war unless it can maintain Western unity and can keep the contested countries independent and out of the Communist bloc.

If the Communists are able to win and organize most of the contested countries, communism will dominate the world. The West has NATO, but it is limited largely to a military alliance. There will probably be no shooting in Khrushchev's war. The Communists have a cheaper, shrewder way. They plan to take us alive, with all our assets intact. If they can encircle us, our grandchildren will live under communism, as Khrushchev has said. Western unity is essential to Western survival.

The 20 OECD countries—18 Western European countries plus the United States and Canada—comprise one-half billion of the most highly industrialized peoples in the world. Acting in unity, there is almost nothing that they could not do. Unfortunately, they are not so acting. Except for the Marshall Plan, the Communists have held the initiative and the West the defensive in this worldwide struggle. Defensive postures win few wars.

If the United States fails to associate itself with the Common Market movement there will be constant economic friction between Western Europe and the United States and its allies in the Pacific. A unified Western Europe, with its highly developed industrial and technological complex and its disciplined workers, would comprise the most efficient workshop in the world.

Heretofore, the United States, with the largest home market in the Western World, has been able to offset high wages (three times the Common Market average) by the mass production of goods, thus keeping costs on levels competitive with those of other industrial nations. The European Common Market already has a home market, in terms of population, almost as large as that of the United States. If all, or nearly all, the Western European countries join the market, as we expect they will, it will then have a much larger home market than the United States, and the implications of that are only too clear.

The Common Market is justifying the most optimistic expectations of its friends. Official reports show that, since 1958, trade among the "Six" has risen by approximately 50 percent—a growth far greater than shown by any other industrial nation. Businessmen of the "Six", many of whom originally opposed this plan for eliminating tariffs, quotas, and other protective barriers, are now in the forefront of pressures for speeding up the transition. As the provisions of the market went into effect there were marked increases in sales of Volkswagen automobiles in France and Renaults in Germany. Also, the number of mergers and corporate alliances across national boundaries has increased rapidly.

By far the biggest, most reliable and profitable markets for United States exports are in the industrialized countries of the free world. When competition has forced all or practically all such countries to join the Common Market, the only way this country can hope to hold its export markets is by associating itself with the Common Market movement. And the United States must hold and add to its export markets, to pay for essential imports and to permit continuation of its heavy commitments abroad.

The longer the United States waits, the more difficult it will be to align its trade policies to match the Common Market's own actions. By the end of this very year, the "Six" will have reduced their tariffs to each other by 40 to 50 percent.

Thus we recommend that the United States open negotiations, as soon as practicable, for a trade partnership with the European Common Market, at the same time stressing the absolute necessity of enlarging the area.

It should not be difficult to show the contested countries that their best interests demand that they associate themselves in this historic process. Among those countries, including the 42 that have gained

their freedom since the end of World War II, less than 10 have populations of more than 25 million and many have less than 10 million. There is talk about industrializing these little entities, though we believe that their first interest demands farm rather than factory production. Granted that industrial effort will be made, it will be a net loss if such countries only set up little industries to serve local populations and bind in their inefficiency permanently by tariff-quota protection.

One way to ease the adjustment for the contested countries, and to meet our principal objective of raising their living standards, would be to grant unilaterally to groups of contested countries, as distinguished from individual countries, the right to free trade on their exports of raw materials to industrial countries. Another way would be by reduction in import tariffs by the contested countries at the rate of 5 percent per annum in consideration of the industrial countries reducing their duties at the rate of 10 percent per annum.

Without restrictive tariffs or other impediments to the movement of goods across national frontiers, production would be rationalized on the basis of comparative advantage, just as it has been in the 50 States of the U.S.A.

Under such conditions there would, in our opinion, take place the greatest expansion in productive facilities, including those of the United States, that the world has ever known. The facilities would be located in the most advantageous areas, based on labor, skills, climate, availability of raw materials, transportation, and markets. Most of them would be built by private capital. Many would be built in the contested countries because of favorable operating conditions and because, no matter where located, the whole trading area with its 2 billion people would be a potential market, without barriers.

In this way, sound development of the contested countries would take place. Their standards of living would rise. The economic gap between the richer and the poorer would be narrowed. Communism as a threat to world peace would recede.

We are fully conscious of the domestic American political difficulties inherent in the policy we recommend, but we believe nonetheless that at this juncture in our history we must face the issues realistically.

CHRISTIAN A. HERTER.
WILLIAM L. CLAYTON.

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