

Routledge Library Editions

DEPRESSION AND PROTECTIONISM



ECONOMICS



Routledge Library Editions

DEPRESSION AND
PROTECTIONISM



ECONOMICS

Routledge Library Editions – Economics

ECONOMIC HISTORY
In 4 Volumes

I	A Short Economic History of Modern Japan	<i>Allen</i>
II	Depression and Protectionism	<i>Capie</i>
III	Enterprise and Trade in Victorian Britain	<i>McCloskey</i>
IV	Economic Phenomena Before & After War	<i>Šećerov</i>

**DEPRESSION AND
PROTECTIONISM**

Britain between the Wars

FORREST CAPIE

 **Routledge**
Taylor & Francis Group
LONDON AND NEW YORK

First published in 1983

Reprinted in 2003 by
Routledge
2 Park Square, Milton Park, Abingdon, Oxon, OX14 4RN
or
270 Madison Avenue, New York, NY 10016

First issued in paperback 2010

Routledge is an imprint of the Taylor & Francis Group

© 1983 Forrest Capie

All rights reserved. No part of this book may be reprinted or reproduced or utilized in any form or by any electronic, mechanical, or other means, now known or hereafter invented, including photocopying and recording, or in any information storage or retrieval system, without permission in writing from the publishers.

The publishers have made every effort to contact authors/copyright holders of the works reprinted in *Routledge Library Editions – Economics*. This has not been possible in every case, however, and we would welcome correspondence from those individuals/companies we have been unable to trace.

These reprints are taken from original copies of each book. In many cases the condition of these originals is not perfect. The publisher has gone to great lengths to ensure the quality of these reprints, but wishes to point out that certain characteristics of the original copies will, of necessity, be apparent in reprints thereof.

British Library Cataloguing in Publication Data
A CIP catalogue record for this book
is available from the British Library

Depression and Protectionism
ISBN 978-0-41 5-31304-9 (hbk)
ISBN 978-0-41 5-60704-9 (pbk)
ISBN 978-0-41 5-31302-5 (set)
ISBN 978-1-136-50388-7 (ebk)

Miniset: Economic History

Depression and Protectionism: Britain between the Wars

FORREST CAPIE

 **Routledge**
Taylor & Francis Group
LONDON AND NEW YORK

© Forrest Capie 1983

This book is copyright under the Berne Convention. No reproduction without permission. All rights reserved.

By Routledge

2 Park Square, Milton Park, Abingdon, Oxon, OX14 4RN
270 Madison Ave, New York NY 10016

First published in 1983

British Library Cataloguing in Publication Data

Capie, Forrest

Depression and protectionism: Britain between the wars.

1. Great Britain—Economic conditions—20th century
2. Great Britain—Politics and government—20th century

I. Title

330.941'082 HC256

ISBN 0-04-330338-2

Library of Congress Cataloging in Publication Data

Capie, Forrest.

Depression and protectionism.

Bibliography: p.

Includes index.

1. Great Britain—Commercial policy—History.
2. Free trade and protection—Protection—History.
3. Tariff—Great Britain—History.
4. Great Britain—Economic conditions—1918-1945. I. Title.

HF1533.C36 1983 382,7'3'0941 83-12652

ISBN 0-04-330338-2

Set in 10 on 11 point Times by Computape (Pickering) Ltd

Contents

	Preface	<i>page</i> vii
1	Introduction	1
2	The Changing Pattern of Trade, 1900-39	12
3	Tariff Legislation	40
4	Depression and Protection	45
5	The Growth of Protectionist Pressure	61
6	Determining the Tariff Structure	77
7	Some Immediate Economic Effects	96
8	Effective Rates of Protection	113
9	Other Considerations	129
10	Conclusion	138
	Appendix	144
	Bibliography	153
	Index	165

