WHY PEOPLE TRADE—By Leland B. Yeager

Extracted from Chapter 3 of Professor Yeager's new book " Free Trade: America's Opportunity"*

"*The theory of free trade is extremely simple and attractive. Each country should expend its productive energies in those fields for which it is best suited by soil, climate, resources, manpower, skill, etc., and buy from other countries the goods in the production of which they, in turn, enjoy particular advantages. In this way presumably all productive energies everywhere would be employed to the highest advantage. A maximum of international trade would thus spring up, to the maximum advantage of all people.*"

Thus has written one of the most prominent of American Protectionists, O. R. Strackbein in *The Tariff Issue Revised and Restated*. But then the Protectionist shows that his understanding is sadly incomplete:

"*It is perhaps unkind to ask just how countries or areas that enjoy no outstanding advantages, such as do exist in the world, would fare under such conditions of trade. To whom, for example, would they sell? How could their producers survive competition from those countries or areas that are economically favoured and well developed?*"

The answer lies in the Principle of Comparative Advantage. For trade to benefit both a particular country and the outside world, the country need not have an absolute advantage over the outside world in producing some goods and an absolute disadvantage in producing other goods. *Even in the extreme case* where the country was absolutely less efficient than the outside world in producing *all* goods, mutually-beneficial trade could still take place. Conversely, even if the country were absolutely more efficient than the outside world in producing all goods, it could still benefit from trade. As long as its degree of inferior efficiency (or superior efficiency) were greater for some goods than for others, the country would import the goods in which its efficiency was most inferior (or least superior) and export the goods in which its efficiency was least inferior (or most superior).

A simple example involving two countries and two goods will help to make this principle clear. Suppose that one country, Superia, is more efficient (in some absolute sense) than another, Inferia, in producing both wheat and cloth. Superia's labour and resources can produce 600,000 bushels of wheat plus 500,000 yards of cloth per year, or more of either product at the cost of some of the other. Since more labour and resources go into producing a yard of cloth than a bushel of wheat, a shift of labour and resources between industries will yield 3 more bushels of wheat for each yard of cloth given up, or $\frac{1}{3}$ yard more of cloth for each bushel of wheat given up. Superia's *substitution cost ratio* is thus 3 bushels of wheat for 1 yard of cloth (1 wheat for $\frac{1}{3}$ cloth).

In Inferia, the available labour and resources can produce 400,000 bushels of wheat plus 300,000 yards of cloth per year. Because of the inefficiency and disadvantages besetting Inferia, wheat production and cloth production both take more labour and resources per bushel or yard than in Superia. However, Inferia's relative disadvantage is worse in wheat than in cloth: a shift of labour and resources between industries will yield more of one product and less of the other at a substitution cost ratio of 2 bushels of wheat for 1 yard of cloth (1 wheat for $\frac{1}{2}$ cloth). Thus the substitution cost ratios differ in the two countries, setting the stage for mutually beneficial trade.

The following table summarizes the situation before trade takes place.

	Production and Consumption		Substitution
	Wheat, bushels	Cloth, yards	Cost Ratio
Superia ...	600,000	500,000	3 wheat=1 cloth
Inferia ...	400,000	300,000	2 wheat=1 cloth

Now international trade opens up. Since the substitution cost of cloth in terms of foregone wheat is greater in Superia than in Inferia, Superia imports cloth and pays with wheat. The *terms of trade* between wheat and cloth must be somewhere between the substitution cost ratios of the two countries; let us suppose that $2\frac{1}{2}$ bushels of wheat exchange for 1 yard of cloth. These terms permit Superia to get cloth by giving up less wheat and Inferia to get wheat by giving up less cloth than before.

Suppose that the people of Superia cut their yearly cloth production by 100,000 yards from 500,000 to 400,000 yards and, in accordance with their substitution cost ratio of 1 cloth = 3 wheat, expand their wheat production by 300,000 bushels from 600,000 to 900,000 bushels. The people of Inferia cut their yearly wheat production by 240,000 bushels from 400,000 to 160,000 bushels and, in accordance with their substitution cost ratio of 1 cloth = 2 wheat, expand their cloth production by 120,000 yards from 300,000 to 420,000 yards. We further suppose that Superia trades 275,000 bushels of wheat a year to Inferia for 110,000 yards of cloth, in accordance with the terms of trade of 1 cloth = $2\frac{1}{2}$ wheat. The following table summarizes the new situation.

	Production, Trade and Consumption	
	Wheat, bushels	Cloth, yards
Superia	900,000 produced	400,000 produced
	Less 275,000 traded away	Plus 110,000 got by trade
	625,000 for home consumption	510,000 for home consumption
Inferia	160,000 produced	420,000 produced
	Plus 275,000 got by trade	Less 110,000 traded away
	435,000 for home consumption	310,000 for home consumption

International trade thus lets Superia's people consume 25,000 more bushels of wheat and 10,000 more yards of cloth than before. Inferia's people can consume 35,000 more bushels of wheat and 10,000 more yards of cloth. Both countries clearly gain. That one country is absolutely less efficient than the other in producing both goods does not matter.

Our illustration of the Principle of Comparative Advantage is admittedly very simplified: it considers only two countries and two commodities and postpones consideration of money prices and wages. The simplifications merely make for clarity and are in no way essential to the conclusion. We assume particular quantities and ratios, for instance, only because algebraic generalization would be harder to understand than definite numbers. It is easy to scoff at such demonstrations as "theoretical"; but, significantly, the scoffers are often precisely the people who most need enlightenment. Actually, the Principle of Comparative Advantage is beyond dispute. Countries where production is efficient and where it is inefficient can all gain by specialization and trade, just as all people gain in the following two examples: An expert surgeon who was

* Published by the Robert Schalkenbach Foundation, New York. 88 pp. 25c. From our offices, 2s. 0d. net.

also an expert instrument-washer would still gain by sticking to his greater speciality and hiring somebody to wash his instruments for him, even though the assistant might be slower than the surgeon himself. Similarly, a lawyer who was also an expert typist might gain by sticking to legal work and leaving the typing even to a typist slower than himself.

