# CAPITAL FORMATION AND FOREIGN TRADE

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## I

THE world's trade and payments dilemma dates back to the First World War and acquired an apparently insoluble character in the wake of the Second World War. The trade and payments balance of the European nations which, until recently, were quite consistently unfavorable can be traced, though not exclusively, back to the loss of these nations of most of their foreign holdings, to their indebtedness for American supplies, a change in the terms of trade, and the shrinkage of their traditional markets. The situation was aggravated by the deterioration of East-West trade which, in part, resulted from political changes and in even greater part from the industrialization of countries that formerly were almost exclusively producers of primary products. America's world dominance in both industrial and agricultural production dislodged still further an already precarious international economic balance. Whereas the last century found Europe a capital-exporting and America a capital-importing territory with a large and complementary trade, the present century reversed the picture in terms of economic power relations but not with regard to the general economic conditions of nineteenth-century capitalism. America became a creditor nation unable to collect and Europe a conglomeration of debtor nations unable to pay.

The difficulties that arose from this change of situation could not be met by the Keynesian instrumentalities devised at *Bretton Woods* in order to restore a quasi-multilateral trade and payments system. The postwar world required national economic policies of a kind that the *Bretton Woods* institutions were intended to prevent. The International Monetary Fund and the International Bank for Reconstruction and Development were soon recognized as wholly inadequate and unable to fulfill their proclaimed functions. Trade deliberations did not even try to eliminate but merely to reduce restraints, discriminations, tariffs, quotas, and exchange-controls. Various "waivers" and special concessions turned the settled agreements into so many changing agreements on trade restrictions. Tariffs prevailed generally fifteen years after the war and twenty-five of the thirty-seven nations participating in the General Agreement on Tariffs and Trade (GATT) still had import restrictions because of balance-of-payments difficulties.

Payments can balance on any level of production and trade. A balance of payments may be lost by way of commodity exchange, through capital movements, and through the requirements of war. By itself, a trade and payments balance means just what it says: a balance of trade which must be settled at a definite period. Neither its existence nor its absence tells anything about actual economic conditions, whether there is prosperity or depression. A persistent imbalance, however, points to a disruption of the market system and to important structural changes of world economy. Between 1946 and 1952 the deficit of the "free" nations with the United States rose to about 34 billion dollars. Some four billion dollars were taken care of by gold and dollar reserves of the deficit nations; over thirty billion dollars by way of American aid.

America's "favorable balance of trade," which at times amounted to ten billion dollars a year, was offset by loans and grants. Trade and payments questions could not be left to the vicissitudes of market events, as the gap between European and American production was far too wide. The United States' favorable balance of trade in 1948 was 5.5 billion dollars and her production in the same year exceeded that of 1937 by seventy per cent. The deficit of the Marshall Plan countries was 5.1 billion dollars and their production was still below the prewar level. As trade was not possible, aid was unavoidable to maintain the "imperfect" market system despite its obvious obsolescence.

But since, for some ideological reasons, trade appears preferable to aid, it was, and often is, suggested that trade be substituted for aid by abolishing American import restrictions. By adhering to a high tariff and by insisting upon import quotas for a number of products, American economic foreign policy, it is said, favors the interests of particular industries and pressure groups at the expense of the national interest. And since, admittedly, a different course would lead to unemployment and liquidation in affected American industries, it is suggested that these eventualities should be mitigated through subsidies, compensations, and by conversions to other lines of business without any further specifications what these lines could be. Such suggestions, however, are no more than a request to shift governmental aid from the international to the national level.

