The Disintegration of the International Division of Labor

Introduction

The international division of labor was an achievement of the spirit of Liberalism. International trade has to some extent existed from the oldest times. There was a regular commerce in some commodities the production of which was limited to special geographical conditions. There was occasional trade when some extraordinary event offered unusual opportunities. But however important the civilizatory consequences of this international traffic were and however important its amount was when compared with the technical difficulties that transport had to overcome, the role played by it in supplying the wants of the markets was negligible. A very small part only of the common man's daily consumption was dependent on foreign produce. The commodities imported might for the most part be regarded as luxury goods, as people could do without them without suffering too great privation. At the beginning of the nineteenth century Napoleon's continental blockade even if it had been strictly enforced would not have had any noteworthy consequences on the daily consumption of the masses in Central Europe. In those days for the ordinary man's supply of even sugar (of course, in those days cane sugar only) and cotton were luxuries.

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The growth of international trade was due to the abolition of the greater part of the trade barriers which misguided fiscalism and the errors of mercantilist policy had erected. Liberalism broke them down and thus paved the way to unparalleled intensification of international trade relations. When Cobden and Bastiat were at the zenith of their prestige it was the universally accepted belief that trade barriers were doomed to disappear forever like the other remnants of a dark past, such as absolutism, superstition, intolerance, ignorance, and wars.

The theory of foreign trade as stated by Ricardo has proved in an irrefutable way that free trade only ensures the highest productivity of the economic efforts and that every kind of protectionism must necessarily result in a reduction of the output of capital and labor. For a hundred and twenty years a flood of books and pamphlets has endeavoured to invalidate the teachings of this theory and to show that some good might be reaped from protection. They have all failed. They could not disprove that as far as the supply of the consumer with commodities and services is concerned free trade is more efficient than any other system. Never has any proposition been brought forward that could shake the foundations of the free trade doctrine.

The most famous objection once was the infant industry argument. But everything that could be said about the inability of newly established industries successfully competing with old and well-established producers holds good in both cases whether the competitors are of the same or of different nations. That nobody likewise ventured to demand protection for new firms starting a new business against the overwhelming competition of older firms working in the same town, district, or country can already be considered as a proof that the argument is not economic but political. Of course, every new plant has to meet difficulties of different kinds until it runs smoothly. There are drawbacks which make the business bad for a longer or shorter period of initiation. If there is no prospect that these losses will be over-compensated by later success then the foundation of the new plant is not a paying concern. Then it is a waste to add new firms or plants to those already existing. In this respect it makes no difference whether the new center of production is working in the same or in another country. Many historical examples prove that industries have been shifted in the same country from a center of less favorable to a center of more favorable conditions, although no protective measures sheltered the infancy of the new establishment. In these cases in the calculus of the entrepreneur the losses of the beginning were outweighed by the later prospective gains. Protection was not
necessary for the impulse. Nor is it more wanted if the shifting has to take place between different countries. Examined more closely, the infant industry argument reveals its purely political character. It cannot be considered as a sound economic argument in favor of protection.

The infant industry argument played an important role both in economic writings and in policies. But economic history does not give us a single example of protection in infant industries that did not turn into lasting and enduring protection. The industries of America, and Australia and of the Eastern countries of Europe in their infancy amply enjoyed the blessings resulting from the infant industry protection argument. Now grown-up, they are still protected and even much more efficiently and there is no question of declaring them of age by abolishing their protection.

The infant industry argument is today a thing of the past. In the present world other arguments have to be credited with the responsibility of protectionism and its logical outcome: the aim of self-sufficiency. These arguments are: the argument of national prestige, the war argument, the wages argument, the over-population argument, and the monetary or foreign exchange argument.

I

The Argument of National Prestige

According to List, every nation has to go through different stages of economic evolution. At the highest stage the nation has not only developed agriculture but trade and industry too. Until a nation has reached this last and highest stage it cannot harmoniously evolve all its productive forces. From this philosophy all the nations of the world which were backward in industrial production inferred that not to have a modern industry and modern big scale production was a sign of inferiority. Whereas the Romantics in the industrial countries wish to bring back the bygone days of a more agricultural age, the Romantics of the agricultural countries yearn for the industrialization of their own country. They think that a nation whose wealth is based on agriculture and the production of raw materials only can never attain the level of moral and intellectual civilization peculiar to the leading nations of the Western world. They long for industry because they desire the perfections of modern culture.

[Friedrich List, a German economist in the 1820s and 1830s, favored free trade accompanied by tariff protection to stimulate the growth of infant industries as a country progresses through the various stages of economic evolution—Ed.]
This Romanticism is accountable for the fact that in the more agricultural countries the programmes of the nationalistic parties always include protection for industry and put much less stress on the wants of agriculture.

In pre-war days, when immigration into the industrial countries of Europe and overseas was still free, the foremost reason for this policy in many European countries was the aim to make emigration superfluous. Conditions for industrial production were in every respect more favorable in Central and Western Europe than for instance in the Balkans. With a policy of laissez faire the excess population of these nations which could not find employment in agricultural production had to emigrate to Central and Western Europe and to the New World. When the governments of these Eastern nations encouraged industrial production by strict protectionism they wished to reduce emigration figures. They considered emigration as prejudicial to the greatness and to the political and military power of their State. They were afraid of the fact that the emigrants would in their new settlements in the course of the years lose their attachment to their old mother-country, its habits and language and its civilization. The policy of protection for industrial production was a policy of national and racial self-preservation. Its aim was to keep the citizens away from the melting pot of the European West, the United States, and other American countries. Today this argument has lost its meaning. Immigration is no longer free; the excess population cannot emigrate because there are hardly any countries where immigration is possible.

