§ 9

Summary

International trade and trade within a nation, we have seen to be alike in so far as both favor specialization or division of labor. By means of such specialization or division of labor the total product of industry in the world at large is increased. Each country is able to make its own labor more effective and to secure a larger per capita income by carry-

ing on trade with other countries. But there is a widespread sentiment in favor of restricting such trade by means of protective tariffs. There may sometimes be justification for such tariffs as a means of building up industries upon which a country might be dependent in war time. And, if it were possible to choose the industries carefully and conscientiously, uninfluenced by political bargaining or pressure, there might be justification for the temporary protection of infant industries which give promise of developing to a point such that protection would be no longer needed and such that they could thereafter undersell foreign rivals. Unfortunately, tariffs are not so made and the arguments by which tariffs are chiefly defended in ordinary political controversy do not predispose the public to limit protection to such cases. Protection is given on the theory that it raises wages and makes employment. As a matter of fact it lowers wages measured in the necessities, comforts and luxuries that the worker can buy with them; while it does not reduce unemployment. In so far as it reduces imports, it also decreases exports. And by it, the average well-being is lowered. A similar effect flows from the interference, by precept and sentiment, with trade wholly within the nation, such as the buying of goods out of one's own town. A tariff "equal to the difference in cost of production at home and abroad, together with a reasonable profit" is a tariff just high enough to do most of the harm that a tariff is by its nature to be expected to do.

In our discussion of international trade and of governmental interference with such trade, no reference has been thought necessary to the details of the banking mechanism through which obligations are settled. Obligations between countries, like obligations between widely-separated sections of the same country, are settled mainly by the use of drafts (commercial drafts and bank drafts), the various claims being made to offset each other through the activities of bankers and brokers who deal in foreign exchange, so that only a minimum of gold needs to be shipped from one country to another. For our purposes the details of the

process are unimportant.[10] It is enough to point out that they in no respect run counter to the principles which this chapter has been written to explain.

We have seen that when trade is carried on between two countries both of which have a gold standard of money, excess purchases by one, of the other, tend to decrease money and reduce prices in the first and to increase money and raise prices in the second. This operates to prevent the continuance of such excess purchases. We have seen, also, that precisely the same result will ensue as regards trade even though both of the trading countries have inconvertible paper money unrelated to gold, or paper money redeemable in varying weights of gold so as to keep the price level stable, or any other kind of money. If a country with irredeemable paper money buys in excess from another, its paper money of course will not be accepted in payment for such excess purchases, but payment can be made by the purchasing of gold as a commodity in the first country and shipping it to the second. This will not decrease money

[10] These are discussed at some length in the author's *Principles of Commerce*, Part I. For the benefit of the curious reader a very brief and partial explanation may be made here. Suppose an American to sell goods to an English merchant to a value of £1000. He would, perhaps, write a draft (commercial draft) on his debtor, ordering the latter to pay his (the American's) bank. The bank would indorse this draft to its London correspondent and have the £1000 credited to itself in London. Then the American bank would have a balance in London. Suppose, now, another American buying goods in London and desiring to remit (say) £100. The American bank could sell him a draft or claim (bank draft) on its London balance, payable to this second American's British creditor. And the American bank would still have a balance remaining from which it could sell drafts to other Americans desiring to pay their creditors.

If, for some little time, Americans have less to pay than to collect, American banks would be unable to sell to customers in the form of bank drafts, claims on all their funds held abroad. The banks would then wish to get these funds where use could be made of them and would have to go to the expense of shipping them, in gold, to the United States. Knowing that they would not be able to sell drafts on the excess balances secured in London (and other foreign) banks, but would have to bring back the gold to the United States, American banks would then be unwilling to pay full value for commercial drafts (claims of Americans on their foreign debtors). An American bank would pay, for a claim of £1000, some twenty or thirty dollars less in American money than it would otherwise pay (depending on the cost of shipping gold, including weighing, assaying, loss of interest, etc.), so as to offset the expense to it of importing the gold.

