INTERNATIONAL TRADE

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INTRODUCTION

THE progress which has been made during the last century or so with respect to transport and communications—aided by improvements in industrial technique which have favoured large-scale production and by the development in the joint stock company of a device for separating investment from direct personal control—has resulted in a great increase in the importance of international trade and investment, and has brought the various parts of the world into much closer economic relations. Economists have always welcomed this development of a world economy, regarding it as a natural sequence in the process by which the independent household economy gave place to a town or local economy and the latter to a national economy; and they have always emphasized the advantages of international trade in opposition to those who favour the ideal of national self-sufficiency. But at the same time the boundaries which separate states must necessarily be more or less arbitrary from an economic point of view,

so that there might appear to be nothing in the international character of certain transactions and relations to give them a special significance for economic theory. What, then, is the need for the study of international trade apart from the study of trade in general?

It may be said at once that the formulation of a theory in terms of national units is to a certain extent a task imposed upon the economist, as it were from outside, by the attitude of the public. It might be said that from a strictly scientific point of view the nation is no more significant as a unit than (say) the county or the province. Yet even if this were true, the fact would remain that people are interested in the progress of national wealth and the way in which this is affected by the relations between nations, whilst they are not interested in a similar degree in the position of the smaller units—or for that matter of the larger units. This attitude shapes the questions which are put to the economist and which he must seek to answer. So far as the strictly internal economic relations of a nation are concerned, the ground is already covered by the general propositions of economics which relate to a single isolated community. But the consideration of the effects on each nation of its relations with other nations calls for the adoption of a special

point of view. Moreover, the lay interest in the latter subject is not merely passive. In practically all countries governments seek to regulate foreign trade in the national interest. This gives rise to questions of national policy on which economists may be expected to advise, and on which they will certainly wish to give advice. Historically, of course, the study of economics largely originated in the discussion of national trade policies.

The political division of the world into states does, however, in some respects modify economic relations and thereby give rise to special problems, apart from any deliberate regulation of international trade.

In the first place, it presents a special obstacle to what economists term "the mobility of the factors of production." As a rule workers will be more willing to move from one region to another within their own country than to migrate to a foreign country, and they are more likely to have knowledge of the opportunities for an advantageous move in the former case. In part, of course, the obstacle to finding employment in foreign countries is one of language; but reluctance to become a foreigner in a strange land is still very widespread, as is also an unwillingness to employ foreigners except for special work.

Similar considerations apply to capital, although in a less degree. To invest abroad it is not indeed necessary to live abroad, and it has sometimes been suggested that the volume of foreign investment has been unduly large. But generally this movement of capital has resulted from the attraction of relatively high rates of interest or high expectations of profit; at the same rate of interest for the same type of investment the capitalist will usually prefer to employ his money at home, because the uncertainties are fewer. It need hardly be added that the natural obstacles to mobility are often greatly aggravated by the restrictions adopted by the various governments.

These differences between the internal and international mobility of both labour and capital are clearly differences of degree rather than of kind; their significance will be discussed later.

In the second place, each country has usually its separate currency system. Within each country there exists normally one system of units of account in which values and debts are expressed, and one system of means of payment (coins, notes, etc.) by which debts in terms of these units are settled. Moreover, the banking system commonly provides facilities for the making of payments between different parts of the country, either gratu-

itously or for a nominal charge. Thus within one country the money in which one is paid will serve to buy anything that is for sale anywhere. In international transactions, on the other hand, the money involved is for at least one of the parties foreign money; arrangements have to be provided for converting the money of one country into that of another, and the rate of conversion (rate of exchange) is generally subject to some degree of variation.

It might perhaps be argued that this again is only a difference of degree. Before the War certain groups of countries formed currency unions—*e.g.* the Latin Union (comprising France, Belgium and Switzerland) and the Scandinavian Union: this meant that the members had common currency units (francs and kroner respectively), that certain coins were legal tender throughout the union, and (in the case of the Scandinavian Union) that the banks maintained the exchange at par. Similarly the sterling currency was then common to the United Kingdom, South Africa and Australia. Apart from these special cases, moreover, it may be said that the general adherence to the gold standard virtually resulted in a universal money system, because the units of all the gold standard countries were definitely linked through their con-

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nexion with gold, and gold could always be used as a means of payment between these countries. To complete the argument it might be pointed out that in large countries with undeveloped or decentralized banking systems, the making of inter-local payments is not free from expense and difficulty.

