28

FORTUNE

SEPTEMBER 1944

THE U. S. HOLDS THE CARDS

But can we play a free-enterprise game at home without setting up rules for free world trade?

by HENRY C. SIMONS

PAPER FOR THIS REPRINT HAS BEEN SALVAGED FROM PRINTER'S OVERAGE

FORTUNE Magazine: Editorial Offices, TIME & LIFE Building, Rockefeller Center, New York 20, N. Y.

COPYRIGHT, 1944, TIME, INC.


A TEXT-BOOK ON LAW AND BUSINESS
SPENCER

THE U.S. HOLDS THE CARDS

...BUT IF WE WANT TO PLAY THE FREE-ENTERPRISE GAME AT HOME WE HAD BETTER BE SERIOUS ABOUT REESTABLISHING FREE TRADE WITH THE REST OF THE WORLD

by HENRY C. SIMONS

THE specialists in international finance have been called upon to lay plans for monetary reconstruction. Their prescriptions, naturally enough, center round a supranational bank—which may be good tactics, since everyone defers to the experts and no one much pretends to understand their elaborate institutional contrivances. If only a little change were needed, such contrivances might bring it off. But a little change will do little good when radical alteration of our commercial policy is necessary to reverse a powerful world trend.

The primary need for international monetary stabilization will be simply the internal stabilization of the dollar itself. This is the prescription from which hopeful planning should proceed. Backed by a vast hoard of gold and by a great foreign-investment potential, the dollar surely will be the predominant world currency—granted eventual respite from political leadership that, in both parties, preaches and practices the doctrine that inflation is the best form of taxation! If the dollar again is violently unstable in purchasing power or commodity value, and especially if it is again debased irresponsibly by tariff increases or devaluations, world economic order, large international trade, and decent national behavior in commercial policies or practices will be unattainable. If we can securely and closely stabilize our own price level and prevent recurrent aberrations of inflation and deflation, we can thereby eliminate the major obstacle to reasonable stability of foreign-exchange rates. Here is perhaps the best single contribution we can make to resumption of orderly international trade—to the ending of arbitrary exchange controls (rationing of foreign exchange), bilateralism, discrimination, and direct national control or governmental monopolizing of foreign trade.

There are very few tough liberals around any more—men proud of the great tradition of political economy that has underlain U.S. development. One of them is certainly Henry C. Simons, Associate Professor of Economics at the University of Chicago, who in the past few years has normally been embroiled in battle against the New Deal and the reactionaries alike. Though an early advocate of strong government fiscal measures to stem both boom and bust, Professor Simons contends nevertheless that fiscal controls are meaningless unless combined with an all-out attack on monopoly—whether found in business or in labor unions. Competition means competition. In the following article Chicago's academic dissenter pries behind the current international monetary proposals to present two things the U.S. must do if it wishes to see its enterprise system flourish. Prescription No. 1: stabilization of the dollar. Prescription No. 2: an all-out attack on tariffs, which in Professor Simons' opinion are just as evil as any European cartel.

If this view is sound, it deserves emphasis in domestic discussion and in international negotiation, for it raises no awkward questions of conflicting national interests or of "impairments of American sovereignty." The policy should be supported by both participationists and isolationists since it is equally important for international and for merely domestic purposes. We shall need a stable dollar for our domestic economy as much as others need a stable international monetary unit. Serving our national interest in this matter, we may also serve the cause of world order and reconstruction.

GOLD IS NOT THE ISSUE

Let us make clear, in the beginning, that stabilization of the dollar cannot be achieved just by repeating worn-out shibboleths about the "gold standard." Gold producers and would-be sellers of redundant, useless hoards have of course a special interest in a continuous subsidy program (such as is involved in our $35 per ounce price). And there may be political reasons for offering the world a gold-plated greenback. It is pointless to attack bad religions if they have become innocuous.