On the other hand, there might be, for a considerable period, more to be paid abroad by Americans than is owed to Americans by foreigners. Under

in the first country or increase it in the second country, but it will make gold scarcer and more valuable in the first and more plentiful and less valuable in the second. Thus, just as in the case where both countries are on a gold standard, equilibrium tends to be restored. It becomes more expensive for the people of the first country to buy in the second, since it takes more money in the first to buy a given weight of gold and since this gold will bring less money and so less goods in the second. It becomes less expensive for the people of the second country to buy goods in the first. In short, whether the people of any country use gold money, silver money, paper money or no money at all, in any case the existence of a more or less definite relationship between imports and exports is a fundamental principle which must not be ignored.

We saw, in the last chapter particularly, how desirable it is to maintain a stable price level. And we considered, also, some of the techniques by which the United States might maintain a stable price level despite possible changing price levels in foreign countries, so that the level of prices in

such circumstances, the balances abroad which American banks could accumulate by sending to their foreign correspondent banks, for credit, the commercial drafts drawn by Americans on their foreign debtors, would not be sufficient. Americans wishing to make payments abroad would wish to buy bank drafts payable to their foreign creditors to a larger amount than American banks could provide them with unless the American banks shipped gold abroad in large enough quantities to make their foreign balances adequate. But if it had to go to the expense of shipping gold to London for the purpose (because the claims of Americans payable by English customers did not provide a sufficient balance), an American bank would not sell an American debtor a bank draft on London worth £100 for as low a price in American money as it would otherwise accept, but would charge him (say) two or three dollars more, to cover the expense of shipping gold. As long as it was cheaper than to ship gold, a bank would compete with others for the commercial drafts offered by American firms of good standing, on their foreign debtors (especially if the debtors had made arrangements to have the drafts drawn on banks which would "accept," i.e., undertake to honor the drafts, the accepting banks collecting from the real debtors). So the limited supply of commercial drafts drawn by Americans on foreigners, would sell, at such times, for a somewhat higher price than at other times. Of course, drafts payable at 60 or 90 days after sight sell at a lower price than sight (demand) drafts, i.e., are "discounted." Those who may be interested in the details of foreign exchange under differing conditions as regards monetary systems and other possible influences, are referred to the various books and articles in which the subject of foreign exchange is treated.

the United States need not be the sport of foreign governmental policies. Among the techniques considered was the changing of the official price of gold. By means of such changing of the official price of gold (the price at which the Treasury will buy or sell gold), when circumstances require, our price level can be as independent of foreign conditions and policies as if our money were entirely unrelated to gold. The difference is that the price of gold, in relation to our money, changes by official pronouncement and government purchase or sale in any amount necessary to effectuate the official price, instead of merely unofficially in a general and independent gold market, as it would in case we had an irredeemable paper money with no official gold price at all. But, in either case, the price of gold is subject to change, so that great fluctuations in the world demand for or the world supply of gold need not upset the price level in the United States.

In this chapter, since we have been considering at length the arguments relative to protective tariffs, it is to be noted especially that the United States has no occasion to levy tariff duties, and thereby interfere with geographical specialization in the production of goods, in order to protect its price level from falling. It is true that to purchase more abroad than we sell abroad and to have to pay the balance in gold, tends to decrease our circulating medium—if this is based on gold—and to reduce the prices of goods. *But if the official price of gold is raised,* a continuation of such excess purchases becomes quickly unprofitable because of the expense of buying the gold necessary to pay for them.

It may appear, on a superficial view, that such raising of the price of gold interferes with foreign trade as much as would a protective tariff. *But this is not the case.* A protective tariff, as we have seen, in the long run necessarily *prevents,* or at least decreases, *both purchases abroad and sales abroad.* But an official raising of the price of gold, sufficient to stop an outflow of gold, *merely prevents us from purchasing abroad more than we can pay for by our sales abroad* (exports) of goods and services other than gold.

It does not prevent us from buying abroad as much as we can pay for with the goods we produce to sell abroad (or from buying abroad on credit, if foreigners will extend us credit).

To have a wisely managed currency means, in this regard, merely that any temporary disequilibrium between a country's imports and exports does not have to wait for correction until the country's price level has been lowered by a decrease of its currency resulting from an outflow of gold, but is corrected as quickly as desired and without serious unsettling effects on the country's business or price structure.

