

*CENTRAL & EASTERN  
EUROPE*

*IN*

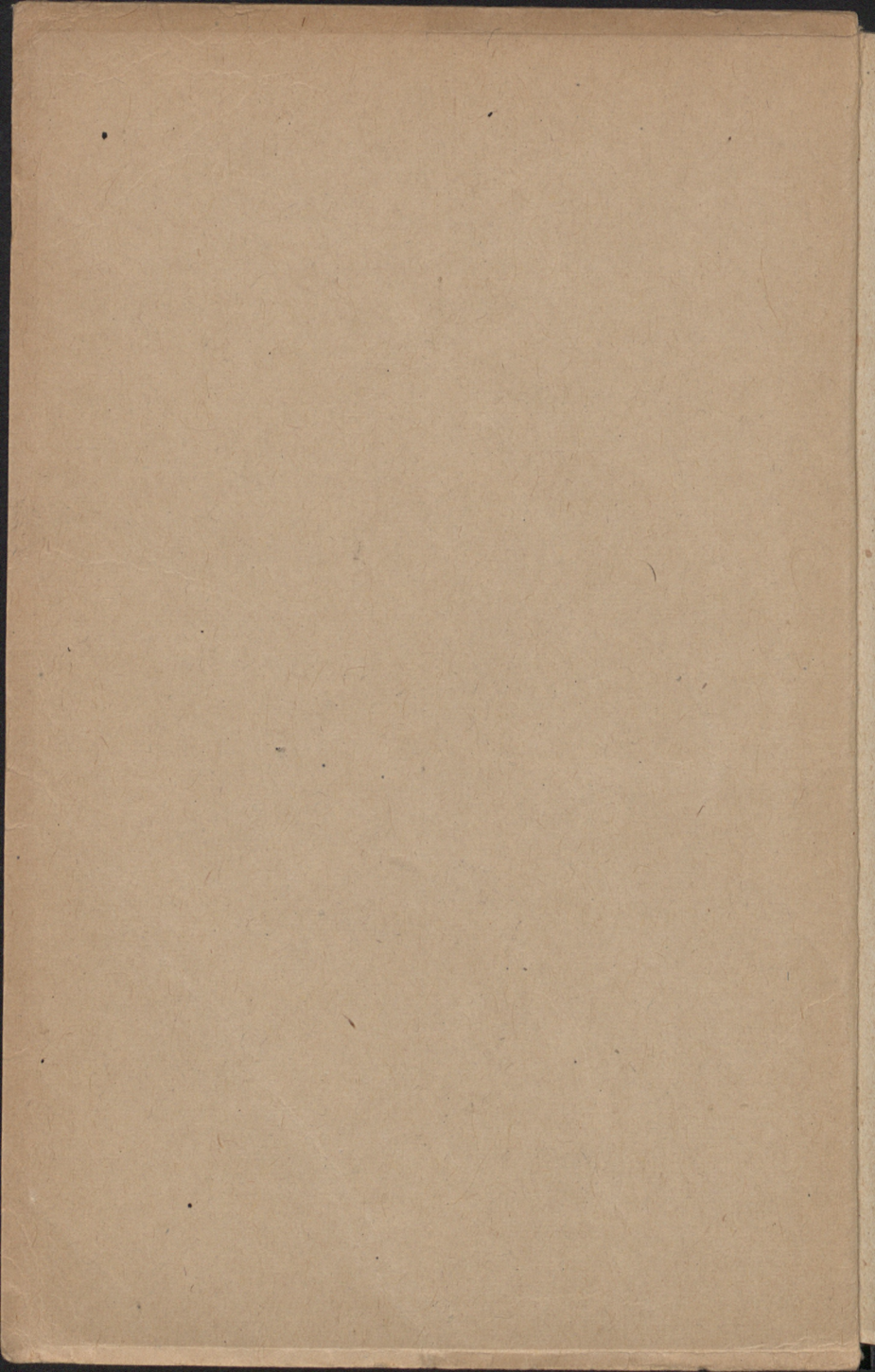
*WORLD ECONOMY*

*by*

HENRYK TENNENBAUM

*Professor at the Warsaw College of Commerce.*