In pre-war days the migration argument was valid not only in the agricultural countries of Europe, but even in one of the most industrialized countries, in Germany. When the German agriculture, especially of the Eastern provinces of Prussia, could no longer compete on an unsheltered market with the agricultural production of more fertile countries like Russia, Rumania, the United States, Canada, and Argentina, Germany step by step progressed on the way to protectionism, because it wished as far as possible to reduce emigration losses. But we have not to dwell on this point any longer as today international migrations on a big scale are impossible.

In the opposite way in which the regard for population figures influenced the commercial policy of the countries which were relatively over-populated and therefore countries of emigration, the population argument influenced the relatively under-populated countries. These nations—in the first line the countries of Latin America—wished to increase their population figures by more immigration;
protection was, in their eyes, one of the means of attracting more hands. But this too now belongs to the past.

Under present conditions, where migrations are reduced to a minimum and where no important country is ready to open its doors to newcomers, such considerations no longer play any role at all. We shall speak of the part played by the immigration barriers later in the essay.

II
The War Argument

The foremost reason for protection and the drive towards self-sufficiency in the world today is the war motive. For the militarist countries the readiness to make war is the primary goal of their policy and war itself the regular means of attaining their objects. They therefore consider peace nothing but the time to prepare the coming war. The economic activities of the country have already in peace time been organized in such a way that they may later serve the interests of war. This scheme includes self-sufficiency for all kinds of produce necessary to a war-making nation.

When the Liberals recommended free trade and international division of labor they did so because peace among all civilized nations was the cornerstone of their political creed. We have to realize that the conditio sine qua non of international free trade is goodwill and peace among nations. Division of labor and war are incompatible. The division of labor within a country presupposes peace between its different parts and districts. In the Middle Ages and even later, when the division of labor was hardly developed, it was possible for single towns and countries to go to war with each other. As every part of the country produced everything which was needed in war time, war-making did not present problems of supply of food, equipment, and arms. The belligerent parties wanted money with which to conduct the war; but if they had it, they could buy what they required.

Things are entirely different in the modern world of international division of labor. The European countries rely more or less on food-stuffs and raw materials imported from abroad. The manufacture of modern arms and war material is only possible in highly specialized big scale enterprises which must have been working already in peace time in order to run smoothly in wartime. A nation which does not produce all the raw materials and foodstuffs and all kinds of arms and military equipment within its borders would in time of war lack them.
When since the nineties of the last century Germany started its preparations for a decisive war, its economic provisions were limited to the supply of food. Protection for agriculture was among other reasons actuated by the necessity of making the country independent of foreign supply in war time. But nobody realized that a belligerent country could suffer from the lack of materials other than foodstuffs. It was the experience of the World War\textsuperscript{2} that taught this lesson.

Today these Powers who regard war as the means of satisfying their "dynamic" aspirations aim at self-sufficiency in order to be independent of foreign supply in a coming conflagration. It is these Powers which have in a systematic way evolved the theory and practice of self-sufficiency for the purposes of war making. Their endeavors have been intensified by the consideration of Article 16 of the Covenant\textsuperscript{3} providing economic sanctions against a nation going to war.

To attain self-sufficiency in war time these nations wish to become as far as possible independent of raw materials which have to be imported. They desire to replace the imported raw materials and foodstuffs by home production. They further the expansion of the production of food and raw materials which can be produced within their own borders by the most strict means of protectionism. They try to replace those raw materials which they cannot produce at home by substitutes manufactured in the country. In these efforts there is no regard for the cost of production. In the eyes of the supporters of this policy it is immaterial whether the cost of production of these suceedanea is many times higher than the price which has to be paid for the imported commodity. What matters only is that it can be produced at home. It was in this spirit that they proceeded to produce synthetic rubber, synthetic petrol, synthetic wool, etc.

In the reasoning of this militarist argument in favor of self-sufficiency there is nevertheless a striking error. Whenever modern technique succeeds in replacing a raw material hitherto used by a synthetic article which is at least not less efficient, and regard being had to its efficiency not more expensive than the natural product, it is obvious that the new article more or less drives the old article off the

\textsuperscript{2}[Bear in mind that this extract was written in 1938 and that the World War that Mises refers to here and throughout this piece is World War I—Ed.]

\textsuperscript{3}[The Covenant was a short concise document of 26 articles stating the purpose and intentions of the League of Nations. Article 16 said that all members promised to join in common action against any other which made war in violation of the Covenant; i.e., the breaking off of all economic transactions and other benefits with the Covenant-breaking state, and, if this were not successful, then of military action. This article also empowered the League's council to expel any member violating the Covenant—Ed.]
market. In this way madder was replaced by aniline. In this way silk and cotton have lost ground to artificial silk. Under such conditions the new article can no longer be called a substitute in the same way as a motor-car is not a substitute for a carriage or a gun not a substitute for a bow and arrow. But this is not the problem we have to deal with. The substitutes under consideration are poor substitutes and do not render better and cheaper services than the commodity they have to replace but are less efficient and more expensive. In the endeavors to find such substitutes one may one day invent something new which will give more satisfaction than the materials now in use. But for the moment we have not to reckon with vague expectations but with the present situation. We have to face the fact that nations wish to attain self-sufficiency by replacing some imported raw materials and foodstuffs by a home production which brings them a more expensive and less efficient substitute than the material they wish to avoid importing. But they believe that these disadvantages are compensated by the fact that the country becomes independent of foreign supply and will therefore not suffer from its lack in war time. They think that if problems of national defence occur, cost of production is negligible. What counts is only independence.