Similarly, it is not necessary to prohibit or restrict a country's sales abroad (exports) in order to prevent an inflow of gold which might cause an undesired rise in its price level. If there is a temporary excess of sales over purchases, which threatens such a consequence, a sufficient *lowering* of the official price of gold will make it unprofitable for exporters to ship out goods for gold, since the gold will now bring a lower price in their country's money than before. Thus, the excess of sales over purchases (of exports over imports) is brought to a halt by the reduction in the price paid for gold and need not go on until it is stopped by a rising general price level in the exporting country. And such a reduction in the price of gold does not prevent or decrease international specialization and trade, as an export tariff or export prohibition or restriction would. It merely brings equilibrium quickly, merely hastens the time when the country must accept foreign goods other than gold for the goods it sells, or the time when it cannot sell goods in excess of the goods (or goods and credits) it takes in exchange.

The thoughtful reader will be able to see for himself, without further explanation, that bounties and other special favors, sometimes granted by governments to selected industries, operate like protective tariffs in that they divert land, labor and capital into industries less advantageous to the country than those industries which would otherwise be carried on. Or, if the encouraged industries would be carried on to some extent anyhow, such special favors

nevertheless divert more land, more labor and more capital into them than is desirable in view of the alternative opportunities in other lines of the extra men and equipment and land so diverted.

In the same general category are to be placed the various suggested schemes for artificially raising the domestic prices of certain farm products, e.g., wheat, by taxing the entire crop and using the funds so obtained to make possible sales abroad at a loss, thus reducing the available domestic supply. Any such arrangement, though it might increase the returns of the producers of the commodity in question, would necessarily, because of the loss on the foreign sales, cost the domestic consumers more than the benefited producers could gain, even if it did not draw, as it presumably would, more labor, land and capital into the favored industry. It should be obvious that any use of the funds of government, raised by general taxation, for such a purpose, likewise involves national economic loss.

When a given class or group are desirous of legislation through which they are subsidized at the expense of their fellows, a large part of the class so seeking subsidy almost always present this legislation as something calculated to benefit the community as a whole. Thereby they serve two purposes. They preserve their own self respect in a social environment where parasitic self seeking is reprobated; and they gain support for the legislation they seek, even from some of the prospective victims of it, since some of these prospective victims are deceived by their propaganda.

Thus, those who seek a protective tariff shutting out foreign goods have more than once attempted to persuade the rest of the public, for whom such a tariff can do nothing but raise the prices of goods they must buy, that the tariff duties urged would benefit the rest of the public as well as the producers of the protected goods. If various manufacturing industries are protected, it is urged, farmers may, indeed, have to pay more for manufactured goods; but those engaged in manufacturing will then have more money with which to purchase the farmers' products, and so the farmers

will get their money back again. The truth is that they will not and do not get it back again unless they give something else of value in return. If a farmer pays more for clothes, because of a protective tariff, than he otherwise would, we may admit that the clothes makers will have more money (than they could otherwise make in that business) with which to buy, if they choose to, the farmer's products; but the farmer does not get back this extra money for nothing; he must give extra products for it. To assume that the farmer does not have to give extra products to get back the additional money paid for the higher priced clothes, is to assume that the protected industry is not encouraged by the higher prices the farmer pays for its goods; for this is to assume that the higher prices so paid by the farmer for the protected goods, are balanced by higher prices which those in the protected industry must pay for the farmer's products. This would mean no change in the relative positions of farmer and manufacturers because of protection, save a merely nominal change. The idea which protectionists who use this "get-it-back-again" argument endeavor to convey is that, somehow, producers of protected goods get larger real incomes because of the tariff; while, at the same time, those whose purchases of goods at higher prices make these larger incomes possible, lose nothing by the system and, even, gain by it.

The absurdity of such an argument is perhaps best shown by an illustration. Suppose that, in a small town, there are a number of robberies, as a result of which each of the merchants of the town finds himself minus several hundreds of dollars. Finally, the thief is apprehended. But upon being accused of his crimes, he asserts in his own defense that he has done no harm. Though he admits having robbed the various merchants of money, yet he points out that he has lived in the town and has used all of this money to buy their goods and that thus they have "got it back again." The obvious fact is, of course, that the merchants have got their money back only by giving up for it other goods of supposedly equal value.

