Studies in International Political Economy

NATIONAL POWER AND THE STRUCTURE OF FOREIGN TRADE

Albert O. Hirschman

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This is the first volume in a series The Politics of the International Economy, edited by Stephen D. Krasner, University of California, Los Angeles.

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By

ALBERT O. HIRSCHMAN

UNIVERSITY OF CALIFORNIA PRESS
BERKELEY, LOS ANGELES, LONDON

University of California Press
Berkeley and Los Angeles, California

University of California Press, Ltd.
London, England

ISBN 0–520–04082–1 paper
0–520–04084–8 cloth

Printed in the United States of America

1 2 3 4 5 6 7 8 9

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CHAPTER II

Foreign Trade As an Instrument of National Power

IN THIS WORK the term *national power* is used in the sense of power of coercion which one nation may bring to bear upon other nations, the method of coercion being military or "peaceful." In trying to expand its power a nation must take account of many factors—historical, political, military, psychological, and economic. Among the economic determinants of power, foreign trade plays an important part. In order to analyze the way in which foreign trade contributes to a certain distribution of power among the various nations, it must be isolated temporarily from the other determinants; for the purpose of our inquiry these other determinants may be impounded in a vast *ceteris paribus* upon which, for the sake of rendering our analysis more realistic, we shall have to draw from time to time.

It will then be our aim to understand why and how relationships of dependence, of influence, and even of domination can arise out of trade relations. We are not concerned with the opposite line of causation which also exists and which may even have had a greater historical importance: the question of how a given distribution of power influences trade relations. It will, however, be well for the reader to remember that frequently the adoption of certain economic policies leading to greater power for a given nation is possible only if there exists an initial power disequilibrium in favor of that nation.

Colonial trade often gives us the opportunity of observing this type of cumulative effect. An initial power supremacy enables the imperial power to shape the direction and composition of the colony's trade, and the trade relations which are thus established in turn strengthen markedly the original power position held by the imperial power.

The Two Effects of Foreign Trade

Foreign trade has two main effects upon the power position of a country. The first effect is certain to be positive: By providing a more plentiful supply of goods or by replacing goods wanted less by goods wanted more (from the power standpoint), foreign trade enhances the potential military force of a country. This we may call the *supply effect* of foreign trade. It not only serves to strengthen the war machine of a country, but it uses the threat of war as a weapon of diplomacy. Although we have seen that free traders have advised statesmen to rely on the supply effect of foreign trade, protectionists have warned them of the dangers of its cessation during war, which, they say, is precisely when it will be most needed. But this danger might be lessened and the supply effect safeguarded:

1) by securing control of the oceanic trade routes;
2) by a policy of extensive preventive accumulation of stock piles in times of peace;
3) by redirecting trade toward those countries from which the danger of being cut off is minimized.

The attempt to trade more with neighboring, friendly, or subject countries is largely inspired by this consideration, and it has been one of the most powerful motive forces behind the policies of regionalism and empire trade.

All these points are obvious and hardly need further elaboration. As far as the supply effect is concerned, foreign trade serves as a means of increasing the efficiency of the military pressure which one country might bring to bear upon other countries. But, just as war or the threat of war can be considered in turn as a means of obtaining a certain result, so the supply effect of foreign trade is an indirect instrument of power, the direct instrument being war or the threat of war. In its final result, therefore, the supply effect of foreign trade requires at least the possibility of war.

The second effect of foreign trade from the power standpoint is that it may become a direct source of power. It has often been hopefully pointed out that commerce, considered as a means of obtaining a share in the wealth of another country, can supersede war.[1] But

[1] This idea, which points to trade as an "economic equivalent to war," appears, for example, in the following characteristic passage from the famous anti-Napoleon tract

commerce can become an alternative to war also—and this leads to a less optimistic outlook—by providing a method of coercion of its own in the relations between sovereign nations. Economic warfare can take the place of bombardments, economic pressure that of saber rattling. It can indeed be shown that even if war could be eliminated, foreign trade would lead to relationships of dependence and influence between nations. Let us call this the *influence effect* of foreign trade, and, because of its importance, give the greater part of this chapter to its analysis.

The terms dependence and influence have hitherto been used indiscriminately to describe the situation which seems invariably to arise out of the trade relations between two sovereign states. But why does such a situation arise at all? In other words, what is the root cause of the political or power aspect of international economic relations? To answer this question we must concede that the explanation of the great power held in the past by Great Britain was the fact that she possessed strategic bases, such as Gibraltar, Suez, and Singapore. The possession of these bases had two consequences: First, it guaranteed the security of British trade; second, as a welcome by-product, it enabled Great Britain to cut off the trade of other countries passing through these points, be it trade with Great Britain or trade between two other countries. This second consequence gave her considerable direct power over, and influence in, other countries, in that they were always exposed to the potential threat of a sudden stoppage of their trade at Britain's will.

But every sovereign nation has some influence of this kind, since through the control of its frontiers and the power over its citizens it can at any time interrupt *its own export and import trade,* which is at the same time the import and export trade of some other countries. The stoppage of this trade obliges the other countries to find

of Benjamin Constant: "War and commerce are but two different means of arriving at the same aim which is to possess what is desired. Trade is nothing but a homage paid to the strength of the possessor by him who aspires to the possession; it is an attempt to obtain by mutual agreement that which one does not hope any longer to obtain by violence. The idea of commerce would never occur to a man who would always be the strongest. It is experience, proving to him that war, i.e., the use of his force against the force of others, is exposed to various resistances and various failures, which makes him have recourse to commerce, that is, to a means more subtle and better fitted to induce the interest of others to consent to what is his own interest."—*De l'Esprit de Conquête et de l'Usurpation dans leurs rapports avec la Civilisation Européenne,* Part I, Chap. II.

alternative markets and sources of supply and, should this prove impossible, it forces upon them economic adjustments and lasting impoverishment. True, the stoppage of trade will also do harm to the economy of the country taking the initiative in bringing about the stoppage, but this is not unlike the harm an aggressive country can do to itself in making war on another. A country trying to make the most out of its strategic position with respect to its own trade will try precisely to create conditions which make the interruption of trade of much graver concern to its trading partners than to itself. Tariff wars and interruptions of trade rarely occur, but the awareness of their possibility is sufficient to test the influence of the stronger country and to shape the policy of the weaker.

That economic pressure upon a country consists mainly of the threat of severance and ultimately of actual interruption of external economic relations with that country was clearly recognized by Article 16 of the Covenant of the League of Nations. The intention of Article 16 was to coördinate and combine the power positions which the various member states of the League had acquired in the aggressor country by entertaining commercial and financial relations with it.

