

# AN INTRODUCTION TO INTERNATIONAL TRADE AND TARIFFS

R. A. HODGSON

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# AN INTRODUCTION TO INTERNATIONAL TRADE AND TARIFFS

BY

R. A. HODGSON, B.Com. (Lond.)

ASSISTANT LECTURER IN ECONOMICS, UNIVERSITY  
COLLEGE, SOUTHAMPTON



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TO  
MY MOTHER





## PREFACE

THIS book is intended for the student commencing the study of that side of economics with which it deals, and for the general reader who is sufficiently interested in the problems of international trade and tariffs to seek to understand the main principles involved. It is an introduction which, it is hoped, will enable readers to turn with profit to more advanced and more technical works.

My purpose in writing it was to bring together, and to treat in an elementary fashion, two sides of the study of trade questions which are often separated, I believe, to their mutual detriment. To discuss tariff problems without having a grounding in the theory of international trade is a mere waste of time; but, on the other hand, a grasp of the pure theory of international trade will not enable us to express any but the most general judgment on a particular tariff issue. In a sense, the whole of the case against protection, the whole argument as to the effects of duties, is contained in the first proposition as to the advantage to both parties concerned of exchange arising out of differences in costs of production. But complex appearances hide the simple realities with which the pure theory deals, and therefore it is necessary to expand and elaborate the substance of the first few pages of this book. The questions discussed in Part II are of a different character, but I have tried to deal with them generally, merely illustrating from actual cases. If, in the future, Great Britain is going to follow a definitely protectionist policy, it is desirable, I think, that what is being done shall be fully appreciated by as many people as possible. To desiderate a "scientific tariff"—if that can ever be translated into reality—is not to admit that a tariff is desirable in itself; it is merely to see that, if we are to have a tariff, it shall be so devised as to obtain its objective with the least possible incidental harm.

The scheme of this book was thought out some time before the events of last autumn brought these questions into the foreground of public attention. It would, however, have been pedantic to ignore those developments altogether, as of merely momentary concern, and, in consequence, more emphasis is laid on some sides of the problem than was originally intended. But in so far as what has been said about the terms of international trade, and the technique of tariffs, is sound, it is not affected by any change in a country's position or policy, though its practical application may be. Anything written about the gold standard system *may* shortly be out of date—but a new international regime has yet to be established.

It is impossible to write an introductory book of this kind without owing more than any specific acknowledgment can express to the leading works in the field. Professor T. E. Gregory's *Tariffs: A Study in Method* is the foundation of all English studies in the subject, and his three smaller books on the gold standard are equally valuable. Professor F. W. Taussig's *International Trade* is a comprehensive and fundamental treatment of that side; while Fisk and Peirce, *International Commercial Policies*, gives a wide survey of technical questions. Without these in particular, it is doubtful whether this book could have been written.

R. A. H.

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## INTRODUCTION

It is now fairly generally accepted that economics is a method of study, rather than a body of doctrine; and that this method is a specialization in application to economic problems of the mental instruments common to all branches of science. To give a complete and exact description of the method used in the study of economics needs a treatise in itself,<sup>1</sup> and is a task outside the scope of this book; but it is necessary to give the reader who has not encountered it before a preliminary explanation. The method of reasoning to be employed has two sides: the inductive, which broadly means the examination of data with a view to framing a theory that shall account for what we observe, and the deductive, which, broadly, means the working-out of the logical consequences of certain assumptions, subject to whatever conditions we may have to consider in the course of our argument. The inductive method is generally experimental or statistical or historical in process, and has achieved its most signal triumphs, therefore, in the natural sciences; but it cannot be used exclusively in any study. The deductive method is more frequently used in economics simply because it is more appropriate; there are relatively few subjects in which the economist has a sufficient body of proved facts to justify induction. Even where there is an apparent wealth of data, in statistical form as in a country's trade returns, for example, it is usually the case that these have to be used with considerable caution,<sup>2</sup> and cannot be regarded as in themselves

<sup>1</sup> Such a treatise for the general reader is provided by J. M. Keynes' *Scope and Method of Political Economy*, still of considerable value.

<sup>2</sup> "The critical faculty should be very alert when statistics are in question; the published heading may be pedantically and officially correct, but it will not contain such a statement as 'every word is used in a technical sense and has a special meaning only known to the officials who made the compilation, the part that is not recorded is more important than that which is, where the facts are not known, an estimate has been made by a method which cannot for departmental reasons be divulged, and the method of computation has been

sufficient basis for a final and comprehensive statement. The result is that the normal approach to the subjects discussed under the heading of International Trade is the well-tried one by which a simple case (not supposed to be a description of any actual circumstances) is stated, and the logical outcome of a hypothetical development argued: as, for instance, where two countries trade with one another on given terms, what would be the effect on these terms of an alteration in the costs of production of one country? One condition after another, requiring a qualification of one step in the argument or another, is then introduced, until our simple imaginary case has become as like the complex reality in which we are interested as we can make it, and our conclusion, therefore, if our arguments have been sound, as near the truth about the real case as possible.

The method has, at least, one practical disadvantage—that the layman is sometimes wearied by the logical processes it involves, and distrustful of the results that are attained through consideration of hypothetical and perhaps unlikely cases. But it must be insisted that, under present conditions, at least, it is the only method that is likely to give us any results of general value in the study of the fundamental problems of international exchange. We have not yet got the statistical material that would be required by the inductive method attempting the same task.<sup>1</sup> And, further, the working out of purely hypothetical cases may provide us with suggestions of practical usefulness as to the situation likely to arise and the policy to adopt if certain circumstances should occur. Extreme cases of a fall in the value of money, for instance, might well have been considered before the War as the mere logical exercises of pure economics, remote from the world of reality; yet had they been exhaustively worked out, the post-war inflation might not have gone to the lengths

modified since the last issue of the numbers,' yet part or all of this is sometimes implied."—Bowley, *Official Statistics* (Humphrey Milford), p. 11.

<sup>1</sup> See, in this connection, Part II, *Verification*, of Professor F. W. Taussig's *International Trade* (Macmillan).

it did in countries where its consequences were not fully realized until a great deal of avoidable social damage had been done. The somewhat formal discipline of the orthodox argument must, therefore, be faced by the student if a clear conception of the elements of international trade is to be obtained.

## ACKNOWLEDGMENTS

I desire to express my thanks for permission to quote from the following works: Bowley, *Official Statistics: What they Contain and How to Use Them* (The World of To-day Series; Humphrey Milford; Oxford University Press); Bastable, ed. Gregory, *The Commerce of Nations* (Methuen & Co., Ltd.). Taussig, *International Trade* (Macmillan & Co., Ltd.); Gregory, *Tariffs: A Study in Method* (Charles Griffin & Co., Ltd.); Andréadès, *History of the Bank of England* (P. S. King & Son, Ltd.); Report on Economic Conditions in the United States of America, to May, 1931; Report for France for 1925, Department of Overseas Trade (H.M. Stationery Office). Particulars as to tariffs of foreign countries have been drawn from the information given in issues of the *Board of Trade Journal* (H.M. Stationery Office).

R. A. H.

PART I  
INTERNATIONAL TRADE:  
SOME THEORETICAL ASPECTS

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## CHAPTER I

### THE NATURE OF INTERNATIONAL TRADE

- (1) THE meaning of the term "International Trade"—(2) The origin of international trade—(3) The terms of international trade.

"Two men can both make shoes and hats, and one is superior to the other in both employments; but in making hats he can only exceed his competitor by one-fifth or 20 per cent, and in making shoes he can excel him by one-third or 33 $\frac{1}{3}$  per cent—will it not be for the interest of both that the superior man should employ himself exclusively in making shoes, and the inferior man in making hats."—David Ricardo, *The Principles of Political Economy and Taxation*, Chapter VI.

#### 1. The Meaning of the Term "International Trade."

THE scope of our study is determined by the meaning which we give to the word "international," and that will depend upon how a "nation" is to be defined for this purpose. It would not be necessary to devote any attention to the point, were it not the case that instances may arise in which it is not self-evident that exchange ought to be included or excluded from the category of international trade. By a "nation" is generally understood a political entity, a territory under one government; and this is a sufficiently good working definition in most cases. Yet this popular meaning is qualified even in popular discussion to the extent that the facts require, since territories that are not continuous or that are not under a single government may collectively form a "nation" for our purpose. The United Kingdom is an example of the first type, India of the second. The alteration in the meaning of the term "United Kingdom," consequent upon the establishment of the Irish Free State, is an illustration of the importance of classification; English manufactures going to Dublin since 1st April, 1923, have figured among our exports, dairy products coming into England from Cork have been included in our imports. Formerly, as is still the case with Northern Ireland, such trade would not have been recorded as "over-seas," but would have counted as internal or home trade,

just as much as, say, the daily consignments of milk from the West Country to London. In other words, it would not have appeared in official returns.

• This gives us a suggestion as to how to define a "nation" as a unit in "international trade," so as to agree with actual practice. If we frame our definition as "a customs area normally making separate returns," we shall be fitting the usual interpretation of the word nearer to the facts. A customs area is almost always delimited with reference to a political entity, and this entity is generally a territory or territories under one supreme authority. Customs unions by treaty (such as that proposed, but not carried through, between Germany and Austria in the summer of 1931), which leave the political and economic integrity of the nations concerned unaffected, do not make the trade between them internal. On the other hand, the duties levied by French towns on produce entering their gates from the surrounding country, known as *octroi* duties, do not convert those movements of goods into anything but local trade, any more than a toll on traffic using a bridge makes it international. Such duties are, in effect, a species of local taxation, and their economic importance is negligible.

It was thought by the early economists that there were essential differences between home and foreign trade, and that it was necessary to work out a special theory for the latter. This view was founded on the belief that within a country capital and labour circulated freely, while they did not move between different countries, or hardly at all. This was expressed forcibly and clearly by Ricardo<sup>1</sup> in a passage in which he says: "The same rule which regulates the relative value of commodities in one country does not regulate the relative value of the commodities exchanged between two or more countries. . . .

"In one and the same country, profits are, generally speaking, always on the same level, or differ only as the employment of capital may be more or less secure and agreeable.

<sup>1</sup> *Principles of Political Economy* (1817), Chapter VII.

It is not so between different countries. If the profits of capital employed in Yorkshire, should exceed those of capital employed in London, capital would speedily move from London to Yorkshire, and an equality of profits would be effected; but in consequence of the diminished rate of production in the lands of England, from the increase of capital and population, wages should rise, and profits fall, it would not follow that capital and population would necessarily move from England to Holland, or Spain, or Russia, where profits might be higher."

As to this we may observe that, in so far as there are peculiar obstacles to the movement of capital and population across national frontiers, it will probably be the case that different returns (or "profits") will be earned in different countries; but this does not prove that economic forces are not at work in the same way as in local affairs. It is merely that their working-out is conditioned or even prevented by the limits imposed by the different political systems, deliberately or otherwise. The nature of the difference between local and international trade presently began to be recognized; J. S. Mill, writing some thirty years later, while following Ricardo in his treatment of the subject in general, laid emphasis on distance. "If capital," he observes, "removed to remote parts of the world as readily, and for as small an inducement, as it moves to another quarter of the same town; if people would transport their manufactories to America or China whenever they could save a small percentage in their expenses by it; profits would be alike (or equivalent) all over the world, and all things would be produced in the places where the same labour and capital would produce them in the greatest quantity and of the best quality. A tendency may, even now, be observed towards such a state of things; capital is becoming more and more cosmopolitan; there is so much greater similarity of manners and institutions than formerly, and so much less alienation of feeling, that both population and capital now move from one of these countries to another on much less temptation than heretofore."<sup>1</sup>

<sup>1</sup> Mill, *Principles of Political Economy* (1848), Book V, Chapter X.

Since Mill's time, the development of which he saw the beginnings has reached the stage at which it is no longer appropriate to think of the nations as closed areas largely cut off from one another, as existing, so to speak, in a vacuum where normal economic forces could not operate. In fact, both the assumptions of the classical economists are invalid under modern conditions. As Professor Bastable has put it: "Two facts have contributed to make this distinction [between home and foreign trade] a false one, when applied to the actual situation. First, the extent to which there was free movement inside a given country was usually exaggerated by the classical economists. Apart from natural differences of talent, of acquired skill, and the like, there exist in all countries barriers of a more artificial kind both for capital and labour; it is only necessary to mention trade union restrictions and the barrier imposed on the movement of ability by lack of means. Secondly, the extent to which freedom of movement between countries existed was generally *underrated* by the classical economists, and this underestimation was continued by those who accepted their theories at a time when the facts on which the theory was originally based no longer existed. We are in fact bound to recognize that, from the wider point of view, international and domestic are both simply cases of exchange generally, subject to the same general laws, and that there is, consequently, no need to evolve a basically different theory to account for international trade."<sup>1</sup>

The theoretic analysis of international trade must, therefore, proceed on the same lines as the analysis of exchange in general. "International value is regulated just as inter-provincial or inter-parishional value is"—and nations can no more than persons, resist or evade the imperatives of economic law.

## 2. The Origin of International Trade.

While we always speak of trade as being conducted "between nations," we refer to transactions that are carried out

<sup>1</sup> Bastable, *The Commerce of Nations*, ed. Gregory, Chapter I.

by individuals or business concerns, for private profit. It is not impossible that national or local authorities should engage in trade with foreign firms or authorities—dealings of this sort were undertaken on a large scale during the Great War—but, so far, it has been broadly true that international trade has been carried on by merchants on ordinary business lines. Importers and exporters will not continue to engage in foreign trade unless it yields them a return not less, all things considered, than they would obtain from whatever other employments of their capital and energy are open to them. There must be a net gain derived from foreign trade, therefore, by both sides of any and all transactions.

It is not difficult to see the advantage of trade between two countries, where, owing to great natural or economic differences between them, each produces some commodity that the other does not, and requires what it does not produce. The trade between the tropics and England in manufactures and natural products is an example of such a case. Nor is it necessary to argue that there is a gain where goods that are imported could be produced at home only with great difficulty and expense. Adam Smith's celebrated illustration may be called to mind: "The natural advantages which one country has over another in producing particular commodities are sometimes so great, that it is acknowledged by all the world to be in vain to struggle with them. By means of glasses, hotbeds, and hotwalls, very good grapes can be raised in Scotland, and very good wine too, can be made of them at about thirty times the expense for which at least equally good can be brought from foreign countries."<sup>1</sup> But, where a nation can produce a commodity which it imports from a foreign country, and produce it on ordinary commercial terms, the question may be raised as to whether there is a net gain obtained from the trade. This can best be answered in the course of the theoretical analysis that attempts to measure the extent of the gain, if any, that may arise from international exchange.

<sup>1</sup> *The Wealth of Nations* (1776), Book IV, Chapter II.

We must begin, as has been said, by imagining simple cases which can be qualified when it is required to bring them closer to a particular case. It must always be borne in mind that the illustrations that will be employed for this purpose are not themselves part of the argument; they are cases worked out to show how the theory, which is general and applies to all cases, can be traced in these particular instances. The arithmetical results obtained, therefore, are valid only for such figures as are here used, and different examples would give different answers. But, as can be tested by the invention of further cases, the final conclusions to be drawn are the same.

Let us consider trade between two countries only, and to remove from our examples any suggestion of their being a picture of a real situation, let us call one country A, the other B. (Some readers will, at this stage, prefer not to deal exclusively in imaginary terms, perhaps, and those who find it difficult to remember which is which under alphabetical designations might substitute, say, "Australia" for A, and "Britain" for B). Both can produce wheat and coal, but, owing either to physical conditions or to differences in economic development, they do not produce the two commodities on exactly the same terms. The expenditure of a given number of hours of labour, assumed of the same efficiency, will not produce the same amount of coal, or wheat, in A as in B. The reduction of production to hours of labour is merely a simplification of the issue. Whatever capital, in the form of agricultural or mining equipment, is employed, is itself the result of previous labour, and can, therefore, be given a labour-hour equivalent for the purposes of this argument. But it may be more acceptable to the reader to speak of "a given quantity of labour-and-capital" as being required to produce so much coal or wheat. This may be called a "capital-labour" unit, or "unit" for short, expended to produce such and such a result. This does not involve the assumption that methods of production are the same in both countries; machinery (i.e. capital) may be used more by farmers—or miners—in A than in B. What is necessary is to have a conception of a unit

quantity of labour, in no matter what form, that does not give the same physical output in different uses in different countries.

We can distinguish the following types of differences in terms of production, or, more shortly, differences in cost—

1. Where each country has an absolute advantage over the other in the production of one of the commodities.

A produces wheat at a lower cost than B can, while B produces coal at a lower cost than A can.

For illustration, let the position be—

In A, one unit produces 2 tons of wheat or 1 ton of coal.

In B, one unit produces 1 ton of wheat or 2 tons of coal.

That is, in A the effectiveness of the wheat producer is twice what it is in B, so costs are one half of what they are in B, and the reverse is true of coal. This case is one of absolute differences of cost.

2. Where one country has an advantage over the other in the production of one commodity.

In A, one unit produces 2 tons of wheat or 1 ton of coal.

In B, one unit produces 2 tons of wheat or 2 tons of coal.

Here, costs in each country are the same in wheat production, but lower in B as regards coal.

3. Where one country has an advantage over the other in the production of both commodities.

In A, one unit produces 2 tons of wheat or 1 ton of coal.

In B, one unit produces 3 tons of wheat or 3 tons of coal.

Here there are comparatively lower costs in the production of coal in B, though the country is superior to A in both branches of production.

Another case of the same type is where the advantage which one country has over the other is of the same degree in the case of each commodity. For example, if B produced 3 tons of wheat or  $1\frac{1}{2}$  tons of coal per unit, the effectiveness of labour in B would be 50 per cent greater than that in A in both employments. In such a case, where the differences in cost are equal in each branch of production, exchange will not take place. Such uniform all-round superiority is what we

are least likely to find in any actual situations. The variety of natural resources and of phases of economic development, not to mention racial peculiarities and such historical episodes as Britain's temporary world-leadership in industrialization, makes comparative differences in costs (including our second and third cases) the most usual state of affairs.

The gain that accrues to each country when they enter into trade, in the various cases set out above, can be shown if we compare the cost to A and B of obtaining coal and wheat without exchange, with the cost when exchange is freely carried out, everything else remaining unaltered. The result will measure the "saving," so to speak, to the consumers resident in the two countries, a saving the amount of which, on the basis of the figures as to costs of production already used, will be determined according to assumed conditions. These may be summarized thus—

(i) There is free trade, or rather, unrestricted barter, between the two countries, costs of transport being eliminated in order not to complicate the sum.

(ii) Production is supposed to be carried on under conditions of "constant costs." This expression means that the cost per unit of product is the same, no matter what the volume of production; 60 million tons of coal raised in B, for instance, cost the same per ton as would 120 millions or 30 millions. It will be perceived that this is only another assumption made in order to allow a first statement of our problem to be worked out simply; it does not require us to argue that in any instance in the real world coal or wheat or anything else must be produced under conditions of constant cost. The differences between the results obtained on our assumption and those that are likely to be obtained under conditions more common in actuality will be suggested later.

(iii) Demand is assumed to be unaltered in the new situation, so that all that A might have produced for herself is supposed to be imported from B, in exchange for what B might have produced for herself, now raised in A. This allows the benefits derived from foreign trade to be shown as a simple



saving to consumers of the imported goods, who are also producers of the exported goods. They get as much as before with less labour, and the picture can be completed by the reader's imagining if he likes that the populations of A and B decide that they prefer more leisure to more goods.

Where A is the cheaper producer of wheat, and B of coal, it is obvious that, assuming that A can produce sufficient wheat, and B sufficient coal, for both, each by concentrating on the commodity which it can produce more cheaply will get both commodities at a lower cost than if they adopted a policy of self-sufficient isolation. But what gain precisely will accrue to each?

For illustration, suppose A to consume annually 50 million tons of wheat and 30 million tons of coal, while B requires 40 million tons of wheat and 60 million tons of coal. Suppose, further, that each has sufficient resources to produce these amounts, and also could produce more of one commodity if capital and labour actually taken up by the production of the other commodity could be diverted to the first (e.g. if some of the capital and labour used in A to produce coal could be put into wheat-growing, more wheat could be raised—there is no lack of suitable land).

If, then, A and B are entirely cut off from one another, the cost to A of supplying her needs in wheat and coal is (in capital-labour units),  $\frac{50}{2} + \frac{30}{1} = 55$  million units.

The cost to B similarly is  $\frac{40}{1} + \frac{60}{2} = 70$  million units.

Or, from another point of view, the whole body of consumers of wheat in both countries must expend 65 million units; the consumers of coal 60 million units.

Let the two countries be opened to one another, and consumers of coal in A discover that they are paying more for it than are consumers in B; while the inhabitants of B discover that wheat is cheaper in A than in their own country. (It must be borne in mind that the "cost" that is "paid" for these commodities means the expenditure of labour required to obtain a given quantity. There is no advantage,

at this stage, in translating this into money terms. That is done later.) If wheat-producers in A supply wheat to B on the same terms as they are already placing it on the home market, cost of transport being ignored, and mine-owners similarly send coal to A, there will be a demand in each country for the imported product up to the limit of consumption.

The outcome of the trade relations between the two countries will be, therefore, that A produces all the wheat required by both, and B all the coal; the exports of wheat from A are, in effect, bartered against the exports of coal from B. Consumers of coal in A get the 30 million tons they require in exchange for 40 million tons of wheat, to produce which has cost them 20 million units. Consumers of wheat in B get the 40 millions of tons at a cost of 15 million units. The cost to A of her requirements in respect of both commodities is 45 million units, a saving of 10 million units; the cost to B of her requirements is equally 45 million units, representing a saving of 25 million units.

Comparing the position of consumers in the area A-B with their former one, we note that now wheat and coal each cost 45 million units to produce, in the required amounts, a fall of 20 million units in the case of wheat, of 15 million units in the case of coal.

Where B is superior to A in the production of both wheat and coal, it may not be so obvious that it is to B's advantage to concentrate on the production of coal, in which it has the greater advantage. Nevertheless, this can be shown to be true, on the same lines as before.

Suppose the needs of each country to be the same as in the first example, then before exchange takes place, A's requirements will be satisfied by home production at the same expenditure as before, but B's will demand, with the figures given above, the expenditure of only  $\frac{40}{3} + \frac{60}{3} = 33\frac{1}{3}$  million units. Now, if trade is opened between the two countries, it is clearly the case that coal will be produced at a lower cost if B supplies the 90 million tons consumed by the whole

area A-B. Only 30 million units will have to be expended to raise this output, as against the 50 millions previously expended. The 30 million tons imported and consumed in A will be obtained in exchange for wheat (since by our hypotheses A has nothing else to offer, and no other employment to which may be diverted the resources no longer required to raise coal). The 40 million tons of wheat consumed in B are a fraction of the wheat raised in A, and has meant an expenditure of 20 million units. In other words, A obtains in exchange a quantity of coal that, had it been produced at home, would have cost 30 million units, for 20 million units—a saving of 10 millions.

The position in B is that 40 million tons of wheat have been obtained for coal that cost 10 million units to raise. The same quantity of wheat could have been produced in B only at an expenditure of  $13\frac{1}{3}$  million units—there is thus a saving of  $3\frac{1}{3}$  million units enjoyed by B.

The factor that determines the course of international trade, i.e. what goods are exported and what imported by any country, under conditions such as those of our imaginary cases, is then the relation between the costs of production of commodities. It is the goods which can be produced *more* cheaply by one country as compared with another, which will be those on which that country will tend to specialize. Since economic resources are not infinite, it pays best to produce commodities in which the advantage held is greatest (or the disadvantage least), and to buy with the surplus over home needs what might have been produced at home, but which is imported from those foreign countries which find such production profitable. If a country does not itself consume what it can produce at great advantage, this surplus may be practically the whole of the output, as was the case until recently with the Indian jute trade.

Since what is true of any nation must be true of all taken together, the world at large must benefit from a development of international trade. The effect of a universal concentration of all communities on whatever may be the work for which

they are best fitted, is an international "division of labour," an international specialization which can result only in a more economical production of all commodities.

The full benefits of such an order of things need not be limited merely to the "savings" such as are calculated to accrue to A and B in our illustrations. The qualifications that the cases worked out above must undergo before they can be related to real life can be briefly indicated by referring once more to our assumptions.

The first was the existence of a Free Trade regime. The alteration in the outcome due to any taxation of imports by A or B must be considered separately. Here it is only necessary to remark that in general the levying of a duty on a commodity may be expected to raise the cost of it to consumers, and this will reduce the benefit calculated to arise in our examples.

As to production at constant costs, it need hardly be said that cases in the actual world are hard to find. The two other classes of conditions generally distinguished by economists—and regarded as of greater practical importance—are those of "diminishing" and "increasing" costs. It cannot be argued here whether any thorough-going and definitive classification of economic activities under these three heads can be made. All that is important in this connection is to admit that a change in the volume of production may be accompanied by a change in the cost of producing a unit of the product. If a rise in the volume of output is accompanied by a fall in the cost of production per unit of output (i.e. a less than proportionate rise in the total cost of production), the industry is said to be operating on diminishing costs, or to be one of "increasing returns." If the reverse is true, it is said to be a case of increasing costs, or "diminishing returns."

The importance of this in the case of commodities entering into international trade is obvious. The two selected for our examples—wheat and coal—are among those products which in old countries are considered to be under conditions of increasing cost. If, as a result of the opening of trade relations

between the two countries, wheat growing becomes confined to A and the cost of production as a consequence rises (because if more wheat is to be produced the expense of the whole crop increases more than in proportion), the benefits derived by A and B will be correspondingly reduced. As there is always being made an attempt to find the most economical terms of production, this will tend to qualify the result that we obtained from arguing on a constant-costs basis; we might, in practice, find that the effect of the opening of trade was that while A grew more wheat than before, and exported some to B, the latter country did not import all that she consumed, but raised a certain amount at home. On the other hand, manufactured articles are considered to be produced under conditions of diminishing cost, and if the commodities exchanged are, say, motor-cars and cotton piece-goods, the gain will be greater than is indicated in our imaginary cases. And neither agriculture nor mining is believed to be carried on subject to increasing costs in all circumstances.

No precise working-out of the gains actually derived by any one country from international trade is, of course, possible; the sum is too complicated, and what is more, we do not know the magnitudes of many of the factors involved. But it may sometimes be of interest to discuss the probable benefit to be obtained from the development of a new source of trade, and then it is essential to bear in mind the conditions just outlined.

Lastly, with regard to demand, it must be remembered that in actual conditions demand for goods is variable, and that any alteration in their cost almost always means an alteration in the amount consumed. A rise in the cost of a commodity to the consumer usually means a reduction in the quantity he will take, other things equal, and a fall in cost an increase.

We have, therefore, to consider the way in which the demand on the part of countries for each other's products will govern the terms on which international exchanges are carried on, in order to discover how the terms ruling at any given time are fixed, and how they may alter.

### 3. The Terms of International Trade.

Still thinking in terms not of money but of quantities of goods exchanged, we have to show how a particular trade position, e.g. in the dealing in wheat and coal between A and B, is determined. It will be best to employ the phrase "barter terms of trade"<sup>1</sup> in this connection, since it stresses the fact that we are still treating of simplified cases of international trade. If the barter terms of trade alter, it means that one country is receiving a different quantity of imported goods in exchange for a given quantity of its own exports, than it did before, and an increase in the amount received represents an improvement, a decrease a worsening, of the terms on which that country trades.

As the machinery of our international bartering, we may imagine that merchants place A's goods on their market in B, and from the proceeds of their sale obtain certain quantities of B's goods which they market in A, on terms that will give them as good a return on commodities exported as if they had sold them at home. These merchants will form an idea of the different quantities of A's goods that it is worth while to offer for specific quantities of B's goods. If only a small amount of B's goods were available, for instance, they might command a large quantity of A's goods, whereas double that amount would fetch only one-and-a-half times the quantity of goods previously offered by A. In other words, merchants will form an idea of the probable demand of A consumers for different quantities of B's goods, this demand being expressed by the varying amounts of A's goods obtainable in exchange for the varying imports from B. And those looking at the trade position from the other side would equally estimate the demand of B for A's goods.

It is convenient to draw up for each country an imaginary schedule of the quantities which it would offer to obtain

<sup>1</sup> This is the phrase used by Professor F. W. Taussig; see *International Trade*, p. 9. A somewhat colourless alternative is that used by Professor Marshall: "rates of interchange"; see *Money, Credit, and Commerce*, p. 161.

certain quantities of the other's goods, in terms of any appropriate measure, such as tons or bushels or yards, according to whatever the goods are supposed to be. This can be done by taking certain quantities of goods imported by a country, and setting against them the quantities of home-produced goods offered in exchange, i.e. exported. The larger the quantity of B's goods available in A, the smaller the quantity of A's goods that will be offered for a given amount of B's; or in other words, an increase in A's imports will, other things equal, represent a cheapening of the imported goods in terms of her own. For example, such figures as the following might show A's schedule, so far as they go (the table can be extended on the same lines); starting with a small quantity of B's goods available, and increasing it by arbitrary amounts, we might have—

1. Quantity of B goods for which A offers	2. Quantities of A goods, in 000's	3. Barter terms: B goods to A goods per 100	4. A's valuation of A goods in terms of B goods per unit
20,000	100	20	·20
80,000	200	40	·40
165,000	300	55	·55
292,000	400	73	·73
450,000	500	90	·90

This table is to be read thus: If only 20,000 (tons or bushels, or whatever it may be) of B's goods are available, A is willing to give 100,000 of her own for them; if the quantity should be increased to 80,000, A will offer 200,000. Looking at the position from another angle, if B's goods, which formerly were obtainable in A at the rate of 73 of B's goods per 100 of A's goods (or their equivalent), should now be placed on the market at the rate of 55 of B's goods per 100 of A's, the consumption will fall off. At the former rate, merchants could dispose of 292,000 of B's goods in A; at the current rate only 165,000 can be marketed. This reflects the nature of A's demand for B's goods; it responds sharply to an alteration

in their cost, increasing when the cost falls, diminishing when the cost rises. Demand of such a character is termed "elastic," and the elasticity of demand is a matter of degree. The demand for some products may alter very little one way or the other with relatively large alterations in their price. This is generally the case with the necessities of life, especially foodstuffs; their consumption does not alter markedly in correspondence to price changes, and the demand is said to be "inelastic." Our table suggests that B's goods do not come within the category of necessities for A; as we have imagined the position, it is clearly not the case that consumers must have B's goods at almost any cost, while, on the other hand, a reduction in cost (= a rise in the figures of columns 3 and 4 of the table) will raise the quantity taken by A.

Similarly, B's trading schedule might be set out as—

1. Quantity of A goods for which B offers	2. Quantities of B goods, in 000's	3. Barter terms: A goods to B goods, per 100	4. B's valuation of A goods in terms of B goods, per unit
25,000	100	25	4.00
90,000	200	45	2.22
186,000	300	62	1.61
304,000	400	76	1.31
410,000	500	82	1.22

This represents a demand of different character, and of slightly higher elasticity. So far as these figures go, the demand of B for A's goods is not so intense as A's demand for B's goods; that is, B consumers would go without imports rather than pay the price demanded, a little more readily than would consumers in A.

Attention is directed to column 4—which might just as well have shown the value of B goods in terms of A goods. It is clear that sooner or later a point will be reached at which the two countries will agree, so to speak, in their



mutual valuation of goods. At this point, exchange will take place, for, from the point of view of each side demand and supply will equate; that is to say, just that quantity of the other country's goods that each country wants will in fact be obtained by that quantity of its own exports that represents the barter terms which make the trade worth while. It would be more accurate to say that the two countries' demands for one another's goods equate, since A's demand for a given amount of B's exports is what A will give of her own goods in exchange—B's supply.

This equilibrium of demands is a stable one, as long as the trading schedules of the two countries remain unaltered, for if more than the quantity of B's goods required by the equation were offered on A's market, a larger quantity than before will have to be given to secure a given amount of A's goods. The returns to merchants from their trading abroad will thus be reduced, and this will bring about a diminution in the volume of B's exports. The fall in the supply of B's goods to A would continue until their value in terms of A's goods was once more such that normal returns were to be gained by merchants. And the same is true of any change—*increase or decrease*—in the supply of A's goods to B.

To sum up, it is the comparative costs at which goods are produced that determines what shall enter into international trade, and it is the trading schedules, representing the intensities of the demands of the two nations for one another's goods, which determine the terms on which these goods will exchange.

## CHAPTER II

### THE CONDITIONS OF INTERNATIONAL TRADE

- (1) THE mechanism of international settlements—(2) International exchange in monetary terms—(3) Services and investment in international trade.

#### 1. The Mechanism of International Settlements.

It is now necessary to take a step that will bring us nearer to the everyday world, and to express some of our illustrations in monetary terms. This is not to come closer to reality; on the contrary, the realities of international trade are what we get in the form of goods and services, and what we have to give for them. These considerations are revealed by the line of argument that has been attempted above. When we put it in terms of money, we are coming nearer to the appearances with which everybody is familiar, closer to the returns of imports and exports by value which is what most people have in mind when thinking of a country's trade position.

While the part played by money in everyday transactions within a country is, in general, well understood, the mechanism of payment in foreign trade is not so familiar to the average person, and it will, therefore, be appropriate to describe the elements of the method of international settlement. What follows is an account of payment for imports, but it must be remembered that there are other transactions than merchandise dealings which have to be settled between nations. These "investment" transactions, as they may be called, will be discussed later; here it is necessary to say only that, as they involve the transfer of funds from one country to another, just as payment for goods does, they make use of the same mechanism and have a similar effect.

To a consumer in a local market there is no difference so far as the method of payment is concerned between home-produced and foreign-produced goods; both sorts will be

priced in his local currency. But the merchant who brings those goods to the market has to settle with the producers in different currencies, according to their origin—he will pay for the home-produced goods in the same money as the consumer pays him, whereas he must pay for the foreign goods in the currency which their producer needs, that is (almost always) in the currency of the country whence the goods were exported. Or, what is, in effect, the same thing, he must give the producer means of obtaining a certain quantity of his own currency, in exchange for his goods. When a merchant comes to pay for the goods he has imported, therefore, he seeks something that will give command over the currency of the foreigner to whom he owes a debt, a debt which is the price of the goods. He buys this command over, or right to, a certain quantity of the foreign currency in a foreign centre with his own currency—and so is finally in the same position as if the goods were produced at home. In other words, he converts some of his local currency into the required foreign currency, and with this discharges his debt.

The process of conversion of one currency into another is really a purchase of a certain quantity of one currency with one's own, or, more exactly, the purchase of a *right* to a certain quantity of foreign currency, payable in the appropriate centre. This right generally takes the form either of a credit instrument or of a balance at a bank (which might be called simply "a credit" unrepresented by an "instrument"). The sort of credit instrument used is a bill of exchange, or a banker's draft, or a cheque; a credit placed at a person's disposal is provided by telegraphic transfer. A purchase by an importer of South American hides in London of that number of Argentine pesos which is their price, for example, involves his getting command over that amount of currency in Buenos Aires; he advises the exporter that the money is at his disposal, and when it is taken up, the debt is settled. The English importer has, either directly or, more probably, through the agency of his bank, entered the

market for pesos—the foreign exchange market—as a buyer. Incidentally, he is a seller of sterling, and as such is at the same time supplying somebody with a means of settling a debt in England.

