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ECONOMIC IMPACTS OF DEFENSE MOBILIZATION
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Onno van Teutem

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Lawrence Witt
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ECONOMIC IMPACTS OF DEFENSE MOBILIZATION ON SELECTED COUNTRIES

A THESIS

By

Onno van Teutem

Submitted to the School of Graduate Studies of Michigan
State College of Agriculture and Applied Science
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AN ABSTRACT

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The problem studied in this thesis is a current aspect of the dynamics of international economic relations. Large scale defense mobilization is having a major impact on the world economic situation. The primary and secondary forces now generated by military and political factors may continue to influence the world economy for a decade or longer.

A characteristic of these developments is an increase in the relative purchasing power of all primary commodities especially of the so-called strategic materials. The result is an increase in effective dollar demand of the primary product exporting countries. Conversely, a deterioration of the terms of trade of industrial countries has developed.

In order to evaluate the impacts of the rapid changes occurring, price data were gathered for important primary products and for representative types of manufactures. With this information an attempt was made to analyze in general terms the domestic situation in, and to determine the probable impacts of the relative price changes on countries in different stages of development. The countries were: Australia, Belgium-Luxemburg, Brazil, Canada, Colombia, Indonesia, Malaya, Netherlands, Sweden, Switzerland, the United Kingdom, the Union of South Africa, the United States, and Venezuela.

This study has been based upon one set of assumptions regarding future political conditions - namely, a continuation of international tensions but no all-out war. While the subject is complex, the following are the major findings of the study:

1) As a result of the rearmament decisions made by the United States and other western countries, fundamental economic changes have occurred

and further changes are pending in nearly all countries of the non-Soviet world.

2) The terms of trade of many primary product exporting countries have improved considerably. The specific percent of increase in recent months does not have much significance in view of the fluctuating character of primary product prices and probable future changes.

3) The impacts of these developments on under-developed countries is moderately favorable. In many cases, lack of capacity, opportunity, or desire to utilize the opportunities may cause much of the gains to be dissipated in inflation or in additional income inequalities instead of being utilized for permanent improvement.

4) Industrial European countries, although burdened by many internal and external difficulties, will have the opportunity to improve their balance of payments by increasing exports to the under-developed areas and to the United States.

5) The immediate problem of the "dollar-shortage" has disappeared and if proper adjustments in policy are now made by the countries concerned, the possibility for more permanent improvement appears to exist.

6) A heavy responsibility rests upon the United States to devise economic policies which will cushion the disturbing impacts of defense mobilization on the rest of the relatively free part of the world and to use the present situation as a stimulus to the formulation of permanently constructive economic measures.

More detailed analysis of the policy problems and presentation of appropriate policy measures is provided in the thesis.

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CHAPTER I

INTRODUCTION

The international situation has become increasingly confusing in the first half of the twentieth century. While many would blame rightly the chaotic political revolutions for this confusion, there seems to be ample justification for at least blaming partially the deplorable economic conditions for creating an environment favorable for the growth of the political vermin of recent years.

Only a short time after the world started to recover from the grevious wounds received during the second World War, new and terrifying prospects seem to arise once more at the horison. What the outcome of the struggle for life between the world's two giant powers will be is a question that cannot be answered by any human. Not necessarily the worst thing will happen, however, and on this assumption it is possible to study some of the worldwide impacts of the sudden rush to rearm the western countries and especially the United States.

International economic relations have been suffering for almost 40 years from a phenomenon which has become widely known in recent years under the name of "dollar shortage." As the name indicates, the demand for dollar goods at a certain price was larger than the supply of funds to pay for them.

Before the outbreak of the first World War a "dollar shortage" or any other currency shortage, would have been impossible. Basically, following the theoretical pattern described by the classicist writers, the comparatively free interaction of the forces of supply and demand would secure an equilibrium both domestically and internationally. If, for some reason or other, one country developed an export surplus and another country an import surplus, a chain of events started immediately to correct the situation. Under gold standard conditions, the country with the import surplus would have to pay gold, which would flow into the country with the original export surplus. In the first country the outflow of gold would result in such changes of relative prices and shifts in relative demands of "foreign" and "domestic" commodities that there would be a stimulus to export more and import less. Conversely, the country experiencing an inflow of gold would find it more desirable to import and less desirable to export. This mechanism worked surprisingly efficiently in the period before the World Wars to restore a new equilibrium in international payments.

It was not necessary, however, to have gold standard conditions for the operation of an "automatic" adjustment of international equilibrium. In the first part of the nineteenth century, when England suspended specie payments temporarily,[1/] and for certain currencies in the interwar period, the fluctuating exchange rates obtained similar results by making exports more desirable in the debtor country and imports more desirable in the creditor country. Exchange rates are prices and are therefore always able to establish a sound equilibrium. Thus, the prerequisite for an "automatic" adjustment mechanism was either free gold flows, with the appropriate monetary authorities not attempting to offset the effect, and relatively fixed exchange rates, or fluctuating exchange rates and no need for a flow of gold.

1/ See Viner, Jacob, Studies in the Theory of International Trade, (Harper and Brothers, New York, 1937) for an excellent analysis of the English currency problems and controversies of the nineteenth century. Especially Chapters III and IV.

With the increasing complexity of the modern economy it seems more and more likely that a return to the gold standard will not be attempted again and is not even desirable. The logical alternative would be to let exchange rates fluctuate freely while the various national governments would take domestic measures to insure a high level of employment and a relatively stable economy.

First under the impacts of the first World War, when many materials were extremely scarce and later with the occurrence of serious fluctuations of the business cycle, rationing and price fixing, two inseparable items, were introduced increasingly into the economic system. At first taking the form of commodity rationing, currency rationing rapidly followed and started to dominate the scene. Exchange rates were fixed, the gold standard was abandoned, and domestic financial and monetary policies were solely directed at the maintenance of a minimum amount of economic stability, without sufficient regard to the international balance of payments. In other words, the mechanism of adjustment of economic relations was not allowed to operate freely, in fact, many measures were specifically designed to counteract the operation of the mechanism.

There still would not have been any specific reason for the occurrence of a "dollar shortage" rather than a "sterling shortage," had not the two World Wars broken out, fought mainly in Europe and paid for mainly by Europeans, had not the United States continued uninterruptedly to grow strong and self-sufficient, and had not the Asiatic uprisings resulted in economic setbacks in large, formerly European colonial areas. Furthermore, the American tariffs, greatly increased in the interwar period and especially designed against imports of manufactures, made it very difficult for the rest of the world to balance its dollar accounts. But after these events and with the post World War II exchange rates fixed virtually at the prewar level, it was not surprising that a tremendous demand for American goods developed hand in hand with a worldwide "shortage" of dollars. The exchange rates or dollar prices had been set too low, or in other words, the degree of inflation in most countries had been too much larger than in the United States to enable world trade to flow along a natural pattern. The large degree of fixity in the various national economies had become one of the most burdensome factors in postwar reconstruction.

In such a situation any autonomous event having economic impacts on one or more countries, changes the outlook for the possibility of reaching a new equilibrium either for the better or for the worse, by changing relative price levels and by influencing, in such a way, the deviation existing between fixed exchange rates and "true" equilibrium exchange rates. It will be the purpose of this study to investigate, in this light, the probable impacts of the new defense efforts on certain countries.

Under the impact of the outbreak of the Korean War and the decision of the western world to rebuild its defenses, prices of especially primary commodities soared in world markets. Since prices of products imported by primary product exporting countries have not risen as much, it is clear that important shifts in the terms of trade have occurred and perhaps the pattern will remain influenced by the defense factors for a considerable time.

The main task of this study will be to evaluate the apparent improved position of many primary material producing areas, as a result of the rise in demand for their products, and also the apparent worsened position of the United States and, to an extent, other industrial countries which buy the primary materials and manufacture them into other goods. Two main hypotheses arise now:

(1) Recent price rises of primary products, if consolidated, will improve the economic position of the areas supplying the products to a considerable extent.

(2) The United States as the financier of the largest part of the rearmament of the West, will either experience relatively larger price increases than other western, especially European, countries, or will be compelled to restrict her exports. In either case, European goods would flow more easily to the United States and to third markets supplied by the United States.

Because of the fact that the various primary product supplying countries are not affected similarly by the price rises during 1950, and that industrial countries are affected differently according to what primary products they import and what their original economic position was, a set of countries have been selected for study, representing various stages of development and different conditions. They are: Canada, the United States, Brazil, Colombia, Venezuela, Union of South Africa, Australia, Indonesia, Malaya, the United Kingdom, the Benelux countries, Switzerland and Sweden.

After having reviewed the chain of events started by the Korean outbreak (Chapters II and III), the procedure will be to determine for each country and for the groups of countries, as far as possible, how much, if any, they stand to lose or gain from the developments, under certain assumptions, (Chapters IV and V).

In the light of these findings an attempt will be made to discuss certain aspects of the United States foreign economic policies, as they exist at present or as they might function better to attain their stated objectives (Chapter VI).

As wide as the scope of these objectives seems and as involved as many of the problems mentioned are, this report must not be seen as the result of a profound and detailed study. It rather attempts to outline in a general way what logically can be expected to happen within the next few years on the basis of certain existing trends and on the basis of some limiting assumptions.

CHAPTER II

THE ECONOMIC SITUATION OF THE UNITED STATES IN 1950

For the second time in one decade the economy of the United States was shaken up vigorously under the impact of international political developments. Both the United States and other western nations saw themselves exposed to a large degree of insecurity because of the inadequacy of their defense machines and realized that fundamental changes had to be made in their respective policies to stem the tide.

While, at the end of the year, the Korean War was still undecided and changing in its outlook, it had become fairly clear by then how much would be required of the economy during the coming years and what would be the strains developing in the absence of a total war.

Public opinion seemed to have reversed itself in a very short time. What had shortly before appeared to be burdensome surpluses now became inadequate stockpiles or even critical shortages, while the actual quantities needed certainly did not change that rapidly.

The United States, for the first time in history, is looked upon as the unquestioned political and economic leader of the West and will, in this function, pay for most of the increased defense bill. In view of this it seems useful to abstract from political complications and review briefly the economic situation of the United States in 1950, both from a domestic and from an international viewpoint.

Domestic Situation

After five years of peace adjustments and increased civilian prosperity, the economy, previous to the Korean outbreak, was at a high level of activity. The mild "inventory" recession of 1949 was followed in the first half of 1950 by increased activity in all sectors so that unemployment was declining and at about five percent of the total civilian labor force. Industrial production was booming at levels close to two times the pre-World War II figure and prices and wages were rising. Purchases of durable goods, which had approached the prewar relation to income in 1949, were above that level in the first half of 1950, increasing rapidly after the Korean outbreak in June, in the anticipation of shortages.

Although it soon was clear that military expenditures would have to be increased in the future, not until the end of the year was it decided by how much.

In fiscal 1950, the last full year of "peace," about $18 billion had been spent for direct and indirect military purposes, including expenditures for the armed forces, atomic energy projects, stockpiling requirements and foreign military and economic aid. This amount, however, does not take into consideration veterans' payments, interest on the public debt, etc. which at least partially should be included in "military expenditures." The Council of Economic Advisers to the President estimated these expenditures for fiscal 1951 and 1952 together to approach $150 billion.[2] In percentages of the gross national product this would require an increase from seven at the end of 1950 (annual rate of $20 billion) to perhaps eighteen (annual rate of $50 billion) at the end of 1951.

In 1940 the situation was entirely different. With more than eight million workers unemployed, 14.6 percent of the civilian labor

2/ Council of Economic Advisers to the President, The Annual Economic Review, Jan., 1951, p. 67.

force, and with other resources unemployed to a similar extent, rapid increases in production were possible. At the end of 1940, military expenditures were at the rate of four percent of the gross national product. This percentage increased to 16 by the end of 1941 and 38 by the end of 1942 to reach a peak of about 45 in 1943. Under the 1950 conditions, it would have been a tremendous effort to bring about similar changes but it was clear that the new acceleration process would be much slower than prior to and in the beginning of World War II, when there was no hope for peace whatsoever.

In spite of the large part of resources unemployed, strong inflationary pressures arose. In order to build up a war plant large investment outlays had to be made, cutting down on the amounts available for current consumption and as a result of all factors the index of consumer prices rose 25 percent between 1940 and 194', most of it occurring before the general price freeze in 1942. Of course, it is difficult to see the real significance of such a figure since there were in addition quality differences and quantitative restrictions on consumption.

With a record industrial capacity inherited from the construction of war plants between 1940 and 1943, the situation in 1950 did not seem to call for as many new outlays for construction.

The actual price rises in the second half of the year were mostly caused by the prolonged effects of scare buying during the summer, resulting in a new round of wage increases. Production, and this was still almost entirely civilian production, was booming under this stimulus. On a 1935-39 base, the index of industrial production rose from 196 in June to 217 in October, leveling off during the rest of the year. Unemployment was further reduced by a million to only three percent of the civilian labor force. Consumer prices which had risen 1½ percent in the first half of the year rose another 4½ percent from June to December. Wholesale prices of all commodities advanced 15½ percent during 1950, of which textiles with 24 percent and chemicals with 21½ percent were the largest. With these price changes business profits were booming and increased from an annual rate of 29.2 billion in the first quarter to $40.0 billion in the fourth quarter.3/

Potential inflationary items were evident in the fact that wages during 1950 increased more than prices in general and that an estimated $150 billion of liquid assets were in the hands of the public. The general situation seemed to leave much less room for new burdens than in 1940.

It was clear that these panicky developments could not be allowed to continue without check and in September a defense production act was passed by Congress, giving the administration wide powers of control.

By the end of the year in the anticipation of shortages of key raw materials, civilian cutbacks in consumption had been ordered for many commodities, including: aluminum, cobalt, cadmium, copper, nickel, rubber, zinc, steel and tin. Preparations were being made to centralize purchases of several scarce imported commodities in a government agency. Prices of nearly all these key materials rose rapidly during the year, in some cases to almost three times the level before the outbreak of the hostilities. This will be seen in greater detail in the next chapter. General price and wage controls seemed likely by the end of the year and were put into effect during January, 1951.

As for indirect controls, taxes were moderately increased, offset

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3/ Ibid., p. 202.

however, by even larger wage increases. Consumer credit was restricted after having increased by almost $2 billion from June to September. Nevertheless, it increased by another billion dollars before the end of the year to an all time high of $20 billion. Finally, the Federal Reserve System increased its reserve requirements virtually to the legal maximum. Commercial bank loans, however, kept increasing all during 1950; from June to December they increased by almost $8 billion to $52.7 billion.[4]

In summary, upward trends in the level of economic activity, existing in the beginning of the year, continued at a faster pace after the Korean outbreak in June under the impacts of inflationary anticipations. Both government expenditures and economic interference were started on a large scale. The situation at the end of the year was far from stabilized.

International Situation

The international economic position of the United States was still largely characterized by the aftermaths of World War II, five years after its conclusion. As the only major industrial country spared from the war destructions, the United States was called upon to fill an extraordinary demand for her goods.

But even under normal conditions, the United States would have been a strong factor in world trade. In 1949 exports of merchandise amounted to $11.9 billion or 21.7 percent of the total world exports. The world's second largest exporter, the United Kingdom, supplied only little more than half as much during the same period. As for imports, the United Kingdom kept its position of world leader with imports

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4/ *Ibid.*, pp. 196-97.

amounting to $8.2 billion, closely followed by the United States with $7.3 billion.[5]

A large part of the United States imports consist of crude materials and her weight in the market for these commodities is generally predominant. Of such commodities as copper, rubber and tin, of vital importance in the defense build-up, the United States share of world imports was respectively 37, 50 and 44 percent in 1948,[6] while also in the imports of crude foodstuffs the share was large.