But the fact is that all talk about currencies based on gold is today just a bit silly. Over half of all monetary gold is now held by one nation, which is also the creditor of almost everybody and the predominant international lender or investor as well. The value of gold is thus merely a fact of the American gold price and of the commodity value of the dollar—i.e., of our fiscal policy. We may continue to hitch gold to the dollar if we choose. To think of hitching the dollar to gold is almost not to think at all. One does not hitch a train to a caboose!

The one serious question for the U.S. about gold is whether we should retreat from the exorbitant price set in 1934. Since it seems likely that after the war the dollar will still be too strong at exchange rates that other nations wish to establish, much could be said for sharply reducing the dollar value of gold. But far more can be said for leaving the price alone, and invoking first the alternative device of lowering our tariffs, i.e., abolishing protection. This action would be equally satisfactory as a means of adjusting the dollar to other currencies. In addition it would get us out of the politically demoralizing business of subsidizing particular industries indiscriminately. It would largely remove the worst manifestations of federal logrolling and of bad governmental centralization.

If we must retain such subsidies, for either military or campaign purposes, they should all be transformed into wholly straightforward subsidies and handled openly as matters of appropriations and expenditures financed out of general revenues, i.e., financed by lower income-tax exemptions instead of by concealed, regressive levies on consumers. Republicans, having long practiced concealed subsidies, deplore open ones; and, having in effect repeatedly devaluated the currency by tariff increases, they deplored the raising of our gold price. We have now the opportunity, with the predominant currency position, to make a clean sweep of past errors, reversing our devaluation by tariff reduction and terminating both open subsidies (e.g., to agriculture) and older concealed ones.

FISCAL POLICY IS WHAT COUNTS

Along these lines we may move simultaneously toward relatively fixed exchange rates and toward a stable international currency. Our own currency may be stabilized in terms of some broad price index. My own belief is that we should convert our federal debt wholly into consols (perpetuities) and currency (demand obligations). While seeking secularly rapid retirement of the consols, we should stand ready to convert them rapidly into currency when deflation threatens and to absorb currency by net issue of consols when price inflation occurs or impends. This means pursuing boldly a traditional open-market policy, but pursuing it preferably by direct Treasury action, or by action of Reserve Banks as branches of the Treasury—although such devices should be regarded as secondary or temporizing measures. The main implementation of monetary stabilization should be found in changes of the relative flows of federal revenues and expenditures. If large changes prove necessary, they should take mainly the form of large revenue shifts around a relatively stable flow of federal spending. If the personal income tax were our major federal levy, the desirable adjustment might best be effected by raising and lowering the personal exemptions, without frequent change of marginal or bracket rates of tax.

Given such internal fiscal policy and effective internal monetary stabilization, we would offer the world a dollar standard to which other nations, given initially proper exchange rates, might willingly and prosperously adhere. Internal fiscal stabilization of currencies by separate nations or blocs, with uncontrolled futures trading on highly organized private foreign-exchange markets, is perhaps closer to the ideal scheme of things than a stabilized dollar and fixed rates of exchange. But the latter is an attainable arrangement and would perhaps largely eliminate the old difficulties of fixed parities. A dollar stabilized in terms of a good, broad index of domestic prices would, in the very nature of a good index, actually be quite stable in terms of internationally traded goods. Thus the small and gradual adjustment of national economies, consequent upon shifts in international demand and in capital flows, might be accomplished easily and without inordinate delay by the "classical" methods of change in wage levels or income structures. Large disturbances (and initially mistaken determinations) probably would necessitate occasional alteration of exchange rates; but such disturbances are not to be expected with monetary stability in a substantially peaceful world. Monetary stability and decent commercial policies, moreover, are necessary if not sufficient conditions of peace.

