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THEIR CAUSES AND NATURE

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II. ECONOMIC AND FINANCIAL
1943.II.A.5

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PRINTED IN THE UNITED STATES OF AMERICA
BY PRINCETON UNIVERSITY PRESS, PRINCETON, N.J.

PREFACE

Under the Mutual Aid Agreements, the Governments of the United Nations have declared their intention to direct their postwar policies towards "the elimination of all forms of discriminatory treatment in international commerce" and "the reduction of tariffs and other trade barriers." During the interwar period, trade was subjected not only to tariffs generally much higher than in the first decade of the century but also in many countries to rigorous quantitative control involving necessarily discrimination or the risk of discrimination.

The purpose of this short study, which has been prepared by Professor Gottfried Haberler of Harvard University in collaboration with Mr. Martin Hill of this Department, is to consider what were the forces that induced governments to adopt these measures of quantitative control; what are the relative advantages and disadvantages of such restriction compared with tariffs and other measures designed to influence trade through the price mechanism; whether quantitative controls were the most suitable instrument to meet the special circumstances that led to their imposition; why, if, in fact, they were the most suitable instrument, they were so generally condemned both by international conferences and by economists; why, if they were not the most suitable instrument, resort to them was so general, and finally, whether the circumstances which led to their adoption are likely to arise again after the present war and in that case what policies should be pursued.

A companion study by Professor Jacob Viner, entitled *Trade Relations between Free-Market and Controlled Economies*, deals with the problem that arises for a country which does not subject its foreign trade to direct regulation when other countries important in its foreign trade relations do so.

These two studies constitute part of a series on international trade and commercial policy which has been prepared with a view to contributing to those objectives of commercial policy that have so long been advocated by the League of Nations and have found fresh expression in the paragraphs of the Mutual Aid Agreements which I have just quoted.

The other publications in this series dealing directly with trade and commercial policy are *Europe's Trade, The Network of World Trade, Commercial Policy in the Inter-war Period: International Proposals and National Policies* and certain sections of the recent report on *The Transition from War to Peace Economy.*

Our thanks are due to the Rockefeller Foundation, which has generously supported the work involved in the preparation of this volume.

A. LOVEDAY,
Director of the Economic, Financial and Transit Department

League of Nations
June, 1943

CHAPTER 1

WHAT IS MEANT BY QUANTITATIVE CONTROL?

Quantitative controls are measures which limit the quantities—or in exceptional cases the value—of goods that may be exported or imported. These limits are fixed by the authorities of a country either by autonomous action or in agreement with other countries ("autonomous" or "unilateral" as against "contractual" or "bilateral" restrictions).

Normally such measures are restrictive—in other words, the quantities permitted are less than what would be exported or imported if there were no controls. Sometimes, however, either by design or owing to unexpected change in supply and/or demand conditions, quotas—especially those on agricultural products—are ineffective or only intermittently effective. But even ineffective or only potentially effective controls may exert an effect by affording greater security to domestic producers.

Quota and licensing systems are the principal forms of direct quantitative trade controls. There is no very clear-cut distinction between these two systems, but there is a tendency to speak of a quota system in cases where the quantities to be admitted are determined in advance and the rules of distribution among countries of import or export and among traders applying for licenses are clearly formulated; and of a license system when these conditions are left to the discretion of the administrative organs and licenses are given on the merits of each case. In the 1920's, quantitative restrictions were only in a few cases (*e.g.,* automobiles and motion picture films) of the quota type, that is to say, the quantities were as a rule not laid down in advance and then distributed according to some general rule, but rather there were sweeping prohibitions to which governments were authorized to make exceptions by granting licenses. One reason for this was that the war had upset all prewar standards of comparison. In the next big wave of quantitative import restrictions that came during the Great Depression in the '30s, pre-depression imports could be taken as a point of departure and quantities fixed and distributed

on the basis of the imports in some "normal" pre-depression period. In the early '20s no such possibility existed.

A quantitative limitation of trade may also be effected through the operations of export and import monopolies and cartels; while tariff quotas, under which limited quantities are admitted at the ordinary tariff and any excess bears an additional tax, give rise to price complications similar to those resulting from quotas. Outright prohibitions—which must be distinguished from the prohibitions modified by licenses which, as we have mentioned above, represented the most common form of quantitative restriction in the '20s—do not involve these complications and therefore fall outside of the scope of the controls that we are considering.

Quantitative restriction is also exercised indirectly by means of foreign exchange control—that is, the regulation of the flow of money and payments which involves the regulation of the flow of goods. In most cases, the control of payments and the direct control of imports sprang up independently and were administered separately. Exchange control grew out of disturbances in the balance of payments and were designed to protect the value of the currency while, in almost all cases, the original motive for the introduction of quotas was the protection of particular industries. But so far as the regulation of trade was concerned, it was of little consequence whether the control was direct or at one remove; during the late '30s in many countries both methods of control were in fact closely integrated for the achievement of both ends—protection of the currency and of particular industries.

The other type of measures with which quantitative controls will be contrasted influence the movement of goods by making them more or less expensive or making them conform to certain conditions, without subjecting them to definite quantitative limits. The authorities may be guided in fixing duties and other charges and conditions by the wish to restrict imports or exports to a certain amount, but the actual determination of the quantities imported or exported is left to the forces of the market.

Under the heading of non-quantitative controls fall export and import duties, fees and taxes of all kinds, differential transportation charges, veterinary and packing regulations,[1] mixing and milling regulations, premia and subsidies, as well as currency appreciation or

[1] These, however, are often equivalent to a total exclusion.

depreciation. Changes in the international value of the currency are equivalent to a wholesale adjustment of prices.

As prototypes for the two contrasting methods of trade regulation, we shall take import quotas for quantitative controls and import duties (tariffs) for controls through price. Other measures will be mentioned in various places, but much of what is said about quotas and duties applies to all measures in their respective groups.[1]

[1] One may conceive of combinations of the two types of control whereby imports are limited to preassigned levels by means of price measures. This could be achieved, for example, by changing duties periodically. A more direct method would be to sell import licenses by auction. Such combination methods have, however, never been applied consistently. "Sliding-scale duties," which are well known in the history of agricultural protectionism, have always been administered with a view to stabilizing prices rather than to regulating quantities.

CHAPTER 2

QUANTITATIVE CONTROLS IN THE 'TWENTIES

In the twentieth century, quantitative restrictions on imports and exports were first imposed on a large scale during and immediately after the first World War. Between 1914 and 1918 such controls were an integral part of war economies. The belligerent countries subjected exports to license in order to prevent strategic materials from reaching the enemy, to conserve strategic material within their own borders, to direct the limited export trade into the most appropriate channels. Exports to neutral European countries were rationed in order to prevent re-export to the enemy; exports from those neutral countries were accordingly limited in turn. Imports were controlled in order that the limited shipping space should be used to the best advantage in the national interest, in order to avoid trading with enemy firms in neutral countries or indirectly benefiting the enemy[1] and in order to economize gold and foreign assets.

After the Armistice, the return to prewar methods and practices involving the abolition of quantitative controls was fairly rapid outside Europe and in Great Britain and certain of the Western and Northern European countries. In the case of some of these European countries, the movement was premature and could not be maintained. For example, France, which abolished its general control system in 1920, felt obliged to reimpose a number of quantitative restrictions in 1922 in order to protect its currency. Switzerland imposed import controls in 1922 as a defense against exchange dumping. But, by and large, within a few years of the Armistice, the problem was no longer of major importance outside Central and Eastern Europe.

There trade had practically ceased by the end of the war and was only gradually resumed, first on the basis of intergovernmental barter and then on that of general prohibition modified by license. The dislocations produced by the war were far more serious than elsewhere

[1] For example, Great Britain prohibited the importation of sugar via the Netherlands (September 23, 1914) on the ground that such importation, though sorely needed in Great Britain, would help the sugar growers and sugar merchants in Germany. (See O. Delle Donne, *European Tariff Policies since the World War*, New York, 1928.)

and many of the reasons which had led to the imposition of quantitative controls during the war continued to apply. Entirely new economic units had been carved out of larger economic areas; frontiers had been radically altered; it was several years before new frontiers were definitely fixed and some degree of political stability assured, while actual fighting continued in certain areas until 1922. Within their new frontiers, countries were groping for a new equilibrium and grappling with acute food and other shortages. This period of uncertainty, shortage, and adjustment was accompanied by violent currency disorders. Countries whose currencies were depreciating attempted to prevent or at least to slow up the depreciation by strictly limiting imports. Countries whose currencies remained stable or appreciated in terms of other currencies used quantitative import controls to protect their industries against competition due to currency depreciation elsewhere ("exchange dumping"). Behind import controls vested interests grew up which made the ultimate problem of decontrol more difficult.