Together with the overwhelming importance of United States imports and exports in world trade, the circumstance that these large amounts involve only a very small share of the national product gives the country a large degree of economic independence. Between 1937 and 1949 the percentage of the United States gross national product which was exported, increased from 3.6 to 4.7 under the stimulus of unilateral grants to aid reconstruction abroad and amounting to more than $5 billion in 1949. Imports, on the other hand, made up a smaller share of the national product after the war. Between 1937 and 1949 the importance of imports decreased from 3.6 to about 2.8 percent. While under peacetime conditions United States imports are closely correlated with domestic production, these figures reflect the fact that many of the war induced self-sufficiency factors were kept in the economy after 1945. Exports, on the other hand, are composed primarily of finished manufactures and are therefore dependent to a large extent on the needs and purchasing power of the more developed countries.

While basically no changes are to be noted in the composition of

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5/ United Nations, Statistical Papers Series D, No. 2, pp. 2-7.

6/ United Nations, Review of International Commodity Problems, 1949.

the foreign trade of the United States during 1950, there were several factors accounting for the changes in quantity and value, influencing the balance of payments.

In the first place the sustained recovery of western Europe made that area return to more normal conditions. As a result, more goods became available for export and less were needed for import under the maintenance of the same standard of living there.

Secondly, the effects of the revaluation of currencies at the end of 1949 began to be felt during 1950. Exports to E. R. P. countries fell by more than 30 percent between the third quarter of 1949 and the third quarter of 1950 while imports from that area increased by over 80 percent. At the same time, European goods were made cheaper in third markets relative to dollar goods, shifting some of the demand of those countries from American to European goods.

The effects of the above factors were partly obscured, partly strengthened by the simultaneous recovery of the domestic economy from the 1949 recession. So, at the time that imports from E. R. P. countries rose, imports from other areas increased too. Price indices of all import groups directly affected by the increased domestic demand rose while unit values of manufactured and semi-manufactured products showed a small decline. Under the pressure of increased world production and competition, export goods generally declined in unit value.

On top of the above three factors, all working in the direction of alleviating the immediate dollar shortage problems, the major factor influencing United States trade relations in the second half of the year, of course, was the outbreak of the hostilities in Korea. While the effects of this factor have certainly not yet been felt in all their force, they are more easily abstracted from other trends. Prices of imported crude materials and foodstuffs rose sharply after June as the government began to fill stockpiling needs. Imports from the areas supplying these products increased so much in the second half of the year that in August and October an actual trade deficit existed.

Table I and Figure 1 show what happened to the gap between the values of United States exports and imports of goods and services since 1945.

Table I. Value of United States Exports and Imports of Goods and Services[a,b] 1945-1950. (Quarterly values at annual rates, billions of dollars.)

Year	Exports	Imports	Difference	Year	Exports	Imports	Difference
1945 I	17.6	10.0	7.6	1946 I	13.4	6.7	6.7
II	18.9	11.0	7.9	II	15.6	6.6	9.0
III	12.7	8.0	4.7	III	15.1	7.1	8.0
IV	12.4	6.4	6.0	IV	14.9	7.5	7.4
1947 I	19.2	8.0	11.2	1948 I	17.9	10.0	7.9
II	21.1	8.4	12.7	II	17.3	10.4	6.9
III	19.3	7.9	11.4	III	16.1	10.9	5.2
IV	19.6	8.8	10.8	IV	17.0	10.6	6.4
1949 I	17.3	10.2	7.1	1950 I	13.1	10.3	2.8
II	17.8	9.7	8.1	II	14.1	10.8	3.3
III	14.7	9.4	5.3	III	13.9	13.6	.3
IV	14.0	9.6	4.4	IV	13.8	13.6	.2

[a]Source: U. S. Department of Commerce, Survey of Current Business.
[b]Income and payments on investments included.

While after 1947 declines in exports accounted for most of the narrowing down of the gap, during the last part of 1949 and all of 1950 rising imports contributed almost solely to this goal. Both imports and exports were rising rapidly by the end of 1950 with a negligible United States export surplus. The apparent trade surplus was the smallest

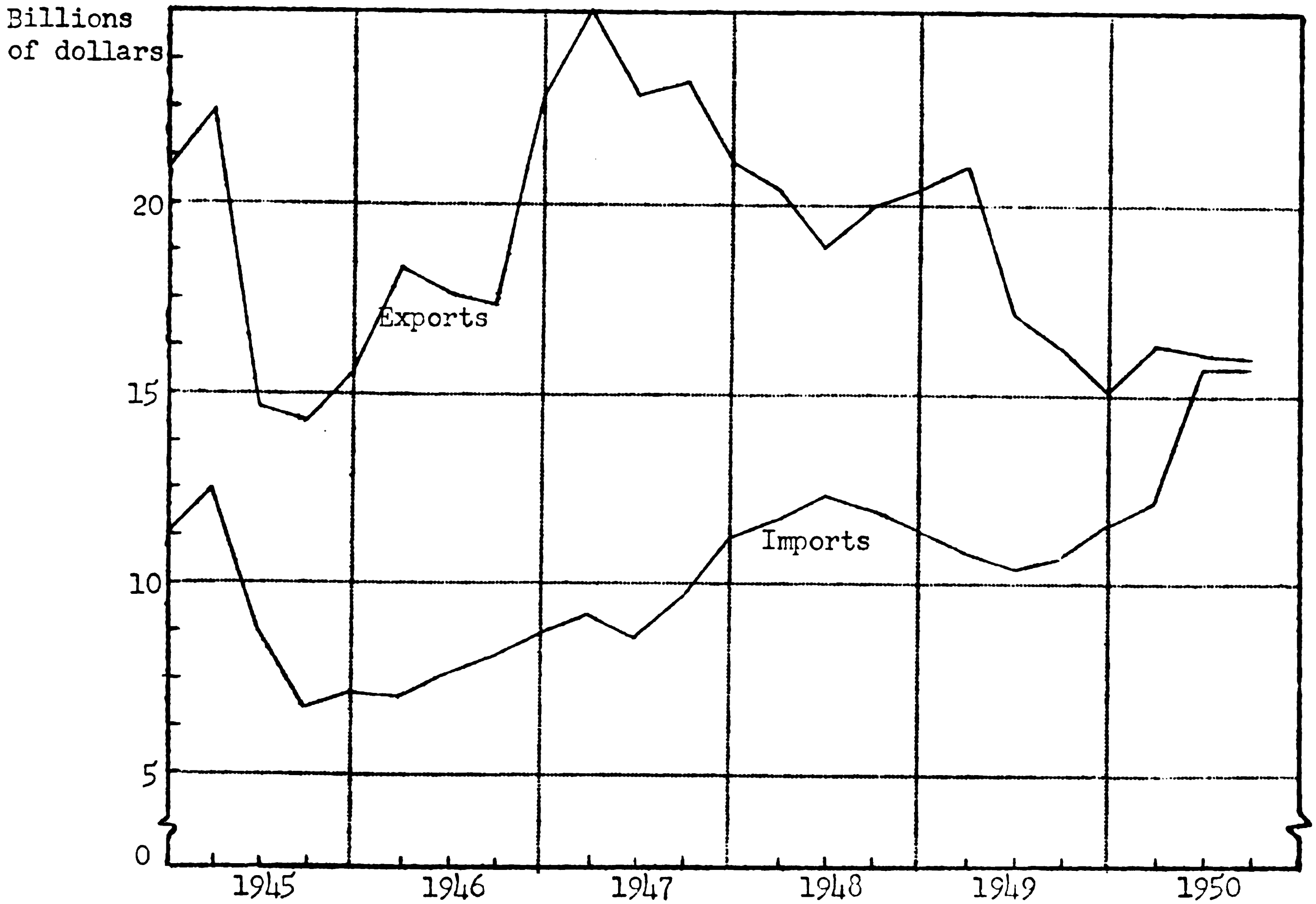

Figure 1. United States Exports and Imports, 1945-1950. (Quarterly values at annual rates including income and payments on investment.)

Source: Survey of Current Business.

since 1937. As government grants and loans really made the continued high level of exports possible, the approximate balance in the current transactions meant an accumulation abroad of gold and dollar reserves. Furthermore, the increased financial strength of foreign countries and perhaps also some speculative forces resulted in a large net outflow of long and short term capital from the United States. In spite of these encouraging signs, however, it would be premature to speak of a new equilibrium in the international economic situation. The trade deficit of European countries with the dollar area was still large even with the maintenance of very strict import controls on dollar goods. An important improvement would be reached when dollar surplus countries would shift their demand for manufactured goods away from the United States to other countries but the newly accumulated gold and dollar reserves were as yet primarily used to pay off old dollar obligations and strengthen their financial position. These factors, however, seemed of only temporary character.

In summary, a worsening of the terms of trade and an increased domestic demand were responsible for the virtual elimination of the United States export surplus of goods and services during the year 1950 in spite of continued large unilateral grants to foreign countries. This balance on the current account did not represent a new equilibrium or solving of the dollar problem under the existing conditions inasmuch as no stability can be seen in a situation as subject to variation as a half-war, half-peace economy.

CHAPTER III

POST WORLD WAR II CHANGES IN PRICE RELATIONSHIPS OF PRIMARY PRODUCTS AND MANUFACTURED GOODS

A very important factor to consider when attempting to measure certain developments in their effect on the economic position of a country, as it is the purpose of this study, is the "terms of trade" of that country or of a product important in the trade of the country.

The expression "terms of trade" will be used in the following pages to signify what Viner calls the "commodity terms of trade," or the relative purchasing power of a given unit of exports in terms of imports.7/ Changes in the terms of trade are then measured by the relative price changes of imports and exports. In the measuring of the terms of trade at any moment many statistical problems arise8/ but these difficulties do not apply to the measurement of changes in the terms of trade. Since the volume of trade is not constant, changes in the terms of trade are only an imperfect measure of the economic position of a country. However, on the assumption of an inelastic demand for and supply of primary products, it appears that at least for these products, measurement of the changes in the terms of trade give a fairly reliable index. Furthermore, the computation of price relatives is a rather simple procedure for these products and in the present circumstances, the relative price changes have been large enough to make certain conclusions possible.

While not much can be said about changes in the subjective utility

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7/ Viner, Jacob, op. cit., p. 558.

8/ Ibid., p. 566. See also: United Nations, Relative Prices of Exports and Imports of Under-developed Countries, p. 131 ff.

functions, an important factor in appraising the present situation will be the changes in the volume of trade, especially trade in manufactured products which might decline because of the increased defense requirements.

With volumes of trade remaining the same, changes in prices or unit values of exports relative to imports result in more or less funds becoming available for the development of a country and the financing of additional imports. In addition, these changes in relative prices or the terms of trade affect the credit position of a country by improving or worsening its ability to meet debt service on foreign loans.

This chapter will, in a general way, describe the present position and present trends of the purchasing power of certain commodities and groups of commodities in terms of other goods. For this purpose, monthly average spot prices were compared for a number of important, internationally traded primary materials and foodstuffs over the post World War II period and unit value indices for various kinds of manufactured goods were compared for several industrial countries of different characteristics.

Naturally, there are limitations to the data and care should be used in interpreting them. In general, not much weight should be attached to small changes in price relationships. The trends of the recent period, however, have been rather clear and, on the whole, important changes have take place in the terms of trade of the various groups of commodities.

Limitations of the Data

The major limitations of the data gathered are:

1. Prices of crude materials are subject to wide fluctuations from year

to year and even within years because of the generally low elasticities of demand and supply.

2. The selection of the base period influences results considerably. For primary materials and foodstuffs the base used here is 1937. This was the last full year before the war when business was rather normal. In 1938 a general business recession occurred, especially noticeable in the prices of primary products. These products declined on an average about 20 percent in price between 1937 and 1938.[9]

3. The index numbers are computed from monthly averages of prices for specific grades of a commodity in mostly United States markets. Prices of other grades may have moved differently. The selected grade may or may not be representative of a certain country's exports of the commodity.

4. Prices are often different under various types of sales contracts and arrangements. The United Kingdom especially, has many long time purchasing agreements with raw material exporting countries and in this way, special advantages are derived.

5. Prices are derived from different sources, quoting prices at different points in the marketing channel. While most figures compare closely with those found in the United Nations study, prices for fats and oils, here derived from the United States Department of Agriculture seem to be on an average more than ten percent higher. Again this calls for care in interpretation.

6. United States markets are taken generally because of easier access to the data and because of the representativeness of United States

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9/ Relative Prices of Exports and Imports of Under-developed Countries, op. cit., p. 31.

markets in most world commodity prices. However, for commodities such as wheat, corn and cotton, the American price support measures influence the results. Those prices taken from United Kingdom markets are converted into dollars at the official rates of exchange prevailing.

7. The selected commodities include many, but not all, of the important primary commodities entering world trade. They represent the ones for which the prices were more easily available and include most of the commodities dealt with in the United Nations study.
8. In appraising the price changes between May and December of 1950, no attempt was made to adjust for seasonal variation.
9. All indices, but especially the unit value indices of manufactured goods, have the disadvantage of differences of weighting and comparability between the goods of different countries. Changes in the various exchange rates and also changes in quality and composition of each group of goods tend to present additional difficulties.
10. Fluctuations in prices of United States commodity markets, even when representative of world prices, do not show the same percentage changes as the quotations in markets of the countries producing the commodities because of the marketing and transportation costs. If these costs would be ten percent of the value of a product, a New York price rise of 50 percent would amount to a 56 percent rise in the export revenue of the producing country unless shipping costs increased with a price rise of the commodity.

Primary Materials, Non-foodstuffs

Prices of nearly all primary materials increased after the war because of world shortages, developing out of the need to reconstruct war-torn areas. With the exception of textiles and lumber, however, these price rises were small compared to the price rises in foodstuffs and also in manufactured goods. The general picture for the primary material group as a whole was one of moderate and continued price increases through 1948. In 1949 the immediate pent-up demand developed during World War II became largely saturated and a more normal supply and demand situation developed for most products accompanied by price declines. Then sharp price rises followed in 1950, starting even before the Korean outbreak and bringing the average price level for the group of commodities to considerably above the postwar peak of 1948. Tables II and III present price relatives for the primary materials.

Textiles - The textile group in contrast with other primary materials had risen sharply in price after World War II. In the case of jute this could be explained by the fact that large areas of Pakistan and India, producing almost the whole of the world's supply, had been diverted to food production. Table II shows that wool prices were the lowest of the group but this is partially due to the fact that the grade selected does not properly represent the Australian and South African clips. Large stocks of wool, however, had been accumulated during the war and were used to fill most of the postwar demand. The decline of stocks could in this way prevent prices from rising very much. During 1950, the situation was quite different. Wool stocks had been largely depleted and the stockpiling demand of western countries accounted for the 82 percent price increase between May and December. Prices of other textiles, however, also responded quickly to the new demand and generally rose to new record levels. Sisal, already very high in price, now rose to more than five times the prewar level. Only jute did not seem

Table II. Price indices of selected primary materials in major markets,[a] 1947-1950. (1937 = 100)

	World trade, 1938[f] (millions of dollars)	1947	1948	1949	1950
Textiles:					
Cotton[b]	600	292	286	268	307
Wool[b]	435	126	128	126	170
Raw silk[b]	124	236	138	139	165
Jute[c]	46	336	393	372	332
Sisal[c,d]	20	293	332	343	366
Average[e]	—	229	220	211	247
Minerals:[b]					
Petroleum	448	159	217	217	222
Copper	325	159	167	146	161
Tin	195	144	183	184	176
Lead	74	244	300	256	221
Zinc	34	161	208	186	213
Average[e]	—	162	201	191	195
Other:[b]					
Lumber	434	278	314	286	334
Hides and skins	310	160	160	133	157
Rubber	207	107	113	91	213
Average[e]	—	195	212	186	247
General average[e]	—	197	212	197	230

[a] New York, Chicago, Boston, London.