The market for foreign exchange, which is constituted by those who deal in different currencies, in any financial centre, is therefore one in which currencies—or rights to certain quantities of various currencies—are offered for one another. From the point of view of an Englishman, London is a foreign exchange market in which other currencies—francs, marks, dollars, and so on—can be got for sterling; from the point of view of an American banker, London (like New York) is a centre where sterling, francs, etc., can be got for dollars. Usually, anyone concerned with foreign currencies thinks of the local foreign exchange market as a place where he can buy another currency with his own, and the price-quotation for that foreign currency is given as so many units to a unit of the local currency; thus, in London, the prevailing “rates of exchange” are quoted at so many dollars or francs to a £ sterling.<sup>1</sup> But, a purchase of dollars is a sale of sterling, and the cost (in shillings and pence) of obtaining one dollar would mean the same thing.

Since paying for imports involves the purchase of foreign currencies (and equally the sale of local currency) on the foreign exchange market, the conditions ruling in the market, and the resulting market-price, or exchange rate, of the currency he wants to buy are of immediate interest to a merchant. “Every transaction in commerce is an independent transaction,”<sup>2</sup> and so every importer settles his debts independently. He enters the market as a buyer of dollars, say, a seller of sterling, not knowing how many other people at that moment are competing with him, or what quantity of dollars is available at the price he is prepared to pay. If on that day there are being offered for sterling relatively large quantities of

<sup>1</sup> This is not true of all the London quotations; a few are given the other way—the sterling price of the foreign unit, e.g. the rupee, the yen. The method used is largely a convention.

<sup>2</sup> Ricardo, *op. cit.*, Chapter VI.

dollars, then he will get the dollars he wants to settle his debt cheaply, i.e. the market quotation of dollars and cents to the £ will show that a larger amount of that currency can be obtained for sterling than ordinarily. "High rates are for us, low rates against us" is the rule that sums up the position so far as any centre is concerned where (as in London) the majority of currencies are quoted at so much per unit of local currency.

In short, payment for a certain amount of imports by value will mean a different outlay in local currency, according to the fluctuations in the rate of exchange. The day-to-day alterations of a particular rate of exchange (the dollar, franc, or other rate) are caused by the changing supply-demand position; at one time there are more payments, or transfers of funds for investment purposes, to be made from A to B than from B to A, and the price of B's currency in A's financial centre rises, at other times the position is reversed and B's currency is cheap. But, in the case of gold standard currencies, the fluctuations are limited.

A gold standard system is one under which the monetary unit of a country (e.g. the £, the mark) has a fixed, determinate value in gold; that is, a certain quantity of gold can be obtained in exchange for it, usually at the Central Bank. The gold values of the units of the two gold standard countries can be compared directly, and on the basis of this comparison we can establish a parity—"Mint (or gold) Par"—between the units. This is, so to speak, their legal, official, relation to one another. Their market relation, the foreign exchange quotation, may show at some times that the value of B's currency in terms of A's is higher than this parity, or *vice versa*.<sup>1</sup> Suppose that the cost in A of obtaining a credit in B (a banker's draft, or whatever it might be, for so many units of B's currency) is rising, so that more of A's currency has to be given for B's than is required by the mint

<sup>1</sup> Any extract from a table of foreign exchange rates will illustrate this: London Exchange Rates, 31st July, 1931, on Brussels (Par, 35 Belgas per £) 34.80 - .81; on Paris, (Par, 124.21 Francs per £) 123.89 - .91.

parity, the question arises: Will it not be worth while for an importer in A to convert his money into gold, pay the cost of shipping it to B, there to turn it into B's currency at the official rate? It *will* be worth while, obviously, if the whole cost to him of doing so allows him to settle his debt more cheaply than by purchasing from his banker a credit at the ruling rate of exchange. But, in so far as any use is made of this power to obtain gold for local currency, and export it, the procedure will, by diverting a demand from the foreign exchange market, bring exchange rates down, or keep them within the limits imposed by the cost of moving gold. The limit above which the rate cannot rise without producing such a movement is A's "export specie (or gold) point"; since the same considerations apply to all countries, there is a rate at which A may expect to receive gold, and this will constitute B's export specie point.

To sum up, limits are set to exchange fluctuations by the possibility of getting gold for a local currency, and sending it abroad. Consideration of the reactions of such a development on the price-level and trade may be postponed for a moment. All that need be emphasized here is, that if it is possible to pay a foreign debt by using gold, that method will be adopted whenever it is the cheapest way of settling the debt. No large movement of gold is under ordinary conditions required to correct foreign exchange rates, i.e. to bring them within the specie points; but a considerable flow of gold in one direction may persist if there are long-continued withdrawals from a particular centre of balances held there formerly by foreigners. This will go on when other than commercial factors are at work; when, on account of political developments, foreigners want to repatriate funds they had deposited in a centre, for example, and they bring about in that market an abnormal selling of local currency, an abnormal demand for their own currencies, forcing and keeping their values up. But this is clearly a matter outside the scope of a discussion of international trade.

## 2. International Exchange in Monetary Terms.

If we are to restate the examples already worked out, it will be necessary further to define our conditions. For the sake of simplicity, suppose that the two countries, A and B, are both on the gold standard, so that gold will flow freely from either to the other whenever the trade position between them requires it. Looking at the question now from the point of view at which we are concerned with nations as units, not—as in the preceding section—with individuals, we may say that this will occur if over any period the gold value of A's exports to B differs from the gold value of B's exports to A (cost of transport still being ignored). If what A imports exceeds in value what she exports, then such quantity of gold as will make up the difference must be sent from A to B. This balances the trade account in respect of that period, but it sets in train developments affecting the trading of the two countries. To be "on the gold standard" means, we have said, that the value of a unit of currency is fixed and kept invariable in terms of gold. The arrangement for effecting this under a simple gold standard regime is that the currency shall be made to vary in volume according to movements of gold into and out of the country, or, in other words, that its volume is related, by legislative provision, to the quantity of gold held in the country, which means, in practice, to-day, in the vaults of the Central Bank. A gold outflow means a reduction in the volume of currency in circulation, which (other things equal) means a fall in the price-level.<sup>1</sup> The price-movement extends into the field of wages with a rapidity that in practice depends upon the organization of industry, the strength of trade unionism, the effect of legal provisions relating to the workers, and similar factors. Here we will make

<sup>1</sup> This assumes the validity of what is known as "the Quantity Theory of Money." This, as it works out in gold standard conditions, is dealt with more fully later, in the section on the Influence of Monetary Factors on Trade. A certain amount of repetition on this subject is inevitable, if we are not to introduce it at every step of an argument concerned, in the first place, with a rather different matter. The reader who would prefer to take nothing for granted can turn to the later section before going on with this.

the further assumption that wages and prices vary directly with alterations in the volume of currency, and as a result of gold movements.

With these assumptions in mind, let us rewrite our examples to compare the prices of commodities produced in A and B on the same terms as before.

(1) **ABSOLUTE DIFFERENCES IN COST.** Let the level of wages in A and B be the same, i.e. an hour's labour can be obtained for—or commands—the same quantity of gold.

Then, if one unit represents so much labour as earns £1 (taking this to be worth a certain fixed quantity of gold), the prices at which wheat and coal can be put on their home markets, the "domestic supply prices" are —

In A: Wheat, 10s. per ton; coal, 20s. per ton.

In B: Wheat, 20s. per ton; coal, 10s. per ton.

The comparison of the supply prices at once explains why, if trade begins between A and B, the first country produces all the wheat, the second all the coal. This conclusion is, of course, identical with the one already reached; but the translation of the case into monetary terms suggests further reflections.

The level of wages in A could be different from that in B, and trade would still take place, though not with the same results as under the former conditions. For example, if wages in A were 50 per cent higher than those in B, the domestic supply prices would compare thus—

In A: Wheat, 15s. per ton; coal, 30s. per ton.

In B: Wheat, 20s. per ton; coal, 10s. per ton.

Similarly, if wages in B were the higher, say 36s. per unit as compared with 20s. in A, exchange would be mutually profitable, for the prices would be—

In A: Wheat, 10s. per ton; coal, 20s. per ton.

In B: Wheat, 36s. per ton; coal, 18s. per ton.

The figures of the different cases, in one of which A's supply price of wheat approaches B's, while in the other B's supply price of coal approaches A's, indicate the limits imposed on such wage-differentiation. The real effectiveness of labour in each country is, in respect of the commodity it produces, at



an advantage, twice that of the labour in the other country. Therefore, if wages in A are twice those in B, or higher, no wheat will move between the two countries, and if A imports any coal from B, it must be paid for in gold; just as if wages in B are twice those in A, only wheat will move.

(2) COMPARATIVE DIFFERENCES IN COST. It is obvious that equal wages in A and B would make it impossible for A to compete with B in the production of either wheat or coal. *A fortiori* a higher level of wages in A would make competitive production impossible, and therefore could not be maintained. When the position is that wages in B are as much higher than A's wages as before, we have these supply prices—

In A: Wheat, 10s. per ton; coal, 20s. per ton.

In B: Wheat, 12s. per ton, coal, 12s. per ton.

(This example uses the figures as to production given in the third case discussed in Chapter I, and the figures as to wages given in the last case of absolute differences in cost just treated.)

The exclusive production and export of wheat by A, of coal by B, is thus profitable to both. It would be so if wages in B were still higher. Twice as high as those in A they would give a supply price of wheat and coal in B of 13s. 4d. per ton, and so on. Again, the extent to which the level of wages in B can be maintained above that in A is limited by the extent of B's superior effectiveness in production. There is thus clearly no singularity in a situation where one country with a higher level of wages than another can export goods which undersell the cheap-labour product in its home market; better industrial organization, special natural advantages, or greater skill—all of which mean higher earnings—make the supply price of the goods lower than that ruling in the low-wage country.<sup>1</sup>

Continuing our restatement in monetary terms of the

<sup>1</sup> The very high level of wages in the United States is often attributed to their high tariff. It must be remembered, however, that there are several European countries with tariffs as high, or nearly as high, in which the general level of wages has always ruled lower than that which obtains in England, and much lower than that of the States. The important thing is the effectiveness of labour, therefore, not the protection of a tariff wall.

illustrations already given, let us trace how gold movements and price changes, resulting from the necessity to settle a trade balance, themselves alter in consequence the relations between two trading countries.

To use the same figures as before, let us suppose that the trade between A and B, when the latter country has the already assumed comparative advantage, and a level of wages 100 per cent above A's, is—

A exports 40 million tons of wheat at 10s. a ton  
= £20 million.

B exports 30 million tons of coal at 13s. 4d. a ton  
= £20 million.

Here there is an all-round equilibrium; imports and exports balance, no gold moves (i.e. no gold moves on balance for the period for which the above quantities are returned), and the wage levels will be steady.

Now, suppose that A's demand for coal increases, and that at the price of 13s. 4d. a ton A calls for 36 million tons instead of 30 millions. This quantity costs £24 millions and, with B taking no more wheat and everything else unchanged, there is a balance against A of £4 millions, i.e. the value of her imports for a period exceeds that of her exports by that amount. Gold moves from A to B to make up the difference. What are the reactions?

The outflow of gold from A will bring prices down under our assumed conditions as surely as it will raise them in B. The extent of the change is not necessarily the same in both countries. If A has a smaller stock of gold than B, and their currencies are managed in the same way, the transfer of any quantity of gold must have a more considerable effect on the former than on the latter country. Let us make the not unreasonable supposition that A's loss of gold brings prices and wages down by 10 per cent, while the same amount gained by B raises prices and wages there by only 5 per cent.

Then the figures are—

In A, the new supply price of wheat is 9s. per ton; of coal, 18s. per ton.

In B, the new supply price of wheat is 14s. per ton; of coal, 14s. per ton.

The cost of one unit in A now being 18s. (reduced from £1), in B now 42s. (raised from £2.)

But A's increased demand for coal was at the former (lower) price, and will tend to fall. On the other hand, wheat is cheaper than before from B's point of view, and the consumption will tend to rise. In the period governed, so to speak, by the new supply prices, we shall therefore have A's imports declining and exports rising, until a position is reached in which there is once more an equation of the value of A's exports to B with that of B's exports to A. For just as long as this equation is not obtained are there set into operation the correcting factors of a movement of gold and an alteration of price levels.

The final equation will depend upon the elasticities of demand of each of the two countries for the other's product. Not to make our illustration unnecessarily elaborate, let us suppose that finally—

A exports 49 million tons of wheat at 9s. a ton  
= £22,050,000.

B exports 31.5 million tons of coal at 14s. a ton  
= £22,050,000.

Equilibrium is reached, and gold will cease to flow.

The barter terms of trade have obviously moved in B's favour, since 49 million tons of wheat for 31.5 million tons of coal is a better bargain than 40 million tons of wheat for 30 million tons of coal. If the former equation of 4 wheat to 3 coal be expressed as 100, then the new purchasing power of coal over wheat is 116.6, representing a rise of one-sixth (from B's point of view). This is the outcome of what the hypothesis implies—that the intensity of A's demand for B's products is greater than that of B's for A's. Their demand schedules are different, and it is this that determines their relative bargaining power. Until there is a further alteration in demand schedules, such as was represented by the initial increase of A's demand for coal at the old price, the terms now

established will remain the basis of exchange between the two countries.

### 3. Services and Investment in International Trade.

A. SERVICES. (1) *Transport*. So far all our discussion has related to physical commodities that are measured and returned in official trade statistics. This is justified by our exclusion of transport as a factor in the situation. As long as it is not necessary to consider what is involved in shifting goods from A to B, we can compare the domestic supply prices of these goods directly, as if to produce them was to place them immediately upon their foreign market. But, in practice, international trade means the carrying of goods, often considerable distances, by land or sea, and this carriage must be paid for, and the payment is an element in a country's trade position.

It is simplest to begin by considering overseas trade, such as the foreign trade of England exclusively is. If wheat is brought from the Argentine by a vessel owned by a United States line, the freight charged for its transportation will be paid in the first place by the Argentine exporter to the American shipping company. It will enter into the price at which the wheat is sold in England, and so will ultimately be paid by the English consumer. The freight earned is an addition to the purchasing power of the inhabitants of the United States, taking them as a group, as a "nation" according to our definition. The addition is just the same as the addition that would be made if Virginian tobacco or Louisiana cotton had been sold to English buyers, to the same amount in money. It gives the United States as a nation the means of obtaining so much more of what other countries have to sell as that amount will buy; they can spend it on English manufactures or Jamaican bananas or Chilean nitrates or whatever they want.

Yet, this service—the provision of ocean transportation—will not figure in the trade returns of the United States, as do exports of tobacco or cotton. It is an export of value—otherwise it would not be paid for—the proceeds of which

can be used to acquire commodities or to command another country's services; but it is not included in the recorded total of United States exports. "Invisible" in the sense that physical commodities, the money-values of which comprise that total, are "visible," the purchasing power that accrues to the United States on account of shipping services rendered to other countries is thus not exactly known. It can, however, be estimated fairly closely.

The information we have to go upon for this purpose is represented by the *import* trade statistics of the countries concerned. In general, the value stated for goods entering a country includes the cost of carriage and of insurance, is the "c.i.f." (cost, insurance, freight) value of the goods. This is their cost to the importer, and is the figure below which he will not ordinarily dispose of the goods. The value stated for goods leaving a country is, in general, the figure at which the exporter values them as they are shipped; it is the "f.o.b." (free on board) value of the goods. The result is that an identical consignment of goods will be returned in the trade statistics of the exporting country at a lower figure than that given in the statistics of the importing country; and the value of the world's exports is, therefore, appreciably lower than the value of the world's imports. Assuming no alteration in the course or volume of trade, a difference between one year and another in this respect would represent an alteration in transport and insurance charges; a continued fall in ocean freight rates, for example, would reduce the margin between world import and export figures. (Incidentally, it might alter the apparent positions of the principal importing nations of the world relative to one another, without the volume or nature of their imports changing in the least.) Such a fall in freight rates means a shrinkage in the invisible exports of a nation that is an ocean carrier for others, a shrinkage that lessens its purchasing power over the products of other countries. On the basis of ocean freight rate changes, taking into account also any change in the total volume of world trade and in the way in which it is shared out among the competing

mercantile fleets, can be estimated the improvement or otherwise, year by year, of a country's position under this head.

If it is important to take shipping services into account in attempting to determine the true trade position of a country like the United States, it is vital to do so when we consider Great Britain, where these and similar services play a much greater part. British-owned vessels carrying goods for the nationals of other countries are a source of income to this country as a trading concern. Out of these earnings can be purchased commodities or other services; that is to say, against this invisible export can be offset imports visible or invisible.

(2) *Insurance and Finance.* Services secondary to that of transport are those of insurance and finance. Marine insurance of ships and goods has been an important feature of England's commercial development for more than a hundred years, and with the expansion of our overseas trade has developed a great and profitable business known the world over as "Lloyds." Dealings in goods must be financed, and the international commercial instrument used for that purpose, the bill of exchange, requires a market. Such a market is provided by London, that is to say, by the specialized dealers in bills of exchange whose business is mostly carried on in the square mile of the City. In so far as this market is used by nationals of other countries who buy or sell bills in London, its organization and conduct is a service rendered to them for which they pay the charges of the English bill-broker or discount house.

Shipping has thus brought insurance in its train, and then finance. Both have developed a variety of subsidiary activities, less directly related to ocean transport. The insurance business of London to-day is of every type; the financial business consists not only in the discounting of bills, but in other services which can be provided only in a highly-developed centre where funds are usually abundant and cheap, and there is a wealth of experience in international dealing. London discount and accepting houses, the London Stock Exchange,

and London banks represent an organization of facilities for dealing in money and in securities which is not yet to be found in any other centre. Since it is generally possible to get business done more expeditiously or cheaply in London than elsewhere, persons and institutions (such as banks or governments) with financial business to transact will resort to London rather than to other places. The commissions or profits earned by the London firms in this work are yet another class of "invisible export."<sup>1</sup>

It may be observed that the *place* in which the services are rendered and consumed is of no importance. Transport is being provided and used continuously over the period and distance of the journey which the goods transported have to travel. Securities sold by a stockbroker in London on behalf of a client in Berlin represent a service done, in return for which England has a claim on German goods and services, if those are wanted, or on the goods or services of some other country for which Germany ultimately foots the bill. English people seeing and hearing American films are in that way accepting settlement for American indebtedness on account of British goods or past loans. People holiday-making abroad are consuming foreign goods and services and pleasures generally, in exchange for which they transfer purchasing power to the hotel-keepers and others whose livelihood they are. So Switzerland can buy English cloth with winter sports, and convert Alpine views and dangers into coal or motor-cars. Remittances to or from abroad equally affect the real trade position of a country, and, in some cases, of which Italy and Ireland are typical, these may amount to a considerable sum. Emigrants from such countries who send home part of their earnings in that way place purchasing power at the disposal

<sup>1</sup> It must be remembered that this side of London's business is peculiarly liable to be adversely affected by financial and currency developments such as occurred during the summer and autumn of 1931. If funds cease to be cheap and abundant in London, or less so than in, e.g. New York, or if foreign confidence in the security and competence of London as a financial organization declines, this source of income may diminish (as did in fact occur, following on the suspension of the gold standard).

of their relatives, and this spent on foreign products will raise the imports (visible or otherwise) of the country concerned. The reality of the situation is that the country exports man-power instead of utilizing it within its own frontiers (perhaps because its population is above the level employable by native resources and organization), and it is in exchange for this that it obtains what it requires.

*B. INVESTMENT.* Up to the nineteenth century, the analysis of international trade, so far as it has been carried in the last few pages, would have offered a practically complete explanation of the factors determining a country's trade position. Before that time, lending to foreigners, while not unknown, was a comparatively infrequent undertaking on anybody's part, and rarely assumed significant proportions. But, industrialization brought first England, and later the other great European countries, an expansion of income which was only partly absorbed by a general rise in the standard of living, i.e. by current consumption. Year by year there was a surplus which constituted the savings of the nation, and these were presently lent abroad. They went into the issues of foreign governmental loans, or into commercial undertakings, as the opening-up of the New World and the recovery of Europe after the Napoleonic Wars provided a demand for them. Some of these investments were merely speculative, and turned out dead losses; but most gave a return sufficiently secure and sufficiently high to compete with the home demand for British savings. The distribution of the funds of a nation between home and foreign investment, and between long and short period investment in each case, will depend ultimately (if investors are left to pursue their own interests according to their own ideas) on the attractiveness of the different types to the investor. This "attractiveness" is a composite quality, involving such considerations as the net yield expected from the investment (that is, as the average net yield over a term of years in the case of a security not bearing a fixed rate of return); the prospect of the full capital value, or more,



being obtainable in the future on realization, or of redemption at that value, and the facilities available for dealing in that security. An issue of bonds or stock, to be redeemed at par at a date neither too distant nor too near, by a public authority whose credit is good, and the issues of which will, therefore, be readily bought should the original investors want to dispose of them, will be able to secure all the money required, in normal times, at a rate of interest below that ruling on ordinary industrial investments. So it came about in the nineteenth century that England, in addition to developing her own railway system, supplied the capital for the construction of railways in India, in the Argentine, in Canada, in the United States; lent money to most of the governments of the world, and financed municipal undertakings of every kind abroad as well as at home. The fact that England was so early in the field, and the large scale on which she lent, powerfully contributed towards the pre-eminence of London in finance to which reference was made in the preceding section. As other nations began to overtake her, England ceased to be the sole international investor; France and Holland became important competitors within a somewhat restricted field, and by the end of the nineteenth century, the United States and Germany, formerly borrowing nations, had entered the realm of international finance. But the years during which England had been lending largely and steadily had placed her far ahead of her rivals at that time.

The influence of such investment on a nation's trade position may be considered in two respects: the effect of the actual making of a particular investment, and the effect of the investment for the duration of its term.

When an investment, whatever it may be, is made, the immediate result is to place a definite amount of purchasing power at the disposal of the borrowing country. A South American city raising a loan in London in order to start a tramway undertaking receives so much money from a number of persons domiciled in England. This will be spent on building and equipping the tramway system—on rails, rolling stock,

and the necessary labour. The rails and rolling stock may be bought in England, the labour will probably be native labour. Just so much of the amount raised as is laid out on foreign goods will go to swell the total of visible imports of the South American country concerned; it will also go to swell the visible exports of the country or countries in which the equipment is bought.

The immediate direct effect of one country's lending to another is, therefore, an increase in the imports of the borrowing country, a corresponding increase in the exports of the rest of the world. It used to be the practice that the borrowing country spent the loan where it was raised; in the early days of British overseas investment this was generally the case because only British industry could supply the manufactures that the borrowing countries needed. Sometimes a certain amount of pressure was brought to bear upon the borrowers by the lenders, and, in the case of countries which were economically and politically weak, this might even involve them in loss by depriving them of opportunity to buy in their best markets. For example, of the foreign loans raised in England in 1824-5, Professor Andreades says: "As regards these loans . . . it may also be remarked that, at any rate in the case of the Greek loans, only a small part of the sums paid in reached their intended destination in the hands of the Greek Government. The remainder was frittered away in the form of orders insisted on by the banking firms which undertook the issue. Thus, the Greeks were forced to buy certain frigates which were never able to reach Gibraltar, and some firearms which exploded as soon as they were used."<sup>1</sup> This has not been unknown even in recent times. Professor Taussig observes:<sup>2</sup> "It was the undisguised policy of the governments in both countries (pre-war France and Germany), and of the financial promoters and institutions which were in close touch with the governments, to arrange the terms of foreign loans in such a way that the borrowers should spend the entire proceeds in France or Germany. Virtually, the same sort of thing

<sup>1</sup> Andreades, *History of the Bank of England*, p. 250, note.

<sup>2</sup> Taussig, *op. cit.* Chapter XII.

appeared in the huge loans which were made from the United States to the Allies during the Great War itself; tho here, . . . the conditions were quite exceptional, and the consequences unusual. It appeared again, and under circumstances not so exceptional, in the American loans of the post-war years."

Some investments are for a definite term only; most loans raised by governments and municipalities, and most debentures issued by commercial concerns, are of this order. The repayment of the principal at the end of the period has exactly the opposite effect, of course, to that caused by the making of the loan. It is the debtor country now which has to place an amount of purchasing power at the disposal of the creditor country, and if the latter takes it out in goods, its visible imports will rise.

While the loan is outstanding—or, for so long as there may be earned a return, in the case of a dividend-bearing commercial investment—periodic payments of interest or dividends must be made by the debtor country to the creditor, i.e. to the holders of the bonds, scrip, stock, or shares certificates that are the legal documentary evidence of the right to receive such payments. The effect on trade is still essentially the same; the nationals of another country now have at their disposal a claim on (purchasing power over) the goods and services of the borrowers—or of producers in other countries who will be paid by these claims on the debtor country—to the extent of the amount of the half-yearly or yearly interest or dividend, whatever it may be. Occasionally, a loan may be repaid in instalments, and this means during that the term for which it has been borrowed, the periodic payments will be larger than are required by the interest terms alone; but at the end of the period, the principal will have been completely paid off, so that the possibly objectionable necessity of having to make a single large payment is avoided.

During the early days of a new country's development, when all its resources are still to be exploited, and abundant supplies of capital are its great need, it is probable that it

will continue to raise loans abroad for many years, so that throughout this stage it will be paying interest or dividends on funds already borrowed, and borrowing fresh funds. At the outset, the amount borrowed in any one year is likely to exceed the interest due on the total of previously contracted debts, and this will certainly be the case if borrowing is maintained at a steady or rising level. As long as this is the case, the value of imports which represents the new borrowing will exceed that of the exports which represent interest payments in respect of the old investment (assuming for the sake of simplicity that both are converted into commodities).<sup>1</sup>

But, sooner or later, the accumulated debt must amount to many times the sum that is borrowed for any single year, and the interest due on it ultimately exceed a single year's fresh borrowings—if only because the lending country is unlikely to go on making advances to an ever-increasing extent, even if it could. Then the position is reversed, the debtor country has on balance to place purchasing power at the disposal of the creditor country. If the latter chooses to take what is due to it in the form of goods from its debtor, the visible imports of the investing country rise, just as do the visible exports of the other—for these imports and exports are the two sides of the same transaction.

The actual instances in the world of to-day of all these developments are well known. The pre-eminent position of Great Britain as a lending and investing country has already been indicated. "New" countries all the world over are indebted to British thrift and enterprise for the capital with which railways and harbours have been built, lands irrigated, municipal undertakings financed. The history of these

<sup>1</sup> Some countries borrowed freely specifically to meet interest or redemption charges on existing debt, in fact, instead of making provision for these charges out of income. Canada and Australia among our Dominions are examples of this practice, probably encouraged by the exceptional borrowing facilities enjoyed under the Colonial Stock Acts, which gave them admission to the popular category of trustee securities. But the day of reckoning cannot be postponed indefinitely, however acceptable this policy may be to the borrower, and the later it comes, the sharper it is likely to be, as the Australian crisis of 1930 showed.

countries, of which the British Dominions, the United States, and the South American republics are the chief, can be summarized broadly on these lines: Large imports of capital for some years, temporarily slackening when the country has absorbed all that it requires for the time being, at its then stage of economic development; during that time an excess of imports over exports on investment account (an "import balance"). A period when interest and dividend payments grow up to and exceed the level of new borrowing; exports on investment account exceed imports. Repayment of loans on term, or acquisition of investments by nationals, so that the country, now sufficiently developed to finance itself, ceases to be dependent on its former creditor; an export balance on investment account, which will dwindle as the payments to be made as either capital or interest decrease. Lastly, an excess of home savings over home demand for capital turns investors to the foreign market to seek for employment for their funds; the erstwhile borrowing country becomes a lending country, and there is once more a growing export balance on investment account, this time of a different nature. Of the countries mentioned above, so far only the United States has reached the last stage.

The lending country itself, it will be noticed, will pass through two stages, so far as each of its debtors is concerned. The first is that when its career is just beginning; there is no interest coming in yet, or the interest is only that due on the lending of a short time, and the amount of fresh investment done in a year will much exceed what is received. There is an export balance, therefore, on investment account. Presently, that particular foreign demand for capital will slacken, while the interest and dividends receivable on investments to date will amount to a total exceeding that of the new lending of each year. The creditor will now have an import balance on investment account. This development is inevitable, though its actual effect on the trade position of the countries concerned may be concealed if the lending country makes it a practice—as Great Britain has done for many years—to reinvest

almost automatically part or all of the returns from past investments. The result is the same as if the income were received and then lent out in a series of new, independent transactions, so far as the capital position goes ; but the figures of both imports and exports of this country are lower than they otherwise would be, to the extent that these invested interest-sums would have been represented by goods.

## CHAPTER III

### THE BALANCE OF PAYMENTS

- (1) The balance of trade and the balance of payments—(2) Great Britain's balance of payments—(3) The influence of monetary conditions of trade.

#### 1. The Balance of Trade and the Balance of Payments.

We are now able to form an idea of what may be the items to be taken into account in estimating a country's trade position.

The first step is, of course, to look at the recorded imports and exports, which show the movement of goods into and out of the country. As returns are at present compiled, the value of imports includes the cost of transport and insurance of the goods, the value of exports does not. If, therefore, we had only to consider goods and the services necessarily provided in trading in them, a difference between a country's imports and exports would represent a balance that, so far as it was not discharged by the net cost of transport, would have to be settled in gold. A country that took goods to a value above that of its exports would export gold until an adjustment of the position was reached along the lines already worked out. Such a position is called "unfavourable" or "adverse," in terms that we inherit from the mercantilist school of thought that held sway in England up to the middle of the eighteenth century, and on the Continent and in America well into the nineteenth—if, indeed, it does not linger on in a more sophisticated guise to-day.

Mercantilism was a politico-economic doctrine that possibly fitted seventeenth and eighteenth century conditions in Europe fairly well. It was during that time broadly true that—as we started by considering—commodities and ocean freight charges were the only factors that had to be considered in the trading position of England, for example. If England

bought from abroad more than she sold, taking shipping services into account, she would pay for the excess of imports with gold and silver, or "treasure," as it was generally termed. A loss of treasure meant, usually, a reduction in the country's supply of currency, i.e. of coin, and this would have caused a serious inconvenience in days when there was no developed banking system, quite apart from the weakening of the "sinews of war" that was an ever-present consideration in the minds of statesmen. It was only natural, therefore, that it should have been the declared end of the policy of every state to increase exports relative to imports, and in any event, to obviate or check any tendency for specie to leave the country. As one of the most important of the seventeenth century writers on economic topics, Sir William Petty,<sup>1</sup> put it: "The great and ultimate Effect of Trade is not Wealth at large, but particularly Abundance of Silver, Gold, and Jewels, which are not perishable, nor so mutable as other Commodities, but are Wealth at all Times, and in all Places: Whereas Abundance of Wine, Corn, Fowls, Flesh, etc., are Riches but *hic* and *nunc*, so as the raising of such commodities, and the following of such Trade, which does store the Country with Gold, Silver, Jewels, etc., is profitable before others. But the Labour of Seamen, and Freight of Ships, is always of the Nature of an exported Commodity, the Overplus whereof, above what is imported, brings home Money, etc." The error of mercantilism comes out clearly in this passage. "Abundance of Silver, Gold, and Jewels" are, in fact, only wealth when and where they are accepted in exchange for "Wine, Corn, Fowls, Flesh, etc."; since they were generally accepted, they represented (as gold still does) a convenient form of purchasing power. Despite Sir William Petty, the "great and ultimate Effect of Trade" is the enjoyment of goods and services, and, if any country had ever succeeded in realizing the mercantilist ideal of a large export trade with no imports except of treasure, it would have discovered that it was, in reality, no better off; it would have achieved only a raising of the price-level.

<sup>1</sup> *Political Arithmetick* (1690), Chapter I.



The mercantilist ideal was never realized ; even in the seventeenth century, settlements arising out of foreign trade were largely offset through the use of the bill of exchange, and comparatively small transfers of bullion on balance had to be made between countries over any appreciable period. The mistaken attempts of European governments to reach that objective resulted only in that restriction of commerce so trenchantly exposed and denounced by Adam Smith in Book IV of *The Wealth of Nations*.

Nevertheless, an excess of imports over exports is still called "unfavourable," even though it may not be associated with a net outflow of gold. If it is associated with such an outward gold movement, the reactions on the country with the unfavourable balance, which may be assumed to be on the gold standard, are of the kind already discussed. But, in what circumstances is this loss of gold likely to occur?

The account given in the preceding sections of the various elements, other than goods, which are produced and consumed by trading countries, suggests the answer. It is only when an excess of imports of merchandise over exports is not offset (i.e. paid for) by services rendered by or investment-income due to the country concerned, that there is any need to settle this balance with gold. To use the accepted term, it is when the "balance of payments" is against a country that there will be a net outflow of gold. The "balance of payments" is here used in distinction from the "balance of trade," to signify the difference between the gold-values of all imports and all exports, visible and invisible. The balance of trade is the difference between the recorded values of all physical commodities coming into a country through the Customs, and all physical commodities going out, and can be exactly stated. But the balance of payments cannot be exactly stated under present conditions, since the magnitude of the items, and in a few cases possibly even their existence in a country's trading account, is a matter of conjecture. However, in general, the side of the account on which the balance falls can be inferred with some certainty, and its size estimated sufficiently accurately

to enable us to say that a country with a permanent unfavourable balance of trade may have (in any particular year) a considerable favourable balance of payments, or that a country with a marked export surplus of goods is one with a heavy balance of payments against it, a balance which, in fact, the export surplus is offsetting.

When an adverse balance of payments (or unfavourable *real* trade position, as it might be called) does exist, then, to repeat, the resultant loss of gold will lower prices at home, raise them abroad, and this movement will restrict importation by the gold-losing country (since foreign products are becoming more expensive). Similarly, its own products will be less expensive and so more attractive to foreigners, and its exports will rise in amount, until the balance ceases to exist and gold to move. It will be remembered that we are not to assume that these changes in price-levels at home and abroad are of the same degree; home prices will fall more or less than foreign prices rise, according to the importance in the different monetary systems of the amount of gold that is transferred. Carrying this reflection a stage further, we may observe that a country which had a comparatively small gold stock as the basis of its monetary system, and a large adverse balance to settle, might not find it possible to export a sufficient quantity of gold to pay for its import surplus, without radically modifying its currency arrangements. To prevent a movement of gold required by the trade position is to abrogate one of the fundamental conditions of the gold standard system; on the other hand, to lose most or all of the gold reserve which the normal operation of the system requires, is to be forced off the gold standard equally. This dilemma is, in essence, that which faced Great Britain in September, 1931, when it apparently became a question either of England's abandoning the gold standard or of gold abandoning England. In the circumstances, no choice but what was actually made could have been expected; the gold standard was suspended by relieving the Bank of England of the requirement imposed by the Gold Standard Act, 1925, to give gold for sterling on fixed

terms, i.e. at a fixed price (the "Mint Price" of £3 17s. 10½d. per standard ounce troy). Gold, therefore, did not continue to leave the country as it must otherwise have done, in view of the trade position.

We must add to the services of transport and finance which arise in connection with current trading, investment factors which do not necessarily so arise. Under this heading must be included: (1) Current international borrowing and lending for both long and short periods; (2) interest and dividends receivable and payable, and repayments of loans. To discover the real, as distinct from the apparent, trade position of a country for any period, then, we must make up an account from all these items, or from so many as enter into the position of the particular country we are concerned with—

On the credit side, representing the country's claims on the rest of the world (= its purchasing power)—

1. Merchandise exported.
2. Gold exported.
3. Transport charges made.
4. Insurance, banking, etc., business done.
5. Visitors' (tourists') expenditure, and emigrants' remittances home.
6. Interest on old investments abroad, and principal of old investments repaid.
7. New borrowing from abroad.