But this reasoning is fallacious. It is not true that it does not play any role whether the production of a material wanted for war-making is more or less expensive. Higher costs of production mean that the same amount of capital and labor produces less. If a belligerent country has to employ more capital and labor to obtain a given quantity of material they will not be so well supplied as their adversaries. Especially the fact that they will have to employ more hands for the production of the same amount of goods is a calamity. Those surplus hands will be lacking in the trenches, as men cannot fight and work at the same time. Already in the World War it was felt as a hindrance by the Central Powers that the production of war equipment absorbed too many younger men.

Then there is a second great inconvenience. The substitutes are less suitable than the materials they have to replace. If they were not less suitable they would not be succedanea but the right material and the adversary too would use them. The fact that one party is forced to use less appropriate material is a heavy handicap. The better equipped party will reap from its better equipment both a moral and a material advantage. It demoralizes even the best army to realize that their adversaries are better fed, better armed, and better protected against every evil than they themselves. Nothing in the World War discouraged the soldiers of the Central Powers so much as when,
capturing trenches of the Allies, they discovered that their adversaries were better armed, equipped, and fed than they were. Nobody can deny that the victory of the Allies was to a great extent due to the superiority of their material.

Then there is to consider that for the production of the substitutes some raw materials too are required. In very rare cases only these raw materials are available in the home market in sufficient quantities. Mostly they too have to be imported, because they are not produced at all in the country, or not in sufficient quantity. For the production of the textile by which Germany wishes to replace cloth, wool is wanted also and it is doubtful whether it may be possible to expand the German wool production to such a degree that it could produce the whole quantity needed. In any case, the expansion of the wool production can only be effected by restricting other agricultural production, as it requires soil which is scarce in Germany. If Germany or Italy try to produce substitutes out of wood they have to face the fact that their wood production does not suffice. When Italy under the sanctions planned to produce cloth from dairy produce it had to face the fact that its milk production too was limited and could not be expanded except by the use of imported fodder. The production of substitutes does not do away with the problem of raw materials, it merely shifts it to other branches of production.

It is the economic characteristic of the modern industrial communities that they cannot do without the import of raw materials which they buy by exporting manufactured goods. These modern industrial countries are thus in relation to the rest of the world in the same position as the centers of industry are in relation to the agricultural and raw material producing districts of their own country. Just as it is impossible for a town to wage a war against the country district which supplies it with food and raw materials, so it is impossible for an industrial country to wage a war against the rest of the world. This is the situation in which the industrial countries of Europe are today.

The Liberal economist deduces from this fact the necessity of international peace. He is of the opinion that war is incompatible with the present state of international division of labor. But the militarist who considers war making as the highest and noblest activity of a nation, believes that this international division of labor imposes slavery on his nation by preventing it from making war. His idea of independence is to attain a state of things for his country in which it could wage war against all other nations or against a group of nations without being dependent on foreign countries for supplies. Both Germany and Italy wish to be able to withstand a war against France
and nations allied to France without suffering from the lack of a supply of food and raw material. This does not mean that they really wish to attack France or that they think that France will attack them. We have not to discuss this problem. But they consider a state of things in which they are unable to have recourse to war as *ultima ratio* as an unbearable handicap. Freedom as they understand it is the readiness to go to war when the national leader thinks it necessary.

It is obvious that this conception of freedom is limited to big nations only. A small nation could never dare to formulate its claim for independence in this way. Hitler and Mussolini emphasize that their revendication is justified, because a big nation cannot live in conditions which may content a smaller one. They demand territories where they may produce raw materials on their own soil and when they declare that their nations are not satisfied they bear out this statement by demonstrating the unfair distribution of colonies and raw materials. It is especially in respect of coming negotiations concerning a redistribution of raw materials and colonies that they wish to be provided with self-sufficiency because they wish to throw the sharpened sword into the scale.

Now we may better understand the role played by self-sufficiency in the plans of these two Powers. They do not consider self-sufficiency of their nation within the actual boundaries of the national territory as a lasting but only as a temporary provision for the preparation of the coming war for supremacy. This is the war frequently alluded to by Hitler in his book *Mein Kampf*.4

Of course, the policy of self-sufficiency does not seem any more reasonable if considered as a preparation for the next war only than if considered as a lasting military institution.

Some military experts consider the coming war as absolutely different from the past World War. They assume that the aggressor will succeed very quickly if he attacks unexpectedly a country which is not aware of this danger and is therefore not prepared to resist. With one stroke such an “Überfallskrieg” could bring the deciding victory. But whether such a surprise attack would be more successful in a coming war than it was in past wars is very doubtful. The sudden attack overthrew Saxony in 1756, and Belgium in 1914, but in both cases it neither decided nor ended the struggle, but on the contrary it kindled it only. There is no reason to think that it would be different

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in a hypothetical new world war. On the other hand, in a war in which the aggressor puts all his trust in a rapid success of his attack, the superiority of his equipment and armament plays a still greater role than in any other war-making. For the success of such a plan inferior quality of the arms due to the use of substitutes for the proper materials may prove fatal.