LONDON, 1944



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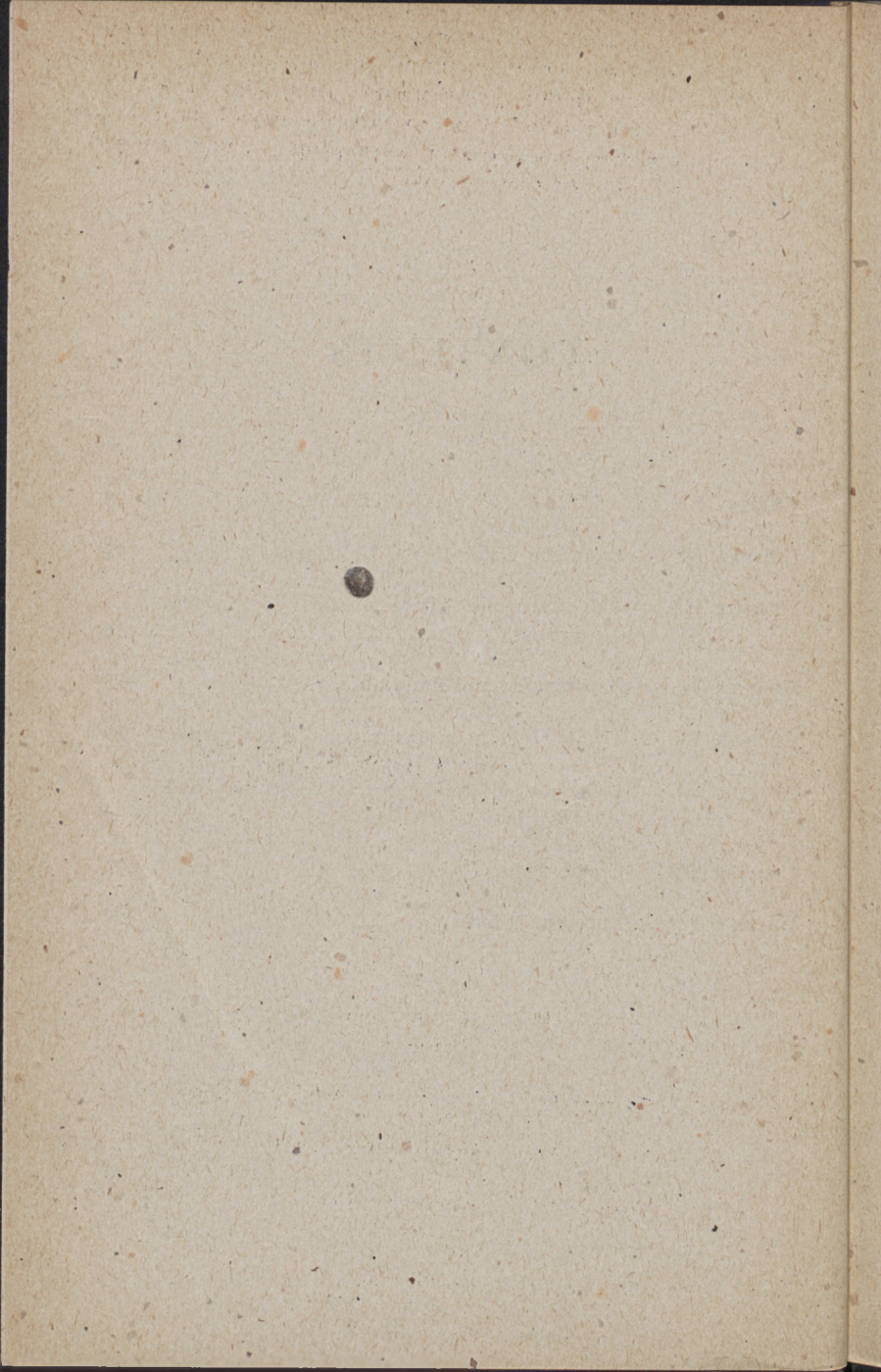
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## CHAPTER I