It is a fact of great importance that all governments without exception were opposed to quantitative restrictions in principle and were anxious to return to prewar trading methods as soon as possible. Prohibitions were condemned by all the major economic conferences of the first post-war decade. The Supreme Economic Council and the Brussels Conference (1920) enjoined states to remove the "artificial economic barriers" that impaired the essential unity of European economic life. Successive congresses of the International Chamber of Commerce pointed to the unfavourable effects of the prohibitions régime. The Genoa Conference of 1922 held that import and export prohibitions constituted at the time "one of the gravest obstacles to international trade" and recommended the replacement of import controls by higher tariffs; the signatories to the Convention on the Simplification of Customs Formalities of 1923 bound themselves to reduce their export and import prohibitions and restrictions to the smallest possible number "as soon as circumstances permit"; in 1924 the Assembly of the League of Nations instructed the Economic Committee of the League to investigate the possibility of concerted inter-governmental action in the matter.

By this time, indeed, conditions were becoming more propitious to a return to normal trade relationships. The extreme scarcities and

dislocations of the early post-Armistice years had been overcome, political stability was being rapidly restored, Europe was beginning to emerge from the period of financial and military chaos. The Austrian financial reconstruction scheme was in operation and the Hungarian and German (Dawes Plan) schemes were about to go into effect. New tariffs prepared in the course of the intervening years were being introduced; in almost all cases these tariffs were higher than before the war; in many cases they provided producers and manufacturers a protection equivalent to that afforded by the quantitative controls, thus rendering the latter unnecessary. With the introduction of a new tariff in 1925, Germany abolished her import prohibitions system; Hungary did likewise and Austria substantially reduced her prohibitions lists. In the same year, it is true, Poland not only raised her tariff but reintroduced a number of import prohibitions that had been suppressed in 1922, justifying this action by the absence of a spirit of reciprocity in other countries and the necessity of combatting the instability of her currency.

Nevertheless, the turning point had been reached and in the course of the next three or four years restrictions of this kind were gradually whittled down. They no longer represented the main obstacles to international exchanges in Europe and were mild compared with the restrictions that developed in the '30s. But they were still far from being inconsiderable or unimportant. The World Economic Conference of 1927 reported that:

> "The experience of the years since the war proves that import and export prohibitions and the arbitrary practices and disguised discriminations which result therefrom, together with the obstacles of all kinds placed on the circulation of goods and capital, have had deplorable results by hampering the normal play of competition, by imperilling both the essential supplies of some nations and the not less indispensable markets of others, and by bringing about an artificial organisation of production, distribution and consumption."[1]

The Conference recommended that on the basis of a draft convention which had been prepared by the Economic Committee in consultation with the International Chamber of Commerce, an international agree-

[1] League of Nations: *Report and Proceedings of the World Economic Conference,* Geneva, 1927, p. 34.

ment should be concluded for the purpose of bringing about by concerted action the complete suppression of the régime of quantitative controls.

At a diplomatic conference convened in Geneva later in the year 1927, twenty-nine states concluded an agreement, the main provisions of which were as follows:[1]

> The Parties undertook, subject to certain exceptions allowed in each case, "to abolish within a period of six months all import and export prohibitions or restrictions and not thereafter to impose any such prohibitions or restrictions." (Article 2)

The following prohibitions and restrictions were excluded from the scope of the convention "on condition, however, that they are not applied in such a manner as to constitute a means of arbitrary discrimination . . . or a disguised restriction on international trade":

> Those relating to public services and traffic in arms and munitions; those imposed on moral or humanitarian grounds, for the protection of public health or protection of animals and plants, for the protection of national treasures; those applicable to gold, silver coins, notes or securities; those which extend to foreign products the régime applicable to domestic products and those which apply to products under State or State-controlled monopoly (Article 4).
>
> Moreover, the Parties reserved the right to adopt prohibitions or restrictions "for the purpose of protecting, in extraordinary and abnormal circumstances, the vital interests of the country" (Article 5).

A second Conference met in June 1928: certain reservations were withdrawn and additional reservations accepted and embodied in a Supplementary Agreement. It was decided that the Convention thus amended would come into force, if ratified by 18 States before September 30, 1929.

By that date, however, only 17 ratifications had been deposited, some of which were made conditional on those of Poland and Czechoslovakia, which had not adhered. At a third Conference, in December 1929, the contingent accession of Czechoslovakia was secured; but

[1] League of Nations: *Proceedings of the International Conference for the Abolition of Prohibitions and Restrictions*, Geneva, 1928.

Poland finally refused to ratify owing to reservations made by Germany regarding trade in certain commodities which Poland considered essential to her economic life, and the majority of ratifications consequently lapsed. By special arrangement, the Convention was brought into force on a short-term basis from January 1, 1930, by a few States in which, in fact, only exceptional prohibitions existed—Denmark, the United Kingdom, Japan, the Netherlands, Norway, Portugal and the United States. By the middle of 1934 it had been denounced by them all.

Reservations regarding the export of hides and skins and bones, put forward by several countries, led to a series of conferences in 1928 and 1929, at which a joint renunciation of prohibitions and a joint limitation of export duties on these articles was achieved. The agreements, ratified by 18 States, entered into force in October 1929.

If, in spite of the limited results of these attempts at concerted action, the system of prohibitions and licenses was being gradually broken down in the later 1920's, two types of quantitative control[1] were becoming more common. The first of these were the import and export quotas fixed by international cartels, which were tending more and more to allocate markets among their members. The second were tariff quotas which were employed to an increasing extent by European countries in their commercial treaties, especially in connection with agricultural imports.

[1] See Margaret S. Gordon, *Barriers to World Trade*, New York, 1941, p. 244.

CHAPTER 3

QUANTITATIVE CONTROLS IN THE 'THIRTIES

The movement away from quantitative controls was arrested in 1929, with the deepening of the agricultural depression; it was reversed in 1930. In that year, for example, Australia—which had been experiencing a recession since 1928 and currency depreciation since 1929—introduced an import licensing system for a long list of manufactured products; Czechoslovakia imposed a licensing system for imports of rye and barley; Spain prohibited the importation of wheat; government trading monopolies and tariff quotas on agricultural products were established or revived in a number of other European countries. But the restriction of agricultural imports into industrial countries anxious to defend their own agriculture and of manufactures into agricultural countries anxious to defend their balances of payments was still effected predominantly by non-quantitative measures—by tariff increases, by the imposition or tightening of veterinary regulations, by milling and mixing regulations, by stricter regulations regarding marks of origin, consular invoices, etc.

The fateful year was 1931. In the early months there was a rapid movement toward State monopolization of trade in cereals and certain other foodstuffs; several countries—including France, Czechoslovakia, Spain, Belgium, Sweden and Mexico—introduced a system of import licenses for such commodities. Licenses were introduced by Hungary for certain imports from non-treaty countries (January and March). In March, Iran established a Government trade monopoly and subjected various classes of imports to quota restrictions, while Brazil imposed licensing restrictions on certain machinery imports in April. In July, France established import quotas on coal and coal products and in August on timber and wine. Fertilizers were subjected to similar restrictions in a number of European countries after the breakdown of the International Nitrates Agreement in the middle of the year.

Thus far the recrudescence of monopolies and quantitative restrictions had been primarily a by-product of the agricultural depression, though France had already taken the first steps toward using such

restrictions for more general protective purposes. The movement towards quantitative restrictions became a landslide and its essential character was changed when sterling, followed by numerous other currencies in every continent, went off gold in September. Between that date and the end of the year, the following countries which did not depreciate their currencies with sterling either introduced licensing or quota restrictions or extended the scope of existing restrictions:

Belgium	Hungary	Turkey
Brazil	Italy	Uruguay
Czechoslovakia	Latvia	Yugoslavia
Estonia	Roumania	
France	Spain	

By the end of the year, legislative authority was obtained for the imposition of quantitative controls in the Netherlands and Switzerland, while exchange controls were in operation in Austria, Bulgaria, Czechoslovakia, Estonia, Germany, Hungary, Latvia, Portugal, Spain, Yugoslavia, Turkey and Iran.