From the military point of view the substitution of succedanea for the proper raw materials seems therefore in every respect unfavorable. When the Central Powers went to war in 1914 without having made any provisions for the supply of foreign raw materials they could rely on the great stores of those goods which represented the normal stocks of business. These stocks were sufficient for the needs of the first two years of the War. The result of the policy of self-sufficiency and economic preparation for war will be that in a new campaign such stores will hardly exist.

It is the paradox of self-sufficiency as economic preparation for war that it weakens the military potential of the nation by rendering its arms less efficient. The present state of international division of labor puts to every nation which ventures to wage war a dilemma to which there is no solution. They have to face on the one hand the fact that they cannot fight without a continuous import of raw materials and food, and on the other hand the fact that the replacement of these imported goods by home production of substitutes diminishes their military force.

In time of peace every nation can buy all the raw materials and foodstuffs it requires and is ready to pay for. Of course, this makes the nation depend on foreign supplies and involves it in the international division of labor. But to consider this as a drawback because it renders war-making impossible is an atavistic view.

III
The War Argument in Neutral Countries

There are fortunate countries which have decided to remain neutral in all wars. For such a country the war argument for self-sufficiency as advanced by the militarists is nil. They do not intend to make conquests and they wish nothing but to live in peace and to have business always undisturbed. But even if they succeed in this policy and if they continue to be a peaceful island in an ocean of blood they may suffer from the consequences of war. Typical in this respect was Switzerland's situation during the World War. Its supply of imported foodstuffs and raw materials was at the mercy of the belligerents. But
for the agreements with the belligerents the Swiss would have had neither fuel nor food and would have starved.

In such a country a policy in favor of self-sufficiency to provide for the dangers of a new world war seems more reasonable than for countries which wish to attack. The Swiss Confederation cannot hinder its neighbors from going to war. It has simply to protect its own interests. This includes not only armaments, but also provisions for the feeding in war time. Many measures of the Swiss economic policy which should be regarded as completely unsound in a peaceful and reasonable world are justified by the international situation which the nation has to face. The conditions for some other nations are not very different, although none of the others is in such an unhappy geographical position as Switzerland.

The trend for self-sufficiency is in these cases too the consequence of the warlike spirit which is now infecting the world. The menace of coming wars endangers the maintenance of the international division of labor and every government, even the most peaceful and internationally minded, has to provide for the event.

IV
The Wages Argument

It is one of the effects of the international division of labor that it creates an interdependency of wages all over the world.

With perfect mobility of labor, capital, and commodities all over the earth's surface there would be a tendency for an equalization both in the rate of profit and in wages for labor of the same kind. Capital and labor would be shifted from the areas where the natural conditions of production are less favorable to areas where they are more favorable until this equalization has been reached. Under the actual state of things where there are very effective institutional barriers against the transfer both of capital and labor from country to country there exist conspicuous differences in the rate of profit and in the level of wages. But the interdependency of both is nevertheless a fact.

One of the factors determining wages in Japan is the circumstance that the Japanese are not free to emigrate because no country tolerates such an immigration. One of the factors determining wages in the United States is the fact that immigration to that country is restricted. Labor is not free to move from Japan to the United States. But there is nevertheless a connection between the height of wages in both countries. This connection is effected by the movability of the produce of labor. The commodities produced by either nation enter
into competition. In a world of free trade for commodities they would have to be sold at the same price notwithstanding the allowance made for transport. The faculty of a country's trade unions to raise the level of wages seems therefore limited by the competition of goods produced abroad by cheaper labor. The trade unions of the countries with more favorable conditions for production and higher wages would like to see the wages in the less favored countries rise. But that could not be attained otherwise than by shifting hands from the less favored to the more favored countries. It is precisely this that the trade unions of the better endowed countries wish to avoid. But without a change in the distribution of workers over the earth's surface equality of wages is impossible.

Under the existing system of immigration restrictions equilibrium wages are different from the level they would attain in a world where labor is free to migrate; they are higher in some countries and lower in others. But there is for every area, within which there are no barriers for the transfer of labor from one place to another, a uniform equilibrium rate of wages for every kind of labor. As long as effective wages do not exceed this equilibrium level employment and unemployment are normal. It is in the nature of the equilibrium rate to make supply and demand on the labor market coincide.

If the trade unions of the countries endowed with more favorable conditions for production were to limit their activities to checking immigration, and if they were satisfied with the rise of equilibrium wages due to these restrictions, they would not increase unemployment figures. But if the trade unions try, as they really do, to raise the wages above this equilibrium rate they bring about lasting unemployment of a great part of the working class. Of course this is in a market economy the unavoidable consequence of a wage rate exceeding the equilibrium rate.

Entrepreneurs ascribe their inability to employ more hands at the rates fixed by collective bargaining to the pressure of foreign competition. Public opinion therefore considers barriers erected against imports from abroad as an effective measure of fighting unemployment without lowering the level of wages. One of the most popular arguments in favor of protection is to defend the national standard of living against the dumping of goods produced by cheap labor.

Now people call dumping the import of goods produced by cheap labor and regard the exclusion of such goods as quite justified. That means for the countries which on the one hand are endowed by nature and by the plenitude of their capital with the most favorable conditions
for production, and on the other hand keep out foreign immigrants, that they consider high import duties, quotas and even complete self-sufficiency as justified.