The liberalization of trade and the lifting of exchange controls can not alter existing economic difficulties. It was these difficulties that led to trade restrictions and controls in the first place. Ending the tariff system would, at best, allocate international trade somewhat differently without necessarily enlarging it. It would not remove the discrepancy in productivity between the American and the foreign economies. A unilateral ending of the tariff system would only be another form of American aid to less productive nations. To many countries, moreover,, "the present inadequacy of reserves, the difficulties and uncertainties of expanding and maintaining much larger exports in an increasingly competitive world, the wide oscillations of relative prices and of the terms of trade, these all appear to present a convincing argument for the retention of essential controls over imports. . . . And they can argue with some justification that the ordinary operations of a free market—the rise of certain exchange rates, for instance, and the fall or maintenance of others—would produce almost exactly the same effect somewhat more slowly and less certainly, and would be equally discriminatory in the sense that the consequences would affect differently the country's trade with other nations."[1]

When both, discrimination and the lack of it, tend to have identical effects, discriminatory policies may be adjudged a precondition for the continued existence and precarious "balance" of any particular nation and for the world at large. There exists then only an apparent desire to restore, not an actual possibility

1 Willard L. Thorp, *Trade, Aid or What?* (Amherst, 1954), p. 53.

of restoring, a free multilateral trade and payments system. Whether to have restrictions and controls is not seriously discussed; what is debated in all the talk about freedom of trade and economic integration is the degree of discrimination and the direction it is to take with regard to various national interests. It becomes apparent that "too much time has been wasted in elaborating rules for a world that cannot be recreated, instead of working out what can be done in a world that exists. What can be attained is . . . a state of affairs in which countries are under an obligation to make their trade and payments as free as they can be made, but with the recognition that there must inevitably be grades of freedom."[2]

## II

Economic integration can mean different things—a free world market with its competitive "equilibrium" mechanism, as well as political unification and planned supranational interventions in the economy. The latter type of "unification" and economic "integration" was, for instance, incorporated in the Nazi vision of a Europe under German control. The political outcome of the war forced the United States to accept European economic policies which were discriminatory to her own economic interests in order to induce a rapid European recovery. European economic "integration" found strong American support, even though it did not suit all the European nations, least of all Great Britain, unable as she was to forget her previous special position in world economy.

Although in its conception "integration" was at once economic and political, at its start it was purely a monetary matter in accordance with the Keynesian view of things which considers economic activities mainly from a monetary point of view. Several hundred changes in exchange rates in concurrence with different degrees of inflation in various countries had led into an impenetrable jungle of inconvertible currencies. To restore at least partial convertibility was then regarded as the starting point for an increase of trade and a consequent rise of production. The first attempt in this direction was the European Payments Union (EPU), modeled after

2 *The Economist*, London, January 30, 1954.

Keynes' International Clearing Union, proposed during the war. It was to make possible a better transferability of European currencies. This was regarded as a precondition for the elimination of import restrictions, export subsidies, and other measures that hampered intra-European trade. It was also regarded as an in-between station on the road to universal convertibility in an altogether free-trading world.

The EPU—or the European Monetary Agreement within the frame of the Organization for European Economic Cooperation (OEEC) at a later date—succeeded only in warding off a possible further deterioration of the European markets. And this necessitated successive manipulations of the EPU itself. Its regulatory mechanism ran out within the frame of a prearranged quota system of allotted dollar reserves, which reflected the economic power relations of the participating countries at the time of the EPU's initiation. As the fortunes of the individual nations changed, the intra-European trade and payments system became once more a matter of national policy. Debtor nations maintained their right to postpone liberalization; the liberalization clause itself became the means of restoring payments balances, which is to say that protectionist policies which the EPU was supposed to mitigate and eventually to eliminate, became the very instrument for the desired payments balance. No longer was the EPU an instrument of trade; trade was to be conducted in such a manner as to assure the continued existence of the EPU.

European trade and payments problems were soon superseded, however, by the overriding issues of Western "defense" and Germany's incorporation into the Atlantic Pact. The decision to revive Germany's economic and military power implied different things for France and England than for the United States. For the latter, it was first of all a military decision, but for France it was acceptable only if accompanied by guarantees that secured her European position. Yet her actual weakness and inability to oppose American policies induced French politicians to anticipate the dangerous aspects of this development and to answer them in advance with the Schuman Plan. The purpose of this Plan, or the European Coal and Steel Community (EEC), comprising France, Germany, Holland, Belgium, Italy and Luxemburg, was to create a single market for coal and steel in all of Western Europe. Adherence by France and Germany made participation by the smaller nations practically mandatory. Britain associated herself merely for the exchange of information, without surrendering control over her own coal and steel affairs. The new supranational institution was hailed as the beginning of a new era in intra-European relations, as the harbinger of better things to come. The drawing into the single market of other products besides coal and steel and the creating of a European atomic energy program were to culminate in a Western European Federation, a veritable United States of Europe.

