

International Trade and Economic Growth:

The Roles of Ministries of Finance, Industry, and Trade

By Anne O. Krueger

Arts and Sciences Professor of Economics at Duke University

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INTERNATIONAL TRADE AND ECONOMIC GROWTH: THE ROLES OF MINISTRIES OF FINANCE, INDUSTRY, AND TRADE

Anne Krueger agreed to talk on trade and economic growth in an historical context. Her theme focused on international trade in goods and services.

My theme is complex. I will focus on international trade meaning the exchange of goods and services to the exclusion of international monetary arrangements, international capital flows, and the like. The major reason for focusing on trade is that as economists look at the international economic system we generally understand that the purpose of international monetary arrangements and other things is to facilitate a smooth flow of goods and services which permit economic efficiency within countries. It focuses on trade as an end product of these other things. I will point out what I regard to be the very important role of Ministries of Finance with regard to international economic arrangements and this role transcends trade and covers other economic arrangements as well.

I will now state my theme and spell it out:

My theme is a very complex one and I want to wind it around the evolution of the international economy and economic growth, on the one hand, and then the role of economic policy and particularly the international economic policy within that role as something interacting with economic growth and then finally trace how in fact the role of finance ministries, i.e., the Treasury, relative to other ministries, has changed in the process of economic growth and where I see one very vital role of Ministries of Finance in today's and tomorrow's world.

My theme then really has three parts:

The first and an important one is that economic growth has been, and is, and will be spurred by increasing international economic integration. In large, trade areas have been essential for the Industrial Revolution, and continuing economic growth will not take place at anything like the rate that would be possible unless we continue to permit the integration of markets.

Secondly, in the process of economic growth Ministries of Finance have changed their roles completely as regards the international economy. Historically, Ministries of Finance, as their name implies, were there to raise revenue; they were there to finance what government or the state wished to undertake. Taxes on imports were important and so Ministries of Finance were pro taxes on imports because they raised revenue. They were key in hurting the integration of the international economy at an early stage.

Third, over time, and for a variety of reasons associated with economic growth, other sources of revenue increased in importance and, at least in countries that were growing, tariffs decreased in importance. This will be related to my first theme of economic integration. Finance Ministries and Treasuries then changed sides. They were long opposed to quantitative restrictions on trade because they did not raise revenue, and that was not worthwhile. But simultaneously, once they could no longer raise tariffs they began to look at the whole international economy from a systemic and public interest viewpoint.

Simultaneously, with increasing integration of the international economy and with falling transport costs, pressure groups sprang up and other ministries, or in our country departments, emerged with very strong roles as being responsive to pressure groups. In this process, trade policy has evolved in ways in which there is an interaction within our government and within most governments between the ministries that are public interest and the ministries that in effect have been at least partly captured by special interests. And in so far as economic growth is to continue, it is going to be more and more the duty or responsibility of Treasury and public interest ministries to protect society from special interest groups which do indeed impinge on trade policy through their particular advocacies. Dr. Krueger argues that that role will become especially vital now and in the years ahead.

Dr. Krueger spells out each thesis in turn.

I. ECONOMIC GROWTH AND INTERNATIONAL ECONOMIC INTEGRATION

1. Falling Transport Costs

Let me first talk about economic growth, economic integration, and the importance of economic integration for economic growth. High transport costs mean very small markets and very small production runs. When transport costs are very high there is not an awful lot that you can send very far; the results are production runs are small, and the scope for division of labor, economies of scale, and the kinds of things that have made the Industrial Revolution are very limited.

Now transport costs were falling even in the Middle Ages. There was a great deal more trade in the United Kingdom in 1500 than in 1200 and more in 1600 than in 1500, but arguably as late as 1600, probably 98 percent by value and 99.5 percent by weight of the goods and services consumed had been produced within 100 miles of where they were consumed. The cost of moving commodities from here to there was prohibitive for almost all commodities. Beyond lightweight, low volume/high value commodities, such as spices, opportunities for trade in the early years were miniscule for very obvious reasons, you just couldn't afford to.