If a country neither tolerates the immigration of labor, nor the imports of goods produced abroad by cheap labor, nor the export of capital, it is on the way to complete economic isolation.

The Anglo-Saxon and some other Western countries are doubly responsible for the low rate of wages and for the low standard of living in the over-populated areas: first, by making immigration practically impossible, and secondly, by fighting the import of manufactured goods. In their endeavour to maintain their own higher standard of living they exert a pressure on the standard of living in other countries, especially in Central, Eastern and Southern Europe, and in Japan. They reduce their imports of manufactured goods but at the same time increase their exports of food, raw materials, and manufactured goods; the consequence is a fall in the total volume of international trade.

The trend to make trade barriers more effective and to isolate the countries economically more and more is therefore an outcome of a policy which wishes to fight unemployment by protection for home production. The idea underlying this policy is misleading. The low wages abroad become still lower and the country’s own selling abroad decreases in the same proportion as imports are reduced.

It is hopeless to try to do away with unemployment by a policy of trade barriers. That wages higher than the equilibrium rate can only be maintained when a considerable part of the labor supply is unemployed is for an isolated country no less the case than for a country buying and selling abroad. It is a fallacy to think that in the long run unemployment can be caused by foreign competition. Foreign competition, or more correctly the fact that the home market forms a part only of the international market, is one of the factors determining the height of the equilibrium wage rate. At the equilibrium wage rate unemployment is only a transitory phenomenon. Foreign competition may make equilibrium wages lower but cannot directly cause lasting large scale unemployment.

If a country tries to keep out the influence of the foreign labor markets from its home market it has to withdraw from the international division of labor. But then it deprives its people of all the advantages of international economic cooperation. That means that in the long run commodity wages have to go down. The policy of economic isolation is in no way the right means of improving a nation’s standard of living.
V

The Over-Population Argument

The over-population argument for protection is nothing but the wages argument as seen from the point of view of the over-populated countries. In these countries wages are low and there is under the present conditions of migration barriers no hope of making the wages higher by emigration.

Equilibrium wages are low in these countries. But as long as actual wages do not exceed the equilibrium rate there is no lasting large scale unemployment. Equilibrium wages of course may fall extremely low as compared with foreign wages.

Low wages are very unsatisfactory and both governments and trade unions are in search of a remedy. Unfortunately, the only effective remedy—emigration—cannot be taken into consideration. Minimum wages, whether imposed by government interference or by collective bargaining, only increase unemployment. To fight unemployment an effort is then made to protect home production. But this raises commodity prices and lowers the standard of living still more.

The recriminations of the over-populated countries against the more fortunate countries are justified. The countries where equilibrium wages are higher harm them in a twofold way: by making immigration impossible and by closing their markets to the import of their produce. Nevertheless, these over-populated countries themselves make their own conditions only worse by closing themselves to their own markets. In doing so they effect nothing else than a further lowering of their standard of living.\(^5\)

In this case, too, protection and self-sufficiency are remedies that only increase the evil.

VI

The Monetary or Foreign Exchange Argument

The monetary or foreign exchange argument in favor of protection differs from most other arguments in that it is purely economic. Unfortunately, it is like the other arguments a fallacious one.

The maintenance of a sound currency has nothing to do with foreign trade. It is the old and fundamental error of all types of Mercantilism, that an unfavorable balance of trade drives money out of the country. But the balance of trade is one item only in the balance

of payments. An excess of imports over exports is compensated or over-compensated by assets from other items. The balance of payments always balances. If both sides of the balance of payments equalize only by an export of gold, prices have to fall. The low prices increase exports and check imports. In countries where the currency is not purely metallic, the outflow of gold forces the Bank to restrict credit. Then the adjustment is effected by the inflow of foreign short-term loans attracted by the higher rate of interest. Thus, under both conditions, the equilibrium is re-established automatically. In the long run a country which has not embarked on inflation and credit expansion can never be in danger of seeing its monetary stocks go out of the country. On the contrary, if there is inflation and if as a consequence of the excess of currency prices rise and the national monetary unit depreciates, nothing can prevent the working of the mechanism described by Gresham's law. If the government attributes the same legal tender quality to the depreciated paper money as to the gold coins the latter disappear from circulation. As under the conditions of inflation and credit expansion the automatic readjustment cannot take place, the gold standard is replaced by a paper currency, which depreciates more and more with the advance of inflation.

It is in vain that governments try to stop the course of depreciation by restricting imports. If the government prevents the citizens from buying foreign goods they will buy more home products. The price of these home products will then go up and their export will decrease. Thus the interference of the government, which is directed to an improvement of the balance of trade by restricting imports, results in bringing down both sides of the balance. It cuts simultaneously both imports and exports. The effect is a reduction in the total volume of foreign trade.

If the government wishes to succeed in its policy it would have to take away from the hands of the citizens the excess of their cash holdings. The government would have to tax the citizens or to issue a loan on the home market and then to withdraw from circulation the money received. This means a policy of deflation. Of course deflation is the only efficacious means of bringing down the rate of foreign exchange and of re-establishing the former purchasing power of the monetary unit. But if the government does not wish to deflate it has no means of reducing the prices paid for foreign exchange.