[b] Source: U. S. Department of Commerce, Survey of Current Business.

[c] Source: Food and Agriculture Organization of the United Nations.

[d] London quotation, converted into dollars at the official exchange rate.

[e] Weighted by value of world trade, 1938, in each commodity.

[f] Source: United Nations, Relative Prices of Exports and Imports of Under-developed Countries, 1949, p. 29.

to be affected. Jute prices continued their decline throughout the year, as production recovered more normal proportions.

Minerals - The mineral group, as a whole, increased relatively little in price in the immediate postwar years and after 1948 price

Table III. Price indices of selected primary materials in major markets, May and Dec., 1950 with comparison. (1937 = 100)

	May 1950	Dec. 1950	Percentage increase or decrease (-) Dec., 1950 Since 1949	Since May, 1950
Textiles:				
Cotton[a]	279	361	35	29
Wool[a]	142	259	106	82
Raw silk[a]	143	219	58	53
Jute[b]	351	319	-14	- 9
Sisal[bc]	332	509	48	53
Average[d]	221	313	61	49
Minerals:[a]				
Petroleum	222	222	2	0
Copper	149	184	26	23
Tin	143	267	45	87
Lead	195	283	11	45
Zinc	184	268	44	46
Average[d]	183	224	19	27
Other:[a]				
Lumber	316	341	19	8
Hides and skins	128	208	56	63
Rubber	147	368	340	150
Average[d]	212	309	119	64
General average[d]	206	283	65	47

[a]Source: U. S. Department of Commerce, Survey of Current Business.
[b]Source: Food and Agriculture Organization of the United Nations.
[c]London quotation, converted into dollars at the official exchange rate.
[d]Weighted by value of world trade, 1938, in each commodity.

declines were registered for all products included. The relative position of mineral prices changed rapidly during 1950, tin leading with an increase of 87 percent between May and December. The fact that the other minerals did not increase as much in price as tin might be explained by the fact that tin exports are supplied for a large part by the political tension area of Southeast Asia. Comparing copper and tin prices, therefore, both essential products for armament purposes, seems to indicate that political scares accounted for part of the price increases of tin, rather than the actual demand and supply situation alone. Petroleum was the only primary product not affected pricewise by the 1950 events.

Other - Of the remaining commodities, rubber was clearly in a similar position to tin, with Indonesia and Malaya supplying over three-fourths of net world exports. In 1947, rubber prices had hardly increased over 1937 and in 1949 the average price was actually lower than before the war. During 1950, however, increased demand, partly caused by the Korean situation, resulted in a price level more than four times as high as in 1949. These spectacular increases, if consolidated, would alleviate the dollar shortage considerably, since Malayan rubber has long been one of the most important sources of dollars for the sterling area. Hides and skins also recovered sharply from the 1949 price declines, while lumber prices, already very high, increased a little more.

Foodstuffs

Except for textiles, foodstuffs rose to much higher levels after the war than most primary industrial materials. This was due to the lagging prices of minerals and the desperate "inelastic" need for food of most of the world. After two years of relatively stable food prices, price declines occurred in all groups during 1949. The subsequent recovery in the beginning of 1950 continued throughout the year, but at a much slower rate than primary material prices. Although new price rises occurred during 1950, the group average for the year was still considerably below the 1948 peak. The December price level approached this peak however. Tables IV and V show the price movements of this group of commodities.

Fats and Oils - The serious shortage of the commodities included in this group resulted in very large price increases after World War II. The group average price level was at more than three times the 1937 level throughout 1947 and 1948. Following the recovery of production, however, most fats and oils declined in price in varying degrees. Such products as copra and palm oil declined much less than such products as soybeans and cottonseed oil. In 1949 there was a variation of 185 points between the prices of copra (338) and cottonseed oil (153). Since the price indices of fats and oils are computed from a different source than the other indices, however, they are not entirely comparable. Comparison with United Nations figures seems to indicate that fats and oils prices did not increase as much as shown in Table IV.[10/]

The events of 1950 resulted in a slight upward price trend in fats and oils. Only cottonseed oil registered an important price gain from 1949 to December, 1950. Linseed oil and flaxseed were below the 1949 level in December, 1950.

Grains - Grains did not reach as high price levels as fats and oils and the postwar price declines generally began earlier. Rice was the only grain to register a large price increase between 1947 and 1948. This is important because of the influence of rice prices on the costs of production of such products as rubber, tin, and oilseeds. The decline of other grain prices, however, resulted in an increase of Far Eastern demand for these cereals, easing the rice shortage. Price declines of all cereals stopped in 1949 and during 1950 moderate price

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10/ Cf. Limitations of the Data, No. 5, supra, p. 18.

Table IV. Price indices of selected foodstuffs in major markets, 1947-1950. (1937 = 100)

	World trade, 1938[b] (millions of dollars)	1947	1948	1949	1950
Animal Products:[a]					
Butter	304	207	220	179	181
Beef	222	234	279	236	261
Pork	216	251	260	235	227
Cattle	106	225	269	225	254
Eggs	96	198	201	228	192
Cheese	92	231	257	199	200
Lard	40	199	187	115	123
Sheep and lambs	17	210	233	237	255
Average[f]	—	199	245	211	215
Grains:[a]					
Wheat	442	220	207	185	190
Corn	220	191	194	123	143
Rice	197	294	361	239	239
Barley	80	229	207	147	170
Rye	41	318	225	154	155
Oats	21	24[illegible]	237	167	198
Average[f]	—	233	236	177	187
Vegetable oils and oil-bearing seeds:[cg]					
Linseed oil	110	357	302	247	179
Groundnuts	93	270	280	283	288
Soybeans	74	321	321	215	261
Copra	72	388	538	338	385
Flaxseed	50	354	321	247	198
Palm oil	34	373	341	251	232
Cottonseed oil	19	341	333	153	207
Average[f]	—	338	345	260	255
Other tropical and subtropical products:					
Tobacco[d]	359	180	217	206	227
Sugar[a]	340	177	160	166	169
Coffee[a]	263	238	241	286	459
Tea[e]	202	199	212	204	188[h]
Cocoa[a]	87	417	474	287	381
Average[f]	—	211	224	217	264
General average[f]	—	229	247	210	229

See footnotes on bottom of page 28.

Table V. Price indices of selected foodstuffs in major markets, May and Dec., 1950 with comparison. (1937 = 100)

	May 1950	Dec. 1950	Percentage increase or decrease (-) Dec., 1950 Since 1949	Percentage increase or decrease (-) Dec., 1950 Since May, 1950
Animal products:[a]				
Butter	174	193	8	11
Beef	260	292	24	12
Pork	229	232	- 1	1
Cattle	253	288	28	14
Eggs	145	263	15	81
Cheese	194	218	10	12
Lard	115	154	34	34
Sheep and lambs	252	291	23	15
Average[f]	208	238	13	17
Grains:[a]				
Wheat	195	195	5	0
Corn	147	154	25	5
Rice	225	272	14	21
Barley	179	170	16	- 5
Rye	157	177	15	13
Oats	212	227	36	7
Average[f]	188	199	13	6
Vegetable oils and oil-bearing seeds:[c,g]				
Linseed oil	177	188	-24	6
Groundnuts	288	279	- 1	- 3
Soybeans	296	288	34	- 3
Copra	362	423	25	17
Flaxseed	211	202	-18	- 4
Palm oil	217	295	18	36
Cottonseed oil	192	282	84	47
Average[f]	256	274	6	7
Other tropical and subtropical products:				
Tobacco[d]	237	230	2	- 3
Sugar[a]	163	180	8	10
Coffee[a]	416	488	71	17
Tea[e]	174	194	- 5	11
Cocoa[a]	340	411	43	21
Average[f]	252	277	20	9
General average[f]	223	245	15	10

See footnotes on bottom of page 28.

increases followed. The variation in relative prices between the grains was large with rice remaining very high. The effect of United States price supports limits the representativeness of the data.

Animal Products - Although postwar price levels of animal products were lower than the price levels of the fats and oils group, they were considerably higher than primary material groups such as minerals.

The definite downward trend of 1949 was reversed in 1950 and the December 1950 price level seemed to approach the postwar peak. Not too much significance should be attached, however, to price increases during 1950 as computed in Table V. The seasonal factor seems to be important here, especially in the case of eggs.

Other Tropical and Subtropical Foodstuffs - The variation between the price movements of the commodities included in this group was, of course, large since these products are not readily substitutable for each other. Cocoa and coffee were largely responsible for the 20 percent price increase of this group between 1949 and December, 1950. High prices led to a considerable rise in the dollar earnings for cocoa exports from the sterling area. The small Brazilian coffee crop of 1949-1950 and world scarcity of the commodity explained the sharp rise in coffee prices during 1949 and 1950. With the tea market in London

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Footnotes to Tables IV and V.

[a]Source: U. S. Department of Commerce, Survey of Current Business.

[b]Source: Relative Prices of Exports and Imports of Under-developed Countries, op. cit., p. 29.

[c]Source: U. S. Department of Agriculture, The Fats and Oils Situation. Indices of this group are higher than the ones arrived at in "b" above, pp. 29-30. See limitations of data, No. 5, supra p. 18.

[d]Source: U. S. Department of Agriculture, Agricultural Prices.

[e]Source: Food and Agriculture Organization of the United Nations.

[f]Weighted by value of world trade, 1938, in each commodity.

[g]Base period, 1935-1939.

[h]Eleven-month average.

remaining closed, a representative world price for tea is difficult to ascertain under the present conditions.[11] Sugar was one of the commodities least affected by the postwar shortage of foodstuffs and also showed only a minor price increase during 1950.

Manufactured Products

As a whole, price indices of the various groups of manufactured products show similar trends in the postwar period as primary product prices, only with smaller deviations from prewar and with smaller fluctuations after the war. After the initial price increases, the price level of manufactured products was more or less stabilized in 1947 at roughly twice the prewar level. Of the countries represented in Table VI the indices of the United States and of the United Kingdom naturally carry most weight since these countries account for a major share of the trade in manufactured products. The United Kingdom price index for exports of manufactures on a 1938 base was 183 in 1947. During 1950 price increases for manufactured products generally lagged far behind primary product prices and the figures suggest that they amounted to less than 10 percent in most cases between 1949 and December, 1950.

During the second World War, prices of manufactured products produced by different countries increased in different degrees and therefore care must be used in interpreting the data of Table VI. While most European countries represented use a postwar year as base period, the United States, Canada and Switzerland still use the prewar base. The degree of inflation in the latter countries was far less serious than in the former ones. With this in mind it appears, however, that American, British and Canadian exported manufactures increased more

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11/ United Nations, Review of International Commodity Problems, 1949, p. 44.

Table VI. Price indices of groups of manufactured products of specified countries, 1947-1950 and May and December, 1950.[a]

	Base period (= 100)	1947	1948	1949	1950	1950 May	1950 Dec.	Percentage increase or decrease (-) December, 1950: Since 1949	Since May, 1950
United States[b]	1936-38								
Exports of manufactures		132	193	181	178	173	191	6	10
Exports of semi-manufactures		169	184	174	170	165	190	9	15
Imports of semi-manufactures		191	217	198	193	177	226	14	28
Imports of manufactures		245	266	258	252	247	267	3	8
Canada[e]	1938								
Exports of fibres and textiles		202	236	244	266	251	306	25	22
Imports of fibres and textiles		260	299	300	327	307	381	27	23
Exports of iron, steel and products		169	192	214	217	219	220	3	1
Imports of iron, steel and products		145	165	179	192	192	192	7	0
Switzerland[f]	1938								
Exports of manufactures		276	264	253	245[g]	251	246	- 3	- 2
Imports of manufactures		208	204	199	177[g]	171	184	- 8	8
United Kingdom[h]	1947								
Exports of manufactures		100	109	113	118[c]	117	121[d]	7	3
Exports of metal goods		100	113	116	124[c]	124	135[d]	16	9
Exports of textiles		100	110	113	118[c]	117	123[d]	9	5
Imports of manufactures		100	112	110	125[c]	124	134[d]	22	8
Tramp shipping freight rates[h]	1948	—	100	—	81[c]	71	98[d]	—	37
Netherlands[i]	1948								
Exports of textiles		—	100	97	102[c]	104	110[d]	13	6
Exports of metal products		—	100	107	96[c]	94	90[d]	-16	- 4
Exports of manufactured food products		—	100	94	92[c]	92	96[d]	2	4
Imports of capital goods		—	100	105	106[c]	94	102[d]	- 3	9
Belgium-Luxemburg[j]	1948								
Exports of manufactures		—	100	105	94[g]	93	98	- 7	5
Exports of semi-manufactures		—	100	96	84[g]	80	97	1	21
Exports of durable producer goods		—	100	120	102[g]	107	103	-14	- 4
Imports of durable producer goods		—	100	103	107[g]	105	99	- 4	- 6

See footnotes at bottom of page 31.

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in price between 1949 and December, 1950 and especially after the Korean outbreak, than the goods of the Benelux countries and Switzerland. Of course, the composition of the various product groups is far from identical between the countries.

Textile products generally increased most in unit value, considerably more than the average of all manufactures; metal products, also largely represented in the Dutch index for imports of capital goods and the Belgian indices for durable producer goods, increased only slightly or decreased in price between 1949 and the end of 1950. Since raw material exporting countries which are generally under-developed, import both large quantities of textile products for consumption purposes, and important amounts of metal capital goods for investment and development purposes, the price trends of these product groups are of vital importance to them.

The indices of Table VI are expressed in terms of the various national currencies and therefore do not take into account the revaluation of currencies in September, 1949. The United Kingdom and the Netherlands and many other European countries with their overseas dependencies

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Footnotes to Table VI.

[a]Not adjusted for relative changes in the exchange rates.
[b]Source: Foreign Commerce Weekly, U. S. Department of Commerce.
[c]Average of eleven months, January-November.
[d]November.
[e]Source: U. N. Statistical Papers, Series D; Dominion Bureau of Statistics.
[f]Source: Monatsbericht des Schweizerischen National banks.
[g]Average of twelve months.
[h]Source: Monthly Digest of Statistics, Central Statistical Office.
[i]Source: Maandschrift van het Centraal Bureau voor de Statistiek.
[j]Source: Bulletin de Statistique, Institut National de Statistique.

devalued over 30 percent at that time; Canada and Belgium-Luxemburg devalued about 10 percent. In terms of the dollar and other non-devaluated currencies, therefore, the products of the devaluing countries became cheaper.

Another important phenomenon is the 37 percent increase in tramp freight rates between May and December, 1950. Shipping lines are almost entirely owned and operated by the well-developed, industrialized countries and high freight rates therefore represent higher costs to under-developed countries.