Where currencies had been allowed to depreciate, the new restrictions introduced in this period were unimportant. A few commodities were placed on the license list in Japan, Portugal and Ecuador; in Colombia, certain prohibitions were imposed in September but were replaced by higher tariffs later in the year. With few exceptions (notably Colombia, Bolivia and Greece where strains on the currency subsisted), this group of countries was also practically free from exchange control.

In the early months of 1932, the Swiss and the Netherlands quota systems got under way; Poland introduced quotas for a wide range of products; France extended her controls to industrial imports. Powers to use quantitative controls as an instrument of retaliation were granted to several governments and began to be applied by Italy against France in July.[1] Uruguay introduced certain quantitative restrictions which had been renounced in favour of higher tariffs the previous year. Austria, Belgium, Czechoslovakia, Estonia, Greece, Hungary, Iran, Latvia, Portugal, Roumania and Spain introduced or extended quantitative controls in the course of 1932, at the close of

[1] Gordon, *op. cit.*, p. 251.

which no less than 11 European countries had a full-fledged quota system in force, covering a substantial proportion of their imports.

In 1933, the United Kingdom introduced quotas on agricultural products in support of national marketing schemes and in favour of Empire suppliers; both agricultural and industrial quotas were imposed in Ireland; the Netherlands East Indies restricted certain imports mainly of Japanese origin, a course which was followed in a number of the British colonies in 1934. But outside Europe, quantitative restrictions remained limited in number and scope. Australia and South Africa actually abolished the majority of their controls in 1932 (Australia did so in connection with a rise in tariffs), and while exchange control was prevalent in Asia and Latin America, it usually retained its primary form and purpose, namely, to protect the currency and not to limit specific imports. Tariffs and export bounties continued to be the characteristic trade measures of Latin American countries throughout the depression; it should be noted that most of these countries' rates could be altered by Executive action without notice and without prior legislative consent. The U.S.A., which had imposed the highest tariff in its history in 1930 and raised still further a number of duties in 1932, avoided quotas except in a few isolated cases.

The most striking features of the development of the quota system in Europe in the course of the first half of the 1930's may be summarized as follows:

1) Whereas quotas were at first everywhere regarded as transitory measures, they gradually assumed a place among the accepted instruments of commercial policy;

2) from being isolated measures to limit the importation of a few specific commodities, they came to be consciously used in many countries as a general instrument of protection;

3) they came to be conceived and employed as an integral part of recovery programmes, aimed at insulating the national economies from economic influences from abroad and permitting an undisturbed expansion at home;

4) they were increasingly used for purposes of retaliation and of commercial bargaining, with a view, that is, to obtaining openings for exports;

5) "autonomous" or "unilateral" quotas were to an increasing

extent replaced by "bilateral" quotas—that is to say, quotas fixed as a result of bilateral negotiations, and organized industries were encouraged to work out quota arrangements with their principal suppliers or competitors in other countries *ad referendum* to the Governments concerned;

6) exchange control and the clearing system based upon it assumed to an increasing extent the same function as the quota system with respect to regulating the quantities and the direction of specific imports.

In 1935 and 1936, it is true, there were some important extensions of the quota system (*e.g.,* in Italy and in Poland); but quotas were frequently enlarged, transformed into tariff quotas or actually removed. The trend towards quantitative restrictions became less marked; and it was in fact reversed for a period of several months following the conclusion of the Tripartite Agreement of September 1936. Immediately after that event, quota relaxations were announced in several of the countries which devalued their currencies, notably France, Switzerland, the Netherlands and Italy—though, except in Switzerland, the relaxations were not of very far-reaching importance. Quotas on grain and other foodstuffs were later enlarged or abolished in Germany, Italy and several other European countries. In May 1937, the Hague Convention led to the removal of a number of quotas between members of the Oslo group. Exchange control was substantially relaxed in Czechoslovakia, Denmark, Roumania, and Yugoslavia and abolished altogether in Portugal.[1]

But in the summer of 1937, this movement toward somewhat freer trade came to an end. France restored most of the quotas that had been abolished. Japan introduced a thoroughgoing control of imports in October. In almost every country operating a system of quotas or exchange control, restrictions tended to be tightened progressively in the two remaining years before the outbreak of the Second World War.

The scope of the quota and license systems in these years among countries not employing exchange-control may be illustrated by the following figures showing the approximate percentage of total value of imports subject to such restrictions in 1937:[2]

[1] It had been progressively relaxed in Austria from 1932 onwards.
[2] League of Nations: *World Economic Survey, 1938-1939,* p. 189.

France	58%	Ireland	17%
Switzerland	52%	Norway	12%
Netherlands	26%	United Kingdom	8%
Belgium	24%		

Among exchange-control countries, Italy and Poland applied quantitative restrictions to almost all, Austria to more than one-half, Czechoslovakia and Greece to a substantial proportion of their imports.[1] As mentioned above, the complete system of trade control in Germany and the less thoroughgoing form which it assumed in a number of other exchange-control countries was scarcely distinguishable from the import permit system.

Before discussing more fully the reasons for the adoption of quantitative controls in the '20s and the '30s it may be useful to analyze the differences between the operation of such controls and measures bearing directly on price, that is to say, broadly, between the operation of quotas and tariffs.

[1] Gordon, *op. cit.*, p. 253 and H. Heuser, *Control of International Trade*, London, 1939, p. 135.

CHAPTER 4

DIFFERENCES IN THE OPERATION OF TARIFFS AND QUOTAS

The consequences of the two types of restrictions differ in several important respects. Quantitative restrictions constitute a much more serious interference with the individualist economy based on the price mechanism and free enterprise than the other type of regulation. We may characterize them as a "non-conformable" type of interference, a foreign substance, as it were, in the body of the free economy which necessarily leads to dangerous ulcerations and suppurations and threatens to weaken or undermine the individualist economy altogether. On the other hand, Customs tariffs, even high ones, are "conformable" interferences which do not destroy the price mechanism on the functioning of which a private enterprise economy must depend.

Under given conditions of comparative cost of production and of demand and supply in the countries concerned, it is always possible to find a duty equivalent to any given quota—that is to say, a duty which would restrict imports to the same level as the quota. It would, however, be a mistake to assume that the effects of a quota and of an equivalent duty are the same. The principal differences between the two types of restrictions are as follows:

(1) Under the quota, the quantity of imports is rigidly fixed in the upper direction. Under the duty, even if it is initially equivalent to the quota, imports may rise for all sorts of reasons—for example, if cost of production and price fall abroad, or if cost and price rise at home (the reason for the change in relative price or cost of production at home or abroad may be a factor affecting demand or supply for the particular commodity, or it may be the consequence of a monetary change such as a depreciation of the currency, or, under the gold standard, a deflation of prices abroad); or if an export premium is granted by a foreign government; or if freights are adjusted so as to overcome a duty; or if dumping sales at lower prices than in the home market are practised by a foreign exporter; or if the national income rises at home and therefore demand for imports increases. Thus the influence of a duty on the quantity of imports can be nulli-

fied by all sorts of developments. Nothing of the sort can happen in the case of a quota.

(2) One important consequence of this is that under a quota the protected producers will feel more secure than under a duty, even if the latter is of such a height as to restrict imports to the quota level. Therefore, producers may be inclined to invest more and expand output more under the quota than under an equivalent duty protection.[1]

(3) But there is another side of the medal: a quota which under competition is equivalent to a given duty may induce the formation of a monopolistic organization of producers with a view to keeping output low and prices high.[2] This danger is a very real one as experiences in many countries with elaborate quota systems (for example, Switzerland) have shown. Such a development may well induce the authorities to take further steps to guard against monopolistic abuses of the quota system. By manipulating the size of the quota according to the price, monopolistic restrictions may be effectively prevented. An alternative (or supplementary) method is price control and the checking of cost accounts of producers. This naturally involves considerable administrative complication and the extension of bureaucratic interference in industry.