On the debit side (= its use of its purchasing power)—

1. Merchandise imported.
2. Gold imported.
3. Transport charges incurred.
4. Insurance, etc., business required.
5. Nationals' expenditure abroad, and immigrants' remittances home.
6. Interest and dividends payable to foreigners, and old loans repaid.
7. New investment abroad.

With regard to the above, it may be remarked that not all the seven items will appear on each side of the account

of every country. The young nations of the world will be borrowers, but not lenders; backward countries of the East will earn nothing from banking and financial services, and there are some territories which have no significant amount of immigration or emigration, or holiday traffic. On the other hand, some countries do present most or all of the features set out above; Great Britain, for example, the premier investing country, is also, as an international banker, a debtor in respect of short-term liabilities.

To sum up: An adverse merchandise balance persisting for any appreciable time implies that other items (numbers 3 to 6 of our statement) are offsetting the excess of imports. To the extent that they do not, there must be a net outflow of gold. The established trade balance of a country indicates the stage of its economic development, a permanent excess of merchandise exports revealing a debtor country, financed by foreign investment, a permanent excess of merchandise imports a creditor country, investing abroad. A final qualification must be made before leaving this topic. The visible trade balance to which in practice our attention is confined is one which relates to a short period; it is the difference between the values of recorded imports and exports for, e.g. a quarter, or a year. It may occur that a visible balance for a particular year is not exactly offset by an invisible balance, e.g. an adverse trade balance by net invisible exports. In the case of the United Kingdom, the Board of Trade estimates of our position have shown for most of the post-war years up to 1931 an excess of all exports—visible plus invisible—over all imports. The actual size of this "real favourable" balance is not precisely determinable, of course, since the figures used in its calculation are to a large extent, estimates. The fact of its existence in normal times can hardly be disputed, however, since it is just what is available for—and ordinarily used as—further investment. It is what England can lend abroad without having to keep consumption below current production, i.e. without making the sacrifice required for fresh saving. If the real balance is unfavourable, it means that

the reverse position obtains; consumption must be reduced relative to production in order to *maintain* foreign investment. A long-continued adverse real balance, therefore, would mean that a country was "living on its capital"; it would represent a reduction, by realization, of former investments abroad, the proceeds being spent on imports. Such a positive reduction occurred during the Great War, under somewhat different conditions from those implied in what has just been said; securities in American undertakings, such as railways, held by British investors were, in effect transferred to Americans in exchange for foodstuffs and munitions. Whatever the situation, however, no perfect balancing off by calendar periods, one side against another, of a nation's account occurs. Yet, it is nevertheless, true that, *in the long run*, all imports must be offset by all exports, and that in the short run of a few years a nation may find that a policy of buying more than it is selling abroad will seriously affect its general trade position.

## **2. Great Britain's Balance of Payments, 1926-31.**

The account given in the preceding section of the items which may determine the trading position of a country was a general one, and therefore dealt with everything arising out of normal commercial transactions, without reference to the question as to whether any single country's position included all the items. In fact, the balance of payments of Great Britain is believed always to include the different constituents which have been discussed, and since the War it has been necessary to take receipts and expenditure on government account overseas into consideration as well. These represent a heading which does not appear in the summary of the credit and debit sides of a country's account on page 54, being omitted because they are not regarded as normal commercial transactions. Nevertheless, when they occur they must be taken into account, since such receipts are part of the nation's purchasing power over the products of the rest of the world, and such expenses are part of the foreign claims of a particular period which the nation has to meet. As will be seen when the actual

figures are examined, this is a variable and comparatively unimportant item. The principal headings, so far as Great Britain is concerned, are merchandise imports and exports, income from shipping services, from insurance and banking business, and from overseas investments.

The sources from which information on these heads is drawn are: articles published in the *Board of Trade Journal*, and the table showing the import and export of gold bullion and coin on pages 372-3 of the 73rd *Statistical Abstract for the United Kingdom* (Cmd. 3465); two papers by Sir Robert Kindersley in the *Economic Journal*, for permission to quote from which I have to thank the Editor; and a series of articles in the *Economist*, reference to which is also made by permission of the Editor. The conclusions reached are tabulated below, but to appreciate the value of the figures it is necessary to know how they are obtained, and how far they can be considered as close approximations to the true position.

In the spring of every year there is published in the *Board of Trade Journal* an article on the "Balance of Trade" for the preceding year. This gives the visible or merchandise balance, which invariably reveals a large excess of imports over exports, and then discusses the invisible items, the amounts of which are estimated in the light of the information available for that year. If the total of invisible exports, so estimated, exceeds the adverse visible balance (which is exactly known, of course), then there is presumed to be a favourable balance of payments on current account which is available for fresh investment abroad. (This does not mean that British overseas investment in any one year is dependent on the "real favourable" balance for that year, it must be remembered; but it represents a net national income which may be used by the individuals who are the ultimate recipients in subscribing towards foreign and Dominion loans and capital issues.) The degree to which this balance corresponds to the actual position will obviously depend on the error in the estimates as to the net national shipping income, investment income, and so on. Each article makes comparison between the year under review

and the two years immediately preceding, so that the article on 1931 also gives figures for 1930 and 1929. It is thus possible for the estimates for each year to be revised in two subsequent articles, and it has so far been necessary in every case to alter figures already given, in the light of later information. While we may, therefore, accept the Board of Trade statement with some confidence so far as it relates to the last year but two, and earlier periods, the necessity for constant and considerable revision makes it difficult to put complete faith in the estimates for the last complete period. On the other hand, if we are prepared to allow a liberal margin of error in the individual items (perhaps as much as 10 per cent above or below the figure actually given), we shall get a broad impression of the present situation not likely to require serious qualification.

We must now consider briefly the transactions included under the various headings, and the bases on which the estimates are made.

GOVERNMENT TRANSACTIONS are constituted by receipts and payments in respect of loans between governments (not in respect of any dealings between governments and private persons, which are included in "Overseas Investments"), Reparations, and Indian "Home Charges," i.e. sums remitted to persons resident in England by the Government of India on account of such items as pensions payable to former Indian civil servants. Receipts and payments on account of the overseas work and establishments of British Government departments are also included.

NET NATIONAL SHIPPING INCOME represents the earnings of British shipping in the carriage of passengers and goods, *less* the expenses of British ships abroad (purchase of stores in overseas ports, dues and tolls, etc.), *plus* the expenses of foreign shipping in British ports. This figure stands for the income from shipping to the nation as a whole, not the profit; a given year, indeed, might show larger earnings than those of a previous year but smaller profits, if the cost of operating our mercantile marine had increased more than the volume of traffic, or more than freights had risen.

The Board of Trade calculations as to shipping are based on the movements of freight rates during the year; the figures for passengers carried in British vessels; and the estimated utilization of the total tonnage available during the year, i.e. the amount of shipping tonnage laid up, and the proportion of the tonnage afloat that represents the actual cargo-carrying, or paying load, of the ships. The last factor is the one about which there is the least reliability; but in spite of this the Board of Trade appears to be fairly satisfied with the estimate obtained, and no significant revision of the figures from year to year is usual.

NET INCOME FROM OVERSEAS INVESTMENTS is the largest single invisible item in recent years, and also, unfortunately, the one in respect of which the official estimates are least satisfactory. The problems that arise in this connection are: the determination of the actual amount of investments in undertakings carried on overseas, and of loans to foreign and Dominion governments, held by residents in Great Britain, and the actual income received from these capital holdings in any period. The amount of British holding of foreign and Dominion government and corporation stocks can be estimated fairly closely, it is believed; and this class of securities always bears fixed interest, so that the income derived from this source can be calculated as accurately as the estimation of the capital held allows. But in the case of investments in companies operating abroad, holdings (except of debentures) will be of securities yielding a fluctuating return in the form of dividends, and here both elements of the sum are subject to an appreciable degree of error.

In 1930 and 1931 Sir Robert Kindersley published two articles in the *Economic Journal*<sup>1</sup>, which gave the results of an investigation into British overseas investments and the income therefrom in 1928 and 1929; there also appeared in the *Economist*<sup>2</sup> in the autumn of 1930 three articles on "British

<sup>1</sup> *Economic Journal*, June, 1930, No. 158, Vol. XL, and September, 1931, No. 163, Vol. XLI.

<sup>2</sup> *Economist*, 18th and 25th October, and 1st November, 1930.



Capital Abroad," which presented the outcome of an inquiry on similar lines. The author of the *Economist* articles accepted Sir R. Kindersley's figures as to British holdings of Dominion and foreign government and corporation stocks, which gave a total in round numbers of £1,400 millions. To this must be added the holdings in Dominion and foreign companies, estimated at £1,000 millions, and the holdings in British companies operating overseas, estimated at £1,050 millions. These estimates are based on inquiries made of some of the companies whose shares are officially quoted on the London Stock Exchange, and certain others; that for the British holdings in companies registered abroad, for example, related to about 300 companies whose combined share capital represented (in 1929) 40 per cent of that of the whole group of concerns to which the figures relate. The three headings together give a total of £3,450 or, say, £3,500 millions, which agrees very closely with Sir R. Kindersley's estimate for 1929, and even when allowance was made for classes of long-term investment not included under any of the above heads, the writer in the *Economist* concluded that £4,000 millions was probably the safest figure to take. This is a smaller total than had generally been thought to be correct, since British overseas investments were estimated to stand at the same level before the War; and since 1919 this country has been a considerable exporter of capital. Our pre-war investments must, therefore, have been depleted more heavily than had been realized, by liquidation (especially in the case of American railway securities) to pay for war-time purchases, and by loss or depreciation due to revolution or inflation after the War—to such an extent, indeed, that post-war investment overseas to 1930 has only sufficed to make up this loss.

The consequence of these investigations is that it is necessary to revise our ideas as to the national income from this source. Sir R. Kindersley, writing in the *Economic Journal* for September, 1931, gave £212 millions as the income from £3,438 millions of British capital invested overseas in 1929, just over half of this £212 millions being dividends. To allow for the

classes of investment not included in the inquiry, at least £19 millions should be added, giving a total income for 1929 of £231 millions. But of this a large fraction represents a variable source of income, and so the figure is by no means likely to remain about the same level, year after year. "If in a bad year average dividends decline, say, to 3 per cent, then, assuming no default in debentures, it is clearly possible for our income from overseas investment to fall to as low a figure as £140 millions, thus illustrating the extent to which world depression may affect our balance of payments through this item. Conversely, in a good year this figure may rise to as much as £300 millions."

In the light of these conclusions, the Board of Trade estimates for 1930 and preceding years have now been written down to the amounts given in the following table. Earlier articles (see, for example, the *Board of Trade Journal* for 27th January, 1927) gave the net national income from overseas investments as £220 millions in 1924, £250 millions in 1925, and £270 millions in 1926. The same amount was at first estimated for 1927, but subsequently the 1926 and 1927 figures were raised to £285 millions, with the suggestion (see the *Board of Trade Journal* for 28th February, 1929) that this was probably an under-estimate for 1928. However, the item remained at £285 millions for 1927, 1928, and 1929, to be reduced to £270 millions for the last two years on revision in 1931. At the same time the 1930 income was estimated at £235 millions, owing to the fall in profits of companies affected by the decline in the price of raw materials. Finally, the revision of the *Board of Trade Journal* for 18th February, 1932, taking into account the results of the investigations already referred to, put the income for 1929 at £250 millions, that for 1930 at £220 millions, and that for 1931 at £165 millions.

SHORT INTEREST AND COMMISSION represent payments for services rendered by British banks, finance houses, underwriters, and others, to residents abroad, as already explained. It is a source of revenue that might well be expected to grow steadily, if slowly, as the general business of Great Britain

expands; more active trade should bring a larger volume of bills of exchange to London for discount, and foreign lending maintained and increased should mean more work for London financial houses handling the issue of bonds, stock, or shares. On the other hand, it will equally be affected adversely by anything tending to reduce general business activity, or the amount of savings available for investment abroad, and by anything which tends to disturb the confidence of persons outside this country in London as an international banking centre, a place where funds are safe and which can, therefore, be trusted with the management of them. It is on account of these considerations that the figure under this head is shown in our table to rise gradually to the 1928-29 level, to fall appreciably in 1930—the year which saw the beginnings of the world slump—and to fall very sharply in 1931, partly owing to the suspension of the gold standard and the events leading up to it.

MISCELLANEOUS RECEIPTS AND PAYMENTS include emigrants' and immigrants' remittances home, sale and purchase of old ships, tourists' expenditure, and similar items, which are not believed to be very large for this country. It is considered that receipts exceed payments to an amount which may be £15 millions for a normal year; it was reduced to £10 millions for 1931 on account of a falling off in the sales of second-hand ships to foreigners, and of tourists' expenditure in Great Britain.

It is now possible to review the account as a whole for the six years 1926-31, the period opening with the first complete year of the new gold standard and closing with the year of its suspension. In the Board of Trade survey (18th February, 1932) there was a novel separation of gold from silver coin and bullion. Prior to this the imports and exports of gold and silver bullion and specie were given in a single total as additions to the merchandise imports and exports, and therefore helped to determine the visible trade balance. As it appeared that the gold movements of 1931 were not all directly connected with normal commercial transactions, those imports and

exports were shown separately, and for the purposes of comparison this practice was applied retrospectively to 1930 and 1929. For the sake of completeness, this has been done for all the years of the table given here, though it is not suggested that the (comparatively small) net gold movements of 1926 to 1930 were abnormal in character as were those of 1931.

**BALANCES OF CREDITS AND DEBITS IN THE TRANSACTIONS (OTHER  
THAN THE LENDING AND REPAYMENT OF CAPITAL) BETWEEN  
THE UNITED KINGDOM AND ALL OTHER COUNTRIES**

In million £'s

	1926	1927	1928	1929	1930	1931
Excess of Imports of Merchandise and Silver Bullion and Specie . . .	463	386	353	381	386	411
Estimated—						
Excess of Govt. Receipts from Overseas . . .	4	1	15	24	19	16
Net National Shipping Income . . .	120	140	130	130	105	80
Net Income from Overseas Investments . . .	250	250	250	250	220	165
Net Receipts from Short Interest and Commissions . . .	60	63	65	65	55	30
Net Receipts from other Sources . . .	15	15	15	15	15	10
Total Credit + or Debit - Balance . . .	449 - 146	469 + 83	475 + 122	484 + 103	414 + 28	301 - 110
Excess of Exports + or Imports - of Gold Bullion and Specie . . .	- 11	- 3	- 6	+ 15	- 5	+ 35

NOTE. Govt. Receipts from Overseas includes some items on loan account. Net National Shipping Income includes disbursements by foreign ships in British ports. The 1928 figures of Gold Movements exclude £18.4 millions transferred to France, an amount of gold pledged as security for a previous loan.

Detailed comment on the above table is unnecessary, but a word of warning as to its significance must be reiterated. The "favourable" invisible balance is set off against the "adverse" visible balance, but it must not be forgotten that all the items

in the account—imports and exports of merchandise with the invisible items—are to some extent interdependent. We usually say that our banking and shipping earnings go to “pay for” our imports of foodstuffs and raw materials; but we might equally well say that those services give us a command over the products of other nations which we take out in the form of merchandise imports in excess of our exports. Again, while current investment is not directly related to the net credit balance in our favour, the size of the balance itself is affected by the amount and yield of prior investment outstanding.

The most striking feature of the table is perhaps the high degree of stability in the four classes of invisible exports, leaving the comparatively unimportant Net Government Receipts out of account, and excluding 1931. The considerable variations in the final balance are, therefore, due to the variations in the size of the adverse visible balance. An examination of our trade returns<sup>1</sup> shows that this is rather affected, over this period, by changes in the total value of our exports than by changes in the value of imports; the large difference between the balances of 1926 and 1927, for example, is to be explained chiefly by reference to the rise in the export total from £778·5 millions to £832 millions, the fall in the cost of imports being only £23 millions. This particular increase is presumably due to the recovery in some branches of our export trade following the conclusion of the coal strike of 1926; a small advance for 1928 of nearly £12 millions was not maintained, the 1929 total being a little lower at £839 millions.

### 3. The Influence of Monetary Conditions on Trade.

The stage has now been reached at which it may be useful to bring together and to develop the observations already made as to the part played by currency affairs in international exchange.

<sup>1</sup> See *Statistical Tables relating to British and Foreign Trade and Industry, 1924-30*, Part I (Cmd. 3737), from which the statistics in the text are taken.

It is clear that the fundamental conditions of international trade do not imply any particular currency arrangements, such as a gold standard. They have been established in the preceding pages in terms of hours of labour and of quantities of products, subsequently translated into monetary terms. But this translation, which makes the more detailed analysis easier, itself suggests the usefulness of money in this connection. It provides us at the very least with a measure of what is finally involved, of indebtedness, a measure expressed in units which facilitate calculation. If the measure were in all cases an unchanging one, there would be nothing more to be done than to describe it. As it is not, as a monetary unit such as a pound sterling may represent a different amount of indebtedness in terms of commodities at one time from what it does at another, it is necessary to consider the possible effects of such changes.

(i) THE ESSENTIALS OF A GOLD STANDARD SYSTEM. The arrangement adopted by most of the civilized nations of the western world, designed to ensure so far as possible that trade shall not be affected by fluctuations in the value of money, is the gold standard. To repeat, the essential condition of the existence of the gold standard is that the unit of account employed within a country shall always have a purchasing power equal to that of a certain weight of gold of a certain fineness. The method used to effect this fixation of the unit (the pound sterling, the dollar, the franc, or whatever it may be) in relation to gold is not the same in every case, though most countries work on substantially the same lines. These lines of operation are in accordance with the generally-accepted "Quantity Theory of Money," which is, briefly, that the purchasing power of a unit of money in any community, supposing the supply of purchasable commodities remains unchanged, will vary inversely with the total number of units there are in circulation. The larger the number of units offered for this (supposed fixed) quantity of commodities, the less of any or all commodities a single unit will command; and *vice versa*. If, therefore, the quantity of commodities

offered for purchase were known, and if the number of units available for purchasing them could be made what we like, the value of a single unit could be fixed at any determinate level. In such a case, the general level of prices (taking this expression to mean the same as "the value of money") could be fixed by a government at any level it chose, and maintained at the selected level, or not, as desired, by appropriate alterations of the number of units of currency with which it supplied the community. Now the level selected in the case of a gold standard system is one related to gold, and thus the quantity of the currency must be varied so as to maintain that relation. The currency must be reduced in volume when the value of a unit of money must be raised in order to keep it at par with gold (i.e. with the definite quantity of gold to the purchasing power of which its own must be equal); it must be increased in volume, when its value must sink with that of gold.

The methods by which this variation of the volume of the internal currency of a country is secured all involve the limitation of the total amount of currency in circulation by reference to the country's gold stock. It is as true of gold as of anything else that abundance causes its value to fall, scarcity causes it to rise. If the world's stock of gold is relatively more abundant in one period than another—more abundant, that is, taking into account the way in which it is used and the supply of commodities offered for it—its value will be lower in the period of abundance. In other words, gold prices—the prices commodities fetch in terms of gold—will be higher. A single country on the gold standard will be affected in the same way. If gold is more abundant, and so lower in value in that country, its currency, which must be kept at a fixed value in terms of gold, must be increased in quantity, and so currency prices will be higher. In short, the internal prices of all gold standard currencies—which will be expressed in different units and may differ in detail in their alterations—must alter as the world-value of gold does; they will rise as relatively increasing supplies bring the value

of gold down, fall as relatively decreasing supplies raise it.

The way in which this regulation of the volume of local currencies is effected, has, so far, involved (a) the free conversion of gold and currency into one another on fixed terms, (b) the free movement of gold into and out of the country. These two provisions are theoretically separable, but in practice, the one is useless without the other. When they are both in actual operation, it means that anybody who holds the local currency of a country, say England, can convert it into gold and send that gold abroad. It will be worth while to do so when English prices are at such a level that, when the general level of sterling prices is translated into gold, they are appreciably above the level of prices in other gold standard countries, for example, France. The English gold standard system gives a fixed quantity of gold for a definite amount of currency; under the Gold Standard Act, 1925, the Bank of England is required to give a bar of bullion of approximately 400 oz. troy of fine gold for legal tender currency presented to it, at the figure equivalent to the price of £3 17s. 10½d. per standard ounce. As the English standard is  $1\frac{1}{2}$  fine, this means that, in practice, £1,700 is the minimum quantity of currency for which the Bank will convert gold under this clause. A rise in sterling prices, therefore, means a fall in the value of sterling and equally of the gold into which it is convertible on fixed terms—a fall in England which we suppose not to be accompanied by a fall elsewhere. If the rise in sterling prices, or fall in the value of gold in England, is appreciable,<sup>1</sup> then it becomes worth while to turn currency into gold instead of into goods, and to transfer the gold to wherever it will buy more than in England, converted into the appropriate local currency.

The transference of gold will affect the price situation, because the outward gold movement has been set in train by the conversion of currency, which has reduced the volume

<sup>1</sup> "Appreciable" here means: beyond the specie point, determined by the cost of shifting gold from England to the regions where it buys more.



outstanding. This reduction in the supply of sterling will check any rise in prices that may have been occurring in England, or bring prices down. Such a movement will go on until the sterling price-level is once more equated to the world price-level, that is, until gold buys the same in England as abroad, or very nearly. This may not mean a very considerable gold outflow and corresponding reduction of the volume of local currency, because the gold leaving England is going to those other countries where price-levels are lower, and these must be affected in the opposite way, i.e. their prices will tend to rise, because the addition to their gold stocks will ordinarily produce a corresponding increase in the volume of their currency. The extent of the effect on the countries concerned will largely depend upon (a) the total volume of the currency prior to the particular movement under consideration, and (b) their currency arrangements, and it must not be assumed that a given gold movement will produce the same results in no matter what direction it moves.

(ii) GOLD STANDARD ARRANGEMENTS. At present two sorts of currency-controls are represented by the different practices of gold standard countries. One way of regulating the volume of currency put into circulation is to limit it by law to an amount not more than so many times the gold reserve of the issuing authority. This is more commonly expressed by saying that the gold reserve must not be allowed to become less than a certain fraction of the total issue of currency, which will not, of course, be of gold; two-fifths or 40 per cent is the figure laid down by law in the case of the Federal Reserve Banks which hold the gold reserve of the circulation of the United States. Such a provision is not accompanied by a limitation of the maximum amount that may be held, and, in fact, the Federal Reserve System has, at times, maintained a reserve around 70 per cent. The other way is to limit the issue of currency by saying that it must equal a fixed quantity of securities held by the currency authority *plus* a fluctuating quantity of gold. This is the method established in Great

Britain by the Currency and Bank Notes Act, 1928, whereby it was laid down that the Bank of England must issue notes to the extent of £260 millions<sup>1</sup> plus whatever was the amount of the gold reserve it might have at any time. (A gold reserve of £100 millions would, therefore, give a note issue of £360 millions, and so on.) The amount of gold being determined by our imports and exports of the metal (which is the same thing as saying the Bank's purchases and sales), it is the day-to-day inflow and outflow of gold that fix automatically the total quantity of currency. But the gold movements themselves, as we have seen, are set in train by the relation between the British and other price-levels.

We must now return to the bearing of these currency matters on the exchange of goods and services which is international trade. When the gold standard system is working in the way in which we have described, monetary questions will not complicate the trade situation, which will be dominated by those underlying economic factors discussed in Chapter I. This is because the working of the gold standard implies an equation of price-levels between all gold-standard countries, and because it provides means whereby any departure from such an equation can be corrected; that is, it allows any interested parties to adjust the volumes and so the values of all currencies on the standard by turning any local currencies into gold and by shifting this gold to wherever it will fetch most in goods and services. The difference between price-levels has only to be enough to cover the expense of doing this. Under an international gold standard regime, therefore, trade between nations will be determined by their comparative costs of production, as according to the general theory.

(iii) DEPARTURES FROM THE GOLD STANDARD, AND THE REACTIONS ON TRADE. When we have any departure from gold standard conditions, however, the position is changed. The simplest case is that represented by the history of most

<sup>1</sup> Raised by £15,000,000 under Treasury sanction, according to the provisions of the Act, as from 1st August, 1931, in the first instance for a period of three weeks, subsequently extended.

of the belligerent nations shortly after 1918; the gold standard abandoned, and the local currency inflated, that is, increased in volume by governments who resort to such a practice as a means of balancing budgets. An inflating government is really attempting to fill up the deficiency of revenue by creating money to the required extent—by issuing notes that constitute the currency, and that are no longer being kept fixed at any particular value in terms of gold. Such action, of course, raises local prices; the purchasing power over commodities of each note decreases, the larger the number put out by the government (or by the Central Bank). But, at least at first, it does not necessarily raise local price to the extent that it reduces the value of the currency in terms of gold standard currencies.

The internal value may fall more rapidly or more slowly than the external (or gold) value, so that we may have a currency at one stage of inflation with a foreign exchange value *higher* than its internal value, at another stage with a foreign exchange value *lower* than its internal value. The reasons for these disparities are to some extent peculiar to each case, but it may be noted here that the external value of a currency can be affected to an important extent by dealings in that currency by foreigners for other than ordinary trade purposes. If it is believed that its value will rise in the future, speculative purchases may be made on the foreign exchange markets, and these will tend to keep the external value above the level corresponding to the internal value; just as speculative sales will bring it down. But again, the internal value, or general price-level within the inflating country, may not alter directly with the increase in currency, because there are a number of money charges that cannot be altered precisely in correspondence with inflation. In this case, the internal value will be higher than the external; and this is the position more usually established when a currency has been divorced from its nominal standard for some time.

A given quantity of a currency in such a state will command, for instance, ten hours' labour within the country,

and a certain quantity of gold or of a gold standard currency outside of it, which represents *less* than ten hours' labour in a gold standard country. The products of the labour of the inflating country will sell on the world market in competition with those of the gold standard country, and a given gold price of a product will have a higher value (in terms of labour, for example) for the inflating than for the other country. Or, to put it in another way, if a commodity represents the expenditure of ten hours' labour, it can be profitably sold by producers in the inflating country for a lower gold price in the world market than would be remunerative to its competitor, assuming equal industrial efficiency. For so long as the situation lasts, therefore, the inflating country has an advantage in export markets. It need not be argued that the same conditions that produce the expansion of exports that normally results, will equally tend to restrict imports.

This state of affairs—of a “bounty on exports,” as it is usually called—is popularly regarded as a mitigation of the evils attendant on inflation, or even as a positive benefit. But this is not the whole story. The increased competitive power of exporting industries is due to the fact that most of their expenses and liabilities have been reduced in terms of gold, while those of their competitors have not been. Those items that represent internally-payable charges and liabilities are a lighter burden, wages and salaries because they are rising slowly, pre-inflation debts and debt-charges, such as fixed interest on debentures, because they are not rising at all. The exporter's gain is thus his employee's and his creditor's loss, and the corresponding reduction in their purchasing power will be revealed not only in the falling purchases of foreign products, but probably also in a dwindling market for the products of non-exporting home industries.

Secondary results of the situation may be briefly noticed. Looked at from the point of view of a country still on the gold standard, or even from the point of view of one in which the currency is of a higher and more stable value than that

of the inflating country, the position is this: a given outlay of the gold standard currency, for example dollars, will command a quantity of the inflated currency, for example kronen, which buys more commodities if spent in the inflating country than would the equivalent dollars spent in the gold standard country. We have already seen how this difference may be turned into goods. In some cases, the inflating country was economically shattered after the War to such an extent that it could, however, produce hardly any goods to be bought by foreigners; such was the case of Austria for some time after the armistice. The holder of dollars could still enjoy the advantage given him by the lower external value of kronen, if he used it to acquire rights in Austria—property in land, for instance—or to avail himself of direct services there, as in Viennese hotels. In all the European countries where inflation to any considerable extent occurred, there was, in consequence, some transference of property to British and still more to American hands, and for some time—until the difference between the internal and external values of the inflated currencies ceased to exist—English and American visitors and residents abroad found themselves able to live abnormally cheaply.

We may observe that this condition of things is in its very nature temporary, and also that any advantages that might be reaped from it may never arise owing to the actions of other countries. The second point—the prevention of the currency bounty to exports having its natural effect—is a matter dealt with later, under the heading of tariff measures to prevent what is called “exchange dumping.” As to the first, experience and theory both suggest that, before very long, the internal purchasing power must overtake the external purchasing power of an inflated currency in its downward plunge. This may occur because the downward movement is reversed, by a government’s stopping inflation and proceeding to deflate (as the British Government did from 1920); or at the other extreme, by inflation proceeding to the point at which money becomes practically worthless, and, ceasing to be used, is

replaced by a new currency (which was, in effect, the position in Germany at the end of 1923); or by the stabilization of the currency at a value possibly higher than the lowest reached, but below the original (abandoned) gold standard value (as in the case of Italy and France). To put it generally, once the fall in the external value of the currency ceases to go on faster than the fall in its internal value, or stops altogether, the internal value equates to the external, and the local price-levels are equated to world price-levels. There will no longer be any stimulus to exports provided by currency conditions, no matter what they may be.

Inflation is the most general case of the developments described, but it is not the only one. It brings out in high relief, so to speak, the features of a situation in which the internal and the external values of a currency are appreciably different. But such a situation can arise without an increase in the volume of currency. It cannot occur if the gold standard is maintained; but departure from the gold standard does not necessarily mean inflation, either previous or subsequent. If a country formerly on the gold standard no longer admits an obligation to give gold for currency on certain fixed terms—suspends the gold standard, as the phrase goes—it may incur no immediate rise in its local price-level, which may be comparatively sluggish in response even to a positive increase of currency, as has been said. We are not even certain to find a fall in the external value of its currency taking place, that is, a decline in terms of foreign currencies, an adverse movement of the exchanges. What will determine this external value, now that it is no longer tied to gold? Obviously, the demand on the part of foreigners for that currency, as compared with the demand for foreign currencies from the side of the country that has departed from gold. In other words, the balance of payments existing between that country and those with which it deals will determine, day by day, the value of its currency. The presumption is, of course, that the balance is very much against it at the time when the gold standard is suspended, since the prime reason for such a step

as the suspension of a currency standard is the difficulty of maintaining it under the pressure of an unfavourable balance of payments, giving rise to an unwonted loss of gold.

Referring this to the suspension of the gold standard in Great Britain on 21st September, 1931, we can say that it is the extent to which the balance of payments was against us that determined the level reached, on any day in October, for instance, by the £ sterling in terms of dollars or francs. Had not the balance been so much against England, the foreign exchange position would have been better, the £ would have been worth more of foreign currencies. But it was the fact that the balance was against us that brought about the suspension, and the resultant fall in the external value of sterling; the suspension of the gold standard *in itself* had no such effect.

A similar result as regards a country's trade position would be produced if, instead of a divergence of internal and external purchasing powers being allowed to arise, an equivalent reduction in costs had been made. Such a reduction would allow the country concerned to sell its goods remuneratively at a lower gold price than its competitors. But it is by no means easy to decide on the reductions necessary to raise competitive power in the export market, and still less easy—and generally unpopular—to put them into force. When a country goes off the gold standard, on the other hand, and as a result the cost of obtaining imports from gold standard countries is raised, the real wages of workers and the receipts of fixed-interest security holders are *automatically* reduced.

To conclude: the visible trade balance of a country directly, and the invisible items indirectly, will be affected by the currency policy pursued by that country. The gold standard system is useful, and the more useful the more widely adopted, because it means exchange stability, in that, practically speaking, any currency has the same purchasing power inside as outside its borders. But this stability is not always achieved, because gold standard countries are not always ready to allow the consequences of the system to work themselves out as

the theory requires. Since the Great War, currency affairs have played an important part in international trade; in the first period because of the general departure from the pre-war gold standard, in the second period (which, perhaps, is now closing) because of the general return to some kind of post-war gold standard. The relative trade positions of the nations of Europe during these two periods have been to some extent determined by the currency policies followed. A temporary stimulus to merchandise exports was felt by inflating countries to a degree determined by the relative depreciation of their currencies. Just after the War, this was largely nullified by the economic dislocation caused by the provisions of the Peace Treaty, and by the uncertainty due to those same currency developments. The subsequent return to gold was made on widely-varying terms. Great Britain raised the £ sterling to its pre-war gold value in 1925, so increasing the cost of her goods to her customers. France and Italy raised the value of the franc and the lira from the lowest level reached during the inflationary period, but only to (approximately) one-fifth and five-eighteenth of the old value, respectively. The effects of the different currency policies can, to some extent, be traced in the subsequent development of the foreign trade of those countries.

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## CHAPTER IV

### SOME EFFECTS OF DUTIES ON TRADE

(1) IMPORT duties—(2) Export duties—(3) General considerations.

It is proposed to consider under this head the broad economic effects of duties which may be levied by governments on goods crossing national frontiers, without having any concern as to the ways in which duties may be levied and the various problems that are involved. Those are matters of tariff technique which are treated of later; here we have to attempt to answer in general terms the questions: What is the effect on the volume and conditions of trade of the imposition of duties? By whom is a duty really paid?

In this connection, the object of the imposition of a duty is not relevant. It does not matter whether a government taxes a particular import solely for the purpose of raising revenue, or in order to protect, by restricting imports, the native producer in the home market, or to obtain some revenue and to give some protection, which in practice is often the result of the imposition of a duty. Nor does the use made by the government of the proceeds of the tax enter into the problem we have to discuss. The important thing is, that the taxation is levied. Such duties are classed as "indirect" taxation because they are not imposed upon the persons who are ultimately meeting the levy, as in the case of income tax, but upon persons who are expected to transfer it to others. The taxes due on imports are actually collected from the importer, but it is expected that he will later reimburse himself by charging a higher price to purchasers of the goods than he otherwise would. This last sentence is not an answer to our questions; it merely relates to the recoupment, in part or in whole, by an importer, of the money he has paid out. This says nothing about the terms on which dutiable imports are obtained by the consumers in the duty-levying country,

that is, about the real cost of the goods to them, as compared with what they would have paid had there been no duty. That must be argued out on the general lines already developed in the pure theory of international exchange.

There are three classes of duties: import duties on goods coming into a country, there to be consumed or re-exported, usually after some degree of working-up; export duties on goods leaving a country; and transit duties on goods passing across a country, consigned from another country to a third and not changing ownership during its transit. Transit duties are not an important feature of modern tariff policy, and so we may confine our attention to import and export duties. As before, we will consider the case of two countries, A and B, in exclusive trade with one another, and think primarily in merchandise terms, in order to bring out any alterations discoverable in the barter terms of trade. The countries are assumed to be trading at an equilibrium before any duty is imposed by one of them on imports from the other.

### **1. Import Duties.**

Let us imagine that, as in our earlier illustrations, A has the advantage in the production of wheat, B the advantage in the production of coal, and that trade between them has brought about a position in which A exports wheat to B in exchange for B's coal. The elasticity of A's demand for coal is less than B's demand for wheat; A must have supplies of coal from B, but wheat consumers in B would turn to substitutes if the price of A's wheat rose. Under free trade conditions an equilibrium has been reached. It is in such circumstances that A imposes a specific import duty on coal, equal to one-fifth of its value (before the imposition of the duty) at her ports or on the frontier. What reactions are likely to arise?

The first result is that, if the fundamental condition that merchants will require the same level of returns abroad as at home be satisfied, the price for B's coal quoted in A will rise by 20 per cent. But, other things equal, this will

bring about a diminution of the purchases of coal by consumers in A.

If the total quantity of coal that A will now take is reduced, the aggregate amount that has to be paid to B is less than it otherwise would be. Is it less than the amount paid (for a larger quantity of coal) before the duty was imposed? The answer to this depends upon the elasticity of A's demand for coal. We have supposed it to be relatively inelastic; that is to say, neither increasing nor decreasing much with changes in price.