The foreign exchange regulations as they exist in many countries are of two different types. There are countries which wish to maintain simply the market rates of the foreign exchanges. They believe that
something should be done to prevent a further depreciation and that foreign exchange regulation is the right way. But they do not intend to force the citizens to buy and sell foreign exchange at a lower price than the market price. Under such conditions the effects of foreign exchange regulations are not very harmful. As there are no endeavors to impose on the market a lower price for foreign exchange, as foreign exchange is bought and sold at the market price, it does not matter whether the dealings are free, or the privilege of an institution like the Central Bank, or a Foreign Exchange Equalization Account. Of course, if the government or this institution for the management of foreign exchange dealings hinder some imports for the sake of economizing foreign exchange, they restrict imports too and thereby the volume of foreign trade. But there is under these conditions no urgent cause to take very drastic measures in this respect, as the foreign exchange regulations do not directly restrict the available amount of foreign exchange.

It is different, where the aim of the foreign exchange regulations is to impose on the market a lower price for foreign exchange than that which would be formed on a free market. If every citizen is bound to sell all foreign exchange to the Exchange Equalization Account at this legal or official price, which is lower than the market price, things are exactly the same as if there were a duty on exports. The amount of exports falls, and therefore the amount of foreign exchange offered to and bought by the Exchange Equalization Account. A scarcity of foreign exchange is the unavoidable consequence of a policy which imposes on the market too low a price for gold and foreign currency. The more these regulations are enforced, the greater the scarcity becomes. Exports would cease completely but for export premiums paid by the government to compensate losses which the exporter suffers by the compulsion to sell the foreign exchange at a price below the market value.

If a country which has adopted this regime complains of a shortage of foreign exchange it has to realize that the evil is due to its own policy only. But for the consequences of foreign exchange regulations, there is no difference for the citizens whether they buy home or foreign produce. There is no such thing as a problem of transfer. Whether a German wishes to buy cotton or some home produce, let us say coal, does not make any difference either for him or for the country's monetary system. In both cases he has to abstain from buying something else. He has to spend less Marks for other purposes than he would have done if he had not bought the cotton or the coal. The problem is whether he is rich enough to buy cotton or coal,
whether he disposes of the amount of Marks necessary. If he buys more imported goods he has to abstain from buying home-made goods. These goods therefore then become cheaper and can more easily be exported, thus compensating the outflow of money by an inflow. If for some reason exports cannot be expanded, the greater demand for foreign exchange makes the prices of foreign exchange and therefore those of the imported goods rise and this upward movement of prices forces the citizens to restrict their buying of imported goods. Here too the automatism of the market works smoothly.

Let us assume that by a redistribution of the areas producing raw materials some part of Australia and of the South of the United States became German possessions. Nothing in the economic and monetary sphere would be changed by such an arrangement. The German consumer would have to pay just the same for cotton and wool as he has to pay now. It would not be easier for him or more difficult for the British or the Americans to buy in these newly ceded territories. Of course, under present conditions too trade between Great Britain and Australia is not conducted in any other way than the trade between Great Britain and Germany, or between Germany and Australia. It is not any advantage for the British buyer of wool that his King is at the same time the ruler of Australia, or that the citizens of Australia speak English and are the offspring of British ancestors. The German buyer on the wool market competes under equal conditions with the British or Danish or Polish buyer.

Let us, on the other hand, assume that Bavaria were separated from the Reich. But for government interference in the currency system and for foreign exchange regulations, the trade between Bavaria and the rest of the Reich could not be affected by such a change. What Saxonians buy in Bavaria has to be paid either by direct exports or by triangular trade, whether Bavaria is a part of the Reich or not.

It is misleading to think that the buying of imported goods absorbs a quantity out of the Devisen-stock [foreign exchange] of the nation. It is an error to say to a man: you must not buy this foreign commodity because for this purchase a part of the nation’s hoard of foreign exchange is wanted. There is no such thing as a fund of foreign exchange. Foreign exchange holdings are in a continuous flux and reflux, they are daily filled up and daily depleted. In buying foreign goods the consumer creates at the same time, by reducing his buying at home, the amount of foreign exchange necessary for his buying.
The fact that there are trade barriers does not alter the working of this mechanism. Trade barriers of course make it more difficult to export and to get foreign exchange. But the fall in exports and in the inflow of foreign exchange automatically leads to a restriction of buying abroad. When prices, wages, and profits in the export industries fall, the groups affected have to reduce either their buying of foreign goods or their buying of home produced goods. In the first case the demand for foreign exchange falls, in the second case the prices of these goods sold on the home market in lesser quantities fall, and it is easier to export them.

If a country wishes to enjoy the advantages of a sound currency and stability of foreign exchanges, it has but to avoid inflation and credit expansion. If it prefers the pretended advantages of depreciation, then it has to let the market fix the value of its currency unit. In both cases it would not find any monetary difficulty in dealing with foreign countries. It is but the aim to fix foreign exchanges below the market price by means of foreign exchange regulations which creates the shortage of foreign exchange.

Germany's position in the world's economic system, like the position of many other European nations, was and is based on industry. They import mostly raw materials and food and export mostly manufactured products. By restricting the purchases of raw materials the German government restricts the exports of manufactured goods too. By using the imported raw materials for rearmament purposes instead of the production in the exporting plants it reduces the amount of foreign exchange available. But Germany is only the most outstanding case of a policy followed today by many other countries too.

