

THE THEORY
OF
INTERNATIONAL TRADE

WITH
SOME OF ITS APPLICATIONS TO
ECONOMIC POLICY

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PREFATORY NOTE TO FOURTH EDITION

SINCE the last edition of this book appeared the subject of International Trade has come into unexpected prominence. In the phraseology lately fashionable it has passed from the domain of "academic discussion" into the position of a "burning question." This change is not altogether favourable to its treatment in a scientific manner. The greater part of the writing in the press and periodical literature is certain to be crude and ill-informed, the product of persons who have not taken the trouble to study the general principles that underlie the more obvious features of foreign commerce. The intrusion of party feeling is a further disturbing influence. Where established principles stand in the way of a particular proposal its supporters will at once declare their disbelief in what they call "abstract theory," though they will readily use any of those principles that can be so distorted as to appear to serve their purpose.

It is, therefore, the more necessary to insist on the indispensableness of a general theory for the correct interpretation of the complicated phenomena of foreign

trade, and also on the connection of that theory with the principles of economics as a whole. Without the assistance of such a theory success is impossible; with its aid a consistent account of the mass of facts, otherwise so perplexing, can be supplied.

The changes in the present edition have been slight, and consist in additional illustrations or notices of criticisms which seemed to require consideration.

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TRINITY COLLEGE, DUBLIN,
11th July 1903.

NOTE TO THIRD EDITION

THE text has been again revised and some mistakes corrected. In particular, Professor Edgeworth's criticism has led to the removal of a serious error, and one of the statements as to comparative cost has been modified at the suggestion of Professor Marshall. An additional Appendix dealing with some disputed points has been added, and the text has by this means been relieved of some controversial matter unsuitable for ordinary students who may require to use the book.

NOTE TO SECOND EDITION

IN this edition the text has been revised throughout, some matter of temporary interest omitted, and the various discussions brought up to date. As the book is specially intended for serious students of economic theory, the principles of the subject are considered, freed as far as possible from unnecessary details. Those who desire to follow the actual course of commercial policy and the several phases of protectionism and free-trade, may be referred to the author's *Commerce of Nations* (Methuen), which supplements, and is supplemented by, the present work.

Very hearty thanks are due to Mr. A. B. Clark, M.A., for his kindly interest manifested by reading the proof-sheets, and furnishing many valuable suggestions and criticisms.

FROM PREFACE TO FIRST EDITION

THE present work is an attempt to restate, in a more complete form, the doctrines of the classical English School on an important and difficult branch of political economy. That school has been severely criticised from several different standpoints, and there need be no hesitation in admitting that the whole body of economic science stands in need of a thorough revision, and, in some of its parts, an entire reconstruction. But it is not, therefore, incumbent on us to throw aside the more solid portions of the older building: it will rather be expedient to utilise all sound material already existing, and, as far as possible, to preserve that continuity of development which is one of the notes of a truly scientific system.

The theory of international trade has, therefore, been selected for exposition as being one of the products of the older political economy which is well worth preserving, and one, moreover, which is peculiarly suited for students, both on account of its intricacies and the logical processes employed, as also by reason of its bearing on the old, but still unclosed, controversy respecting the comparative merits of "protection" and free-trade.

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CHAPTER I

PRELIMINARY—THE GENERAL FEATURES OF INTERNATIONAL TRADE

THE theory of Foreign Trade, with the various applications of that theory, admittedly forms one of the most complicated branches of economics. After all that has been written on the subject, there seems to be a haze over some of its most critical points, and even some difficulty in exactly apprehending its foundation. Much of this confusion is due to the vacillating attitude of the propounders of economic principles; but then it is also true that this vacillation is in itself evidence of the intricacy of the subject-matter to be dealt with. It is not possible to doubt that the difficulty thus arising is due to the fact that the phenomena under examination, as well as the theory which deals with them, have been changing during the course of history, so that an analysis which would be accordant with the objects to be examined at a former period is no longer well-founded. In brief, we have here the opposition so often to be found in economic, and indeed in all social inquiries between the historical and the analytical method. Closer investigation of the basis of the

theory which we are considering will make the assertion still clearer. For wherein lies the first difficulty which perplexes the student? Is it not in the very conception of a separate "international" as opposed to other kinds of trade? The statement that there are special conditions which render this branch of exchange so peculiar as to need a different form of exposition, has been questioned, not only by untrained and sentimental writers,¹ but also by sober and eminent economists. And even among those who accept it, the reason which is assigned does not always bear a strict investigation.

To elucidate this matter, it is necessary to consider the origin of the distinction. It is beyond dispute that it is historical. The early writers on trade found that nations were in reality isolated, and, more especially since they treated economic matters from the side of art rather than of science, their attention was directed towards the various ways in which national prosperity might be increased. The strength with which mercantilist doctrines were held at that period led to a very general advocacy of restraints on the course of foreign trade, for the purpose of increasing national wealth, and also, in some cases, adding to the relative *power* of the State. The examination of the conditions under which such measures should be used formed a groundwork for a theory of international exchange, based, it is true, on erroneous views, but yet useful, as furnishing a starting-point for further development. The overthrow of mercantilism by Adam Smith and

¹ Thus Mr. Ruskin, *Munera Pulveris* (edition of 1886), p. 111, tells us, "International value is regulated just as inter-provincial or inter-parishional value is."