The Industrial Revolution could not have gone very far without falling transport costs. And by transport I mean entire complex of things that lets us get goods from here to there. Communications is important, the ability to move things without damaging goods, and so on. Dr. Krueger cites Eli Heckscher's example of the 400 tolls at which ships had to stop up and down the Rhine River. The point is not only that there were all these stops that interfere with trade, but the cost of the tolls was less than sending the ship itself [that is, shipping costs were still higher than tolls].

While there were man-made barriers to trade, the tolls, there were also some real barriers to trade, which were the very high cost of shipping.

Over the next several hundred years shipping costs fell enormously. [There was] also the steam engine, railroad, stage coach, Panama Canal, and so on. There were some other things. Transoceanic shipping costs fell by 63 percent with the elimination of piracy; when they got rid of heavy guns they could put more goods on ships. For example, three times as many goods is one-third the cost.

All of these things together, it is estimated, meant that about 1900 it cost 3 percent in real terms of what it cost in 1800 to ship something across an ocean.

The elimination of piracy, steam engines, canals, the whole entire thing: It was a revolution in how we could get things from here to there.

Dr. Krueger gave as example the home of Washington Duke, tobacco magnate. She went through his large homestead; asked where things came from. Everything in his house came from 50 miles away and Duke died in the 1880s. Everything had been produced within the local area. It would not make economic sense to have things produced further away and shipped as shipping costs were too great. Today North Carolina still produces but it ships furniture everywhere, and shipping costs are a very small fraction of price. That has changed the nature of the economic transaction.

Mass production is a very important part of the Industrial Revolution. But what good would it have been without falling transport costs and increasingly large markets. We think about those things in terms of goods, but cities themselves could not exist if we had transport costs as high as they were 200 or 300 years ago. A city depends upon the supply of goods and services coming to it.

With economic growth that process has continued and is continuing. I want to stress that it is not a process that has yet ended. In the 20th century we have seen air transport and communications and their real costs fall enormously. Dr. Krueger cites airplane and fax machines to move goods and designs quickly. This is tremendously efficient and cost effective. It's an integrated world economy. Anyone not able to use various countries' resources is at a true disadvantage in the modern world. The world is still being transformed [into one] in which we can become more productive.

The process is continuing with gains for all; those gains differ from time to time and many of them we forget.

But the point I would stress is that what is happening technologically is we are finding exactly the right square peg of exactly the right dimensions to go in exactly the right hole. And the more we can do of that the more we lower costs.

But things are becoming so specialized that the gains come from sizeable production runs, but you have one run that satisfies a very large fraction of this month's world demand of this very particular item. That means in turn that we need an international integrated economy.

There are other gains that are visible to consumers such as Chilean fruit in the winter.

Availability of goods and services is increasing in ways that are very important and in which none of us can afford at this stage of the world economy to reject.

2. Trade Policy

Having showed how important the fall in transport costs are to economic growth, let me turn to trade policy.

Transport costs are real barriers to trade. It doesn't matter whether the factors of production I am using are spent in the process of transporting the goods or producing the goods. You should never pay more for something, by the time you pay transport costs, that is greater than if you can produce the goods yourself, because those are real resources spent on the phenomenon.

That is not true of tariffs. Tariffs are man-made barriers and artificially interfere with the flow of real goods and services.

Adam Smith showed that there was comparative advantage and efficiency that come from trade. When transport costs were 500 percent or 1,000 percent of the cost of production, tariffs mattered, but a 20 percent reduction in tariffs did not matter very much when transport costs were 500 percent of the cost of production. But as transport costs fell, artificial trade barriers-tariffs-became important in influencing the flow of trade.

