Free Ways To Free Trade

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Free Trade between the countries is like peace: in spite of everybody's warm devotion wars and trade barriers have always been humanity's faithful followers.

If conferences, lectures, articles, orations and declarations had been decisive, free trade would have been established long ago. But alas, the declarations are never as sincere as they sound. There are always reservations. Everybody wants free trade, but everybody also wants exceptions made for special sensitive regions. Ultimately it is these demands for exceptions that place a stumbling block in the way of free trade. Nevertheless the mass of conferences and declarations bear witness that people in their hearts understand the value of trade being as large and free as possible.

The most important event in the area of international trade during recent years has been the creation of the Six State Union between France, Italy, West Germany, the Netherlands, Belgium and Luxembourg. This is essentially a customs union, and the first tariff reductions were undertaken on January 1, 1959. The reductions so far made have been small, but if they are continued according to plan, they will remove important trade barriers between the six countries *inside* the union. There are not only economic motives for the union. A fundamental thought is that the partners shall be brought together politically.

Of course such a union has many positive ingredients, but the question is whether people have not been blinded to its disadvantages. I see it as my task here to point out some negative items which have been largely overlooked.

UNIONS MEAN WALLS AND ISOLATION

The Six State Union is intended to bring the partners into more intimate economic and political relations. But such a union has within it the seeds of many and serious conflicts both between the countries *inside* the union and between the partners and countries *outside* the union. It is doubtful whether it will be the positive or the negative items which will predominate when the final reckoning is made.

Within the Union—" Little Europe "—tension is already discernible between France on the one side and West Germany, Belgium and Holland on the other, and this tension between protectionist France and a more free-trade-minded West Germany probably would increase, if Mr. Erhard should succeed Mr. Adenauer as Chancellor. In this regard recent developments in the European Coal and Steel Community (founded 1952)—the forerunner of " The Six "— are illuminating. Because of stronger competition from oil, the economics of the coal industry has been more and more strained, and during the past year shortage has given way to a surplus of coal. This has led to bitter conflicts between the Community member-countries, and in the spring of 1959 the situation was so serious that the Community was on the point of being burst asunder. Eventually a temporary solution was reached, involving postponement of the conflict for five months.

By its very nature, such a union functions as a *cartel,* favouring member-countries with lower prices and better conditions than are offered to outsiders. Herein lie seeds of conflict with the outside world. For example, the shipyards outside the Community have had to pay much higher prices for ship plates than have those within the Community. These conditions are interpreted by the disfavoured as exploitation and they have evoked bitter protests in GATT. Another and quite natural consequence of this " exploitation " is that Sweden now is investing 200 million dollars in building a steel-works of its own for ship plates.

" The Six " is essentially a customs union, that is a cartel. It is to be surrounded by a relatively high common tariff wall—a fortress with walls and a moat around it. The walls will " protect " the peoples inside from the hard gales of competition from the outside world. They choose to live in a *closed* and *isolated* world and in an antagonistic " en guard " position.

Is it a policy of isolation and closed doors we need in the present world ? Or a policy of extended hands and open doors ? Is it more walls we need to build ? Or should we instead pull down already existing walls ? Is it a new " Hansa Bund " or a new " imperium " with an accompanying imperial preference policy we should build ? The British imperial preference policy (from 1932) has not been very successful, and after many disappointments and conflicts this bloc is now disintegrating.

Experiences of economic planning *within* nations have not been very successful. And I cannot help feeling sceptical at the sight of these attempts at supranational planning.

THE SECONDARY BLOCS

History teaches that political blocs and alliances regularly give birth to anti-blocs and anti-alliances. And the laws of economic warfare are essentially the same as those of political warfare. The economic six state bloc has given birth to feverish attempts from the excluded to create balancing anti-blocs.

At first they concentrated their efforts on attempts to create a European Free Trade Area. This was to have comprised all the seventeen O.E.E.C. states, including "The Six," but was not to have been surrounded by a common tariff wall. This project was totally unrealistic and is now practically buried.

Later they tried to form an economic alliance between "the outer six"—England, Switzerland, Austria, Denmark, Norway and Sweden—or "the outer seven" (these plus Portugal). In spite of a nervous and feverish activity all attempts have so far failed and at the time of writing the whole affair seems to be at a deadlock.