In a more prosaic mood, however, the EEC appeared to be merely an extension of the European steel cartel of pre-Hitler days. This cartel was a price-fixing arrangement whose existence indicated the relative capital stagnation which preceded the Second World War. And in 1950, when the Schuman Plan was born, there were signs of impending surpluses of coal and steel, so that the Plan was probably codetermined by the desire to avoid another period of cutthroat competition. Yet, at the time of its ratification, the situation had already changed in favor of a general expansion of coal and steel production. There was now a need for collaboration not so much to secure the given market as to assure a larger production. Whatever the future would bring, for the time being the EEC satisfied all those engaged in its foundation. For America it increased the war potential of the West; for Germany it offered a chance for a quicker recovery, and for France it provided the opportunity to participate in the control of the apparently inevitable development of Germany's productive power and war-making ability.

Existing for a time only in latent form, the EEC, soon after the Korean war, increased its activities. As in previous periods of prosperity, the economic upswing after 1958 created a climate of optimistic readiness to forego some of the stifling measures of protectionism. A series of tariff reductions in 1959 were coupled to the proclaimed intention of reaching a single, six-nations, tariff-free market by 1965 or 1970. Although the first tariff reductions were not of great significance, they did help initiate a rash of economic changes of greater importance. A series of industrial agreements led to many mergers of companies, encompassing joint selling and production, the pooling of resources, specialization and rationalization. As the removal of trade barriers increases both competition and protection against competition, so it fosters capital concentration which, in turn, strengthens the competitive abilities of the industries within the EEC. By promising greater profitability, it attracted a great amount of new American capital. While all this spelled "prosperity" it also increased international competition. But competition in a generally expanding economy merely accelerates the upward swing. European production and exports increased, cutting the United States trade surplus to its narrowest margin since the end of the war.

However, the EEC did not lead to the political and economic unification of the whole of Western Europe. Some nations, and England in particular, were not willing, or found it disadvantageous, to subject even part of their economic activities to supranational control. What *was* realized, in this respect, was a kind of supranational protectionism. With the EEC a reality, England joined six other nations (Austria, Denmark, Norway, Portugal, Sweden, Switzerland) in a European Free Trade Association (EFTA) to counteract the possible competitive advantages of the six-nation trading bloc. Retaining full control over their national economic policies, including tariffs with countries outside the EFTA, these seven nations pledged themselves to cut tariffs within the EFTA (leading to their complete abolishment by 1970) to fair competition, to the equalization of supply conditions, and to a full employment policy. As in the EEC, so in the EFTA, agricultural products were not included in the planned tariff reductions.

The common market, by leading to a division of the European economy into two trading blocs created as many problems as it solved. While it does increase free trade beyond national boundaries, it may decrease it on an international scale. The gains implied in the existence of free-trade areas are largely offset by difficulties arising from the disruption of earlier trading practices based on previously established patterns of production. While capital will perhaps flow more freely within the separate trading blocs, it will most likely flow less freely from one bloc to another. And while the two trading areas may be considered as a first, and at this juncture the only possible step, toward a single market for all the

OEEC countries and beyond, it may also, in time, demonstrate the hopelessness of the task of reintegrating either the European or the world economy. It all depends upon the economic weather, whether or not a necessary degree of world prosperity can be maintained.