One point remains to be cleared up. Practical businessmen don't know or care anything about Comparative Advantage and don't need to: they want to buy where *money prices* are lowest and sell where *money prices* are highest. How, then, can Inferia, with its generally inefficient production, hope to attract any foreign customers and so take part in international trade? The answer lies in a generally low level of wages and other incomes ("low," that is, as translated through prevailing currency exchange rates and compared with wage levels in more efficient countries). Low wage levels—the famous "cheap labour" — permit Inferia's businessmen to price their goods low enough so that the goods in which their country has the least disadvantage can actually find foreign markets. Low wages are an inevitable result of Inferia's inefficient and disadvantaged production; but they are also what enables Inferia to export the products in which it has the least disadvantage and so earn the foreign exchange needed to import the products in which it has the greatest disadvantage. Low wages permit Inferia to share the benefits of international trade and so to have less poverty than otherwise.

As we have already seen, Superia also gains from international trade, even when trading with an inefficient, "cheap-labour" country. If Superia's government shut out imports because they were made by "cheap labour," it would harm its own people as well as the Inferians. It would be equally foolish for Superia to restrict trade because Inferia had an "unfairly depreciated currency." The difference in wage levels between Superia and Inferia—wages being translated through the exchange rate into a common currency—is necessary to allow the product price relationships that lead profit-seeking businessmen to import and export and so secure for the people of all countries involved the benefits explained by the Principle of Comparative Advantage. Superia's government would also be foolish to take a shrinkage of particular home industries as evidence of need for tariff Protection. As our numerical example showed, such a shift of labour and resources out of the industries in which Superia has the least superior advantage is an essential part of the process of benefiting from international specialization and trade.

BOOK REVIEW

The new book *Free Trade*: *America's Opportunity*, by Leland B. Yeager, is very welcome. Although, as is to be expected, its orientation is American (very early on it calls upon American businessmen to make U.S.A. Free Trade's pioneer exemplar to the world!), its appeal soon broadens, and the author's call for clear thinking and courageous action will surely be answered by all who believe "there is no more ultimate limit to the extent of markets than there is to human wants," and that all communities have the right to employ their productive energies to the maximum advantage of all people.

In less than 100 pages, this lively and important work sets out the arguments for and against both Free Trade and Protectionism, explains the principles of comparative advantage and specialization and, by brilliant use of image and apt quotation, reveals how tariffs, subsidies, quotas and customs regulations serve sectional interests at the expense of the people generally—"expedients for dealing with local sores while ignoring the general health of the body politic," and how these "negative railways" block and impede national and world trade.

Here is a reasoned examination of the vexed question of sweated labour, low costs and dumping, and here are exposed the false assumptions of the "practical business man" based on incomplete knowledge and muddled thinking; the wilful ignoring of what history has taught us of the changes wrought by improved technology and a people's natural capacity for adaptability. The author explodes the fallacies contained in those pleas for special consideration which lead to lobbying and political corruption, and does not spare the lunatic fringe of "practical men" who can claim gloves, pens and peanuts as strategic materials, and the army of customs officials like those who delayed a shipment of coats while wondering whether to charge duty according to the wool or the buttons, and treacle tarts (molasses pie in U.S.A.) because an inspector said there was no such thing as treacle in the regulations.

We are asked to consider what it would mean to world peace if these manufactured difficulties for restricting trade were swept away and, by "wise economic co-ordination," the nations became "one financial and trading community."

A practical summing-up tells of efforts already made to reduce tariffs by trade agreements (incidentally casting a significant light on the precarious position of the balance of trade in U.S.A.), and outlines a course of thought and action for nations and individuals who would restore Free Trade and do away with the present "misuse of business ability and political machinery."

E. W. PILCHER.

TWO KINDS OF "PROTECTION"

Dry footwear and warm gloves, so necessary to the maintenance of health and bodily comfort in a northerly country, may well be regarded as a combined form of insurance and health service, the essential equipment of every prudent person. But for many working people on low wages and with large families to feed and clothe, and for old folk living on fixed incomes savagely diminished by inflation, the cost of British footwear and knitwear is beyond their means. If it were not for Hong Kong sending such goods cheaply they would have to go without or would have to deprive themselves of some other item. In a very real sense, that far away colony is providing a "welfare service" much appreciated in many British homes as well as maintaining its own economy by such trade.

Protectionists regard such imports as a dangerous threat to British industry.

Questions asked, June 17, by MAJ. N. MACPHERSON (Cons., Dumfries) were typical of many repeatedly directed to the President of the Board of Trade. Was the Minister aware of the concern felt at the rapid increase in the volume of imports of rubber footwear? Would he investigate with the Hong Kong government whether the competition at present was entirely fair? If it was not, would he go further into the matter to see whether action could be taken along the lines taken before the war? Was the Minister aware of the concern that was felt by both the employers' and the employees' organizations at the volume of knitwear imports from Hong Kong? Was he aware that goods were being offered at prices which scarcely covered the cost of the raw materials contained in them?

The Minister of State, Board of Trade, replied that he had no evidence of "sweated conditions" in Hong Kong. To impose quotas or duties on imports from that or any other colony would be contrary to the policy of H.M. Government.