In a work entitled *DEMOCRATIC IDEALS AND REALITIES*, published in 1919 Sir Harold MacKinder, the well-known British writer, drew attention to the importance of the fact that a maritime power's strength is in direct relation to the size and wealth of its land base, and he warned his fellow countrymen against the danger of ignoring this vital truth. He went on to draw the conclusion that any power, or powers, which gained the mastery of the Eurasian Continent would have at its, or their disposal resources large enough to depose Great Britain and the United States from the pre-eminence which they now possess.

We have to agree with Sir Harold MacKinder that there is a danger that the great land mass of the Eurasian Continent may fall under the control of a single power, which would be able to use that continent as a base for the development of a sea-power excelling that of Great Britain. And for this reason the maritime powers should seek to obtain support on the Continent itself, in order to ensure that the great land powers remain within their own proper frontiers.

This function can be performed by the states comprising the great tract of territory which extends from the Baltic, through Eastern Europe and Asia Minor to India, for they can act as a counterbalance to the great land powers. Political blocs, politico-economic associations and straightforward alliances could all be formed among these countries, under the aegis of the maritime powers.

Starting from the foregoing assumptions, the *ROUND TABLE*

for September 1940 discussed the idea of the consolidation of the peoples living in the border lines between Germany and Russia, from Estonia to Greece. A proposal to form a central-European bloc had considerable support among British public opinion after the outbreak of the war, and only in the middle of 1942 did reservations in regard to the proposal begin to be made. A considerable factor in bringing about this change of opinion in Britain was Russia's entry into the war and the political and territorial demands which she put forward.

The emergence of several new states in central-eastern Europe after the last war came at a time when Germany had defeated Russia, while Germany in turn had been defeated by the Coalition powers. The defeated Germans were unable to go forward with their proposal to form a *Mittel-Europa*, while Russia had to resign her pretensions to Constantinople and her influence in the Balkans. To-day Russia, as a participant in the victorious Coalition, is putting forward territorial demands, and wishes to extend her sphere of political influence.

In a broadcast speech on March 21st 1943, reported in the *TIMES* the following day, Mr. Churchill said:

“ One can imagine that under a world institution embodying or representing the United Nations, and some day all nations, there should come into being a Council of Europe and a Council of Asia. As, according to the forecast I am outlining, the war against Japan will still be raging, it is upon the creation of the Council of Europe and the settlement of Europe that the first practical task will be centred. Now this is a stupendous business. In Europe lie most of the causes which have led to these two world wars. In Europe dwell the historic parent races from whom our western civilisation has been so largely derived. I believe myself to be what is called a good European, and deem it a noble task to take part in reviving the fertile genius and in restoring the true greatness of Europe.



“ I hope we shall not lightly cast aside all the immense work which was accomplished by the League of Nations. Certainly we must take as our foundation the lofty conception of freedom, law and morality which was the spirit of the League. We must try — I am speaking of course only for ourselves — to make the Council of Europe, or whatever it may be called, into a really effective League, with all the strongest forces concerned woven into its texture, with a High Court to adjust disputes and with forces, armed forces, national or international or both, held ready to enforce these decisions and prevent renewed aggression and the preparation of future wars.

“ Anyone can see that this Council when created must eventually embrace the whole of Europe, and that all the main branches of the European family must some day be partners in it. What is to happen to the large number of small nations whose rights and interests must be safeguarded? Here let me ask what would be thought of an army that consisted only of battalions and brigades and which never formed any of the larger and higher organisations like army corps. It would soon get mopped up. It would therefore seem, to me at any rate, worthy of patient study that side by side with the Great Powers there should be a number of groupings of States or confederations which would express themselves through their own chosen representatives, the whole making a Council of great States and groups of States.