his followers, though it was accomplished by showing that the economic interests of nations were, for the most part, harmonious, nevertheless left the scientific problem open for discussion, and it is from this side that the theory has in reality been worked out. International trade is, then, in its development, as the very name implies, "trade between nations," so that it is necessary to explain what is meant by the term "nation" in ordinary and general use. Political philosophers have found it hard to give a concise and, at the same time, definite explanation; but here we may say with Mr. Freeman,¹ that "the word suggests to us a considerable continuous part of the earth's surface, inhabited by men who at once speak the same tongue and are united under the same government." Though the term "nation" is thus borrowed from political science, it is the economic features of the bodies coming under this description that have here to be noticed, since it is from them that the peculiar aspects of international exchange result; and economists have consequently followed this course. Bagehot, for instance, who would, on the political side, quite accept Mr. Freeman's description,² yet, from our special point of view, speaks of "a nation in the economic sense—that is, a group of producers within which labour and capital freely circulate";³ and again, "English Political Economy, as we know, says that capital fluctuates from trade to trade within a nation; and it adds that capital will not, as a rule, migrate beyond that nation."⁴ Thus, for the purpose of economic inquiry, the meaning

¹ *Comparative Politics* (1st ed.), p. 81.

² See *Physics and Politics*, chap. iii.

³ *Economic Studies*, p. 240.

⁴ *Ibid.* p. 88.

of the leading term is altered, and a new connotation given to it, though the thread of connection between the two meanings is plain enough. Nations have been kept apart by various barriers of language, religion, mutual dislike, and, in most cases, by geographical distance, so that the economic conception of a nation is in truth a natural outcome of the facts of history. Still the alteration of meaning has to be carefully remembered, as well as the possibility in some cases of nations in the ordinary sense being excluded, and even more probably of some new cases being included in the new conception. Nor is it at all unusual to meet with these developments and amendments of popular language in economics. The term "rent," for example, instead of being "applied to whatever is annually paid by a farmer to his landlord," is confined, by Ricardo, to "that portion of the produce of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil."¹ The analytical description of a "market," as given by Jevons,² is another instance, and many such cases may be found in other social sciences.³

The meaning which is thus conveyed by the word "nation" has, in some cases, been expressed by other terms which have, however, proved less convenient. In the *Wealth of Nations* it is of "every society or neighbourhood" that the mobility of labour and capital is predicated, and the later theory of international exchange would seem to be applicable to these "neigh-

¹ Ricardo, *Works* (ed. M'Culloch), p. 34.

² *Theory of Political Economy*, pp. 91-94.

³ The treatment of some fundamental juridical conceptions, by Austin and the analytical school, at once instructively illustrates this process, and also shows its use in a kindred subject.

bourhoods.”¹ Again, in Jevons’ interesting examination of exchange, in his *Coal Question*, we have the term “trading bodies” used, as it appears, in a somewhat similar sense; but, on the whole, the old and long-established title has held its ground, and with good reason; for though the immobility of industrial agents may seem an insufficient justification for forming the boundaries of nations for the purpose of economic inquiries, still it cannot be denied that the political and economic boundaries do often coincide. It must, too, be noticed that both these classes of forces act and react on each other. The absence of the free and steady circulation of labour and capital helps to support political differences; while, as we have seen before, the political influences tend towards economic separation: and to the causes given above may be added the specially economic influences of different currencies and different financial systems. The operation of the various customs duties, too, is in itself a potent reason of estrangement between nations. From the point of view of social science in general, we may further say that international trade is trade between “societies,” *i.e.* between the different social organisms which Sociology assumes as its field of investigation.

It results from the foregoing considerations that this description of a nation implies two conditions, one positive, and the other negative, *viz.*—(1) The free circulation of labour and capital within each group; and (2) the complete immobility of all the agents of production as regards transfer to other groups. To this assumption, however, objections from opposite sides

¹ See *Wealth of Nations*, book i. chaps. vii. x. Ricardo almost invariably uses the word “country” for this purpose.

may be and have been advanced. On the one hand, it may plausibly be argued that exchange is never between nations, but always between persons, either natural or artificial. Russia and the United States did indeed trade, when the transfer of Alaska from the former to the latter was arranged; but in almost every foreign exchange it is the individual member of a nationality which trades with members of another nation; and it may, therefore, be urged that as the laws of value do not change with climate or circumstances, there is no reason why the mere accompanying fact of immobility should alter the general law of the phenomenon. Some disputants would further argue that the laws of value should be simple, and reducible to one great general principle.¹ A conclusive answer to this class of objections is to be found in the fact that the power of free movement is essential for the existence of competition, and that value is altered by the presence or absence of that element; not, in any wise, by setting aside the so-called law of supply and demand, but by affecting the forces which are concisely described under that frequently misused phrase. The position of the parties under different social organisms, or different "nations," is thus a condition which affects the law of exchange, and which should be taken into account. The argument from simplicity, though supported by an appeal to "physical science," is but the old scholastic maxim that "Nature always acts by the simplest means," and

¹ "If, then, Economics is a Physical Science, and to be treated after the methods of a Physical Science, it is the essential condition of its being so that all the phenomena in it should be reduced to one grand General Theory."—H. D. Macleod, *Elements of Economics*, vol. i. p. 104.