The project for a common market for the Scandinavian countries is old but has come to the fore as a result of the formation of "The Six". But in spite of all pompous orations about the Scandinavian community these efforts have totally failed. The Norwegian industrialist fears competition from the Swedish one, and the Swedish peasant is, if possible, still more afraid of the Danish one. Denmark stands like an ass between three wisps of hay, and doesn't know if it wants introduction into the six state union, "the outer six" or a Scandinavian market.

Lone voices have pleaded in Sweden for her to join the six state club, but they have been brusquely silenced by references to the political character of this union. The motivation is here the same as the motivation for Sweden's staying outside NATO.

Every failure to form secondary blocs increases the nervousness and bitterness of the excluded. And certainly the intensity of these feelings will increase as the walls around "The Six" are built higher and higher, and more and more firms find themselves excluded from markets to which they earlier were admitted.

SET A FOX TO KEEPING GEESE

Free Trade between countries is hampered more by Government price control of commodities, credits and foreign currencies than by anything else. Agricultural policy everywhere has worked as a brake on the wheels of international trade. An example from my own country, Sweden, illustrates the consequences of these government agricultural regulations.

As a result of these the Swedish internal price level for farm products has for many years been much higher than that of the world market. The high prices have stimulated production and hampered consumption and this has resulted in great surpluses of corn, butter and pork meat. To sell these surpluses to foreign countries, at the low prices of the "world market", would have meant such great "export losses" that the whole agricultural policy would have been threatened.

In order to save the face of the regulation system Sweden tried to sell these surpluses to other countries, mostly West Germany, at prices well above those of the world market. Such "over-prices" were set as a condition for Swedish-German trade agreements, but as the Germans could get their food products more cheaply elsewhere naturally they resisted. But there were still other complications. Traditionally the Germans have been the greatest suppliers of coke to the Swedish steelworks, but because of their rapid industrial expansion the Germans themselves ran short of coke in 1954-55 and had to import from U.S.A. at substantially higher prices than their own coke had been sold for. In these circumstances the Germans naturally were less interested in exporting coke to Sweden, and least of all at the former low prices.

The Swedish Government and its negotiators, however, insisted on getting their coke in the same quantities and at about the same price as before. A not unimportant cause of this Swedish desire probably could be found in the big state steel works. If it had had to buy its coke at world market prices, its losses would have increased by about 5 million dollars a year.

When the Germans refused in the autumn of 1955 to accept Swedish demands about corn and coke prices, the Swedes unlimbered their political cannon and virtually declared economic war on West Germany. Since Sweden was then the greatest foreign purchaser of German cars, the first offensive was aimed at the German motor car industry. From October, 1955, Swedish imports of German cars were cut by two-thirds. The first Swedish " trump " had been played. That so many Swedes preferred German to other cars is evidence that they found them superior as to price and quality. But when government indulges in economic warfare, the legitimate interests of the consumers are set aside.

The Swedish Government still had its best trump card on hand—the iron ore export. Discreetly the negotiators let their German colleagues know that this big export to West Germany would be jeopardised if they did not accept Sweden's conditions. Eventually a new trade agreement between the two countries was signed in November, 1955. The Germans promised to buy 300,000 tons of Swedish grain and to sell 2,000,000 tons of coke and to do so at prices that meant certain concessions to the Swedish demands. At the same time the Swedish import restrictions on German cars were abolished.

I cannot help looking upon this strange intermezzo in the history of Swedish-German commercial relations as a frightening propensity for aggression in the Government of a country that has enjoyed unbroken peace for 150 years. Incidentally, the Government prides itself on being exceptionally peaceful. In my opinion, the Swedish " violence methods " were not only morally objectionable but also economically foolish. It must have been at least as much to the advantage of the Swedes to sell their iron ore as for the Germans to buy it. If the Swedes as a stage in economic warfare cut or stop their export of ore—one of Sweden's most important export commodities—the greatest losses will be on their own side.

Another question: how could the Swedish Government in 1955 behave *as if* it were the owner of all Swedish ore mines ? The greatest Swedish mine was not nationalised until 1957.

But, somebody may object, since the Swedes held trump cards, why should they not have used them ? Thanks to these cards they got advantages both in corn export and coke import.

To this objection my answer is that I regard such " blackmail " methods as being not only morally abominable but also economically foolish. Nobody can get me to believe that the German " concessions " meant some sort of net profit for Sweden. Of course the Germans made up the loss in one way or another, but whoever in the last round had to pay the price—the Swedish car purchasers or perhaps the shipyards ?—the Swedish people will never get to know.