Thus, the power to interrupt commercial or financial relations with any country, considered as an attribute of national sovereignty, is the root cause of the influence or power position which a country acquires in other countries, just as it is the root cause of the "dependence on trade." It should be noted that the only condition for the emergence of these political aspects of trade relations is that of unfettered national sovereignties. It has often been pointed out that central regulation by separate sovereign units leads to a dangerous "politicalization" of trade.[2] Undoubtedly the identification of every private interest with national interest and prestige may add a heavy strain on international relations. But state regulation by no means *creates* the political aspects of international economic relations (as the term politicalization seems to imply). It merely emphasizes them or makes them more apparent and exploitable. For the political or power implications of trade to exist and to make them-

[2] J. B. Condliffe, *The Reconstruction of World Trade* (New York, 1940), p. 56; Lionel Robbins, *Economic Planning and International Order* (London, 1937), pp. 90 f.; Sir Arthur Salter, "The Future of Economic Nationalism," *Foreign Affairs*, Vol. X (October, 1932), p. 18; Eugene Staley, *World Economy in Transition* (New York, 1939), p. 178.

selves felt, it is not essential that the state should exercise positive action, i.e., organize and direct trade centrally; the negative right of veto on trade with which *every* sovereign state is invested is quite sufficient.[3] We shall now examine the conditions making this right of veto or the power to interrupt trade an effective weapon in the struggle for power. To bring these conditions about will obviously be the goal of a nation using foreign trade as an instrument of power policy.[4]

The Influence Effect of Foreign Trade (Section 1)

What we have called the influence effect of foreign trade derives from the fact that the trade conducted between country A, on the one hand, and countries B, C, D, etc., on the other, is worth *something* to B, C, D, etc., and that they would therefore consent to grant A certain advantages—military, political, economic—in order to retain the possibility of trading with A. If A wants to increase its hold on B, C, D, etc., it must create a situation in which these countries would do *anything* in order to retain their foreign trade with A. Such a situation arises when it is extremely difficult and onerous for these countries:

1) to dispense entirely with the trade they conduct with A, or
2) to replace A as a market and a source of supply with other countries.

The principles of a power policy relying on the influence effect of foreign trade are in their essence extremely simple: *They are all designed to bring about this "ideal" situation.*

[3] The powers of the state with respect to foreign trade conducted by private enterprise may be compared to the powers of a labor union which, though refraining from collective bargaining, would have the power to call a strike and to determine its length. It will probably be granted that, in this case, most of the effects of combination would still obtain.

[4] Since the power position of a country will be of importance in its commercial negotiations, the inquiry which follows gives incidentally an analysis of what is commonly called bargaining power. This term, however, for three distinct reasons, is inadequate for our purposes. First, the achieving of tariff and similar concessions is only one of the many uses to which the political power arising from foreign trade might be put; cf., in this connection, Hans Staudinger, "The Future of Totalitarian Barter Trade," *Social Research,* Vol. VII (November, 1940), p. 426. In the second place, bargaining power in commercial negotiations is traditionally associated with a certain position of the trade balance between the two countries in negotiation, a view which will be explained and criticized below (pp. 32 f.). Third, the term bargaining power has a definite meaning in the theory of bilateral monopoly which is markedly different from the meaning which it would assume in our analysis. This difference and its implications are shown on pages 45–46 of this chapter.

Our analysis of these principles is divided into two parts. In the first, it is assumed that the countries which are the objects of the power policy have no possibility of shifting their trade with A to each other or to third countries, whereas country A remains free to trade with whatever country it desires. Given this assumption, which will be dropped in the second part of our analysis, we have to pay attention only to the first characteristic of the "ideal" situation.

The difficulty for country B, C, D, etc., of dispensing with the trade conducted with A seems to depend on three main factors:

1) The total net gain to B, C, D, etc., of their trade with A;

2) The length and the painfulness of the adjustment process which A may impose upon B, C, D, etc., by interrupting trade;

3) The strength of the vested interests which A has created by its trade within the economies of B, C, D, etc.

GAIN FROM TRADE AND DEPENDENCE ON TRADE

The influence which country A acquires in country B by foreign trade depends in the first place upon the total gain which B derives from that trade; the total gain from trade for any country is indeed nothing but another expression for the total impoverishment which would be inflicted upon it by a stoppage of trade. In this sense the classical concept, gain from trade, and the power concept, dependence on trade, now being studied are seen to be merely two aspects of the same phenomenon, and this connection can serve as a modern application of the ancient saying *fortuna est servitus*.

The whole theory of the gain from trade and its distribution therefore becomes relevant to our subject. The gain from trade has been defined by Marshall in the following terms: "The direct gain which a country derives from her foreign trade is the excess of the value to her of the things which she imports over the value to her of the things which she could have made for herself with the capital and labour devoted to producing the things which she exported in exchange for them."[5] This definition brings out clearly that the gain from trade cannot be measured either by comparing the satisfaction derived from the consumption of the imports with the satisfaction which could be derived from the consumption at home of the exports or by comparing the hypothetical domestic cost of the imported com-

[5] Alfred Marshall, *Money, Credit and Commerce* (London, 1923), pp. 109–110.

modities with their actual cost.[6] If a country was shut off from trade it would normally neither continue to produce the goods formerly exported nor try to produce at home all the goods formerly imported, but, given the reduced resources, an adjustment would take place toward the production of the goods most desired.

Professor Viner has elaborated an even more complex concept of the gain from trade. He has shown that differences in satisfaction between the trade and the no-trade situation might occur not only through a different composition of the goods to be consumed in the two situations, but also because of differences in the occupational pattern or in the general balance between work and leisure in the country concerned.[7]

Provided we keep in mind the qualification arising from these considerations, Marshall's definition still gives a good account of the value of trade to a country or, in other words, of that part of a country's well-being which it is in the power of its trading partners to take away.

The first conclusion which could be drawn from the connection which we have established between gain from trade and dependence on trade is that in order to increase its influence in other nations, nation A should simply bring about an expansion of its foreign trade. In accordance with a general presumption established by theory, a voluntary increase of trade on the part of A's trading partners is indeed indicative of an increase of their gains from trade and, hence, of their dependence on A. But this reasoning overlooks the fact that in this way the influence which the other nations hold in country A would also be increased. Some countries might be able to neglect this consideration because of their geographical position, their military power, or other noneconomic elements. But, in general, a country embarking on a power policy will have fixed for the amount of its trade relations with foreign countries a certain maximum limit which it will think unsafe to exceed.[8]

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[6] The latter error was attributed by Malthus to Ricardo. Cf. Jacob Viner, *Studies in the Theory of International Trade* (New York, 1937), p. 528.

[7] Viner, *op. cit.*, pp. 519 ff.

[8] It remains true that complete autarky can hardly be considered as an element of an intelligent power policy. And if the nations which have proclaimed autarky as their ultimate goal have remained far off the mark, this may be due not only to the economic difficulties which they have experienced in trying to dispense with foreign trade, but also because they have found it politically inexpedient to do without trade relations.

