SUMMARY

It gives us much pleasure to publish in this issue two articles by Prof. T. Balogh, 'The Concept of a Dollar Shortage', and 'Should Sterling be Devalued', in which the author discusses the basic problems arising from the large-scale disequilibrium in the economic relations between the European countries and the United States, and revisits the need — if a sound and equitable readjustment is to be attained — of a strict policy of economic planning, the discriminatory unification of Western Europe as an economic unit and the planned expansion of European trade with the rest of the world.

Prof. Balogh thus takes up a position which is somewhat extreme, meeting with marked opposition not only in American circles and in Europe — which is now tending towards the liberalization of her economy — but even in Great Britain itself. The complexity of the proposal system of controls and their incessant manipulation and adjustment to the changing requirements of the economic trend may well give rise to serious doubts — and Prof. Balogh himself is aware of this —, especially in some European countries which have experienced the serious results of administrative clumsiness and inefficiency.

But Prof. Balogh's analysis, now succinct, now detailed, and his attempt to revive the principles of economic theory in the light of present-day reality, is decidedly stimulating. One might perhaps consider this 'new language' as the scientist's transcription of the great changes that have occurred in Britain's position. A critic might even suggest that objectives and responsibilities are regarded from an unilateral standpoint, the former is function of Britain, the latter as exclusively European. Undoubtedly some interesting historical precedents may be found and some pointed remarks might be made on this subject. But we think it is only fair, on the whole hand to pay tribute to respect of the vigorous realism tendency and to the unprejudiced analysis that characterise these two articles, and on the other hand, to draw attention to a passage that sums up well the transitional and alternative nature of the solution he offers, its implications — which are not only British but European and world-wide — his desire to secure an equitable distribution of income and opportunity on an international scale, and the recognition of the importance of international cooperation and of the path to which the Marshall Plan and Truman's Fourth Point lead: "The 'critics of multilateralism' are neither opposed to all "rules of the game" in international relations nor are they opposed to multilateralism if multilateralism is not conducted on the basis of rules which tend to perpetuate the inequalities of opportunity in the world. They want new rules which would energize the world to faster and more equal progress. The tenets of the general equilibrium theory, based as it is on given means, known "indifferences", perfect knowledge, must not be used to discuss problems of growth and problems arising out of the economic contacts of different civilizations at different stages of their technical progress. Should the richer countries consent — in proportion to their recovery and wealth — to promote technical and economic progress in the poorer areas systematically, through grants and (low interest) loans, this would obviously represent the most desirable solution, far superior to a system of planned and graduated discrimination."
The Concept of a Dollar Shortage
by THOMAS BALOGH

The breakdown of the policy of convertibility of currencies, provided by the Bretton Woods agreement, within a few weeks after its first test in 1947 undoubtedly caused some discomfiture among its erstwhile advocates (1).

This had failed to appreciate the gravity of the European economy, and had hoped, rather naively, to be able to emerge from the breakdown of the world economic system of 1938 by trusting to the "free" market forces. Fortunately we did not have to pay the full penalty for taking the advice.

The worsening of the international political situation resulted in a reconsideration of U.S. policy. The rigid dogmatism of Mr. Cordell Hull and Mr. Clayton was superseded by the more flexible approach of general Marshall and his expert advisors. A catastrophic fall in the standard of life and of national economies, which had previously been decomposed, this is due to the obstacles and delays in its application, caused partly by procedural hindrances and partly by the drain of resources on the Italian market which often makes unwise the absorption of the grants for domestic concerns.

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tions and advice of the most highly practical character. Professor Haberler's "equilibrium" position, implicitly taken as an "optimum" discloses his view of the nature of the "world economy" which underlies his policy recommendations. It demands that a country's international payments (perhaps excluding capital flight) should be made to balance without any direct controls over payments, without quantitative restrictions, and without resorting to crude protectionist policies which, even if they succeeded in alleviating transitional strains, would do so only at the cost of permanently impeding the international division of labor and preventing the optimum allocation of resources.

The proof which has to be furnished by Professor Haberler in order to establish his case is not whether the United States is able by retaliatory action to enforce convertibility and nondiscrimination. No one doubts that threats by the United States with her overwhelming military and economic power would be effective. The question is who has the ethical justification for the United States to use her power to enforce the rule of the unfettered price mechanism on other countries. An attempt will be made in this paper to show that the "model" as Professor Haberler's policy recommendations have no conceivable relations to the world we live in. Consequently Professor Haberler's "optimum" is devoid of any scientific meaning. Mr. Truman, General Marshall, and their expert advisers have successfully penetrated the fog and uncertainty created by the orthodox expert, and tack-

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1. Let us first turn to the so-called "long-run" problem, i.e., disregarding, for the moment, monetary disturbances. We need not suspect Professor Haberler of having a physical maximum in mind when he discusses the goal of his policy: though the phrase "optimum allocation of resources" might be interpreted in the sense of the point yield maximum physical product. This concept, in the sense that the same output could not be achieved with less effort or a greater output with the same effort has no economic relevance whatever reference to the distribution of the product. Should he think of maximizing some quantity of "utility", or reaching "higher indifference levels", his difficulties are not less. Only if the following conditions were satisfied - they partly are not - would his optimum have any meaning (and we shall see not much meaning at that):