Now I come to a very interesting historical anomaly. Under mercantilism exports were good and imports were bad, because [countries] wanted to get gold. What the kings and the lords did was give their exporters, such as the East India Company, trading monopolies; and then collect tariffs on imports. The idea of the trading monopoly was that you encouraged the exporters; the idea of tariffs was to discourage imports and collect revenue.

The point of all this is that trading monopolies were there because there were so few commodities internationally traded and transport costs were so high that what few things were traded were the very specialized items that only one country could produce. Over time, as transport costs fell, the monopolies disappeared. The Dutch could compete with the English and they could compete with the French, and the monopoly was not worth anything; most faded away. There was never any conscious decision to end the monopolies but it was not worth anything to be the only English exporter of commodity X because there were several Dutch exporters, etc.

While monopolies on the export side went away, the tariffs on the import side remained. What happened in the 19th century was that the Industrial Revolution progressed both on falling transport costs, and they fell dramatically, but also on the move to free trade that was the aftermath of Adam Smith's and David Ricardo's focus on comparative advantage. And most of the European economies in the 19th century had much of their growth based on this combined impetus of increasing economic integration because of falling transport costs and increasing economic integration because of removing trade barriers. By 1856 England had almost no barrier to trade of any kind remaining; England had almost free trade.

Now the United States was different; it had higher tariffs. But the United States had a larger internal market so that the gains in the United States were coming in large part from integrating while transport costs externally were still higher because we had that whole ocean to cross. So in effect we got more of our impetus to growth from falling transport costs and somewhat less on the tariff side than did Europe in the 19th century. So our history is a little bit mixed in that regard. But in either case, certainly trade liberalization has been important.

The quarter century when the economic growth of the world economy has been the most rapid in the history of mankind was 1948-1973. World per capita income increased more absolutely in that 25-year interval than in the entire 19th century, i.e., the quarter century growth rate exceeded the century growth rate. And, once again it was a period of tremendous trade liberalization; institutions to assist international trade began after World War II: the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), and the General Agreement on Tariffs and Trade (GATT). But in terms of the impetus to growth since World War II, European dismantling of their trade barriers and the gradual reduction and often elimination of tariffs between the industrial countries, through various rounds of tariff reduction negotiations under GATT, were clearly of critical importance in sustaining that very successful episode in world economic history.

I will come back to that at the end because the question of whether that goes forward or is sidetracked is of crucial importance and is an issue where, as I said, I think public interest ministries have a good deal of potential to serve the world well.

II. CHANGING ROLES OF TREASURIES AND MINISTRIES OF FINANCE

Dr. Krueger moves to her second topic, Ministries of Finance and their changing roles in all this. Import duties were a major source of funds. In the United States, however, things were somewhat different. In the United States there was initially a debate over what the role of the tariff should be. The first Secretary of the Treasury, Alexander Hamilton, was deeply involved in this issue. Hamilton had read Adam Smith. Hamilton's writings are full of contradictions on what the role of tariffs should be; his writings are not entirely internally consistent. He did argue in some of his writings that you needed a strong government that assumed some control over the economy; influenced to some extent by his belief in mercantilism and the need for revenue. He, however, also noted that tariffs were important for raising taxes. Quoted Hamilton: "No mode [meaning tariffs] can be so convenient as a source of revenue to the United States; it is agreed that imports on trade when not immoderate or improperly laid are one of the most eligible species of taxation."

So, while Hamilton on occasion had had mercantilistic leanings, and later he had his *Report on Manufactures* and his infant industry argument, he moved around the issue to a great extent. Hamilton's view on tariffs was more multisided than Anne Krueger had been led to believe before she began boning up for this lecture. In the *Federalist* [Hamilton] warned that tariffs would give domestic manufactures a premature monopoly of the market and he was very concerned that prohibitive tariffs should be implemented only when "a manufacture has made much progress and in so many hands as to insure competition and an adequate supply on reasonable terms."