This page intentionally left blank

Preface

My interest in the subject of protectionism derives from three sources. The first was working as a civil servant administering import controls and being concerned about the causes and consequences of these policies. The second was some research I did on protection in the agricultural sector in the 1930s. The third was the developing mood of protectionism in the mid 1970s. Much of this recent protectionist mood, and some emerging consequences, looked at least at first glance very similar to the 1920s and 1930s; and as the years have passed the similarities have increased. It therefore seemed worthwhile to examine that previous experience more thoroughly – particularly the economic origins and effects of the abandonment of free trade. A great deal of attention has been given to political aspects of the event but much less to strictly economic factors. These latter are then the focus of this study and it is hoped that the outcome is of value to the current debate on protection. In Bacon's words, 'it should excite the judgement briefly if not inform it tediously'. The book should appeal to the student of international economics and commercial policy and to the student of modern British and international economic history.

I have incurred many debts in the process of writing the book and I should like to thank several people. The research was funded in part by a grant from the Social Science Research Council. Rob Davies provided stimulating research assistance. David Harkess gave unstintingly of his expert computing guidance. Michael Collins listened patiently to the arguments and offered constructive criticism. Geoffrey Wood kindly read the whole manuscript. Barry Eichengreen and James Foreman-Peck made valuable comments at important points. Pamela Angel has done an admirable job of typing without complaint. My greatest debt however is to my wife Dianna, without whom none of the research would have been undertaken.

This page intentionally left blank

1

Introduction

Free trade is not the natural order, but something that has been struggled for and, once achieved, defended against the multifarious forces of protection. There have been two outstanding examples of success: the first was in the developing international economy in the third quarter of the nineteenth century, and the second was in the Western world in the third quarter of the twentieth century. Both were comparatively short-lived episodes. Writing of the American readoption of tariffs in the closing quarter of the nineteenth century, Jacob Viner talked of 'the end of the intermission in Mercantilism', and this idea, of a free trade interlude between long periods of state regulation of trading activity, is a much more accurate characterisation of the norm than the one held by many, particularly those unencumbered with heavy historical baggage. The common experience in international trading relations has been the erection of barriers to trade in the selfish and largely misguided pursuit of greater gain. Only in the period between the Second World War and the 1960s was there a broad-based concentrated effort at promoting free trade in the world economy. Actively avoiding the perils of protection was prompted by the calamitous trading experience of the 1930s. But in spite of the valiant attempts at trade liberalisation of post-1945 and a period of success, the international community is again sliding into protectionism and is more and more arranged in various trading blocs. Invisible barriers to trade have been growing and, in the 1970s and 1980s, protectionist forces and measures can be found emerging everywhere.

This book considers the case of the oldest advocate of free trade, and its greatest exponent, Britain, and examines the developments that led to the reversal of that policy in the 1930s; it also considers the consequences of the protectionist policy for the domestic economy. This introductory chapter provides some background, outlines the argument of the book and draws attention to some aspects of the problem that are either not dealt with explicitly or not dealt with at length.

2 DEPRESSION AND PROTECTIONISM

The book concentrates on the domestic economy – on the pressures for protection arising there (or at least manifesting themselves there) and on domestic effects of tariffs – but this will be placed within the context of prevailing conditions in the international economy. When examining the domestic pressures for protection in Britain we shall note how war and economic instability in the 1920s produced conditions that facilitated the growth of protectionist forces. The international setting in that decade was complex, however, and the first task is to present a sketch of that setting.

Before the First World War there had been signs of a movement back to trade protection in many parts of the world – a reflection of the growth of nationalism. The First World War, itself a product of political and economic nationalism, exacerbated the spreading distrust and tensions nascent in 1913. In the 1920s this continued on a greater scale as new states were created. The gold standard was suspended in 1914 by all the belligerents. But when Britain abandoned the standard in a formal legal fashion in 1919, that signalled the beginning of several years of floating exchange rates, which, in the climate of the time, did nothing to promote confidence or any sense of cooperation. What was needed was some lead, and Britain was reluctant to assume (and partly incapable of assuming) such leadership and the United States had withdrawn into isolation, rejecting involvement in European affairs and remaining outside the League of Nations. The absence of cooperation is brought out in two areas. One was war debts: some countries, such as Britain, favoured writing them off while the United States insisted on repayment. More serious was the reparation burden imposed on Germany, this largely at the insistence of the French. These were of such a scale that, as Keynes pointed out at the time,¹ the Germans could never repay them, and the payments simply aggravated the international payments problem.

