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GENERAL EDITOR: C W GUILLEBAUD, M A

INTERNATIONAL ECONOMICS

INTERNATIONAL ECONOMICS

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INTRODUCTION TO THE SERIES

By the General Editor

SHORTLY after the war of 1914-18 there seemed to be a place for a Series of introductory Economic Handbooks "intended to convey to the ordinary reader and to the uninitiated student some conception of the general principles of thought which economists now apply to economic problems."

This Series was planned by the late Lord Keynes under the title *Cambridge Economic Handbooks*, and he wrote for it a general Editorial Introduction of which the words quoted above formed part. In 1936 Lord Keynes handed over the editorship of the Series to Mr. D. H. Robertson, who held it until he became Professor of Economics in the University of London.¹

The judgment of its originators has been justified by the wide welcome given to the Series. Apart from its circulation in the British Empire, it has been published from the start in the United States of America while translations of the principal volumes have so far appeared in German, Spanish, Italian, Swedish, Japanese, Polish and Lithuanian.

It is symptomatic of the changes which have been taking place in recent times in the development of economic science, changes associated in a high degree with the work and influence of Lord Keynes himself, that within the brief space of fifteen years the text of part of the Editorial Introduction should have stood in need of revision. In its original version the last

¹ Professor Robertson now holds the Chair of Political Economy in the University of Cambridge

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paragraph of the Introduction to the Series ran as follows :

“ Even on matters of principle there is not yet a complete unanimity of opinion amongst professors. Generally speaking, the writers of these volumes believe themselves to be orthodox members of the Cambridge School of Economics. At any rate, most of their ideas about the subject, and even their prejudices, are traceable to the contact they have enjoyed with the writings and lectures of the two economists who have chiefly influenced Cambridge thought for the past fifty years, Dr. Marshall and Professor Pigou.”

When the Editorship of the Series was transferred to Mr. Robertson, Lord Keynes consented to the retention of his general Introduction, but subsequently re-wrote the concluding paragraph in the following form :

“ Even on matters of principle there is not yet a complete unanimity of opinion amongst professional students of the subject. Immediately after the war daily economic events were of such a startling character as to divert attention from theoretical complexities. But to-day, economic science has recovered its wind. Traditional treatments and traditional solutions are being questioned, improved, and revised. In the end this activity of research should clear up controversy. But for the moment controversy and doubt are increased. The writers of this series must apologise to the general reader and to the beginner if many parts of their subject have not yet reached to a degree of certainty and

INTRODUCTION TO THE SERIES

lucidity which would make them easy and straightforward reading."

Still more recent events have produced a world so far removed from that which existed when the foregoing words were written, that it has fallen to the lot of the present Editor to provide a new Introduction.

This is perhaps a good vantage point from which to survey very briefly some of the principal trends in the evolution of economic thought in this country during the past thirty years. Prior to 1914 economic theory here was largely dominated by Alfred Marshall, and economists, following him, thought in terms of the long period tendencies of the different sections of the economic system towards positions of equilibrium, even though ever-present dynamic factors were perpetually modifying the existing structure and presenting new and equally distant, if equally unattainable, goals as stimuli to change and adaptation. Moreover, in the Marshallian system, those tendencies resulted from the working of persistent underlying forces which were conceived of as largely competitive in character. The increasing trend towards monopoly was certainly affecting thought, but not so much in the realm of the theory of value as in the emphasis which came to be laid on possible discrepancies between the private interest and the social interest. Under the influence of Professor Pigou a Welfare Economics was developing side by side with, and out of, the Value Economics of the older generation.

After 1918 the long-drawn-out agony of the depressed areas, the weakening of the position of this country in international trade, and the tremendous intensity of the economic crisis of 1930-32 (to mention but a few

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out of the many contributing causes) combined, on the one hand, to focus attention on problems of the short period and, on the other hand, to throw doubt on the extent to which the self-adjusting, seemingly automatic mechanism, which on the whole had operated so effectively during the nineteenth century, was capable of coping with the deep-seated maladjustments and disharmonies which characterised the post-war world. At the same time value theory itself was profoundly influenced by the emergence of a number of writers who approached value problems from the view-point of monopoly, and emphasised the unrealistic nature of an analysis which was based on the assumptions of perfect competition and a perfect market. Most of all, however, economic thought was dominated by the desire to find a solution for the problem of how to maintain the level of effective demand so as to avoid the recurrence of phases of deep depression and widespread unemployment. There was a growing feeling of impatience with the economics of the long period "in which we are all dead," and a great, perhaps even excessive, concentration on the short period in which we live and move and have our being.

The result was a remarkable ferment of ideas, the challenging of ancient orthodoxies, and "for the moment controversy and doubt [were] increased." This ferment had by no means subsided when the second war with Germany broke out in September 1939, bringing in its train a degree of State interference with the normal peace-time working of the economic system far exceeding that reached even in the last years of the war of 1914-18.

In so far as it is possible to foresee future trends, they

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would seem to lie in a much greater measure of conscious public control over many aspects of economic activity than has existed in the past. It will no doubt still remain true, to quote Lord Keynes's Introduction again, that :

“ The Theory of Economics does not furnish a body of settled conclusions immediately applicable to policy. It is a method rather than a doctrine, an apparatus of the mind, a technique of thinking, which helps its possessor to draw correct conclusions.”