In more recent years, with the United States government,

in the Agricultural Adjustment Act, paying farm owners to reduce their output of wheat, corn, cotton and other crops and even penalizing, by a high tax, producers who exceed a permitted "quota," a similar argument has been put forth intended to show that to take money away from city workers (whether in higher prices of farm products or in other ways) and give this money to farmers, makes the city workers more prosperous than if the money were not taken away from them. The idea is that to take money away from (say) city clothing workers and give it to farmers will, by increasing the demand of farmers for clothing, increase the employment and prosperity of the clothing makers.

The fallacy here is, of course, the same as in the case of the activities, just described, of the burglar. But there is another way of putting the matter which may, for some readers, be more illuminating. It is true that raising the prices of farm products (if sales are not proportionately decreased) increases the ability of the farmers to buy clothing. But, since the cost of food is increased, the ability of carpenters, bricklayers, automobile workers, steel workers and coal miners to buy clothing is reduced. There is no reason to conclude, then, that employment and prosperity in the clothing industry will thus be made greater, and, to the extent that the clothing workers must pay more for their food, they suffer a clear and definite economic loss.

Similarly with other workers, e.g., the workers in automobile factories. If food prices are higher, the farmers can, indeed, buy more automobiles, but the clothing workers and other non-rural workers can buy *fewer* automobiles. And the higher cost of food to the automobile workers themselves is a clear loss to them.

A recent variant of the view that the public or any large section of the public is made more prosperous by having something taken away from them for the benefit of a particular class is to be found in the Townsend proposal and propaganda for a very large old-age pension—$200 a month to each person over sixty years of age—the funds

for which were to be raised by a general sales tax on all goods, including the necessities of life. It was contended that the expenditure of this money by the aged recipients of it (who were, supposedly, to expend it rapidly) would so stimulate demand as to increase the prosperity of the younger persons by whom the taxes to provide the pensions were to be paid. Why it should be supposed that to take hundreds of millions of dollars every year from the persons who have earned it and who would, presumably, like to spend it, and transfer it for spending to other persons, would increase the demand for goods or the output of goods or in any way promote prosperity, might perhaps be put down as a problem in the psychology of senility,—were it not that a similar psychology seems to possess, by turns, hard-headed manufacturers and their apologists, farmers and their spokesmen, and others. To those not initiated into the psychology of aspirants for subsidies, it must seem that any stimulus which might be supposed to come from the spending of money, could be brought about just as quickly if those who have earned the money are permitted to spend it as by first transferring this money to others and *then* having it spent—after it has been thus transferred—by its new recipients!

In general, the idea that any class becomes more prosperous through contributing to another class which is thereby enabled to purchase more goods from the class that contributes, is altogether fallacious. Whether it be argued that the resident of a town is made more prosperous through buying goods at a higher price from the home town merchant than the price he could buy for elsewhere; or that the unprotected worker gains through purchasing goods protected by a tariff at a higher price than if there were no tariff; or that city workers gain through making contributions to farmers; or that employers are more prosperous if they pay higher wages to their employees who are thereby supposed to be able to purchase more of the employers' output; or that the young and middle-aged are more prosperous if they make forced contributions to the old who are there-

with supposed to purchase goods and services from their involuntary benefactors,—in any case the argument has not the slightest validity. The products of each class of city workers are salable to other city workers and are not limited, for a market, to farmers. The factory owner's goods are sold, in considerable measure, to other factory owners and part owners (stockholders and bondholders), as well as to farmers, factory workers et al., and are not limited, as regards a market, to his own employees. Goods produced by the young are obviously sold in large quantities to the young and do not depend, for a market, upon monetary contributions to the impecunious old. And similarly, throughout the entire industrial structure.

It would be obviously impossible to anticipate here every sophistical argument that will ever be advanced in favor of giving tariff protection or some form of subsidy to various privileged groups. Sometimes it is urged that a particular group, e.g., the producers of corn, should be subsidized because they are the victims of a special tariff privilege accorded another group, e.g., the manufacturers of woolen cloth. In this view, if the A's have been robbing the B's and the C's, the balance is to be restored by allowing the B's to rob the A's and the C's. This, of course, leaves the C's worse off than ever.

