CABINET.

COMMITTEE ON THE BALANCE OF TRADE.

Memorandum of Dissent from the Committee's Report by the Lord Privy Seal.

I MUCH regret to be in disagreement with the Recommendations of the Committee (C.P. 25 (32)). I desire to state briefly some of the reasons for my dissent.

The Committee was appointed to consider the "adverse" Balance of Trade, to make recommendations for its adjustment if an adverse balance were found to exist, and if it were believed to be injuriously affecting our economic and financial position.

The Committee has proceeded on the assumption that the generally accepted test of the balance of trade, namely, taking the visible imports and visible exports, and adding to the latter the invisible exports, is the one and only test of whether our foreign trade is favourable or adverse. I am not convinced that this is the whole story. If there be, on the accepted view, an unfavourable balance—that is, an excess of imports over visible and invisible exports—it is assumed that the excess of imports is being met in one of two, or both of two ways, namely, by getting the excess of imports on "tick," or by the drain of capital from this country. We have no evidence, which is conclusive, that either or both of these things is taking place. Imports represent individual transactions between traders in this country and abroad, and they are paid for in the ordinary commercial way. We have no evidence that commercial debts are being piled up in foreign countries on account of imports. It is improbable on the face of it for three reasons. First, British importers are not likely to be given credits for long periods by impoverished traders abroad; second, imports are sold by the importer within the usual ninety days' period as a rule, and the proceeds are available to liquidate the bills on maturity; and in the third place, while individual traders in this country may buy ahead in a favourable market, they are not likely to do so on "tick," or out of capital, but out of their liquid resources. All the investigations we have been able to make do not support the assumption that capital is being drained away to pay for an excess of imports.

The Committee abandoned the question of how far the movements of capital may affect the balance, because of the difficulty of getting adequate statistics. It is deplorable that there should be such a lack of information on this vital matter, and I suggest that steps should be taken to try to remedy our ignorance. The Committee state that violent movements of capital may have serious effects on our exchange, and, without being dogmatic on a matter on which we have so little knowledge, I venture to think that if we had more knowledge of capital movements it might upset our assumptions about the Balance of Trade.

I do not think that what has been called "the automatic equilibrium theory" has been disposed of by the arguments which have been put before the Committee. Indeed it is admitted that the theory in general is sound, but that
it would be fatal to allow it to operate to the extent of depreciating the exchange value of sterling to practically nothing. No doubt that is true; but if that did happen it would show that there was something radically wrong with our balance of payments. But that it not the case. The pound has kept fairly steady since the departure from the Gold Standard, at a figure round what we are told is its real external value. Its present value is about the figure before the return to the Gold Standard in 1925, and at that time we had a large "favourable" trade balance on the accepted assumptions.

In short, I think we are exaggerating the influence of the alleged adverse balance of trade, and that we are in danger of applying medicine to cure a suspected disease which has not been thoroughly diagnosed, and about whose existence we are not quite sure.

But leaving these matters aside, I will come to the recommendations of the Committee for dealing with the assumption that there is a serious adverse balance which must be set right. The Board of Trade, proceeding on the assumption that we can get at the balance of trade by the simple method of taking the excess of imports over exports and adding to the exports the invisible items, conclude that in 1931 we shall have an adverse balance of about £100 millions, perhaps as high as £120 millions.

Since the ratio between visible imports and exports remains the same, however much the volumes may fall, the adverse balance is accounted for by the fall in the return from foreign investments, freights, insurance and commissions. There is no controversy about the falling off of this source of income. But it is well to bear in mind what effect may be produced on these items by any policy we may adopt for restricting imports. I will deal with that later. The Committee has assumed that no Governmental action can increase the "invisible exports" except very slowly and indirectly. In regard to foreign investments, I agree that they may be in a considerable measure true, but the other items—shipping, freights, &c., may be very materially affected for good or bad by fiscal policy.

Having satisfied themselves that the problem is one of the excess of the imports of merchandise over exports, the Committee proceed to suggest measures for rectifying this excess. They propose to do it by restricting imports and encouraging exports. This is the policy of all Protectionist countries. Its fallacy should be transparent. If every country in the world is restricting imports and trying to increase its exports, where in the world is the market going to be found for increased exports? I would call attention to the facts revealed in the trade returns for last year. The figures are a lesson to those who think that by lessening imports we are going to redress the balance of trade. The Committee aim at reducing imports by £52m. in 1932, and this, with a mythical increase of exports by £106m., is to redress the balance. In 1931 our imports were reduced by £181m., and it was in the year this huge reduction of imports took place that we had for the first time an adverse balance, except in the abnormal conditions of 1926. But there is another important fact revealed by the 1931 figures. The reduction of imports was accompanied by exactly the same reduction in the value of our exports! This is no new feature. A survey of the trade returns over fifty years will show this correspondence between imports and exports.