If we take account of this objection, another method might be proposed: country A, seeking to increase its influence in country B, might have an interest in altering the terms of trade in B's favor. Here, then, it would seem, we have an ideal instance of the opposition between a policy trying to maximize national income and a policy setting out to maximize national power.

This statement, however, needs qualification and elaboration. In the first place, the functional relationship between gain from trade and dependence on trade points to a potential clash, not only between national income or welfare and power, but also between the two different types of power policy, the one relying mostly on the supply effect of foreign trade and the other relying upon the influence effect. It is indeed clear that a policy using foreign trade as its instrument may sometimes have to choose between better terms of trade, i.e., more plentiful supply of needed materials for a given quantity of home products, on the one hand, and more influence on the trading partner, on the other.

But is there an inevitable conflict between national welfare and national power, or, within a power policy, between the supply effect and the influence effect of foreign trade? This is a necessary conclusion only if we accept the common conception that a given amount of trade results in a fixed total gain to be distributed between the trading countries according to some ratio determined by the terms of trade. An increase of the gain of A can then only be procured at the cost of a decrease of the gain of B. This view, however, should be suspect if only because of its resemblance to the cruder Mercantilist idea that A's gain is B's loss.

Actually we have here to clear up a terminological confusion which is at the root of the whole matter. What is commonly called total gain from trade is by no means, as one might expect, the sum of the gains from trade as defined by Marshall for the individual participating countries. The term total gain, as used generally, is rather to be understood as the physical surplus of goods made possible by the international division of labor. This physical surplus is indeed fixed under given cost and demand conditions. It might be called the total objective gain from trade. But a moment's reflection should show that although this objective gain might be wholly nonexistent (as in the absence of any international specialization following the opening up of trade), a substantial *subjective* gain as defined by Marshall might still accrue to the various countries, provided only that they do not produce the same range of commodities.[9]

If, therefore, an objective gain from trade in the form of a physical surplus of goods is not even a necessary condition for the emergence of a subjective gain from trade, the existence of a close relationship between the distribution of the objective and the subjective gains as between the countries trading together may be legitimately doubted. The theory of the terms of trade has succeeded in showing how the objective gain is distributed and how its distribution can be affected by changes in tastes and techniques or by commercial policies. It has generally been thought that the terms of trade give a broad indication of the gain from trade; and in spite of its many limitations pointed out by Professor Viner,[10] this method of approach still seems fruitful if one is interested mainly in knowing when a country increases or decreases the gain from its trade with another specified country, as this can under static conditions—i.e., with tastes and techniques constant—occur only through a movement of the terms of trade in its favor. But the method fails us decisively if we are interested, not in the increments of the subjective gain from trade, but in its total amount for any given situation. It is indeed not possible to assert that the respective extents of the subjective gains from trade correspond to the division of the objective gain without assuming for the two countries a similarity of tastes and of the levels of satisfaction prior to trade—in other words, without assuming the whole problem away. In the absence of such assumptions there is no reason whatsoever why a country should not obtain a smaller part of the physical surplus of goods obtained by international specialization whilst deriving a larger increase in satisfaction from trade than its trading partner.[11]

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[9] Even under the very simplest classical assumptions of two commodities of similar importance, two countries of similar size, constant costs, absence of transport costs, and similar tastes in the two countries, it can be shown that further specialization after the opening up of trade, as required by the principle of comparative cost, is not a prerequisite for the existence of some subjective increase in satisfaction from trade. Cf. diagrammatical exposition of this case on pages 49–52 of this chapter.

[10] Viner, *op. cit.*, pp. 555–582.

[11] The belief that the position of the terms of trade gives a clue to the respective extent of the subjective gains from trade has been much strengthened by the often-quoted case of two countries of unequal size trading in two commodities. In this hypothesis the larger country specializes only partly, its pre-trade ratio of exchange

The inquiry into the factors which determine the amount of the subjective gain from trade has to be made directly. It has been undertaken with the help of diagrammatical illustrations by the neoclassical writers, Edgeworth[12] and, in particular, Marshall.[13] Marshall's conclusion, which is unaffected by two errors in his method,[14] is that "the surplus (of country G) is the greater, the more urgent is G's demand for a small amount of E's goods and the more of them she can receive without any great movement of the rate of interchange in her favor." In other words, with a given volume of trade the subjective gain is smallest if the supply-demand schedule of a country maintains a high elasticity throughout its relevant part; whereas the gain would be largest if a country's demand, after having been very elastic for small amounts of the other country's goods, becomes inelastic in its later (and relevant) stages.[15]

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between the two commodities remains unchanged and the whole physical surplus of production due to specialization accrues to the smaller country whilst the supply in goods of the larger country remains unchanged. But so far from being an illustration of the general correspondence between the position of the terms of trade and the extent of the subjective gains, this is actually the only case in which the correspondence holds—a quite paradoxical case—as trade leads neither to an increase in quantity nor to a change in composition of the goods consumed in one of the trading countries.

[12] F. Y. Edgeworth, "On the Application of Mathematics to Political Economy," *Journal of the Royal Statistical Society,* Vol. LII (1889), pp. 558–560. Edgeworth reproduces in the main the "beautiful reasoning" of Auspitz and Lieben, *Untersuchungen über die Theorie der Preise* (Leipzig, 1889), pp. 413–415. In a later work, "The Theory of International Values," *Economic Journal,* Vol. IV (1894), Edgeworth deals essentially with the increments in the gain from trade, not with the total amount; cf. Viner, *op. cit.,* p. 576 and footnote 3.

[13] Marshall, *op. cit.,* Appendix J, pp. 338–340.

[14] As pointed out with respect to the algebraic illustration by Allyn A. Young, "Marshall on Consumer's Surplus in International Trade," *Quarterly Journal of Economics,* Vol. XXXIX (1924), pp. 144–150, and with respect to the diagrammatical exposition by Viner, *op. cit.,* pp. 570–575. Viner also shows that the more general objection of Allyn A. Young against the whole concept of Marshall's "surplus" in international trade (which is nothing but another expression for the subjective gain from trade) does not hold.

[15] In this context elasticity means the response of the imported quantity to a change in the terms of trade. Although it is not identical with the ordinary concept of demand elasticity, it is related to it. Cf. T. O. Yntema, *A Mathematical Reformulation of the General Theory of International Trade* (Chicago, 1932), pp. 52–56. Professor Kindleberger has shown the inconsistent use made by various economists of the term urgent demand and has proposed the terms flexible and inflexible demand instead of not urgent and urgent demand; cf. C. P. Kindleberger, "Flexibility of Demand in International Trade Theory," *Quarterly Journal of Economics,* Vol. LI (February, 1937), pp. 352–361. He, however, as our quotation shows, is incorrect in contending that Marshall did not use the term urgent demand; paying attention only to the ordinary Marshallian price elasticity, Professor Kindleberger does not realize that Marshall's elasticity concepts, as developed in connection with his foreign trade curves, can take care of the various situ-

This statement may seem surprising, as a country which finds itself in the latter situation is generally said to be in an inferior strategic position and to be exposed to a manipulation of the terms of trade against it. Actually, however, this is only another aspect of the same situation: A country which gains much from the exchange of its home produce against imports may be maneuvered more easily into concessions according to the rate of interchange than a country for which trade is only barely profitable under existing conditions.