(4) There is still another important consequence of the fact that under the quota system the quantity of imports is rigidly fixed in the upper direction. It introduces an element of rigidity into the balance of payments. The larger the number of goods that are subjected to quota restrictions, the more difficult it becomes to make necessary adjustments in the balance of payments. Take the case of a debtor country from which short-term capital is withdrawn or which desires to refund some part of its outstanding foreign obligations. If the creditor countries impose quota restrictions on a large scale, the increase in the active trade balance of the debtor country required to effect this transfer of capital becomes far more difficult to achieve. This was in fact what happened after 1931.[3]

[1] It is interesting to observe that in the case of a drop in home demand for the imported goods (which may be due, for example, to a fall in national income) the quota may become ineffective. In that case a duty which was originally equivalent to the quota would be a better protection for the home producers.

[2] It is true that monopolies are also fostered by duties. But there is less scope for monopolistic price rises under a duty because imports will tend to rise when the price of the local product is raised. Under the quota, imports cannot increase.

[3] Quotas, it is true, are rarely fixed for a period of more than one year. This

Under the tariff system the quantities imported remain flexible. A rise in duties will restrict imports but even under high duties (excepting the case where a duty becomes prohibitive) imports will fluctuate according to changes in demand and supply. The adjustability of the balance of payments is preserved.

(5) Effective quotas give rise to price differences between the importing and the exporting country which are not covered by duty and transportation cost. If the quota is smaller than the amount which would be imported in the absence of the quota, the price will tend to rise in the importing and fall in the exporting country. The resulting price difference cannot be wiped out by competition between importers.

Under a duty system, on the other hand, so long as the taxed commodity is still imported, *i.e.*, so long as the duty is not prohibitive, there can be no lasting price difference greater than duty plus transportation cost (including all expenses incidental to moving the commodity from one country to the other). Any price difference which is greater than that will make imports profitable and thus will tend to be eliminated by competition. If the price difference is temporarily smaller than duty plus transportation cost, imports will fall and this will recreate the appropriate price difference.[1]

One important consequence of this mechanism is that under the tariff system prices in the two countries remain in contact and tend to move parallel to one another (except when transport cost or duties change). Hence quantities and values of imports are allowed to fluctuate in both directions as demand and supply conditions change. Under the quota system, quantities are not only fixed in the upward direction—imports cannot exceed the quota—but they are also rigid in the downward direction. Suppose general demand falls in the importing country (and/or rises in the exporting country) ; the quantity of imports of goods which are subject to quota restrictions is not likely to respond to the changed demand conditions, because of the

should make it easy to adjust them to the exigencies of the balance of payments situation. But such desirable adjustments have, in fact, rarely been made by creditor countries.

[1] These statements must be somewhat qualified if there are international monopolies. International cartels may be able to maintain price differences that are larger than transportation cost plus duty, if they are sufficiently well organized to prevent buyers from buying in a cheaper market. It should be observed, however, that the existence of national monopolies or imperfections in competition does not invalidate our conclusion. Nor is it invalidated by dumping sales.

wide price margin produced (or maintained) by the quantitative restriction. Only after the price has fallen in the importing country (and/or risen in the exporting country) so much as to close the price gap (in other words, only after the quota has become ineffective) will the quantity of goods subject to quotas respond to demand changes.

It follows that the adjustability of the balance of payment is even more impaired by the quota system than would appear from the circumstance mentioned under (4). If the position of the balance of payments (because, say, of capital movements) requires a change in the volume of exports or imports, this change can be achieved under an extensive quota system only at the expense of great price fluctuations. The efficiency and smoothness of the international money mechanism is reduced; transfers of funds are harder to effect and it becomes more likely that strains on the balance of payments will be countered by exchange control or other measures in order to avoid painful price adjustment. This is one of the reasons why quotas tend to lead to further interference and planning in international trade.

(6) Another important consequence of the price gap between countries created or maintained by quotas is the following: it tends to make the business of importing quantitatively restricted commodities a very lucrative one. If the quota is small compared with what otherwise would be imported (and if demand and supply in the importing country are inelastic), large price differences between the exporting and importing country result and those traders who are able to import reap large profits.[1] Certain countries have imposed license fees in order to absorb part at least of these profits, but so far as these fees have not been—and in practice they can scarcely be—perfectly adjusted, the problem remains. The method of distribution of the quota among applicants for licenses, therefore, becomes an important question.

In many countries when quantitative import restrictions were introduced in the early '30s, global quotas were fixed and everybody was permitted to import until the quota was exhausted.[2] This in-

[1] As shown below, however, these profits may go, wholly or in part, to the foreign exporters where (a) licenses are granted to exporters and not to importers, or (b) exporters can exploit a monopoly position.

[2] The French example is especially well known. See F. A. Haight, *French Import Quotas*, London, 1935, pp. 21-23, and H. Heuser, *op. cit.*

volved serious consequences not only as regards equal treatment to exporting countries—the system discriminating against distant countries—but also as regards the domestic economy—many importing firms being cut off entirely from their normal source of supplies, contracts being broken and the field left open to speculators, who were in a position to force up prices as soon as the frontier was closed. It was therefore necessary to adopt some system of allocation; but this presented great administrative difficulties. It involved *first* the allocation of the quotas among countries of supply, and *secondly* allocation among individual importers. The first problem, which is closely connected with existing contractual obligations in commercial treaties (mainly with most-favored-nation clauses) will be taken up later. A few words may be said about the second.

The usual solution has been to allocate quotas to individual importers according to their imports in some pre-quota base year which was considered normal; in many cases the base year was 1931 or 1930. In order to understand the issue it must be borne in mind that, because of the existing price differences, the allocation of a slice of the quota to an importer (*i.e.*, the granting of an import license) is equivalent to granting him a cash subsidy. Hence importers vie with one another to obtain import permits.

The distribution according to a base year cannot be equitable. As time goes by the base becomes more and more obsolete; some firms expand, others contract, new ones would like to enter the field. Almost all countries, it is true, in time made provision for the periodical allocation of a percentage of the quota to new firms and for corresponding adjustment in the case of existing firms. But this did not overcome the basic difficulty that the quota system prevents selection of the fittest through competition and creates vested interests in favour of maintenance of short supply. The import business ceases to be an activity in which commercial ingenuity, efficiency, discovery of cheap sources of supply and routes of transportation count for everything; the primary aim of the importer is to obtain the license.

In many cases quotas were allocated not only to home importers but also to foreign exporters, or only to the latter. Foreign interests were thus given a part of the spoils and induced to acquiesce in the situation, creating further vested interests and removing possible opposition. The whole benefit, indeed, sometimes went to the exporter.

Complaints to this effect were voiced by French importers against the system of "bilateral quotas" arranged between France and various countries (especially Germany) in 1931-32—a system under which the only licenses were those issued by the foreign government (or exporters' association) to the exporters. Similar results ensued from the imposition of the quota restriction on Danish bacon imports into the United Kingdom in 1933. The Danish exporters, who were organized, were able to raise bacon prices so that they were more than compensated for the cut in the quantity of their exports.

Under the tariff system all these complications are absent. No allocation, no rationing is necessary; no big unearned profits are reaped by traders; the difference between the price in the exporting and in the importing country flows into the coffers of the national treasury and not into private pockets.[1] The only task of the authorities is to collect the duty at the frontier. The competitive forces of the market, supply, demand, and comparative cost conditions take care of the rest; they determine the sources of supply, and assure that imports come from the cheapest centres of production. All this is achieved with a minimum of interference, coercion and friction. That is the main reason why the tariff system may be called a "liberal" method of commercial policy, conformable to a free competitive enterprise economy, while quotas are non-conformable measures which disrupt the market mechanism and lead necessarily to further interventions.

(7) In the field of international relations, quantitative restrictions make it virtually impossible to prevent discrimination between countries. The most-favoured-nation clause is practically inapplicable to quotas and quantitative restrictions in general. For there is no accepted or plausible principle of quota allocation which could be called non-discriminatory and consistent with the most-favoured-nation principle.[2] Various systems of quota allocation have been proposed as non-discriminatory but none is satisfactory. Equal quotas for all countries of supply are clearly inequitable. Allocation in proportion

[1] When a duty is raised similar profits may be made by those who hold duty-paid stocks of the dutiable commodities which were imported before the rise in the duty.