It is then probable on *a priori* grounds that the total number of tons of coal still demanded by A at a price per ton 20 per cent above the old price, is *not* less by 20 per cent than the former number. Say it is only 10 per cent less: after the imposition of the duty, A takes 90 tons for every 100 formerly taken, while each ton costs 20 per cent more, so that 90 tons is now quoted at a figure (in money) which previously would have bought 108 tons.

This coal is, in reality, being obtained by exports of wheat, and we must consider the result of this development from that aspect. The real cost of coal to A is not raised, if no more wheat is being given for coal, ton for ton, than before. This is the case if the price of A's wheat in B can be raised, so that wheat and coal are exchanged on the same terms—with both commodities at higher prices and in smaller quantities—as before.

But B's demand for wheat is relatively highly elastic, by hypothesis; therefore, an increase in the price of wheat in B will cause the consumption to fall off more than in proportion—a rise in price of 10 per cent will reduce the quantity purchased by, say, 20 per cent or 25 per cent. Any increase in the price asked for wheat by A would reduce the demand for wheat, which is indicated by the amount of coal offered in exchange by B, sharply and considerably.

The result is that the price of wheat in B will not rise to an extent which will appreciably reduce the quantity of wheat sold there, for if it did, the total proceeds of the sale of wheat would fall. (If the price of wheat per ton rises 10 per cent

and, as a consequence, wheat consumption falls off 20 per cent, the gross proceeds of A's exports are 88 per cent of what they were at the old price.) These proceeds constitute A's purchasing power over B's coal and thus the volume of coal imports would be further reduced. But, since A's demand for coal is inelastic, i.e. about the same quantity will be called for even if a yet higher price must be paid, this threatened or actual reduction would raise the price of coal still more. To follow this out would only be to repeat the argument at a different level.

It should now be clear that, in these circumstances, A can raise the price of wheat very little, if at all, in response to the rise in the price of coal. The final position is, therefore, that, with the price of coal raised by 20 per cent after the imposition of the duty, A is taking less coal, but not much less, than before. In payment of her larger coal bill, A exports wheat which, if it is to be sold for sufficient to settle for the coal, will have to be sold in larger amount and possibly at a lower price than before. To take an extreme case, let us imagine that A can increase her wheat exports to B only by lowering the price of wheat in B by 5 per cent. The demand being elastic, such a reduction will mean a more than 5 per cent rise in the quantity sold, so that the total proceeds are larger than before, and this is what is wanted.

When A's demand is extremely inelastic, B's demand extremely elastic, therefore, the new equilibrium that will eventually be reached, when the value of each country's imports and exports balance, is one that reveals A in a less favourable position than before. A is importing a smaller quantity of coal and giving a larger quantity of wheat for it than before; the barter terms of trade have moved against her owing to her inferior bargaining position, to the fact that her need for coal is greater than B's need for wheat.

The answer to the question, Who really pays the duty? follows from the answer to the question as to the effect of the duty on trade. The fact that A's demand is largely maintained is the important consideration. If it were completely

unaffected by the increased price of coal, then, since the amounts of coal sold in A and in B would be the same as before, and nothing else in the situation is supposed to have changed, the price of coal in B and the return to merchants (their profit) would be unaltered. The same return, by hypothesis, is obtained by merchants on coal disposed of in A and, therefore, the price of coal must stand permanently above the level ruling in B by exactly the amount of the duty imposed by A's government. The consumers of coal in A are, therefore, paying the tax, in a higher price paid for every ton in reimbursement of the amount actually paid earlier by importers.

But this is dependent upon the condition given: that the demand of A for coal remained exactly the same when the whole of the duty was "passed on" to the consumer to pay—which was not argued to be the outcome. In fact, while such a thing is theoretically possible, it would be extremely unlikely under actual conditions, and in working out our instance we imagined a 10 per cent fall in the amount of coal purchased. Taking this into account, together with our original assumed condition of exclusive trade, we may be obliged to modify our conclusion as to who pays the tax. Supposing the same aggregate output of coal as before, B will have a larger supply on the home market (since A is taking less at the price 20 per cent above the old level), and this will tend to bring down the domestic price of coal. The foreign price (ruling in A) will move with the domestic price, though still above it by the whole amount of the duty. The result will be that consumers of coal in A will pay a price for each ton higher than before, but not higher by the whole amount of the duty. Again this is true only when a particular condition is satisfied, the condition that a larger amount of coal than before is offered in B's own markets and that, as a consequence, the price must be reduced to dispose of the whole output. If no more coal than before is placed on the home market, producers in B must have reduced their aggregate output to the extent by which sales in A (i.e. exports) have fallen off. In such a case the price in B will not alter; the price in A will be higher than

the old price by the amount of the duty, and B's coal industry will be reaping smaller aggregate profits than before, but the same profit per ton sold as before.

Lastly, it may not be out of place to remark once more that these arguments and conclusions must be modified appropriately when we consider actual circumstances, which will almost always be certain to differ from those we have assumed. It must not be forgotten that our two general assumptions are: (1) that the trade is between the two countries only, i.e. that a producer can sell only in his home market or in one foreign market and that these are both open to him under the same conditions; (2) that production is at constant cost and that a given market price per unit means the same profit (calculated as a fraction of the price) whatever the number of units sold, or, in other words, whatever the volume of production. In most cases in the world of to-day we shall find that, however important a foreign market may be to a producer, it is usually not his only export market, and that a duty imposed on his goods entering a particular country will make him turn to other markets, which have no such barriers, unless he can shift the duty on to the consumer. Even if he does succeed in this, the imposition of the duty may, all the same, stimulate him in the search for and exploitation of fresh markets, and the maintenance of output will, therefore, not necessarily bring about any increase of sales (at lowered prices) in the home market. Should any alteration of the volume of production occur, it is, moreover, likely to cause a change in the cost of production per unit of output, and this will ultimately affect the selling price.

## 2. Export Duties.

Duties imposed on goods leaving a country are not met with very often in modern fiscal systems, but they are not unknown even in recent times, and deserve a brief consideration. In order to take an extreme and, therefore, simple case, let us imagine that B's demand for A's wheat is extremely inelastic—practically fixed no matter what the price, while

A's demand for B's coal is highly elastic—likely to be greatly reduced by a rise in price and to expand considerably on a fall. Suppose that A's government imposes a specific duty on the export of wheat to B, equal to, say, 10 per cent of its price f.o.b. or at the frontier.

The immediate result will be an increase of 10 per cent in the price of wheat in B, which will cause a very small decline (if any) in sales. If no reduction in B's wheat consumption occurs, then 10 per cent more will have to be paid to A, or, in other words, the proceeds of B's coal exports will have to be increased in order to pay for the larger wheat-bill.

By hypothesis, to raise the price of coal per ton in A is to reduce consumption more than in proportion, and this will merely make the situation worse. The solution, therefore, is to reduce the price of coal in A, since this will bring about an expansion of the demand. If A's demand is extremely elastic, a very small reduction may be sufficient to give the gross proceeds required. (The proceeds of the sales at the old price are assumed to have been just sufficient to pay for A's wheat at its old price. The cost of obtaining wheat is now up by 10 per cent. If coal prices in A are cut by 5 per cent, then an increase of almost exactly 15.8 per cent in the amount sold will give the required total.) But that is to say that not only has the whole of the tax been exacted from the consumers of A's wheat, but also—for as a community they are the same as the producers of coal sold in A—a further amount has been forgone, in the reduction of price which has had to be made.

What effect is exerted by this adjustment on the barter terms of trade? No smaller volume of wheat is consumed by B than before A imposed the export duty, and a larger quantity of coal is now sent from B to A. The result is, therefore, that the command of B's coal over A's wheat has now been reduced; on the figures employed above, the amount of wheat that formerly could be obtained for 100 tons of coal now requires 115.8 tons of coal.

It is unnecessary to repeat the conditions which must be granted before this argument can have any validity, or to

emphasize the fact that this is an extreme case. Much more likely in real life would be a small reduction in the consumption of wheat by B after the imposition of the duty. Equally, the reduction of the price of coal in A to the extent suggested might not bring about an increase in the demand by the figure required to balance the account; a less than 5 per cent cut might be sufficient or a more than 5 per cent cut might be necessary to make any appreciable difference. But it must be observed again that it is the relative elasticity of demand of countries for one another's products, other things given, that will determine how the terms of trade alter when an existing equilibrium is upset by the imposition of a duty or any other cause. It is the same factors, the interaction of which determined the old equilibrium, that will establish a new equilibrium position.

It is sometimes suggested that an export duty can only be exacted to any extent from foreign consumers when the country levying the duty has a monopoly of the taxed commodity. A monopoly or nearly a monopoly of the production of the article it is proposed to tax is in practice a great advantage, if only because the probable effects of the tax and the revenue likely to be obtained from it are easier to predict when there are not several competitors of varying productive power. But, when it is a question of where the real burden of the tax is to fall, elasticity of demand is the important consideration. If, in our example, A, the export-duty country, was extremely dependent upon B for coal, while B's demand for wheat was an elastic one, the argument would have brought us to a different conclusion, although A has a monopoly of wheat supply so far as B is concerned. A monopoly of an unwanted article is of no advantage; what places a country in a strong bargaining position is a monopoly or quasi-monopoly of a commodity much in demand.

### 3. General Considerations.

The discussion so far has dealt with cases which represent only certain restricted aspects of the problems arising out of



the imposition of duties. The line of argument followed out in the preceding sections can, however, be extended to cases which more nearly resemble the position in which most countries stand to-day; that is, to cases in which an important export of one country is taxed by another country, which supplies the first with an important import on which a duty is levied by the consuming country. Still using our simplified instance of exclusive trade between two countries, we may ask what are likely to be the results when both A and B impose duties on imports?

It need not be argued that, if both countries are taxing imports to the same extent, the relative elasticities of demand will determine the degree to which the burden of the duty on each commodity is shared (between producers and consumers) and the barter terms of trade that are established. This does not mean, of course, that the result will be the same, whatever the duty, the total volume of trade alone being affected. The volume of trade will be affected and, in general, will be smaller, the higher the duties; but the barter terms of trade also will alter on the imposition of duties, or on their increase. A doubling of duty on each side, for example, would reduce an elastic demand for imports more than an inelastic demand, and since (in our simplified case) a country's demand for imports is exerted, so to speak, by the proceeds of the sale of her (exported) goods in the other country, the nation with an inelastic demand would have to offer more than previously, relative to what would be obtainable in exchange. In short, if the regime is to be one of duties at a common level, it is directly to the interest of the country in the weaker bargaining position that the level should be a low one.

The last sentence must not be read to imply that, conversely, it is to the advantage of a country in a strong bargaining position that duties should be high all round. The only thing that can be said with safety is that its loss will be smaller than that suffered by the other country. For example, if once more we consider the position where A's demand for B's coal is relatively inelastic, and imagine what happens

when both countries impose a duty equal to 20 per cent of the value of imports, we shall reach some such conclusion as this: Coal producers may be able to shift all or nearly all the burden of the tax on to consumers because, if they raise prices by the whole amount of the duty (20 per cent), their sales in A would fall off to such a small extent that the aggregate profits would be nearly as large as before (the profits per ton produced the same and the aggregate proceeds larger than before). Wheat producers, on the other hand, cannot raise prices to anything like the amount of the duty, because to do so would be to lose such a large part of their market that their gross proceeds would be lower than before. As A is buying coal out of the proceeds of wheat exports, wheat prices cannot be raised to an extent that could reduce sales so much as not to realize the figure required to buy the now more expensive coal. Hence wheat will be increased in price by less than the amount of the duty and the producers will bear part—conceivably the whole—of the tax.

Both sides may lose, in that each is getting a smaller quantity of goods than before, while consumers are paying more per ton for what is still imported—and if imports (and therefore exports) of both wheat and coal are smaller in amount, aggregate profits of producers of each commodity are lower.

It will be realized from what has been said that it is possible to argue cases in which one side, the country A, for example, is in so disadvantageous a position as to bear the whole burden of the duties. If A cannot raise the price of wheat to B at all, then the tax is being paid by her nationals; and, if, at the same time, A takes the same quantity of coal as before at a price higher than the old price by the full amount of the duty, B's import duty is being paid by nationals of A. But it would be difficult, if not impossible, to find an actual nation in such a position, even if we substitute all-round tariffs at a certain level, for import duties on single commodities, and substitute for the one country, B, with which A is supposed to trade, all the other nations of the world. There may, perhaps, be countries which are generally in a weak bargaining

position, but it is unlikely—in a world in which high tariffs have been a feature of everyday conditions for many years—that a country in so extremely inferior a situation could carry on trade for any length of time. Equally unlikely is it that a country could be found to occupy the favoured position of B, and any attempt by a nation with a mistaken opinion of its economic importance to throw the burden of its own high tariff, with that of their own, on to its foreign customers would meet with failure.

One more point may be raised in this connection. Suppose the two countries A and B in the relative positions that we have imagined, and exchanging wheat and coal under free trade conditions. If B now imposed an import duty on A's wheat, will it be to the interest of A to impose a duty on B's coal?—leaving out of consideration the possibility of such a retaliatory measure being used as a mere *quid pro quo* to be offered for a removal of B's duty.

The simplest way of dealing with this is to see what the result will be if A does *not* impose a duty and compare it with that argued above, when a duty is imposed. There will be no alteration in the price of B's coal in A, which will, therefore, come in at the same quantities as before. But if the price of wheat does not rise in B, it will mean that wheat producers in A are bearing the whole of the duty. If the price of wheat does rise, the demand for it in B will fall, and, by hypothesis, more than proportionately. The problem for A is similar to that previously discussed: what new price for wheat will give the largest aggregate proceeds with the smallest share of the duty?

Imagine that A takes 100 million tons of coal at the (unaltered) price of £1 a ton. Previously, B took 100 million quarters of wheat at 20s. a quarter; but now a duty of (to use the same figures) 4s. a quarter is levied on all wheat crossing her frontiers. As the demand is an elastic one, a rise in the price of wheat by 4s. a quarter would reduce its consumption more than correspondingly; say only 75 million quarters would then be taken. Obviously, if A is to have 100 million tons of coal costing £100,000,000, or as near

100 million tons as possible, and has only the proceeds of wheat sales to pay for it, the price of wheat cannot be raised by the whole amount of the duty. If at 22s. a quarter, 91 million quarters can be disposed of in B, then this will be the price established, for this gives sufficient to buy the same quantity of coal as before.<sup>1</sup> Such a price means that half of the duty—2s. a quarter—is borne by wheat producers, that is, by A. Would more or less have to be borne by A if the government put an import duty on coal? It has been argued that a tax on a commodity in great demand can, under normal conditions, be shifted largely, if not entirely, on to consumers, in the form of a price raised by an amount corresponding to the tax. Coal importers would, therefore, be able to recoup themselves for any duty they had to pay to A's government by raising the price of coal in A, and, in the circumstances, such a rise (to the extent of the duty) would be checked only by a small falling-off in demand, if any occurred. A moderate duty might mean none at all; then A's citizens as coal consumers would be paying the whole of the duty levied by their government on imports, in addition to bearing half of the duty levied by B's government.

Generalizing from this argument, we can sum up by saying that there can be no doubt that, under conditions such as we are considering, the more countries there are imposing tariffs and the higher the tariffs imposed, the larger the number of consumers who will get less of goods and pay more for them.

To bring what has been discussed still closer to reality, it must be admitted, yet further qualifications have to be introduced. So far as some commodities are concerned, the theoretical analysis of the results of the imposition of a duty can be applied directly. This is the case when we have imports of commodities which cannot be produced whatever

<sup>1</sup> Actually, it gives a little over; but then A might not be able to raise even the smaller quantity of 90-91 million quarters at the lower level of returns to producers. A more likely outcome then would, perhaps, be a slight decline in A's coal imports at the old price and wheat exports only just sufficient to buy, say, 95 million tons of coal (say, 85 million quarters of wheat).

happens within the country levying the duty, and for which there is a large demand of a certain recognized character. Such is the case with several tropical and sub-tropical products imported into Great Britain, such as tea, rice, tobacco, and rubber, and these commodities are, therefore, suitable for the levying of duties on which the Exchequer counts for a stable and substantial revenue. But, in most developed communities, it is possible to find a large variety of goods which are, or could be, produced at home, but which are at present largely imported. How far does this modify our train of argument?

Where import duties are purely of a revenue character and there is a countervailing excise (or internal tax) on home production, no modification is necessary. The prevailing market price for such goods will be higher than it would be, other things equal, if there were no duty and excise; and sales of both home and foreign goods, and therefore the country's import trade, will be smaller than otherwise would be the case. But the proportion of home demand met by imports will be determined by the same factors as those which would determine the position in a tax-free regime.

Where an import duty is not counterbalanced by an excise duty, its effect is to make the imported commodity more expensive than it otherwise would be, to the extent that the duty is passed on to the consumer. The importation of a commodity implies that, at whatever price rules in the market into which it is imported, the home production (if any exists) is insufficient to satisfy the home demand. This may be due to a paucity of natural or other resources which is not to be remedied by any price-changes; but, in respect of manufactures which are being produced in competition with imports, we can, in general, assume that an alteration in market price will make a difference to the home industry. Generally speaking, the higher the price, the larger the output of a commodity will tend to be if demand is maintained and, in the case of a commodity selling against a taxed foreign product, any rise in price will cause an expansion of output,

representing a larger share of the home demand taken up by the home industry. This will occur because a rise in the market price up to the amount of the duty will mean no gain to the foreign producer (and may even involve him in a loss, if the price does not rise to the full amount of the duty), whereas it does mean an equivalent gain to the home producer. Local industry is stimulated, foreign industry is discouraged in supplying that particular market; if the tax is high enough, and local production is adequate to supply the (probably diminished) demand at the enhanced price, imports of that commodity may cease altogether. (With them, of course, the revenue from the duty stops.) How does this fall into line with our earlier analysis of the conditions of international exchange?

This development is to be explained in terms of comparative costs thus: The imposition of the duty has made the products of foreign industry more expensive to the consumer, that is, has had the same effect as would an increase in transport charges, or a falling off in the efficiency of labour, or any other similar change in a factor of production, other conditions remaining the same. Producers who under former conditions of keener competition were not able to supply the market, because their costs were relatively too high (that is, because returns were low in that industry relative to those obtainable in other industries in the same country), are now able to do so. These producers are the home manufacturers. Comparative costs have been altered, in effect, by the imposition of the duty, so that the home market is now supplied by firms (among others) which formerly were unable to do so, because their costs would have been so high as not to enable them to make normal profits. There has been a diversion of effort and capital into the protected industry (to allow of its expansion), of which by hypothesis the comparative advantage was less (or the comparative disadvantage greater) than that of other industries of the country. If nothing else alters, therefore, we are bound to conclude that the duty involves a less profitable employment of the resources of a

country than would be the case under what we might call "natural economic conditions," i.e. those which allow of the free play and complete working-out of the forces considered in the first chapter.

A last question that might be raised is, what might be the outcome of a duty so far as the government is concerned? If a revenue is obtained from it, how may this affect the economic position and so the foreign trade position, of the country? This question to-day is usually raised in connection with the possibility of tariff revenue becoming an important item of a country's budget, and, by rendering a certain amount of direct taxation unnecessary, affecting the industrial and trade position favourably. Or an export bounty might be given to some home products out of the proceeds of import duties on other commodities; or research in home industries be assisted.

It is not easy to show that such a development would materially improve or prejudice a country's position, because the effect of the tariff on import trade, the effect that the presumed alternative direct taxation would have on production, both for the home and for foreign markets, and the effect of the government's expenditure of the revenue raised, are all factors difficult of estimation, much more of comparison. In few cases are the proceeds of any duties earmarked for particular expenditure, and it would, perhaps, be impossible to find an actual instance in which any earmarked expenditure affected the foreign trade of the country concerned. Nevertheless, it can be said that, in so far as the spending of amounts raised in taxes does affect industry and trade, a government can, by its use of the proceeds of duties, benefit or injure the foreign trade of a country. Such benefit would have to be set against any harm caused by a tariff, as the injury would have to be added, in an attempt to determine the furthest and most minute reactions of a fiscal policy. But, if this could be done, it is doubtful if it would ever be worth the trouble; and as a guide to study and to practical affairs we may be content with the arguments already conducted, obvious though they may be and general as their conclusions must be.

## CHAPTER V

### PROTECTION AND FREE TRADE

- (1) THE application of economic theory—(2) The theory of protection—(3) The theory of free trade—(4) General conclusions.

"It is the maxim of every prudent master of a family never to attempt to make at home what it will cost him more to make than to buy. . . . What is prudence in the conduct of every private family, can scarce be folly in that of a great kingdom."—ADAM SMITH, *The Wealth of Nations*, Book IV, Chapter II.

#### 1. The Application of Economic Theory.

It is now necessary to develop our theoretical structure, so that we can apply it to the case for protection and the case for free trade under actual conditions.

The situation dealt with in the previous chapter was one where two countries exchanged commodities, without producing at home any quantity of the imported commodities. This was taken up from the imaginary case discussed in Chapter I, where it was shown that, given different costs of production, it was to the advantage of each country to concentrate on the production of that one of the two commodities for which it had the greater advantage (or smaller disadvantage). But each country could, if isolated, meet its own requirements in both commodities, though at an expense greater than that required when it specialized on one and imported the other. The imposition of duties on imports will not alter the position if exactly counter-balanced by a tax on home-produced articles, i.e. on what *would* be produced at home if there were no such tax, and what is, therefore, not produced because comparative costs are still at a level which render it unprofitable.

When a commodity which is imported is also produced at home, however, and an import duty is imposed without a countervailing excise, the position is different. Without retracing the argument of the last chapter, let us see if our



theoretical structure needs any more alteration to fit actual circumstances. What may be the outcome of a duty?

If no alteration in the price of the commodity results, then the foreign producer must be meeting the whole of the duty, and the division of the market—between home and foreign producers—will not be altered (by the imposition of the duty). This may occur when foreign producers as a whole hold a quasi-monopolistic position, and the country imposing the duty is a valuable market to them.<sup>1</sup>

In such a case, the producer may think that to bear the duty is the lesser of the two evils, since to find new markets is often a long and expensive process. He may also have enjoyed in the past, as a result of his position relative to the country concerned, profits higher than normal, a reduction of which leaves him sufficiently remunerated. Obviously, there are limits to this; a high duty, or uncertainty as to the future, may bring about a considerable reduction in foreign supplies.

A more likely development, however, is a rise in the price of the imported article, if not to the extent of the duty. This means that home producers can now raise their prices and still sell in competition with the foreign producer. The higher price means better returns, which will lead to an increased output, by making production of the protected commodity profitable to undertakings which, at the former price, could not pay, and by causing a shrinkage in foreign supplies. Alternatively, in some branches of production, the foreign producers might be driven out of the market by the refusal of the home producers to raise prices at all, in which case a foreigner producer not prepared to bear the whole of the duty would be unable to put goods on the market at a competitive price. Articles produced at constant or at diminishing costs are those in which such a policy could be followed by

<sup>1</sup> Such cases are not numerous at present, but the pre-war relation of Denmark to the English market for dairy products, especially butter, might be instanced. About four-fifths of the Danish production was (and is) exported; of this, very nearly the whole went to England. The record was 98·7 per cent in 1906. This supply was about 40 per cent of England's total imports of butter before the War. (Since the War, other markets for Danish butter have been developed.)

protected producers; that is to say, manufactures in general which can be standardized and turned out in very large quantities. Some classes of goods cannot be produced on these terms, or even greatly increased in output at all (in some countries); minerals and agricultural products in an "old" country are generally produced under conditions of increasing cost. Deeper mining or more intensive agriculture in Europe, for example, will be brought about only by a rise in price behind a tariff barrier.

Duties can exclude imports altogether if made sufficiently heavy and if the resources of the country concerned are such that the home demand for the commodities affected can be met by home production. Clearly, the second condition is vital, and the possibility of its being satisfied varies from country to country and from time to time. A general tariff high enough to exclude all goods that can be produced within the country imposing it might be one covering a small range of articles and making very little difference to the trade of the country; this would be the case in, e.g. a largely self-sufficient community in the temperate zone, which imported chiefly raw materials from the tropics. At the other extreme would be a community which produced a large variety of goods, but imported supplies of these goods to varying degrees, in exchange for exports of articles which were consumed at home only to a small extent, but in the production of which went much of its resources. (The reader will perceive that the author has Great Britain in mind; though most highly-industrialized countries are approaching this position.) In such a case, the tariff that shut out foreign supplies would create a higher level of prices at which the home producers would meet a necessarily reduced demand; for only with a higher level of prices could returns be such as would make production profitable.

When foreign goods are entirely excluded, no duty is paid to the government; but it is clear that a tax is being paid by the community at large. (The effect of the duty having been to cause an employment of the country's capital and

labour in the protected industry to an amount in excess of what would otherwise have been called for, there will be an increase in the expense of obtaining its product, since the protected industry is one in which costs are comparatively high. In other words, the result is to put the country concerned into the position of isolation we first considered, the position in which trade has not been commenced and there is no specialization on the work for which the country is best suited.

It is difficult to say how far such complete reservation of the home market to native producers has in any instance been achieved by a tariff, even when this has been its object. A duty on a particular class of commodity, such as woollen piece goods, may be sufficient to shut out the lower-grade imports without preventing the best qualities from coming in as before. This is partly a problem in technique, and must be considered under the heading of "classification." When the imported goods are not "articles of final consumption," but enter into the production of other commodities which are or may be exported, the effect of the duty is wide-spreading. Goods such as machine-parts may be the "raw material" of an industry as much as iron ore, and a duty on imports of such articles may seriously injure a burnishing and finishing, or assembling, industry, particularly if it works for export.

This is not to suggest that duties on goods finally consumed in the importing country, such as clothing and foodstuffs, need less consideration in this connection; if these goods are important objects of working-class expenditure (as they generally are) an increase in their cost will lead to a demand for higher wages which, if granted, will mean a reduction in the competitive power of exporting industries. But this will be spread over the whole economic field, whereas duties on things which are re-exported or worked up into articles ultimately exported will fall directly on the trades concerned.<sup>1</sup>

<sup>1</sup> In this connection, the following extracts from a letter to *The Times* of 3rd December, 1931, by Mr. Arthur J. Parkes, of the Birmingham Corrugated Iron Co., Ltd., of Widnes, may be quoted: "Some years ago I sat on a committee which was appointed by the trade to consider what could be done to revive the steel industry. The

Lastly, we may recall that transport is a factor which has been left out of our arguments, though taken into the account of a country's trade balance. But transport is an industry itself, which on some sides is much affected by tariff policy. If tariffs reduce the volume of international trade—and they can hardly fail to do that—they reduce the demand for the carriage of goods between nations.

It has been said that the policy of some countries, especially of the United States, is to cut down imports while expanding exports. There is no impossibility in this, provided that the country attempting it is ready to lend abroad sufficiently, as will be necessary to support the policy when a favourable visible trade balance is achieved. But, in so far as it requires high and elaborate protective tariffs, it involves the reactions on economic life which have just been traced and, typically, a high-cost regime.

## 2. The Theory of Protection.

Nothing is more protean than the case for tariffs, perhaps because they have been applied in many countries over a long period of time. As a result, there has been developed a variety of forms of the general theory, which to-day provide the protectionist with a remarkable armoury of arguments, at least one to fit any situation that may arise in practice. Nevertheless, this large number of types can be reduced to a small number of classes, of which we may discuss the four best known: the doctrine of a balanced economy; the promotion of infant industries; the ideal of an ultimately competitive development; and the policy of "taxing the foreigner." These are not alternative, but rather complementary to one another; but emphasis will be laid now on the prospect of establishing a particular new industry, now on the maintenance of

committee was small, but the biggest steel-making firms in the country were represented by their most important working directors. I think they were all, and still are, tariff reformers, but after we had gone thoroughly into the whole question, we were faced with this problem: that 70 per cent or 80 per cent of the steel production was ultimately for export, that tariffs could not benefit in the slightest, and that the only real help would be to get costs down."

employment, according to whatever may be the important consideration in the case of the moment.

① The theory of a "balanced economy," as it has been termed, has been used more by Continental than by English and American writers as a defence of protection. As set out by List<sup>1</sup> and, later, Wagner<sup>2</sup> in Germany, it amounts to this: Specialization of a nation's production prevents the complete development of national life, and the best possible use of all its productive powers. A country ought not to be exclusively or even predominantly either an agricultural or a manufacturing community. List preached the development of industry to a mainly agricultural Germany, asserting that civilization and power could be obtained only by that means. Wagner, sixty years later, advocated the protection of German agriculture in order to arrest the growing industrialization of the country. Both admitted that the encouragement, by means of a protective tariff, of the weaker side of the nation's economic life would involve a certain cost, though this might ultimately be recovered. List says: "The nation must sacrifice and give up a measure of material property in order to gain culture, skill, and powers of united production; it must sacrifice some present advantages in order to ensure to itself future ones."<sup>3</sup> With more caution, Wagner admits that the protection of agriculture involves sacrifices, but does not suggest that these will be recompensed by future gains; he claims that they are necessary to secure a desirable balance in national affairs. The objective in this later statement of the case is thus something outside the scope of economics. The loss is certain, and measurable in economic terms; the gain is not certain and is incommensurable.

A secondary consideration sometimes brought under this head is the possibility of a war in which foreign sources of supply, on which the specialized nation is dependent, of important commodities may be cut off. List argues that the

<sup>1</sup> Friedrich List, 1789-1846.

<sup>2</sup> Adolf Wagner, 1835-1917.

<sup>3</sup> *National System of Political Economy*, trans. S. S. Lloyds, p. 117.

classical political economy of Adam Smith, J. B. Say, and others of that period is at fault in taking for granted something that did not actually exist—universal and perpetual peace. In such ideal conditions, free trade is obviously the best policy ; but, in actual circumstances, no single nation can depend on this state of affairs and, therefore, it must do the best it can for itself. The principles of “cosmopolitan” economics do not apply.

The “infant industry” argument is, perhaps, most widely used in English-speaking countries, where the idea of making economic activities subserve a defined national purpose has not become popular. Possibly the—very temperate—approval given to the argument by an orthodox economist, John Stuart Mill, also partly accounts for its importance. Briefly, the case is that, in some instances, the superiority of one country over another for the production of a particular commodity is due simply to the fact that it made an early start, not to any great natural advantages. Established in a former generation, with market connections and a trained labour supply, it now has an artificial advantage which daunts private enterprise in another country, otherwise equally suited for that branch of production. Those who might build up a home industry will not do so if they are certain to make losses in the early years, and so they must be encouraged and protected by a duty on imports from the competitor country. Behind the tariff wall, the new firms can get their footing and eventually—if the country is really as well suited to that production as its rival—they will attain the same level of efficiency as the older foreign industry has reached. Then they will be able to supply their home market with products as good and as cheap as those turned out abroad, and there will no longer be any need for the import duty, which can be removed.

This case in modern times is frequently made with reference to mass-produced articles, which, it is sometimes said, will be produced even more cheaply than they had been obtained

from foreign sources, once the home market is entirely assured to the native producer. Ultimately the industry, when fully grown, may become an exporter of its products—and may then find itself shut out from foreign markets by tariffs designed to foster infant undertakings in other countries! But this is not a necessary outcome of the policy even if it is successful. The acid test is the removal of the duty and the cessation of imports. If no appreciable import continues under the duty, then it may be assumed that the tariff has been effective in that respect; if there is no significant increase of imports when the duty is removed, then the home industry is holding its own. If the price of the commodity inside the country is equal to the price at which foreign products can be put on the market, or less, then if the home industry is large enough to supply the whole local demand, there will be no imports on balance,<sup>1</sup> and the removal of the duty is indicated.

It is clear that this may be part of the first case, since the industry which is considered essential to the all-round development of the nation may be a new and untried one, and so a candidate for protection on both grounds.

The third case is one difficult to designate exactly. It is really a plea for the maintenance of the existing employment of capital and labour, that is, for their distribution between occupations (and, to-day, for the reduction of unemployment), and of the existing standard of living. This might be called "pure protection," protection of everything against change, a status quo theory. In England since the War stress has been laid on the decline in employment in some industries formerly basic to our prosperity, especially coal mining and the heavy manufacturing industries; in Australia and the United States the emphasis is on the workers' high standard of living,

<sup>1</sup> On balance: there may be imports across one frontier, exports across another frontier of a country, of the same goods because the local market to a producer is not necessarily wholly within his national borders. In a country with a long land frontier and with neighbours who are big producers and consumers of the commodity in question, there may always be such a movement of goods.

considered to be imperilled by the competition through international trade of foreign workers with a lower standard. It is argued that, if imports are reduced in quantity and raised in price by a tariff, home producers will be able to expand output and gain a higher return (to the extent to which prices are raised by the duty) on each unit sold; as a result, employment will increase. It is true that higher prices mean a reduction in the standard of living of persons on the same incomes as they had before the tariff, because their incomes will not buy so much; but, so far as wage-earners as a class are concerned, any such loss is offset by the increase in employment. Further, the rise in local prices above the world level may only be temporary; in some branches of production the protected industries will eventually be able to reduce prices owing to the economies of increasing production. (This fall in price is assumed to occur, because competition between home producers will bring selling price down with costs.) Finally, the security afforded by protection will encourage the capitalist to adopt new and expensive methods and equipment, to organize and to experiment as he would not do in an uncertain free trade world, and will bring about such improvement in production as will raise the general standard of life above what it would otherwise have been, employment apart.

What is implied in this is a development on lines already laid down, and not a change over from old to new uses of capital and labour. Since the foreign competition which it is desired to combat by a tariff is by hypothesis driving capital and labour out of former uses, by making it difficult for them to get the returns which they expect out of selling their product, protection is essentially a policy of securing to these industries their old position. The only effective protective duty on a competing import, so far as any home producer is concerned, therefore, is one that equals the difference between the price at which the foreign product is put on to his local market and the price at which he can sell there. If the competition is believed to be due to the foreigner's not getting his usual profit—if he is selling "under cost" or "at



a loss" or on similar terms—it is complained of as "dumping," and the duty frequently described as an "anti-dumping duty." But it may, in some cases, be admitted that a country's costs of production, in general, are so high as not to allow it to compete in some lines, while these costs involve returns to producers that cannot be lowered without reducing the standard of life. In this case, a general tariff is required, aiming at equalizing the position all round.

The last argument is of somewhat limited application. In its strongest form, it might be expressed thus: Duties on goods will be paid by the foreign producers, when they are producing on terms which mean that they would incur a greater loss if they took any other line—if they tried to pass the duty on to the consumer and, as a result, lost their markets. Further, if it is not a single duty or a number of duties on a variety of articles that is in question, but an elaborate, all-inclusive tariff, then the foreign producers will pay on account of the fact that they are as a body the same as the consumers of the protected country's exports. If they failed to bear the duties and an appreciable diminution of imports (their exports) occurred, they would suffer in the reduced quantity of goods they would be able to buy from the protected country.

The actual revenue accruing to the government from such a tariff, the tax paid by the foreigner, would obviously be an uncertain quantity. In so far as the tax was paid by the foreign producer, his sales inside the tariff area would not decline, and the revenue to the government would then be as considerable as the protection to home industry was negligible.

The cases in which such a policy could be confidently applied are, however, few, since the vital factor is the importance of the market around which it is proposed to raise the tariff wall to the foreigner. Or, more precisely, it is the protected country's dependence on the foreign producers, relative to their dependence on its exports, that is vital to the issue.