We have mentioned above the possibility that a country, though obtaining a smaller objective gain from trade, may still enjoy a greater subjective gain; it is now seen that this situation is not necessarily an oddity, but may, on the contrary, be considered as probably true.[19]

These theoretical considerations are directly relevant to the twofold object of a power policy by foreign trade which we have described. Country A may possibly increase the gain from trade and therefore the dependence of its trading partners either by a change

ations which arise in international trade and are denoted by the terms urgent or inflexible. It remains true that these special terms are useful in shortening the description of the shape of a Marshallian demand-supply curve which is at first extremely responsive to favorable changes in the terms of trade and becomes inelastic for further changes in these terms. The conflicting interpretations of the term urgent demand derive from the fact that the various writers have considered different stretches of the *same* supply-demand curve. Professor Kindleberger rightly shows the connection between the concept of urgency of demand and that of income elasticity. The two, however, are not identical, since income elasticity means responsiveness of the demand of a commodity to income increases, whereas the elasticity of the Marshallian curve means responsiveness of demand of a commodity to a favorable change of its rate of exchange for another commodity.

[19] It seems that J. S. Mill had this situation in mind when he wrote in his *Essays on Some Unsettled Questions:* "If the question be now asked, which of the countries of the world gains most by foreign commerce, the following will be the answer. If by gain be meant advantage, in the most enlarged sense, that country will generally gain the most, which stands most in need of foreign commodities. But if by gain be meant saving of labor and capital in obtaining the commodities which the country desires to have, whatever they may be; the country will gain, not in proportion to its own need of foreign articles, but to the need which foreigners have of the articles which itself produces."—J. S. Mill, *op. cit.,* p. 44; cf. also p. 46. Mill has not reproduced this passage in the *Principles* where he has elaborated only the second concept of gain; indeed, the first one hardly fits in with his value theory. Jevons obviously ignored Mill's earlier writings when, as exposed in the *Principles,* he attacked the concept of gain in the following terms: "So far is Mill's statement (about the distribution of the gain from trade) from being fundamentally correct that I believe the truth lies in the opposite direction. As a general rule, the greatness of the price which a country is willing and able to pay for the production of other countries measures or at least manifests, the greatness of the benefit which it derives from such imports."—Stanley Jevons, *The Theory of Political Economy,* 4th ed. (London, 1911), p. 145.

in the composition of trade or by a change in partners without having to submit to more unfavorable terms of trade. To resolve in this way the conflict between the supply effect and the influence effect of foreign trade which at first seemed inevitable, A has to seek trading partners with an "urgent" demand for its export goods.

In the first place, A will therefore turn to countries which have no possibilities of themselves producing the commodities country A exports. A second and more general case, which has been pointed out by Marshall, is the trade with "poor countries," that is, countries with low real incomes before the opening up of trade. Marshall has applied to this case the "law of the diminishing marginal utility of income" in the following terms: "The rich country can with little effort supply a poor country with implements for agriculture or the chase which doubled the effectiveness of her labor, and which she could not make for herself; while the rich country could without great trouble make for herself most of the things which she purchased from the poor nation or at all events could get fairly good substitutes for them. A stoppage of the trade would therefore generally cause much more real loss to the poor than to the rich nation."[17]

A nation pursuing a power policy may be assumed to export industrial goods and to import mainly those articles for which it has either no substitutes at home or only poor and expensive ones. It must be prepared to incur a certain dependence on foreign countries in order to obtain these articles—or, in our terminology, in order to profit from the supply effect of foreign trade. Its problem is there-

[17] Marshall, *op. cit.*, p. 168. It will be noted that, for Marshall, the case of a rich country trading with a poor country and the case of a country having a monopoly in some article trading with another country having no such monopoly are somewhat intertwined. A conclusion similar to that of Marshall follows from Edgeworth's comment on his own assumption in the analysis of foreign trade that "the hedonic worth of money is the same in both countries"; he conceded indeed that "when we know that one party is much better off than another, the assumption may be illegitimate."—"The Theory of International Values," *Economic Journal*, Vol. IV (1894), p. 436. That the comparison of utilities between two collective groups, such as countries, is less rather than more hazardous than intrapersonal comparisons of utility has been shown by a recent contribution (L. G. Melville, "Economic Welfare," *Economic Journal*, Vol. XLIX [September, 1939], pp. 552–553). The possible exceptions to the case which have been pointed out by Marshall are not likely to arise from the difference in the "capacity for enjoyment" of the citizens of the two countries, but rather from the difference in the effect of foreign trade upon the distribution of income in the two countries. If, indeed, the goods imported into the relatively poor country add mainly to the enjoyment of its wealthier classes, whereas the contrary happens in the relatively rich country, the effect described by Marshall may well be neutralized.—I am indebted to Dr. Fellner for this point.

fore how to induce a maximum dependence of foreign countries, given a fixed dependence of its own. In solving this problem it can avail itself of our findings by determining what to export and by choosing the countries from which to import.[18] It can see to it, first, that it possesses a monopolistic position in its export articles by directing trade to those countries which are relatively poorly suited to produce these or similar articles. In our case this means the agricultural countries; and the prevention of industrialization or even the removal of already existing industries is an important part of a policy of trying to preserve or to increase the influence acquired in these countries by an industrial nation.

In the second place, the nation conducting a power policy has an interest in diverting its trade to poor countries in which the marginal utility of income is high. Thus, if nation A, embarking on a power policy, has had a certain amount of trade with group B of other rich industrial nations, it might of course try to enlarge its influence in these countries by granting them better terms of trade. But this would interfere with its own production and, in addition, these countries might not value very highly the additional supplies coming from A. If, on the other hand, the nation diverts its trade to group C of poor and agricultural countries from which it can receive the same supplies, the gain from trade obtained by group C will exceed what group B's gain had been, and consequently A's influence in group C will be much greater than it was in group B. Although the real costs of the supplies may be higher in group C than in group B, A will then have little difficulty in manipulating the terms of trade in such a way that she gives no more of her home produce in exchange for her imports than formerly.