[Secretary] Hamilton also recognized that there are great benefits in an open, international economy. [He] noted that some other countries protected their commodities--does this sound familiar--and therefore wondered if there should be a role for American protection as a countervail to what was being done abroad and concluded that that was a dangerous policy. Hamilton felt that Congress might impose some protective duties on imports or place prohibitive duties on rival articles or Congress could prohibit the export of raw materials, use bounties and premiums, exempt raw materials from duties, etc., but such measures should "be short term in nature and be removed as soon as industry grew competitive enough for world markets."

Interestingly enough a debate then followed over what the role of tariffs should be and Hamilton's view on the infant industry did not prevail. Congress decided on having higher duties, imposed duties of a range of 5 percent to 15 percent and even up to 20 percent as a source of revenue, collected by the Treasury Department. In 1800, 90 percent of federal revenues were collected on tariffs. Tariffs were *the* source of revenues for the U.S. Government and a major source for most other governments at that time.

TREASURY IS PRO-TARIFF BECAUSE OF ITS REVENUE EFFECTS. That tariff which maximizes revenue is not a tariff which is as protective as possible. The most protective of all tariffs is, of course, one that prohibits imports and has no revenue. If you want revenue

there is a maximal height on tariffs and some of the Treasury's positions in the 19th century, which were for tariff moderation, quite clearly were taken because of the concern with the revenue implications of going to ever higher tariffs. Nonetheless, tariff revenue was important and the TREASURY was generally PRO-PROTECTION. Now while the Treasury was pro-protection, it was also opposed to quantitative restrictions. Why? Because they do not raise revenues which turns out to be fairly important in American economic history. There were proposals for prohibitions for import licensing and, on most occasions, the Treasury stood firm saying no we want a system where tariff duties are the major barrier to trade with obvious bureaucratic turf ground in mind in that particular connection.

During the 19th century tariffs did rise and fall, but, despite these fluctuations, the average tariff gets to 40 percent and falls to 20 percent. But while that was going on, tariff revenue as a percentage of total revenue was falling sectorally. As other sources of revenue, such as excise taxes, increased, tariff revenue diminished in importance. If we were to define the time when indeed tariffs were no longer of concern to the Treasury as a major source of revenue, it would of course be with the introduction of the income tax [1913]. By that time tariff revenues were down to about 10 percent of total revenue, and by that time Treasury concern with these issues, here and in most other industrial countries, was non-existent and Treasuries were much more concerned with other issues.

III. PRESSURE GROUPS, TREASURIES, AND TRADE POLICY

This leads me then to the third of my interrelated themes. Over time with transport costs lessening, competition from abroad increasing, and the increasing integration of the international economy, the share of trade in GNP naturally rises and has risen in almost every industrial country. In most European countries the share of exports in GNP is well over 50 percent. We are an outlier because we are a large country separated by oceans, etc., but even so our share of exports to GNP is around 15 percent, an historic high. Trade is much more important, we are much more integrated.

More and more notions of ships in ports and of tariffs on machine goods are outdated as we now have communication by satellite, fax, all kinds of other ways, and it makes less and less sense to keep on thinking trade policy as we used to do.

But as all those things are happening, there have been Ministries of Commerce or Trade or Industry, depending on the country, and Agriculture, and other things that have been established, and those ministries which initially were established for domestic internal reasons have increasingly become concerned with issues of trade and trade policy because with the increasing integration of the world economy it is more and more perceived that what is happening there affects us. The U.S. Department of Agriculture did not ignore foreign trade but it was not central; it is now very central for most commodities. How the exchange rate moves affects agricultural prices in this country and affects farmers' incomes

directly and visibly. That was true 50 years ago but it was not as direct, not as visible, and not quantitatively as significant.