The figures given in the Committee's Report covering the last two years support this conclusion. In paragraph 10 it is stated that the Exports for the twelve months ended September last were valued at £422m., as compared with £720m. in 1929—a fall of £307m. The Imports for the same periods were respectively £814m., as compared with £1,111m., a fall of £297m. Two things are clear from these figures. First, that, as imports fall, exports fall; and second, that a reduction of £297m. in imports in two years has brought about the assumed adverse balance of trade. We have reduced imports by that huge figure in two years, and yet we are asked to assume that if we can reduce them by £52 millions in 1932 we are going far to reduce the adverse balance! But the important fact which emerges from all the figures is that any attempt to reduce imports will result in a reduction of exports, and I submit that it is a delusion to imagine that we can increase exports and at the same time reduce imports.

The reduction in the return of invisible exports from shipping, &c., would not be remedied by reducing imports. The shipping industry depends more upon
imports than upon exports, for, I understand, that the great bulk of imports are brought to this country in British ships.

The Committee propose to effect the reduction in imports by a general tariff, and by specific tariffs upon goods of a luxury nature, and upon goods which can be produced in this country. "Goods which can be produced in this country" is a wide and indefinite term. We could produce everything we need in this country at a price, and for a time—at a very short time.

These recommendations of the Committee travel far beyond its terms of reference, which were to find means of reversing the balance of trade. These recommendations are for a complete and permanent reversal of fiscal policy. They lay the foundations of a Protectionist system upon which the complete structure can be gradually built. I do not wish to introduce the political aspects of this question, but I must point out that this is going far beyond the programme upon which the National Government went to the country. Its mandate is clear and unequivocal, and was well stated by Mr. Baldwin on the 24th October. He said:

Perhaps I should say a word about those who have tried to confuse the issue with attempts to revive the Free Trade-Protection controversy of twenty-five years ago. Now, this is not the real issue. Here the Prime Minister and Mr. Snowden have both stated the position fairly accurately—that the National Government must be free to consider any and every expedient which may help to establish the balance of trade.

The 10 per cent. general tariff is put forward as a "revenue" tariff. It is to be all but universal in its application. It is to be permanent. It is to apply to nearly all the categories of food-stuffs and to a large number of raw materials, and to all semi-manufactured and manufactured articles. I want to know whether this 10 per cent. duty is to be regarded as a revenue duty or a protective duty. It may be answered that it is both. It may raise revenue and it may protect. But in so far as it protects by reducing imports it defeats its purpose as a revenue producer. We cannot have it both ways. Such a weapon in the hands of an unscrupulous Chancellor will always be a temptation to increase the rate of the duty. And to place such a duty in the hands of any Protectionist Chancellor is to give him all he needs to turn the tax into a full Protective duty. If this 10 per cent. duty is advocated as a revenue duty, then it is outside the reference of the Committee, which was confined to finding "expedients which may help to establish the balance of trade."

It is proposed to exempt from the general tariff certain articles of food and a few raw materials. There is no logical defence of such exemption. The exemption of certain food-stuffs is justified on the ground that the main item in this category—wheat—is being dealt with by a quota, and meat and bacon form a prominent item in household budgets, and that to tax these articles might cause such a rise in the cost of living as to incur a demand for an advance of wages. Tea is apparently to be dealt with in the Budget. I find from a summary of the Imports of food-stuffs supplied by the Board of Trade that the value of these articles in 1931 (including those at present dutiable) was £397m. Of these it is proposed to exempt from the 10 per cent. duty a total of £134m., leaving taxed articles of food for men and beasts to the value of £263m. In addition, raw materials to the value of £95m. are to be taxed, and materials to the value of £52m. are to be exempt. Manufactured goods to the value of £292m. will be taxed, including £45m. already paying duty. All articles of domestic use and consumption, with the comparatively small exemptions mentioned, are to be taxed. When we add the profit on the duty in the intermediate stages, and the inevitable increase of prices of the home-produced articles, we must contemplate an increase of probably not less than 15 per cent. in the cost of living.

Taken in conjunction with the possible increase in prices owing to the fall in the exchange, we get an increase in the cost of living which will be intolerable to the working class. This is bound to cause wages troubles at a time when it is vital not to add to the difficulties of the manufacturers by adding to the wage item in the cost of production.

If the 10 per cent. duty is advocated as a revenue producer then other objections can be urged which I need not stress here. If the revenue is to be used
to reduce direct taxation—to reduce the income tax, for instance, by sixpence—the change will be a relief of the well-to-do at the expense of the working classes. A reduction, or even the abolition of the Income Tax would give no relief to a married man with three children and an income under £400 a year. But from the analysis of family budgets the proposed revenue tax would involve the taxation of these people to the extent of from £7 to £15 a year.