Renewed attention has been given recently to the analysis of ex-

[18] We assume here, as stated in the beginning of this section (p. 17), that only the country conducting a power policy is at liberty to choose its trading partners, whereas the latter have no option but to trade with that country. This assumption will be dropped below. Here we also disregard the fact that the power-seeking nation may prefer to obtain a small influence in a neighboring state rather than a large one in a distant country. In a sense, our analysis considers every country as an equally interesting object of a power policy. Total influence is for us the sum of the influences secured in the individual countries, whereas actually every influence should be weighted according to strategic or other considerations. But this means only that the role played by the economic determinants of power must eventually be combined with and be qualified by the other determinants. The reader must judge whether the results reached by our analysis warrant the admittedly artificial isolation of the economic factor.

ploitation, both with respect to the factor of production in the domestic economy and to that of one country by another in international economic relations. For the latter subject it has been shown what conditions and what policies are required for a country to turn the terms of trade in its favor. At the outset this type of inquiry seems to be the exact opposite of our analysis of the influence effect, which depends on the gain from trade of the trading *partners.* The possibility of a conflict between the policy of maximization of national income, on the one hand, and the policy of securing the greatest position of influence with the trading partners, on the other, certainly deserves to be pointed out. But our subsequent analysis has shown that these two types of policies are not necessarily alternatives. The successful pursuit of the one policy may even condition the emergence of the other. The ability to manipulate the terms of trade in one's favor depends, indeed, on the gain from trade derived by the trading partners, and the policies we have described are directed precisely to increase this gain. The monopolistic exploitation of a trading partner can then be considered as one of the uses to which the power secured through the influence effect may be put. We are here concerned only with the methods and conditions leading to this power, not with its possible uses which may be the reaping of advantages of any kind—military and political, as well as economic.

ADJUSTMENT DIFFICULTIES AND VESTED INTERESTS

The threat of an interruption of trade—the ever-present characteristic of commerce between sovereign states—has two main effects upon the economy of the country the trade of which is interrupted: It impoverishes this country and also imposes a process of adjustment, since, when imports are no longer forthcoming, the goods formerly exported will no longer be consumed in the home market. Marshall's definition of the gain from trade: the excess of utility of the imports over the utility of the goods produced by the resources otherwise devoted to exports if there were no imports—compares the utilities of two nonsimultaneous sets of goods and thus obviously includes a time element. The immediate loss from the stoppage of trade is much greater than the ultimate loss after resources have been fully reallocated. The classical theory of international trade was aware of this distinction;[19] but it concentrated upon the ultimate loss and considered the time elapsing from interruption of trade to reallocation of resources within the country as a short-run period. Modern theory insists that this is not necessarily true; and even if it were true, our analysis would have to take into account the fact that harassed statesmen generally have a short-run view. Given a certain ultimate loss, the influence which one country exercises upon another through foreign trade is therefore likely to be larger the greater the immediate loss which it can inflict by a stoppage of trade.

For a country cut off from foreign trade the most urgent problem is to produce at home or to find substitutes for goods which were formerly imported and to find new employment for the factors of production formerly employed in export industries. The first problem is definitely connected with the ultimate loss from the interruption of trade, whereas the second is a short-run problem. Nevertheless, the "danger of losing a market" if political conditions deteriorate makes for as much concern as the danger of losing supplies. According to classical theory the active side of the gain from trade derives only from the imports, and the exports are set as a passive item against them. Modern theory, on the other hand, has presented an analysis which, within the framework of a national policy aiming at full employment, considers exports as an incentive to employment and national income, and imports as "leakages" which to a certain degree prevent the working of this incentive.[20] The classical and the modern approaches are of course based on quite different assumptions, and each is valuable in its own field for the explanation of some relevant economic facts. The modern approach, with its emphasis on immobility, overhead costs, and incomplete use of resources, leads to an understanding of why the common belief that the real benefit arising from trade lies in exports rather than imports is more than a mere "popular fallacy."

Obviously, the difficulties arising out of a cessation of exports will be greater the greater the exports (and consequently the imports); and the short-run problem is thus intimately connected with the extent of the long-run gain from trade. But with a given quantity

[19] Ricardo, in his *Principles of Political Economy*, states it thus at the beginning of the chapter on "Sudden Changes in the Channels of Trade."

[20] For a discussion of the "Foreign Trade Multiplier," see Gottfried Haberler, *Prosperity and Depression*, 3d ed. (Geneva, 1942), pp. 461–473, and literature quoted in that work.

of exports the problem created by an interruption of trade will be the more difficult, (1) the smaller the mobility of resources within the country, (2) the more the economic activities leading to exports have been concentrated in certain lines of production or in certain regions.

The mobility of resources includes the possibility of diverting capital goods to new purposes (i.e., their more or less "specific" character), the geographical mobility of the factors of production, and, above all, the ability of labor to turn to new tasks. The inherent advantage with respect to all these aspects of the mobility of resources lies overwhelmingly with the great manufacturing and trading countries as opposed to countries in which agriculture or mining predominates. Here again the prevention of industrialization would be the aim of a power trying to make the adjustment problem appear insoluble to the countries with which it trades.[21]

The second factor having a definite bearing upon the relative ease of adjustment after an interruption of trade is the extent to which production for export is concentrated in certain products or in certain regions. If most of the exports are made up of one particular product, there is very little probability that any great part of it can be consumed at home if the foreign outlet fails; if the exports all come from certain specialized regions within the country, there will be "distressed areas" and a need for large-scale relief and resettlement. It is highly unlikely that the pattern of the economic activities devoted to exports will follow closely the distribution of general economic activity among geographical regions and lines of production. But the discrepancy of the two patterns may be more or less pronounced, and, accordingly, the contribution of exports to dependence upon foreign trade will be large or small.

This subject is directly linked with the vested interests created by trade: a greater concern with the maintenance and expansion of trade in certain quarters than in the country as a whole. The actual going volume of trade, indeed, produces its own vested interests,

[21] We are considering the mobility of resources only so far as it influences the distribution of power created by foreign trade. Of course the mobility of resources has an extremely important *direct* bearing upon political and economic power. This aspect has been pointed out very clearly by Mr. Hawtrey, *op. cit.*, pp. 83–92. For a good discussion of the various factors influencing the mobility of resources within an industrialized country with special reference to the trade cycle, see C. M. Wright, *Economic Adaptation to a Changing World Market*, Chapter V (Copenhagen, 1939).

just as does the limitation of trade through protection; and the history of commercial policy offers convincing evidence that the protectionists would have been still more successful than they have been if they had had to contend only with the opposition of the "consumers at large."

If conditions are such that the possible loss from a stoppage of trade would fall with special weight upon certain groups within the country, these groups are likely to form a sort of "commercial fifth column." Aside from the purely commercial groups, such as import and export companies, the influence of which is generally meager, the vested interests will consist of the producers for export and of the industries using imported raw materials. If exports are concentrated in some region or some industry, not only will the difficulty of adjustment in the case of loss of these exports weigh upon the decisions of the government, but these regions or industries will exert a powerful influence in favor of a "friendly" attitude toward the state to the imports of which they owe their existence. Creation of potential adjustment difficulties and of vested interests is thus the twofold result of a commercial policy which aims at an intensive specialization of the trading partner's economy and which tries to prevent the diversification of the partner's exports with respect to regions and to products. In the social pattern of each country there exist certain powerful groups the support of which is particularly valuable to a *foreign* country in its power policy; the foreign country will therefore try to establish commercial relations especially with these groups, in order that their voices will be raised in its favor.

