

INTERNATIONAL ECONOMICS

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CAMBRIDGE ECONOMIC HANDBOOKS

INTERNATIONAL ECONOMICS

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INTRODUCTION TO THE SERIES

THE Theory of Economics does not furnish a body of settled conclusions immediately applicable to policy. It is a method rather than a doctrine, an apparatus of the mind, a technique of thinking, which helps its possessor to draw correct conclusions. It is not difficult in the sense in which mathematical and scientific techniques are difficult ; but the fact that its modes of expression are much less precise than these, renders decidedly difficult the task of conveying it correctly to the minds of learners.

Before Adam Smith this apparatus of thought scarcely existed. Between his time and this it has been steadily enlarged and improved. Nor is there any branch of knowledge in the formation of which Englishmen can claim a more predominant part. This Series, however, is not directed towards making original contributions to economic science. Its object is to expound its elements in a lucid, accurate, and illuminating way, so that the number of those who can begin to think for themselves may be increased. It is intended to convey to the ordinary reader and to the uninitiated student some conception of the general principles of thought which economists now apply to economic problems. The writers have been more anxious to avoid obscure forms of expression than difficult ideas. Most of the omissions of matter often treated in textbooks are intentional ; for as a subject develops, it is important, especially in

books meant to be introductory, to discard the marks of the chrysalid stage before thought had wings.

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

J. M. KEYNES

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INTERNATIONAL ECONOMICS

CHAPTER I

INTRODUCTORY

§ 1. *The Scope of this Volume.* It is proper at the outset to give some idea of the scope of this volume. The title does not sufficiently define it, for international economics is a large and complex subject ; it might be surveyed from a historical or a geographical point of view ; a brief description of the principal constituent items of international trade might be attempted ; above all the reader might hope to find an analysis of the causes and phases of the present crisis, with a view to forming opinions about the probable course of events and the appropriate remedies for the situation. The purpose of this book is more precise and definite. As a preliminary to understanding aright the inner nature of particular events or to forming an intelligent opinion on matters of current controversy, it is necessary first to be apprised of certain simple and fundamental truths about international economic relations in general. It is to expound and elucidate these that an attempt is made here. The reader

will find a treatment of what may be called the simple arithmetic of international economics. Far too much is commonly said and written in ignorance of or with complete disregard of this simple arithmetic.

The reader may console himself that the body of doctrine which he is asked to master is not a large one, nor is the intellectual effort required for the purpose great. It may be compared with that needed for the understanding of three or four theorems in elementary geometry. Yet that much effort is indispensable. The path is short but slippery. The subject is one in which fallacy and specious argumentation abound. Only by a thorough grasp of a few central propositions and of the means by which they are reached can immunity from the insidious attacks of quacks and propagandists be achieved. In pursuing a more developed branch of science, the student would not expect to be completely exempt from intellectual effort. Yet, really, the fact that the achievements of economics are exiguous and the tools used simple makes it necessary to concentrate all the more closely on what there is. Their complex technique of proof provides the conclusions of the more highly elaborated sciences with a defence against the inroads of charlatans. In economics fools are only too ready to rush in.

There has been much discussion as to whether economics should confine itself to the tracing of cause and effect or extend out into the practical sphere of advice and recommendation. Critics hold that, in making recommendations, economists are impinging on the region of ethics or politics. Controversy about method should, however, be settled, not on abstract grounds, but by reference to the achievements of the subject. Study

of the most notable economic work reveals that it has in fact contained a large element of the practical recommendation. The objection to this rests on a misunderstanding. The phenomena studied by the economist are largely connected with human purposes, which in their interaction have given rise to a system of some complexity. When a change occurs in part of the system, it may be interesting to know, and appropriate for economists to study, what consequential changes are likely to occur in other parts of the system. It is also interesting to test the system by the criterion of how far the purposes which give rise to it find their fulfilment through it.

To test the system in this way is not to criticise the purposes themselves, which would, indeed, be an ethical matter. In studying the system, an approach may be made either by analysing the interaction of changes in its parts or by testing it with reference to its efficacy. The two approaches sometimes lead into the same terrain of analysis. It may be convenient now to adopt one, now another. Testing the system leads naturally on to making recommendations. Indeed the recommendations can often hardly be distinguished from a precise statement of how the system fails when the test is applied to it. In what follows the test method of approach is rather prominent. It is used in the analysis of the course of international trade and of the monetary system. The question is asked, what are the conditions in which trade takes such a course, that the purposes for which trade is admittedly undertaken are most fully realised? Again, what is the kind of monetary system which best fulfils the purposes for which the use of money is admittedly devised? No *a priori* justification for the procedure will be given; it has in fact yielded the best results in this

particular field. The recommendations which rise naturally out of such an examination contain no ethical element or political bias.

This book does not profess to break new ground in fundamental matters. But complete freedom is used in the mode in which established doctrines are set out, and it is possible that some of the secondary propositions are novel. The treatment of the direction and scope of foreign trade is based on the doctrines of the classical writers. These have been subjected to much criticism in the past, mostly of a pettifogging or terminological kind ; the main classical position in this sphere seems inexpugnable. The old economists were more concerned with the direction of trade than its volume. The connection between the volume of trade and the monetary system has only been worked out by more recent writers. In the later chapters, where this is dealt with, it is concluded that money should have stability of value. This appears to be the orthodoxy of the subject, if we trace the development of it in the best writers since Jevons. In the popular press other schools of thought, the deflationists, the so-called "sound currency" men, those who favour an "automatic" gold standard or a gold standard "worked according to the rules of the game" (are these the same ?), seem to have gained the reputation of orthodoxy. Their views find no favour in the following pages.