Whatever the expectations or apprehensions associated with the establishment of the two separate European market systems, their very existence—quite aside from their eventual destiny—points, on the one hand, to the increasing inability to maintain national economic policies, and, on the other hand, to the improbability of a return to a "free" world market. This will not prevent futile attempts in either direction. When necessary, nations will always tend to insulate their economy against the detrimental effects of international competition. Yet, they cannot cease hoping for and working toward the restoration of an internationally integrated economy. Regional groupings constitute, in a sense, a kind of "compromise" between these extremes, so as to overcome the limitations of national economy in a world not susceptible to rational arrangements of international economic affairs. The European trade blocs initiated a general movement from Africa to Latin America for custom unions and intranational market arrangements. While the regional "solution" seems the only one available, it appears as a "solution" only on the assumption that it will move toward, and not away, from world-wide integration.

Although the existence of the two trading blocs demonstrates the present impossibility of integrating into a common market, or a free trade area, all the European countries, this hoped-for eventuality remains the proclaimed goal of both the EEC and the EFTA. This goal, however, is less likely to be reached the longer the trading blocs retain their separate existence. Newly evolving patterns of competition will tend to harden; and breaking up regional arrangements may prove even more difficult than overcoming national protective policies. If one group should gain exceptional advantages by virtue of the regional arrangement, it will not sacrifice this advantage to the principle of free trade, which, at any rate, would still be operative only within the European markets.

## III

The "final" solution of the world's trade and payments problem is then conceived as a merger of all the various trade areas and in "the economic fusion of the free world's nations."[3] It is recognized, of course, that such a "fusion," involving the elimination of tariffs and other trade restrictions, would aggravate the problems for nations competing with the United States. But this is to be dealt with by a "relatively unimpeded movement of capital and labor," by agreement on the part of the "strong" nations to "extend great blocs of credit to weaker nations to tide them over their balance-of-payments difficulties," and by the creation of "an international fund to ease the pain of unemployment and of capital liquidations in segments of any economy hard-hit by the process of integration."[4]

Against the "relatively unimpeded" movement of capital stands, however, the actual decline of capital exports in recent history. American capital exports have been less than the inflow of earnings from American long-term foreign investments. It is often pointed out that the low proportion of total American production that goes into exports and her relatively limited capital exports testify to a lack of "economic imperialism" on the part of the United States, and that American competition can consequently not be blamed for the economic difficulties besetting the world. From a consistent capitalist point of view, however, it would be just this lack of "economic imperialism"—whatever its cause—which, to a large degree, accounts for the contraction of the world market. During the period from 1870 to 1913, for example, "Britain invested abroad two-fifths of her savings, *i.e.*, something like one-tenth of her income. By 1913 her foreign investments, equal to nearly four-ninths of her home investments represented one-third of all European foreign investments and contributed one-tenth of her national income."[5] The equivalent of this on the scale of the now dominating American economy "would be an American foreign investment of about 600 billion dollars yielding thirty billion dollars a year income and growing somewhat like fifteen billion dollars a year."[6] Instead, United States foreign private investments after the Second World

3 Raymond Vernon, *Trade Policy in Crisis* (Princeton, 1958), p. 21.
4 *Loc. cit.*
5 Willard L .Thorp, *op. cit.*, p. 183.
6 *Loc. cit.*

War have been, for a long time, at a rate less than one billion dollars a year, representing less than one-third of one per cent of her national income, and slowly rising to three billion dollars in 1957 and to 4.5 billion dollars thereafter. Total investments abroad were estimated to be about 37.5 billion dollars. This insufficiency, relative to the existing capital mass and compared with capital exports at the turn of the century, allowed for only an insufficient rise of international trade.

The recent spurt in American capital exports, though for the time being decreasing payments difficulties, may, at a later time, come to have the opposite effect by an outflow of dividends, interest, and profits which will exceed new investments. The setting-up of American manufacturing enterprise in Europe and the participation of American capital in European industries compensate to some extent for the export decrease of American commodities due to the actual, or potential, dollar shortage. Yet part of the profits made in this manner must find their way back to the American base. If not, it ceases being American capital and functions as European capital in competition with America and the rest of the world.