“ It is my earnest hope, though I can hardly expect to see it fulfilled in my lifetime, that we shall achieve the largest common measure of the integrated life of Europe that is possible without destroying the individual characteristics and traditions of its many ancient and historic races. All this will I believe be found to harmonize with the high permanent interests of Britain, the United States and Russia. It certainly cannot be accomplished without their cordial and concerted agreement and participation. Thus and thus

only will the glory of Europe rise again.

" I only mention these matters to you to show you the magnitude of the task that will lie before us in Europe alone. Nothing could be more foolish at this stage than to plunge into details and try to prescribe the exact groupings of States or lay down precise machinery for their co-operation, or still more to argue about frontiers now while the war even in the west has not yet reached its full height, while the struggle with the U-boats is raging, and when the war in the Far East is only in its first phase. This does not mean that many tentative discussions are not taking place between the great nations concerned or that the whole vast problem of European destiny — for that is what I am speaking of now — is not the subject of ceaseless heart-searchings."

Compare the Russian statements on the subject with these views. The journal *WAR AND THE WORKING CLASS* declares that the anti-democratic and semi-fascist elements are opposed to Russia's participation in the organisation of the post-war world, criticises plans for forming an Eastern-European federation, and says that such plans can be realized only by ignoring the principle of the necessity for maintaining friendly relations and co-operation between Russia and her allies, in other words, only if the Anglo-Russian pact is abandoned.

In his book *U.S. FOREIGN POLICY*, the prominent American publicist, Walter Lippmann, has declared himself in forthright terms in favour of an alliance between the United States and Russia. Lippmann considers that the Anglo-Saxon states are not in a position to assure the independence of the states of Central-Eastern Europe despite Russia, as the maritime powers of themselves have no possibility of opposing a great land power. Yet later on in his work Lippmann considers that any Russian policy aiming at expansion in Europe and thus threatening Russia's neighbours must be regarded by both Great



Britain and the United States as a menacing phenomenon, and one which may lead to their giving their whole support to the states resisting Russia. If Russia were to menace China, relations between the United States and Russia would inevitably worsen. Similarly, if China aimed at territorial acquisitions in the South, it would inevitably provoke opposition on the part of the Anglo-Saxon states and of France and Holland. Any intention on the part of any state to make territorial conquests must meet with the resistance of other states, and must inevitably provoke tendencies to draw the conquered states to their side, which could be done only by restoring to them their destroyed strength. For instance, if after this war the allies were to fall out among themselves, rivalry might start among them to win the regards of Germany or Japan. Any tendency towards territorial conquests may transform former allies into rivals, and endeavours to restore strength to the conquered States.

Proposals have been made to divide Europe into a Russian and a British zone of influence. It would appear that the majority of British people are against such a division. Apparently the Moscow Conference took decisions in this spirit, but it is clear that the principle of maintaining indivisible Europe should be interpreted properly. There is an imminent danger that it may not be so. The danger that Russia represents in this direction is keenly realised by the states adjacent to Russia; the examples of Latvia, Estonia, Lithuania and Poland speak for themselves; the consciousness of this danger plays an important part in Turkish policy. The fear of Russia is intensified by the fact that for many years past Russia has been pursuing a trans-settlement policy, on a large scale, and aims at mixing together the nations living in Russia so thoroughly that certain areas have lost their national character. Russian policy is based on completely different postulates from that of Britain; for instance, no one has ever challenged the rights of the French minority in Canada, who have retained

their separate character down to the present day.

Russia considers that the incorporation of part of Poland with her territory will give her considerable strategic advantages; yet an inevitable result of such an annexation will be Polish irredentism for at least a century to come. The lesson of Alsace and Lorraine may well be recalled. Germany waited continually for the generation remembering the lost war of 1870/71 to die out, but waited in vain. Alsace and Lorraine exacerbated German-French and general European relations for half a century. In order to circumvent Polish tendencies to recover the land which Russia proposes to annex, in the event of the annexation being successful Russia will deport from these areas not only the Poles but the Ukrainians also, with the object of giving the entire area a Russian character and of destroying all *points d'appui* for future Polish claims. But the annexation of Polish lands would remain an ulcer exacerbating European relations for a very long time to come.