§ 2. *International Economics as a Branch of General Economics.* International economics is concerned with all economic transactions involving passage across a national frontier. Examples are emigration, the loan of capital by the nationals of one country to those of another, the purchase of goods by the nationals of one country from

those of another. A set of infinitely vigilant frontier officials might be able, by examining all persons, cargoes and mail-bags entering or leaving Great Britain, to draw up an inventory of all the international economic transactions in which she was involved. It may at once occur to the reader that the findings of this company of officials might not be very different from those of another set whom we may imagine to have formed a cordon round the county of Warwick. They, too, would have their passengers, goods and mail-bags to examine, and they, too, would find migration, loans, the sale and purchase of goods, etc., in progress across the boundary. The Warwickshire inventory of transactions with the outer world would be quite similar to the British inventory. Nor need we stop at the Warwickshire example. A circular cordon might be described, having Rugby for its centre and ten miles for its radius, and a similar result could be achieved.

Clearly if international economics is to be justified as a proper subject of study, it is necessary to show that the transactions entered on the British inventory have attributes which make them differ substantially from transactions recorded in any of the similar inventories which might be drawn up on boundaries *not* coincident with national frontiers. In what ways do the economic transactions between people living under different national governments differ from those between people living under the same national governments, but in different localities?

It is important not to exaggerate the differences. For instance, there is one notable respect in which the international and, may we call them, inter-county transactions do not differ, namely, that the inward payments to which all give rise must roughly balance the outward payments,

the difference, if any, being covered by an actual remission of money. Theories regarding the mechanism by which the national balance of foreign payments is maintained may be tested by applying them to any arbitrarily defined area. If they implicitly assume the presence in every such area of a mechanism which does not in fact exist, they are properly suspect.

Moreover, it is also important to recognise the close interconnexion between international and internal transactions. It would lead to disastrous errors to treat the two in watertight compartments. The state of the external world may affect not only the volume of our imports and exports, but also such apparently domestic matters as the yield of income-tax and the rate at which new houses are constructed. Special attention will be given to this interconnexion.

§ 3. *Distinguishing Features of International Transactions.* What, then, are the distinguishing attributes of the inventory of international transactions?

(i). First and foremost, attention should be paid to the migration figures, the movement of persons across the boundaries. Temporary visits need not be considered here. A number of persons born and bred in Warwickshire leave it to settle and earn their livelihood in other parts of the kingdom, and vice versa. Similarly, each year a number of persons emigrate from the kingdom to seek their fortunes in other countries. But the volume of inter-county movement, considered in proportion to the size of the area affected, is much greater than that of the international movement. Labour is more mobile between the different parts of a national unit than between different national units.

The reasons for this are sufficiently obvious. Barriers connected with language, national habits and sentiment, and, in recent times, stringent legal restrictions, obstruct the free flow of labour between different countries. The consequences are important. Within the national unit there is a tendency towards equality throughout the country in rewards to work, requiring given intensity and skill. Good opportunity for earning high rewards in one locality attracts movement to it from other parts of the country, and this movement sets up the tendency towards equalisation. But great differences in the rates of reward may subsist in different countries; the general level of real wages is roughly twice as high in New York as in London, roughly twice as high in London as in Rome. Such differences could not continue long in one country. What is true of the movement of labour applies, though in less degree, to the movement of capital and enterprise.

It follows that internal trade consists largely of the interchange of goods between producers who enjoy similar standards of life. International trade often consists of the interchange of goods between producers enjoying widely different standards. It is clear that the principles which determine the course and nature of these two kinds of interchange must be in some respects different.

This is the most important circumstance which makes a special study of international trade necessary. Analysis of internal trade assumes that there is a tendency towards an equal standard of living among those doing the same kind of work. The assumption may not accord with the facts precisely, but it is a workable approximation. In the case of international trade it has to be dropped entirely.

Similar standards may prevail in different countries, but there is no *a priori* probability that they will. The analysis of the advantages which accrue from international trade is independent of whether they do or not. The frequent claim that the import of goods made with cheap foreign labour should be checked thus implies ignorance of the first principles of the subject ; for it assumes that inequality of wages in two competing countries is abnormal, whereas in fact it is on the probable presence of that feature that the special study of international as distinct from internal trade is founded.

(ii) Special facilities for production may differ from place to place in one country and be similar in different countries, crossing political frontiers freely. But there are certain facilities and disabilities which are co-terminous with national frontiers, namely those connected with the activities of government. The citizens of one country are subject to the same system of national and local taxation, to the same regulations for health, sanitation, factory organisation, education, and social insurance, the same policy with regard to transport and public utilities, the same laws regarding industrial combination and trade unions, the same commercial code. Here is another basis for the distinction between internal and international trade. Even if capital and labour flowed freely between countries, so that wages, interest charges, profits, etc. were the same everywhere, the general level of real costs might be lower in one country than another, by reason of the superior advantages provided by the system of government. It would still be possible to distinguish between internal trade as interchange between producers provided by the government with similar amenities for production, and international trade as interchange between