Relative Price Trends of Groups of Commodities

Prices of primary materials and foodstuffs had increased generally more than prices of finished manufactures during World War II. Foodstuffs as a whole increased considerably more than primary materials except textiles. The disappearance of the most serious postwar food shortages as production increased, however, together with an increased demand for raw materials as industrial countries recovered industrial capacity resulted in a narrowing down of the gap between the prices of these two major groups. Price declines occurred in 1949 for all products but they were sharpest for the fats and oils, the grains and the animal products groups and the smallest for textiles and minerals. As a result of the developments during 1950 the process of equating raw material prices relative to food prices continued. This time prices of textiles and minerals rose fastest, since these groups contain many commodities directly affected by the stockpiling demand and by the increased armament production. Fats and oils, grains and animal products also appreciated in price during 1950, but to a lesser extent. During 1950 the favorable price position of foodstuffs relative to primary materials was

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reversed. While in 1947 foodstuffs had increased by about 15 percent more than primary materials, the December, 1950 situation was the reverse. Both groups had risen in price but primary materials were now about 15 percent dearer than foodstuffs.

Manufactured goods, in the meantime, showed less distinct price trends. On the whole, much more stability was present. During 1950 the general trend of unit value indices of manufactures was upward, but relative to the 1949 position these trends were not always strong enough to offset price declines of 1949 and the first part of 1950.

Table VII. Relative Price Trends of Groups of Commodities, 1947-1950.[a] (1937 = 100)

	1947	1948	1949	1950	Dec. 1950	Percent increase 1949-Dec., 1950
Foodstuffs						
Fats and Oils.....	338	345	260	255	274	6
Grains............	233	236	177	187	199	13
Animal Products...	199	245	211	215	238	13
Other Tropical....	211	224	217	204	277	20
Average...........	229	247	210	229	245	15
Primary Materials						
Textiles..........	229	220	211	247	313	61
Minerals..........	182	201	191	195	224	19
Other.............	195	212	186	247	309	119
Average...........	199	224	211	230	283	65
U. S. Export Manufactures[b]...........	182	193	181	178	191	6

[a]Sources: Tables II, III, IV, and V.

[b]1936-1938 annual average = 100.

General Implications on the Terms of Trade

During the period preceding the second World War, prices of all primary products showed a secular downward trend relative to prices of manufactured goods. The United Nations estimated[12/] that a given quantity of primary exports could buy only 60 percent of the quantity of manufactured goods it could buy at the beginning of the century. In the post World War II period the relative price position of primary products had improved but had not reached, generally speaking, the level of the beginning of the twentieth century. The period immediately preceding the Korean outbreak furthermore, brought some price declines of primary products relative to manufactures and thus a lowering of their purchasing power. In this light the recent price increases may be seen as a partial and possibly temporary relief from seriously depressed prices rather than as a favorable event on top of a prosperous situation of the primary product exporting countries.

It appears that primary products improved their relative purchasing power greatly during 1950. On the basis of the above data a similar quantity of food could buy 11 percent more United States manufactures in December, 1950 than on the average in 1949. For primary materials, non-foodstuffs, this increased purchasing power amounted to 27 percent. In terms of foreign manufactured goods the purchasing power of the groups of primary materials and foodstuffs seemed to have increased even more. These goods did not increase in dollar unit value as much as dollar manufactures, or did not increase at all, basing this conclusion upon the unit value indices of Swiss and American imports of manufactures of 1949 and December, 1950.

12/ Relative Prices of Exports and Imports of Under-developed Countries, *op. cit.*, p. 7.

An important share of the primary products entering world trade is produced by a number of countries, mostly located in Southeast Asia and Latin America, while those areas depend on the manufactured articles of Europe and North America. At a first glance, therefore, it appears that the former areas probably had improved their terms of trade greatly during 1950. To a certain extent, however, this conclusion is subject to qualification. Because of the large dependence of some countries on one or two export commodities for the obtaining of their foreign exchange, large variations may be expected to exist between the changes in the terms of trade of individual countries since some of the primary products increased three times in price, while others actually declined between 1949 and the end of 1950. Furthermore, many primary product exporting areas are large importers of food and textile products. Taking an imaginary example of a country entirely dependent for its export revenue on petroleum and importing large quantities of wool and meat the conclusion is obvious that the terms of trade of such a country would have turned seriously against it during 1950. Chapter IV therefore throws some light on the problems of some of the countries concerned with this problem.

With these qualifications, however, it remains true that the primary product areas improved their terms of trade during 1950. At the same time, this must mean that the terms of trade of the industrial areas worsened. The countries in this area vary considerably in the extent that they are dependent on imports of certain types of primary materials and foodstuffs and in their general economic situation before the recent price changes took place. Considerable variation in their new economic position and outlook may, therefore, be expected also between the individual industrial countries. Chapter V devotes some attention to this side of the problem.

CHAPTER IV

THE IMPACTS ON PRIMARY PRODUCT PRODUCING COUNTRIES

Introduction

The economies of most important primary product exporting countries tend to be very highly dependent on changes in the demand and supply situation for their particular products. Their trade is largely complementary with their exports supplying the industrial needs of well-developed countries and their imports consisting almost entirely of manufactured consumption goods and capital goods, often originating from far away overseas areas. This crucial dependence on foreign trade, which in most cases, makes up a considerable part of the total national income, is still further accentuated by natural conditions which tend to increase the production and export specialization of the various countries and areas. The insecure area of Malaya and Indonesia for instance, is responsible for three-fourths of the world's exports of rubber and tin. The skewed distribution of the world's production of various primary commodities naturally tends to influence critically the degree to which each area is dependent on a specific change in world demand. Since the United States is a major buyer of most primary products, the demand situation in that country largely determines prices of these products. A typical example of this is the temporary drop in the price of tin in New York from $1.80 on March 5, to $1.34 on March 9, 1951. This was the result of a decision of the United States to stop stockpiling the metal until prices would decline to "more normal levels." Since European countries took advantage of this favorable price change, however, the tin price soon recovered to about $1.50. The existence of such large price fluctuations in many primary products constitutes a serious disadvantage to the stability of less developed countries.

With respect to political conditions, tremendous differences exist between the status, the postwar political changes, and the level of political stability in general of the various less developed primary product producing countries. This factor, as will be seen later, is important when an evaluation is attempted of the effect of certain price increases of export products or of the mobilization in general on the economic position of the selected countries. Among the countries selected for specific consideration are: independent republics, such as the Latin American countries and since recently, Indonesia; colonies, such as Malaya, under the direct supervision of the United Kingdom; and areas such as Australia and the Union of South Africa, which, although completely independent politically, have made certain arrangements with other countries of the sterling area to pool their dollar resources. Because of such arrangements the improved dollar position of one part of the area influences directly other parts.

Finally, large differences exist among the less developed countries in their standards of living. Generally, their living standards compare unfavorably with those of western Europe and North America. National income statistics are generally scanty for the under-developed areas but in a recent estimate of the United Nations, per capita incomes in such countries as Indonesia and the Philippines as one extreme were found to be under $50, while Australia as the other extreme, fell in the group of $600-900, ranking with the United Kingdom and certain more prosperous continental countries.[13] In view of the divergent effects of

13/ United Nations, World Economic Report, 1949-50, p. 9.

saving and investment on inflationary tendencies under the impact of the improved trade relations of the various countries, some consideration to this factor will also have to be given in the following pages.

Realizing the complexity of many of the problems dealt with in this study, a thorough discussion of the position of each individual country in the new world conditions should not be expected as was previously remarked. The area discussions following hereafter will, in general, consist of three stages:

1) the original situation of the area, that is, immediately preceding the Korean conflict;
2) the initial speculative or anticipatory activity which mainly affected international market prices of industrial primary materials;
3) the more fundamental changes likely to result from the increased amount of the resources of industrial countries devoted to the production of armaments, and the consequences which they impose.

Not so much because of their feasibility, but rather because of the necessity to start a logical train of thought from a specific point, it will be necessary to make certain assumptions as to the general political outlook of the world during the coming years. Doubtless, the conclusions of nearly any study of this kind would be of no value whatsoever in the case of the outbreak of another large scale war. The precarious assumptions are therefore:

1) the political world situation will not deteriorate below the level of the second half of 1950, which might be called with The Economist "three-fourths peace."[14]

14/ The Economist, London, March 10, 1951, pp. 521-23.

2) the United States and her western allies will proceed with their contemplated defense programs, that is, they will spend, for a number of years, considerable new amounts for the rebuilding of, and later the maintenance of, a strong defense machine.

Even with these assumptions fulfilled, however, prices of primary products are not likely to be stabilized at their new and higher levels and so any quantitative estimates should rather be considered as an indication than as a measure of the direction of change of the economic situation.

Indonesia and Malaya

Indonesia played, prior to World War II, an important role in the international payments system. Since the dollar demand for many of her products, particularly rubber and tin, was high, the country was able to earn considerable amounts of dollars. The dollar deficit of the Netherlands could be offset in this manner since interest payments on Dutch investments were made in dollars. At the same time, a large volume of mainly complementary trade was carried on between the Indies and the Netherlands.

During the war, Japanese occupation resulted in the destruction of much capital and in the serious depreciation of most transportation facilities and other fixed assets. Exports and imports came to a practical standstill and under these conditions it was, of course, impossible to resume the prewar pattern immediately after 1945.

Between 1945 and 1949 the country was disturbed by nationalistic and terroristic uprisings which, among other things, retarded greatly its economic recovery. The territory became independent on December 27, 1949 and because of the price increases for the major export products since that time, due to the recovery of United States demand, much improvement has since been made.

The strenuous efforts of the British government to hold down terrorism and concentrate on economic recovery resulted in a more favorable turn of events in the case of Malaya. This colony has long been one of the most important dollar earners of the entire sterling area as a result of its rubber and tin exports to the United States. The triangular pattern of payments therefore was also an important feature of Malaya's economy.

Due to the destructions and shortages in Europe, the pattern of trade of both areas was directed mainly to the United States in the first postwar years. Indonesia, which before the war depended only upon the United States for 12 percent of her imports, had to obtain 24 percent of all imports from that area in 1949. The import dependence of Malaya on the United States increased in the same period from 3 to 6 percent.[15]

The disappearance of the traditional trade surplus with the dollar area had to be financed by grants and loans from the United Kingdom, the Netherlands, and the United States. In spite of this, however, it was not possible to maintain the old exchange rates, for deficit financing and the slow recovery of production together with large population increases had resulted in dangerous inflationary tendencies which, by their discouraging effect on exports and stimulating effect on imports, exercised tremendous pressures on the financial reserves. Together with their metropolitan countries, both territories devaluated approximately 30.5 percent in September, 1949.

While the general economic situation in Indonesia was far worse

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15/ United Nations, Economic Survey of Asia and the Far East, 1949, p. 212.

Table VIII. Unit values of exports and imports and over-all terms of trade of Indonesia and Malaya.

	1938	1948	Third quarter, 1949
Indonesia[b]			
Exports..................	100	318	308
Imports..................	100	687	611
Terms of trade[a]..........	100	46	51
Malaya[b]			
Exports..................	100	230	211
Imports..................	100	276	267
Terms of trade[a]..........	100	83	79

[a]Ratio of export price indices to import price indices.
[b]Economic Survey of Asia and the Far East, 1949, op. cit., p. 242.

than in Malaya as a result of internal disturbances and domestic inflation, the terms of trade had turned radically against the former and moderately against the latter in the immediate postwar period. The ECAFE[16/] attributes this to the depressed prices of especially rubber and tin and the high prices of metal goods, engines and metal working machinery. Although no reliable unit value figures are available for the period, the Commission estimates the price indices shown in Table VIII.

The significant fact is that while the industrial areas of the world were at a high level of economic activity, this under-developed region was at a disadvantage and in the case of Malaya, the terms of trade actually deteriorated further in the third quarter of 1949 as a result of the slight recession in the United States.

The pre-Korean situation therefore was serious, contrary to the situation of many other under-developed countries in which the export

16/ Economic Commission for Asia and the Far East of the United Nations.

products had risen more in price since the '30's than the import goods.

With the tremendous price rises of rubber and tin during 1950, price relationships have, of course, moved in favor of both countries. In Tables IX and X estimates were made of the additional export revenue that would become available annually if December, 1950 prices would continue to exist. The estimate for Indonesia made on the basis of United States price changes, compares reasonably well with the actual trade surplus of the latter months of 1950, which amounted to about 100,000,000 rupiyah per month. On the basis of quantum indices, however, a less favorable impression would result. Exports of Malaya in 1949 were one-third higher than in 1938 but Indonesia had not reached the prewar volume in 1949. For rubber, tin and copra, the export percentages compared with prewar were respectively 90, 76, and 62 in 1949, which is a reason for concern when the population probably increased by at least 15 percent in the same period.

The impacts of the recent reversal of the balance of trade are likely to be both favorable and unfavorable, depending on local conditions and administrative skills. In the first place, however, it is significant that the re-emergence of the dollar surplus of both countries will enable the triangular payments scheme to resume its operation, contributing towards a real new equilibrium. The resumption of "dollar containing" interest payments on investments will both contribute to domestic stability and to the investment reputation of the countries, which is important in view of the desirability to attract new foreign capital. At the same time, however, the increased earnings are likely to bring about inflationary pressures directly by increasing the money supply and perhaps indirectly by encouraging the worker population to demand

Table IX. Indonesian major exports and estimated effects of 1950 price rises. (000 omitted in money figures.)

	1949 export value[a]	Percent of total exports	Percent price rise 1949 - Dec., 1950	1949 export value at Dec., 1950 prices	Estimated increase in export revenue due to price rises	
Copra..................	Fl. 155,647	11	25	Fl. 194,559	Fl. 38,912	U.S.$ 14,149
Palm oil...............	89,988	6	18	106,186	16,198	5,890
Petroleum and products.	412,205	28	2	420,449	8,244	2,999
Rubber.................	348,529	24	304	1,408,057	1,059,528	385,255
Sugar..................	16,816	1	8	18,161	1,345	489
Tea....................	53,086	4	- 5	50,432	- 2,654	- 965
Tin and tin ore........	169,110	11	45	245,210	76,100	27,671
Tobacco................	67,582	5	2	68,934	1,352	492
Total................	1,312,963	89[b]	—	2,511,988	1,199,025	435,977[c]

[a]Source: Ichtisar bulanan statistik, Republik Indonesia, Penerbitan kantor pusat statistik.

[b]Separate items do not necessarily add to total because of rounding.

[c]Converted at official exchange rate prevailing during 1949 (1 guilder = 36.361¢).

Table X. Malayan major exports and estimated effects of 1950 price rises. (000 omitted in money figures.)

	1949 export value[a]	Percent of total exports	Percent price rise 1949 – Dec., 1950	1949 export value at Dec., 1950 prices	Estimated increase in export revenue due to price rises	
Coconut oil............	M$ 54,986	3	16	M$ 63,784	M$ 8,798	U.S.$ 3,821[b]
Palm oil...............	38,472	2	18	45,397	6,925	3,008
Rubber.................	731,385	44	304	2,954,795	2,223,410	965,627
Tin....................	273,638	16	45	396,775	123,137	53,478
Total..............	1,098,481	65	—	3,460,751	2,362,270	1,025,934

[a]Source: Summaries of Malayan Foreign Trade.

[b]Converted at official exchange rate prevailing during 1949 (one M $ = 43.430¢).

higher wages and to strike, if necessary.