[2] The Economic Committee of the League of Nations reached the conclusion ("The Most-Favoured-Nation Clause," Geneva, 1936, p. 13) that "quotas, no matter how excellent may be the intentions of the countries imposing them, necessarily compromise the very object of the clause, which is equality of treatment. Up to the present, no system has been discovered by which quotas can be allocated without injuring the interests of countries entitled to benefit under the most-favoured-nation clause."

to imports from different countries in some base year is unsatisfactory and unjust in the case of crops which fluctuate from year to year. In the case of industrial products too it is liable to get more and more out of date, as the underlying situation changes.

There are no such difficulties in the case of tariff protection. The content of the unconditional most-favoured-nation clause (the only variety of the clause now current) is unequivocally defined, generally accepted and easily applicable with respect to tariffs. Imports from all countries enjoying most-favoured-nation rights are subject to the same duties.[1] The actual distribution of imports among countries of supply is then left to the forces of the market. The cheapest sources come first. Marginal cost everywhere tends to be equated to the price (making allowance for the duty) which, according to established principles of welfare economics, is a condition of optimum allocation of productive resources.

(8) If distribution of quotas according to imports in a "previous representative period"[2]—the formula used by the United States in the Reciprocal Trade Agreements—is unsatisfactory, it is naturally preferable to distribution on the basis of pure reciprocity, which is the negation of the most-favoured-nation principle. Now quotas, as the history of the '30s has clearly shown, are a peculiarly appropriate instrument for applying discrimination and countries with a quota system are under constant pressure from their own exporters, on the one hand, and from foreign countries (particularly the great markets in a powerful bargaining position), on the other, to accord the special favours which the system makes possible. Even under the most discriminatory form of tariff, such as the triple-decker fighting tariff, no such degree of or opportunities for discrimination were possible if only because (a) there was a norm (the minimum tariff) towards which the rates applicable to different countries tended to move and which, once attained, assured equality; (b) the nature and extent of the discrimination were public knowledge and thus amenable to public sanction, while the bases of the apportionment of quotas (and consequently tangible evidence of discrimination) can be, and in fact often have been, concealed.

[1] Difficulties and opportunities of evasion arise in connection with the classification and description of commodities. But they are of minor importance compared with the insoluble problem of an equitable and non-discriminatory quota allocation.

[2] *cf.* Diebold: *New Directions in our Trade Policy*, New York, 1941, pp. 29-31.

(9) It has sometimes been maintained that quotas help to stabilize international trading relationships, which are less likely to be affected by the vagaries of demand than under a tariff system. This argument was used, for example, to support the French policy of industrial ententes (bilateral quotas). Now it is true that the quantity of imports of certain articles can be and often has been stabilized by means of quotas. But since import requirements are constantly shifting as regards both composition and volume, any comprehensive system of restrictions which imposes on imports a given volume and pattern needs constant modification. The massive instability of international trading relationships on the continent of Europe in the '30s was at least in part the inevitable consequence of the quota system.

(10) Parliamentary procedures are much too slow to permit of the rapid changes which are required under a system of quantitative restrictions. It is a not unimportant fact that, under such a system, much latitude must be left to the executive branch of government (administration) while in most democratic countries the adoption of the tariff has traditionally been a jealously-guarded prerogative of the legislative branch (parliament).

CHAPTER 5

REASONS FOR THE ADOPTION OF QUANTITATIVE TRADE RESTRICTIONS

Quantitative controls were imposed in the early '20s and the early '30s when, owing to special circumstances, a higher degree of restriction and control of imports than could be achieved by tariff changes was felt to be urgently necessary for the defence of national production structures or national currencies. These circumstances differed in the two periods. In the '20s the majority of European countries were under great financial strain as a direct consequence of the war. Raw materials, fuel and equipment were vitally needed to re-start their industrial production; in many cases food was critically short; but owing to shortage of gold or foreign assets and of commercial credits, the problem of obtaining such supplies presented almost insuperable difficulties. Inevitably—though they could not of themselves provide a solution—the most rigorous measures had to be taken to prevent the use for non-essential purposes of such foreign exchange as might be available. At the same time, vital supplies had to be kept at home—hence the widespread embargoes on exports of foods and raw materials—while non-essential exports had to be stimulated. Under the financial strain, the currencies of these countries collapsed. A rigorous limitation of imports thus became desirable for an additional reason, namely to stem the currency depreciation. Exports, many classes of which were subsidized or encouraged by bounties, received a further stimulus from the reduction of their price in terms of other currencies. Countries with stable or relatively stable exchanges found themselves flooded with imports at artificially low prices and, in the interests of their own producers, felt constrained to take extraordinary measures to curb this "dumping."

Thus in Western Europe, both the weak and the strong currency countries were led to follow a similar course. For example, in 1922—as we have seen—France subjected a long list of imports to license with the avowed purpose of strengthening her currency position; Switzerland did likewise in order to prevent dumping.

But the primary seat of the infection was further east, in Germany and the new and truncated States which had emerged out of the old

Russian and Austro-Hungarian Empires. Here additional factors, also arising out of the war, operated in the direction of rigid import control. In the case of Germany, there was the need of finding the means of paying reparations. The new countries were faced with a still more formidable problem. To quote from another League of Nations study:[1] "They were ignorant of world markets and those markets themselves were disorganized. Their old trade connections had been severed and to many of the small new states the cost of creating an export market, of appointing consuls, sending salesmen, etc., was prohibitive. Nor had they the capital necessary to reorganize their economic life. Inevitably, their primary concern was to secure at least the home market to their existing industries. Inevitably, their attitude towards foreign trade was defensive."

So indeed was the attitude of the majority of the larger European countries, owing not only to the effects of structural changes in the world's markets on their export industries but also to the pressure to protect war-expanded industries and to keep in employment some part of the plant and labour which had become excessive.

We now come to the problem with which this chapter is mainly concerned: why was the desired restriction of imports not effected entirely by tariffs (plus anti-dumping or countervailing duties, if necessary)? Why did Governments employ the system of prohibitions and licenses, which, as we have seen, they were unanimous in condemning?

The first point to be borne in mind is that, at the end of the war, Europe's trade was almost completely under government control. The situation was thus very different from that which arose in the '30s when an existing system of "free" trading regulated by tariffs was supplemented and in large measure superseded by a system of quantitative control.

The conditions prevailing on the European continent for several years after the Armistice were such as to make the jump from controlled to "free" trading extraordinarily difficult and hazardous. Special anti-dumping and countervailing duties were extensively introduced to meet respectively differential exchange depreciations and subsidies abroad. Overall adjustments in specific rate tariffs to changes in the domestic currency value were likewise very common, as were

[1] *Commercial Policy in the Inter-war Period*, Geneva, 1942.

adjustments in individual items of the tariff schedules. But such measures, by and large, did not fully meet the fundamental problems: a) that the pre-war tariff schedules required a complete overhaul because of changes in the structure of domestic production and foreign competition due to the war and b) that prices in international trade were subject to very rapid and largely unpredictable fluctuations. In such circumstances quantitative controls provided with certainty the protection that was considered necessary; the alternatives were often felt to involve not only such frequent modifications in the rates and regulations concerning innumerable tariff items as no Administration could hope to grapple with, but also the quasi-certainty that action to meet new contingencies would always come too late. There were also special factors operating in individual countries. For example, in Germany freedom to raise the tariff was circumscribed by the provisions of the Peace Treaties.

Let us now turn to the events of the 1930's. The reasons for the great wave of protectionism accompanying the depression and the chain of effects of the breakdown of the system of international settlements have been analyzed in companion volumes.[1] Here we may confine ourselves to considering some of the factors determining more particularly the recourse to quantitative controls. The most important of these fell under four headings:

a) *The depth, violence and persistence of the fall in prices.* The efforts, stoutly maintained by most countries until 1931 or 1932, to protect national production against the fall in import prices by purely non-quantitative measures were only abandoned when such measures were seen to be inadequate and the prospects of early and substantial recovery became increasingly remote.

There were good reasons why quotas were first widely applied to agricultural imports in European countries: 1) owing to the relative inelasticity of demand for food—and especially cereals—a small increase in supply tends to exercise a very pronounced effect on prices; 2) the determination of agricultural exporters (or their governments) to find outlets at any price was often such as to neutralize the most stringent non-quantitative measures of import regulation; 3) especially in countries which were almost self-sufficient in food

[1] *Commercial Policy in the Inter-war Period, op. cit.,* and *The Network of World Trade,* Geneva, 1942.