In an economic system based on barter and direct exchange between two parties only, nobody would doubt that satisfaction is given to both parties. The function of money is to provide the same facilities in triangular trade. This clearing function of money is not limited to local trade only; it works in the same way in inter-local, inter-regional and international trade. The most efficient clearing system and the most simple too is the monetary system. If a nation replaces the use of money in international trade by bilateral clearings it deprives itself of the advantages of triangular trade. It loses thereby the faculty of buying on the cheapest market and of selling where it may obtain the highest prices. It has to buy notwithstanding the height of the prices where it has something to sell, and it has to sell notwithstanding the low level of prices where it wishes to buy something.
The gold standard was and is still the best and even the only practical solution to an international organization of triangular trade. That it no longer works is not due to inherent defects or to a change in the conditions it presupposes. It is simply the consequence of the fact that governments no longer wish to let its mechanism work. They combat the international division of labor and they therefore intend to destroy the most important tool of international trade. It is not the breakdown of the gold standard, and it is not the unsatisfactory state of the world's monetary system which necessitate a policy of trade restrictions for monetary reasons. On the contrary. The gold standard and the world's monetary system collapsed because the governments destroyed them purposely for the sake of doing away with international trade.

VII

Protection from the Point of View of Home Policy

The nations went in for protection because they believed that in trade the national interests were in conflict with the interests of other nations and that it was therefore necessary to protect the home market against foreign commodities. But even if these erroneous considerations of national interests as contrasted with the international point of view had not worked, considerations of home policy only would have brought about the same effect.

In many countries of the world today it is commonly assumed that it is the duty of the State to protect the less efficient producer against the competition of the more efficient. In this way the government prevents the more efficient producer from using his full superiority. It restricts the sphere of action of big stores for the benefit of the shopkeepers. It forces upon a whole industry a proportional reduction of output instead of letting the market eliminate the marginal producers. It makes it more difficult for the motor-car to compete with the railway. It tries to create by interference a better marketing for commodities which are produced in greater quantities than public demand.

The strong governments of the authoritarian States, who emphasize their mission to lead and not to be led and to force their subjects to obey their orders act under the rule of the theories of government interference and interventionism not differently than the democratic governments whom they reproach with their weakness. Every government, whether parliamentary or dictatorial, is today ready to interfere for the particular interests of groups on whom they wish to rely. Even small groups are sometimes considered as very important
for the political concept of the ruler, whether he is democratic or
dictatorial. The case of silver in the United States is an excellent
example of how a special strategic position may even to a small group
give the possibility of influencing a big country's policy. In a similar
way, in every country small groups of entrepreneurs and trade union
members back particular measures of protection and restriction.

It seems to our contemporaries justified that our fellow citizens
who find it difficult to stand foreign competition should be protected.
It is the belief that a government which did not try to help a less
efficient producer would neglect its first duty.

But it would be too simple an explanation to say that at the bottom
of protection is the selfishness of particular interests as contrasted
with the general interest. These particular interests are always the
interests of minority groups. The producers—both entrepreneurs and
workers—of every single commodity are always a minority if com-
pared with the bulk of the consumers. They succeed in getting their
particular interests protected against the greater interest of the
majority only because they are supported by public opinion, which
considers such protection as beneficial for the nation. A hundred
years ago the coachmen and the postilions did not find protection
against the overwhelming competition of the steam-engine and the
railway, because in those days the Liberal spirit was opposed to
privilege which benefited a small group to the disadvantage of the
public. Today, the claim of the railways for safeguard against the
motor-car seems justified to the legislator. Today every particular
interest is sure to find support in public opinion. It is this attitude of
public opinion which is responsible for the privileges and not the
desire of those who wish to enjoy a privilege. Seen from the point of
view of home policy, protection is but a category of measures in the
system of government interference.

VIII

The International Conflict of Economic Interests

In our world of migration barriers there are very grave conflicts
of economic interests between nations. In restricting immigration
figures some nations succeed in making wages for their citizens
higher, but only at the expense of the citizens of other nations. The
international clash of economic interests is due to this fact. There are
no serious conflicts about raw materials or colonies in a world of peace
and peaceful trade, where everybody has the right to buy on the same
terms as everybody else. But there is a conflict when the citizens of
some countries of Europe and Asia are prevented from moving to the
countries where they may earn more than in their own country. The high standard of living in the United States and in the British Dominions has its corollary in the low standard of living in Eastern, Central and Southern Europe, in India, China, and Japan.

The people of the United States and the British Dominions defend their higher standard by closing their doors to newcomers. The result is that within their boundaries many millions of acres lie barren, whereas much poorer soil in other countries has to be cultivated. Any account of the world's present economic and political situation which does not stress this fact is inadequate.

There are three reasons why this vital problem is generally overlooked in present public discussion. First of all, our economic and political considerations are prejudiced by the Marxian doctrine. According to Marxism, the interests of the proletarians all over the world are identical. The conflicts between nations and States are only the outcome of the prevailing particular class interests of the bourgeoisie. Nationalism, hatred between nations and imperialistic and militaristic tendencies in international relations are peculiar to the rule of capitalists. A world of popular regime would be peaceful and adverse to international conflict. The proletarians are all brothers and friends. Biased by this dogma, the Marxians ignore that the poverty of the great mass of the proletarians in Europe and Asia, which they deplore, is due to the fact that they have to dwell, live, and work in areas where the natural conditions of production are less favorable because the proletarians of better blessed areas refuse them the right to enter their countries. A consistent application of the Marxian "superstructure" theory would have to say: the proletarians of Europe and Asia are exploited by the proletarians of the New World; modern imperialism and militarism are the "superstructure" of the conflict of economic interests between the proletarians of the more favored with those of the less favored nations. But the Marxians intentionally keep silent over these conflicts. It is very characteristic how scarce the writings about the migration restrictions are when compared with the abundance of publications on all other measures of present economic policy. It is even more characteristic how eager the Marxians are to develop highly artificial and futile hypotheses to explain imperialism out of alleged difficulties of the capitalist order.