Much will depend, therefore, on the actions of the government to hold down inflation. There were indications that rigid taxation measures were underway in the form of increased export taxes on rubber and tin. Imports were also encouraged by various inducement schemes towards the end of 1950. The cost of living, however, was definitely rising and the inflationary danger was far from curbed.

Since exports of such products as rubber and tin were far larger than actual world consumption of these commodities during 1950 and since the scare-stockpiling might be slowed down with U. S. synthetic rubber production increasing rapidly, the question might be raised whether the 1950 purchases were not made out of fear of external political disturbances in the area.

Assuming, however, that demand will remain strong, the largest difficulty will be for the area to increase its imports especially of capital goods. In view of the low standards of living existing, the governments will probably try to increase the food and textile supply also. This would raise the standard of living but unless new development projects would be started with the new funds, it would probably mean only temporary improvement. In order to change the outlook of the countries fundamentally for the better, the improved trade position would have to result in an increased inflow of capital goods. It appears, however, that under the threat of renewed war, public opinion has been awakened to realize that international cooperation for the development of backward areas is a necessity. The Point IV program of the United States and the Colombo plan of the British Commonwealth seem to be created by this new line of thought.

Australia and the Union of South Africa

The economies of Australia and the Union of South Africa are comparable in many respects although they are quite different from most other primary producing countries. Under the impact of World War II, manufacturing became an important branch of activity in contrast with the prewar situation when mining and agriculture accounted for the largest share of the national income. The export position of both countries, however, is traditionally determined by a few primary products: Australia, the world's largest exporter of wool and also an important exporter of wheat; South Africa with wool, diamonds and gold accounting for a major share of her exports. Manufactured products are produced mainly for domestic use and, although the basis for heavy industries is available in both countries in the form of a variety of ores and coal, metal goods and machinery constitute, with textile products, more than half of all imports.

The wool price is for both countries the most important indicator of the terms of trade and, as could be expected, the tremendous rise in wool prices during 1950 brought about considerable improvement in the respective trade positions of the countries. Traditionally, Australia had had a slight export surplus to pay for services and to finance investments. During 1950, this merchandise export surplus increased fourfold. Under the arrangement of the sterling area dollar pool, Australia's dollar income is added to the pool and she receives drawing rights in the form of sterling. Imports of dollar goods, however, remain subject to Commonwealth regulations, encouraging soft currency imports.

The Union of South Africa withdrew in 1947 from the dollar pool and has since taken care of her own reserves. Her financial position was characterized by a fairly large import surplus paid for in gold and also with diamond exports. Import restrictions were in effect but they were relaxed in 1950 when, instead of the usual trade deficit, an approximate balance was reached. Political insecurity probably had some influence on this achievement since the "free" price of gold had risen, presumably as a result of hoarding demand. In addition to these exports the Union exports such strategic ores and metals as platinum, chrome ore, and manganese, the demand for which is likely to increase with tense world conditions.

The inflationary factor was felt rather strongly in both countries during 1950 under the impact of high export prices and high investment expenditures. In Australia this trend even resulted in curbs on "unproductive" capital issues or investments. With the relatively high standard of living, however, the pressure of additional export revenue is not likely to be as inflationary as the distribution of additional income among low income peoples such as Indonesians, since the demand for food and mass-produced manufactured products would increase more in the latter case. Nevertheless, the cost of living went up from 163 in May to 172 in December, 1950 in the Union of South Africa, and from 171 to 188 in Australia between the first and fourth quarters of 1950.[17/] (1937 = 100.)

In general, the position of the two countries is not comparable to the position of Indonesia and Malaya. While the higher export prices provide an additional stimulus for domestic saving and development, the economies are not crucially dependent any more on the terms of trade.

17/ International Monetary Fund, International Financial Statistics.

The stability of their forms of government and the attractive opportunities provided a sound base in the postwar years to increase the inflow of foreign capital. To some extent, of course, the availability of additional capital goods in countries such as the United Kingdom and the United States would determine the rate of economic growth, but the general effects of western rearmament appear to be very favorable to both Australia and the Union of South Africa. Tables XI and XII present the export situation of the countries. An additional favorable factor for the Union is the fact that after the devaluation wave hit in September, 1949, imports became cheaper in terms of its product gold, or which is the same, the price of gold in terms of sterling, rose.

Brazil, Colombia and Venezuela

These selected countries of Latin America are dependent on entirely different types of export products than the wool, rubber and tin groups dealt with above. While the latter materials are supposed to have a specific strategic value, coffee, the major export product of Brazil and Colombia is a commodity for which the demand presumably is dependent upon the level of income of importing countries, in this case, primarily the United States. Petroleum, accounting for about 95 percent of all of Venezuela's exports, might be called a strategic material but the world supply was not necessarily short in 1950 and Venezuela also seemed politically more secure to the United States.

With the increased United States demand pushing against the relatively inelastic supply of coffee, prices rose sharply and seemed more or less stabilized by the end of 1950 at a price level 70 percent higher than that of May. Petroleum, however, showed hardly any increase in price. Compared with prewar, coffee prices were about six times as high,

Table XI. South African major exports and estimated effects of 1950 price rises. (000 omitted in money figures.)

	1949 export value[a]	Percent of total 1949 exports	Percent price rise 1949 - Dec., 1950	1949 export value at Dec., 1950 prices	Estimated increase in export revenue due to price rises	
Wool[d]	S.A.£34,998	26	106	S.A.£72,096	S.A.£37,098	U.S.$134,462[f]
Hides and skins[c]	7,275	5	56	11,349	4,074	14,766
Copper	3,519	3	26	4,434	915	3,316
Diamonds[e]	10,130	7	—	—	—	—
Gold[b]	10,500	8	—	—	—	—
Total	66,422	49	—	—	42,087	152,544

[a]Source: Monthly Abstract of Trade Statistics, Department of Customs and Excise.

[b]Source: International Financial News Survey, International Monetary Fund, Vol. III, p. 292.

[c]Including cow, ox, goat and sheep skins.

[d]Including greasy and scoured.

[e]Both rough and polished.

[f]Converted at official average exchange rate prevailing during 1949 (one £ S.A. = 362.45¢).

Table XII. Australian major exports and estimated effects of 1950 price rises. (000 omitted in money figures.)

	1949-50 export value[a]	Percent of total 1949 exports	Percent price rise 1949 - Dec., 1950	1949 export value at Dec., 1950 prices	Estimated increase in export revenue due to price rises	
Wool[b]	A.£314,439	51	106	A.£647,744	A.£333,305	U.S.$ 983,516[e]
Wheat[c]	88,510	14	5	92,936	4,426	13,060
Butter................	25,312	4	8	27,337	2,025	5,975
Frozen meat[d]	12,544	2	23	15,429	2,885	8,513
Total..............	440,805	72[f]	—	783,446	342,641	1,011,065

[a]Source: Quarterly Summary of Australian Statistics, Commonwealth Bureau of Census and Statistics; data are for the year July, 1949–June, 1950.

[b]Including greasy and scoured.

[c]Including wheat flour.

[d]Including beef and lamb.

[e]Converted at official average exchange rate prevailing during 1949 (1 A.£ = 295.08¢).

[f]Separate items do not add to total because of rounding.

while petroleum had less than doubled in value. Prices of both commodities, however, similar to many other primary products, have been relatively depressed for decades and especially during the '30's, a period characterized by the deficient demand of the United States.

In spite of these price developments, however, Venezuela's economic position in 1950 was far more favorable than the positions of either Brazil or Colombia, due to internal development and especially the tremendous increase in quantum. Petroleum production in Venezuela was almost three times as high as in 1937. The volumes of coffee exports of Brazil and Colombia, however, were respectively only about 20 percent and about 15 percent higher.18/ These figures were temporarily obscured by high coffee prices, but, in view of population increases, seem to form a less permanent basis for prosperity.

How much, even after the war, the three economies were dependent on United States demand appears from the following figures. During 1949, percentages of total exports which went to the United States were 40, 81, and 29 for Brazil, Colombia, and Venezuela19/ respectively. Moreover, a considerable part of Venezuela's oil is exported to the United States indirectly via the Netherlands Antilles. Improvement in United States demand between the first half of 1949 and the first half of 1950 resulted in a considerable improvement of the trade balances of the countries. These are shown below:

	First half of 1949	First half of 1950
Brazil (Mil. U.S. $)	- 122.5	+ 70.3
Colombia (" " ")	- 15.9	+ 7.7
Venezuela(" " ")	+ 93.3	+ 309.3

(Source: United Nations World Economic Report, 1949-50, p. 66.)

18/ International Financial Statistics.

19/ Ibid.

Prior to World War II the traditional trade pattern of the countries had consisted of export surpluses, especially with western Europe, in order to finance investments and also to earn dollars to offset the trade deficit with the United States. With the elimination of the European market during the war, however, the dependence on the United States both as an outlet for export products and as a supplier of manufactured goods was greatly increased. This association resulted in an accumulation of dollar reserves which could not currently be spent on additional imports because of the scarcity.

These circumstances, in addition to the fact that the internal economic activity of the countries had risen so as to supply themselves with a number of formerly imported manufactures, contributed to the post-war international settlement difficulties. Europe was not any more able to supply dollars to Latin America[20] and after the accumulated reserves had been depleted to normally desirable levels or lower, recourse had to be taken to bilateral agreements and import controls on United States goods. Multiple exchange rates were instituted by all three countries so that in the beginning of 1950, Brazil had three while Colombia and Venezuela both had six different rates for different classes of imports and exports. In view of this situation, the dollar surpluses earned as a result of the new price rises are actually artificial, although for the time being, they certainly relieve the pressure on the reserves.

As far as the present trade is concerned, therefore, the effect of the first phase of events inspired by the mobilization certainly seems to be favorable.

Similarly to the countries previously dealt with, however, temporary

20/ E.R.P. dollars temporarily provided the means to continue the pattern with European countries paying in this way for their import surpluses with Latin America.

high prices, especially after 50 years of depressed prices, are not a sufficient basis for optimism. On the contrary, they contain serious dangers resulting from the large fluctuations in the money supply and the difficulty in adjusting imports or domestic production immediately to the new situation. Only if the new supplies of foreign exchange can effectively be used for the economic development of new industries or the expansion and improvement of existing primary product facilities, or can be sterilized as additional reserves, can the economic position be said to have improved permanently. But, from a defense point of view, the United States is also highly benefited by increases in, for instance, mineral production of the Latin American countries and is likely to assist in the capital needs of the enterprises. The case of Venezuela seems especially favorable in this respect in the light of recent discoveries of 1,000,000,000 tons of high content iron ore. The countries here dealt with are strategically situated much more favorably than southeast Asia and in previous years the United States has gained some experience in dealing with the Latin American peoples.

Brazil, Colombia, and Venezuela, therefore, probably similar to other Latin American countries, are likely to be affected very favorably by the increased United States demand resulting from defense mobilization, not so much because of improved terms of trade as because of the interest of the United States in increased production of primary materials and foodstuffs closer to home. Inflationary pressures were strengthened greatly during 1950 however, especially in Colombia where the cost of living rose about 25 percent during the year. Another possible problem for the countries' economies is the anticipated shortage of capital goods imported from the United States and Europe. Tables XIII, XIV, and XV present the export position of the three countries.

Table XIII. Brazilian major exports and estimated effects of 1950 price rises. (000 omitted in money figures.)

	1949 export value[a]	Percent of total 1949 exports	Percent price rise 1949 - Dec., 1950	1949 export value at Dec., 1950 prices	Estimated increase in export revenue due to price rises	
Coffee...............	Cr.$11,610,700	58	71	Cr.$19,854,300	Cr.$8,243,600	U.S.$445,600[b]
Raw cotton..........	2,006,900	10	35	2,709,300	702,400	37,970
Cocoa...............	963,500	5	43	1,377,800	414,300	22,390
Hides and skins.....	692,600	3	56	1,080,500	387,900	20,970
Total.............	15,273,700	76	—	25,021,900	9,748,200	526,930

[a]Sources: Banco do Brazil, 1949, p. 309; Resenha Economica Mensal.

[b]Converted at the official exchange rate prevailing during 1949 (1 Cr.$ = 5.4054¢).

Table XIV. Venezuelan major exports and estimated effects of 1950 price rises. (000 omitted in money figures.)

	1949 export value[a]	Percent of total 1949 exports	Percent price rise 1949 - Dec., 1950	1949 export value at Dec., 1950 prices	Estimated increase in export revenue due to price rises	
Petroleum and der. ..	B.$3,258,707	95	2	B.$3,323,881	B.$ 65,174	U.S.$20,823[c]
Coffee...............	52,252	2	71	89,350	37,098	11,853
Cocoa................	25,451	1	43	36,395	10,944	3,497
Total..............	3,336,410	97[b]	—	3,449,626	113,216	36,173

[a]Sources: Boletin de Estadistica; Boletin del Banco Central de Venezuela.

[b]Separate items do not add to total because of rounding.

[c]Converted at the official exchange rate prevailing during 1949 (1 B.$ = 29.851¢).

Table XV. Colombian major exports and estimated effects of 1950 price rises. (000 omitted in money figures.)

	1949 export value[a]	Percent of total 1949 exports	Percent price rise 1949 - Dec., 1950	1949 export value at Dec., 1950 prices	Estimated increase in export revenue due to price rises	
Coffee.................	C.$474,908	79	71	C.$812,093	C.$337,185	U.S.$172,908[b]
Petroleum..............	113,500	19	2	115,770	2,270	1,164
Total...............	588,408	98	—	927,863	339,455	174,072

[a]Source: United Nations, Summary of World Trade Statistics, Statistical Papers, Series D.

[b]Converted at the official exchange rate prevailing during 1949 (1 peso = 51.2825¢).

Conclusions on Primary Product Exporting Countries

The countries dealt with above are perhaps not representative of all the under-developed countries of the world. Rather, they represent in their foreign trade important amounts of the world's supply of some key commodities and therefore, the demand for their products may result and partly has already resulted in more favorable price relationships. The additional amounts of foreign exchange becoming available in this way may be used to finance larger imports. Table XVI and Figure 2 show the dramatic changes in the terms of trade of some of the countries under review. In the case of Australia, Malaya, and Indonesia, the business recession in the United States of the first part of 1949 is clearly visible while after the third quarter of 1949 a general recovery of the terms of trade started. Significant improvements occurred for all countries during 1950.

The increased export revenue could result in both favorable and unfavorable tendencies. On the one hand, the revenue could be invested, either by the government or by individuals to increase the national productivity. If imported capital goods would continue to be available, this would provide a strong stimulus for improvement. The revenue could also be used for the resumption of payments on old debts or investments or for the amortization thereof. In this case, the reputation of such a country would improve in the eyes of the capital exporting countries, and a new flow of private investment might be encouraged. Investment both in new and in old branches of economic activity would be beneficial since the real income would tend to be raised in both cases. The tremendous price fluctuations during 1950 reveal once more, however, the precarious status of the under-developed economies in being dependent

Table XVI. Export and import price indices and over-all terms of trade of selected primary product exporting countries. (1948 = 100)

	Venezuela[a]			Union of South Africa[a]			Indonesia[bc]			Malaya[b]			Australia[ab]		
	Imp.[d]	Exp.[e]	T.[f]	Imp.	Exp.	T.	Imp.	Exp.	T.	Imp.	Exp.	T.	Imp.	Exp.	T.
1938	51	65	127	—	—	—	15	28	192	36	43	120	37	35	93
1947	90	98	109	—	—	—	96	—	—	90	66	95	86	70	82
1948	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
1949 I	94	104	111	107	100	93	95	89	92	103	94	93	105	125	119
II	92	106	115	109	102	93	93	88	94	101	93	93	104	149	144
III	88	106	122	110	105	96	92	90	98	97	92	95	106	110	104
IV	85	107	128	111	104	93	97	110	113	103	112	110	113	126	112
1950 I	79	105	134	115	103	89	—	115	—	99	118	119	115	147	129
II	74	104	142	119	109	92	—	246	—	102	135	133	117	157	160
III	—	—	—	—	—	—	—	342	—	115	183	159	120	192	190
IV	—	—	—	—	—	—	—	440	—	—	—	—	126	223	210

[a]Source: United Nations, Summary of World Trade Statistics, Statistical Papers, Series D.