(France provides the clearest case in point), it seemed patently absurd that the whole agricultural population should be subjected to violent fluctuations in income on account of price changes in the small fraction of supply coming from abroad.

b) *The currency factor*—more particularly, the abandonment of the gold standard by some of the world's greatest trading countries, combined with the determination of the majority of continental European countries to avoid devaluation at all costs. The pressure on the home markets of the latter group of countries was such as to call for emergency defensive measures, while their increased difficulties in finding export outlets were a strong motive in favour of bilateral trading policies and recourse to subsidies and bounties. But in this group were found not only strong-currency countries (the "gold bloc") but also—unlike the experience of the 1920's—many of the highly indebted weak-currency countries. In these, the motive of protection, however powerful, was usually secondary to the need of defending the currency parity. Exchange control was an essential instrument of currency defence. And, as was quickly realized in Germany, it was something more. It provided an extraordinarily effective method of exercising bargaining power and exploiting the latent possibilities of discriminating monopoly in foreign markets.

c) *The social factor.* Quantitative restrictions appeared on a large scale after at least two years of acute and almost world-wide deflation and at a time when unemployment had, in many countries, reached an unprecedented level. They were introduced, sporadically, to relieve unemployment or check the fall in incomes in specific industries; but, more important, they were developed as part of a network of measures constituting the national recovery programmes that had become socially and politically indispensable. These programmes involved quantitative planning to which a quantitative regulation of imports was far more appropriate than tariff regulation. Given the absence of co-ordinated reflationary measures, moreover, expansionist economic policies were only possible in countries such as Germany and Italy under a system of rigorous control of all foreign payments.

d) This leads to a very central point, namely, the fact that there was *no concerted action* between the principal economic powers nor even agreement as to the action that ought to be taken, severally or jointly, to cope with the depression. Each country or group of coun-

tries acted independently and defensively; their independent actions enormously enhanced each other's difficulties and set up a vicious circle of competitive restriction.

If such were the main general reasons for recourse to quantitative controls in the '30s, special considerations were often of decisive importance for individual countries and in individual cases.

France extended her quota system to industrial products primarily because the rates on so many of those products had been bound for long periods under the commercial treaties she had concluded in 1927-28. The proximate motive for Italy's first quotas was retaliation for quotas directed against Italy's exports to France. The Netherlands Government justified recourse to quotas on the ground that quotas were preferable to tariffs as an emergency measure; for it was assumed that they would be easier to abolish than duties after the depression had passed. (Quantitative controls had been abolished in the '20s, but experience had shown that duties were hard to reduce after having been in force for a while and instances of tariff reduction had been few and rare.) In other countries, large quotas, which were not expected to become effective, were imposed in order to allay the fears or overcome the resistance of certain interests when duty concessions were made to foreign countries in commercial treaties. The United States quotas on agricultural products contained in the reciprocal trade agreement with Canada were of this nature.

The British quotas were introduced as part of two programmes, that of agricultural rehabilitation in the United Kingdom and that of Imperial Preference. Various quotas were introduced in countries with which the United Kingdom concluded bilateral agreements in order to enlarge and stabilize the importation of certain British products (particularly coal); concessions to other countries in a strong bargaining position often led to similar results. It is important to note that—political and financial pressure apart—the bargaining power of a country depends very largely on its having a *passive* balance of trade with its partner in the negotiation. The United Kingdom imported far more from most countries than she exported to them. The threat to restrict their outlets in the British market thus placed her in an immensely strong bargaining position. The United States, exporting far more than she imported was, on the contrary, in a weak position.

In the struggle for a share in the dwindling world markets, many

Governments favoured quotas because of the power they provided to withhold or to bestow special advantages which the most-favoured-nation clause proscribed. Most-favoured-nation clauses were usually so formulated and interpreted as to apply to tariff protection only, while pledges in commercial treaties not to raise duties did not, as a rule, mention quantitative import restrictions. The imposition of quotas therefore appeared to be a way to get around such contractual fetters. It is very doubtful whether this theory could have been sustained before a court. A quantitative import restriction does violate the obligation contained in a commercial treaty not to raise the duty on the article concerned; for the intention of the parties when entering into such an agreement evidently was that the article should be admitted at a duty not higher than the one mentioned. Similarly, a quota which is not distributed among the various countries of supply equitably and in a non-discriminatory fashion does violate the spirit, if not the letter, of a most-favoured-nation pledge, even if the clause is so formulated as not to mention quantitative controls explicitly.[1] In practice, retaliation was often resorted to in cases of flagrant and deliberate discrimination (an example is provided in the blacklisting of Germany by the United States in 1936), but minor discrimination was usually accepted with resignation if the country concerned made an effort to maintain some degree of equality of treatment.

As was pointed out in the last chapter, effective quotas yield unearned profits to importers (and, in certain cases, exporters) throughout their lifetime and not only, as in the case of duties, when they are introduced or tightened. They thus tend to be more attractive than duties to the interests immediately concerned, whose resistance to restrictions limiting their turnover is consequently weakened or overcome. This factor was of especial importance where foreign exporters, along with domestic importers, were allotted licenses and consequently permitted to share in the spoils. Such a policy induced the foreign exporters to refrain from instigating their governments to protest and retaliate against the restrictions imposed on their exports.

[1] There have occurred formulations of the clause so careful and wide that there can be no doubt that they cover all sorts of restrictions, not only tariffs. After quotas and exchange control became prevalent, the United States under reciprocal trade agreement policy has tried to evolve formulations of the clause which explicitly include quantitative restrictions, exchange control and similar devices. For reasons indicated in a preceding section this policy has not been—and could not be—very successful. See H. J. Tasca, *World Trading Systems*, Paris, 1939.

The introduction of restrictions was thus made more easy, for experience has shown that the interests of traders and middlemen and large industrial consumers are always more forcibly and effectively represented than the interests of the final consumer.

Quotas necessitate administrative action. They dispense with the cumbersome legislative procedures required for tariff changes. This was also a factor making quota protection more attractive to governments than tariff protection. Another was that quotas on food imports were politically much easier to impose than tariffs. The public has always been well aware of the price-raising effect of the second, but not of the first.

CHAPTER 6

REASONS FOR THE PERSISTENCE OF QUANTITATIVE RESTRICTIONS IN THE 'THIRTIES

It is true that one of the main reasons for the persistence of quantitative controls in the 'thirties was the persistence of some of the factors that had originally given rise to them. For example, the efforts made by the Herriot Government in 1932-33 to return to a régime of tariff protection were frustrated by the continuation of international monetary instability and the absence of any prospect of monetary agreement. To quote the reflections of the *Economist* on the breakdown of the London Monetary and Economic Conference:

> "It is no secret that the French delegation at London was prepared to discuss a plan for the progressive abolition of quotas over a period of two or three years, to be followed by the establishment of a new tariff adjusted to more settled world conditions. Why this plan could not even be discussed is obvious. Without a certain stability of world monetary conditions it lost all meaning."[1]

Similarly, the decontrol movement of 1935-37 was made possible by the removal or correction of certain factors that had originally led to control. Austria was enabled, by 1935, to restore freedom of the exchanges, so far as commercial transactions were concerned, by means of an international loan and internal economies carried out under the guidance of the League of Nations Financial Committee. The abolition or relaxation of exchange controls in other small countries in this and the following year were made possible by an improvement in their foreign exchange position resulting from the general economic recovery. The "gold bloc" and certain other countries which devalued their currencies in 1936 felt able to enlarge or abolish a small proportion of their quotas as a result of the currency alignment and the prospects of international exchange stability offered by the Tripartite Agreement.

But why was the movement toward exchange decontrol not more general? Why was there no relaxation in Germany or Italy or Japan? Why were the quota relaxations so limited in scope? Why, too, in cases where exchange control was relaxed, were governments reluc-

[1] *The Economist*, October 7, 1933. Quoted in F. A. Haight, *op. cit.*, p. 103.

tant to abandon the power to regulate trade by quantitative measures? So far as the quantitative regulation of trade was concerned, exchange decontrol often meant little more than a transfer of powers from the Ministry of Finance to the Import Control Board. It is as important for any consideration of future policy to answer these questions as to ascertain the reasons for the original imposition of controls. Let us deal with them in turn:

The exchange decontrol movement of the mid-'thirties was limited because

(a) Especially after 1935, a great European conflict was generally held to be likely, if not inevitable, in the near future; controls had to be maintained to prevent the flight of capital that would otherwise have occurred;

(b) the foreign capital that would have been necessary in certain cases to support an orderly devaluation was discouraged not only by the political dangers but also by what were considered to be the unsound economic policies of some of the countries concerned;

(c) the growing preponderance of Germany in the foreign trade of the countries of South-Eastern Europe, and the German trading methods which raised their prices and thus reduced their competitive capacity in other markets, made it difficult for them to break away from the German system of controlled trade.