Within such a framework of policy, the discussions at Bretton Woods begin to make sense and can be readily explained to the mystified Senator or businessman. The various proposals, and the American one especially, for an international fund are not really monetary plans at all—or, as monetary plans, they are like *Hamlet* without the Prince of Denmark. They are, properly conceived, just commercial-policy schemes, designed to facilitate orderly resumption of decent trading practices. In spite of their anomalous solicitude about capital flights and their demand for "good" exchange controls, they are really intended mainly to facilitate abolition of exchange controls and of governmental exchange rationing, which, of course, were the great invention of the devil during the thirties. If we provide nations with available loans or overdraft facilities, if we make moderate devaluations respectable by international sanction, then we may temporarily hold off a resurgence of bilateralism and totalitarian trading until monetary order and commercial decency have a chance to prevail. But the best augury of American responsibility would be radical reduction of our tariff barriers; at the least, we must undertake gradual reduction and avoidance of increases.

THE BRITISH PROBLEM BEGINS IN THE U.S.

There is of course the question of British policy, especially as regards bilateralism, cartels, and imperial preference. One may sympathize with the English because of their weakness in bargaining with us, and because of their naturally skeptical estimate of our willingness to behave responsibly. Here again our tariff level assumes critical importance. We cannot hope to restore equality of treatment by other nations ("most-favored-nation" practices) or to prevent a deadly resurgence of bilateralism, if we persist in practically excluding imports, however impartially and multilaterally. On the other hand, we can, with promises of over-all reductions, easily trade England out of her bilateralism and arbitrary trade controls—and probably with applause from the dominions. If we fail even to try, England will probably retrogress into totalitarian foreign trading, if not into unmitigated collectivism—which is perhaps the easiest and surest route to our losing the peace.

Let us hope that the English will bargain skillfully—but that they will not in the process themselves become apologists for English isolationism! They have fought an exhausting war, joining the issue two long, terrible years before we would make open declaration against the Axis. We should not begrudge them a cautious or gradual return to unmanipulated trade; neither should we seem intolerant of their desire again to establish a low sterling-dollar rate. What matters is their post-transition objective in commercial policy. We should seek assurances that their exchange controls and bilateralism will not be consolidated or continued beyond a reasonable period of time. In return, we should undertake to do what we can to ease their return to free trade.

There is probably no possible or prospective English policy that we cannot trade them out of with moderate concessions. Only when one posits our refusal to improve our own commercial practices does the outlook become alarming. And, to repeat, the improvements in question should be made if only on grounds of domestic policy. One should recognize that the usual temporary disturbances of radical tariff reduction are now of little moment when we must, in any case, reorganize drastically from wartime to peacetime production. It will be little harder to reorganize industrially for responsible participation in the world economy than to reorganize for economic isolation and irresponsibility.

PROTECTIONISM CAN KILL FREE ENTERPRISE

Intelligent conservatives should see that our real policy choice lies between substantially free trade and governmental monopoly of foreign trade—and that their case against federal centralization and interference with business is a case against manipulation or control of private foreign trade. We cannot have the traditional federal interference with private importation without being driven into other governmental economic policies that are anathema to conservatives and simply incompatible with liberty, individualism, or free enterprise. The dominant national economy cannot remain protectionist without driving other nations, even its close allies, into more and more totalitarian control of their trade and thus itself being driven there too because it failed to go the other way. We may want undiscriminating protectionism and equality of national treatment (a tenuous conception, if not a sheer contradiction of terms); but the world will not let us have it. We may want internal free trade and free enterprise and no collectivist control of our domestic economic life; but, again, the world simply will not accord us the possibility unless we foster the larger scheme of free trade within which our own institutions might survive. The U.S. cannot persist as an island of individualism in a radically different world context. Institutional isolation is as impossible as military isolation.

American protectionism is simply done for. It is *the* utterly unrealistic prescription for the future. If we try to maintain it, we shall find ourselves with an institutional anomaly wholly unsuited to its world environment. It will drive other nations, as did our needless deflation and then our gold policy as a final catalyst, into wholly different schemes of commercial policy, which in turn will produce radical changes here. There can be no enduring issue, in the predominant nation, between free trade and protectionism. The real issue concerns a more extreme and epochal choice, namely, a choice between free external trade and national, collectivist monopolies of foreign trade. Surely conservatives would repudiate congressional manipulation of trade via tariffs if they knew it must lead to creation of a federal authority that would administer all our purchases and sales abroad and, in effect, prohibit all private negotiation of such contracts. Let them seriously contemplate the Export-Import Bank, which would fix all terms for import and export transactions, recognizing that such an agency would in fact be an executive agency, unamenable to action by rule of law and beyond reach of legislative control.