The Influence Effect of Foreign Trade (Section 2)

We must now drop a simplifying assumption under which we have worked hitherto and allow for the possibility of alternative markets or sources of supply. A country menaced with an interruption of trade with a given country has the alternative of diverting its trade to a third country; by so doing it evades more or less completely the damaging consequences of the stoppage of its trade with one particular country. The stoppage or the threat of it would thus lose all its force. In order to prevent this, the country wishing to conserve the influence derived from foreign trade in the real world of many nations must therefore take some precautions. The principles which we have formulated for power policy through the instrumentality of foreign trade retain their full validity. They were aimed at rendering it difficult for the other countries to *dispense* with foreign trade; but if we wish these principles to be effective in the real world, they must be supplemented by measures which make it difficult for other countries to *shift* the trade conducted with them by the nation trying to increase its power by foreign trade.

Any switching of trade would, of course, be rendered impossible by a monopoly of trade imposed by one nation upon another. In the old colonial system a colony was not permitted to turn to other buyers or sellers, even though the mother country had no obligation at all to provide the colony with goods or to buy from it. Under modern conditions subtler methods must be devised in order to arrive at similar results. A country may still hope to create conditions in which the diversion of trade to a third country will be much more difficult for its partner than for itself.[22]

In a very general way the difficulty of substituting country A as a market or supply source for country B may be said to depend not only on the absolute amount of A's trade with B, but also on the importance of this trade relatively to B's total trade. If, for instance, a country loses 5 per cent of its export trade, it should be able to find additional outlets in the markets which account normally for 95 per cent of its exports and where a sales organization for its products is likely to exist already. Similarly, if the country loses a relatively small fraction of its import trade, it is probable not only that its economic activity is not based to an undue degree upon these supplies, but also that other countries will be able and eager to make up for them. The greater the percentage of exports and imports involved in a dominant market, the more difficult it will be to provide substitute markets and sources of supply.

If a nation with an absolutely large volume of trade imports from, or exports to, a small trading nation, the trade they conduct together will inevitably result in a much higher percentage for the small than for the large trading nation. German-Bulgarian trade in 1938, for example, represented 52 and 59 per cent of Bulgarian imports and exports, respectively, but only 1.5 and 1.1 per cent of

[22] How important this problem is even in simple commercial bargaining is repeatedly brought out by N. F. Hall, "Trade Diversion—An Australian Interlude," *Economica*, Vol. V, new series (February, 1938).

the German imports and exports. These figures indicate that although the same absolute amount is involved, it will be much more difficult for Bulgaria to shift her trade with Germany to other countries than it will be for Germany to replace Bulgaria as a selling market and a source of supplies.[23] In the real world of many sovereign states it will therefore be an elementary principle of the power policy of a state to *direct its trade away from the large to the smaller trading states.* This principle must then be added to the one established above, viz., that trade should be directed toward the poorer countries. The two are by no means contradictory, as there are many states which are both poor and small.

Similarly, it will be an elementary defensive principle of the smaller trading countries not to have too large a share of their trade with any single great trading country, so that the integration of their economies with those of the great countries (for which no reciprocal integration is forthcoming) may be kept at a minimum compatible with their economic well-being. The idea that dependence can be diminished by distributing the trade among many countries has been clearly enunciated by Macaulay. These two principles, the one offensive for the large countries, the other defensive for the small countries, gave rise to the first two inquiries of our statistical section.

A more specific policy by which a country could try to prevent its trading partners from diverting their trade to other countries would consist in the creation of monopolistic or monopsonistic conditions with regard to certain products.[24]

With respect to exports, country A may try to change the structure of country B's economy so as to make it highly and artificially complementary to A's own economy. First, A may encourage the production of products having but little demand in other countries. This amounts to the creation of what might be called "exclusive complementarity" between the economy of country B and country A.

Furthermore, country B may have a comparative advantage in the production of a certain commodity with respect to country A, but not with respect to countries C, D, E, etc. If by some preferential

[23] Not only is it more difficult for Bulgaria than for Germany to shift trade, but it is also harder for Bulgaria to *dispense* entirely with the trade conducted with Germany, because this trade is much more "essential" to her. This is, however, not a consequence of her comparative smallness, but of factors pointed out in section 1 of this chapter.

[24] Cf. H. K. Heuser, *The Control of International Trade* (London, 1939), pp. 250–251.

treatment, A induced B to produce this commodity for export, A becomes B's only market, and the dependence of B upon A thus created may be well worth to A the economic cost involved in not buying in the cheapest market. In general, any attempt to drive the prices of exports from trading partners above world prices, whether by the direct encouragement of production contrary to the comparative cost principle or by general monetary manipulations, will fit in with the policy of increasing their dependence.

The paying of a higher price is only the most obvious way of rendering more arduous the diversion of a trading partner's exports to third markets. The offer of some special advantage relating to the conditions of the contract other than the price works toward the same effect. Firms often reward loyalty on the part of their customers by rebates and other devices.[25] The economies of regularity and the considerations of risk which explain this practice play an even greater role in foreign trade; with prices uniform, exports will therefore be directed preferably to those countries which are able and willing to guarantee stable prices for a prolonged period.

With respect to imports, the substitution of the imported products from any country will be more difficult in the absence of a natural monopoly the more highly differentiated are the products. Such products tend to create fixed consumption habits and production techniques, and difficulties arise when these products have to be replaced by similar but not identical products from other countries. Hence, it is generally easier for an industrial country to change the source of its supply of foodstuffs and raw materials than it is for a country producing foodstuffs or raw materials to change its traditional supplier of industrial goods.[26]

Under conditions of incomplete use of resources, however, it will generally be much easier to switch imports than exports, all countries being ready to sell and none ready to buy. This fact has indeed tended to dominate the whole discussion of the determinants of bargaining power between two trading countries. It was held that superior bargaining power is *always* on the side of the country having a passive trade balance with its trading partner. In other words,

[25] Cf. W. A. Lewis, "Notes on the Economics of Loyalty," *Economica*, Vol. IX, new series (November, 1942), pp. 333–348.

[26] Cf. R. F. Harrod's distinction of A, B, and C goods in his *International Economics*, new ed. (London, 1939), pp. 60 ff.

the difficulty of shifting imports was entirely discounted, whereas in assessing the difficulty of shifting exports no account was taken of the various factors enumerated above. It was thought that the country having the greater absolute volume of exports would automatically experience the greater difficulties of diversion and thereby find itself in an inferior bargaining position.[27] This is, of course, far too great a simplification; but the fact remains that an intelligent power policy must take account of the greater difficulty which is generally experienced in diverting exports.