- the original endowment of the units participating must be given, unchangeable by policy and distributed optimally (whatever that may mean). There must be full employment;
- there must be a given set of "social" technical knowledge in the wider sense of the term: they must not be subject to alteration by conscious policy involving international trade;
- perfect competition must prevail within (and between) countries; moreover, there must be free internal mobility of factors;
- the relative weights between social and private costs must be proportionate and must not be influenced by risk induced by foreign trade,

i.e., comparative advantages must be large and unchanging (2);
- absolute international immobility of all factors including capital.

If these conditions are not fulfilled, "non-discrimination", commercial and monetary, would certainly not bring about an "optimum".

The first condition is certainly not fulfilled because quite apart from any other difficulty - of the vast increase, during the war, of inequality of opportunity and means between the United States and the rest of the world. Professor Haberler is guilty of free-throwing total and marginal conditions and neglecting increasing returns. He has also fallen foul of a fallacy already discovered by Marshall in failing to inquire into the distribution of original endowments. Indeed, one might say that almost any position which resulted from some discriminatory action turning the terms of trade of the United States against her would seem to fit the description of "optimum" better than which would be brought about by "non-discrimination".

Moreover, and this is perhaps even more important, every single one of the other conditions required to justify Professor Haberler's "optimum" is violated in such a way as to lead the dice cumulatively in favor of the United States. Thus the "optimus" of Professor Haberler and his colleagues must be rejected as false.

2. The concept of a definite "long-run equilibrium" towards which the system is tending, is still subject to the gravest doubt. Professor Haberler, as we have seen, invokes high authority for, instead of proving, his dictum that it is "comparative" and not absolute costs which determine trade. If taken literally, this statement is obviously untrue. Comparative costs are unknown to entrepreneurs or governments conducting trade. They act in the absence of direct controls on the basis of money prices and exchange rates. It is wholly illogical to assume that money prices are proportionate to long-run real social costs. We know that neither private money costs are proportionate to social real costs, nor are prices proportionate to private money costs. Moreover it is ill-advised to assume that the free market system possesses an inherent mechanism which would restore proportionality between these three sets of variables, i.e., maintain a full employment. Comparative costs might be said in any meaningful sense to determine foreign trade only if equilibrium in the sense of conditions (1) and (2) of the previous section has already been reached and therefore prices have risen to the current account of any participating country.

But these conditions rob Professor Haberler's arguments of such relevance as it might still possess.

If a large-scale disequilibrium has arisen the concept of the eventual equilibrium position has no sense independently of the path taken. Its position will be determined by the path of readjustment. The path itself, however, is determined by absolute costs and monetary factors.

Sustained inflation (or deflation) e.g., in a leading country will decrease (or increase) its competitive power and therefore will lead to the appearance of disequilibrium in the non-European countries (in comparative costs) which are likely to persist after the original disequilibrating effect is removed. In any case the enforcing of secondary readjustments by the restoration of the equilibrium of the country originally responsible for the disturbance might well depress opportunity costs to zero in other countries.

There is no earthly reason, for instance, why a country could not "underwrite another on the line" (6) provided loss of reserves takes place on the part of the deficit country. The short-run elasticities, which seem extremely low (whatever they may be in the long period), will further impede readjustment and may result in substantial lowering of the standard of life - through a worsening of the terms of trade - of those on whom readjust-
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1) that discriminatory methods will lessen the required extent of readjustment of the weaker countries, and
2) that discrimination will also produce a more equal international distribution of income and opportunity.

are based on a model of the international economy which a priori excludes a discussion of the problem which the writers set out to investigate (14).

(14) Mr. MacDougall's further interesting attempt at demonstrating (Notes on Britain's Bargaining Power, in a lecturers' Economic Papers, New Series, November 1949) that Britain's bargaining power as a large country and as a large country does not appear as it sometimes thought is based on a similarly static and equally irrelevant model. His concept of exploitation represents an illi- indicated application of the tools of equilibrium analysis to problems concerned with extreme disequilibrium. Moreover, as the margin of production the effects of the extension of the output of primary products is much greater than that attached to manufactures (because the supply and demand for them is infinite), the advantages of unbalanced markets and, therefore, of Britain's capacity to reduce the risks of primary production cannot be measured by the percentage which Britain's trade represents in world imports of individual commodities or other manufactured exports. In earlier writings (An Economic Journal, September 1948) MacDougall maintained that the ratio of a country's total exports to exports to Britain was a fair measure of Britain's bargaining power. On being shown that Britain might not be a sufficiently important market for certain products, the production of which might not be easily doubled or diminished (cf. my article, Discrimination, in a Bull. at), he expressed (in a letter to me 1949) his desire to undertake a detailed investigation of the import structure of the United Kingdom by countries and commodity markets. He calls attention to the fact that Britain's trade in textiles represents an appreciable share of their total export trade and invests the relation of their export earnings to their total income. He concludes that Britain a vulnerable country because the types of the textile commodities to which they are most exposed are also the ones on which the other countries are most exposed, as a result of which a large proportion of their demand for manufactured exports from other countries might be met by other textile products. This conclusion is based on the idea that textile industry can be a major factor in the international economy, and that the demand for textiles is more sensitive to changes in the balance of trade than is the demand for other manufactured products. The conclusion is also based on the idea that textile products are more likely to be affected by changes in the balance of trade than other manufactured products.