As these things have happened, special interest groups have become more important in attempting to influence those ministries in terms of their policy stance toward trade issues. They respond to them and one therefore finds in most countries that Trade Ministries are typically ministries which are responsive to the interests of various domestic producer groups who perceive themselves threatened by imports. Now the perception of an import threat and reality are not necessarily the same thing. Managers blame imports for a lot, such as incompetent management or a move from North to South to cheaper labor. They are the real reasons; imports are the public reason; [they] blame unfair foreign competition.

We blame imports for a lot whether they are at fault or not. And as imports increase in size and as the international economy gets increasingly integrated, it gets easier and easier to look at the international economy and then to put pressure on local representatives. Now as that happens, of course, one gets more and more special interest group politics as one factor determining trade policy.

To bring us up to date, we had the Smoot-Hawley Tariff, a rather disgraceful episode in U.S. history; it was the highest tariff ever imposed in U.S. history. It was put into effect in 1930. The American Economic Association (AEA) got almost [all of] its members to sign a petition that it was unwise; [it was] possibly the only thing 100 percent of its economists ever agreed upon. The Smoot-Hawley Tariff was a disaster. [Look at] it in the context of the Great Depression. Depression would have happened anyway but it would not have been quite as deep or as prolonged and other countries would not have in turn retaliated, and perhaps the debacle would not have been quite as complete as it was, the turn around might have been sooner, who knows. Almost everybody by the end of the 1930s did recognize the folly of the Smoot-Hawley tariff.

The United States was fortunate to have Secretary of State Cordell Hull who recognized some of this silliness and who worked very hard to get the most favored nation into U.S. trade relations as the building process for our postwar trading policy.

So in the 1940s at the same time as American, Treasury leadership was busy with the World Bank and the IMF, it was also busy with the International Trade Organization, where it was proposed there would be an international body. The ITO was supposed to be the international agency to set down rules of the game so if someone was playing unfairly [other countries] could go to ITO for dispute settlement. The U.S. Senate failed to ratify the ITO treaty; just why I am not even sure. (Dr. Krueger has read conflicting accounts.)

In place of the ITO, the General Agreement on Tariffs and Trade, GATT, was made a Presidential agreement; it is not a treaty but it is binding under international law. All signatories to GATT subscribe to the principles of free trade and to an open multilateral

trading system and undertake certain obligations vis-a-vis each other. They can take their claims for unfair treatment to GATT and its dispute settlement mechanism.

After the second World War what happened was, of course, that Europe and Japan were devastated; we started out in 1946 where no European country had any degree of currency convertibility whatsoever, except Switzerland. And indeed, bilateral payments between pairs of European countries were subject to barter deals. There wasn't any multilateral clearing of any kind. In that context, the American government, including State and Treasury, led the way in forming a European Payments Union. [We got the] beginning of an economic miracle; 25 years of growth.

And in that process, once the European economies had recovered, we began various rounds of trade negotiations; first was the Dillon Round, aptly named; countries met and bargained reciprocally for tariff reduction.

The funny thing about the GATT, and it's still a problem, is that--I don't know if it was an astute model of political economy that led to it or what--because every economist knows if I put up my tariffs I hurt myself. I may hurt the other guy too a little bit, but I will hurt myself much more. And yet the underlying principle of GATT is that countries get together and negotiate where I will lower my tariffs if you will lower yours.

By the early 1970s the highest average tariff of any country in the OECD was about 17 percent; tariffs had fallen to historic lows to a point where they are relatively unimportant. However, as that happened a couple of other problems arose.

The GATT procedure was one under which a country once it negotiated its tariff reduction, then bound its tariff. Tariff binding is a process whereby once you have bound your tariff you are bound under the GATT rules not to raise the tariff again unless there is special injury under very carefully defined conditions. So raising tariffs was not any longer a policy option in most of the countries that had been bargaining through the GATT. The result of which was that when protectionist pressures did arise and did get to a point where there was a response, those pressures were for protective measures other than tariffs. And, in the American case, as in the European, those protective measures have taken two forms: one, various kinds of quantitative restrictions on trade and, two, those agreements euphemistically called Voluntary Export Restraints.