This brings us to the second question. If most of the smaller European countries were keenly anxious to re-enter the orbit of the free exchanges, for Germany—and later, for Italy and Japan—the rigid control of trade and foreign exchange transactions was essential for the purpose not only of mobilizing internal economic resources for war but also of obtaining essential supplies from abroad without the use of foreign exchange. Such controls were thus maintained deliberately as part of the preparation for war.

The persistence of direct quantitative trade restrictions (quotas) was partly due to the continuing insecurity, economic and political (for what government would willingly renounce its powers to control the foreign trade of its country at a time when war was becoming monthly more imminent?). But it was also partly due to two causes which, if they stemmed directly from that insecurity, became in a measure independent of it.

First, as commercial bargaining weapons, quotas are, as we have

seen, not only usually more powerful than tariffs but also far more precise, in that the value of the concessions to be offered or withheld can be exactly measured. It is therefore not surprising that governments in a strong bargaining position (such as Switzerland, France and the United Kingdom) should have been hesitant, at a time when economic warfare was rife, to accept the measure of economic disarmament that any far-reaching unilateral abrogation of quotas would have involved.

Secondly, the importance of many quotas in national economic programmes was a factor setting rather narrow limits to what might be accomplished in the absence of some form of international planning. Such programmes, originally devised to increase employment and prevent further deflation, and usually connected with a drive toward greater self-sufficiency, survived the depression emergency, took root and quickly extended their scope. Never again—such was the argument current among European governments in the middle 'thirties—must the country's economic life be at the mercy of fluctuations coming from abroad. The depression had given a violent impetus to secular movements toward economic isolationism and toward increased government control both of domestic production and of foreign trade.

It cannot be claimed that quantitative trade regulation was always a necessary element in the national planning schemes of this period, or that even a large proportion of the restrictions were justified on any ground. It was the line of least resistance—and the line too often followed—to bolster up the *status quo* by an import restriction instead of carrying out desirable economic adjustments. But, in a time of tension and uncertainty it is easy to understand the temptation to cling to a method offering such precision in the control of foreign competition and such a degree of certainty in the regulation of foreign trade. And in respect to agriculture, special arguments for the employment of this method were not hard to find in Western Europe. There were cogent reasons, socio-political as well as economic,[1] for maintaining a high degree of stability in agricultural prices. It was

[1] The peculiar conditions of agriculture with reference to the general problems of economic policy, as contrasted with the conditions of industry and commerce, are well brought out in Wilhelm Röpke, *International Economic Disintegration* (London, 1941 and New York, 1942). This author makes a strong case against the exaggerations of agricultural protectionism.

clearly demonstrated that, in the conditions prevailing up to say 1934 or 1935, tariffs were an inadequate protection against violent fluctuations in agricultural prices, while it was possible to achieve a considerable degree of internal stability by quantitative controls, which enabled the resources of the overseas (or the Danubian) countries to be used as a sort of cushion to offset fluctuations in domestic output or demand. Such stability was, of course, achieved only at a heavy cost to the non-agricultural population, and most agricultural policies avowedly aimed at gradually reducing domestic costs and prices (and thus making possible a relaxation of trade restrictions) by means of agricultural reorganization involving, for example, a shift from cereals production to the production of protective foods. But it was a common criticism of agricultural policies in the later 'thirties that such reorganization was entirely inadequate.[1]

The commercial warfare and the national economic planning characteristic of the 'thirties became, it is true, in some measure independent of the prevailing political and economic insecurity. But had that insecurity been overcome, the first of these tendencies would undoubtedly have been greatly weakened and the second might have found its fulfilment in an international programme aimed at full employment and trade expansion. Economic insecurity and above all monetary instability, on the one hand, and political insecurity on the other, remained the fundamental factors in the persistence of the quota system.

[1] See, for example, P.E.P., *Report on International Trade* (London, 1937), pp. 200-210.

CHAPTER 7

CONCLUSIONS

The foregoing survey and analysis suggest a number of conclusions bearing on problems of future economic policy. These conclusions relate to: (A) the effects and implications of quantitative controls, especially quotas; (B) the technical methods by which controls have been removed or their operation improved; and (C) the conditions leading to, or preventing the removal of, quantitative controls.

The last set of conclusions, which may help to answer the question how widespread recourse to quantitative controls may be avoided in the future, is naturally of special importance.

A. *Implications and Effects of Quantitative Controls.*

(1) If the trend toward economic isolationism, autarky, regimentation and State control, characteristic of the nineteen-thirties in many parts of the world, were to be renewed after the war, quantitative trade controls would necessarily play an ever-greater rôle. Equilibrium in the national balances of centrally controlled trade would be maintained by rigorous exchange control, the means of economic pressure and discrimination furnished by which would be at the disposal of those states that had the power to use them. Quotas, a half-way house between a liberal and a centrally planned trading system, would tend to give place—as, in several countries, they tended to give place in the 'thirties—to public or semi-public monopolies. Being essentially a method of controlling the import activities of private firms, they are ill-adapted to a fully planned and socialized economy; nor is there any place in such an economy for the unearned profits which go to the receivers of import licenses under the quota system.

(2) A movement in this direction, however, would not only belie the intentions of the governments of the United Nations as expressed in the Atlantic Charter[1] and the Lend-Lease Agreements[2] as well as innumerable statements of national policies; it would also prevent the achievement of those basic economic and social objectives which

[1] "Fourth, they will endeavour, with due respect for their existing obligations, to further the enjoyment by all States, great or small, victor or vanquished, of access,

most of them have proclaimed—greater human welfare and full employment, within the framework of a social system designed to preserve individual liberty. An expanding international trade is essential, not as an end in itself, but because these ends cannot be attained without it. And if an expansion of trade, though altogether unlikely, is nevertheless conceivable under a comprehensive system of quantitative controls or of State trading, a highly controlled trading system is incompatible, in the long run, with a relatively free domestic economy. For quantitative controls are "non-conformable" types of State intervention, in the sense defined in Chapter 4; they introduce rigidities which undermine the functioning of both the price mechanism at home and the system of multilateral settlements; every control imposed tends to call for further controls, both of trade and of domestic industry. Such inherent characteristics are perhaps of small consequence when the restrictions affect only a small proportion of total imports or are limited to special classes of commodities, *e.g.*, farm products. It is clearly impossible, however—except over short periods—to have generally regimented and socialized international trade and a domestic economy based on free enterprise.

B. *Procedure for the Removal of Relaxation of Controls.*

(1) Many countries will no doubt find it necessary to maintain exchange controls for a considerable time after the war, at any rate as regards capital movements. But, if effective machinery is estab-

on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity." (Principle IV)

[2] Article 7 of the Master Agreement between the United States and the United Kingdom reads:

"In the final determination of the benefits to be provided to the United States of America by the Government of the United Kingdom in return for aid furnished under the Act of Congress of the 11th March 1941, the terms and conditions thereof shall be such as not to burden commerce between the two countries, but to promote mutually advantageous economic relations between them and the betterment of world-wide economic relations. To that end they shall include provision for agreed action by the United States of America and the United Kingdom, open to participation by all other countries of like mind, directed to the expansion, by appropriate international and domestic measures, of production, employment, and the exchange and consumption of goods, which are the material foundations of the liberty and welfare of all peoples; to the elimination of all forms of discriminatory treatment in international commerce, and to the reduction of tariffs and other trade barriers; and, in general, to the attainment of all the economic objectives set forth in the Joint Declaration, made on the 12th August 1941, by the President of the United States of America and the Prime Minister of the United Kingdom."

lished to overcome the initial difficulties of financing the essential needs of countries left after the war without adequate means of external payment and to facilitate multilateral clearing, it should prove possible to liberate commodity trade rapidly from control via the exchanges. How this might be carried out is discussed in a recent League report.[1]

Where quotas are maintained, some of their more injurious features might be removed. For example, the efforts frequently made[2] in the 'thirties to divert to the national treasury part of the profit resulting from the price differences in importing and exporting countries might be extended and developed. A method commonly adopted was to charge a fee or impose a tax on the import license. An alternative method might be to sell licenses to the highest bidder at public auction. If quota profits were completely taxed away by some such method, the result would be practically equivalent to a system of sliding-scale duties so adjusted as to restrict imports to a pre-assigned level.