Unconditional multilateral non-discrimination and convertibility - which underlie both I.T.O. and Bretton Woods - stand condemned as neither just nor workable under present conditions. They were unjust because they would have nothing but a simple extension of the doctrine of classical welfare economics based on a closed and perfectly competitive economy to the infinitely more complex problems of the present world economy.

Even for a closed economy the whole analysis depends on the assumption that perfect competition and perfect foresight prevail. Moreover, even perfect competition, the integral counterpart of the free-trade dogma, could not be demonstrated to bring about an optimum distribution of income and opportunity unless the distribution of resources and output could be demonstrated to achieve this distribution. The distribution of wealth between a modern community possessing and using the full, all the paraphernalia of taxation and social services remains an illusion in the sense that inequalities exist which cannot be attributed to the need to stimulate output. If the conclusions of classical welfare economics cannot be applied to the case of a closed economy, it follows that the conclusions of classical welfare economics cannot be applied to the case of an open economy.
provide, much guidance to domestic policy, still less do they apply in international relations, where there is no taxing power and any redistribution of international wealth and income can only come about by way of unilateral gifts and default or by a conscious modification of the terms of trade.

The "critics of multilateralism" are neither opposed to all "rules of the game" in international relations nor are they opposed to multilateralism if multilateralism is not conducted on the basis of rules which tend to perpetuate the inequalities of opportunity in the world. They want new rules which would energize the world to faster and more equal progress. The tenet of the general equilibrium theory, based as it is on given means, known "indifferences," perfect knowledge, must not be used to discuss problems of growth and problems arising out of the economic contact of different civilizations at different stages of their technical progress. Should the richer countries consent—proportional to their recovery and wealth—to promote technical and economic progress in the poorer areas systematically, through grants and (low-interest) loans, this would obviously represent the most desirable solution, far superior to a system of planned and graduated discrimination. But the latter in turn is preferable to the status of general equilibrium. It would be insane to try to achieve a balance in the international payments of the United States by reducing her agricultural output to domestic requirements (or below). It is clear that an agricultural revolution is taking place which will violently change value-productivity per man in agriculture, and the future "opportunity" cost relations are wholly incalculable. Moreover the world needs the United States output and the domestic social consequences of the "free" play of forces would be most undesirable (15). The alternative of systematic grants, however, could not be considered practical politics prior to the Marshall-Truman declarations. It should gradually be extended by the participation of European countries in the grants to underdeveloped territories, after they have themselves recovered.

With the inauguration of the Marshall Plan a splendid beginning has been made for the reconstruction of a multilateral world economy. For its full fruition, however, certain permanent changes in the structure of the world economy will have to be envisaged and promoted. The first and foremost condition of success is the clarification of the United States policy in diminishing the strain of readjusting the world dollar balance after the prospective end of Marshall Aid. This demands (a) unilateral United States tariff concessions to increase direct imports from the U.S. (16), (b) toleration of a system of discrimination against the United States within Western Europe and in Western Europe's trading relations with other countries, i.e., the revision of the Havana Charter; (c) indication of two or more United States domestic policy in managing demand at home; (d) indication of the magnitude of deferred loans or grants to develop certain fields; (e) a task before the United States help, instead of being dedicated to building up a viable regional unit, was to maintain strongly national units whose position in a newly non-discriminating, multilateral, world will be so weak and unstable, as to compel at the first stress, whether caused by a reappearance elsewhere of cyclical fluctuations or because of the steady unfavourable trend of the terms of trade.

Much educational work has to be done in this respect. We must obtain the consent and cooperation of the United States in the organization of a strong European economic unit (19)—which for a period far longer than Marshall Aid would demand consent by the United States to preferential arrangements both within Western Europe and between Western Europe and certain complementary outside territories. Yet even enlightened economists with obvious sympathy for the plight of Europe interpret this plea as a distrust of and hostility to United States prosperity (20). Nothing is further from the intention of those who advocated a close economic co-operation of Europe. What should be attempted in the interests of all is to prevent a widening discrepancy between the United States and the rest of the world and the tendency by the United States under the slogan of non-discrimination to secure a monopoly of, and prevent others from developing, industries with the greatest degree of increasing returns, which would inevitably result in the widening of the difference in the standard of life.