Voluntary Export Restraints are export restraints because the quantity that may be imported is negotiated with the exporting country and the exporter then takes the responsibility for assuring that the volume limits will not be exceeded. And, to our great shame, the United States has engaged in bargaining for the multifiber arrangement which limits the quantity of textiles and clothing of various kinds that are imported. We have had a number of voluntary export restraints on stainless steel, steel products, color TVs, automobiles, electronics of various kinds. There has been a little bit of a disaster scene in that regard.

Economists have long since been aware of the problem that there is something of a fallacy of misplaced concreteness.

Man in the street sees a Toyota driving along and he says there go four American jobs. He forgets several things. First, for every one job in producing automobiles there are four jobs in servicing automobiles. And if cars are cheaper there are more cars. And the employment effect of more cars probably directly outweighs the employment effect of fewer American cars. Beyond that he forgets that if we are importing some things we are exporting others. People say we want protection because it will help our balance of trade. Whereas, everybody in this room knows very well that if we have some more protection it is very likely that, unless something changes saving or investment behavior in the private or the public sector, what will happen is that our exchange rate will appreciate somewhat to offset this and our trade balance to a first approximation will remain unchanged plus or minus small timing difficulties. And when that happens some of our export industries will not expand as they otherwise would have.

Now it seems to me that in those circumstances, as every economist knows, there is a public interest. The public interest is the interest of those unemployed people who would have found jobs in the export factory had it expanded. It is in the interest of those who would otherwise have had the export orders who did not come forward; and those we do not know. And that conflicts very much with the special interests that are reflected in the more narrow desire for protection of particular groups within society.

Protectionist pressures have come to the fore in the 1980s for a variety of reasons. It is well documented, I think, that protectionist pressure increases whenever, on the one hand, the unemployment rate goes up or, two, when the real exchange rate appreciates. In the early 1980s we had the largest appreciation of the real exchange rate of any point in postwar history combined with the highest unemployment. And we got protectionist pressures. And we got a political response which was very much the result of these particular interest groups pressuring for relief because of this fallacy of misplaced concreteness.

Now in that regard Treasuries have become increasingly a bulwark for the public interest and not just in the United States. They recognize the common good, they in general tend to be looking at economic efficiency as a whole, and to be one of the viewpoints in government where indeed the interests of the entire system and the interests of those anonymous workers who will get the jobs if we have the export sector and where the arguments for economic efficiency are respected.

Treasuries have, I think, on the whole, been reasonably solid in their record with regard to protection and so on in the 20th century. There has been trigger pricing on steel administered by Treasury but it can be argued that it was administered so half-heartedly and so reluctantly that the steel industry didn't like it. And one could go on with some of these other occasional ventures into other forms of protection.

But the trouble is that trade relations have been captured not by Treasury but by other ministries where these special interests tend to prevail and there is increasing danger, I submit, of increasing capture and on a sector specific basis.

One of the great difficulties confronting the trade negotiations going on right now in the Uruguay Round, which are really a watershed in terms of whether we resume economic growth and get back to the trajectory of the 1970s or not, is that there are tremendous gains to be had if agricultural trade will be liberalized. The Europeans are finding it exceptionally costly to maintain their very high subsidies and other forms of protection that have them exporting commodities they should be importing, and at low prices. The Japanese are finding it increasingly costly to continue protecting their industries. World prices are lower and that hurts us and that hurts some other agricultural exporters.

Simultaneously, there are a number of our export industries that would be vastly benefited by increasing liberalization in other countries of trade in manufactures. And there are some of our manufactures where we probably, in return for the public good interest in the longer run and with appropriate trade adjustment assistance, should liberalize, as for example, the multifiber agreement.