It might be easier to tax the foreigner by laying an export duty on a much-needed commodity, in the production of which the taxing country had a great advantage, than to seek the same end by a tariff on imports.<sup>1</sup>

### 3. The Theory of Free Trade.

The free trade case has two aspects—a positive and a negative. The positive case is nothing but a statement of the conclusions to be drawn from the pure theory of international trade; the negative case is composed of the answers that may be made in this sense to the various protectionist arguments. It is because the positive case is very simple, and the negative case is merely critical, that free trade is less impressive as a dialectic structure than protection can be made to appear.

The theory of free trade is based upon the same reasoning as that employed in the measurement of the benefit derived from international exchange. It rests upon the fact that when an area can be used in several ways, i.e. for different economic activities and ends, and some of these give better results, a higher yield, to a given expenditure of human resources than the others do, it is to the interest of all concerned to devote those resources to the use or uses giving the highest returns. The alternative is to use part of the area and resources in one branch of activity, part in another; so that, for example, instead of the specialization of a particular locality on dairy farming, which in the prevailing circumstances gives the highest returns, we should have some dairy farming, some stock raising, some arable cultivation and a little forestry. Such a distribution over a variety of uses would give a "balance" in the activities carried on by the inhabitants of that area; it would also give a smaller reward in terms of value to the whole resources. This is, of course, provided that, if the people want other than dairy produce,

<sup>1</sup> Such a tax in intention was represented by the export duty on British coal of 1s. per ton, imposed by the government of this country from 1901 to 1906. It was argued that this would be paid by the foreign consumer. (The ostensible object in the first place was to raise extra revenue for the special expenditure caused by the Boer War.)

they can get the commodities they require in exchange for dairy produce. If the area is cut off from others, then trade does not arise, and free trade *versus* protection is an irrelevant controversy. So long as exchange of the products of different areas goes on, then for each area it is true that, given that returns to different uses of resources vary, the best policy is to concentrate on those uses that give the best returns. The employment of capital and labour which requires the smallest expenditure to obtain a given satisfaction, is the best employment of whatever may be the alternatives offering.

This local specialization is a common feature of any developed community, however protective its tariff, and no one to-day will seriously assert that it is against the interest of any constituent area or of the country at large that it should have occurred. That a crop should be raised on the land best suited for it and that the soil should not be wasted in the growing of other crops which bring in less, is the opinion of every farmer and will be his policy, if he is left alone to make the most of the resources at his disposal, and similar considerations guide industrialist and merchant.

What is to the benefit of every single component of a nation cannot be an injury to the nation as a whole, whether engaged in foreign trade or not. Thus, if it is more worth while for a man in the east of the United States to give his time and energy to manufacturing rather than to agriculture and more worth while for a man in the Middle West to turn all his energies to agriculture rather than to manufacturing, the whole of the United States will be benefited by the economical use of the resources of the population. Yet if the separate States—which are some of them as extensive and nearly as populous as some European nations—raised tariffs against one another, there would probably be more industry in the west and more agriculture in the east than there is at present. But it would be an agriculture in the east to which had been diverted resources that could have been more profitably used in industry, and the difference between the value that would

have been produced in manufactures and the value produced in farming, by the diverted resources, would be the measure of the loss involved by the protection of eastern agriculture. What is true of a large part of the North American Continent is equally true of the world at large. There is no element of difference between nation and nation, except that of language, that is not paralleled by the differences to be found between the conditions, interests and resources of the States of the American Union.

It must be understood that what is implied here is that the best use of capital and labour shall at all times be sought, and that this means that, as conditions change, and returns to different branches of production vary, producers are ready to change their occupations. The necessity will be faced when the alteration is in the natural conditions outside human control; but where a change is due to invention, to improvement in industrial organization, or an alteration in demand, there will, in practice, often be a tendency to resist it. Instead of changing over to the production of what the market wants, producers in a formerly prosperous industry may attempt to have excluded from their market the new products that meet the new demand; instead of putting in new machinery, they may attempt to maintain their position on obsolescent plant, by demanding measures that will make the products of up-to-date works artificially dear (a tax) or make their own products artificially cheap (a bounty or subsidy). Nor must it be denied that the development of new, the abandonment of old, branches of production, as their relative remunerativeness alters, may be an expensive and difficult matter. Capital in some forms is practically irredeemable; of the very large sums sunk in the permanent way and fixed equipment of a railway, for instance, only a small fraction could be recovered if the undertaking came to an end and was completely liquidated. On the other hand, capital in some industries is largely invested in commodities which are bought and sold, and here—as in the case of a retailer's stock in trade—to go out of business is not necessarily to incur a great loss. Similarly,

labour can be transferred between industries with much less difficulty in some cases than in others; if the occupations offered by the new industry are not very unlike those followed by workers in the declining industry, or if the latter did not develop in workers a specialized skill useless for other purposes, the shift may be accomplished rapidly with no great hardship.

At the present time, unfortunately, it seems to be the case that it is those industries which have a large amount of practically unrealizable capital and which demand a peculiar skill from their workers, that are relatively declining. They are, too, in many cases, industries which were first developed in Great Britain, and on which much of the economic life of this country is based, so that the shift of the economic centre of gravity, so to speak, that is occurring has involved grave losses and a large semi-permanent body of unemployed. The continuance of the re-allocation of our resources of capital and labour, which is the consequence of the maintenance of a free trade system will, if present conditions hold, be likely to cause further difficulties of the same sort for a time. The difficulties would be less if the change were slower; but the rate of alteration in economic affairs seems to be accelerating. A free trade economy, therefore, may be one in which (if invention and discovery go on as in recent years) there is always some capital loss and some unemployment due to the changing positions of different industries. In one generation it may be coal mining and cotton spinning that are losing their old pre-eminence, while artificial silk and electrical equipment are showing the best returns; in a future generation artificial silk may be a dying manufacture and investors and young workers may be striving to enter the television apparatus industry.

Before we conclude, however, that the reactions of a free trade system which are referred to above constitute grave disadvantages, it would be well to carry further the implications contained in the foregoing arguments. It is not one of the claims to be advanced for free trade that it increases

employment, even in the long run ; on the contrary, the fundamental tendency of free trade is to diminish employment. To repeat a previous observation, if the economic resources of a group of people, as of a single individual, are anywhere used in those of the many possible ways which give the highest returns and in those ways only, their production will be carried on at lower costs than would be the case if they distributed their resources among a variety of uses, some with lower returns (per man-hour, or whatever unit of economic resources may be taken) than others. In the first simple illustration of the benefits of such concentration on the part of two groups of persons (called "nations") on their respective high-return employments, we spoke of the benefit as a "saving" to each. If consumption is not increased when it is possible to get more goods for a certain expenditure of resources, then the same production as before goes on with a smaller expenditure ; less capital and labour are required. Under present conditions, the saving is likely to be mainly under the head of labour, because invention is more common and more successful on the mechanical side of production and so labour-saving devices usually take the form of a new sort of capital equipment. But the tendency is to reduce employment, by devising ways whereby the same thing can be done in less of the worker's time, or with less effort on his part, or even without his labour and attention at all. Such developments have the same effect as would a change in the climate that improved the yield of our fields, or an alteration in underground conditions that made mining easier. All of these things mean that less employment of men's time and energies is called for to get a certain result, or that a more abundant output can be enjoyed from the same employment. A free trade regime is of the same nature. The consequences can be declared in general disadvantageous only if we are prepared to object to labour-saving devices in the home or the factory, or to say that a product of much toil is to be preferred to the same thing produced easily and quickly. It is possible to take up this attitude, but not on economic grounds ; the increase of leisure,

or the alternative increase of goods, that has occurred under industrialism, may be deplored for moral considerations, perhaps, but these are not relevant to the issue.

// The probable consequence of free trade on an industrial country's employment are, therefore, twofold: the amount of employment called for to produce a given output (or a certain "National Income") will be lower, the further specialization lowers costs, and also when industries are changing in relative profitability, there will be unemployment due to the time taken and possible loss involved in the transfer of resources now redundant from the declining to the advancing industries. The first sort of "unemployment," the reduction in the amount of labour required to produce or obtain by exchange a certain satisfaction, is the same thing as an increase in the real wages of labour. This increase will go on faster under a free trade than under a protectionist regime, simply because the latter is designed to maintain or induce a volume of economic activity that would not otherwise exist, i.e. economic activity carried on at relatively high costs. In other words, all consumers will tend to get what they want more cheaply under a free trade than under a tariff system; the imposition or increase of a tariff lowers real wages, or checks their rise, by making things more expensive to consumers.<sup>1</sup>

The second sort of unemployment, which is the chief public concern at the present time, is transitional and short-period in nature, and is a normal result of economic progress. However, this is not to say that it may not continue at a very high level for a long time, since the dimensions it assumes and the duration will be determined by the organization of industry, by the branches of industry affected and by the rate of industrial change. If the declining industry is one in which there are a large number of small producers of varying

<sup>1</sup> It might, perhaps, be worth while to remind the reader that consumers are not only private individuals buying in retail shops. Railways are large consumers of coal and of iron and steel; a rise in the cost of getting supplies, whether from at home or abroad, may mean a rise in railway rates, which may increase the costs of industries working for export, *inter alia*; and so over the whole economic field.

efficiency, then its shrinkage may be a piecemeal affair, a disappearance of the weaker units one by one as profits fall, creating a reduction of employment that can perhaps be anticipated.

An industry counting only a few very large units may reduce the employment it offers drastically and suddenly when a single concern closes down; the adjustment of the volume of employment to the ability of the industry to pay for the labour it requires at the existing level of wages is made in a few sharp jerks, so to speak, instead of by a gradual, continuous process. The alternative is the lowering of wages in the relatively declining industry, which will make it less attractive to workers and so bring about a diversion of labour to other more prosperous industries, until adjustment is effected. But, owing to the reluctance of workers to change over from one employment to another, particularly when that means—as it often does—a change of residence, or to obstacles to their making a change, even a considerable lowering of wages may not bring about the voluntary transfer of labour sufficiently quickly or to a sufficient extent. Besides, in most industrial countries there is a strong, organized feeling on the part of the workers against rapid or considerable downward revision of wages and, in such circumstances, positive unemployment must result. There must be workers, who can no longer be employed at the prevailing wages in their former occupation, who are not yet taken up by the relatively advancing occupations. Their maintenance is one of the costs of technical progress.

Finally, we may consider how far a "transition" phenomenon is necessarily of brief duration. A "short period" is a different measure of time according to what we are referring to in using the term; the business man is sometimes inclined to be impatient at the length of the economist's "short period," which may run to several years, though that will be a very brief moment compared with the geologist's or even the historian's. Handicrafts in England lasted on something like their old footing for a generation after the



beginning of industrialism and some survive (with an appropriately small employment) to this day. It is not impossible that before one adjustment occasioned by the rise of a new industry or the decline of an old is completed a fresh revolution in economic affairs will begin and another body of transitional unemployment grow as the former dwindles. In short, the future may, if invention, rationalisation, changes in final consumption, or alteration in natural conditions persist, see the maintenance of a large amount of transitional, short period unemployment, together with steadily-rising real wages and, possibly, falling hours of labour.

There is no need to deal at length with the negative aspect of the free trade case. Criticism of arguments for protection will depend on what those arguments are and how they are framed. The principal objection, though, must be raised to all forms of protection, however subtle, that they involve the diversion of economic resources to what are admittedly their less remunerative uses, in every case. If the end desired lies outside the scope of economics, then the argument cannot be sustained on either side. The idea of a balanced economy, the view that it is good that a certain proportion of the population should live and work under specified conditions (even if these are artificially promoted), are matters of social theory, with which the economist as such is not competent to deal. The same applies to the advocacy of particular protective measures for fear of war. Adam Smith, while arguing against restrictions on industry and trade, remarked: "As defence, however, is of much more importance than opulence, the act of navigation is, perhaps, the wisest of all the commercial regulations of England"<sup>1</sup>—the Navigation Acts being designed to foster the British shipping and make it a "nursery for seamen," so that it should be useful in time of war, by

<sup>1</sup> Book IV, Chapter II. As *The Wealth of Nations* was published in 1776, this passage was presumably written, or at least composed, before the revolt of the American Colonies threatened. The Navigation Acts, restricting the colonial trade to ships owned by British subjects, were part of the "Old Colonial System," which the independence of the United States effectively terminated.

restricting our trade to our own vessels and those of the countries from which we imported. On the general thesis, two observations might be made. There is no point in contrasting "defence" and "opulence"; what we want to know about a given policy is, how much defence will it provide at the sacrifice of how much opulence? Should we get as good results with a smaller sacrifice in some other way? Secondly, it is usually best to attempt to secure a desired result by means as direct as possible. If we want defence, it is better to create a special instrument for that purpose, rather than to turn something not designed for the task into a makeshift tool.

The "infant industry" argument is a much weaker exception to the application of free trade than it appears to be. The conditions required really to justify a tariff for an infant industry (which must mean an unborn industry, since, if the industry has established itself, however modestly, under free trade, the conditions do not apply) are so peculiar as to be rare in practice. If any claimant be given the benefit of the doubt, then the final outcome promised in the protectionist case does not appear—that is, has not yet appeared in any instance. The industry, after ten, twenty, or thirty years of protection has not been ready to stand against all comers in its own market; nor can it be shown in any actual case that it is producing on terms equal or superior to those of the competitors shut out by the tariff wall.

The claim made for a protective measure that it affords a means of "taxing the foreigner" has already been discussed from various angles and it is not necessary to do more than sum up that discussion here. It is possible to conceive cases in which a certain country's demand for the products of another is at once very important to the producer, and highly elastic; in such circumstances, a duty imposed on those products by the importing country might be borne largely, even entirely, by the foreign producer. But there are limits to this; the duty cannot be larger than the normal profits required by the producer, since he will not go on supplying the market at a loss. An export duty on a commodity, the foreign demand

for which is highly inelastic, may equally be paid by the foreigner, though this is not what is usually meant by protection. But, again, there are limits, and, in fact, the conditions required before these possibilities arise are rarely to be found in practice.

#### 4. General Conclusions. <sup>Good</sup>

Without attempting to give a final decision on the issue between protection and free trade, we may sum up the position which has been reached. There is no difficulty in coming to a decision on purely economic grounds, and the decision that must be reached is implicit in all that has been said; the difficulty lies in the fact that arguments for protection appeal in the last resort to other than economic criteria. These—social ideals, nationalism, the desire for security—cannot be weighed up against the other than economic claims that can be advanced for free trade—such as the value of freedom, the elimination of international friction—for they are not of the same nature. Confining ourselves, therefore, to the considerations already dealt with, we may say: Free trade means the territorial division of labour, local specialization on the relatively low-cost, high-return branches of production and the exchange between specializing areas of their products. Protection means the promotion or maintenance, against competitors, of relatively high-cost, low-return branches of production within a national area and a consequent diversity of products, with a smaller range and volume of exchange between areas. A particular industry may enjoy relatively low costs over a period owing to conditions that are not permanent, so that free trade means that leadership may pass from one industry to another. Protection seeks to preserve the position in which industries stand at the time when it is inaugurated as a policy. Free trade means that real wages will increase as fast as industrial improvement goes on under the pressure of competition. Protection means that real wages will not be as high as they would otherwise have been, since part of a country's production is being

carried on more expensively than that for which it is best suited. In a word, free trade has a dynamic, protection a static, effect on the economic life of a country.

To hold that free trade is the sound policy for a country to pursue in economic affairs is not to rule out all duties on goods. An import duty counterbalanced by an excise is the characteristic form of indirect taxation in nineteenth century England at the height of the free trade movement, when it seemed that the rest of the world was going to be persuaded by our example. It does not alter the competitive position of different industries and it may be the more convenient alternative to direct taxation. In some countries, the development of a tariff has undoubtedly been encouraged partly by the contribution which it makes to the revenue, a contribution which cannot be obtained from direct taxation because of the lack of efficiency and experience of the Civil Service, or of the trouble and expense involved in the collection of internal taxes. Countries with populations scattered over difficult country, with a foreign trade passing through a few ports, may find it best to rely upon duties for the bulk of the national revenue, whether these are protective or not. Federal governments, again, may draw most of their income from the yield of duties, since this obviates the difficulties which may arise out of the alternative policy of dividing their expenditure among the constituent states or provinces, to be borne by them, on some other basis, out of direct local taxation. Instances of countries in which such considerations have had peculiar weight are Brazil (the United States of Brazil), the nature and extent of the interior of which constitute a big problem to the administrator, and the Commonwealth of Australia.

**PART II**  
**TARIFFS: SOME TECHNICAL ASPECTS**

## INTRODUCTORY

WHATEVER may be one's opinion as to the desirability or otherwise of tariffs, they must be faced as important facts in the world of to-day, which can and do play a considerable part in determining the course and progress of trade and industry. The convinced protectionist should study the technique of tariffs, since a belief in the general advantageousness of a protectionist regime ought not to lead him into the comfortable error that any tariff will do. In fact, if a protectionist has any peculiar interest that he wants protected, he will soon realize that some tariffs are much more effective than others and that it is necessary to frame a tariff carefully to get a desired result. The staunch free trader, however, should equally be a student of tariff policy and practice, just as the higher the value we place upon health, the more closely we study diseases and their symptoms. Besides, in practice, even a free trade country imposes duties on imports, generally on a few goods not producible in the country, or counter-balanced by an excise on home products of the same sort. Such a Customs system, though not what is generally meant by a tariff, presents in a minor degree some of the problems involved in a protectionist regime.

The more elaborate the tariff, the more complex and important are the technical problems involved, and hence the more necessary is it that the nature of these problems, the solutions so far attempted, and their effects, should be understood by the people of a country in which changes in fiscal policy are being contemplated. For no important change can either be forced upon a democratic community, nor withheld from it if widely desired, for very long—though public opinion may be mistaken because uninstructed, or misled by interested parties, or unable to grasp the force of expert counsels. It is essential, therefore, that there should be a sufficient number of people who, when a particular tariff policy is

demand, know what is wanted to be done, and, further, how to do it.

In this connection, issues and details, otherwise abstract and trivial, become of immediate moment and practical importance. The precise form that a duty shall take is not only of interest to the importer who has to pay it and the official who has to collect it. Different sorts of duties have different effects, and the decision to impose an *ad valorem* instead of a specific duty on a certain commodity may, in the future, make all the difference in the world to the home producer, who seeks protection, and to the home consumer. If it is desired to bargain for concessions with other countries, the general structure of the tariff system, and the means by which it can be changed, are vital questions. When we wish to discriminate—against dumped products, for example—definitions of what it is against which we are discriminating, must be framed with care and with regard to policy.

This raises the question: How far should such matters be public affairs, i.e. how far ought tariff problems to be political issues, ultimately decided in the same way as quite different questions, by the electorate? There is a strong body of opinion which holds that tariff problems, at least technical problems, ought to be outside of ordinary politics. With this is often associated a demand for a "scientific tariff." It is felt that if tariff problems are discussed in the same atmosphere and on the same grounds as the controversial issues of party politics, any outcome will be more a compromise, more influenced by ulterior considerations, than what would be produced by the calm deliberations of a few impartial experts. Yet it is difficult to see how it is possible to "take the tariff out of politics" in a democratic country, except so far as purely executive provisions are concerned. Even when the question as to whether or not a tariff shall be a permanent feature of a country's economy has been decided, even when there is general agreement among the supporters of the different parties that there should be a tariff, the large number of questions that must be answered in determining the *sort* of

tariff a country shall have, almost certainly will be dealt with on party lines. Indeed, the tariff questions may themselves give rise to special parties, like the "agrarian" or "farmers" parties of protectionist Europe and America. Nor is it obviously desirable in every case that such issues should be fought out on other than party lines. The effects of duties are economic effects, of the kind already discussed, just as the effect of minimum wage legislation or similar modern State activity is economic. Since these things necessarily affect the lives of the whole population practically and intimately, they cannot be excluded from the scope of politics, within which popular desires and objections can declare themselves.

We must, therefore, treat of all the problems that may arise in connection with a tariff, so as to reach some comprehension of what it means to embark upon a protective regime, what has been the experience of other countries and what variety of tariff systems offers itself. This involves consideration of the different sorts of tariffs and duties which can be distinguished; of the processes of making a tariff; of the problems of working one. Much of what may be said is general, and therefore true of certain conditions whenever and wherever found. This may be illustrated by examples drawn from the practice of various countries at different dates. Some points are, however, special to the tariffs of particular countries, and therefore of less general interest. Most examples of these will be drawn from recent British experience.



## CHAPTER VI

### THE STRUCTURE OF TARIFF SYSTEMS

- (1) TYPES of tariffs—(2) The forms of tariff systems—(3) The development of tariff systems—(4) The most-favoured-nation clause.

"Only innately insular persons who have never given unprejudiced study to modern economic thought in any language but their own can use the word tariff as though it represented some sort of uniform policy or stereotyped conception."—MR. J. L. GARVIN, *The Observer*, 17th January, 1932.

#### 1. Types of Tariffs.

IN order to make our survey of tariffs as comprehensive as possible, it is proposed to include under this head any duties on imports and/or exports levied by a government. These duties may or may not form a system in the ordinary sense of the word—that is, an organic whole with a definite form—but, in any case, they must have some effect on the trade of a country, or on its public revenue, and are usually designed to have a certain effect on either or both. If, therefore, we extend the scope of the term "tariff system" to cover all such arrangements, we can classify the fiscal policies and practices of all countries on a single scheme. The state of affairs prevailing in Great Britain in the 1870's will be described as a tariff system, for this purpose, just as the fiscal policy of the United States to-day will be. This will allow us, without confusion or ambiguity, to speak of a "Revenue Tariff."

The basis on which a broad classification can be made is that of the *effect* of the tariff as a whole. A tariff may be—

1. A source of revenue only.
2. Protective of home industries only.
3. Mixed in effect, affording some revenue and some protection.

It will be understood that the essential feature of the purely revenue tariff is that the competitive position of home producers is left unchanged. Under a purely protective tariff, conversely, the effect of the duties is to give home producers

the whole of the differential advantage that is required to enable them to take the maximum share of the home market. This is not necessarily a 100 per cent share. It may not be possible to expand the output of some goods enough to satisfy home demand completely, on account of physical conditions. In other cases, the duty will improve the position of producers as competitors with unprotected industries for capital and labour; if such industries, which are usually those working for export, are not to be injured, the tariff must not be so high as to prevent them from obtaining capital and labour at a cost which they can meet without their returns being reduced. This limits the share of the home market obtainable by protected industries.

We may, therefore, define revenue, protective and mixed tariffs in more detail thus—

1. A revenue tariff consists of duties levied
  - (a) On imported articles which cannot be produced at home; and/or
  - (b) On imported articles, when there is a countervailing excise duty levied on such articles as are produced at home.
2. A protective tariff consists of duties levied
  - (a) To afford protection to home producers of commodities which were being imported before the imposition of the duty;
  - (b) Without a countervailing tax on home products.
3. A mixed tariff is one in which duties are levied
  - (a) Partly giving protection to home-produced articles;
  - (b) Partly raising revenue, with or without an excise on home-produced articles.

A mixed tariff may consist of duties all of which are both protective (to a certain extent) and revenue-yielding; or of duties some of which are purely protective, some purely revenue in character (being imposed on imports of commodities which cannot be produced at home), and, possibly, some of which are both protective and revenue-yielding. Naturally, it will generally be very difficult to say of any particular duty that it is of this composite "protective-revenue" character, because

as long as any revenue is coming in under that head, imports of the taxed commodity are continuing, and so the protection that is being afforded by the duty is doubtful. Nevertheless, it is clear that in many tariff systems such mixed duties exist, since on the one hand the imposition of a duty on a class of goods will cause imports to decline, while those that still come in will yield a revenue. This is often due to the fact that a duty imposed on a class of goods, such as woollen piece goods, is in reality levied on a number of articles with different markets, and the same duty will have different effects on the various articles coming under the same heading in the tariff-schedule. What this has meant in the development of tariff systems will be discussed later under the heading of classification and specialization of rates. As to the other sort of mixed tariff, it is only necessary to observe that most modern systems come under this head; the tariff system of Great Britain as it has developed during the Great War and the following years is an example, presenting as it does "McKenna" (protective) duties, and Safeguarding duties, together with the revenue duties, like that on tobacco, inherited from the free trade era.<sup>1</sup>

In any type of tariff the level of duties is an important consideration, since the effect of the tariff may be determined, at least in part, by the duties imposed. A duty not intended to be protective may fall so heavily on certain imports that foreign producers cease to supply them and a home industry has to be established if local needs are to be met; or, where the taxed commodities cannot be produced at home, consumers have to turn to substitutes, and imports cease altogether. Wherever revenue is looked for, and the increase of duties is under consideration, the possibility of bringing about so sharp a falling-off in trade as more than to counterbalance the higher rate or amount of duty paid on what is actually imported, must be borne in mind. When it is not desired to establish a protective system, the effects of duties must

<sup>1</sup> Cf. the title of the U.S. Tariff Act of 1930: "An Act to provide revenue, to regulate commerce with foreign countries, to encourage the industries of the United States, to protect American labour, and for other purposes."

equally be watched; as Professor Gregory has put it: "those rates which are most fruitful of revenue at a particular moment need not necessarily be those which offer *no* protection, for the duties may be quite high enough to encourage a local industry to rise up in their shade. Thus, duties which were originally not protective in *intention* may become so in *effect* in the course of time. But such is not the purpose of a revenue duty, and when it is found that the rates imposed are encouraging the rise of local industries, they should be supplemented by internal excise duties."<sup>1</sup>

## 2. The Forms of Tariff Systems.

By the "form" of a tariff is meant the structure of the system of duties which comprises it: the number of duties that are provided for any single article or class of articles is the basis of classification usually adopted. This rate or duty or linear or schedule basis of classification applies to any type of tariff, though it is generally the case that the more protectionist in inspiration the tariff is, the more elaborate is its form.

We may divide tariff systems into (1) those in which there is only one duty or rate (or schedule, or line in the measure fixing the duty) on every single commodity or class of commodities, and (2) those in which there are two or more duties, so that goods from one country will pay a different tax from that paid by similar goods coming from another country. The first form can be referred to as a single-line (unilinear) or single-schedule system, the second as a multi-linear or multiple-schedule system, or as bi-linear or tri-linear, according as to whether there are two or three rates to be found for each item coming within the scope of the tariff.

The form of a tariff may be determined solely by the legislature of the country which is imposing it, i.e. may be purely autonomous; or it may be determined partly or entirely by treaties between that country and others, i.e. may be conventionally determined ("convention" in the sense of "agreement"); or it may be determined by other states, in which

<sup>1</sup> Prof. T. E. Gregory, *Tariffs: A Study in Method*, p. 488.

case the country concerned has no tariff autonomy. Where one country obtains tariff concessions from others in return for reductions granted to them, these arrangements may be "conventionalized," that is, made the subject-matter of a treaty; in this case an extra "line" will be introduced into the list of duties that comprises the tariff, wherever goods imported from the co-contracting countries are concerned. If several such treaties are made independently, there may be established a second "conventional" set of duties for most or all imports and even—if the treaties overlap one another in scope—two or three duties for the same commodity, according to its origin.

We may, therefore, compare the different forms one with another by considering their logical development. In this connection it will be useful to discuss their relative advantages and disadvantages.

### 3. The Development of Tariff Systems.

(a) SINGLE-LINE TARIFF. This, the simplest possible form, is generally autonomously created. It is represented by (among other cases) the tariff systems of Denmark and the Netherlands. An example of a single-line tariff non-autonomously determined is the tariff of China during the second half of the nineteenth century, under the "Open Door" policy of the Great Powers.

An autonomous country can, of course, conventionalize its tariff if it chooses to make treaties binding itself to a particular level of duties.

(b) DOUBLE-LINE TARIFF. A double-line tariff can come into existence either by being established at the outset in this form, or by the addition of a second set of rates to an existing single-line tariff. In the latter case, it may be that only part of the tariff is bi-linear, the second rates being added only in respect of some items.

(i) *Maxima-(and)-Minima Form*. With this, the two sets of rates are autonomously determined. There is usually a fixed "margin" between the rates throughout; for example, in the

United States tariff of 1909 (often referred to as the "Payne-Aldrich" Tariff) the maximum rate was merely the minimum rate plus a fixed amount, in each case. Alternatively, the minimum rate may be fixed as a certain fraction of the maximum rate. As might be expected, it is generally the case that it is the base rate, as it might be called, that is designed to be the more widely applicable; when the declared rate is the higher, it is unlikely that many imports will be admitted at the minimum duty. Conversely, when the declared rate is the lower, the maximum rate is likely to be used as a means of penalization of certain classes of goods.

✓(ii) *General-(and)-Conventional Form*. The essential feature of this form is that there is one basic rate, the general rate, autonomously determined and a lower rate fixed by bargaining between the tariff-making country and others. This was a popular method of tariff construction among European countries before 1914, especially during the second half of the nineteenth century. It arose out of the movement towards free trade in Continental countries, inaugurated by the Cobden Treaty concluded in 1860 between England and France. The effect of the treaty in bringing the Most-Favoured-Nation clause into commercial policy will be considered under that head; it is sufficient to note here that the reciprocal reductions in import duties on the part of France and of England were secured by treaty, because this was an easier method than any alteration of general rates in the French tariff would have been. Under the then constitution, the making of treaties was part of the Imperial power, and so the Emperor Napoleon III was able to conclude the agreement without getting the consent of the legislature, which, indeed, being much less influenced by "economic liberalism" than the Emperor, would very probably have refused it. Once the treaty (which chiefly gave France concessions in respect of the duties on wines and spirits, in return for concessions on most British manufactured goods) was in force, however, it started a series of such conventions between France and other countries, which lasted until the change in French tariff policy in 1892.

Meanwhile, the operation of the Most-Favoured-Nation clause, which became a common provision in treaties of this period, brought about a general lowering of duties throughout Europe, as country after country came within its scope. A check was given to this movement in the last decade of the century, and the twentieth century saw a resumption of "economic nationalism" in many countries; but the Most-Favoured-Nation clause continued to exercise a moderating influence on tariff developments.

✓(c) **TRIPLE-LINE TARIFF.** This form is almost invariably a development of a double-line tariff, where it is desired to discriminate between different countries more closely than is possible with the bi-linear form. When it arises out of a maxima-minima tariff, the third rate may be based on the existing minimum (e.g. a certain fraction of the minimum in every case), when it will usually be lower than the minimum; or it may be based on the existing maximum, when it will usually be intermediate between the other two rates. Similarly, when it is a development of a general-conventional tariff, it may be based on either the general (higher) or the conventional rate.

This development is a common feature of the tariffs of countries with colonies, and of the colonies or dominions when these have tariffs of their own, in order to give special treatment to colonial trade. It is represented in the British Empire by the tariff systems of Australia and Canada, in which a British preferential rate, lower than what is, in effect, the conventional rate (the "Intermediate rate") has been created. The application of this rate to imports from the United Kingdom and some other Dominions and possessions of Great Britain, into Australia and Canada, gives producers in the favoured countries an important advantage in those markets over foreign competitors. These preferences were granted autonomously in the first place, and without reciprocal concessions being made by Great Britain, since at that time this country had nothing to offer to the Dominions in return. Such autonomous preferences may, however, be extended by

negotiations and this has been the method by which the British preferential rate has been extended to cover a good deal of intra-Imperial trade.

(d) MERITS AND DEMERITS OF THESE FORMS. The great merit of the single-line form over multi-linear forms is its simplicity. It is generally easier both to construct and to work, since the framers of the tariff are concerned only with the probable effect of a single duty in each case, and the Customs officials know exactly what is payable on imported goods.

Against this must be set the disadvantages of its indiscriminate character and its lower bargaining value. A single-line tariff does not discriminate between colonial and foreign products, nor between imports from countries of high tariffs and those from countries of low tariffs. Such discrimination is, of course, a partial admission of the protectionist case, and therefore it is only natural that orthodox opinion in England during the last century should support the single-line system that we then had, with no preferences.

The smaller bargaining power that a single-line tariff is supposed to give to a government desirous of obtaining reductions of duties from other countries, is asserted to be due to the fact that its system is all-round in effect. While this may well make it difficult to induce another country to grant concessions—since, if it does so in return for a lowering of rates in a single-line tariff, it will be no better off, as compared with competitors who may have made no such concessions, than before—it is possible to imagine cases where a single-line tariff country would be in a strong position. The prospect of a rate-reduction or increase might be a powerful factor in negotiation with a nation which found its most important market in the single-line tariff country, for example, and the fact that the single-rate may be anything the government likes to declare (whereas bi-linear tariffs generally limit rates) is a point in favour of that country.

When we turn to double-line tariffs, we find that, with advantages and disadvantages in common, the two types also present differences in working. Their principal advantage is,



of course, the fact that they make discrimination possible, and, indeed, imply it. Their principal disadvantage is that they are, as a result, often somewhat complex to construct and administer and always less calculable in their effect, both from the point of view of the authorities imposing them and of the merchants who are concerned with them. For if some imports of a certain commodity are coming in at one rate, while the remainder come in at a different rate, it is very difficult, if not impossible, to determine with any degree of precision the protection likely to be afforded to home production (where this exists) and the revenue likely to be raised, and if it is possible for the duty on an import to be altered at short notice, neither the home producer nor the foreigner exporter can regard the position as a very settled one.

Subject to these general considerations, there are special advantages and disadvantages attaching to each of these forms. Under a maxima-minima tariff, the difference between the two sets of rates is fixed and known, and as long as a particular tariff measure remains in force, the government, the home producer, and the importer know how their respective interests are affected. At the same time, as the tariff is autonomously fixed, the rates can, any or all of them, be altered by the government, so as to give the required degree of protection or amount of revenue. On the other hand, bargaining power is limited, since the greatest concession that can be offered is the difference—equal to perhaps only a third or a quarter of the higher rate—between the maximum and the minimum chargeable. Since the same concession of the minimum rate must be offered to all, it may be that a country with such a tariff will sometimes give this in exchange for a reduction of duties on its goods which is not worth so large a concession and could have been obtained for less.

Under a general-conventional tariff, there is no all-round difference between the higher and the lower rates, since the latter may be established by a number of treaties and modified by the Most-Favoured-Nation clause. The advantages of this

are, from the point of a government, that bargaining power is unrestricted and, from the point of view of the producers concerned, that the conventionalizing of the lower rate may give greater stability to the tariff. A treaty is usually concluded for a definite period of years, and automatically renewed for a year at a time until one of the parties gives notice of its intention to "denounce" (i.e. terminate) it. One of the longest-lived of such treaties was that concluded, in the first place for twelve years, between Prussia and the United States in 1828, which lasted until war was declared in 1917. Against this system it is sometimes urged that the fixing for a long period of the lower rate may operate to the disadvantage of the country with the general-conventional tariff, particularly if it is extended through the operation of the Most-Favoured-Nation clause, or if economic conditions change during the period of the treaty. The advocates of a maxima-minima tariff have, indeed, stated that in fact no great difference in this respect need exist between that form of tariff and a general-conventional one, since maxima-minima tariffs can be just as stable as the other form and, so far as European experience up to 1914 goes, generally were.

It is not possible to give judgment for one or the other form, since the importance of the various points that have been advanced will depend in each case on the objective in view. On the whole, it is true to say that modern "high protectionism" prefers maxima-minima tariffs to general-conventional, as might be expected, since a government desirous of fostering home industries will want to have its hands free. If low duties and a trade revival are aimed at, then treaties will be popular. Whichever form is selected, it will, in practice, almost certainly be modified in detail by earlier commitments or by autonomous limitations; for example, the German Tariff of 1906 established a general rate and also a minimum below which no conventional rate could be fixed.