Let us suppose then that country A buys a percentage of B's exports sufficiently large to render a substitution of these exports well-nigh impossible for B. Is there any means of extending this impossibility to the switching of B's imports as well? We see immediately that the policy of bilateralism is perfectly fitted to take care of this problem. Indeed, under conditions of bilateralism, a real impossibility of switching exports induces a *technical* impossibility of switching imports. In this way the device of bilateralism is seen to be an important link in the policies by which the aim of maximum power through foreign trade may be attained.

In all our analysis we have spoken exclusively of direct import and export trade. *Transit trade* plays a special and somewhat contradictory role when we try to answer the question: Should a country, from the point of view of power policy, aim at a large transit trade? On the one hand it would seem that transit trade can always be replaced by direct trade and that therefore the country handling the transit trade is in a rather weak position. But if the replacement of the transit trade is impracticable for geographical, technical, or contractural reasons, transit trade is immediately seen to be an ideal means of increasing power by trade. Indeed, the economy of the country handling this trade is only superficially affected by the trade; whereas it acquires the influence normally deriving from exports and imports both in the country of origin and the country of final destination of the transit commodities. In other words, pro-

[27] Relatively early the German economist Dietzel attacked this view: "In respect to the question of the strength of the (bargaining) position, it does not matter so much which one of the two nations waging a tariff war buys more from the other; it matters more which of the two nations can better do without the market of the other, and is able in the case of loss of this market, to sell nearly as much elsewhere."—Karl Dietzel, *Der deutsch-amerikanische Handelsvertrag und das Phantom der amerikanischen Industriekonkurrenz* (Berlin, 1905), p. 20.

vided only that its services are indispensable, the country handling the transit trade acquires from that trade a twofold influence and at the same time evades almost entirely any dependence of its own economy.

AN ILLUSTRATION: GERMAN TRADING METHODS UNDER NATIONAL SOCIALISM

The conditions or policies which have been described as being conducive to increased national power by means of foreign trade can be summarized by the following synoptical table:

Principles of a Power Policy Using Foreign Trade as Its Instrument

I. Policies relying on the *supply effect* of foreign trade and trying to insure its working even in times of war.

- A. Concentrate imports on goods needed for the war machine.
- B. Accumulate large stocks of strategic materials.
- C. Redirect trade to neighboring politically friendly or subject nations.
- D. Secure control of the oceanic trade routes.

II. Policies relying on the *influence effect* of foreign trade.

- A. Policies designed to make it more difficult for the trading partner to *dispense entirely* with the trade.
    1. Increase the trading partners' gain from trade (without impairing the supply effect).
        - a. Develop exports in articles enjoying a monopolistic position in other countries and direct trade to such countries.
        - b. Direct trade toward poorer countries.
    2. Increase the trading partners' adjustment difficulties in case of stoppage of trade.
        - a. Trade with countries with little mobility of resources.
        - b. Induce a wide discrepancy between the pattern of production for exports and the pattern of production for home consumption.
    3. Create vested interests and tie the interests of existing powerful groups to the trade.
- B. Policies designed to make it difficult for the trading partners to *shift* trade to each other or to third countries.
    1. In general: Direct trade toward the small trading countries.

2. With respect to the exports of the trading partners:
   a. Import products for which there is little demand in other countries.
   b. Drive prices of the export products of the trading partners above world prices:
      i. By fostering high-cost production.
      ii. By monetary manipulations.
   c. Grant to the trading partners' exports advantages not relating to the price of their products.
3. With respect to the imports of the trading partners:
   a. Export highly differentiated goods creating consumption and production habits.
   b. Develop trade on a bilateral basis.
4. Develop transit trade.

Practically all the outstanding features of German foreign economic policy since 1933 can be subsumed under this scheme. This does not mean, as will be explained below, that Germany has consciously worked out such a master plan. Keeping this in mind from the outset, we shall show very briefly the correspondence in each point between German policies and the general principles of a power policy through foreign trade which we have established. We shall list the German policies in the order indicated by the synoptical table and refer back to it each time by its own symbols. In our account of German policies, we rely on numerous studies of German trading methods to which the reader may turn for full information.[28]

[28] Antonin Basch, *The New Economic Warfare,* Chapter I (New York, 1941); H. M. Bratter, "Foreign Exchange Control in Latin America," *Foreign Policy Reports* (February 15, 1939); J. B. Condliffe, *The Reconstruction of World Trade* (New York, 1940), pp. 256–262, 291–294, 323–324; "Germany's Trade Offensive," *The Economist* (London, November 5, 1938); Paul Einzig, *Bloodless Invasion* (London, 1938); Howard S. Ellis, *Exchange Control in Central Europe* (Cambridge, Mass., 1941); A. G. B. Fisher, "The German Trade Drive in South-Eastern Europe," *International Affairs,* Vol. XVIII (March-April, 1939); Margaret S. Gordon, *Barriers to World Trade,* Part IV (New York, 1941); H. C. Hillmann, "Analysis of Germany's Foreign Trade and the War," *Economica,* new series, Vol. VII (February, 1940); *Europe's Trade* (League of Nations, Geneva, 1941); Fritz Meyer, "Devisenbewirtschaftung als neue Währungsform," *Weltwirtschaftlisches Archiv,* Vol. XLIX (May, 1939); von Mickwitz, "The Economic Structure of Capital Exports to South-Eastern Europe," Mimeographed for the International Studies Conference (Bergen, 1939); Douglas Miller, *"You Can't Do Business With Hitler* (New York, 1941); Mark Mitnitzky, "Germany's Trade Monopoly in Eastern Europe," *Social Research,* Vol. VI (February, 1939); *South-Eastern Europe* (Royal Institute of International Affairs, London, 1939); *South-Eastern Europe* (Royal Institute of International Affairs, London, December, 1940). (this is a separate and distinct work from the previous same-named publication); Hans Staudinger, "The Future of Totalitarian Barter Trade," *Social Research,* Vol. VII (November, 1940).

Little need be said concerning the policies relating to the supply effect of foreign trade. Germany considered her exports a means of obtaining in exchange certain imports deemed essential for her purposes (I A.); she accumulated large stocks of strategic materials (I B.); and she directed her trade toward countries from which she hoped not to be cut off in the case of war (I C.). The two latter policies, coupled with the autarkic program, were considered as a substitute for the control of the oceanic trade routes (I D.) which Germany could not hope to achieve.

Let us now turn to the influence effect. Germany's attempt to concentrate on exports of finished products, on the one hand, and on exports to agricultural countries, on the other, had obviously the result of giving her exports a quasi-monopolistic position so far as the productive system of her trading partners was concerned (II A.1.a.). In addition, to maintain this position, it was one of the great principles of German foreign economic policy to prevent the industrialization of her agricultural trading partners. Particular insistence on this point has been noted in all the commercial negotiations of Germany with her southeastern neighbors and even, to some degree and some success, with Italy.