[b]Source: United Nations, Monthly Bulletin of Statistics.

[c]Export index is a unit value index, import index is an index of wholesale prices. The two figures are not strictly comparable. Beginning April, 1950, value of foreign exchange certificates is included in the index. The extremely unfavorable terms of trade up until that time seem to be at least partly due to overvaluation of the currency in the computation of the export index.

[d]Import index.

[e]Export index.

[f]Ratio of exports over imports.

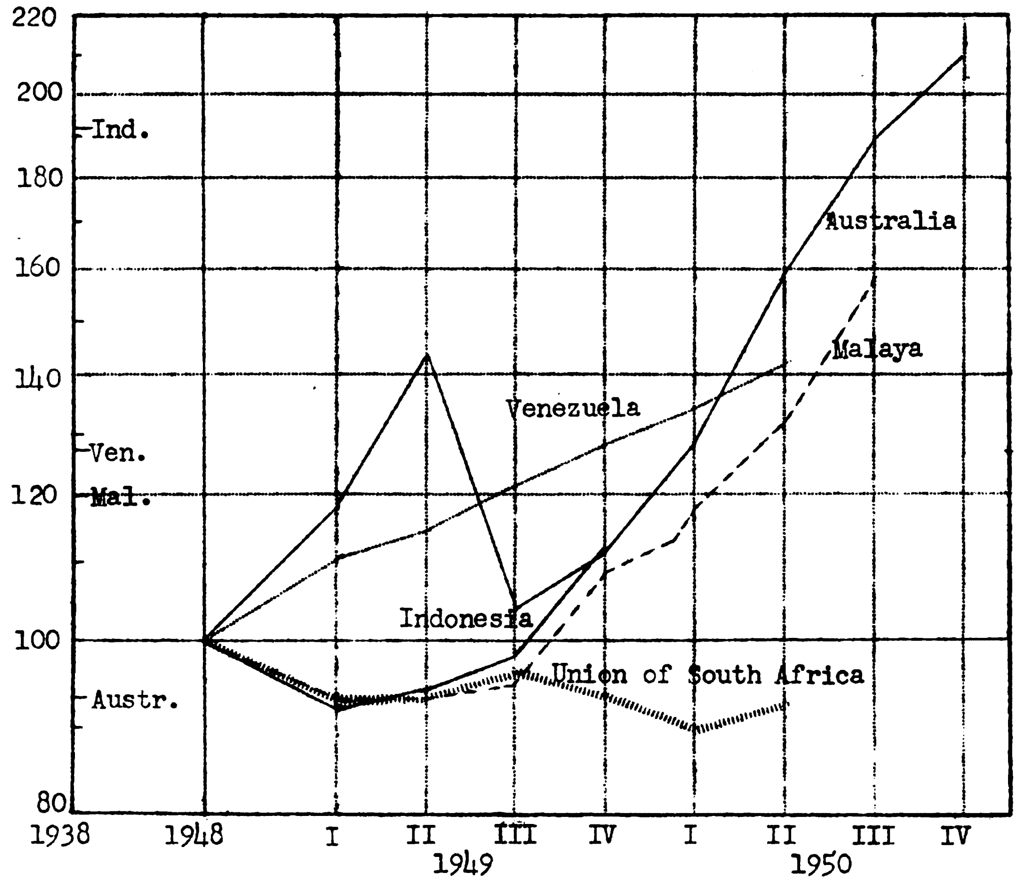

Figure 2. Over-all Terms of Trade of Selected Primary Product Exporting Countries (1948 = 100). (Logarithmic scale)

Source: United Nations.

upon external demand. Their desire to stimulate diversification rather than further specialization, seems understandable in the absence of any agreements stabilizing within limits their terms of trade.

On the other hand, the additional export revenue could accrue in the hands of a few wealthy, strategically situated producers and/or exporters and could be spent to buy luxury goods or mansions or it could even flow off as additional interest on investments of foreign companies. Theoretically at least, this danger is present with a large amount of the total investment in estates and mines of the under-developed areas owned by nationals of other countries.

Even if the income were divided equally over the entire population, a dangerous situation could develop. With the generally low level of living of the population increased income would cause a large demand for food and simple mass-produced manufactures which, in view of the inelastic supply of many of these commodities, would result in strong inflationary pressures. If this last situation were to prevail, the effect of the improved terms of trade would decidedly be detrimental to certain groups in the economy.

Apart from the changes in the terms of trade there is another factor to be considered. This is the free flow of private capital. Naturally, this flow is disturbed by the slightest rumor of war, but, as suggested above, the general political outlook may also move countries such as the United States to invest its available capital closer to home. Although this factor would work naturally as a disturbing influence, its discussion falls perhaps outside the scope of this study which tries primarily to analyze the possible effects of increased spending for defense of certain countries.

The net effect of the above trends and changes appears, under the conditions of the first part of 1951 of "three-fourths peace," to be favorable for most primary product exporting countries. Any reduction in the availability of manufactured consumption and capital goods, however, could quickly reverse the outlook.

At the twelfth session of the Economic and Social Council of the United Nations at Santiago de Chile in early 1951, general expectations seemed rather pessimistic perhaps in the anticipation of shortages similar to those of World War II. The attention was devoted mainly, however, to the fear of new inflationary pressures rather than to the consideration of the relatively long time effects of increased defense spending without total war.

CHAPTER V

IMPACTS ON SOME INDUSTRIALIZED COUNTRIES

This chapter will deal with a consideration of the second hypothesis, namely that "the United States as the financier of the largest part of the rearmament of the West will either experience larger price increases than other western, especially European, countries or will be compelled to restrict her imports. In either case, European goods would flow more easily to the United States and to third markets supplied by the United States."

The thoughts underlying this hypothesis are that the United States will spend relatively more on rearmament than the European countries. This would then result in greater inflation in the former country which, in turn, would have a similar effect to a devaluation of the European currencies in terms of the dollar. United States goods, according to these assumptions, would become more expensive and scarce, so that less would be purchased by Europe, while at the same time, the flow of relatively less appreciated European goods to the United States would increase, To the extent that there would be a differential in the price rises between the United States and Europe, competition in third markets would also be changed in favor of European merchandise. One of the differences between relative inflation in the United States and a currency devaluation in European countries would be that in the former case, United States exports would become dearer and United States imports would become relatively cheaper where in the case of a devaluation, all non-devaluating countries would be affected. In other words, relative inflation in the United States would appear to be more specifically favorable in view of solving the dollar problem than currency revaluations by other countries. Many of the same weaknesses that apply to the effectiveness of devaluation, however, also apply to the case of relative inflation. Exports from Europe to the United States would have to increase more in volume than the price change, so as to make the total value in constant purchasing power larger than before. In order to gain from such a situation then, there would have to be a price elasticity larger than one and the newly obtained changes in the relative purchasing power of the currencies would have to be retained permanently.

Under present conditions, these weaknesses would probably appear to limit the favorable effect on Europe seriously. Because of the rigid restrictions on imports of American goods into Europe and, to an extent, on imports of European goods into the United States,[21] the flow of goods to Europe consists mainly of necessities and the flow of goods to the United States consists mainly of luxuries. The price elasticity of both groups appears to be rather low. Furthermore, existing inflationary pressures in many countries are not directly reflected in the cost of living indices and thus in the cost of production. If price increases would not be permitted to occur, however, the effect on trade of the hidden inflationary pressures would in many respects tend to be the same as in the case of open inflation. Export controls or import limitations would work in the same direction.

21/ Of interest is the following remark made by the United Nations Economic Commission for Europe with reference to the graduated tariffs of the United States: "Since, however, European countries have to live chiefly by their exports of manufactures, the American tariff is probably no less discriminatory against Europe in its economic effects, if not in outward form, than the more obvious controls which European countries in turn, impose with respect to imports from the United States." Economic Survey of Europe in 1949, p. 160.

Actually, however, it appears to be not at all sure whether relative inflationary pressures are greater in the United States than in Europe. In the first place, the relative size of additional military expenditures appears to be quite large in European countries. Secondly, the dependence of Europe on imports of the scarce raw materials to feed her industries tends to be larger than for the United States, which factor impedes the expansion of industrial production in the former area. And thirdly, the existing imbalance in the payments and the low level of reserves in Europe tend to endanger the financial stability of the area, even when quantitatively the defense effort there is on a smaller scale than in the United States. These three factors require some elaboration.

Table XVII shows the size of military expenditures in a number of North Atlantic Treaty Organization countries and Sweden in the present and in the coming year. Although the figures represent the best estimates available from official sources it would seem improbable that they are mutually comparable. The United States figure, for example, includes an amount for strategic stockpiling and also includes foreign economic and military aid. The United Kingdom budget on the other hand, considers stockpiling as a non-military expenditure, but here it is not clear whether military aid from the United States and Canada is included in the estimates of the defense budget. In spite of these limitations, however, certain general conclusions still appear to be justified.

In terms of percentages of the per capita national income of the countries shown, military expenditures were largest in the United States both before and after the Korean outbreak. Due to considerably lower

Table XVII. Defense budget estimates for selected European and North American countries, fiscal 1951 and 1952 (billions of U. S. dollars).

	Fiscal 1951	Fiscal 1952	Percent increase	1949 per capita national income[g] (dollars)	Defense expenditures as percent of income 1951	Defense expenditures as percent of income 1952	Percent of income to be given up
Belgium[a]	.170	.315	85	579	3.5	6.4	2.9
Canada[b]	.8	1.6	100	926	6.8	13.0	6.2
Netherlands[c]	.224	.395	76	372	5.9	10.5	4.6
Sweden[d]	.163	.234	43	773	3.0	4.3	1.3
United Kingdom[e]	2.3	4.2	83	560	8.5	14.8	6.3
United States[f]	21.0	41.4	97	1,453	9.7	19.1	9.4

[a] Royal Institute of International Affairs, The World Today, March, 1951, pp. 109-17.

[b] U. S. News and World Report, April 24, 1951.

[c] The New York Times, March 14, 1951.

[d] Statistika Centralbyran, Statistik Årsbok, 1950.

[e] British Information Services, British Economic Record, April 14, 1951.

[f] International Monetary Fund, International Financial News Survey, Vol. III, p. 218.

[g] United Nations, Monthly Bulletin of Statistics.

incomes in other countries, however, they constituted also important shares of the incomes of most other countries. With the exception of Sweden all countries increased their defense budgets by between 70 and 100 percent. If constant incomes are assumed, the last column of the table shows which part of his income each individual will have to give up in order to pay for the increased defense preparedness. The United States heads the list but it should be considered that 9.4 percent of the per capita income of a rich nation may weigh less in terms of inflationary pressure than 6.3 percent in the case of a poorer nation. How strong actual inflation is likely to be in the various countries cannot be concluded from the figures in Table XVII. This depends on the way in which the programs are to be financed. If increased taxation could supply sufficient funds to pay for the entire increase, as apparently is the goal in the United States, inflationary pressure would be reduced to a minimum, whereas deficit financing by a government would represent the other extreme. The levels of taxation as percentages of the net national income, however, seem to be higher in Europe than in America, with the United Kingdom taxing 42.5 percent of the net national income in 1949.[22] In countries where thus far low levels of taxation prevailed more room seems to exist for increasing government revenue this way. It may be concluded, therefore, that both in the United States and in European countries the greatly increased defense programs tend to have strong inflationary influences, while several factors add to the seriousness of the problem in Europe although the relative share of the expenditures is larger in the United States. The timely application of sound monetary and fiscal policies by the various governments may prevent further price increases.

The raw material situation is another factor which tends to limit the extent to which European countries will be able to profit from the increased demand for manufactures both in the United States and in third markets. Except for iron and coal, which materials appear to be present in sufficient quantities in Europe, most primary products have to be imported from overseas. The United States, on the other hand, is much more nearly self-sufficient in such key commodities as copper, aluminum, zinc, and petroleum. While the share that industrial raw materials constitute of total imports in European countries is therefore, even larger than in the case of the United States, total imports form a much larger share of the national income. Table XVIII shows the percentage raw

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22/ United Nations, Economic Survey of Europe in 1949, p. 275.

Table XVIII. Raw material imports in industrial countries[a] (millions of U. S. dollars).

	1949 value of raw material imports	1949 value of total imports	Percent of total imports	Percent of total national income	Percent price increase May-Dec., 1950
Belgium[b]........	781.9	1,803.4	43.4	13.7	38
Canada[c].........	368.9	2,698.7	13.7	2.9	14
Switzerland[d]....	297.6	881.6	33.8	7.6	16
United Kingdom[d].	2,871.6	8,430.1	34.1	7.6	32
United States[e]..	1,855.2	6,598.1	28.1	.9	14

[a]United Nations, Statistical Papers, Series D, No. 41

[b]Includes semi-manufactures.

[c]Agricultural and primary products.

[d]Raw materials.

[e]Crude materials.

material imports are of total national incomes. Typical industrial countries such as the United Kingdom and Switzerland spend almost 8 percent of their national income on imported raw materials while the same figure for the United States amounts to less than one percent. Any change in the prices of these materials, therefore, tends to influence the economic position of most European countries much more profoundly than the United States or Canada. For the same reason, changes in the over-all terms of trade are of much more importance to European countries which derive between 20 and 30 percent of their national income from international trade than to the United States or Canada. Table XIX and Figure 3 present the picture of the deterioration in the terms of trade of all industrial countries here under review due to the increased cost of imports after the Korean outbreak. It can be seen, however, that the terms of trade of most countries already started deteriorating before the recent military events.

Table XIX. Unit value indices of exports and imports and over-all terms of trade of selected industrial countries. (1948 = 100)[a]

	Belgium			Netherlands			Switzerland			Sweden			Canada			United Kingdom			United States		
	Imp.[b]	Exp.[c]	T.[d]	Imp.	Exp.	T.	Imp.	Exp.	T.	Imp.	Exp.	T.	Imp.	Exp.	T.	Imp.	Exp.	T.	Imp.	Exp.	T.
1938	—	—	—	24	25	104	40	39	98	45	42	93	46	47	102	—	—	—	41	48	117
1947	—	—	—	95	100	105	98	104	106	95	90	95	88	92	105	90	92	102	90	94	104
1948	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
1949	95	100	105	96	94	98	90	97	108	101	93	92	103	103	100	101	103	102	95	92	97
1950 I	91	88	97	100	101	101	80	91	114	—	—	—	107	104	97	112	106	95	94	90	96
II	92	88	96	102	101	99	82	91	111	111	94	85	108	104	96	113	106	94	94	88	94
III	93	84	90	104	96	92	80	93	116	—	—	—	109	105	96	115	108	94	95	88	93
IV	95	85	89	104	99	95	81	90	111	—	—	—	110	106	96	118	108	92	96	87	91
V	91	87	96	106	97	92	78	94	121	113	95	84	109	105	96	119	109	92	96	86	90
VI	98	87	89	110	97	88	78	95	122	—	—	—	109	108	99	119	109	92	99	88	89
VII	95	88	93	108	92	85	80	90	113	—	—	—	110	110	100	121	111	92	102	89	87
VIII	94	88	94	107	92	86	78	94	121	114	98	86	111	111	100	122	111	91	105	90	86
IX	100	93	93	107	90	84	80	91	114	—	—	—	113	113	100	123	111	90	109	92	84
X	102	94	92	110	92	84	83	94	113	—	—	—	114	112	98	129	113	88	112	94	84
XI	107	94	88	115	98	85	84	96	114	122	109	89	114	113	99	132	115	87	115	95	83
XII	110	99	90	118	103	87	87	94	108	—	—	—	117	113	97	135	117	87	117	98	84

[a]Source: United Nations, Monthly Bulletin of Statistics.
[b]Imports.
[c]Exports.
[d]Terms of trade or E/I.