Economic stability depends in good part on political stability, and political stability in the years immediately after the First World War was to say the least fragile. Mussolini's march on Rome in late 1922 and the French invasion of the Ruhr in 1923 dealt further blows to a shaky structure. Depreciating currencies, in part the product of uncertainty and instability, were accompanied by soaring inflation, the latter being both cause and effect. Such was the climate of the international economy even in the middle of the 1920s. There was some establishment of order after that and some recovery in the major economies. But Britain's return to gold in 1925, and the subsequent readoption by others, was done in such an *ad hoc* fashion and at unsatisfactory rates that it contained all the seeds of its own destruction. When collapse did finally come in the financial crises and economic depression of the years 1929–32, a fresh outburst of protectionism appeared and world trade collapsed.

Trade flows had suffered quickly and severely in the war of 1914–18. Consumer goods production was replaced by military production; shipping was requisitioned for war; there were hazards of transporting goods around the world; all these led to a virtual cessation of normal international trade. Countries deprived of goods they had formerly imported were forced to produce substitutes and it was these infants established in wartime that were part cause of the protective legislation after the war. Of course on top of all this there were the huge material and human costs of the war (7 million died) and after the Armistice was signed the atmosphere in international relations was full of bitterness. The international economy was physically changed, for example by the total withdrawal of the Soviet Union, and it was psychologically changed by the whole range of factors that emanated from the bitter distrust.

Tariff barriers around the world grew in size and number after the First World War, many of them having their origins in that war.² Some were 'legitimate' in the sense that they protected infant industries, and there had been many infants born in wartime. Others can be attributed simply to the exuberance of nationalism. The birth of new states (a product of war and its resolution) contributed to the growth of nationalism and led to economic antagonisms that resulted in protection. Further, when one important country adopted protection, other countries were liable to follow for no good reason. Governments have seldom been attracted by the niceties of theoretical argument or convinced by the genuineness of an infant industry at such times, and were inclined simply to retaliate. The Fordney–McCumber tariff of 1922 and the Hawley–Smoot tariff of 1930 in the United States are widely regarded as having been unnecessary in any sense. They represented purely retaliatory, irresponsible action from such a major economy, and provoked in their turn further retaliation.

The need for revenue was an argument advanced by countries suffering from balance of payments deficits. Most primary producers enjoyed a brief boom immediately after the war but thereafter suffered from sluggish demand that was the result of the slowdown in population growth and relatively sluggish income growth in their important markets. They faced a severe fall in agricultural prices and a deterioration in their terms of trade and found themselves in deficit. Agricultural communities everywhere were badly affected and these were often powerful political groups. It is not going too far to say that the agricultural lobby in the United States was a major factor behind the growth of protection in that country in the 1920s. European countries were similarly affected and Britain was not excepted. British farmers were very vocal and played their part in supporting protection, claiming that it was cheap imported food that was destroying domestic agriculture. In spite of their claims being false, or at

4 DEPRESSION AND PROTECTIONISM

least greatly exaggerated, they had a considerable degree of success in a variety of measures that were adopted after 1930.