Other nations simply will not follow our lead in the half-discriminatory, half-collectivist control that is tariff protectionism. The alternative to freer trade, achieved by bold American leadership, is a resurgence of bilateral trading, quota restrictions, and exchange controls—which in turn will tend to be consolidated in single national trading authorities. Thus nations will seek, if only from defensive necessity, to manipulate foreign trade as a national monopoly-monopsony. Private competitive trading, even with much protectionist restriction, is essentially a peaceful and productive process, serving to promote economic division of labor and generally higher real income. The collectivist trading of national monopolies, on the other hand, is essentially exploitative and essentially a power contest, imperialist in the worst sense, and conducive to lower real income (and militarism) everywhere. If such economic warfare again gets strongly under way, no nation may escape participation. If we, as the leading power, let the world go that way, we must go that way too, organizing for global economic war, if only to preserve the dubious security of our separate relative power. Our foreign trade would have to be nationally regimented to meet such regimentation elsewhere, and to assure us our share of economic-political conquest and of vassal economies. It goes without saying that, to play this game, we must also regiment our economy internally.

AMERICAN FAILURE AFTER WORLD WAR I

Viewing these possibilities in the light of the immediate pre-war developments and of Nazi trading methods especially, one realizes how much real international organization we had formerly when it seemed that we had none. We see now that English hegemony of a century produced not merely cessation of major wars but a substantial institutional organization for peace, especially in the area of commercial policy. This or-

THAT AMERICAN TARIFF

COMMODITY	TOTAL VALUE*	DUTY PAID	AVERAGE RATE OF DUTY
Sugar	$80,097,000	$44,714,000	56%
Woolens	49,554,000	33,935,000	69
Meat products	20,200,000	6,798,000	34
Dairy products	13,232,000	4,174,000	32
Clocks, watches, and parts	10,138,000	5,808,000	57
Glass and glassware	5,152,000	3,177,000	62
Cotton lace	4,302,255	2,689,023	63
Chinaware	3,539,774	2,719,762	77
Copper	1,695,000	853,000	50

**In 1939. Dutiable merchandise only.*

The above items are presented only as samples of what the American consumer pays to individual producers through the high tariff policy so ably attacked by Professor Simons. The tariff on certain of these items, sugar and meat for example, is supplemented by even more restrictive quotas and other quantitative controls. It can be argued, and of course it is argued by tariff advocates, that what is good for American producers is also good for American employment. However, this argument overlooks the fact that what is good for *some* American producers is equally bad for other producers. This inevitably difficult point, involving the whole relation of tariff policy to the fixing of international exchange rates, has been put with great force by Professor Simons as follows:

"Suppose that an exchange rate of $4 per pound sterling (which we use for the sake of simplicity) would bring about balanced payments between America and all other nations *if there were to be no American tariff*. Clearly then [if there were a tariff], payments would be far out of balance, i.e., our exports would exceed our imports including long-term securities. Retaining our protective duties, we should have to fix a lower exchange rate, say $3 per pound sterling, to achieve balance. But at this lower rate it would be profitable to import many nondutiable commodities that it would have been unprofitable to import under free trade and a $4 exchange rate. Thus if we favor some industries with heavy import duties, we must injure other domestic industries and *all those that produce for export*. Furthermore, the uniform protection of a proper exchange rate is conducive to larger total trade and to more efficient use of our national resources. And, viewed internationally, such protection is less exposed to arbitrary and inopportune manipulation than is a miscellany of duties on particular imports—which duties are continuously exposed to political logrolling and pressure-group demands."

ganization was manifest in mutual self-denying ordinances among nations—inhibitions that, in spite of tariffs, preserved the spirit of free trade. A first task of world reconstruction is the rebuilding of that international commercial organization which was devastated by the great deflation.