Nevertheless, economists may well find themselves to a greater degree than hitherto called upon to express their views on matters of economic policy, and—for a time at least—the writers of future volumes of the Cambridge Economic Handbooks may be concerned rather with specific problems than with the more general aspects of economic theory.

C. W. G.

Cambridge,

July, 1946

AUTHOR'S NOTE TO SECOND EDITION

In this revised edition Chapters VI–VIII have been completely rewritten. The theory of the balance of trade and the balance of payments has been treated more fully; and its relation to certain modern views regarding fluctuations in employment and the balance of saving and capital outlay at home expounded.

R. F. H.

January 1939

NOTE TO THIRD EDITION

This volume is mainly concerned with general principles of permanent validity. In Chapter V (Foreign Exchange), however, there is a detailed description of mechanism with illustrations from the British system between the two wars. Since this provides a good example for study and since we do not know how the mechanism will be re-shaped after the war, I have thought it expedient to make no change.

R. F. H.

November 1941

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APPENDIX

THE principles on which the calculations in Chapter II are based may be explained as follows.

When the output of one commodity, B, is increased in England by an amount Q, it is assumed that the output of A is reduced in England by an amount equal to $\frac{Q}{r}$, where r is the rate at which B is exchanged for A in the new state of affairs. r is the cost of producing A divided by the cost of producing B and is referred to throughout Chapter II as "the ratio."

If the cost gradient of A is equal to that of B (simplest assumption), and if an increase in the output of B by Q leads to a rise in the cost of B by an amount q , when the output of A is decreased by $\frac{Q}{r}$ its cost falls by $\frac{q}{r}$.

If the initial ratio of costs in England is represented by x ($x=1$), the new relation of costs is expressed by the following equation:

$$\frac{x - \frac{q}{r}}{x + q} = r \dots \dots \dots (1)$$

From this it follows that

$$q = \frac{(r)(x-r)}{r^2 + x}$$

If the cost gradients of sources in England are equal to those abroad, and a given amount of output is transferred from England to the outer world, a change in the English cost of a given amount is accompanied by a change in the foreign cost of that amount multiplied by n , where n is a

fraction showing the ratio of England's initial output to the initial foreign output (=the number of sources in England divided by the number abroad).

If the initial ratio of the foreign cost of A to that of B is $\frac{1}{p}$, the relation of foreign costs which accompanies the state of affairs represented in (1) above is expressed by the following equation:

$$\frac{1+n\frac{q}{r}}{p-nq} = r^{(*)} \quad (2)$$

From this it follows that

$$q = \frac{r(p r - 1)}{n(r^2 + 1)}$$

From equations (1) and (2) it may be deduced that

$$r = \frac{1+n}{p+n} \quad (3)$$

Example Suppose trade is opened when costs at home are 1 and costs abroad 2 and $n = \frac{1}{8}$ (cf Table X, p 29)

$$r = \frac{1 + \frac{1}{8}}{2 + \frac{1}{8}} = \frac{1\frac{1}{8}}{2\frac{1}{8}} = \frac{1}{2} = 0.5$$

$$\text{and by (1), } q = \frac{(\frac{1}{2} \times \frac{1}{2})}{(\frac{1}{8})^2 + 1} = \frac{\frac{1}{4}}{\frac{1}{64} + 1} = \frac{1}{25} = 0.04$$

Consequently costs relations will be as follows

	In England.	Abroad
A	$\{1 - (0.196) (\frac{1}{2})\} x$	$\{1 + (0.196) (\frac{1}{8}) (\frac{1}{2})\} y$
B	$\{1 + (0.196) (\frac{1}{2})\} x$	$\{2 - (0.196) (\frac{1}{8})\} y$
i.e.	In England	Abroad
A	0.625 . x	1.037 . y
B	1.196 . x	1.980 . y

* If cost elasticity instead of cost gradient were used the left hand denominator would run $p(1-nq)$

If cost gradients in England are not equal to those abroad, let g stand for the average English gradient divided by the average foreign gradient over the relevant range.¹ Then a foreign change in costs of nq would be accompanied by an English change of gq , etc. The cost relations would be represented by the equations.

$$\frac{1 - \frac{q}{r}}{1 + gq} = \frac{1 + \frac{n}{r}q}{p - nq} = r$$

It follows that

$$r = \frac{g + n}{gp + n}$$

Example if $p=5$, $n=\frac{1}{10}$, and $g=2$ (cf. Table XII, p. 32)

$$\begin{aligned} r &= \frac{2 + \frac{1}{10}}{10 + \frac{1}{10}} = \frac{2.1}{10.1} = \frac{21}{101} = 1 : 4\frac{1}{2} \\ q &= \frac{(r)(1-r)}{g(r^2+1)} \\ &= \frac{(\frac{21}{101})(\frac{80}{101})}{2(\frac{441}{10201} + 1)} = \frac{1680}{21284} = .079\dots \end{aligned}$$

Cost relations will be as follows

In England	Abroad.
A $\{1 - (.079\dots) (2) (\frac{1}{10})\} x$	$\{1 + (.079\dots) (\frac{1}{10}) (\frac{1}{2} \cdot 1)\} y$
B $\{1 + (.079\dots) (2)\} x$	$\{5 - (.079\dots) (\frac{1}{10})\} y$

i.e.

In England	Abroad
A .24...x	1.038...y
B 1.158...x	4.992...y

¹ Demand considerations may be neglected by supposing that each demand gradient is proportional to its appropriate cost gradient.

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