In similar vein, it is argued that since some manufacturers may have had a degree of monopolistic control and may have been able to restrict output and hold up prices, and since wheat farmers have been unable thus to establish monopoly by themselves, therefore the government should aid them to restrict the output of wheat so as to hold up wheat prices. The result may, of course, be a benefit to certain wheat growers, but life is thereby made harder than before for those persons who, not being in any privileged group themselves, must now contribute to a new privileged group just because they have previously had to contribute to an old one.

When individuals or small groups succeed, by burglary, picking pockets or holdups, in abstracting wealth from others,

those who are robbed at least have law on their side. But what if a larger and politically powerful selfishly interested group succeeds, by such sophistical arguments as have been described above, or by legislative bargaining with other selfish groups seeking privileges at the expense of the general public, or merely by gaining the support of legislators who are more afraid of losing the votes of an active and well organized privilege-seeking minority than of an unorganized and comparatively unaware and inert majority,—what if such a group thus succeeds in using the tax system and the legislative appropriation machinery to abstract wealth from the rest of the people! In such a case, those from whom wealth is being abstracted find that even the law is against them and that, if they refuse to make the required tax contribution, it is they, and not those profiting at their expense, who are considered the criminals.

What if there should be a continued and progressive extension of government interference, regimentation and control in the interest of such privilege-seeking groups! Might we not finally discover, as we approached the end of this unhappy journey, that men's incomes depended mostly on their skill in political bargaining, threats and chicanery, and scarcely at all on their productive efficiency? And would it not then be widely argued that the voluntary price system ("Capitalism") had failed, and that the state must henceforth control all those economic activities which were previously guided, in a régime of economic freedom, by the market and by the lure of price?

Proposals for the granting of special privileges to one or another kind of industry, by means of tariffs, bounties, or subsidies, and otherwise, are being constantly made and receive, too generally, widespread support. Always there are groups which hope to gain something for themselves at the common expense. Always there are groups which are easily moved by fallacious argument the underlying fallacies of which they do not detect. It is partly through the machinations and propaganda of selfish interests, partly through their own ignorance and prejudice and, of course,

mainly by their own votes, that the masses in every democratic country are laid under tribute. And so, for the occasional citizen whose ideals impel him to support the common interest against the assaults of prejudice, ignorance, selfishness and chicanery, there is never lacking the chance to engage in a fight, too often not a victorious one.

We of the United States of America are lucky beyond most other peoples. When, in 1787, the Federal Constitution was adopted, it prohibited the levying of tariffs on trade between the several states, tariffs which had already begun to be levied under the previous Articles of Confederation. Probably few, if any, members of the constitutional convention then dreamed of the immense extent of territory which the new nation would one day cover. But there followed the Louisiana purchase, the Lewis and Clarke expedition into the Northwest, the war with Mexico and the final inclusion within the nation of all the territory between the Atlantic and Pacific oceans, from Canada to Mexico and the Gulf. And over all this territory has extended the guarantee of free trade given by the constitution, a guarantee now accepted as a matter of course; although it must be admitted that there has recently grown up a tendency to interferences by state governments, under the guise of truck regulations, license fees, inspection, etc.

The United States a protectionist country! Yes, in some degree, it unfortunately is. Yet the people of the United States undoubtedly enjoy more free trade—over an area three thousand miles from east to west—than any other people on earth. And this is without question one of the reasons why we have enjoyed so much of prosperity as has fallen to our lot, despite the fact that we have tried, our blundering best, as to that trade not under the protection of our constitution, to decrease it and so to make ourselves poor. In Europe there are many nations of smaller population and smaller area than ours, each, by its tariff, excluding goods from each other. Thus, every few hundred miles and, sometimes, every few miles, there is a tariff barrier to trade, and a geographical specialization which

would be profitable to all is interfered with. This is not the only reason why the peoples of Europe are less prosperous than the people of the United States, but those readers who have clearly comprehended the argument of this chapter will not doubt that it is one of the reasons and a not entirely unimportant one.