The policy of trading with agricultural countries and, furthermore, of preventing the establishment of industries in these countries is indeed prompted, not only by the consideration just mentioned, but also by the fact that agricultural countries have generally but little mobility of resources (II A.2.a.), and that manufactured products, being highly differentiated, are often difficult to replace immediately by similar products from other countries (II B.3.a.). Here we have an example of the above-mentioned cumulative effect of power. Germany could never have hampered or prevented the industrialization of the Danubian countries if she had not had an initial political and economic ascendancy over them, and the prevention of industrialization in turn served to enhance or to maintain Germany's initial power position.

The modification of the structure of German trade can also be interpreted as a shift of trade from the relatively rich to the relatively poor countries (II A.1.b.). In order to give a statistical illustration, we have computed the shares in German trade for the eleven countries which, according to the thesis expounded by Colin Clark, are "richer" than Germany in the sense that real income per head of the employed population is higher.[29]

Looking at the percentages of the single countries, one notices that, with the exception of Eire, Denmark, and Sweden, an all-round decrease from 1929 to 1938 is evident. For Denmark and Sweden the incentive of regionalism may have outweighed other considerations. The trade with Eire is relatively insignificant.

The policy of trading with countries having but little mobility of resources (II A.2.a.) has already been commented upon. Germany has also induced the southeastern countries to use still more resources in the production of certain crops (oil seeds, fiber plants)

SHARES HELD BY ELEVEN COUNTRIES "RICHER" THAN GERMANY IN TOTAL GERMAN IMPORT AND EXPORT TRADE*

Year	Imports per cent	Exports per cent
1929	41.9	49.0
1932	39.1	48.9
1937	29.9	38.6
1938	31.3	37.1

* In 1938 Austria is excluded from the foreign trade statistics. In order to make the figures for the other years comparable to those of 1938, Austria has been excluded throughout, i.e., the figures are percentages of the total German trade minus Austrian trade. The figures have been computed from German sources (*Statistisches Jahrbuch für das Deutsche Reich* and *Wirtschaft und Statistik*).

and mineral resources which would practically be exported in their entirety (II A.2.b.). By offering a stable market for the agricultural surplus production of these countries, she tied landowners and peasants, the most powerful social groups in these countries, to her own interests (II A.3.).

Coming to the policies rendering a diversion of trade more difficult for the trading partners, we shall show in Chapter V how Germany concentrated her trade on the relatively small trading countries (II B.1.). The fostering of special products such as oil seeds and fiber plants is also an example of the creation of exports for which there would be little demand in other countries (II B.2.a.). Germany's encouragement of cultivation of cotton in Brazil, Tur-

[29] Colin Clark, *The Conditions of Economic Progress* (London, 1940), p. 41. The eleven countries are, in the order indicated by the author: United States, Canada, New Zealand, Great Britain, Switzerland, Australia, Holland, Eire, France, Denmark, Sweden. The margin of error of such calculations is admittedly very wide, but, over a short range of years, a computation such as we give on this page may serve our purposes.

key, and Greece, and her exploitation of low-grade mineral resources in Rumania and Yugoslavia can be shown to be contrary to the comparative cost principle (II B.2.b.i.). In general, Germany supported the agricultural economies of southeastern Europe without insisting upon the adjustments necessary to render them competitive on a world level. This had the effect of adding to basic cost disequilibria a monetary disequilibrium which drove the price system of these countries upward by the device of overvaluation of the reichsmark (II B.2.b.ii.). In this connection it must also be recalled that Germany has not only paid prices higher than those which could be had in the world market, but that trade with Germany offered to the southeastern countries another substantial advantage over trade with other countries: Germany had promised to these countries conditions of stability in both price and volume of their exports (II B.2.c.).[30]

With respect to imports which create consumption and production habits (II B.3.a.), we have already mentioned the general advantage of industrial countries in comparison with agricultural countries. The export of armaments to the Balkan countries, extensively practiced by Germany, is an item very much to the point, since a retraining of personnel is a necessary accompaniment of any improved style or variety of arms. In addition, once the main weapons had been accepted from Germany, the importing countries had to rely on her for ammunition and spare and repair parts. Bilateralism (II B.3.b.) has not only been the most evident new principle introduced by Germany into trade relations, but it has also had exactly the same function which we have attributed to it in our exposition: forcing the countries selling a substantial share of their exports to Germany to grant Germany a similarly dominating position in their imports. Finally, Germany has made the most sustained efforts to increase the amount of transit trade which she traditionally handled as a result of her geographical position (II B.4.). She tried to sell to the world the Balkan products, and to the Balkans she attempted to sell such "colonial" products as coffee, cocoa, etc.

[30] There is nothing paradoxical about the fact that the power of the state to interrupt trade may be made into a more effective weapon by granting to its trading partners certain advantages, e.g., of security—for a time. The security, indeed, is revokable; and the power of the state granting security in trade relations is precisely born of the desire of its trading partners to prevent the loss of this security. Here again *fortuna est servitus.*

The correspondence between German policies and the principles of a power policy carried on through foreign trade, which we have deduced from simple premises, will now have become clear. Just as these principles were originally derived by us from the single postulate of maximum power, German policies can be understood as a coherent whole by reference to this postulate.

Only future research into the proceedings of the inner councils of Nazi leaders will show how far their plans for economic conquest were actually laid down in advance. It seems probable, however, that the amazing coherence of German policies was due only in part to detailed planning springing from economic analysis and that an important role was left to experimentation in the elaboration of actual policies. But if we assume only that in every decision of commercial policy the political power standpoint was given due consideration, the coherence of German policies need not surprise us, for, in every case, this power, so far as it is based on foreign trade at all, goes back in the last analysis either to the strength which foreign trade lends to the German war machine (supply effect) or to Germany's power to menace her trading partners with a stoppage of trade (influence effect). It is therefore only natural that by examining in a general way the processes through which these two sources of power through foreign trade could be best developed, we should at the same time have described the actual policies of a state which had made power the primary object of its actions in every field.

It will have been noted that a single policy such as the prevention of industrialization realized simultaneously several distinct features of the power policy outlined in different parts of the present analysis. Similarly, we have seen how an apparent conflict between the supply effect and the influence effect of foreign trade could find a solution. Furthermore, a shift of trade toward the poorer countries will often be found to implement the other principle of power policy which impels a country to divert its trade toward the smaller trading countries. All these instances tend to show that there is a real danger of attributing too much cleverness to German policy by supposing a motive behind certain effects of policy which, though welcome, may not have been actually aimed at.

Economists have often dwelt upon situations in which a policy is self-defeating, i.e., leads to certain unforeseen repercussions which