All these points are worth noting, but the argument is hardly convincing. The arrangements by which separate currency systems may be connected are terminable. The pre-War currency unions were brought to an end by the War and have not been revived; even where countries continue to have currency units with a common name their values may be different—*e.g.* the French, Swiss and Belgian francs. The gold standard was abandoned more or less completely during the War, and, after its general restoration, has again been abandoned by a number of important countries. Thus the possibility of disconnected currency units, free to diverge in value, has always to be taken into account in the theory of international economic relations, whereas in dealing with affairs internal to a particular country we know that there must be a definite limit to the cost of sending money from one part to another. But perhaps the most decisive consideration is that the international gold standard, whilst it is

in operation, gives rise to problems which do not in fact arise in the internal management of a single currency.[1]

It might be said more correctly that the division of the world into regions with different currency systems does not normally affect the way in which the real resources of the world are used and enjoyed, and that therefore it introduces differences in the mechanism of adjustment rather than in the nature of the final adjustments. Accepting this, however, it may be maintained that the mechanism itself is an important subject of study, particularly as it does not always function smoothly.

As another characteristic, it is sometimes said that international trade is predominantly long-distance trade. This is not a feature which is dependent on political divisions, and obviously international trade in the strict sense and long-distance trade are not synonomous. Moreover, although the distance between the parties to a trade is of practical importance, both in so far as it increases the cost of transport and in so far as it implies

[1] There may be several reasons for this. I think the chief is that transferences of purchasing power between countries in the form of gold tend to invoke further changes in the volume of bank credit. This is not the case with internal re-distributions of purchasing power.

divergent geographical conditions, it hardly presents points of theoretical interest, except in so far as it affects the mobility of capital and labour.

Thus we see that the most definite objective features which distinguish international trade are the special regulation to which it is subject and the special monetary problems which it involves. The latter will provide the main theme for the earlier part of this book. Later chapters will deal with the regulation of international trade, but here the treatment will be different from that of the earlier part, inasmuch as we shall not be concerned to find an explanation of what is or must be, but rather to suggest what should be. Before we reach these questions of policy, however, we shall have to discuss in Chapter V the effects of international trade, with particular reference to its effects on the utilization of the world's real economic resources. Since the regulation of international trade alone is in question, we shall need to discuss these effects irrespective of whether they are peculiar in kind to international as opposed to domestic trade. But this will be the place in which to discuss the bearings of the relative immobility of capital and labour between countries.

CHAPTER I

THE TECHNIQUE OF INTERNATIONAL PAYMENTS

The payments which have to be made between one country and another as a result of the various transactions of their citizens are usually settled in the last analysis by a process of offsetting or cancellation. This fact used to be held up as rather a peculiarity of international transactions, distinguishing them from dealings within one country, which were supposed generally to be settled by the payment of cash. Nowadays, however, this distinction has lost most of its importance; for within each country the banks provide a system in which book entries are substituted for the transference of cash in payment, and it is through this system that the greater part of the domestic debts is in fact settled.

In the technique of payments between countries an important part is played by the bill of exchange, and some writers represent this instrument as providing in itself the means of cancelling debts between countries. Suppose, for example, that A in France has

sold goods to B in England to the value of £1,000, and that C in England has sold goods to D in France also valued at £1,000. Then A may draw a bill on B for £1,000, the amount of his claim on B; and it is supposed that he will sell this bill (for francs) to D, who will send it to C in settlement of his debt. C collecting sterling payment on the bill from B on whom it is drawn, in effect B will pay C instead of paying A, and D will pay A instead of paying C. Thus no payment between France and England is necessary.

An example such as this serves to reveal the essentials of the process of offsetting international indebtedness, but somewhat falsifies the actual business procedure. In practice a single bill is seldom used to settle two transactions. For one thing the sums involved in two transactions would rarely match precisely. Another difficulty would be that the bill drawn by the exporter is not generally marketable until it has been "accepted" or endorsed by the importer, and considerable time would be wasted in sending it from the exporter to the importer and then back again to the exporter. Yet further complications are introduced by the period of credit commonly allowed in foreign trade. The exporter draws a bill payable (say) 90 days after sight: he wishes to realize money on the bill in his own coun-

try at once, but the importers in his country will only wish to purchase remittances to their foreign creditors when their debts are due for immediate payment.

These difficulties are overcome by the mediation of the banks and exchange dealers. The French exporter, having drawn a bill on his English customer, hands it over, together with the documents which give control over the goods in transit, to his bank, which either purchases (discounts) it outright or makes an advance to the exporter of a certain proportion of its value. In either case the current rate of exchange determines what the exporter will receive for this foreign bill in terms of francs. The bank then sends the bill and the documents to its correspondent bank in England; the correspondent gives the documents to the importer in return for his acceptance of the bill; and finally, the accepted bill is probably discounted in the London bill market. As a result of this chain of transactions, the exporter's bank has paid out money in France, but is credited with a balance with its London correspondent. But this same bank may have other customers who are importing from England, or who have for other reasons to make payments to that country. Let us suppose that some of these customers are importers who have arranged

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