The difficulty is that the Ministry of Agriculture or our Department of Agriculture is pretty much handling agricultural trade subjects and our USTR with the Commerce Department is pretty much handling industry. And to make the appropriate trade offs between sectors of the economy which is the essence of an open trading system and the essence of how you get economic growth is going to be the responsibility of the public interest ministries of which Finance Ministries are one.

In almost all countries institutionally, and there is one exception, this is a major problem. The IMF can have its meeting in September of the Interim Committee and the IMF is after all very concerned about trade policies and Mr. Michel Camdessus [Managing Director of the IMF] lectures to all of the assembled Finance Ministers about the importance of an open trading system and they all agree with him. And the World Bank has its meeting of the Development Committee and in comes some of the aid ministers, a few Foreign Ministers, and some Finance Ministers who happen to be the Governors, and Mr. Barber Conable [President of the World Bank] or before him Mr. Tom Clausen could again talk about the importance of trade because the developing countries with their heavy debt burdens had to be able to export in order to pay their debts and every body there agreed.

The only trouble was, and is, is that those people are not the people involved in the trade negotiations to a very significant degree. Trade negotiations have to a large degree, not entirely, in most countries been the province of the special interest mission to a greater extent than they should have been and Treasuries in general have, to a certain extent, been standing back from their public interest role in this regard with very grave consequences for the international economy.

Now one could say, well, that's the way it is and that's the way it will be. And perhaps on the 300th anniversary of the Treasury we will conclude that in the year 1980x the Treasury really lost its major leading role in trade policy issues in the United States. Or perhaps, and I hope, the public interest groups and the public interest ministries will once again find ways in which they can have a stronger influence and, therefore, move the world back toward a path of healthier economic growth, pulling together these diverse sectors of the economy rather than dealing on a sector specific basis.

How would that happen? I don't know. I think it is a challenge in every industrial country except two. And those two are Canada where the Trade Minister is under the Foreign Affairs Ministry, it's not separate, it's within foreign affairs and reviewed as part of foreign policy; and Australia where one agency is charged with policy with regard to agriculture and industry and charged with looking at the impact on the entire economy of any protectionist measure undertaken.

But with the exception of those two countries, there is, I think, at the present time a structural problem in every major industrial country in that trade issues have been captured to a large degree by the ministries that do not have the general overview that the Treasury has.

The GATT Round is now in progress. The Uruguay Round had its halfway point in Montreal. It almost stalled there but there was some temporizing choice of words that came out in April which nobody knew what it meant, but it meant that the Round would go forward. There are two years left in the Uruguay Round which does, I think, represent a crossroads. If there cannot be found ways within it in which procedures can be had so that the multilateral system can resume its functioning, we can start removing the sector-specific barriers to trade and otherwise get back on track, I fear for the history of the Treasuries and the special interest ministries over the next hundred years.

QUESTION AND ANSWER PERIOD

Question: How deeply intertwined is and do you think the nations will be able to get out of the interconnection between the debt crisis and the trade crisis?

Dr. Krueger: Well, actually that is an ideal question to reinforce the point that I was making. One of the crying issues it seems to me of the 1980s is how one ties together policies dealing with developing countries and, I suppose, Eastern European countries' debt and trade issues. We have at the moment just incredible anomalies. We have, for example, people telling the Brazilians they have to straighten out their economy, they have to earn more foreign exchange so that they can finance their debt servicing obligations. Simultaneously, we have put Brazil on the Super 301 list on account of how we think they are cheating in their trade practices. Now in some sense maybe they are and maybe they aren't and one can worry about that. But two parts of the American Government are going in very opposite directions with regard to the very same country on the very same set of issues.

And the urgency of saying, look, if developing countries are to service their debt the international trading system has to remain sufficiently open so that their exports can grow. And the exports of the heavily indebted countries as a group must grow at least the nominal rate of interest or their debt service ratio by definition will rise further.