Economic policy is the main area in which governments act. It is the main focus of discussion in that action-out-of-discussion that is the democratic process. It is really our major business as citizens, just as earning activities are our major private preoccupation. Moreover, it is the crucial or marginal area in the ideological conflict of individualism and totalitarianism. If our economy is largely absorbed into the state, if "political" comes again to include "economic," then state will in fact largely *be* society, not its servant or instrument.

The breakdown of the last peace was mainly an economic breakdown—a consequence of errors in economic policy that at bottom or in the beginning were no less errors of domestic than of international action—no less errors of isolationists and jingoists than of participationists and utopians. Their main causes were just ignorance and stupidity, not bad motives or wrong values. To believe otherwise is to be a romantic planner or authoritarian, and to distrust the democratic process as a means for getting the big things done if the little things most amenable to governmental action are half well attended to.

Reflect casually on what the thirties might have been if only we had not permitted the stock-market crash to initiate a long and precipitous deflation in the U.S.—if we had maintained by proper fiscal measures the essentially stable dollar of the twenties. The not inconsiderable world progress and international reconstruction of the twenties *might* have proceeded without any grave setback. Hitler and National Socialism might have been merely a ludicrous episode in the early growth or consolidation of German democracy. The French Revolution, after a century and a half, might have redeemed itself in a sound domestication of the democratic process. Russia, likewise seeking a short cut to democracy, might by now have modified her authoritarianism and begun really to import the institutions of freedom as well as industrial organization. Who can tell how long peace might have lasted or deny that it would have lasted much longer than it did?

Such sanguine "if-only" speculations become of course implausible if pushed too far. There is no need to imply that sound fiscal-monetary measures in this country would have carried the world straight into the good society. One may, however, insist that a little difference at the beginning of the thirties might have meant a big difference at the end. In any case, the thirties should make it clear that American deflations, devaluations, and high protection are inimical to world order; that in comparison with totalitarian trading they are poor instruments for economic-military defense in a disordered world of organized economic warfare; and that monetary policy and trade control are aspects of the same thing and, though usefully separated in theory, are not really separable in practice. In the past, decentralization of monetary control and lack of international organization for concerted fiscal action, as well as misunderstanding of the monetary responsibilities of the state, left the world a rather helpless victim of deflations. England ran the gold or sterling standard creditably, to be sure, when one considers her small monetary power—much as she kept the world at peace with small military power. Acquiring financial hegemony after the last war, we administered it abominably, in spite of our abundant power.

There will be no excuse for our failing so miserably again. Our monetary power will be overwhelming. In this respect, we face none of England's old difficulties as the world's banker. We need only stabilize our dollar domestically and make it freely convertible into goods by unsubsidized exportation and unrestricted or unmanipulated importation—and, incidentally, by maintaining free internal markets among our own functional minorities or producer pressure-group "states," for which purposes free foreign trade is the best simple means.

OUR NEW OPPORTUNITY

American conservatives and libertarians still hold all the cards. They can easily win the peace if only they show a little sense. But they displayed little sense when unopposed and act like hysterical fools now that some threat to their world has arisen. Their whole institutional complex—private property, private enterprise, an unobtrusive, instrumental state, and systematic dispersion of power—rests primarily upon free trade and a stable currency. But they reflexively oppose lower tariffs and antitrust prosecutions. They demand smaller deficits during deflations and larger ones during wars. They applaud governmental regulation or control of business in all its worst manifestations (e.g., in foreign trade, in coal mining, in resale price maintenance) and loudly deplore it where it is indispensable, desirable, or innocuous (e.g., in fiscal-monetary stabilization, in natural resources, in public utilities). This is no way to resist a collectivist danger. *If free enterprise is destroyed, it will be because its would-be guardians have stupidly cut away its foundations.*