(2) Of the circumstances facilitating a removal of import quotas, perhaps the most common has been a growth in exports. Quotas have been successfully removed also (a) when owing to currency devaluation in the country concerned or a change in domestic demand or supply conditions, imports tended to fall short of the quota, which consequently ceased to serve any purpose; (b) when tariffs were raised to afford protection equivalent to the quota; (c) when owing to a revival in business and consequent growth in domestic demand, larger imports were necessary; (d) when reciprocal concessions were negotiated bilaterally or by agreements (*e.g.*, Hague Convention, 1937) between small groups of countries.

Of these, (c) and (d) were the only circumstances in which the removal of a quantitative restriction had an appreciable effect on the movement of trade. (c) points to the basic fact, which is confirmed by the whole history of commercial policy in the interwar period, that the difficulties in the way of scaling down the barriers to trade are least formidable in times of rising prosperity.

[1] *The Transition from War to Peace Economy*. Report of the Delegation on Economic Depressions, 1943.

[2] Especially in France, the Netherlands, and Belgium. See Heuser, *op. cit.*, pp. 236-9.

C. *Conditions of Avoiding Widespread Recourse to Quantitative Controls.*

An analysis of the reasons for the adoption of quantitative controls in the interwar period involves, on the one hand, the question why there was a movement toward greater economic isolationism, and, on the other, the question why quantitative controls were preferred to tariff regulation.

(1) Conditions of Avoiding a Revival of Autarkic Policies

The first of these questions has been discussed at length in a companion volume[1] and a number of lessons for the future have been drawn which—since they coincide with the main conclusions emerging from the present study—may usefully be summarized here:

(a) The early post-Armistice experience clearly suggests that the chances of getting generally adopted commercial policies designed to promote rather than to restrict international relations as a whole may be jeopardized in the first few months of peace if governments fail to agree in advance upon some orderly process of decontrol and some financially and economically sane system of reviving the economic life of countries impoverished by the war.

(b) No less essential is the establishment of a mechanism for the preservation of peace so adequate and sure as to create confidence despite antipathies and mistrust.

(c) Since the experience of the 'thirties, apprehensions resulting from economic insecurity have become at least as important as fear of a recurrence of war. If a revival and spread of autarky is to be avoided, commercial policies must become part of general, constructive policies agreed among governments for the prevention or mitigation of economic depressions and the maintenance of full employment.

The dependence of commercial policy on an orderly transition from war to peace economy, political security and economic security and advancement are perhaps the three major lessons to be drawn from the commercial history of the interwar period; but several others are also of great importance:

(d) Experience has shown the absolute necessity of adapting commercial policies to the circumstances influencing national balances of payments. If creditor countries impede the import of goods with

[1] *Commercial Policy in the Inter-war Period, op. cit.*, Part II, Chapter VI.

which their debts can be paid, if new obligations are created and no commodity provision made for their service, if debtor countries obstruct the export of goods with which they may meet the service of their debts, disequilibrium must be caused which will render widespread restrictions on imports inevitable.

(e) Again, to draw an arbitrary line between commercial policy and other measures necessary for economic adjustment, as was frequently done especially in the 'twenties, is almost certain to produce harmful results. Questions of commercial policy should be considered by international bodies in conjunction with the whole catena of post-war problems—relief and the manifold problems of reconstruction, as well as long-range questions such as the needs of countries anxious to promote industrial development—that are likely to arise.

(f) If wider free trade areas are desired, they ought to be created immediately after the war before vested interests have time to develop; and the possibility of establishing a derogation from the most-favoured-nation principle to permit the formation of preferential unions under certain circumstances should be considered.

(g) Finally, the pursuit of uncoordinated programmes by great States "is likely to involve a disruption of the whole mechanism of trade and economic relations in general and must inevitably do so if severe quantitative restrictions on trade are an integral part of such programmes." Planning for full employment and economic security must be a major concern of the economic policy of the future; there is little hope that international trade can be restored or that national economic objectives can be achieved unless such planning is coordinated and—in a large measure at least—worldwide.

(2) Conditions of Avoiding Recourse to Quantitative Controls.

(a) In both the periods we have been considering, the most clearly discernible factor leading governments to introduce quantitative controls was *currency instability* accompanied by exchange dumping. In the 'thirties, the situation was complicated and aggravated by the protracted disequilibrium in national price levels resulting from the unwillingness of important countries openly to adjust the value of their currencies. Of no less importance, however—and itself a primary cause of the currency instability—was the *breakdown of the*

mechanism of international trade and settlements as a result, in the 'twenties, of the war dislocation and, in the 'thirties, of the catastrophic fall in prices. The first lesson to be learned from this experience is that an extension of the system of quantitative restrictions cannot well be avoided after the present war without international action aimed both at maintaining stability of the exchanges and at restoring the credit and the production and trade of the countries which have most suffered from the destruction and dislocation of the war.

(b) After the experience of the 'thirties, few countries will in future be prepared to undergo a severe internal price deflation, with its train of unemployment, in order to maintain or restore equilibrium in comparative price levels and the balance of payments. This equilibrium can be disturbed—and in a dynamic economy is likely to be constantly disturbed—by one or more of the following factors: rise in incomes and prices (which include costs) at home; a fall in incomes and prices abroad; a shift in international demand without previous expansion or contraction of incomes or prices; capital movements. Under an automatic gold standard, such disturbances, if they involve an over-valuation of the currency, are met by an outflow of gold and corrected by internal deflation. If the deflation required is too severe, the disturbances may be corrected by currency devaluation. In the 'thirties, they were, in many countries, met by quantitative trade restrictions and exchange control and were not (or very inadequately) corrected.

What other courses are open to meet the push and thrust of international economic life? This issue is fundamental to our whole problem. Discrepancies in national price structures can only be overcome by changing prices in terms of domestic purchasing power, that is, by deflationary or inflationary processes, or by changing the external purchasing power of currencies by a modification of the exchange rates. In the immediate postwar period national price and costs structures are likely to be so much out of gear with each other as to necessitate the latter course. This is one reason in favour of the establishment of special machinery by means of which credit may be furnished to meet changes in the balances of accounts, by which orderly changes in currency parities may, if necessary, be carried through, by which

national monetary policies may be co-ordinated and kept in line, and multilateral trade and clearing facilitated.

But such machinery requires for its effective working concerted measures against economic depressions and for the maintenance of full employment, especially among the major creditor countries and the world's major markets. The importance for the whole world of the maintenance of prosperity in the world's great markets cannot be overemphasized. International supervision of commercial policies, and possibly some form of international veto, should also contribute to reducing disturbances. Finally, international machinery for facilitating industrialization or essential public works in backward countries and the economic reorganization of countries which found it necessary to undertake a radical readaptation to changing conditions would be of quite special importance.

(c) These various elements in a possible long-range plan[1] for the preservation of an international economic system form a whole and together provide a challenge to the constructive vision and the co-operative spirit of our generation. A return to the old restrictive methods—the alternative which the forces of inertia and the forces of narrow nationalism will no doubt combine to favour—would be a disaster of incalculable magnitude.

This brings us to our final point. The failure to break down the system of quantitative restrictions in the 'thirties was in the end due not so much to a lack of understanding of the technical issues at stake as to the unwillingness of certain great States to abandon their designs for political aggrandisement or the methods by which they were able to exercise pressure on others. If wise concerted economic measures are one of the bases of a durable peace, they provide by themselves no solution of the political problem. And on the solution of that problem the success of all efforts to create a better economic world ultimately depends.

[1] Proposals for the problems of the transitional period following the war have been put forward by the League of Nations Delegation on Economic Depressions in Part I of their report (April 1943) entitled *The Transition from War to Peace Economy*. Part II of the report will deal with the longer-range problems of fluctuations in economic activity in peacetime.

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