Through the division of labour and competition a free and large international trade will give us great profits and possibilities of higher living standards. When this trade is going on as a free and direct exchange of commodities between individual buyers and sellers in different countries it will create contacts, understanding and goodwill and build bridges between the peoples. An absolute condition for this is that the exchanges come about *in a wholly voluntary way* so that both parties derive advantages from the transactions.

Every form of compulsion, pressure, blackmail, etc., is inconsistent with such an exchange. Private sellers and buyers lack the powers necessary before compulsion can be exerted but in any case all real enterprisers and businessmen desire above all that transactions should be made in such a way that their customers will be pleased and therefore will return with further orders. As a fact, no business can be conducted on single once-for-all orders.

Instead of building bridges between nations international trade very often creates hostility and bitterness. This is wholly the result of governmental interference with private transactions and regulation of prices, quantities and other conditions. In contrast to private persons, governments have power to practise compulsion which they are always tempted to misuse, employing methods that are best characterised as economic warfare, methods that poison relations between peoples and damage trade. To let Government manage trade is like setting a fox to keeping geese.

GOVERNMENT CURRENCY REGULATIONS PLUS INFLATION

War and inflation have always been faithful companions. During time of war Governments always live above their means, underbalancing their budgets. Inflation is a natural consequence of such expansive economic policy. Even if most nations since the second world war have been able to cut their budget deficits as compared with the war years, their economic policy has continued to be decidedly "expansive". There is a "war economy during peace".

An inflation combined with a free currency market is no obstacle to international trade. But a state-regulated currency market with "pegged" exchange rates combined with inflation is an exceedingly strong hindrance to trade. In my opinion since the second world war this obstacle has been more important than tariffs. The mechanism of this fatal combination functions in the following way.

Suppose that in countries A and B the two currencies at first are of the same value, so that 100 A-mark = 100 B-mark. Next suppose country A mismanages its economy with the result that the value of its currency is halved, while the currency of country B maintains its value. If exchange rates were allowed to move freely—free exchange market—the rate for the A-mark in country B would drop so that 100 A-mark = 50 B-mark. In country A on the contrary the rate for the B-mark would increase so that 100 B-mark = 200 A-mark.

Since the second world war, however, most countries have had a price control on foreign currencies, and the prices—exchange rates—have been changed only with the greatest reluctance even although the real value relations have changed. It is these fixed prices that have been called "pegged." With such a currency control the original exchange rate between A-mark and B-mark, 100-100, probably would have been maintained, in spite of the fact that the real relation on account of the inflation in country A is 200-100.

What are the consequences of such "pegged" and totally unrealistic exchange rates on trade between the two countries ?

With a free currency market the importers of country A would have to pay 200 A-mark for an imported commodity, worth 100 B-mark, but as a consequence of the currency control they do not need to pay more than 100 A-mark for it. So the import from country B will be very cheap and advantageous in country A, and a big import rush will follow.

For the exporters in country A the consequences will be the contrary. If they sell a commodity to country B for 100 B-mark in a free exchange market they would have got 200 A-mark for these 100 B-mark. But on account of the control they get only 100. In such circumstances, export to country B will be unprofitable and therefore will soon come to an end. This means that the export income of country A—that income with which imports are to be bought—will disappear. And what benefit does country A derive from cheap imports when it has nothing with which to buy them ?

The swelling import and the shrinking export of country A means that its stock of B-mark—the currency reserve—will rapidly melt away. This is not surprising since the "pegged" currency exchange rate means that country A is selling B-marks for one A-mark apiece when in fact their real value is 2 A-mark. Any commodity sold at an "underprice" normally will disappear very rapidly. Confronted by the prospect of emptied currency reserves, country A has to choose between two roads. The only one that radically removes the evil is to alter the rate of exchange so that it corresponds to the real value relations, 200 A-mark = 100 B-mark.

But such a radical operation — devaluation — is an acknowledgment visible to all that the government has mismanaged the economy. Therefore, as it wants to postpone making such a public admission for as long as possible the government chooses the other road: import restrictions. And the more unrealistic the exchange rates are, the harder the restrictions must be.

How shall this most dangerous trade obstacle be eliminated?

As has been mentioned already, it is not just inflation alone nor currency control that is dangerous but the combination of the two. The evil is eliminated if either is, or both are, ended.