The principal international organisation of the time was the League of Nations. The League busied itself with the problem of protection – indeed was the international focus of such activity and worked to resist the protectionist pressures – but had little success. Restrictions on trade were widely condemned by almost all international bodies. They had been categorically condemned at the Brussels Financial Conference in 1920, at the Porto Rosa Conference of 1921, again at Genoa in 1922 and at the Geneva Conference on Customs Formalities in 1923. In 1924 a resolution on free trade was passed by the League that was well received by country delegations. At the World Economic Conference in 1927 it was the view of the League that ‘there appears to be a sufficient consensus of opinion in favour of abolishing or reducing to a minimum the system of import and export prohibitions’.³ The League’s economic committee, investigating the problem at the time, believed that most countries accepted the principle of suppression of prohibitions, but that the time for international action was not quite ripe and would not be ripe until some monetary and economic equilibrium had been re-established. Although there was a deep resolve to attack the growth of customs tariffs, the preliminary draft agreement drawn up for the 1927 conference shows how out of touch the League was, for it talked of the abolition of all trade restrictions and prohibitions within six months and even of ridding the world of invisible barriers to trade. However, there was a let-out in that the final article of the draft agreement stated: ‘Nothing in this Agreement shall affect the right of any contracting state to take. . . all necessary measures to meet extraordinary and abnormal circumstances and to protect the vital economic and financial interests of this State’.⁴ By the time the final report of the conference was drawn up, a much more realistic position had been adopted.

On the one hand the League seemed aware of the insurmountable immediate obstacles and looked to a holding operation. And while the same high-sounding sentiments as had been expressed at previous conferences were present again, a practical scheme was also outlined. The League claimed it was the unanimous desire of the members of the conference to make sure that 1927 would mark the beginning of a new era ‘during which international commerce will successively overcome all obstacles in its path that unduly hamper it’. Along with this there was a sensible proposal that, if agreed upon, would have led to a containment of tariffs and provided the basis for gradual elimination.⁵ The scheme included the recommendation that all countries should sign and ratify the Brussels Convention of 1913, which provided for consistency of definition of traded goods. The report also

realistically listed the steps that should be followed thereafter. There would be a unification of tariff nomenclature and a simplification of customs tariffs that would do away with double schedule tariffs (that is, where there was a maximum schedule designed for bargaining purposes and a lower schedule that was adjusted to the needs of the country).⁶ The conclusion of an earlier study by the League showed that bargaining tariffs were a particularly poor device and even one of the direct causes of the high tariff rates that characterised the post First World War period.⁷ Following a simplification of nominal tariff structures and a unification of nomenclature, stability of tariffs would then be made feasible and could be pursued with greater hope of success.

In the midst of all this there was an interesting British contribution that has been almost wholly neglected and, as a result, whose significance has never been determined. This was the work of a Conservative Member of Parliament, Sir Clive Morrison-Bell, who embarked on a one-man crusade to promote European cooperation in trade. His method was to demonstrate the futility of the obstacles to trade by building a physical model of the tariff walls of Europe. The model received enormous publicity all over the world. Photographs appeared in the local newspapers wherever the model was exhibited. A special pavilion was built to contain it at the World Economic Conference in Geneva in 1927 and it attracted great numbers there and wherever else it was shown. However, the argument of the model was not unambiguous. Some did not seem to know whether it was an argument for protection or free trade. The *Morning Post*, which was highly protectionist in outlook, exhibited 'Tariff Walls' in its window, and when asked for its return begged for the loan to be extended. This proved impossible since the Free Trade League in Manchester had booked it! In 1930, Conservative Office – promoting a protectionist line – wanted to use it in their political campaign. But the most notable example of its use in support of protection was in the United States. When Senator Smoot's attention was drawn to it he found in it a vindication of his protectionist views and decided it must go on show in the Senate building; it did and it stayed there to assist the passage of the Hawley–Smoot tariff bill in 1930. Smoot used it to show how dangerously protectionist Europe was and stressed the need for the USA to take similar action.⁸

The failure of the international campaign against tariffs, in so far as it can be so described, was a result of domestic forces overcoming international sentiment. As one writer put it; 'protectionists worked on the home front while the internationalists were encouraging each other abroad. No national government was strong enough to resist the political pressures of the minority interest groups.'⁹