To be sure, a great flow of capital from "stronger" to "weaker" nations may improve the balance-of-payments positions of the latter, for the fact that foreign capital is entering a domestic economy is itself a sign that the latter is expanding and is in the process of ending, or narrowing, its balance-of-payments difficulties. It is only under conditions of an expanding economy that capital movements affect the payments sufficiently so that the "free" movement of capital appears as an "equilibrium" force. This does not do away with, but merely covers up, the concentration and monopolization process of capital accumulation by which a widening disequilibrium appears at times as an apparent equilibrium. The course of actual development cannot be derived from fluctuating balance-of-payments situations, which may be in "equilibrium" merely as a precondition for a still greater disparity between creditor and debtor nations after a given phase of expansion comes to a halt.

Although it may be "immaterial" for a national economy whether its capital investment is of domestic or foreign origin (provided the rate of capital formation is not affected by the transfer of profits to the foreign investors) it is not immaterial for the domestic capitalists to find their own traditional sphere of capital expansion invaded by foreign capital. While the incentives for capital exports are getting smaller, the readiness to invite capital from abroad is also diminishing—at any rate in the European countries. Both the EEC and the EFTA tend toward a continental allocation of capital resources which involves the curtailment of American investments in European industry. In England, for example, where American controlled capital approaches three billion dollars, opposition against the potential foreign domination of some British industries becomes increasingly more vocal.

Whereas the "unimpeded" flow of capital will accomplish little toward a more balanced international economy, the "unimpeded" flow of labor is altogether an impossibility. It cannot be realized —except on a small and insignificant scale—even in supranational combinations such as the EEC and EFTA. The relatively free movement (to varying degrees) of commodities, capital, and labor in the United States is an advantage not to be duplicated by either one of the European trade blocs, or by a Pan-European market. Here the *free* flow of labor is as impossible as is the free flow of labor between Europe and America.

Since capital movements are governed by profitability and security, the most profitable economies attract most of the capital and thus become still more profitable. This diminishes the competitive ability of less productive, under-capitalized nations and this, in turn, decreases the *general* flow of capital through its concentration in "overcapitalized" nations. The movement of capital from less profitable and less secure to more profitable and more secure nations cannot have an "equilibrating" quality, as it is bound to increase the gap between the "strong" and the "weak" countries. It is the profitability principle which induces, but also prevents, large-scale capital exports, and which induces, or hinders, the "flight of capital." To have a capital movement of an "equilibrating" nature implies the sacrifice of the profitability principle by even those nations still able to enjoy its results, that is, it implies not the *free* movement of capital, but a rational allocation of capital according to the actual requirements of world economy as seen from the point of view of human needs. This clearly transcends the possibilities of the private enterprise economy, and even minimum requirements in this direction—to assure a necessary degree of social stability and international intercourse—depend upon the interventions of governments which "socialize" the "losses" thus engendered.

European proponents of a "fused" Western economy envision its "actualization" not so much as freedom of trade and the free movement of capital and labor as the avoidance of economic warfare in which they could not win. They accept the EEC and EFTA as arrangements that need not necessarily lead to conflicts within, and between, themselves, or with the rest of the world if only there is recognition of, and free consent to, a variety of preferential treatments for nations within the trading blocs, between these blocs and the large-scale economies. This would involve the continued support of the European by the American economy not, to be sure, by way of additional aid, but by making allowances for the disadvantages of the European economies *vis-à-vis* the United States. Despite all the ideological free-trade verbiage accompanying policy statements, the international, like the national economy, is no longer thought of as capable of functioning in an "automatic" way but as requiring conscious considerations of actual economic relationships —if necessary, in defiance of the so-called "market laws"—in order to secure as much as possible of the market economy. Of course, this kind of partial "planning" of the international economy to secure a necessary "balance" implies gains and losses and the acceptance of losses by the stronger capitalist powers.