I confess that I am pessimistic about inflation being eliminated. Inflation is like sin: everybody is condemning it theoretically but doing it practically. There are very many large, powerful groups in society with demands on governments that can be met only by pursuing inflationary policies. Everybody wants a stable currency but nobody wants to pay its price. Everybody wants the pleasures of inflation but nobody its consequences. In such circumstances a stabilised money value cannot be realised, and I think we must resign ourselves to inflation continuing indefinitely.

About exchange control I am more optimistic. Here development is proceeding in the right direction. There is a growing understanding of the importance of more free and flexible currency rates. At the end of 1958 the European Payments Union (EPU) came to an end and most currencies in Western Europe were made "convertible". Alas, the "convertibility" is not a real one in the full sense of the word, as such convertibility cannot exist except in combination with free exchange rates. Without this combination a result such as the fiasco of the British convertibility experiment in 1947 must be feared.

An adjustment of the right sort which may be mentioned is the 17.5 per cent devaluation of the French franc in December, 1958, as this means a more realistic rate of exchange.

THE HARMONISATION IDEA—A DANGEROUS ENEMY OF FREE TRADE

A dangerous fallacy which permeates thinking on trade policy is the so-called harmonisation idea, the idea that a "fair" competition on "equal terms" cannot exist while wages, taxes, interest rates, social charges, holidays, etc., are unequal in different countries. According to this idea, countries with higher wages and taxes always must fall short in competition with countries with lower wages and taxes. The conclusion is that so-called high-wage-countries necessarily must protect their industry and business against competition from so-called low-wage-countries by means of tariffs and other import restrictions.

For instance in the U.S.A. which has the highest wages in the world this argument has been the strongest weapon of protectionists. In most other countries, too, it is frequently used in favour of imposing tariffs against lower-wage-countries. As soon as competition comes from countries with higher wages, other suitable weapons from the protectionist arsenal are selected.

The harmonisation idea is founded on a common and unfortunately seductive fallacy. What is important in competition is not the wage rate *per hour* but the wage cost *per produced commodity unit*. Therefore, although the American worker has the highest hourly wage rate in the world, the wage cost per unit in the U.S.A., is often lower than in the so-called low-wage-countries because of the high productivity of the American worker. This also explains why low-wage-countries so often find it necessary to build high tariff walls against competition from high-wage countries.

If firms in an industrially "under-developed" country are to compete with firms in a more advanced country, an absolute condition is that the wages *per worker* of the former are lower than the wages per worker of the latter. When firms in the advanced countries do not understand and admit this fact but demand protection against "low-wage" competition they damage their own country's prosperity while also hampering the development of the poor countries.

If the harmonisation idea were correct, it would not be sufficient to level wages, taxes, etc., in different countries. For competition on "equal terms" in this sense to be realised, it would be necessary to equalise also natural resources, climate, location and so on.

The fine thing with a free trade is that countries with very marked differences in the degree of industrialisation, natural resources, wages, etc., are able to do business with each other, transactions which both parties find advantageous. And most important of all: it is the very differences that form the foundation of the commodity exchange. If all countries were exactly alike, no trade or exchange could come about.

THE OPEN DOOR POLICY

In spite of all state interferences and obstacles international trade since the second world war has increased in a hopeful way. A picture of this increase is given in the following schedule. This development indicates that the driving forces of international trade, viz, the advantages afforded by the international division of labour and by competition, have been strong enough to drive back monopolistic forces of different kinds.

Volume of international trade 1957 (1948 = 100)[1]

	Import	Export		Import	Export
U.S.A. ...	146	150	Canada ...	183	130
U.K. ...	130	119	W. Germany	255	338
France ...	195	292	Belgium ...	175	201
Denmark ...	221	268	Sweden ...	170	197

[1] U.N.: Monthly Bulletin of Statistics.

The volume of international trade in the western countries approximately doubled during the nine years, 1948-57. That result is not so disappointing as to warrant giving up the earlier direction and choosing totally new ways. By forming the European Economic Community "The Six" have chosen a new way, the way of closed doors, isolation, wall-building, cartels and collective action. The first distance of this road they have already left behind them, and high hopes are held out for the future.

In the face of this optimism I am sorry to have to feel like a doubting Thomas. I cannot share these expectations and this trust in the future. I fear this broad way of closed doors and collectivism will prove to be a false path. I am so old-fashioned as to confess that I trust more the narrow old way of liberalism and individualism, that way where the walkers, everybody in his or her town and country, diligently and patiently, one stone at a time, pull down already existing walls, clear away barriers, barbed-wire fences and toll gates, so that both people and commodities can move freely—the way of out-stretched hands and open doors.