6 DEPRESSION AND PROTECTIONISM

All of the activity on the international front reflected the dominant academic view, at least in the English-speaking world, on international trade. Academic opinion in the interwar years was firmly of the view that free trade maximised welfare. The traditional case was argued on the grounds of efficient allocation of resources and that the restriction of imports led to a reduction of exports or increased the flow of capital abroad. Keynes was steadfastly in the mainstream of thought on this issue in the early 1920s when he said, 'is there anything a tariff can do that an earthquake could not do better?'. He also took the widely held position that protection certainly could not cure unemployment. It is true that by the end of the decade Keynes had moved away from the classical position to a belief that the traditional free trade case did not hold when there were less than fully employed resources, and that he had moved to arguing for a revenue tariff that would help relieve the budgetary difficulties and revive business confidence. But he regarded this as an emergency measure only and one that would be dropped when world prices recovered. He rejected the idea as soon as the gold standard was abandoned in 1931, the pound depreciated and the need for a revenue tariff was rendered redundant.¹⁰

The purpose of this book is to place the British return to protection in this setting, showing that the protectionist forces were on the move from the First World War onwards. It will also draw attention to certain aspects of the subject that have been relatively neglected and thereby seek to improve our understanding of the economic origins of the industrial tariff in Britain. Using an explicit economic framework, it will also examine the determinants of the shape of the effective tariff structure, and take a new approach to a consideration of the effects of the tariff. The structure of the book is as follows. Chapter 2 lays out the path of British trade over the years 1900–39.

Ever since the second half of the nineteenth century there had been a growing concern in Britain with foreign industrial rivals, increasing competition in trade and the possibilities of a solution in Empire self-sufficiency. The promotion of Empire trade by various means became a declared objective, and this chapter provides essential background to the trends in trading relationships that date from the 1870s and to some of the reasons lying behind these trends, particularly those associated with Empire. The chapter also provides information on related issues such as trade balances. More importantly, it examines the changing pattern of British overseas trade over the years 1904–39 and discusses some prominent explanations for the Empire bias that entered into the pattern.

There are a number of useful histories of commercial policy that provide all the necessary detail on measures that were in force in the period and of the additional legislation that grew up. There is no

point in reproducing a catalogue of tariff measures here and so Chapter 3 simply describes the measures briefly, providing essential information for the reader.¹¹

There follows the first part of the argument on the origins of tariff legislation. Briefly this is that the emphasis should be shifted from viewing the tariff as a sudden, unpremeditated response to the world economic depression that began in mid-1929; rather it should be seen as being the outcome of a variety of economic causes that date essentially from the First World War and flourished in the 1920s. Primary sources are used in this part of the exercise in spite of a huge secondary literature on the political origins of the tariff. The reason for this is that the book is concerned primarily with the much neglected area of business involvement and responses to their pressures. Chapter 4 tackles the question of the tariff arising out of the crisis of economic depression. One point that can be made here is that the depression of 1929–32 in Britain was not as severe as is sometimes believed. Output fell in only one year, 1931, and that by 5.6 per cent. The trade balance was not seriously weakened before 1931 and yet by that date the tariff legislation was prepared and it was hastily introduced in November 1931 in the form of the Abnormal Importations Act. This chapter will show that that Act looks very much like an excuse, and a feeble one at that, for preparing the way for the general tariff.

Having shown that the tariff policy was not entirely, and possibly not even mainly, the result of depression, the way is open to show in Chapter 5 that the reversal of the free trade policy had as much to do with pressures originating in the First World War and developing with the economic difficulties throughout the 1920s. One of these pressures came from Empire. In particular, the protectionist Dominions had been extending tariff preferences to Britain from the 1890s onwards and had an interest in seeing Britain armed with protective measures that could be used to keep foreigners out, but at the same time pave the way for some preferential arrangements being made that would allow Empire countries easier access. This was a pressure that found a sympathetic hearing amongst some sectors of British industry, notably those with Empire markets. Against this there was the wider 'international' desire, already described, for freer trade. But in spite of the sentiments expressed at the many international conferences on the need to reduce tariffs, tariff walls continued to be raised in most industrial countries. Thus pressure on Britain also arose from the domestic fear that without tariffs Britain would become the dumping ground for manufactures facing prohibitive barriers elsewhere. An extension of this latter argument was that the barriers could then be employed as bargaining weapons in trade negotiations. One pressure group in particular is given extra atten-