## IV

This desired "reversal" of the trend of international capital accumulation, or the undoing of history, is as unrealistic as the widespread nostalgia for a "free" world market and is merely a state of mind camouflaging the actual impasse in which international capitalism finds itself. Notwithstanding all declarations, and even actual policies, to the contrary, it cannot be America's objective (or that of any other nation) to bring about a well-functioning world economy at the expense of her own *dominating* position. To come to the aid of other nations, even if dictated by national interest, cannot be a limitless process, nor can it be done in perpetuity without assisting in the destruction of the social fabric of the free enterprise system. Such a course finds its "justification" in "emergencies" but remains foreign to the capitalist mode of production. As the "emergency" passes, competition supplants "philanthropy." It is then that "philanthropy" is revealed as but one of the necessary parts of competition.

There is, at any rate, no indication of an American readiness to sacrifice her dominant position in world economy to a more balanced international economy. After all, America's preponderance is the result not only of her own productive efforts, but is due also to the occurrence of two World Wars which left the European economies far behind the American. At least in part, the United States owes her exceptional growth to exceptional circumstances and some of the "blessings" of these circumstances will disappear as the recovery of the European economies narrows the gap between European and American production. The gap will be even narrower should the European economies find ways and means for a more rapid capital expansion than is now possible in the United States. Relative to the growth of European production, American markets for these products will become smaller and thus American exports to Europe will also decline. Because European expansion is by sheer necessity geared to the world market, its continued profitable expansion depends on a successful penetration of extra-American markets in competition with the United States. And not only in competition with America but also with the Eastern economic bloc, which limits still further the external expansion of both the European nations and the United States. With the growing competitive strength of the Eastern economic bloc and increasing European competition, America's exceptional position during the first half of the twentieth century is coming to a close.

Further international capital expansion points then to an intensified competition in a shrinking world market, and the arising trade blocs may also be considered instrumentalities to counteract the monopolistic pressures of the large-scale economies. So far as America is concerned, Europe's recovery, however necessary, can only be a dubious affair. America's acquiescence in discrimination against herself is wearing thinner under a growing demand that the European nations, now that they have recovered, must share in greater measure the profitless burden of Western "defense."

Concern over a growing American payments deficit despite a continued favorable balance of trade shifts the previous emphasis upon foreign economic policies to national economic interests, in full recognition of the renewed force of European competition aided, on the one hand, by the cutting down of intra-European competition and, on the other, by the threatening possibility of higher common tariff walls against American competition.

Although, in theory, competitive international capital accumulation in the traditional sense could continue if economic activities were left to the free play of the world market, the recognizable results of such a free play preclude the play itself. Even in a world without tariffs, quotas and other restrictions, trade would still face the discriminatory situation of unequal levels of productivity, different degrees of industrial development, and unequal distribution of natural resources, which cannot be coped with by the sole incident of lower wage-levels in the competitive but less fortunate nations. Over a period of time, "if there are divergent rates of growth of productivity, the trade will be progressively less favorable to the countries less rapidly advancing in productivity."[7] Under conditions of free trade, American competition could ruin European producers and disemploy European labor, not to speak of even less developed non-European areas. The less productive nations will try to block the foreign competitor by all available means, including the utilization of the national state and the formation of trade blocs in their defense. And economic legislation will come to their aid the more readily as capital production necessitates a definite degree of social stability.

Structural changes in world economy brought about by previous accumulation exclude international economic "integration" by way of a market-determined capital formation. Yet all attempts at "integration" are still based on this assumed possibility and are simultaneously contradicted by practices which divide the world market into "spheres of interests" and "autarchic" zones which prevent the revival of free competition on a free world market. Nor can this be otherwise, for if there cannot be a "free" capital accumulation (due to its concentration effect) neither can there be a "free"

7 John H. Williams, *Economic Stability in a Changing World* (New York, 1953), p. 38.

market nor market integration of the international economy. And just as a controlled international capital expansion is likewise an impossibility, so is a controlled international market. A mixture of free *and* controlled capital expansion, of free *and* controlled market relations excludes both an "automatic" and a "controlled" integration of world economy. It does not exclude economic manipulation, to be sure, but this manipulation, which could only serve particularistic interests, cannot serve the needs of world economy.

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