To make that very obvious linkage which is part of this public interest--let's get these issues together that I was talking about--has, I think, been one of the failures of policy in the World Bank, the IMF, the American Government, the European Governments, the Japanese Government, and the developing country governments and the academic community. Nobody has been able somehow in public consciousness to sort of tie these issues together and make clear that you can't sort of talk about financing developing countries' debt and not simultaneously talk about the trade that goes with it. How you do it, I'm not sure. If I had a good idea I'd be delighted to share it. All I can say is that a lot of people have talked about the absence of a way to make vivid this link and spent time on it and so far at least the connection has not been made with the short kind of one liner that captures enough attention among politicians and the public to get anywhere.

Question: A question was raised on transport costs and other costs of trade in economic history.

Dr. Krueger: A good question. While we know that there was trade in tin and other raw materials many hundreds of years ago, it was a very small volume relative to what would have been GNP had anybody then calculated it.

Two pieces of evidence:

One is events since World War II. At the end of World War II if you looked at world exports and then you looked at world imports c.i.f., the ratio of imports to exports was on the order of 1.2 to 1; i.e., 20 percent was eaten up in transport costs, that number is now down to 8 percent. It's fallen in half, relative to those commodities, even since World War II.

In so far as they have been able to work out the numbers going backwards, it fell by more than half between 1800 and 1850 and again by more than half between 1850 and 1900. It is transport costs relative to the cost of goods that I was speaking about not in the absolute sense.

Secondly, an economic historian looked at the terms of trade between England and Italy; both countries had improved terms of trade. Why? Because, due to falling transport costs, both had falling export prices and rising import prices. How can that be? Because in terms of broad aggregates the relative price that declined the most was in transport.

The Treasury Historical Association celebrates Treasury's role in Financing Freedom for 200 years.

Treasury is the second oldest department in the Federal Government.

Treasury was the first government agency to collect international trade data. Between 1790 and 1903 Treasury collected, analyzed, and published data on exports, imports, duties, and tonnage.

But Treasury's interest in trade predates its statistics gathering.

On July 4, 1789, the second law of the new United States Government was a tariff measure, fixing rates of duties on imports at 5 to 15 percent with 17 items on the free list.

On July 31, 1789, the fifth Act of Congress created the Customs Service establishing an administrative system of customs districts, ports, and collectors that is still in use today.

From the first, the Treasury Department participated in the formulation of commercial policy.

In February 1791, Alexander Hamilton, first Secretary of the Treasury, in response to a request from Congress, submitted a report on the importance of trade with China and India. He wrote:

As an additional and extensive field for the enterprise of our merchants and mariners, and as an additional outlet for the commodities of the country, the trade to India and China appears to lay claim to the patronage of the Government.

In December 1791, Secretary Hamilton presented his famous *Report on Manufactures*, ably arguing for protective duties aimed at encouraging domestic manufactures.

Recognizing that trade was an engine of economic growth and would fulfill the Constitution's promise of a truly national market, Albert Gallatin, Thomas Jefferson's Secretary of the Treasury, urged, in an 1808 *Report on Roads, Canals, Rivers, and Harbors*, that the National Government build the internal improvements that would bring regional products to national and foreign markets.

Henry Morgenthau, Franklin Roosevelt's Secretary of the Treasury, saw the need to restore the Depression-and war-torn international economic system. Under his leadership, the creative proposals for an International Monetary Fund and World Bank, developed by John Maynard Keynes and Treasury's Director of Monetary Research and Assistant to the Secretary, Harry Dexter White, were, after a year of study by the Finance Ministries of the

United Nations, accepted by 40 of the 44 nations at Bretton Woods, New Hampshire in July 1944.

In August 1971, Secretary of the Treasury John Connally and Under Secretary Paul Volcker developed the Nixon Administration's policy for suspending the convertibility of the dollar into gold and for floating exchange rates.

THA, therefore, felt it only fitting that our Bicentennial lecture series include the important topic of international trade.

(From the introduction of Anne O. Krueger)