Nor are the opponents of Marxism on our political stage, the fascists and nationalists, more ready to discuss the migration barriers. Their philosophy is against emigration. They want all their men for the coming war. They wish to conquer the richer countries and to annex them; they do not wish to send their sons as emigrants to foreign lands. Their
remedy for the *Volke ohne Raum* (people without room) is conquest. The population pressure in Italy, highly aggravated by the post-war migration checks, does not make Mussolini criticize the policy of the countries not allowing Italian immigration. On the list of his grievances no mention is made of immigration barriers. On the contrary, desirous of increasing his military strength, he himself is against emigration and wishes to raise the birthrate.

There is still a third reason for the underrating of the importance of the migration barriers. The most eminent upholders of international mind today are the intellectuals of the English-speaking nations. Without their noble attitude the case for peace and international collaboration would be hopeless. But these intellectuals sympathize with trade unions, which in the English-speaking countries are the champions of immigration barriers.

The drawbacks of the immigration barriers are further increased by the obstacles raised against the transfer of capital. It is difficult to decide whether it was more the policy of the debtor countries or the policy of the creditor countries which was responsible for the abolition of the movability of capital. The countries which had imported capital destroyed the internationality of capital transactions by open repudiations and by foreign exchange regulations. But the capital exporting countries too had their share in limiting the outflow of capital. The result is that the populations, which by the immigration restrictions are forced to work in areas where the natural conditions for production are less favorable and where in consequence wages have to be low, find their existence made even worse by a shortage of capital, which lowers the marginal productivity of labor and thereby wages still more.

It may seem striking that public opinion is more concerned today with the apparent problem of raw materials and does not deal with the most serious problem of contemporary international relations: the problem of the movability of labor.

But whether we consider the raw material question or the migration question as the crucial point of internationalism, in any case we have to realize that neither the suppression of international trade nor war can be considered as appropriate remedies. Even a nation handicapped by the poverty of its territory, which cannot yield enough raw materials, and whose citizens are prevented from emigrating cannot draw any advantage from protection. It is noteworthy to realize that Ricardo's irrefutable proof of the superiority of free trade policy is precisely based on an argumentation which assumes that capital and
labor do not move freely from country to country as they do within a
country. This assumption of the immovability of capital and labor was
true for the days of Ricardo. It was not true for the late nineteenth
century and for the beginning of the twentieth century; it is true again
for our days. It is therefore a mistake to say that Ricardo’s arguments
are no longer valid for our days as conditions have changed. On the
contrary, conditions are again the same.

But neither is war a solution for the present conflicts. Given the
geographical and political conditions of our world, it seems hopeless
for the over-populated European countries to force by war upon the
countries closed to immigration a change in their policy. That is why
Hitler in *Mein Kampf* does not propose as the goal of German policy
the conquest of overseas territories, but only of European territories.
But these European neighboring countries of Germany, apart from
the fact that they are already now over-crowded, could not give the
German emigrant what he wants.

It would be ostrich policy to deny the existence of very grave
conflicts between the nations of our world. But we have to realize that
neither war nor protectionism and self-sufficiency can provide a
solution for the problems involved.

**Conclusion**

Liberalism is a philosophy of peace and international cooperation.
It is the basic point of its social and economic theory that, rightly
conceived, the interests of all individuals and of all nations are
harmonious in a society of private ownership and free trade. For the
Liberal democracy and peace are the outcome of his ideas on life,
work, and human cooperation.

But Liberalism is for the time being the privilege of a small and
uninfluential minority. The world is ruled by other ideas. These ideas
lead to armaments and to protectionism, to barriers against the
movability of commodities, labor and capital, to militarism and to
dictatorship.

It is a mistake to assume that as long as such conceptions prevail
any endeavors to lower the obstacles to international trade could be
successful. If the theories in favor of protection and self-sufficiency
are considered as right, then there is no reason to bring down trade
barriers; only the conviction that these theories are wrong and that
free trade is the best policy can shake them. It is inconsistent to
support a policy of *low* trade barriers. Either trade barriers are
useful, then they cannot be high enough; or they are harmful, then
they have to disappear completely. The pre-war policy of moderate protectionism was the result of a labile equilibrium between two conflicting theories; now when the theory of protectionism has driven the theory of free trade off the field of public opinion there is no more limit to trade barriers.

It is hopeless to expect a change by an international agreement. If a country thinks that more free trade is to its own advantage, then it may always open its frontiers. But if it views free trade as a disadvantage to its own interests it will not be more willing to grant it in an international treaty. Every nation is today anxious to expand the volume of exports, but no nation is prepared to sacrifice the particular interests of an existing industry or even of an industry which has still to be created. It is this tendency that is continually reducing the volume of international trade.

The poor results obtained by the League of Nations and the failure of the World Economic Conferences and of the more special conferences and negotiations between smaller groups of nations are due to the fact that the world lacks today the mentality of peaceful cooperation. Under the rule of militarist ideas the efforts at international collaboration are doomed.

What the world needs is not more conferences and conventions but a radical change of mentality.