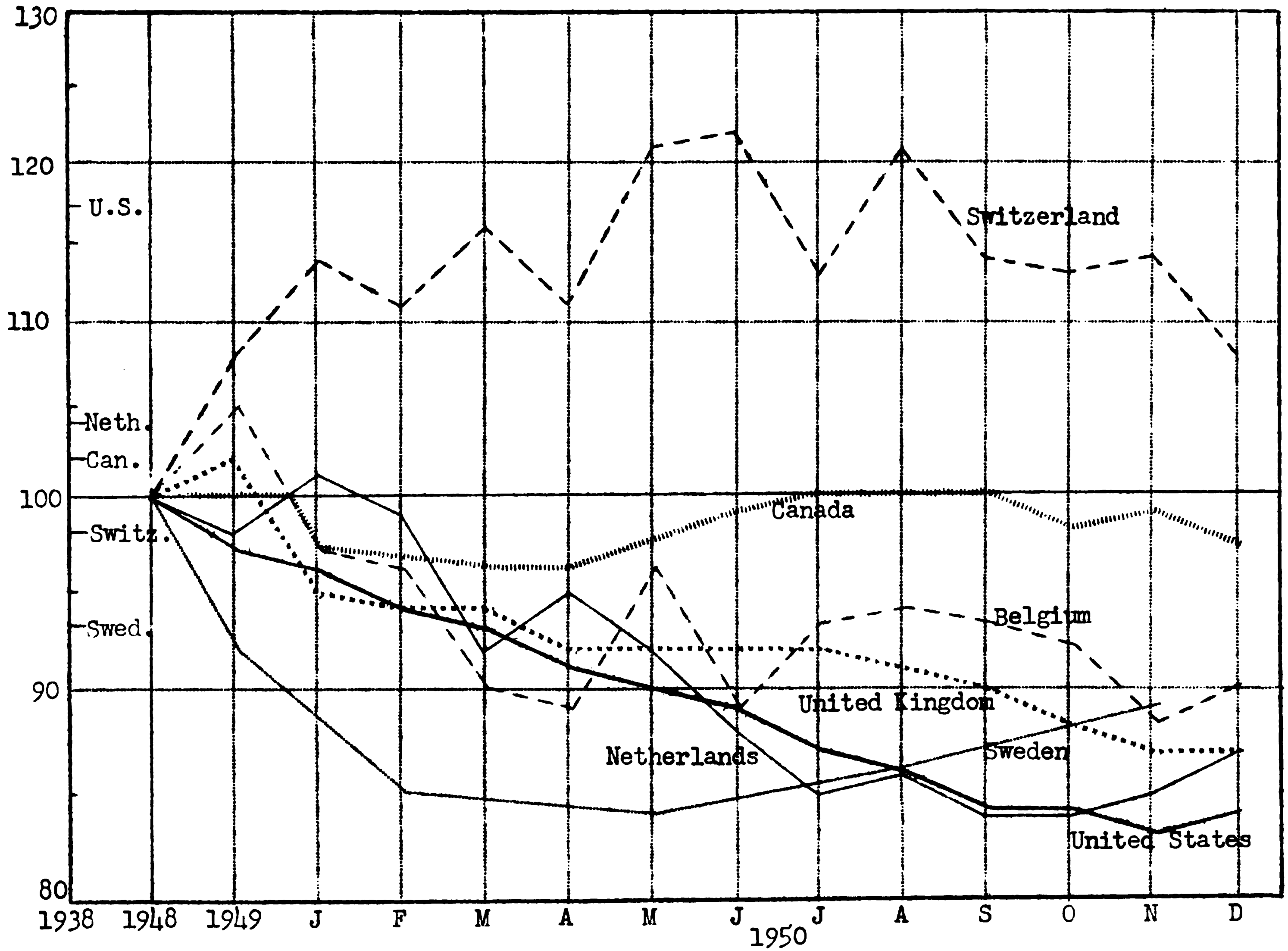

Figure 3. Over-all Terms of Trade of Selected Industrial Countries (1948 = 100). (Logarithmic scale)

Source: United Nations.

Absolute shortages of certain imported raw materials would, of course, further limit an expansion of industrial output.

The third factor in which Europe's economic position compares unfavorably with the North American industrial area is the difficulty which European countries were facing before the Korean outbreak in their balances of payments and the accompanying low levels of reserves. Due to the postwar recovery needs, financial reserves in Europe had generally been depleted to dangerously low levels while in the United States opposite trends were apparent. As a result, Europe cannot allow any further drain of its reserves. Since the terms of trade have deteriorated this means that more exports have to be supplied in payment for the same quantity of industrial raw materials at the same time that large additional military requirements have to be fulfilled in nations where all resources are already fully employed. It is clear that even maintaining the same imbalance as previously would therefore be inflationary in Europe, while actually closing the existing gap would become more difficult.

The United States, on the other hand, could freely allow the gold and other reserves to absorb most of the shock of the higher import prices while the country's original position of a "favorable" balance of trade would be an additional strengthening factor.

With this background it is not surprising that inflationary pressures were strong in nearly all European countries during 1950 and that a similar situation is likely to continue to prevail. It also has to be considered that the actual diversion of resources from civilian to military use in most European countries is a certain number of months behind the similar adjustment in the United States. Looking at the

Table XX. Increases in price levels of selected industrial countries, May-Dec., 1950.[a]

	Wholesale prices	Cost of living
Belgium....................	20.0	3.8
Canada.....................	9.5	4.3
Netherlands................	13.3	5.1
Sweden.....................	14.4	1.9
Switzerland................	11.1	1.3
United Kingdom.............	14.5	1.8
United States..............	12.3	6.1

[a]Source: United Nations, Monthly Bulletin of Statistics.

figures in Table XX it appears that as far as retail prices are concerned, the United States experienced the largest increases of the seven countries shown during the latter half of 1950. In the Netherlands, Canada, and Belgium also, however, important increases in the cost of living were registered, while the United Kingdom, Sweden, and Switzerland succeeded in holding the line in spite of higher prices of imported foodstuffs and raw materials. Subsidization, however, plays a considerable role in the economies of the three latter countries and therefore, retail prices are perhaps not as good a measure of existing inflationary pressures as wholesale prices. Increases in the wholesale price levels of all countries were much larger than the changes in the cost of living indices and it seems significant that all selected European countries except Switzerland, which belongs to the hard currency area, experienced larger wholesale price increases than Canada and the United States. This was not entirely due to the anticipation of larger defense outlays, however, but resulted also from the decisions of various governments to cut down on food subsidies. While the real impact of the actual defense expenditures had not yet begun in either North

America or Europe by the end of 1950, inflationary pressures appeared to be equally high in both areas. There seems to be no indication of the validity of the first part of the hypothesis.

Nevertheless, most countries were able to improve their dollar balances considerably. The very high level of economic activity in the United States was perhaps more important than price levels as such. Table XXI shows that United States imports, especially from the European soft currency countries, during the first months of 1951 were at levels two to three times as high as the average for 1949. Although exports from the United States had also increased in that period, the net result was still a considerable reduction in the dollar deficit on current account which the European countries and Canada incurred with the United States. Sweden actually changed from a dollar deficit to a dollar surplus country due to important price increases in wood pulp and other export products of importance in her trade with the United States. Restrictions against dollar imports, however, continued to exist so that to an extent such a dollar surplus should be considered somewhat artificial.

Table XXI. United States exports and imports from selected industrial countries[a], (millions of dollars).

	Monthly average 1949			January, 1951			February, 1951		
	Exp.	Imp.	Trade Deficit	Exp.	Imp.	Trade Deficit	Exp.	Imp.	Trade Deficit
Belgium	25.6	6.9	18.7	24.9	19.5	5.4	29.2	19.2	10.0
Canada	163.3	129.2	34.1	195.7	184.4	11.3	194.3	153.8	40.5
Netherlands	23.7	4.9	18.8	17.0	9.4	7.6	19.0	9.7	9.3
Sweden	7.1	4.5	2.6	8.1	10.8	-2.7	7.8	8.9	-1.1
Switzerland	11.9	7.8	4.1	13.3	10.9	2.4	14.7	10.6	4.1
United Kingdom	58.4	18.9	39.5	41.9	37.3	4.6	55.4	38.6	16.8
Total	290.0	172.2	117.8	310.9	272.3	28.6	320.4	240.8	79.6

[a]Source: U. S. Department of Commerce, Survey of Current Business.

Because of changes in her own trade and in the trade of her overseas territories, the United Kingdom was able to improve her dollar position radically during 1950. The gold and dollar reserves of the sterling area as a whole increased by $1.6 billion during the year to a level almost as high as the 1938 figure, although the purchasing power of this reserve remained, of course, far below the level of 1938.[23/] This improved reserve position of the United Kingdom opened possibilities for continental European countries to earn dollars through export surpluses with the United Kingdom.

An important favorable factor in the position of the countries under review will certainly be the increased demand of third markets, both dependent and independent overseas areas. Since this new demand is caused by the larger dollar earnings of these areas from the exports of rubber, tin, wool, and coffee to the United States, European countries will here have a real opportunity to offset their persistent trade deficit with the dollar area. The higher prices for primary products and the continued recovery of these areas from the war will result in export surpluses, which are able to play a very important role in the international payments system. There would, of course, also be an increased demand for the manufactures of the United States in competition with European products but the currency depreciation of 1949 improved Europe's competitive position and with the recovery of that continent the flow of goods to the third markets already had been increasing compared with the early postwar years. The new situation with respect to the demand in third markets, however, is not one in which Europe and the United States are competing to satisfy an existing and constant

23/ Source: British Information Services, Labor and Industry in Britain, June, 1951.

demand, but rather the total demand has increased considerably so that both Europe and the United States may be able to expand their sales. Before the impacts of the mobilization were felt there was very little incentive and opportunity for the European countries to expand their exports to these areas since this would not solve the dollar problem.

Whether or not actual trade will flow along the lines discussed above depends largely on the elasticity of production in Europe and on the part of production that will have to be diverted to defense. A return of Germany in the markets of under-developed countries would do much to improve western Europe's dollar position since German exports have traditionally consisted of machinery and capital goods desirable for development purposes. In spite of the serious obstacles discussed above the current situation has potentialities of improving the payments position of industrial European countries and Canada if sensible domestic economic policies are adopted and if serious efforts are made to increase the mobility of resources so as to benefit from the new export opportunities to the United States and third markets.

In summary, the most important problem now confronting western European countries is how to benefit from the increased demand in the United States and in primary product exporting areas while maintaining domestic stability. The weight of additional military expenditures, although not as large as in the United States, presents the countries with serious problems in maintaining economic stability at a time when most resources are already fully employed. The problem is very difficult since a further drain of the financial reserves cannot be permitted to finance new imports and since the terms of trade in general are turning against them as a result of large price increases in raw materials.

The position of Canada and Sweden appears to be more favorable than that of the other countries discussed. Here exports of woodpulp and other raw materials and semi-manufactures to the United States tend to improve the terms of trade and the balance of payments.

CHAPTER VI

SOME POLICY CONSIDERATIONS

The bold decision of the United States, supported by the United Nations, to resist aggression in Korea by force may be considered a basic change in the political leadership of the world. Both in the first and in the second World Wars the first blows were received by other countries and the United States was forced later into the conflict. In the post-World War II period wide recognition was given to the United States as an economic leader but since the outbreak of the Korean war it is clear that the three-fourths of the world population which are not under control of the Soviet Union look to the United States for political guidance and leadership. The privileges, but also the heavy responsibilities of this fact are becoming clearer every day to the American taxpayer. It is especially important to those in the American Government who have the responsibility for formulating a long-term foreign economic policy which corresponds sufficiently to the ideals upon which the American society is built and which is also sufficiently practical for the actual conditions of political insecurity, widespread poverty and scarce democracy.

The following remarks are, of course, only very sketchy and tentative since the number of variables is too large and each variable is too uncontrollable to make definite conclusions at this time. They are based on similar assumptions as already have been stated or implied above, namely:

(1) a political climate no less favorable than the second half of 1950;

(2) the continued necessity of a defense program on as large a scale as proposed by the President of the United States;

(3) a continuation of the policy objectives of the last six years, namely, a further liberalization of economic relations wherever and whenever economically and politically possible.

Immediately the main problem emerges out of these assumptions. Since defense mobilization is assumed given and indispensable, how can a coordination be made between this relatively short-run objective and the long-run objectives of any sound foreign economic policy? Both kinds of objectives are equally imperative. Is it possible that the political climate within or outside the United States is now psychologically favorable, dangerous as it may be, to press some economically sound measures, which might otherwise not be adopted by democratic processes? It would certainly be in the interest of the United States if such measures would be passed so as to strengthen the economic interdependence of and to increase the prosperity of the relatively free part of the world. In many ways, of course, defence mobilization will constitute a serious setback to the fulfillment of such objectives since precious resources which could be working for them entirely, are now engaged in producing destructive weapons. Nevertheless, there appear to be things which can be done even now to improve the situation.

During 1950 the apparent "dollar shortage" largely disappeared. As was shown above, high prices for primary products were mainly responsible for this development and the additional dollars received by the countries producing these products are, under certain favorable domestic and international conditions, in a position to finance additional imports of manufactured capital goods. Although the dollar deficit of industrial European countries with the United States declined, this area still had substantial deficits in the latter part of 1950. Moreover, in view of future armament needs it is conceivable that the trade gap will be widened again in the near future. The passive balance of payments with overseas areas had been Europe's most serious economic problem as soon as the worst phases of war destruction had been overcome.

Since the amount of goods that needed to be imported from the United States was extraordinarily large with the disappearance of Germany as a supplier and since the prewar triangular payments scheme, through which Europe earned dollars with its export surpluses to other overseas areas, had been disrupted, European countries became much more "dollar conscious" in that they stimulated direct exports to the dollar area in many ways. However, this export drive was none too successful. The volume of business activity in the United States is a most important variable in determining changes in the volume of imports originating from Europe. An additional problem for this period was the limits on the productive capacity of European countries due to war destruction and dislocation. A third factor is the structure of United States tariffs. It is generally considered that the type of manufactured products imported from Europe is rather price inelastic. Because of this, many people are led to believe that neither the lowering of prices nor the removal of tariffs can increase the volume of European goods imported into the United States appreciably.