There is little to add in regard to triple-line tariffs. In theory, the larger the number of duties provided for each

article, the higher the degree of discrimination possible and the greater the bargaining power of the country; but in practice the actual duties, and the importance of a country as producer and consumer of goods entering into international trade, are of more moment. The great disadvantage of such a tariff is in the administration of the preferential range of duties, as it is not always easy to be sure that only those classes of goods to which the preference is supposed to apply are, in fact, enjoying it. This question can best be treated, however, under the general heading of the problem of specialization.

#### **4. The Most-Favoured-Nation Clause.**

This celebrated provision of commercial treaties has had a long and not uneventful history. While it is most prominent in tariff affairs during the nineteenth century, it is found in eighteenth century treaties and has figured in post-war agreements.

The clause may be said to have arisen out of reciprocity treaties between countries, the effect of which was at first limited to the two contracting parties in each case. As these treaties became more common, it became necessary to generalize the position, because if one nation obtained concessions in respect of duties chargeable on its goods from another, which subsequently gave more liberal concessions to a third, the first nation's position as a competitor in the foreign market was not improved, in spite of what it had itself given up to secure an advantage. To obviate the possibility of this development, it became usual to introduce into any treaty for reciprocal reductions of duty a clause providing that, if either of the parties A and B later gave to a third, C, any concessions on goods covered by the A-B treaty, these concessions should automatically be extended to the other party. That is to say, if a country bound by such a clause reduced duties to any other country, the country with which it had the Most-Favoured-Nation treaty would at once enjoy the same concession (without any further negotiations). In other words, the benefiting country is placed on the same footing

as the (other) most favoured nation ; it is impossible that its exports should be at a disadvantage in the country granting Most-Favoured-Nation treatment.

It is clear that in its widest application, the Most-Favoured-Nation clause would have the effect of reducing duties to one common level, and that level the lowest granted to any nation by any of the countries bound together by Most-Favoured-Nation treaties. This all-round lowering of duties was a feature of the period 1860 to 1892, when Europe was covered with a network of treaties ; it was the defence of those who upheld the treaties against the rigid Free Traders who, in England, attacked all such measures as compromises with Protection. But the clause is not always interpreted or applied in the widest possible way, and in different periods its effect has been somewhat limited.

There are, broadly, two interpretations of the clause—the unrestricted or European interpretation, and the restricted or American interpretation. The European conception of the clause is, that it extends to nations with Most-Favoured-Nation treaties all the concessions and privileges granted to any nation, unconditionally and without restriction. The American interpretation is, that the United States extends to a nation under a Most-Favoured-Nation treaty the same concessions or privileges as are granted to a third party, (a) freely and completely, where the original concession was gratuitous, (b) in return for the same or equivalent concessions as were made by the third party, where the original concession was only granted reciprocally. That is to say, a country under a Most-Favoured-Nation treatment with the United States does not *necessarily* obtain a concession granted to another country, if the concession was conditional. It receives the benefit of the concession only if it fulfils the condition.

A Most-Favoured-Nation treaty may be reciprocal or non-reciprocal, i.e. a country granting Most-Favoured-Nation treatment to another may not receive such treatment itself. Non-reciprocity generally occurs only when the two countries are of very unequal standing ; for example, under treaties with

the United Kingdom (1855) and the United States (1856), Siam granted Most-Favoured-Nation treatment to goods from those countries without getting any similar concession in return. A modern instance is provided by the Treaty of Versailles, 1919, by which Germany was made to grant for a certain period "without request and without compensation" Most-Favoured-Nation treatment to the Allied and Associated Powers.<sup>1</sup> Germany regained tariff autonomy under the provisions of the Treaty on 10th January, 1925.

The clause may be limited or unlimited in its effect. A limited Most-Favoured-Nation treaty is one definitely precluded from affecting the position of certain states, or from applying to certain commodities. Again, the clause may be conditional or non-conditional. With regard to the former, Gregory says: "The conditional form emphasizes the factor of bargaining or reciprocity. It is desirable to avoid discrimination, but it would be unfair to give any State all the advantages for which another State may have to pay. Consequently it lays down the principle that future concessions must be paid for, and on approximately the same terms for all the contracting States, and should only be freely granted to any one State if they have been freely granted to all."<sup>2</sup>

To sum up, the effect of the Most-Favoured-Nation clause has in various ways been limited or diluted in many cases, so that it has not done so much to reduce duties as might have been expected. In some periods and under some systems it has had a wider scope than elsewhere, its greatest effectiveness being among European countries from 1860 to 1914. The Great War terminated treaties formerly existing between the Allied and Associated Powers, and the Central European Powers and Russia; after the War there was a period of acute uncertainty combined with a highly-developed nationalism

<sup>1</sup> With this may be contrasted the provision of the Treaty of Frankfurt, 1870, by which *both* France and Germany were required to grant each other gratuitously and unconditionally any concessions subsequently given to the other principal European nations. This was a reciprocal, unconditional, limited Most-Favoured-Nation clause.

<sup>2</sup> Prof. T. E. Gregory, *op. cit.*, p. 456-7.

that militated against all movements which in purpose or effect lowered international barriers.<sup>1</sup> Moreover, the need for revenue, and the desire to be uncommitted in future negotiations, made many countries prefer tariff autonomy, at least for the time being. For example, France denounced all her treaties containing a Most-Favoured-Nation clause in the autumn of 1918, this taking effect by the Act of 29th July, 1919, unless agreements were prolonged. Great Britain continued to enjoy Most-Favoured-Nation treatment, but new treaties were made with Canada, Czechoslovakia, Austria, and Italy. However, after 1924, the old policy—of making the Most-Favoured-Nation principle an integral part of commercial treaties—may be said to have been restored by France, and other European countries have, in general, returned to the pre-war position.

<sup>1</sup> It was recognized that the Succession States of Europe were in a peculiar position, in which it was not appropriate to apply the Most-Favoured-Nation regime maintained before the War by the Empires, of which the new States had been merely provinces. Thus, it was provided in the Peace Treaties that mutual tariff concessions made by Austria, Czechoslovakia, and Hungary should not be extended automatically to other countries having treaties with these States by the operation of the Most-Favoured Nation provision; and, similarly, with concessions between Turkey and the countries formerly part of the Turkish Empire. The same considerations apply to the new Baltic States, such as Finland, Esthonia, and Latvia.

## CHAPTER VII

### DUTIES

- (1) TYPES of duties—(2) Advantages and disadvantages of each type  
—(3) Tariff level indices.

#### 1. Types of Duties.

TARIFFS differ from one another not only according to form, but also according to the type of duty principally used. A duty may be of a certain fixed amount, or it may be of a certain fixed proportion of the value of goods taxed, or it may be compound in character. The first kind of duty is known as "Specific," the second as "*Ad Valorem*." It will be useful here to consider the nature and effect of these different types, and their relative advantages and disadvantages.

(i) A SPECIFIC DUTY is one based on some definite and invariable physical quality or attribute (or qualities or attributes) of the dutiable commodity, such as weight or superficial measurement. It, therefore, does not vary *automatically* with the value of the commodity; but this does not mean in practice that it is imposed without reference to value, or will not be revised if values alter.

The bases of specific duties need careful definition, particularly if a duty is required to yield a certain minimum result in the way of protection or of revenue, since a duty based on a physical condition that is not essential or peculiar to a commodity may be evaded by an unimportant alteration of the commodity. For example, a particular specific duty on a product such as linoleum might be based on the linear yard of a certain width, with another and lower duty per linear yard on linoleum of less width; if the first duty is so framed as to apply to linoleum of exactly a certain width, foreign manufacturers may get their linoleum in at the lower duty by making it of a new standard width just sufficiently less

than that laid down in the tariff schedule.<sup>1</sup> Under any heavy duties, where it is worth while to go to the trouble of making products specially to "get round" the provisions of the tariff, there will be a continuous battle of wits between the customs authorities and the importer.

When weight is the basis of the duty, it is possible to define it with a high degree of precision. There are three general bases—

(a) Gross weight including packing, which is represented by the practice of Switzerland, among other countries.

(b) Net weight, the weight of the goods without packing, used in the United Kingdom customs system.

(c) Legal net weight, or semi-gross weight, which usually means the weight of the goods together with their packing or wrapping, but not including the outer case which is their general receptacle. The semi-gross weight is represented by the French regulations, the legal net weight by those of some of the South American States.

Examples of specific duties based on weight are the British duties on silk and artificial silk yarns and tissues imposed by the (Churchill) Budget of 1925, which were fixed per lb. of yarn, etc., imported.

Superficial measurement as a basis has already been described. It is obviously appropriate to such commodities as textiles and timber, which are generally dealt with in standard widths, though in highly-developed tariff systems the content may be the basis. Content as the basis, in the case of duties on textile fabrics, means that the duty varies according to the number of threads per square inch; the larger the number of threads, and the finer and more expensive the fabric, the heavier the duty it will bear, in general.

The duty may be based on area measurement, but is usually per linear yard of a certain width. An example is the British duty (under the "McKenna" duties) on cinematograph films; the duty is per linear yard of 1½ in. wide.

<sup>1</sup> This occurred under the U.S. Tariff of 1897 (the "Dingley" Tariff). Linoleum is no longer dutiable on that basis. Similar developments are always likely to arise with a high level of duties.



In the case of some liquids, specific gravity is the physical quality on which the duty is based; this is the case with the British duty on beer. Duties on wines and spirits are generally based upon the "proof" measurement of the liquid; thus, under the British customs tariff, wine pays a certain duty to which is added a further duty for every degree by which it exceeds 42° proof.

Sugar answers to two tests for quality—colour and polarization or yield. Specific duties which are designed to increase with an increase in the value of the commodity may, therefore, in the case of sugar, be based upon the colour-grade<sup>1</sup> which is a trade method of determining the quality. The better the colour, or higher the yield, the better the quality, and the heavier the duty which it can bear.

Tale or number is the only suitable basis for duties on some articles, chiefly those where weight or measurement would give the customs officials an undue amount of trouble. Under the Safeguarding of Industries (1925) Act, gas mantles for incandescent lighting imported into the United Kingdom were dutiable at 6s. the gross.

(ii) AN AD VALOREM DUTY, as the name implies, is based upon the value of the dutiable commodity and is invariably expressed as a percentage of that value. What value is taken as the basis of the duty depends upon customs practice; the questions that arise in this connection are discussed later. Here it is only necessary to point out that *ad valorem* duties are not entirely unrelated to the physical qualities or attributes of the goods to which they apply; values must be quoted per ton, or per yard, or whatever the unit of measurement is. This allows of different *ad valorem* duties being placed on different kinds or grades of an article, these being defined in physical terms.

(iii) A MIXED OR COMPOUND DUTY is one that contains both Specific and *ad valorem* elements, so as to avoid in part the defects of either. Thus, there may be imposed a certain specific duty on an article, so that the more valuable classes

<sup>1</sup> The "Dutch Standard."

may bear a larger specific duty with a constant *ad valorem* rate, or a constant specific duty with a rising *ad valorem* rate, or a higher specific and a higher *ad valorem* duty. The purpose of this elaborate construction appears when we consider the advantages and disadvantages of the two main types of duties.

(iv) ALTERNATIVE DUTIES are a device whereby the tax levied on imports by a duty can be maintained at a minimum level. Thus, it may be provided that a specific duty shall be levied on a class of imports, and that not less than a certain *ad valorem* rate of duty is to be paid on the goods; if their value rises so that the specific duty represents less than the minimum percentage of the value, the higher duty becomes chargeable. Again, when an *ad valorem* duty is imposed, it may be provided that in no case shall less than a certain specific amount (per yard, per lb., or whatever may be the basis of the duty) shall be paid. Both of these types are found in modern developed tariffs, such as the Canadian and American.<sup>1</sup>

## 2. Advantages and Disadvantages of Each Type.

The purpose of most tariff systems being two-fold, to raise revenue and to give protection to home industries, the effects of particular types of duties must be considered with relation to both these objects. In addition, administrative convenience has also to be taken into account in deciding between specific and *ad valorem* duties. There are a few classes of articles for which there can be established no appropriate physical basis of measurement, and of which the value is the only thing that customs officials can be concerned with; these, such as pictures, or furniture, must be taxed according to value. But,

<sup>1</sup> For example, in the U.S. Tariff, 1930, we find—

“Par. 201 (b). All other brick, not specially provided for:

... if glazed, enamelled, painted, vitrified, ornamented, or decorated in any manner, 5 per cent *ad valorem*, but not less than \$1.50 per thousand.”

“Par. 223. Plate, cylinder, crown, and sheet glass . . . when made into mirrors . . .

exceeding in size 144 square inches and not exceeding 384 square inches, 15 cents per square foot;

... *Provided*, That none of the foregoing shall be subject to a less rate of duty than 45 per cent *ad valorem*.”

in general, the tendency is for the *ad valorem* rate to disappear, the more highly developed the tariff becomes, because the more dutiable articles there are and the larger the variety of rates to be applied to them, the more important and difficult the work of valuation becomes. Thus, the United States tariff was originally one of *ad valorem* duties, but it now contains many specific and compound duties. The tariffs of European countries mostly show specific duties, though a certain revival of *ad valorem* rates appeared in the exceptional circumstances of the period immediately following the War. Nearly all the new duties imposed by Great Britain since the War have been *ad valorem* rates, such as the 50 per cent duties on "abnormal imports" of a variety of manufactured goods imposed by Mr. Walter Runciman as President of the Board of Trade, under Orders during November and December, 1931. This is characteristic of a hastily-devised measure.

(a) PRODUCTIVENESS. In respect of the raising of revenue the character of the demand for the goods taxed is an important consideration. The revenue obtained is the result of the levying of a certain amount of duty on a certain volume of imports, but this volume is itself determined partly by the level of duty. If the demand for the imported commodity is inelastic, then a very heavy duty may make very little difference to the amount brought into the country, unless the duty is protective in effect, when it will presumably give such an advantage to the home producer as will allow him to capture part of the market formerly supplied by imports. This case has already been argued on general grounds, and there is no need to deal with it again. If, or in so far as, the duty is not protective, and the demand is elastic, it is important to discover the level of duty which gives the maximum yield. There are two extremes: a low rate of duty that will make little difference to the volume of imports, and will thus bring in a large revenue because the total quantity of dutiable goods is large, and a high rate of duty that will cause a very considerable falling off in the volume of imports, and thus bring in a smaller revenue.

(This is not to say that every increase of duty will bring about an actual decrease of revenue, because of a more than proportionate shrinking of trade; that may occur, but it is not necessarily the case that it will follow in all circumstances. It is possible to imagine a situation in which beyond a certain point increases of duty have less effect than previously on the volume of trade; a diminished demand would have become no longer elastic, but constant.) In each case it is assumed that part at least of the duty is passed on to the consumer in the form of higher prices for the imported goods within the tariff area; if it were not, of course, it would make no difference to the demand for them.

The importance of this is obvious when we consider the different effects on prices of specific and *ad valorem* duties. An *ad valorem* duty, being only a fraction of the value of the taxed commodity before the duty is imposed, increases automatically with the price of the commodity. A specific duty, being a fixed money sum, does not represent any particular fraction of the price of the commodity, and is a burden that diminishes as the price rises. To take an extreme case, suppose a commodity not produced at home taxed on import by a duty equal in amount to 20 per cent or one-fifth of the market price of the commodity at the date of imposition of the duty. The whole of the duty is passed on to the consumer in a higher market price, and the demand is elastic. If the price outside the tariff area rises, then an *ad valorem* duty of 20 per cent will rise with it, bringing in a larger sum in duty per unit imported than before; but demand will fall off, so that the volume of imports will decrease. A specific duty equal in the first place to one-fifth of the price of the commodity, will be equal to less than one-fifth when the price rises, so that the extra cost of the commodity to the consumer within the tariff area will be less than before, and demand will not fall off to the same extent as under an *ad valorem* tariff. Equally, an *ad valorem* duty represents a constant burden when prices are falling, while a specific duty represents an increasing burden, so that in

this case demand—and therefore imports—is not likely to expand so readily on a fall in price. On the whole, when large movements in prices are not the rule, the presumption is in favour of greater stability of revenue being obtained from specific duties. Professor T. E. Gregory observes: "In a period of rising prices, specific duties tend to reduce the aggregate revenue as compared with the *ad valorem* duties, in a period of falling prices *ad valorem* duties tend to bring in less than specific duties would, *granted that the demand for the commodity is inelastic*. If the demand is elastic, a rise in price cuts off demand sharply, a fall in price stimulates demand and, therefore, a lower duty per unit will not decrease the revenue when prices are rising so much as it would be reduced by a higher duty—i.e. elasticity of demand makes for specific duty in this case; whilst *falling prices* accompanied by an *ad valorem* duty will, under conditions of elastic demand, increase the revenue more than a specific duty would."<sup>1</sup>

When rapid and violent price-changes do occur, as was the case in Europe immediately after the War, there may be a return to *ad valorem* rates simply because it is not practicable to alter specific duties sufficiently frequently to maintain anything like the desired level of revenue or protection. But, even in such circumstances, it may on other grounds be desirable to retain specific duties, and these can then be kept at their former level by means of "multipliers" or "coefficients" which raise the amount of the duty *pari passu* with the increase in prices. This device was adopted by most European countries during the inflation period, i.e. between 1918 and 1924.<sup>2</sup>

(b) PROTECTIVENESS. The degree of protection afforded by

<sup>1</sup> Gregory, *op. cit.*, Chapter V.

<sup>2</sup> Incidentally, this enabled subsequent lowering of tariffs without alterations of rates, usually an elaborate and controversial procedure. According to the Department of Overseas Trade Report on France for 1925, by Mr. Cahill: "By a decree of 20th September, 1924, import duties on certain foodstuffs were reduced thus, the coefficients of increase (or multiples) applicable to the duties on sausages, condensed milk, butter, barley, rice, and preserved tomatoes were suppressed, and a reduction was made in the coefficients on hard and soft cheeses . . ." (Report, p. 46.)

an *ad valorem* duty is constant, while the protection afforded by a specific duty varies according to changes in the price of the dutiable commodity, and, in the case of a duty applying to different qualities of the same article or to a class of articles, according to the quality of the goods. A specific duty becomes increasingly heavy, the lower prices fall, or the lower down the scale of quality we go; that is to say, it is *regressive* in character.

When changes in price are occurring, the regressiveness of a specific duty can be largely overcome, as we have seen, by the use of coefficients. This makes it possible to keep duties at the desired level without undertaking the laborious and complicated task of revising the tariff, and, since the coefficients can be declared at short intervals—each month or even week, if need be—the method is suitable to cases of currency depreciation when prices are rising very rapidly.

With regard to the inequitable burden of the same absolute amount of duty on a cheap as on an expensive quality of an article, we may observe that this may be no disadvantage, from the point of view of the protected producer. But, if it should be desired to prevent an excessive burden falling on the lower-grade articles (which are probably those most in demand among the poorer consumers), this can be effected by more detailed classification. In fact, the increasing use of specific duties in European tariffs has been accompanied by increasing specialization, so that in many cases every important grade or type of any commodity has a separate specific rate. An equitable distribution of the protection afforded by the tariff is therefore attained, at the cost of making a schedule containing hundreds of different rates.

The purpose of compound duties is, of course, to get the advantages of each type without the disadvantages. How far this object is achieved will depend upon the way in which the compound duty is constructed, and the nature of the trade on which it is levied. Its complexity is an objection from the point of view of administrative convenience.

### 3. Tariff Level Indices.

The expression "degree of protectiveness" has been frequently employed in the last few pages, and it is, therefore, proper to inquire at this stage whether any measure of the effect of tariffs on trade, in this and other respects, can be obtained. What may be looked for is a measure of the differences between tariffs of different countries at the same time, and also of the differences between the tariff of any country at different times. If we can obtain any such measure, it will enable us to say with some precision that A's tariff is higher than B's, or that the general level of rates in a tariff is higher to-day than it was before the War, or whatever may be revealed as the actual situation.

The method used in the comparisons of prices or measurement of price changes is familiar to most people; it is the method of the index number. The prices of a selection of commodities at a certain date are taken as the base; the changes found to have occurred by a later date are measured, and a suitable average calculated to form a single number. The prices at the base-date being expressed as 100, the different prices of the second date, and therefore their average, will be comparable, i.e. will represent a percentage change in prices in general. This is most widely used in the measurement of differences in prices (or of the cost of living, with a specialized index) over time; but, if the same base is employed, differences in price over space, i.e. between different areas, can be equally measured. (This is derivative from the first use, since if we find different index numbers for prices in two places at a given date, it means that prices in one area have changed since the base-date, more than prices in the other area.)

Substantially, the same methods can be applied to the measurement of tariffs, and various attempts to construct tariff level indices have been made. Before we use any such indices as expressions of the height of tariff walls, it is necessary to understand their nature and limitations.

As soon as we consider actual tariff systems, it becomes

obvious that we cannot compare rates or amounts of duties directly, no matter how these have been averaged to obtain an expression of their general level, because the volume of imports affected by duties differs from country to country. For instance, a country like Great Britain with a very few fairly high duties, as was the case prior to 1931, might show a higher index than that calculated for the tariffs of France or Germany, with thousands of rates covering almost the whole trade of the country, most of which ruled somewhat lower than the British duties. Such a result would clearly give a wrong impression from any point of view of the relative position of these countries, and the same objection would apply to changes in the index for a country like Great Britain over a period of time—the increase or decrease of a single duty might make a difference quite out of proportion to its effect on trade.

We must, therefore, attempt to construct an index that shall bear some relation to the importance in trade of the dutiable commodities. As duties may be of different kinds, they must be converted into a common form, e.g. specific duties must be converted into *ad valorem* duties, by calculation of the percentage of the prices of the goods at a certain date which they represent. Finally, for practical purposes, a selection of the most important out of the almost infinite number of commodities entering into world trade must be taken.

These lines were followed in an inquiry into the height of foreign tariffs made as long ago as 1904 by the Board of Trade; by the "Balfour" Committee on Industry and Trade in their "Survey of Overseas Markets," 1925; and by the committee which prepared a report on Tariff Level Indices for the International Economic Conference held at Geneva in May, 1927. There is thus a certain agreement as to what these indices do and do not show. None of the results of these investigations shows the actual "degree of protection" afforded to home producers by a particular tariff. A little reflection will indicate why this is the case. Let us imagine that we have a case



far simpler than any likely to be found in practice; two countries with tariffs composed of *ad valorem* rates levied on (among other commodities) the range of items—say 100 important commodities—which we have selected as the basis of our indices. The index for one country, A, will come out higher than that for the other, B, if most or all of A's rates are higher (none lower) than B's rates on these commodities. But the question as to whether this gives producers in A more protection than producers in B enjoy is to be answered with reference to the economy of each country. If, for instance, industry in A is at a considerable inferiority to that of other countries, a very high tariff will perhaps not serve to give the home producer a competitive position in the domestic market, whereas a relatively low level of duties in B, where industry is more favourably situated, might effectively protect the home producer.

What, then, does a tariff level index show? It might be said to indicate the external aspect of a tariff; it gives a measure of the obstruction offered to the goods of an exporting country. This was the point of view adopted by the inquiries of 1904 and 1925, with special reference to England's position. The indices given in the *Survey of Overseas Markets* show the estimated *ad valorem* incidence of the tariff on British goods as higher in 1924 than in 1913 in many of our important markets. It was lower in the cases of Canada, Germany, France, Japan, the Argentine, Brazil, Belgium, Italy, Spain, and Sweden; but in the cases of Canada, the Argentine, Italy, and Spain, the difference was small—so small as to make it doubtful, having regard to the nature of the indices, that any significant reduction of the barriers against British goods had, in fact, occurred. The practical interest of such a measure is considerable, and it also has the advantage that, even if it does not provide a perfect index of the actual height of a tariff wall at any date (and, of course, no index number can completely satisfy all the requirements of theory), as long as conditions remain substantially the same, it *does* show changes in its height over a period of time.

More generally, tariff level indices show the burden on international trade due to the fiscal systems of various countries, and the higher they are all round, the more restrictive their effect. The International Economic Conference inquiry used four methods, or two methods, A and B, with three variants of the second, of measuring tariff levels, the difference being the basis of valuation of the selected commodities employed. By Method A, the average *import* value of 78 commodities or groups of commodities was taken; by Method B, the average *export* value of 278 commodities. Each of these bases has a particular significance from different points of view, and comparison of the different indices obtained is useful as a means of checking the results. Countries with double- or triple-line tariffs are difficult to compare with others, since two or three indices have to be calculated, and it cannot be determined with certainty how far any particular index-number affects trade as a whole. (As regards the trade of particular countries, of course, there is no difficulty, since we know whether or not exports from, e.g. Great Britain, to an overseas market come under the higher or lower, or intermediate, rates.) All the indices given make it clear that tariffs were higher in 1925 than they were in 1913, with few and relatively insignificant exceptions.

## CHAPTER VIII

### PROBLEMS OF TARIFF-MAKING

- (1) TARIFF areas—(2) Tariff-making authorities—(3) The processes of tariff-making—(4) Tariff-making in the United States—(5) Tariff-making in Great Britain.

THE construction of a tariff will be a matter, the difficulty of which will be determined by the objective which it is designed to achieve and the circumstances in which it has to be undertaken. It may be comparatively simple to frame a revenue tariff; the construction of a general protective tariff is a much more difficult task, involving, as it does, the consideration of the probable effects on thousands of different producers of tariff provisions that—since they are drawn up in anticipation of conditions that may not come about—are necessarily somewhat experimental. It is all the more important, therefore, that the processes of tariff-making shall be laid down on the right lines, so as to give machinery whereby the framing of a new tariff or the revision of an old one can be accomplished as rapidly and efficiently as possible. Most countries with elaborate tariffs to-day also have well-established methods and bodies used in the construction of their systems, but these have been developed more through trial and error during a long experience than through the prior working-out of principles. A change in a country's fiscal policy is, however, an opportunity for applying the soundest methods that have yet been discovered by the experience of other nations, from the very outset.

In order to consider the main questions that may arise in connection with tariff-making, it will be necessary to treat the separate processes in turn. A tariff is a complex of rates applicable to certain goods entering (and leaving, where there are export duties) a defined area, which is administered and controlled by a particular authority. We must then deal with (a) tariff areas, (b) tariff-making bodies, (c) the steps to be taken in making a tariff.

## 1. Tariff Areas.

The general principle on the basis of which tariff areas are defined is, that they shall be co-extensive and co-terminous with existing national areas, so that tariff and political sovereignty and administration coincide.<sup>1</sup> But there are a number of exceptions to this rule.

### TARIFF AREAS NON-COINCIDENT WITH POLITICAL AREAS.

(i) Tariff areas of smaller extent than the corresponding political area are found where there exist frontier areas, free districts, or ports, and exclaves. Countries with long land frontiers usually establish a frontier district of from 4 to 10 kilometres width, the local trade of which is free of duty, being outside the tariff area. This is obviously to the convenience of those inhabitants of the two countries concerned, who happen to live on the frontier. Trade between these areas and the rest of the countries within the tariff boundaries is dutiable, and local trade is usually carefully watched by the authorities to prevent smuggling. Most trade will, of course, be "through" trade, i.e. passing straight across the free frontier zone, and so paying duty.

Free districts and ports are those where goods otherwise dutiable pay no duty on being imported from abroad into the free area, or on being exported direct from the free area. Goods exported from a free port to a place within the tariff boundaries are regarded as imports, and therefore taxed exactly like direct imports. A free district or zone as distinct from a free port is an area in or adjacent to a port, without a resident population, where goods are warehoused for reshipment or manufacture.

The history of free ports in Europe has, in general, shown that they are of importance rather in the early than in the later stages of the commercial development of a nation. They

<sup>1</sup> It is presumably in accordance with this principle that the Abnormal Importations (Customs Duties) Acts, 1931, does not apply to the Isle of Man. (Sect. 7, subsec. (2) of the Act.) Nor does the Import Duties Act, 1932, except as regards the imposition of supplementary duties on imports from countries which discriminate against British exports. (Sect. 12 of the Act.)

appeared in Italy as early as the sixteenth century, in France and Germany in the seventeenth century, in Austria and Hungary in the eighteenth century. They were abolished in the nineteenth century in Italy and France, as these countries attained their modern tariff development, though in Austria-Hungary and Germany the status was retained by such ports as Trieste and Hamburg. Their purpose was the encouragement of transit trade, and there are still made demands for such facilities by merchants in Europe and the United States; but the trend of tariff development seems to be away from these local exceptions to a national system. Nevertheless, free zones have been established in some European countries since the War.

That they are not essential to the building up of an entrepôt trade is shown by the development of the trade of Great Britain. Equivalent facilities are provided by bonded warehouses, in which goods can be deposited, under customs supervision, without having to pay duty. They will pay duty as imports when taken out of bond for domestic consumption, and will not pay duty if they are withdrawn for re-export. From the point of view of the merchant, therefore, they present two great advantages; they provide storage accommodation, and they make it unnecessary to pay duties on goods as soon as they arrive which, in cases where some time elapses before the goods are disposed of, would mean the locking-up of a part of his working capital for a period. Under some systems, e.g. that of the United States, manufacture under bond of articles for export is permitted. Bonded warehousing is naturally most important in countries such as Great Britain and the United States, where the free port or free zone system does not obtain.

Exclaves are parts of a country's political area administered for convenience as part of the tariff system of another country.

(ii) Tariff areas of greater extent than the corresponding political areas are found where there exist enclaves and "assimilated" areas. Enclaves are territories, not part of the political area of a country, incorporated, for the sake of

convenience in administration, into that country's tariff system. Examples are Monaco, an enclave of the French tariff area, the Free Port of Dantzig, an enclave of the Polish system by the Conventions of 1920 and 1921, and Luxembourg, formerly an enclave of the Zollverein, the German system, since 1922 part of the Belgian tariff area. It will be noticed that enclaves may be politically independent areas, or may be exclaves of other states, as in the case of the Austrian territories of Mittelberg and Jungholtz, which were included in the German system before the War.

"Tariff assimilation" is the practice of incorporating colonies with the mother country for tariff purposes, so that they constitute externally a single-tariff system. This usually goes with assimilation in other respects, e.g. the ocean communications between the mother country and the colonies is considered to be coastwise shipping, and reserved for vessels owned by nationals of the assimilating state. Such a policy makes for simplicity in tariff administration, but when the tariff is framed primarily in the interests of the mother country—as must almost inevitably be the case—it may not give comparable protection to colonial producers, or raise an adequate revenue on their trade. The principal examples of tariff assimilation to-day are France, Japan, and the United States. It is obviously unsuitable to communities which have a measure of political and economic independence, and very different conditions from the mother country and from one another, such as the Dominions of the British Empire.<sup>1</sup>

(iii) CUSTOMS UNIONS. Various forms of customs unions may be distinguished, but only two are important in practice. We may have mutual reduction of duties with external unity of tariffs, or mutual free trade with external unity of tariffs, with or without common administration. The second might be considered as the final form, the logical development, of

<sup>1</sup> Yet it is difficult to see what else is meant by "Empire Free Trade," assuming a common tariff wall against the products of the outside world. The administrative difficulties involved in the construction and working of the "general utility" tariff necessary would surely be enormous.

the first, since it gives to the fullest extent the great benefit which union is designed to secure—an extension of the market, by reduction of tariff barriers, of producers in the area concerned.

The classic example of such a union is the German Zollverein, which in 1834 welded the various independent states, such as Prussia, Bavaria, Hesse-Darmstadt, which then constituted Germany, into a single tariff area. There was thus established an important degree of economic unity years before the political unity—which it helped to promote—was possible.

## 2. Tariff-making Authorities.

We have already distinguished between nations in respect of tariff autonomy, for the purpose of discussing different forms of tariffs; we may adopt this distinction in classifying them as different kinds of tariff-making authorities. All nations may thus be divided into the three classes of (i) completely autonomous, (ii) autonomous within limits, and (iii) non-autonomous, states.

✓(i) Completely autonomous states are those, the tariff-making power of which is not limited in any way, such as Great Britain.

(ii) States whose autonomy is limited in some way, by treaty or otherwise, are consequently not able to frame tariffs in any way that may be desired. Examples already quoted are those of France and Germany under the Treaties of Peace of 1871 and 1919. A limitation of a different sort is that provision of the constitution of the United States which prevents the imposition of export duties. While this could be removed by an amendment of the constitution, as long as it stands it is a restraint upon the body engaged in framing the tariff.

(iii) Non-autonomous states are either politically dependent states, or independent states the tariffs of which are determined by others. The most important example of the latter type is the "Open Door" Area, an invention of the nineteenth

century used by the Great Powers in their exploitation of backward countries. The essential feature of an open door area is that, at least as far as certain other countries are concerned, no discrimination is made between them in trade and tariff matters. This means that two conditions must be fulfilled: the tariff autonomy of the area is limited by treaties which it may not denounce, and these treaties place all the co-contracting parties (other than the open door area itself) on an equal footing.

The treaties determining the character of the area, e.g. the level of duties to be charged, the terms on which goods from the treaty powers are to enter, may be made as between the non-autonomous state and each of the other states separately, as in the case of China and Siam, or as between the co-contracting nations themselves, the non-autonomous area not being a party, as in the case of Egypt under the Anglo-French agreement. It will generally be found that the first arrangement applies to politically independent areas, the second to those that are in effect, if not nominally, controlled by the outside powers, or to dependent areas such as colonies, protectorates, and mandated areas under the Covenant of the League of Nations. "Class A" mandates, as they are generally known, the former possessions of Turkey, may be regarded as separate tariff areas, while "Class C" mandates, "territories, such as South-West Africa and certain of the South Pacific Islands," in the terms of the Covenant, are, for administrative reasons, made integral parts of the territory of the mandatory power; only "Class B" mandates, therefore, which means such areas as the Cameroons, need be considered as open door areas for our purpose. By Article XXII, the mandatory power is required to "secure equal opportunities for the trade and commerce of other members of the League." In subsequent practice, this has come to mean that discrimination against imports from League members, and in favour of imports from the mandatory power, are contrary to the intention of the Article.

The tariffs of open door areas are usually, but not necessarily, composed of low duties fixed under treaties that allow



of revision only with the consent of all the co-contracting parties. Thus, in the case of China, there were originally simply 5 per cent duties on all dutiable imports and exports. Subsequently, specific import duties were substituted, the amounts of these being calculated to impose a tax on goods about equal to 5 per cent of their value, as determined under the Treaty of 1858. In the course of time, changes in the values of commodities brought about a very different state of affairs from that which had obtained when the original duties were fixed, but the difficulty of securing unanimous consent, and the interest of the Powers in keeping duties down, delayed revision. By the end of the War, the level of duties was absurdly unrelated to the nominal 5 per cent; and in 1921 the Washington Treaty provided for the setting up of a commission, composed of delegates of the Treaty Powers and China, to revise the tariff.<sup>1</sup>

Which institution (or institutions) within the autonomous or semi-autonomous state is entrusted with the actual business of tariff-making, will depend upon how the processes involved are carried out, and this again will depend partly upon the nature of the tariff. In general, we may say that the final form, and the actual legislating, of the tariff will be the work of the supreme organ of government, but the preparation of the material, and possibly the first draft, will be in the hands of some other body. The more elaborate the tariff, the more likely is this to be the case, since otherwise the time of the legislature will be taken up with the construction of the tariff in detail, for which a large, inexpert body is not well fitted.

We must, therefore, analyse the whole process of the making of a general tariff from start to finish, distinguishing different stages that can be dealt with by special institutions.