All the British press has been against the French action in Lebanon and emphasises that the separate identity of the Lebanon is rooted deep in history. The British Government has declared that "His Majesty's Government support and associate themselves with the promise of independence." By taking this attitude the British Government stands for principles which, if acted upon in Eastern Europe, would involve the recognition that the Eastern territories of Poland are distinctive in their character from Russian territories; and these Polish territories have been united with Poland and her culture for centuries. In any case, any Russian annexation of these lands, with the inevitable result of the deportation of Poles and Ukrainians from them, will constitute a violation of the principles which have been proclaimed during this war.

If Germany is disarmed, it can be said that the more thoroughly and effectively she is disarmed the less complete need be the fusion of a Central-European bloc for the



purposes of defence against Germany. In other words, the more Germany is disarmed, the looser may be the Central-European federation. In this situation Russia is suspicious that Central-Eastern Europe may be organized not against Germany but against Russia. It must however be pointed out that although after the last war the states of Central-Eastern Europe were not linked by any federal alliance, Russia nevertheless regards them up to now as a Cordon Sanitaire; hence it would appear that Russia regards the very existence of these states as a Cordon Sanitaire. Whether the Central-European countries take up an anti-Russian attitude or not will depend on the attitude of Russia. If Russia renounces her proposals for annexations, she will *ipso facto* assure the countries of Central-Eastern Europe that they have nothing to fear from her. But if Russia insists on annexations and succeeds in her intentions, the inevitable result will be that certain European countries will become centres of anti-Russian activity.

We consider that a political bloc of the countries of Central and Eastern Europe is necessary, but we also consider that within these blocs the national units should continue their separate existence, — subject, of course, to the proviso that their defence policies should be properly co-ordinated.

This separate existence is to a large extent necessary for economic reasons also. We are no advocate of autarky, but it must never be forgotten that people are happier if they are not dependent upon other nations for certain activities requiring higher qualifications, intelligence and knowledge, but are able to perform these themselves. Let us assume, for example, that average earnings would be higher in Poland if there were no Polish engineers, mechanics, artists, scholars, etc., but if all Poles were woodcutters, shoemakers, swineherds and the like; in other words, if all the machinery, motors, industrial equipment, etc. needed in Poland were imported from abroad. Then despite

their higher earnings, it is safe to say that the Poles would not be a happier people.

Willingness in such circumstances to forgo some measure of productive power for non-economic ends would be evidence of a certain idealism. But what is to be done if people are prepared to accept a lower standard of living in order to satisfy their self-respect, pride, or even vanity? In the economic sphere, the profit motive is giving place to moral motives; and a community may prefer to work harder and consume less if by so doing it believes that it can reach a higher level of social or technical development. For that matter, I am not in the least convinced that a larger area will guarantee a higher productivity.

For the purpose of common defence against potential aggressors, co-ordination of the economic policies of the Eastern European States may be necessary. I think, however, that those who believe that this co-ordination must necessarily bring about political unification are mistaken. In my opinion, such attempts might have the opposite result.



## CHAPTER II

### FROM THE BALTIC TO THE BOSPHORUS.

As the nineteenth century drew to a close the Germans were busy drafting ambitious plans which became known as "The Three Bs Programme." The three 'Bs' stood for Berlin, the Bosphorus and Baghdad, while the programme contained the most ambitious plans for a German drive to the East. This programme of expansion was doomed to frustration, but it is scarcely necessary to point out that German ambitions have grown apace in the intervening years.

The vast area in question, stretching from the Baltic Sea to the gates of India, embraces Poland, the Baltic and the Danubian states, Turkey and the Arabian world. Including some of the oldest inhabited portions of the globe, it has been the cradle of ancient civilisations and great religions. But with the uprise of the modern great powers along the Atlantic seaboard the importance of these older states began to wane. Towards the end of the eighteenth century, Poland was torn asunder by Prussia and Russia, while the subsequent dismemberment of the Ottoman and Austrian empires, though due to quite different causes, contributed to the weakening of the lands between the Baltic and Baghdad. Conditions in this area grew increasingly unstable and it inevitably became the sphere for Russian and German expansion.

