INTERNATIONAL ECONOMICS

ENKE and SALERA

G7-114

INTERNATIONAL ECONOMICS

STEPHEN ENKE, Ph.D.
UNIVERSITY OF CALIFORNIA
LOS ANGELES

VIRGIL SALERA, Ph.D.
MIAMI UNIVERSITY
OHIO

1947
Prentice-Hall, Inc.
70 Fifth Avenue, New York

PRINTED IN THE UNITED STATES OF AMERICA

To
Max Enke
and
June D. Salera

Preface

INTERNATIONAL ECONOMICS attempts to analyse foreign trade and finance in terms of the practices and theories of today. Even before the war, most books in this field devoted excessive space to a non-existent gold standard, to "classical" theories of foreign trade based on a discarded labor-theory of value, and to tariffs as a means of regulating trade. The present volume includes at least one chapter on each of these three subjects, but it treats of much else besides. The theoretical sections on national specialization and international equilibrium follow neo-Marshallian value principles, and modern analyses of the balance of payments, and include chapters on the trade multiplier and monopoly theories. The chapters on trade regulation feature import limitations by means of exchange control and quotas. In the final part, on international finance, the emphasis is on restricted currency areas, exchange stabilization funds, and the International Monetary Fund and Bank. The descriptive chapters also incorporate up-to-date material dealing with recent history and current problems.

The present book embraces more topics than can easily be covered in a single term of study. From the outset, certain chapters were planned to be "core chapters," and these are essential if the reader is to benefit from continuity and balance. The authors therefore recommend that Chapters 1, 3; 4, 6-9; 13-17, 23, 26; 27, 30, 32-35 be emphasized. The remaining chapters, comprising about forty per cent of the book, are supplementary. They may be included to suit the interests of the student of international economics, and as time permits. For a year's study, the entire book should prove adequate.

The two authors have attempted to combine the predominantly theoretical interests of one with the Washington experience of the other. It is hoped that a diverse collaboration of this sort will make for a stronger treatment and a broader approach. Professor Enke wrote Part I and most of Part II, except Chapters 4, 8, and 9. Professor Salera wrote Part IV and most of Part III, except for Chapters 14, 15, 19, and 25, and also prepared the index. Each author gave the other advice and no effort was spared to effect a unified treatment of the whole.

Professor Salera wishes to express his appreciation to Dr. Arthur I. Bloomfield, of the Federal Reserve Bank of New York, who contributed a number of ideas incorporated in the present text; and also to June D. Salera, for her constant advice and counsel.

S. E.
V. S.

Los Angeles and Piedmont, California

Contents

Part I
THE WORLD ECONOMY

Part II
INTERNATIONAL ECONOMIC ANALYSIS

PART I

THE WORLD ECONOMY

Chapter 1

National Welfare and Foreign Trade

The Economics of Frontiers

NATIONAL boundaries have no commercial or financial importance in themselves, but are only material to economic life because governments have regulated goods, services, and monies in terms of these boundaries. National frontiers have thus been endowed with a significance that would be lacking under a regime approaching *laissez faire.* The incidental losses which usually result from converting boundaries into barriers are a real, but often justifiable, cost of government regulation.

The natural irrelevance of national boundaries is apparent when one considers how often they run counter to the geographic facts upon which the division into economic regions is usually based. The frontier of the United States and Canada is a case in point. Here, geographic factors, such as topography and rainfall, establish economic boundaries that run north and south. The Maritime Provinces are akin to the New England States just as the prairie provinces of Canada are similar to the States of the Great Plains. However, the political frontier runs west and east, and has, by dint of government regulation, created national economic regions without root in geographic fact. In many ways such division into economic regions is unfortunate, as the benefits to be derived from economic intercourse are not conditioned upon the participants residing on the same side of a national boundary.

It is widely recognized that the extra productive efficiency, so often released by extreme specialization, would not be economically practicable but for the possibility of subsequent exchange. Consumers' needs are varied and become increasingly diverse as their plane of living rises. For example, the wisdom which prompts a producer to specialize in making butter is predicated on the expectation of his being able to exchange his tons of output, through the medium of money, for the foods, clothes, furnishings, and so on, desired by himself and his family. Productive specialization and sumptuary diversity are compatible only as exchange is facile. This principle does not cease to operate when a political frontier is reached. It is true rather that tariffs, quotas, and other national obstructions impede exchange and contract the area over which exchange can be carried on; for this reason, tariffs and other national obstructions tend to prevent the realization of potential gains.

The more direct advantages of exchange are simplest to comprehend in the case of barter. Smith has grown more oats than he needs, but is short of fertilizer. Jones is short of oats, but has more manure outside his barn than he can use. An exchange of oats for fertilizer will yield a gain to both traders. The reality of this gain is not altered by the fact that each farmer will probably *sell,* instead of trade, his surplus, and then use the money proceeds of this sale to purchase the things he needs. On the contrary, the existence of money, besides facilitating such trades, extends the area of exchange; and the benefits which are realized from trading a commodity surplus for a deficit are just as real when the exchange of goods is across a national boundary.

Little imagination is required to conceive of the sacrifices that would attend an extreme degree of self-sufficiency. The relatively high living standards in the United States are due in no small measure to the vast extent of the free-trade area which it constitutes. Suppose, however, that each of the forty-eight States were prevented from trading with one another! Only a few of the more densely populated States would have sufficient sales to maintain an automobile industry. The people of New Jersey would suffer from a rather impoverished diet if it had to grow all its own food. Many States would lack fuel to work their factories, heat their buildings, and drive their vehicles. The people of Florida would come to loathe the sight of citrus fruits and would long for all the metal products which they could not make for themselves. People in the Pacific Northwest would have to revert to the timber-and-fish economy of the earlier Indian tribes. Part of the greatness of America depends upon the thoughtful prohibition by the Founding Fathers of obstructions to interstate commerce. However, the benefits of free trade are also realized when, instead of State boundaries, it is national frontiers that are ignored in trade.

Investment, like trade, should not be confined to a small area. Rational investment should benefit both lender and borrower. The lender gains because the rate of interest is higher than the rate of return that he could realize from additional funds employed in his own enterprises. The borrower gains because he can use extra capital in a way that will yield a rate of return superior to the interest rate that he must pay. This mutual benefit is not lessened when the lender and borrower reside in different nations. In fact, there is usually a wider disparity between the abundance and scarcity of capital funds amongst different countries than within a single nation. Consequently, unless any additional risks are unrewarded, international investment often affords a more attractive margin of gain than does the domestic variety.

Nothing would retard economic development more unjustly than the necessity of self-financing. What would be the situation of the United States today if each of the States had been forced to limit the pace of its industrial expansion to the rate at which it could save? The varied industries of California—petroleum, moving picture, synthetic rubber, and so on—would never have attained their present stage of development if they had not been financed by outside capital and the profits from state "exports." Similarly, Canada would