<sup>1</sup> This commission was followed by a special Tariff Conference in 1926, which recognized in principle the claim for tariff autonomy put forward by the Chinese delegates. Accordingly, a new customs tariff, largely composed of specific duties on imports representing a higher level of rates than that previously existing (with export duties unchanged), was promulgated by the Chinese Government in December, 1928. With its coming into force on 1st February, 1929, the "Open Door" period of China's history may be regarded as at an end.

### 3. The Processes of Tariff-making.

The work of constructing a tariff can be divided into four main stages which are normally successive in time—

- ✓(i) The collection of information and the investigation of economic conditions.
- ✓(ii) The determination of the nature and form of the tariff.
- ✓(iii) The drafting of tariff schedules.
- ✓(iv) The legislating of the tariff.

The second stage may not, of course, arise if the general line of tariff policy has clearly been laid down beforehand, as is the case when the new tariff is merely a revision of a well-established system. Moreover, the first and third stages may be going on simultaneously, if both are entrusted to the same body; but it is obviously desirable that when a tariff is being drafted, material shall be available, and this usually means prior investigation.

(i) The collection of information and the investigation of economic conditions, so that the effect of a duty on particular imports can be estimated with some exactitude, can best be carried on by a small expert body. This will usually be a committee of the appropriate government department, or a special permanent commission, which will give hearings to interested parties, possibly pay visits to local industrial areas demanding protection, and examine and report on the claims and statements submitted to it. The constitution of this body is likely to be determined by the fiscal policy of the country; where protection is the basis of the policy, the tendency is to set up an independent institution having general powers, whereas in countries in which protective duties are the exception rather than the rule, an *ad hoc* body set up by a government department will consider each case separately. The methods employed in Great Britain and in the United States to date are described in outline below; here it is only necessary to say that the *ad hoc* committee has been characteristic of British practice, as the permanent Tariff Commission is of the American. The same development is typical of the systems of those British Dominions which have elaborate

tariffs; thus, the Government of India set up a Tariff Board of three persons, for one year in the first instance, in 1923, the existence of which was subsequently extended indefinitely. In Canada the original Tariff Commission (so-called) was a body of Cabinet Ministers who toured the country in order to ascertain public opinion; under such an arrangement, the same persons—who are not necessarily expert—take part in the two functions of investigating conditions and framing policy. But, in 1926, the Advisory Board on Tariff and Taxation was set up, with the duty of making inquiries into and hearing representations on all matters pertaining to the tariff and other forms of taxation, as may be directed by the Minister of Finance. The Board visits plants and factories directly or indirectly concerned with the matters referred to it, so far as possible, and advises the Minister in accordance with its investigations. This arrangement, which is obviously more desirable than the old one, as it relieves the Cabinet from the burden of preliminary work and makes it possible for this to be done by an expert specialist body, somewhat resembles the method adopted in the construction of the German tariff of 1902; in that case, the material was collected by the Ministry of the Interior assisted by an "Economic Committee," representative of agricultural and industrial interests.<sup>1</sup>

(ii) The determination of the nature and form of the tariff involves such questions as its technical form (e.g. whether it shall be unilinear or multilinear), its scope, and its purpose (e.g. whether it shall be revenue or protectionist). A good deal of what comes under this head is, or may be, the subject of political issues; a general election may have given the government a mandate for the protection of agriculture or against food taxes, for example. In so far as these matters are subject to controversy, their decision rests with the legislature alone, and the framing of a policy respecting them is the responsibility of the Cabinet. But the selection of actual rates, specific or *ad valorem*, and the classification of dutiable

<sup>1</sup> See Gregory, *op. cit.*, Chapter I, § 14.

goods, are questions that can best be treated by an expert body. In any case, the outcome of anything done by any other body is subject to the approval or revision of the legislature.

(iii) The drafting of tariff schedules is again a matter where technical knowledge and experience is most valuable. There will always be a tendency for importers to seek loopholes in the regulations through which they can bring in goods without paying the duty they were intended to pay, and so very careful wording is necessary. Obviously, the more complex and comprehensive the tariff, the more important this stage becomes.

(iv) The legislating of the tariff gives the final opportunity for alteration, an opportunity of which the various interests represented in the legislature will generally avail themselves, unless they have been able to secure what they want in the preliminary processes. The tariff, which in the most highly-developed systems may be based upon a year or more of investigation and consideration by the appropriate body, may be presented in the form of a bill by the responsible Minister. In few cases have recent tariffs of protectionist countries passed into law without having undergone modifications by the legislative assemblies. But, to modify a completely-drafted tariff is one thing, to debate the whole form and content of an elaborate measure is another, and to attempt to legislate a modern protective tariff without a large amount of preparatory work by specialist bodies is to court failure.

In this connection, it may be of interest to contrast the position in the United States, as representative of modern high protectionist countries, with that in Great Britain up to 1931, where an ambiguous protectionism has made a piecemeal invasion of a Free Trade fiscal system.

#### **4. Tariff-making in the United States.**

Originally, the United States tariff was framed by the legislature, with the collection of material obtained through

"hearings" of interested persons and government departments by the Ways and Means Committee of the House of Representatives. There was an *ad hoc* Commission in 1882, appointed to investigate and report on the various economic interests, so as to assist in the framing of the tariff; but it was not until 1909 that a permanent Tariff Board was set up.<sup>1</sup>

The function of the board set up by the Payne-Aldrich Tariff Act of 1909 was "to secure information to assist the President in the discharge of the duties imposed upon him" in determining whether undue discrimination was being practised by any country against the United States (imports from that country then becoming liable to the penal maximum rate under the tariff); it was continued for the purpose of investigating terms of production at home and abroad "with a view of determining to what extent existing tariff acts, actually exemplify the protective principle." That is to say, it was to discover what differences, if any, existed between American and foreign costs of production of goods, so that a tariff rate could be made to compensate for American higher costs. The Board began these investigations, and also the compilation of a tariff dictionary; it did not draft the actual schedules, and had no part in the determination of tariff policy.

The Board was a Republican creation, and when the Democrats gained power in 1912, it was abolished, the work of investigation of costs being handed over to the Department of Commerce.

In 1914, the Federal Trade Commission Act gave the Commission it brought into being the power to investigate trade conditions in other countries, and "to report to Congress

<sup>1</sup> There already existed the Department of Commerce and Labor (established 1903), to which was transferred in 1912 the Statistical Department of the Department of State, and the statistical work of the Treasury, which included foreign trade statistics. In 1913 the labour side of the work was taken over by the Department of Labor created for that purpose, and the commercial side left to the Department of Commerce organized in eight bureaux, one of which was the Bureau of Foreign and Domestic Commerce. The statistical work fell into this bureau, and, in addition, trade conditions in foreign countries and other countries' tariff systems were studied. Some of this might well be regarded as proper to a specialist tariff body.

thereon, with such recommendations as it deems advisable." This last clause might have covered the whole field of tariffs, had the work of the Commission developed; but, in 1916, the existing Tariff Board was set up. It was composed of six members, not more than three of whom were to belong to the same political party—a provision presumably designed to "keep the tariff out of politics," at least so far as the Board's share was concerned—and it was required to investigate the working of the United States tariff system and to report thereon; to put at the disposal of the President, the Committee of Ways and Means of the House of Representatives, and the Committee of Finance of the Senate, all the information it possessed, and to carry out investigations as required by those Committees or by the President.

Under the Tariff Act of 1922, the functions of the Tariff Commission were extended, so as to make it part of its work to carry out, when required by the President, special investigations in order to discover whether it is desirable to impose special rates and restrictions (a) in order to equalize costs of production, (b) to cope with unfair methods in export trade (e.g. subsidies given by other countries to their exports), or (c) to assure equitable treatment of American products and commerce by foreign countries. These were the outcome of extended discretionary powers given by the Act to the President, in order that he might deal with those matters promptly.<sup>1</sup> As the President must rely largely upon the findings of the Commission, this increased "flexibility" of the tariff means that the Commission and its work have become of more importance. As a result, the Commission reorganized itself, setting up various divisions for the investigation of particular trades, each division consisting of a chief investigator and a number of experts. The work of the staff is co-ordinated

<sup>1</sup> The President was given the power to modify existing rates either upwards or downwards, to the extent of 50 per cent, on the recommendation of the Commission. This was to allow of interim adjustments of particular rates, so that it should not be necessary to wait for a revision of the whole tariff. Between 1922 and 1929, several such changes were made, nearly all increases, but no considerable modification of the tariff at large occurred.

by an Advisory Board, which reports only to the Commission, and is under its immediate direction.

By the Act of 1930, the Commission's powers were again broadened; it can now act more promptly than before on applications for revision, and can protect trade secrets and confidential information given in evidence. This obviously makes it likely that valuable particulars, formerly not available, will, in future, be supplied as material on which the Commission's recommendations are based. Further, foreign manufacturers and merchants can initiate proceedings before the Commission. It is observed in the Department of Overseas Trade Report on Economic Conditions in the United States of America to March, 1931, that "The clause constitutes, in its present form, a very interesting experiment in tariff-making that may lead eventually . . . to the transforming of the Tariff Commission into a quasi-judicial rate-making body similar to the Inter-State Commerce Commission in this country and the railway commissions abroad, that keep the levels of railway rates in harmony with the changing necessities of trade and traffic."<sup>1</sup> That some such body is required, if the technical problems of tariff-making are to be treated with increasing efficiency, is indicated by the comments made earlier (page 22) in the same Report on the tariff of 1930, the "Hawley-Smoot" Tariff. For this preliminary hearings by the Commission began early in 1929; the Bill became law on 17th June, 1930. "The accomplishment of this task occupied 18 months of investigation and debate, the resulting measure representing the usual compromise between the conflicting interests and demands of different industries and different sections of the country, and containing various inequalities and maladjustments which a reorganized Tariff Commission is charged with the function of straightening out." The Act raised rates in each of the fifteen classes under which imports are grouped, the average change by schedule varying from an increase of about 3 per cent. on the 1922 rates in Schedule 6, Tobacco and Manufactures thereof, to about

<sup>1</sup> Report, p. 25.

69 per cent on Schedule 7, Agricultural Products and Provisions. (The level of the actual rates of duties in Schedule 6 is nearly double that of Schedule 7.)

## 5. Tariff-making in Great Britain.

When we turn to the British tariff and its construction, we find many contrasts with American methods. It would be out of place to relate here the story of protectionism in this country during the present century; what is of interest is the variety of ways in which the tariff has been built up since 1915.

Duties on imports into this country levied during the period 1915 to 1932 may be grouped under nine main heads, to which are here given the popular designations of the various types. The groups can be summarized as—

(i) The revenue duties of the Budget, comprising only non-protective duties.

(ii) The "McKenna" duties.

(iii) The "key industries" duties, under the Safeguarding of Industries Act, 1921.

(iv) The "safeguarding" duties, under the Safeguarding of Industries Act, 1925.

(v) The silk duties (on natural and artificial silk).

(vi) The "petrol duty" (duties on hydrocarbon oils).

(vii) The "Runciman" emergency duties, under the Abnormal Importations Act, 1931.

(viii) The "Gilmour" duties, under the Horticultural Products Act, 1931.

(ix) The "general tariff," comprising duties levied under the Import Duties Act, 1932.

In order to appreciate these tariff developments, it is necessary to consider briefly the origin and scope of the different classes of duties.

The ordinary revenue duties in the Budget are introduced every year by the Chancellor of the Exchequer, and form part of the Finance Act for that year. They are thus variable annually, as passed by Parliament, and may at any time be removed altogether, as was the tea duty in 1929. The granting



of preference in respect of imports chargeable under these duties, and any similar matters, are likewise determined by Parliament.

The McKenna duties were first imposed in 1915, the main objective being, according to Mr. McKenna, threefold: to "reduce imports, and reduce consumption, and bring in revenue." The reduction of imports was desired partly in order to prevent the throwing of a strain on England's foreign exchange, partly to release shipping space for the carrying of foodstuffs and munitions. The duties have been reimposed for every year since 1915, except 1924, when they were removed by the Budget of the first Labour Government, to be restored by Mr. Churchill in the following year, under the succeeding Conservative Government. They are *ad valorem* duties of 33½ per cent, with a preference of one-third of this on imports from Empire sources, which apply to a small range of manufactured articles: Motor vehicles, motor-bicycles, parts and accessories; motor tyres; cinematograph films; clocks, watches, and component parts; and musical instruments. Motor tyres were not included until 1927, but, as it was then stated by Mr. Churchill that it had originally been intended to bring them within the scope of the duties, it is, perhaps, permissible to group them with the other items.

The key industries under the Act of 1921 are of a different character and subject to a different procedure. They are covered by Part I of the Act, and comprise a number of products, chiefly scientific instruments and apparatus and material necessary for medical and research work. It was intended to protect in particular those industries in which the War had revealed that this country was inferior as compared with Germany. Duties at the rate of 33½ per cent *ad valorem* were imposed for a period of five years in the first instance; in 1926, when they were due for reconsideration, a committee appointed by the Board of Trade examined the position, and recommended that they should be extended for a further five, and if possible ten, years. The latter recommendation was accepted by Parliament.

The safeguarding duties under the (second) Safeguarding of Industries Act were brought into being by methods different again. Part II of the Act of 1921 was a measure aimed at the dumping of goods from countries with depreciated currencies, which was then anticipated. It was for a period of three years, and came to an end in August, 1924; it was later declared by Mr. Lloyd George, who was the head of the government responsible for the passing of the Act, that exchange-dumping had never been the danger that had originally been feared. In any case, the menace of large-scale dumping owing to inflation by European countries had practically ceased to exist when the Act of 1925 was passed.

The King's Speech at the opening of Parliament in December, 1924, when the Conservative Party had been returned to power in the General Election of the preceding month, made mention of a proposed "Bill for safeguarding employment in efficient industries." In February, 1925, the Board of Trade issued a White Paper (No. 2327), which stated that it was the intention of the government to impose duties for the safeguarding of industries only if satisfied that the duties ought to be imposed, and only for a limited period. The Board of Trade was to set up a committee to examine the position of any industry that applied for safeguarding, if satisfied that a *prima facie* case for investigation had been made out. Rules were laid down as to the tests to be applied by the Board in making this decision, and as to the considerations to be observed by any Committee in making such an inquiry. A committee was to consist of not more than five persons appointed by the President of the Board, no one who might be materially affected by anything done in consequence of the Committee's report being eligible. A Committee determined its own procedure; its sittings were to be held in public, except during the hearing of evidence of a confidential character.

The conditions that must be satisfied by an applicant industry can be summarized thus—

- (i) It must be of "substantial importance," having regard either to volume of employment or nature of product.

✓(ii) The competition of foreign exports is "exceptional" and causing, or likely to cause, serious unemployment.

✓(iii) The competition is "unfair," owing to differences between foreign and British conditions of production.

The instructions to the committees amplify these conditions. The tests to be applied in respect of the last—and most important—are, briefly, that competition is unfair when it arises from—

(i) Currency depreciation giving a bounty on exports. ✓

(ii) Direct bounties and subsidies from governments. ✓

(iii) Inferior conditions of labour. ✓

It was always to be ascertained that the industry was being carried on with "reasonable efficiency and economy."

When the reports of the various committees that have been set up under this Act are examined, considerable differences are found in the way in which these considerations have been applied—even the employment criterion which figures so much in the instructions—and conclusions reached. With a different personnel in each case, without a common secretariat, and no well-established and well-understood procedure, it would, indeed, be difficult to conduct all the inquiries on the same lines. The absence of official data made it necessary in some cases to accept figures supplied by the applicants, which—as in the cases of the cutlery, the lace and embroidery, and the enamelled hollow-ware, industries—were subsequently found to differ from those returned for the Census of Production. The enamelled hollow-ware industry was, in fact, not considered to have made out a claim when first examined, in 1926; a second inquiry in 1928, however, resulted in the imposition of a duty of 25 per cent *ad valorem*.

As the work of the committees is not co-ordinated in any way, the actual duties recommended are not related to one another, and cannot be said to form any kind of system. The 33½ per cent *ad valorem* duty is the most popular, though lower rates have been imposed. The Committee on Tableware of Translucent Pottery, it is interesting to remark, recommended a specific duty of 28s. per cwt. (estimated to be

approximately equal to 33½ per cent on the main classes of imported pottery), because the opponents of the application pointed out that a flat *ad valorem* rate would bear very heavily on some high-grade imports, such as Royal Copenhagen china, in which British manufacturers did not compete. Again, the duty on gas mantles was a specific duty of 6s. per gross.

Unsuccessful applications for safeguarding were made by the worsted industry, the hosiery industry, the Aberdeen granite industry, the superphosphates industry, and the light leather goods and metal fittings industry. Their committees considered that they failed to substantiate their claims under one or other of the heads of substantial importance, unfair competition, or serious unemployment.

The recommendations, as accepted, are legislated by Parliament as Safeguarding of Industries (Customs Duties) Acts, and it is by virtue of these statutes that the duties are chargeable. It cannot be said that, any important effect has been produced on these tariff developments at this stage; the reports and recommendations of the committees have been debated and criticized, but, being presented as government measures, have passed into law. This is hardly to be wondered at, since the presumption is that during their inquiries, which sometimes last for several months, at which the case for and against the duty is argued by counsel representing trade bodies or interested parties on either side, the Committee have thoroughly explored the position, and recommend only duties that are justifiable according to the White Paper. The work of Parliament, therefore, becomes merely the implementing, in due form, of the findings of the committees. But, as has been suggested, in the circumstances we have small justification for presuming that the committees collectively built up a co-ordinated tariff structure such as would secure the objectives of safeguarding, as defined in the White Paper.

The duties were legislated for a period of five years, the various dates of expiry falling between 30th June, 1930 (duty on lace and embroidery) and 12th June, 1933 (duty on enamelled hollow-ware.)

The next four headings are similar in origin, in that they are not the outcome of any special procedure, being introduced by the responsible minister as Government measures; but they comprise duties differing considerably from one another in nature and purpose. The silk duties, first imposed in 1925, include customs and excise duties on real and artificial silk, and manufactures thereof. These commodities were selected as being of the nature of luxuries, which were suitable objects of taxation, primarily for revenue. The duty on hydrocarbon oils was imposed in 1928 for similar reasons, but, as no corresponding excise was levied, a degree of protection to home producers was therefore afforded.

The "Runciman" and "Gilmour" emergency duties arose out of the peculiar situation of the autumn of 1931. Following upon the suspension of the gold standard by this country, the value of the £ sterling in terms of such currencies as still remained on gold fell steadily for the next three months; the dollar exchange reached its lowest point at \$3.23, the franc exchange its lowest at Fr. 82.62, in December.<sup>1</sup> These exchange movements were due in part to the continued operation of the same forces that, by throwing an excessive strain on the maintenance of the gold standard, had brought about its suspension, in part to the special conditions of that autumn. The General Election was fought on the question of the way in which the financial crisis, and in particular the currency aspect, should be dealt with, and the National Government was returned to take action to "save the pound," among other things. The means envisaged to improve the foreign exchange position included a tariff, possibly of a temporary character, the argument being that, now that England was

<sup>1</sup> There was, subsequently, a recovery to a level of about \$4.20 and Fr. 97 at the end of March, 1932, which was not maintained in the following month, during which francs remained fairly steady, a little above Fr. 90 to the £, the dollar fluctuating under \$4 to the £. But with the introduction of the general tariff new conditions had been created, not wholly comparable with those of the autumn and winter of 1931-2. Moreover, in April the Government set up an Exchange Equalization Account, the operation of which restricted exchange fluctuations.

off gold, the external value of sterling was determined from day to day by the balance of payments, and that the most direct method of affecting the size of the balance was to restrict imports. (A tariff was being advocated on other grounds as well, but the argument relevant to the special features of the situation was that which regarded it as a means of "correcting the balance of trade.") But, even the simplest tariff cannot be devised overnight, and it was feared that, in the meantime, foreign exporters would rush goods into this country. These "abnormal importations" in anticipation of the imposition of a tariff would mean a correspondingly abnormal purchase of foreign currencies by British importers, which would tend to drive down the value of the £ sterling for the time being; accordingly, power was sought to prevent this. The Abnormal Importations (Customs Duties) Act was passed in November, under which the President of the Board of Trade (Mr. Runciman) was empowered to issue Orders imposing duties not exceeding 100 per cent *ad valorem* on imports of manufactured and mainly manufactured goods. The Act was to remain in force for six months only. In addition, the Horticultural Products (Emergency Customs Duties) Act gave similar powers to the Minister of Agriculture (Mr. Gilmour), though in this case the duties were specific, and the Act applied for a year. By a series of Orders during November and December under these Acts, duties of 50 per cent *ad valorem* were imposed on a large variety of manufactures, the imports of which at this time were considered to be abnormal, i.e. markedly in excess of the usual quantities imported for that part of the year, and duties were imposed on luxury horticultural imports such as flower-bulbs, broccoli, and tomatoes, applying for those months of the year that correspond to the season of the products.

Meanwhile, a Bill to provide for a general tariff, and to set up a special advisory body to deal with further tariff developments, was prepared, and introduced as a Government measure early in February, 1932, becoming law on the 29th of the month as the Import Duties Act. Here we are concerned with

the machinery set up, and the tariff system to which this Act contributes new features, rather than with the details of the measure; the main scheme must, however, be indicated briefly.

It is provided that a duty of 10 per cent *ad valorem* shall be charged on imports, as provided in the Act, as from 1st March, 1932 (Sect. 1). Imports not so chargeable are those on the Free List (given in the First Schedule to the Act), and those already chargeable under any other Acts. An Advisory Committee—of which more is said below—is constituted (Sect. 2), which has the power to recommend that duties additional to the 10 per cent general duty should be imposed on goods (Sect. 3), and also that such additional duties should be varied or discontinued. Imports from the Dominions, India, and Southern Rhodesia are exempt from the general or any additional duty until 15th November, 1932, or any later date fixed by Parliament (Sect. 4)—that is to say, preference is granted to those territories until that date (whatever it may be). Before the date when this provision ceases to have effect, preferential arrangements may be made; it was understood at the time when the Act was passed that such arrangements would probably be made at the Imperial Conference at Ottawa in July, 1932. Preference is given to the Colonies without a time limit (Sect. 5). Power is taken to give preference to foreign goods (Sect. 7), and, on the other hand, to impose supplementary duties on imports from foreign countries discriminating against British exports. (Sect. 12.)

The above form the salient features of the Act, the sections not referred to dealing either with the functioning of the Advisory Committee, or with technical questions such as methods of valuation, which have their place elsewhere in this book. The Free List includes, broadly, foodstuffs and raw materials of industry, the precious metals and stones, and certain products of an educative character. The more important items are: Wheat in grain, maize in grain, meat (not including extracts, essences, or tinned meats), raw cotton, raw flax and hemp, raw wool, wood pulp, rubber, metallic ores, and coal and coke. Tea is included, but was taxed by

Mr. Chamberlain's Budget of 1932. Books, newspapers, periodicals, and scientific films represent imports of a class excluded from nearly all tariffs, for obvious reasons.

The machinery for tariff-making set up by the Act is under the control (under Parliament) of the Treasury. The Import Duties Advisory Committee consists of a chairman and not less than two or more than five other members appointed (and removable) by the Treasury, to hold office for three years in the first instance. (The Committee appointed on the 1st March consisted of Sir George May as Chairman, Sir Sydney Chapman, and Mr. Allan Powell.) The Committee makes its own rules of procedure for carrying out its functions of considering "the advisability in the national interest of restricting imports into the United Kingdom and the interest generally of trade and industry in the United Kingdom," and recommending additional duties accordingly to the Treasury. The Treasury may then, if they think fit, after consultation with the appropriate Department, make an Order levying an additional duty on goods specified in the recommendation. The Order may impose a duty less than that recommended by the Committee; it cannot impose a higher duty. The Order is laid before Parliament as soon as possible after it has been made and, unless approved by resolution of the House of Commons within 28 days from the date on which it is made, it ceases to have effect. (Sect. 19.)

As we have seen, one of the most important sides of tariff-making is the preliminary investigation of trade conditions. Powers in this connection are given by the Act to the Advisory Committee and also to the Board of Trade. The Committee may "require any person to furnish them with returns or other information or . . . to attend as a witness before them," or before a person authorized by them, and evidence may be taken on oath (Sect. 2, subsect. 7 & 8). Sect. 10 of the Act empowers the Board of Trade to collect information "as to the condition and progress of trades and industries engaged in the manufacture in the United Kingdom of goods of a class or description which, if they were imported into



the United Kingdom, would be chargeable with a duty of customs" under the Act, by requiring from any factory or workshop engaged in such manufacture returns as to quantity and value of output, quantity and cost of materials used, quantity and cost of fuel and electricity consumed, and numbers employed. The information obtained in respect of any year is to be presented to Parliament.

The first recommendations of the Advisory Committee were made on 8th April, 1932, and on 19th April the Treasury made an Order for the imposition of additional duties as recommended, ranging from 5 to 23½ per cent on a long list of commodities,<sup>1</sup> chiefly manufactured or mainly manufactured articles. These were duly approved by a resolution of the House of Commons, and so brought into being higher levels of duties than 10 per cent over a wide range of imports. As they were, in a number of cases, goods which had been taxed 50 per cent under the Abnormal Importations Act, however, the new rates represented, to some extent, a lowering of the tariff barrier set up at the end of 1931.

It is clear that in the Advisory Committee we now have a body very similar to the Tariff Boards or Commissions of our Dominions and of the United States. The Advisory Committee is permanent, and its work is of general reference, not *ad hoc*; it is the initiatory body in the actual work of tariff construction. It appears that meetings and investigations of the Committee will be conducted *in camera*,<sup>2</sup> and that reports of proceedings will not be published; nor may information relating to any particular business obtained by the Committee or the Board of Trade be published without consent of the owner of the business. This is in accordance with the practice of the various Safeguarding Committees, which published only their conclusions and recommendations. While

<sup>1</sup> There are included 97 separate headings, many subdivided, in the schedule of duties attached to the recommendations (Cmd. 4066).

<sup>2</sup> It was announced at an early stage by the Committee that it was not proposed to hold formal hearings, as a rule; applications for changes in duties—preferably from representative trade bodies—were asked for in writing.

presumably necessary to ensure that all information required shall be supplied to the Committee without prejudicing the business of the informant, this lack of publicity is regrettable in that it makes it impossible for Parliament or the public at large to form an opinion of the efficiency of the Committee's methods. Not the least useful part of the publications of a Royal Commission is, generally, the Minutes of Evidence taken, and if the Advisory Committee develops on the lines at present laid down, it can hardly fail to become a permanent Commission on the economic life of Britain, in so far as that is affected by tariffs. If the preliminary investigations of the Committee, and the material they will yield, at least, were published, a great deal of valuable information would be made available to the legislator, to the business man, and to the student.

Briefly to classify the British tariff system, as it has developed in the period 1915 to 1932, is not easy. In character, it is now (1932) a mixed tariff, the protective section of which is being extended and intensified. In form it may be classified as an autonomous bilinear tariff, the various preferences granted to the Colonies and Dominions giving the lower level of duties chargeable. The provisions in the Import Duties Act relating to the power of the Treasury to grant preferences to imports from certain foreign countries, on the recommendation of the Board of Trade (Sect. 7), presumably are intended to open the way for negotiations for tariff reductions, and this may bring about a development of our tariff into a general conventional system. The same development may conceivably arise in the case of the Dominions.

It appears from their observations in their first Recommendations (Cmd. 4066) that the Committee contemplate an extension of the general tariff as the duties under other measures, such as the Safeguarding Act, 1925, expire; in so far as this occurs, the tariff will become more homogeneous. But, until the number of headings under which duties are levied is reduced, the British tariff will remain the most variegated of structures, without organic unity and of uncertain effect.

## CHAPTER IX

### PROBLEMS OF TARIFF-WORKING

- (1) VALUATION—(2) Specialization—(3) Classification in tariffs—  
(4) Allowances and drawbacks—(5) Dumping.

"What is to be the classification of the goods to be withdrawn? What drawbacks, if any, are to be given? What exemptions are to be granted? The answer to every one of these questions is not so simple as it looks."—RT. HON. WALTER RUNCIMAN in the House of Commons, 16th November, 1931.

THE actual working of a tariff system presents many interesting questions, the answers to which will probably determine in part the form of the tariff. Thus, as we shall see, it is partly administrative considerations that have brought about the movement away from *ad valorem* rates that is a feature of recent tariff history. Since the practical problems that arise in the administration of a tariff are legion, it will be possible to consider only the main types involved. These may be classified under the headings of valuation; specialization, and discrimination; allowances and drawbacks; dumping.

#### 1. Valuation.

There are two main bases of valuation for custom purposes—  
✓(a) Official valuation, a list of prices of commodities being drawn up by the tariff authority, and used by officials as a basis of calculation of duties payable.

✓(b) Valuation by importers' declarations, with or without check by customs officials.

The discovery of the exact value (however "value" is defined) of the goods is of prime importance in the case of *ad valorem* duties, since if too low a value is taken, a given rate will give a smaller revenue and less protection than it was intended to do. ✓ But it may also be of the same importance under specific duties, since these may be differentiated according to the values of various qualities or classes of the dutiable commodity. In general, however, a specific duty will be based

on some measurable physical characteristic, and so the valuation problem will not arise (so far as the tariff is concerned). It is on this account that specific duties are easier to administer.

✓ (a) Where valuation is required, the method of official valuation has largely been abandoned (it formerly obtained in the tariffs of South American states), owing to the difficulty of ensuring any close correspondence between official and actual values. Very frequent revision, i.e. more often than once a year, is usually impracticable.

✓ (b) Valuation by importers' declarations may be based on a variety of values, not all of which give the same result. Thus, the value that the merchant is required to declare may be the import value (or the export value), calculated inclusive of certain specified costs.

Import value is usually reckoned as being the c.i.f. value of the goods either at the time of arrival at the port of importation, as in the case of Japan, or at the date of exportation, as in the case of Canada. Import values are not necessarily inclusive of all charges to the port of destination; they may be calculated by including only certain specified costs, or by adding a percentage to the value of the goods as otherwise determined, the percentage representing part or all of the costs of shipment to the port of importation. The last method is used by Australia, where the value of imports for tariff purposes is taken as being the fair market value of the goods in the exporting country f.o.b. at the port of export, *plus* 10 per cent of such market value.

Export (Shipment) value is usually reckoned as being the f.o.b. value of the goods at the date of exportation, or at the date of purchase, or at the date of shipment. Whether these three dates can ever be different will depend on the meaning of the term "exportation" in the tariff regulations of the importing country. Thus, when the purchase of goods abroad by importers is *not* considered to be exportation from the country in which the goods are purchased, the date of purchase may be several days or weeks prior to the date of

export, and the value of the goods may have changed over the intervening period. In practice, the date of export, which is taken as being the date of shipment, is almost always the basis selected.

The "Fair market value" that appears in the regulations of several countries as a basis of export and of import values, deserves a further description. A typical definition is that used in the Canadian tariff. It is the "fair market value (of goods) as sold for home consumption" at the time and place of direct exportation to Canada. It must include (i) the amount of any drawback allowed by any other country; (ii) the consideration or money value of any special arrangement between exporter and importer or any interested persons; (iii) the amount or money value of any "so-called royalty, rent, or charge for use of any machine or goods of any description," actually or usually charged when the machines or goods are sold or leased or rented for use in the country of direct exportation; (iv) the amount of any excise duty or tax paid or payable on goods sold for home consumption.

The American method as represented by the Tariff Act of 1930 is to take as basis the foreign value or the export value, whichever is the higher. The foreign value is the market value or the price (at the time of export) at which such and similar merchandise is freely offered for sale in the principal markets of the exporting country; the export value is defined in almost exactly the same terms. When neither can be satisfactorily determined, the United States value, or if this cannot be determined, the cost of production, is taken. Cases where it is not possible to determine the "fair market" or "foreign," or "export," value are likely to be rare, but they do occasionally arise. Some commodities entering into international trade may not be "freely offered for sale" in any market, because in the domestic market (the exporting country), if there is any domestic consumption, they may be transferred within an integrated combine, or among members of a cartel, at a purely nominal figure; while in the country of import they may be consumed solely by agents of the

exporters or producers, in which case again any prices quoted are purely nominal. Thus, the Board of Trade Committee on the Safeguarding of Industries Act, 1921, reported in 1926 that it had been represented to them that the *ad valorem* duties under the Act had operated unfairly in the case of the chemical industry, because foreign firms with branches or sole agents in this country invoiced chemical goods destined for these branches or agents at a figure much below their true value. The Committee added that they understood that in such cases customs officials tried to fix a proper value.

The value of goods dutiable under the British general tariff is defined by Sect. 15 (1) of the Import Duties Act as being "the price which an importer would give for the goods on a purchase in the open market if the goods were delivered to him at the port of importation, freight, insurance, commission, and all other costs, charges, and expenses incidental to the purchase and delivery at that port (except any duties of customs), having been paid"—that is, the basis is the import value.

In determining what price an importer "would give for the goods on a purchase in the open market" the Customs authorities are to have regard not only to the importer's declaration, but also to (a) the price being paid by other importers at the same time for the same kind of goods; or (b) the price at which such goods are being marketed in the United Kingdom, taking into account the duties paid and reasonable expenses and profits of marketing after importation; or (c) failing the discovery of the market price, the price at which such goods wholly or partly produced in the United Kingdom are being put on the market, taking the duty chargeable if the goods had been imported, and reasonable expenses and profits, into account, as before.

Customs regulations relating to merchants' declarations assume that there will normally be no difficulties arising in the actual calculation of the value of dutiable imports, once the basis of valuation is defined. This will be the case when the countries concerned are on the gold standard, since the

exchanges will be stable (within very narrow limits), and the conversion of invoices made out in foreign currencies into the currency of the importing country will present no difficulties. But when the importing country is not on the gold standard, and its exchanges can therefore fluctuate appreciably day by day, it is necessary to lay down rules as to the method that shall be followed. In the case of Great Britain, the Customs authorities have adopted the practice of converting foreign currencies into sterling at whichever of the previous day's rates is most favourable to the importer. For example, the rate of exchange between sterling and marks varied between  $15\frac{1}{2}$  and  $15\frac{3}{4}$  marks to the £ on 26th May, 1932; when an invoice for goods, the price of which was expressed in marks, came to be converted for the purpose of assessing duty chargeable, on 27th May, the rate taken would be  $15\frac{3}{4}$  marks. This would give the lowest sterling equivalent, and therefore the least amount of duty to be paid.

**METHODS OF CHECKING DECLARED VALUES.** When valuation is based on merchants' declarations, there will be a tendency to consistent undervaluation, particularly when the tariff consists of high *ad valorem* rates. There are two methods by which these declarations may be checked.

(a) Appraisement by the Customs officials is a means of checking declared values which is in operation in, e.g. the British and the American systems.

The function of the appraiser, who may be a specialist or who may be a Customs officer with other duties, is to determine the value of goods imported on the valuation basis laid down for the calculation of the duty, and the actual quantity and value of goods passing through his hands. He can thus detect undervaluation due to incorrect valuation or an incorrect return, and the possibility of a declaration's being questioned may prevent a merchant from making a false or incorrect return.

(b) Authentication of documents for Customs purposes is the other method of checking valuations or returns.

The practice is for the Customs officials to require that

invoices relating to goods imported shall be produced, and that these invoices shall be authenticated before the goods are imported. The method of authentication is usually the making of a statutory declaration by the exporter before the consul of the importing country, that the invoice is a correct return and the valuation a true one. The consul is supposed to examine the invoice and verify its correctness; he then certifies that it is correct, and the document becomes a "consular invoice,"<sup>1</sup> which will be taken without further investigation by the Customs officials at the port of import.