It is intended now, or later, to give a reduction of the 10 per cent. duty on imports from the Empire. If duties are required to reduce imports there is no justification for this preference. Goods from the Empire affect the alleged adverse balance just as much as goods from foreign countries. But if the primary purpose of these duties is to reduce imports to redress the balance of trade, it is more important to reduce Empire imports than foreign, for the trade with the Empire is more adverse to us than our foreign trade. The figures are illuminating. Taking the first nine months of imports and exports for 1929, 1930 and 1931, we find that the "adverse" balance of merchandise trade with foreign countries has been declining, and that with the Empire rapidly rising. The "adverse" value with foreign countries in 1929 was £257m.; in 1930, £254m.; in 1931, £241m. The "adverse" balance with the Empire countries was in 1929, £12m.; 1930, £224m.; 1931, £394m. An encouragement of imports from the Empire will increase this "adverse" balance still more.

In addition to the general duty of 10 per cent., the Committee recommend specific duties of a higher rate upon articles of luxury, and upon articles which can be produced in this country. The Board of Trade assumes the possibility of the imports of articles "wholly or mainly manufactured" being reduced in 1932 by one-quarter. How this possibility is visualised we are not told. It is assumed that these excluded imports will be replaced by home-produced goods. Can anybody really believe that this is possible? In the sphere of food production I do not deny the possibility over many years, by a thorough reorganisation of agricultural production and marketing, of producing a much larger proportion of our food consumption, but it will take years. We have been told that in the matter of bacon it would take five years to establish a system comparable with the Danish system. In the meantime, we are not likely to encourage higher production of dairy produce by taxing imported oats and grain and other feeding-stuffs for cattle, or poultry farming by taxing equipment and produce.

How an encouragement is going to be given to exports by increasing the cost of production by the taxation of the materials which enter into production I don't know. The assumption of an increase of £100m. in exports this year is fantastic; and it certainly will not be helped by increasing the costs of production. Taxed imports of raw material and semi-manufactured articles which enter into the production of exports are not to be entitled to drawbacks; so it is undeniable that costs of production will be increased.

The Committee clearly contemplate that the specific duties will be so high as to be a great extent prohibitive. The repercussions of an increase in the prices of iron and steel, for instance, are bound to be injurious to hundreds of important industries who are large buyers. The case of timber is important. This, I assume, falls under the 10 per cent. duty. Foreign timber is an essential import, and to increase its price when we are trying to reduce the cost of building is indefensible.

It is asserted that the proposed duties will give us a bargaining weapon with Protectionist countries, and that we may by this demonstration of our readiness to impose duties, induce them to lower theirs. This is the oldest of the controversies between Free Trade and Protection. All experience has proved its ineffectiveness. If protective duties tended to get lower tariffs, we should have had universal free trade long ago. On the contrary, tariffs beget tariffs, and tariffs beget higher tariffs. At the Economic Conference, a few years ago, over fifty countries unanimously agreed that tariffs were a great hindrance to the exchange of commodities, and called for a reduction. But most of these countries, with the bargaining weapon of high tariffs in their hands, have been increasing their tariffs ever since, and the bargaining weapon has been useless to bring a reduction.

Recent events are instructive. In the last few months a considerable number of countries, with the weapon for bargaining for lower tariffs in their hands, have largely increased their tariffs. Italy, India, Argentina, France, Colombia,
Denmark, Finland, Poland, Uruguay and Norway; and Holland is now considering a new tariff schedule. Where every other country has found the tariff ineffective to induce tariff reduction, we are not likely to succeed. On the contrary, our entry into the tariff war is far more likely to lead to still further increases.

It is further suggested that the "specific tariff" may be used to compel the reorganisation of our industries. I cannot deal fully here with this hope. Our experience of efforts to induce reorganisation has shown us that the industries will not reorganise without a tariff, and if they get a tariff they will fall asleep under its protective charm.

To sum up the grounds of my dissent from the Protectionist proposals of the Committee, I may say that I do not believe they will do anything to redress the balance of trade; they will make the recovery of our export trade more difficult, they will increase the cost of living and the costs of production; they will discourage enterprise and efficiency; they will be useless to induce a lowering of foreign tariffs.

I may be asked what are my alternatives. The purpose of this memorandum is to try to show that the proposals of the Committee will do more harm than good, and not to set forth alternative proposals; but I may briefly say that I think the causes of the world economic situation are (1) reparations and war debts; (2) the maldistribution of the world gold stocks, which is due in a large measure to reparations and war debts; (3) tariffs, which impoverish the consumers and reduce their purchasing power; (4) exchange embargoes; (5) burden of armaments; (6) in our own country, inefficient organisation in industry and particularly in agriculture; and the high Bank Rate and the restriction of credit.

International action is needed to deal with the first five of these causes. We should press with the utmost vigour for a permanent settlement of (1); a second Genoa Conference on gold and currency and general economic questions should be aimed at, as I think many countries would now be ready for it. The question of tariffs would be bound to arise at such a Conference.

It may be said that it will take time to deal with these questions. That is true; but it is better to be dealing with fundamental causes than to apply so-called remedies which will not cure, but will aggravate the disease.

January 18, 1932.

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