The structure of American tariffs is such that the effective duty increases with the degree of manufacture a certain product has undergone, with the result that primary materials can enter the country relatively easily while many manufactured goods find the tariff rates prohibitive. Since Europe is mainly dependent on exports of manufactured goods this policy has in effect, led to severe discrimination against that area, which, in the opinion of the ECE 24/ probably was no less severe than the direct restrictions on imports of dollar goods prevailing in many European countries in the immediate postwar period. 25/ The Commission shows how duties on certain categories of woollens and worsteds, although less than half their rate in 1939, still amount to between 28 and 35 percent. 26/ This may suggest that the existing tariff structure, although much less severe than during the '30's, is still able to exclude exactly those products in which Europe's competitive strength is largest and that, therefore, perhaps the low volume of imports into the United States from Europe is caused by the existing tariff structure and not by the low price elasticity. The latter, in this way of reasoning, would then be a direct result of the existing tariff structure. Whatever the actual situation may be, the ECE carefully expresses itself as follows:

> "If optimistic assumptions might be made with regard to a consistent set of policies by European exporting countries and by the United States, there would seem to be no very definite limits that might be assigned to the expansion of European sales in the American market, particularly in such items as woollen textiles, chinaware and leather goods, all of which are products in which Europe seems to have a competitive advantage owing to smaller differences in productivity compared with industry in the United States than in other branches of production." 27/

This statement also seems to point at the fact that by eliminating differential tariffs and facilitating the imports of manufactures in

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24/ Economic Commission for Europe of the United Nations.
25/ United Nations, Economic Survey of Europe in 1949, p. 160.
26/ *Ibid.*, p. 178.
27/ *Ibid.*, p. 178.

general, more price elasticity can be introduced in United States imports from Europe. A lowering of the marketing margins through larger scale imports may further contribute to increase the import price elasticity.

The United States cannot insist on reciprocal and equal percentage tariff reductions when other countries start off with lower rates even without consideration of the necessary leadership of the United States. The temporary obscuring of the "dollar shortage" by factors of defense mobilization does not mean that the world, including the United States, will not benefit from such a fundamental improvement in international relations. While to an extent this has always been true, the argument is that the United States as a leader should now proceed, alone at first if necessary, to continue to lower tariff rates. The political arguments against it have gradually lost most of their validity and under present conditions perhaps also most of their popular support for several reasons:

(1) Annually billions of dollars are spent on military and economic aid abroad. If other countries can earn more dollars by exporting to the United States this may well mean a smaller need for these sums of taxpayers' money.

(2) Increased imports into the United States at a time when inflation threatens to unstabilize the economy will constitute an anti-inflationary factor.

(3) The circumstance that with high levels of economic activity, industries adversely affected by competition will find more profitable alternatives elsewhere in the economy.

Another factor which may gain importance in later years is that an import surplus into the United States would create a most favorable atmosphere for an outflow of capital investment. The general opinion would perhaps be unaware of this factor but Sir Arthur Salter points at the British experience previous to World War I and explains it by the facilitation of transferring interest payments.[28]

As was pointed out in Chapter V, European countries also are in the process of adjusting their economies to the needs of their substantially increased defense programs and, therefore, also experience inflationary pressures. These pressures appeared rather stronger than weaker compared to the United States situation. All defense programs, however, are temporary even if they may last for some ten years. Continued tariff reductions, however, constitute real and permanent gains if brought about wisely.

Changes in the restrictions on imports of manufactured products, however, limit their beneficial effect mainly to Canada and parts of Europe. Large parts of the world, since recently associated with the name "under-developed areas," are also in great need of a positive American economic policy. The situation brought about by the political events of 1950 appears to change certain policy goals previously held by the United States government and in the problems which now arise there is a great need to distinguish between relatively short-run defense goals and the long-run general goals which would need to be fulfilled anyway.

The Point Four Program, to be sure, was not born out of the Korean situation. Similar programs had existed at least ten years earlier in

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28/ Salter, Sir Arthur, Foreign Investment (Essays in International Finance, No. 12, Princeton University), p. 6-7.

cooperation with certain Latin-American countries. The implementation of the objectives stated in the presidential inaugural address in January, 1949 seems to have gained new impetus in view of the fact that economic improvement is considered basic to maintaining a reasonable political security. The objectives then of "making the benefits of our scientific advances and industrial progress available for the improvement and growth of under-developed areas"[22] have not changed at all but the means of implementing these policy goals, such as technical and capital governmental assistance, the role of private enterprise and the role of defense requirements of the non-Soviet world, are to be seen in a new light.

As was discussed above, many primary product exporting areas have experienced a substantial improvement in their balance of payments and terms of trade, thus far mainly because of increased stockpiling activity of the United States and other western countries. In view of the fact that the actual rate of consumption of primary materials will also increase with the maintenance of large defense programs and that new backlogs in the demand of countries such as the United States will certainly guarantee high levels of economic activity for a number of years after the defense program will have disappeared, it seems reasonable to suppose that the improvement in the terms of trade of primary materials will remain for perhaps a period of ten years. It was also seen above that it is not at all certain whether the newly available dollar resources will be used for constructive development or for increasing temporarily the food supply, or will be lost in inflation.

22/ Inaugural Address by President Truman, January 20, 1949. Excerpt in: Partners In Progress, Report by the International Development Advisory Board, p. 91.

But on the assumption that at least a considerable part of these resources will be available for constructive purposes and also assuming that no serious impediments will arise with respect to the availability of capital goods in industrial countries, it is perhaps wise for the United States to shift temporarily the emphasis of development programs from more capital assistance to more technical assistance. Unless impartial and wise guidance is exercised in the formulation of the development programs of these countries, premature ambitions rather than urgent necessities may dominate. Here, of course, there is a limitation to what any American policy may bring about. The other countries are not likely to tolerate any inroads on their sovereignty even if economically speaking a program might be sound. Mr. Eugene R. Black, President of the International Bank for Reconstruction and Development stated this problem as follows in an address to the Twelfth Session of the United Nations Economic and Social Council at Santiago de Chile:

> "Idleness and inefficiency, corruption and unstable government can be heavier drags on progress than lack of capital, and indeed, are likely to be among the root causes of a lack of capital. Of all the desirable reforms, the reform of land tenure is probably the most important. The economic development of a country is primarily the responsibility of the country itself. It is not something which can be imported from abroad but must be won internally by acceptance of responsibility, hard work, and sacrifice. Once these factors begin to appear, external capital may be used effectively. 30/

The outlook for a flow of private capital has probably experienced a serious setback after the Korean events. As far as the United States is concerned, it appears now to be almost prohibitive to invest any private funds whatsoever outside the western hemisphere. In view of this fact and the continued fear of expropriation, it is surprising

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30/ International Monetary Fund, International Financial News Survey, Vol. III, p. 278.

that the International Development Advisory Board in its report to President Truman stresses the role private enterprise is expected to fulfill.[31] On the contrary, it would appear that governmental assistance would be much more appropriate in the anticipation of an improvement in the political situation. The great danger is, however, that short-run defense objectives will dominate in the formulation of American policy. It may be very urgent to increase the rubber or tin production of certain Latin American countries but it remains equally urgent to reconstruct the transportation systems of such countries as Indonesia. The effect of the second World War has been precisely the former so that the western hemisphere became much more self-sufficient in both primary materials and manufactured products while other regions became more dependent on imports from the western hemisphere. A long-run equilibrium, therefore, will not be obtained if the United States will engage in a regional self-sufficiency program rather than in world wide development.

Another aspect needs to be mentioned briefly. The formulation of capital depends on the level of income after taxation. If the United States would pay for the entire defense program out of current taxation, the amount of capital that could possibly be invested abroad by private investors would certainly tend to decrease. The Advisory Board on the other hand, envisages an expansion of the annual capital outflow from the United States from $1,000,000,000 to $2,000,000,000. This does not seem to be realistic in the coming decade, however desirable it otherwise may be. The need for this capital outflow, however, is apparent and the government may, therefore, decide to take part in this investment.

31/ Partners In Progress, op. cit., Chapter 8.

It seems to be an irony of fate that the West, already having full employment of its resources, is now urged to build up an adequate defense machine, and at the same time, has to embark upon a world wide development program while its fertile resources lay idle for almost ten years previous to World War II.

In summary, the following general conclusions with respect to an appropriate United States foreign economic policy in the present conditions were explicit or implicit in the above discussion:

(1) The United States should continue to proceed towards further liberalization of trade among the relatively free countries of the world, and, if necessary, should lower her tariffs unilaterally.

(2) Emphasis of foreign development programs should be directed, for the duration of the mobilization, towards supplying impartial technical assistance rather than large capital gifts, in countries benefiting from high primary material prices.

(3) The United States should continue to make available the necessary exports of capital goods to the under-developed areas of the world.

(4) The immediate defense needs should not lead the United States towards a regional self-sufficiency program within the western hemisphere. Instead, the pooling of strategic stockpiles within the allied block would provide adequate political safety, as far as possible while no serious economic maladjustments would be created.

(5) For the duration of the political turmoil private capital should not be expected to fulfill the objective of economic development.

(6) Above all, the United States should coordinate her foreign economic policies with those of other countries individually, and also with the United Nations agencies engaged in similar programs.

CHAPTER VII

SUMMARY AND CONCLUSIONS

Economic developments in virtually all countries of the non-Communist world have been profoundly affected by the outbreak of the Korean war in June, 1950 and by the subsequent decisions of the United States and many other countries to increase their defense preparedness rapidly. Throughout this report it has been assumed that this reversal in the post-World War II defense policies of western countries constitutes an important structural change the economic impacts of which will be felt for a considerable period of time, at least a decade. These economic impacts may be divided in primary and secondary impacts. The primary impacts consist mainly of price rises of various proportions. The secondary impacts will be the changes in the cost of production pattern as a result of these price rises and the adjustment of international trade and international economic policies to the changed situation.

In the present situation the United States has emerged as both the political and the economic leader of the non-Communist world and in view of this fact, it is the immediate interest and the grave responsibility of the United States to see to it that the increased defense armament, the effects of which are propagated abroad especially by changes in the trade and prices of primary materials, will have the least possible disturbing effects on the sound economic development of other countries. Indeed, if at all possible, the changes in attitudes and economic conditions of the western world should be utilized to improve the situation.

The price rises of primary materials during 1950 which appeared for the most part to level off by the end of that year, affected virtually all products but especially certain strategic products produced in strategic areas. Rubber, tin, and wool registered the largest price gains. In December, 1950 these commodities found themselves at price levels respectively 150, 87, and 82 percent above the ones in May, 1950, the last month before the Korean outbreak. Industrial primary materials, as a group, rose about 45 percent in price during the latter half of 1950 and the prices of primary foodstuffs entering international trade rose about 10 percent in the same period.

Many so-called under-developed countries are dependent on a small number of primary materials as a source for nearly all their foreign exchange while domestic production supplies only a very small proportion of the manufactured goods consumed. In view of the short-run, inelastic supply of their export commodities, fluctuations in the prices of these commodities are large as are the fluctuations in the countries' national incomes. Over the 70-year period since 1880, however, prices of most primary commodities have become more and more depressed relative to prices of manufactured goods. Recent price changes have been upward and since prices of manufactures are only slowly catching up, the purchasing power of many primary commodities has been increased. With the large scale armament prospects and the resultant virtually guaranteed high levels of economic activity in developed countries for the next decade, the amount of foreign exchange available to less developed countries is definitely expected to remain at much higher levels than previously.

An attempt was made to measure quantitatively the effect of the 1950 price rises in primary products on specific countries. For this purpose the 1949 volume and constitution of each country's exports was taken as a base and then recalculated to obtain an estimate of the increases in export revenue which would occur due to price rises between the 1949 average and December, 1950. Since import prices rose also during this period the results do not represent the net improvement of each country. Furthermore, during the first part of 1951 it was seen that prices of primary products had not yet found a new equilibrium. The quantitative estimates therefore are only a momentary picture.

The following figures are the percentages export revenue was estimated to increase over the actual amount in 1949: Malaya, 215; Indonesia, 91; Australia, 77; Brazil, 64; Colombia, 57; and Venezuela, 3. The position of the Union of South Africa is complicated by the importance of gold in her exports.

Under the stated conditions the selected countries could dispose over an annual additional amount of foreign exchange in terms of United States dollars of about $3,200,000,000. Of this amount, Malaya would receive $1,026 million; Australia, $1,011 million; Brazil, $527 million; Indonesia, $436 million; Colombia, $174 million; and Venezuela, $36 million.

This does not mean, however, that the economic problems of the so-called under-developed regions are now solved. The new financial resources may well be used unproductively either by private individuals who dispose of them as additional personal wealth or by governments which lack the capacity or the will to embark upon an all-around sound economic development program. On the other hand, potentially the opportunity appears to exist to utilize the resources productively to maintain or obtain a better balanced economy and to increase political and economic stability. There is a great need, however, to obtain impartial technical assistance from the more developed countries on a large scale. Especially serious is the circumstance that at present technical assistance programs sponsored by the United States alone may well be devised so as to fulfill relatively short-run defense objectives which, in the long-run, may be detrimental to a sound development of the world.

As the situation existed in early 1951, it appeared that those primary product exporting countries which are already developed to some extent, will have a much better chance to benefit from the price rises than other countries which will tend to feel the price rises in the first place as a disturbing, e. g. inflationary factor. Much will depend, however, on the foreign economic policy adopted by the United States.

The industrial area of western Europe is affected quite differently and also quite considerably by the recent defence developments. The deterioration of its terms of trade as a result of higher import prices for primary products tends to affect western Europe similarly to North America. However, the importance of this deterioration in terms of national product is much larger in western Europe and the inflationary impact of this factor is therefore more severe in Europe than in the United States. Actual rearmament will take place on a larger scale in North America than in western Europe although substantial increases will occur also in the latter area. The still precariously low levels of reserves and the balance of payments difficulties of many western European countries present an additional problem to them as contrasted with the United States.

The indices of the cost of living increased in all countries. In

Switzerland, Sweden, and the United Kingdom, these increases were between one and two percent from May-December, 1950. In Belgium and Canada the increase was about four percent, in the Netherlands five percent and in the United States six percent.

Wholesale prices increased much more and along a different pattern so that it was not clear in which area actual inflationary pressures were highest. May-December, 1950 wholesale price increases were as follows: Belgium, 20 percent; the Netherlands, United States, United Kingdom, and Sweden, between 12 and 15 percent; Switzerland, 11 percent and Canada, 10 percent.

On balance, there are a number of favorable and unfavorable factors affecting the western European economies which are difficult to evaluate against each other. The unfavorable factors are mentioned above. The favorable factors are first, that total demand of under-developed countries for European products has been increased and that the availability of new dollar resources in these third markets will open the possibility of new triangular payments schemes. Secondly, and probably equally important is the fact that the United States as the bulwark of the entire non-Communist economy will continue to have virtually full employment for a number of years. In the past year there has already been considerable improvement in the European trade balances with the United States and this fact, together with the new export opportunities opened in third markets may aid considerably in relieving the "dollar shortage" problem, if proper policies are adopted by all countries.

The present economic situation and the state of mind of non-Communist peoples should be utilized to increase the interdependence of the non-Communist world. Continued liberalization of trade, payments and the movement of capital, indeed, the entire integration economically and politically of the area is not only attractive but also mandatory. Naturally, the aim should not be to obtain a permanently closed bloc. However, the goal of an eventual improvement in the relations between the two major areas of the world at present may well be served best by a demonstration of solidarity on our side. Whatever measures the United States will take to implement such objectives will be of tremendous importance to all other countries.

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