It is obvious that the effectiveness of this method depends on (i) the degree of expert supervision exercised by the importing country's consul abroad, and (ii) the extent to which statutory declarations are binding on merchants, and the degree to which penalties can be enforced.

Fraud in declarations is almost invariably punished by a fine, and under some tariff regulations by the forfeiture of the fraudulently declared goods as well. Alternative penalties are the exaction of an increased duty (double or treble that normally due), with or without forfeiture.

Incorrect declarations may be quite *bona fide*, however, and means have been devised whereby such a case can be met. When the merchant's valuation is below the official appraisement, the Customs may exercise a right of pre-emption, i.e. they may buy the goods from the importer at his own valuation. When a merchant considers that the official appraisement is too high, he may (if the regulations permit) exercise the right of abandonment, i.e. he may require the Customs to take the goods at their own valuation. This right cannot always be claimed under systems which give the Customs authorities the right of pre-emption.

Under the Import Duties Act, it is provided that disputes as to the value of imported goods shall be settled by arbitration (Sect. 16). The referee is to be a person appointed by the Lord Chancellor, and shall not be an official of any

<sup>1</sup> This is called a "certified invoice" in the administrative provisions of the U.S. Tariff Act of 1930.



Government department. There is no provision for either pre-emption or abandonment.

## 2. Specialization.

The objects of specialization are these—

(a) It overcomes the deficiencies of simple specific and *ad valorem* duties. The regressive character of specific duties, and the non-progressive character of *ad valorem* duties, can largely be removed by the appropriate classification of commodities into narrowly defined groups, each with its own specialized duty.

(b) Discrimination between different countries can be made, without avowal of the fact, or without the establishment of a preferential tariff, by suitable specialization. Thus, if a particular commodity is imported mainly or entirely from one country, the rates imposed on the group of commodities to which it belongs may be specialized so as to tax the imports from that country more heavily or more lightly, as the case may be, than the goods of other countries.

(c) It is a way of limiting the effects of concessions, Most-Favoured-Nation treaties, and similar arrangements. By specialization of rates so that there is a separate rate for every commodity or class of commodities imported, reduction of duties brought about by bargaining with another country may, in fact, be restricted to imports from that country—if that is the only source of supply of the particular commodities so far as the concession-granting country is concerned—although nominally extended to other nations under Most-Favoured-Nation agreements. Whereas with broad classes of goods under the same level of duty, or a single *ad valorem* rate of wide application, reductions in duties may affect countries which it was not intended to benefit.

METHODS OF SPECIALIZATION OR DIFFERENTIATION. The essence of specialization of rates is, that, instead of having one rate applying to one class of goods of varying qualities or contents, different rates shall be applied to goods according to differences in the goods themselves, which are defined and

graded. The closer and more numerous the gradation, the greater the degree of rate specialization possible, and the more complete the discrimination that can be practised. The definition may be (i) by description, or (ii) by measurement. Which basis is taken will be determined, generally, by the nature of the commodity, i.e. whether it is susceptible of exact measurement, or not.

(i) *Definition by Description* requires a careful use of terms, in order to make clear distinction between different classes which it is proposed to tax at different rates. The terms used in tariff schedules are frequently trade terms, but these are sometimes given official interpretation.<sup>1</sup>

(ii) *Definition by Measurement* gives a greater degree of exactness than verbal description can, and provides a variety of bases for duties. The different bases that can be used have already been referred to, and it is only necessary to summarize them here. Goods may be graded for the purposes of differentiation on the bases of—

- (a) Length, e.g. gloves under United States tariff, 1930.
- (b) Breadth, e.g. watch movements under the same tariff.
- (c) Thickness, e.g. sheets of iron or steel, under Canadian tariff, 1930: two classes—.08 in. or less, and more than .08 in., in thickness.

<sup>1</sup> See Gregory, *op. cit.*, Chapter VI. Discrimination in this way is exemplified by the German tariff of 1906, of which M. Méline, the French minister, remarked: "If you wish, for example, to give preference to the importation of Swiss cattle to the detriment of French breeders, you create a special category at a reduced rate 'for cattle from the region of the high plateau and from the mountains, which belong to the large speckled breed and to the brown breed' . . . For meat, preserves, and game you create a special class with very high duties for 'products designed for higher grade consumption', an absolutely arbitrary and fantastic denomination which clearly seems to be aimed at French products." Quoted by Gregory, *op. cit.*, p. 147: here translated.

A modern instance of the elaboration necessary in this kind of definition is provided by such an entry as this from the Greek tariff as revised in May, 1930: "Furskins, furs, and furriers' wares: (a) 3. Skins of coffee-coloured common foxes, or natural-colour or coloured foxes . . .

NOTE. Category (a) 3 above does not include skins of natural-coloured red foxes (Canadian, Russian, Alaskan, etc.), black, silver, spotted, blue and white foxes, nor white, grey, or pinky fox skins, which are classed under (b)."

(d) Diameter, e.g. pipes and tubes, of wrought iron or steel, under Canadian tariff, 1930.

(e) Weight, e.g. motor-cars, under Spanish tariff of 1930: five classes—up to 800 kg., more than 800 and up to 1,200 kg., more than 1,200 and up to 1,600 kg., more than 1,600 and up to 2,000 kg., more than 2,000 and up to 2,400 kg., more than 2,400 kg.

(f) Number, e.g. matches in British tariff under the Finance Act, 1927.

(g) Specified content, e.g. moisture in tobacco under British regulations.

(h) Specific quality, e.g. the specific gravity of beer under British Customs regulations; the polarization of sugar, the duty increasing with increases in the degree of polarization above 76 degrees.

(i) Value, e.g. clocks in the United States tariff.

(j) Other, e.g. power-consumption of electric light bulbs, in the New Zealand tariff of 1930; not exceeding 8 watts, exceeding 8 watts, and not exceeding 80 watts, and so on.

In theory, gradation could be made, in the case of many commodities, on a basis combining two or more of the above standards, e.g. by weight and length. In practice, however, one attribute is selected for grading, and the duties are specialized according to the grades.

DIFFERENTIATION OF RATES. When a given commodity has been graded or defined, so that different classes are clearly distinguished, the question arises: How are the duties applying to the commodity to be correspondingly differentiated? It is possible to have—

✓(i) *Ad Valorem Duties on an ad Valorem Basis.* A commodity can be classified according to value, and different *ad valorem* rates imposed on the different value-classes. Thus, the lowest-valued goods will bear the lowest rate, the higher classes of goods increasingly higher rates of duty.

✓(ii) *Ad Valorem Duties on a Specific Basis.* Commodities classified on a basis of physical measurement may be dutiable at *ad valorem* rates, a separate rate applying to each class

of goods. This is the most usual practice in tariffs with chiefly *ad valorem* rates.

✓(iii) *Specific Duties on a Specific Basis.* Here the duty is varied according to variations in the physical attribute in terms of which the commodity is graded; for example, under the Polish tariff the duty on "cotton tissues, containing over 15 sq. metres per kg.," varies according to the number of threads in warp and weft in a square of 1 cm. side. The number of threads is divided into the three classes of up to 40, more than 40 and up to 70, more than 70, so that there are three duties, increasing in amount the finer (and therefore the more valuable) the tissue.

✓(iv) *Specific Duties on an Ad Valorem Basis.* It is possible to grade a commodity on the basis of value, and to impose different specific duties on the different value-classes.

The actual differentiation of the rate from class to class, or grade by grade, will be a factor in determining its effect as a revenue, and still more as a protective measure. The duty may be differentiated by equal or by unequal amounts (in the case of a specific duty), or percentages (in the case of an *ad valorem* rate). When the duty does not rise by equal steps, or by steps corresponding to the grading of the commodity to which it applies, it will generally be found that the higher the class, the heavier in proportion is the duty.

### 3. Classification in Tariffs.

The process of classification for tariff purposes may start from the side of the goods, or from that of the rates. In the first case, the goods are classified and then rated, i.e. duties are applied to them; in the second case, the rates are drawn up and dutiable goods are divided among the rate-classes. The schedule of the first type of tariff will show classes of goods, with rates varying within each class; that of the second type will show classes of rates, each of which may apply to a large variety of dissimilar commodities. In practice, it is most common to classify goods, in any general tariff system, since this method makes specialization easier; it is obviously

more convenient for reference by the merchant, who will usually be concerned only with the duties on the particular goods he is importing, not with the relation of these duties to others.

The tendency in all developed tariff systems is for more minute subdivision of tariff headings, with consequent greater specialization of rates; broad classes are replaced by groups of items each with its own duty. Recent tariff revisions have almost without exception meant a material increase in the number of entries in the schedules; thus, in 1927, the classification of the French tariff was made more elaborate so that the number of main articles was increased from 650 to 1,900, and the subdivisions to 6,500, in round numbers. The new Peruvian tariff of 1930 meant an increase in the number of headings from 2,300 to 2,600; the new Canadian tariff of the same year had over a thousand separate numbers, or main items, many of which were subdivided into two or more entries, each with a separate duty. With increasing elaboration of the tariff usually goes its division into main schedules or sections of chapters which will generally be found to correspond to the divisions of official trade statistics. A logical arrangement of some kind or another is obviously a convenience to persons consulting the tariff measure, and if it is drawn up so as to correspond with the trade statistics, it will be easier to draft and revise. But the question arises: How shall the tariff schedule be drawn up? Goods can be grouped in a variety of ways; which logical arrangement—out of the several possible—is to be selected?

There are four principal methods that may be followed. We can classify goods according to material origin; or according to actual content; or by use or purpose; or by degree of finish or stage of manufacture.

By material origin is meant that goods derived from the same physical substance are grouped together, e.g. all articles made of or from wood might be brought into one division of the tariff. In practice, where dissimilar products are derived from the same material origin—such as furniture and paper

from wood—they will be separated. This basis is the one adopted in the United States tariff classification, so far as it can be; the 1930 tariff is presented in fifteen schedules, of which typical headings are: (1) "Chemicals, Oils, and Paints." (3) "Metals and Manufactures of." (5) "Sugar, Molasses, and Manufactures of." (7) "Agricultural Products and Provisions." It may be noted that "Papers and Books" is a separate schedule from "Wood and Manufactures of," and that the "Silk and Silk Goods" of the 1922 tariff has been divided into "Silk and Manufactures of" and "Rayon, etc."

*Actual content* is not the same as material origin, because goods of the same (main) physical origin may change their (chemical) content in the process of manufacture, and will therefore fall under different schedules according to the stage of production at which they are imported. The Australian tariff appears to be framed rather on this basis than on the former, since Oils (Schedule VII), which includes paints and varnishes, is separated from Chemicals, while Earthenware, Cement, China, Glass, and Stone form a single Schedule (VIII).

*Use or purpose* may bring together articles of a very different composition and quality; this may, however, be the most useful way of dealing with imports of manufactured articles, the material content or origin of which is difficult to determine exactly. The Canadian tariff is not drawn up in schedules, but its items are so defined and grouped as to suggest that those who drafted it generally had this criterion in mind. Thus, item No. 403, "Wire, of steel" is divided into four sub-headings, each dealing with a particular sort of wire imported "for use exclusively" in specified ways.

*Degree of Finish or Stage of Manufacture* is an important consideration when what is desired is to protect an industry drawing its raw material from abroad. It is often difficult to define a degree of finish so as to be able to adjust rates to keep the finished product out and let the partly finished product in to supply the home finishing industry. Provided

that no unduly arbitrary distinctions between stages of manufacture have to be made, however, working classification can be made on the basis of foreign trade statistics. In the case of the United Kingdom, official trade statistics are classified in four groups: Class I, Food, drink, and tobacco; Class II, Raw materials and articles mainly unmanufactured; Class III, Articles wholly or mainly manufactured; Class IV, Animals, not for food. This division of commodities other than food-stuffs, broadly speaking, into Classes II and III represents an elementary classification by stage of manufacture, which proved sufficient for the purpose of the 50 per cent emergency duties of 1931. Those duties, designed to check the dumping of foreign manufactures, applied simply to Class III; but it is doubtful whether the existing classification will prove suitable for the tariff schedules if our tariff becomes an elaborate and highly specialized one.<sup>1</sup>

In practice, no classification, either for a tariff or for trade returns, keeps rigidly to a single principle, and even the most elaborate usually contain a residual category in which can be put miscellaneous items not classed under other heads.

TREATMENT OF NON-ENUMERATED ARTICLES. It will be found that, even in the most exhaustive schedule, there are some articles that are not entered, and if these should be imported, the question arises: Are they dutiable or not? There are two principles represented by the practice of different countries: the principle of inclusion and the principle of exclusion. Under the first, all goods not on a "free list" are dutiable, whether stated or not. The non-enumerated articles may then be treated as a class by themselves, with a special duty or duties applicable, or they may be assimilated to the enumerated articles and charged the corresponding duty, or they may be provided for in both ways, i.e. assimilated

<sup>1</sup> In this connection it is interesting to note that the Advisory Committee contemplate the preparation of more detailed schedules for machinery, for the purposes of the tariff, than are at present used. They observe that, as the British Engineers' Association divide the whole category of machines under 2,000 headings, "the task will be no light one." (Cmd. 4066.)

(on grounds of use, substance, etc.) if possible, and charged a special rate if not. This last is the American practice. By the principle of exclusion, all articles not definitely enumerated are free. This was the British practice in the past, and is typical of a free trade regime. The principal disadvantage is that a duty may be evaded by substitutes. It has, on the other hand, the advantages that it makes for careful drafting of Customs provisions, and that an importer knows exactly what goods are dutiable, and by how much, without the fear that his calculations will be upset by the assimilation of one article to another by the Customs officials.

**TREATMENT OF MIXED ARTICLES.** Most manufactures contain more than one component, and when different duties apply to the various parts, the question of the assessment of the article for tariff purposes arises. Two methods are possible: the article may be analysed and its components assessed separately; or the article may be taken for the purposes of the duty as represented by the chief component and charged the single duty applicable. This may mean that the article is taxed as if it were entirely composed of the chief component, or that only the actual amount of the component may be dutiable. The type of problem that arises is represented by the case of manufactured goods containing silk and artificial silk, e.g. silk-lined handbags, under the British silk duties. The solution adopted in that particular case is a compromise between the two sorts of treatment just described. Different rates of duty on the value of the manufactured article are charged, according to the proportion of the total value of the goods which the silk represents. If the silk contents represent not more than 5 per cent of the value of the article, the duty is 2 per cent *ad valorem*; if more than 5 per cent but not more than 20 per cent, the duty is 10 per cent *ad valorem*; if more than 20 per cent, the duty is 33½ per cent *ad valorem*.

**TREATMENT OF PARTS AND WHOLE.** Constituent parts of some articles are of no use in themselves, and can be consumed only when they have been assembled, e.g. pairs of boots,



machinery; the way in which they are treated under a tariff may, therefore, affect the development of an assembling industry within a country. In some tariffs, lower rates are levied on parts than on wholly assembled commodities in order to create or protect an assembling industry; this is the case in the Australian tariff on motor-chassis. Otherwise, it is usual to bring constituent parts under the same duty as the complete article; thus, under the McKenna duties, the components, parts, and accessories of motor-cars and motor-bicycles, clocks and watches, and musical instruments are dutiable at the same rate as the main article.

**TREATMENT OF PACKING AND CONTAINERS.** Reference has already been made to the different practices as to treatment of wrappings discoverable in various tariff systems. The question as to whether containers, wrappings, etc., are dutiable or not is to be answered in general by reference to the way in which they are treated when the weight of goods is being determined. If they are included in the weight, and the duty is based on weight, this may constitute a considerable burden on imports, particularly in the case of that increasing category of goods that can be transported only in special containers, such as prepared or preserved foodstuffs. When a tare allowance off the gross weight of the packed goods is given, and this is less than the weight of the packing, it means that the goods are paying more than the amount due on their net weight. When the packing, containers, etc., are taken separately, and assessed for duty, the burden is likely to be small, particularly with *ad valorem* duties, as the value of packing cases or materials is usually very low.

While the question is most frequently important where specific duties are levied, it does sometimes arise with *ad valorem* duties, as in the case of the Canadian tariff. But, in that case, on such items as "vegetables, fresh, in their natural state, the weight of the packages to be included in the weight for duty," which bear a 30 per cent *ad valorem* rate, it is provided that in most instances "the duty shall not be less than" so many cents per lb., which gives in effect an alternative

specific duty, the amount of which will be determined partly by the packages in which the goods are imported.

#### **4. Allowances and Drawbacks.**

There are some trades and industries which would obviously be directly injured by the operation of a tariff, rather than protected; these are principally those finishing and improvement industries which draw raw materials from abroad, and sell their products in foreign market. It is necessary in order to allow them to compete against producers in other countries to exempt them partly or wholly from the ordinary tariff regulations. (This assumes that producers cannot avail themselves of bonded warehouse accommodation, or free ports or zones, for the carrying on of their trade.) Two main ways of effecting this are to be found in protectionist systems: the special treatment of goods entering into improvement trade, and the system of "drawbacks" or refunds in respect of duties paid on articles imported to be re-exported. The special treatment of improvement trade means that goods imported to be finished and exported are allowed in free of duty or at lower than ordinary duties. This is preferable to the other method from the merchant's point of view, as the drawback on duties already paid may not be received for some considerable time. This may represent a serious locking up of capital in the case of a firm engaged in purely entrepôt trade. The two methods have peculiar advantages and disadvantages from the point of view of the authorities, however, and it is the consideration of these that usually decides which is adopted.

IMPROVEMENT TRADE (*Admission Temporaire*). When goods are imported free of duty (or at reduced duty) in order to be re-exported, perhaps after undergoing some process of manufacture, the problem is: How can the re-export of those goods be ascertained? How can evasion of duties properly chargeable be prevented?

There are two principles on which the regulations may be based—

✓(i) The principle of identity. The free imports are marked

distinctively, so that the actual commodities imported can be checked against those exported.

(ii) The principle of equivalence. Given a certain quantity of imports, an equivalent quantity must be exported, the equivalence of imports and exports being checked by the issue of certificates.

It is clear that the principle of identity can be applied only to some classes of goods. Most bulky raw materials, e.g. coal, cannot be identified by consignments, and some commodities change form and content in the course of improvement, e.g. wheat made into flour. But difficulties arise when the principle of equivalence is applied to such commodities, especially where they are also produced within the country concerned. Goods under improvement trade are not always imports which are going to be re-exported; there are also cases where goods are exported for improvement to be re-imported and where these re-imports are desired to be relieved from the burden of the ordinary duty.

**IMPORT AND EXPORT CERTIFICATES.** The general method of working a system of import and export certificates (or "free clearance certificates") is that the importer of goods for re-export, or exporter of goods for re-import, obtains an import or export certificate—as the case may be—allowing him to import a certain quantity of a dutiable commodity free, provided that an equivalent quantity is exported (or to export a certain quantity, provided that an equivalent quantity is re-imported). In order to avoid over-elaborate propositions, we will confine our attention henceforward to home improvement trade, i.e. to importing goods for re-export.

A natural development of the idea of equivalence is to make certificates transferable, so that a merchant who did not eventually export amounts corresponding to his imports could dispose of the certificates, representing the excess of imports to be re-exported, to anyone who wanted them. In theory if, e.g., iron or wheat was exported from France or Germany (countries which were the principal users of the

system before the War) to an extent equivalent to the free imports, the position was no different from what it would be without free imports, even if all the imported coal or wheat was consumed within the country, and the exports were of French or German products. But, in fact, the system did produce differences in the trade in goods so dealt with, on account of two facts.

When the equivalent exports were of the imported commodity in an advanced stage of manufacture, e.g. wheat as flour, coal as coke, it was impossible to be certain that exact equivalence was obtained. The exports might represent lower grades of the commodity than the corresponding imports, e.g. the coke might, in fact, have been produced from cheaper (local) coal. If a fixed ratio between raw materials (imported) and finished products (exported) were adopted, improvements in production would make the real ratio different from the official one, e.g. fewer tons of iron ore might be required to produce a given quantity of steel than was supposed to be the case. In the case of materials produced at home as well as imported, the effect of such developments is to make merchants and manufacturers buy abroad (importing under certificates) rather than at home.

When merchants were allowed to export commodities from one part of the country, obtaining a transferable certificate, the tendency was for speculation in certificates to arise. For example, in the case of Germany wheat might be exported from East Prussia, instead of being sold in the Rhine valley, a certificate being obtained allowing the free import of an equivalent quantity of wheat from France into the Rhine valley. The German home market price for wheat was higher than the world price by the amount of the import duty. Thus, if the world-price of wheat was 30 marks per kilogramme and the duty 5 marks per kilogramme, the exporter sold a given quantity of wheat abroad at 30 marks, and the holder of the certificate imported an equivalent amount duty free to sell in Germany at 35 marks per kilogramme. But the double transaction might be more profitable than to sell wheat,

grown in East Prussia, in the Rhineland, because the cost of transporting the wheat from East Prussia to its foreign market *plus* the cost of transporting wheat from France to the Rhineland might be *less* than the cost of shifting wheat across Germany from the region of its production to the Rhine valley. Whether this development in fact occurred at any time would clearly depend upon transport costs and the foreign markets for German wheat; but such a position *could* arise, and the result was that a trade in certificates took place, to take advantage of a profit that might be reaped, exports sometimes being made simply to gain an import certificate.

The unsatisfactoriness of this led to the abandonment of the system in Germany after 1910, while it had been modified in France after 1902. It will be noticed that similar developments might arise out of a system of transferable certificates for the import of foreign wheat, or other commodity also produced at home, under a quota system. Whenever, owing to changes in prices, or to differences in costs, it is possible to obtain a profit out of dealing in certificates giving the right to import amounts of a commodity, there will tend to be speculation in such certificates.

FREE IMPORTATION UNDER THE BRITISH TARIFF. The Import Duties Act allows for dutiable goods to be imported free in the following circumstances—

✓(a) Where the goods are consigned direct to a "registered shipbuilding yard" for use in the building, repairing, or re-fitting of ships, according to whatever conditions are laid down by the Customs authorities (Sect. 11).

✓(b) Where the goods are imported solely for re-export after transit or transhipment, or if undergoing any process in the United Kingdom, are re-exported without being changed in form or character (Sect. 13).

(c) Where the goods are being re-imported after export from the United Kingdom, and have not been subject to any process abroad. Where they have undergone any process abroad, but their form or character has not been changed,

duty is chargeable only on the amount by which their value has been enhanced by the process (Sect. 14).

A place is a "registered shipbuilding yard" if it is so registered by the Customs authorities on application being made to them, and on its being shown to their satisfaction that the premises are occupied and used for the building, repairing, and fitting of ships. Goods not consigned direct, but brought into a registered shipyard from some other place in the United Kingdom, may be treated by the Customs as if they had been exported, for the purpose of allowing drawback. In other words, if the goods are of a class on which drawback is allowed on re-export, this allowance may be made on dutiable imported goods which do not go direct into a registered shipyard, but which are ultimately brought into it.

It should be noticed that concessions relating to goods going into registered shipyards, and to goods imported for re-export, are granted at the discretion of the Commissioners of Customs and Excise. The Act does not say that they shall be granted, as it does in the third case, under Sect. 14.

**DRAWBACKS.** Drawbacks are refunds of duties paid on imports: (i) of raw materials, when these are worked up into a finished product which is exported; (ii) of finished articles not consumed within a country, and re-exported. Generally speaking, drawbacks will be given when it is desired to build up finishing trades; being alternative to the system just described, we find them in the tariff regulations of countries where improvement trade as such is not recognized, notably the United States, the United Kingdom, and the British Dominions.

The practical difficulties are those concerned with the treatment of mixed or finished goods, of which the raw materials were imported. If drawbacks are granted on some or all of the constituents of the exported article, the different quantities of the imported materials entering into the finished product must be assessed—sometimes a matter of great difficulty. Secondly, if a raw material is imported, worked up, and exported in a refined form, an official ratio between raw material and finished product must be established, so as to

determine the amount of drawback to be paid on the export of a given quantity of the final product. It is clear that if a certain amount of raw material produces more of the finished product than it should according to the official calculations, the drawback paid will be more than in proportion to the duty paid. A concealed subsidy will thus be given to exporters, which will encourage sales abroad (probably at a low price made possible by the bounty) as against sales at home. The tendency will be for home prices of the final product to be kept above world prices, and for exporters using imported raw materials to be favoured at the expense of producers working on home supplies (if there are any) or for the home market. There is, however, an incidental advantage; the more efficient the producer the larger the quantity of finished product he will obtain from a given amount of raw material, and the larger the bounty he will gain.

The same effect, of course, is obtained when there is an excise on home production of a raw material entering into an exported commodity, and the drawback is a refund to the exporter of the amount of the excise, which has entered into the price of the home produce which he has bought. This was the case in Germany, the commodity in question being the sugar beet. The positive loss of revenue due to the fact that the drawback exceeded the excise paid, owing to the continuous improvement in the methods of beet-sugar refining, led to the abolition of the system in 1891, and the same thing occurred in France, 1884-97.

The amount of the drawback obviously has an important practical bearing on such developments. It varies from country to country, but, under protective tariff systems, is usually the whole, or nearly the whole, of the duty. Thus, the full amount is refunded in the case of Australia, and 99 per cent in the case of the United States; whereas the drawbacks allowed on British revenue duties, such as those on coffee or tobacco, generally represent appreciably less than the duty charged. The position as regards drawback of duties under the Import Duties Act is governed by the provisions of the

Second Schedule of that Act. It is the function of the Advisory Committee to recommend that a drawback should be allowed on any class of goods dutiable under the Act, and the Treasury may, after consulting the appropriate department, make an Order for its allowance. The Committee are required to "have regard to the general interests of the industries concerned, including the export trade, and to the facilities available for warehousing in bond, and otherwise for enabling goods intended for re-exportation to be dealt with without payment of duty." To qualify for drawback, which must be equal to the whole amount of the duty paid, goods must be re-exported unused, in the same state as that in which they were imported.

### 5. Dumping.

The word "dumping" has passed into popular controversy almost with the connotation of "any successful competition in a national market by producers outside that area." Nevertheless, if dumping is to be dealt with by tariff regulations, it will be necessary to frame a more precise definition, so that we can determine whether or not it exists in particular cases, and how it can best be corrected or prevented.

It is clear that, whatever else dumping means, it means the sale of goods in the area that is complaining of it at prices lower than those at which the same or equivalent goods are being offered elsewhere, or lower than those at which home producers are selling goods. With regard to the first clause, we may note that it may mean (a) sale in a foreign market at prices below those ruling at home (the most common accusation against the dumper); or (b) sale in *one* foreign market at prices below those at which sales are made in other foreign markets, (but not necessarily below home prices); or (c) sales abroad at prices below home prices, and at a loss to the seller.

These various sorts of dumping may arise in different circumstances, and the same methods of dealing with them will not be appropriate in all cases. Both sales abroad at prices



lower than those ruling at home, and sales in one foreign market at lower prices than in others, may be ordinary business practices due to differences in market conditions. Generally speaking, lower prices will be charged for large orders than for small, and if one market takes goods in large quantities and another takes them only in small quantities (as is often the case with the home market) there will be differences in price between the two which do not represent any deliberate dumping or under-selling. What is called "exchange-dumping," i.e. the ability of an exporter in a country with a depreciating currency to sell abroad remuneratively at a price at which other producers cannot compete, is equally not due to a definite policy on his part. It is in any case a temporary feature of currency instability, as has already been explained, resulting from the external value of a depreciating or depreciated currency being lower than its internal value.

Sales abroad at prices lower than those ruling at home, and below cost of production, may be due to export bounties, open or concealed, or subsidies granted by governments. Where they are not, they are usually an attempt to capture or develop a market, an attempt which cannot be of very long duration, unless the producers concerned are prepared to take less than normal returns on their whole output for an indefinite period. Occasionally, however, it may be considered that this form of dumping will not involve net loss, on account of the economies obtained from the larger scale of production on which the successful dumper can work. For instance, if one market, say the domestic market, is limited, and its demand inelastic, while other (foreign) markets are capable of expansion and have an elastic demand, then the cutting of price—and dumping of goods—in some markets will enable goods to be produced on a large scale, and a profit obtained, even though the dumped goods are sold at a price which (if they are considered separately) does not yield a profit.

When the objection to dumping is that it constitutes "unfair competition," this may really mean that one or more of several possible considerations are in mind. When the

conditions under which the dumped goods are produced are, on the face of them, abnormal, such as is the case with exchange-dumping, or when they are affected by government action so as not to be ordinary commercial terms of production, as in the case of subsidies or export bounties, it may, perhaps, be permissible to describe competition from such sources as "unfair." When, however, there is normally a difference, not artificial or promoted by deliberate government action, between the dumper's costs of production and his competitors, to describe any resultant advantage to him as "unfair" is to assume that the industrial conditions ruling in the country where goods are being dumped are to be treated as the economic norm. Lower costs of production, even if they are associated with lower standards of living, ought not to be assumed to be uneconomic. Yet, in practice, most anti-dumping legislation seeks to shut out all competition that successfully clears the general tariff wall; that is, to counter-vail any exceptional advantages enjoyed by foreign producers as compared with home producers.

The actual measures adopted in representative tariff systems may be summarized as—

(i) Positive prohibitions of the import goods made under certain conditions, such as convict-made goods; this is found in American practice.

(ii) Special duties or increases of duties against dumped goods, according to the definitions framed for this purpose. Under this head we may have

(a) ANTI-BOUNTY DUTIES. When goods are exported under a bounty which it is desired to nullify, the importing country may impose countervailing duties. The duty may be simply the exact equivalent of the bounty, where this is known precisely, or it may be calculated so as to raise the selling price of the bounty-fed imports to a defined level (e.g. the current market price of such goods in a particular area). Under the United States tariff, anti-bounty duties are amounts equal to the net amount of the bounty, additional to the ordinary duties on the goods.

(b) DUTIES AGAINST UNFAIR COMPETITION. Unfair competition may be defined with respect to actual trade practices, or with respect to the probable effects on the home market of such competition. The former method is represented by the regulations of the United States tariff of 1916 which imposed an additional duty, equal to double that already chargeable, on goods imported on condition that the importer or buyer should not deal with other sellers of such goods.

The latter method is represented by the Australian provisions, which cover the importation of goods on terms that—

(i) Would ordinarily probably lead to Australian goods no longer being produced.

(ii) Are unfair in the circumstances.

(iii) Would probably or do result in inadequate wages in the Australian industry.

(iv) Would probably or do result in substantial disorganization or unemployment in the Australian industry producing goods in competition with the imports.

This is similar to the point of view of the Safeguarding Committees in this country, 1921 to 1931.

(c) ANTI-DUMPING DUTIES. Simple anti-dumping duties are represented by their development in the Canadian tariff. Here the test of whether the export price of the imported article is less than its "fair market value" in the country of export, has been established.

The broad effect of all such provisions is, to raise the cost of goods imported into a country to the level of the highest price at which the same goods are sold elsewhere, or at which the competing home product would normally be disposed of within the country. In short, anti-dumping duties are local increases—crenellations, so to speak—in the height of a tariff wall.

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(A signifies Advanced.)

THE following suggestions for further reading are limited to books, most of which can be found in any good library. There is a vast amount of polemical literature on Free Trade and Protection, the bulk of which is of small interest and value. Important articles are to be found in the files of such periodicals as *The Economist* (weekly) and *Economica* (quarterly). Particulars of British and other tariff developments are reported week by week in *The Board of Trade Journal*, and accounts of the trade and tariff position of foreign countries are given in the Reports issued by the Department of Overseas Trade, at about yearly intervals, separately for each country. The Dominions also issue official year books, which contain statistical and other information as to trade, and (usually) a review of recent tariff history. The statistics of the overseas trade of Great Britain are available in the Monthly Statements of Trade and Navigation, and, in a summarized form, and for periods of fifteen years, in the Statistical Abstract. (See Note at end.)

### I. THE THEORY OF INTERNATIONAL TRADE.

The classics—

Adam Smith, *The Wealth of Nations*, Book IV.

David Ricardo, *Principles of Political Economy*, Chapter VI.

John Stuart Mill, *Principles of Political Economy*, Book V.

The development of the orthodox theory of international exchange may be traced through these books.

Modern general treatises—

Cannan, *Wealth*, Chapter XIV.

✓ Marshall, *Money, Credit, and Commerce*.

The latter carries the analysis of some problems in the pure theory of international trade much further than do the other works mentioned.

## Special studies—

Bastable (ed. Gregory), *The Commerce of Nations*.

✓ Taussig, *International Trade*.

Taussig's work is in the straight line of descent from Ricardo and Mill so far as the pure theory goes, but he takes the argument further at some points. Part II, Verification, is an attempt to test out the propositions of Part I with reference to certain important events, such as the effect of the payment by France after 1870 of her indemnity to Germany. Part III deals with international trade under inconvertible paper currency conditions.

## 2. MONETARY QUESTIONS.

(1) *The Mechanism of International Settlements: Foreign Exchanges*.

✓ Withers, *The Meaning of Money*.

A general introductory textbook, with a good chapter on Bills of Exchange.

Spalding, *The Finance of Foreign Trade; Foreign Exchange and Foreign Bills*.

Technical studies, dealing with their subjects from the banker's point of view, but containing much interesting material.

Walters, *Foreign Exchange and Foreign Debts*. -

A general textbook of more theoretical treatment than Mr. Spalding's.

✓ Gregory, *Foreign Exchange, Before, During, and after the War*. A.

This deals only with the immediate post-war years; it is not easy reading, but constitutes a valuable training in the logic of the subject.

(2) *The Gold Standard System*.

Gregory, *The Return to Gold* (1925); *The First Year of the Gold Standard* (1927) A.; *The Gold Standard and its Future* (1932).

The second is chiefly a detailed study of the problems arising out of the stabilization of currencies by various nations, including Great Britain. *The Return to Gold* is an introduction to the nature and working of the gold standard system.

(3) *The Balance of Trade*.

This subject is treated in most of the general textbooks. A discussion of the British trade position since the War is to be found in Loveday, *Britain and World Trade*.

A specialist study is—

✓ Boggis, *The International Trade Balance in Theory and Practice*. A.

## 3. PROTECTION AND FREE TRADE.

Nathan, *Free Trade To-day*.

A restatement of the Liberal point of view, with a good deal of information about safeguarding (to 1928).

Brooks, *This Tariff Question*.

An able presentation of the modern case for Protection.

✓ Beveridge and others, *Tariffs: the Case Examined*.

All the aspects of the contemporary English Protectionist arguments and proposals examined one by one, by a committee of economists under the chairmanship of the Director of the London School of Economics.

Historical studies—

Ashley, *Modern Tariff History*. A.

A study of the tariff histories of some leading countries.

Fuchs (trans. Archibald), *The Trade Policy of Great Britain and Her Colonies Since 1860*. (1905.)

Young, *Great Britain's Recent Trend Towards Protection*.

A readable survey from the American standpoint.

#### 4. TARIFFS.

General textbooks—

✓ Gregory, *Tariffs: a Study in Method*. A.

A very elaborate treatment of the technical problems of tariffs.

A standard work, indispensable to the serious student. It deals with developments up to 1921.

Fisk and Peirce, *International Commercial Policies*.

Somewhat similar to *Tariffs*, but covering a wider field in much less detail. Written from the American viewpoint, so the United States bulks large.

Special studies—

Higginson, *Tariffs at Work*.

A little book on Customs practice, based on pre-war experience.

Taussig, *Some Aspects of the Tariff Question*.

Essays on the history of various American industries under the tariff.

✓ Viner, *Dumping, a Problem in International Trade*. A.

A standard work, containing a thorough examination of the whole subject up to 1923.

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