Given a long peace, this destruction might have proceeded so long and so far that it could not have been undone. If collectivism had not prematurely precipitated global war, it might have triumphed everywhere by sheer default, i.e., by the unwitting cooperation of misguided enemies. But a mistaken military calculation now gives Anglo-American democracy a chance to clean its house and to reestablish its potentiality and promise as an ecumenical movement or faith. This is an exciting and challenging opportunity that we should cherish because it was nearly lost and might soon be lost again. To capture and hold it will require wise action on many policy fronts. One may properly be skeptical of any grand scheme for short-cutting the necessarily slow growth of international political organization. But, to repeat, one should not be skeptical or cynical about the democratic process of doing the big things, if the obvious little things of proximate, deliberate action are not grossly misplanned or miscarried.

What is exciting about postwar economic policy is its inordinate potentialities for good, along with the large freedom of action that the occasion offers. The usual solicitude about small vested interests should not now be inhibiting. They have been buffeted unmercifully in the industrial transition to war and, inevitably, will be buffeted again in the transition to peace. Industrial investment must be reallocated wholesale in any case. It may be adjusted almost as easily to one policy as another. Besides, having been rough about wartime conversion, we might well be a little rough about winning the peace.

One hopeful circumstance is that monetary reconstruction must be so thoroughgoing. The landmarks and traditional relations are gone or obscured. All that remains is the American gold price, itself a recent innovation. We must decide where to stabilize our price level, as must many other nations, where their currencies still exist. A whole structure of exchange rates must be reconstituted, tried out, and then, at least by gradual readjustments, reconstituted again. We may revalue the dollar upward internationally by lowering the gold price, or by leveling our tariff, or by both devices. If we retain protection, other nations must obtain lower dollar prices of the currencies when parities are determined; if we abolish protection, we may demand higher exchange rates against the dollar. So regarded, the issue is not protection versus no protection for our trade, but simply the uniform, undiscriminating protection of a proper exchange rate versus a mixture of this with arbitrary protection of politically selected domestic producer groups. If we protect some industries by tariffs or subsidies, we must, in the adjustment of exchange rates, accept less protection for others and less favorable parities for our exporters (cf. box. page 5).

AN AMERICAN POLICY

In this flexible framework of action and negotiation, and with our huge gold stock, neither gold-price reduction nor tariff reduction need embarrass or restrict us in domestic monetary-fiscal policy. The notion that freer trade would interfere in this country with a proper fiscal policy aimed at large domestic employment is simply an anachronism—a kind of intellectual tropism that now often misguides thought. We can stabilize our price level almost anywhere we please, if our pleasure is not insane, and expect other nations to accept reasonable exchange-rate adjustments to it. Even if the adjustments left the dollar relatively weak (an unlikely contingency), the worst that could happen would be exchange of our redundant gold for something useful or yieldful; and that process itself would probably serve only to raise price levels elsewhere to conform with exchange rates and our level, and not require any deflation here to prevent excessive drain on our gold—if one can imagine or define excessive drain.

The practical program of responsible American action in commercial policy is fairly clear. (1) We should leave the gold price where it is, at least until alternatives to its reduction have been exhausted. (2) We should reverse our 1933 action, not by lowering the gold price, but by lowering our tariffs and abolishing tariff protection—substituting explicit subsidies in those cases (if any) where only the lesser evil is an alternative to protection. (3) We should generously help to implement some simple version of the Keynes-White plan for oiling the new monetary machinery and for facilitating such orderly alteration of initial, experimental parities as experience may dictate. (4) We should seek extensive collaboration from other nations in the fiscal task of price-level stabilization, with the purpose of securing reasonable stability in the commodity values of the major currencies. Finally, and perhaps as a basis for all relevant negotiations, we should determine where we hope or intend to stabilize our domestic price level after the war, or after reconversion, and then communicate this decision to other nations.

Along these lines we could contribute toward a better world order and a better America, avoiding grave dangers to individualism at home and avoiding hopeless isolation in an otherwise collectivist or statist world.