A similar process of disintegration has been witnessed during the present war. The fall of Czecho-Slovakia sounded the first warning, soon to be followed by the

collapse of Poland. After this it was inevitable that the Danubian and Baltic states should succumb to German might. Russia betrayed the fact that she is still in some sense imperialistic by declaring war upon Finland and by seizing eastern Poland, Lithuania, the Baltic states and Bessarabia.

Between the members of the Baltic—Bosphorus—Baghdad block there are important geographical ties. The defence of coastlines and straits is dependent upon a hinterland. The hinterland of Turkey and Greece is formed by the other Balkan states and that of the latter by the Danube Basin; while Poland, in its turn, lies in the defence area of the Danubian states.

The present war has brought to light vast strategic areas which extend far beyond the frontiers of individual states.

Thus an American strategic region, far more extensive than the United States or even the American continent, is now coming into being. Again, German Europe is at present one vast strategic region. Should Germany lose the war it will be necessary to place many European countries into one or another of the main strategic zones. One lesson which the war has driven home is that certain countries are of such importance from the strategic point of view that they can never again hope to maintain neutrality. Denmark, Belgium and Holland are obvious examples; they will certainly have to become component parts of one strategic zone.

The countries which comprise the territory between the Baltic and the Bosphorus may have several courses open to them. Politically and strategically, they would obviously come within the German orbit should the enemy win the war. On the other hand, should Britain and her Allies be victorious several alternative solutions would present themselves. In my own opinion, the wisest solution of the problem would be to set up one vast political block which would extend from the Baltic to the Black Sea and the Adriatic, and would include all the states which



lie between Germany and the Soviet Union. In certain British circles the opinion has been expressed that some of these countries should be placed under Russian leadership, though what degree of influence is contemplated has not been specified. It may be noted that if some part of this territory were transferred to Russia the remainder might find itself too weak to resist German pressure and might consequently be destined to fall into the latter's sphere of influence.

## CHAPTER III

### THE ECONOMIC CHARACTERISTICS OF EASTERN EUROPE.

For the sake of brevity, we shall apply the title Eastern Europe to Poland, Lithuania, Czecho-Slovakia, Hungary, Roumania, Jugoslavia, Bulgaria and Greece, which had an aggregate population of around 107,000,000 in 1939. With the exception of Czecho-Slovakia, all these states are over-populated and insufficiently industrialised. For the purpose of illustrating their principal economic features we may conveniently draw upon the results of an investigation by L. Landau entitled "World Economy, Production and Income," which was published just before the war by the Institute of Social Economics in Warsaw.\* The value figures were given in Polish zlotys and, since we are dealing in comparative, not absolute, values, this unit is retained.

We may begin with the following statistics, which show the percentage of the population engaged in agriculture in the different countries of the world:

#### Percentage of Population in Agriculture

**Below 10 per cent.**

The United Kingdom

**Between 10 & 20 per cent.**

Belgium

Australia

---

\* A review of this work appeared in the *Economic Journal* for September, 1939. (Number 195).



**Between 20 & 30 per cent.**

Germany	United States
Holland	Argentine
Switzerland	Austria
	New Zealand

**Between 30 & 40 per cent.**

Canada  
Denmark  
France  
Luxemburg  
Czecho-Slovakia  
Sweden  
Norway

**Between 40 & 50 per cent.**

Uruguay  
Japan  
Greece  
Italy  
Chile  
Cuba  
Portugal

**Between 50 & 60 per cent.**

Hungary  
Spain  
Estonia  
Eire  
Latvia

**Between 60 & 70 per cent.**

Poland  
Finland  
Brazil  
Egypt  
Roumania  
Netherlands Indies  
Lithuania

**Between 70 & 80 per cent.**

Mexico  
U.S.S.R.  
India  
Jugoslavia

**Over 80 per cent.**

Turkey

The table brings out the fact that a high proportion of the population of Eastern Europe is engaged in agriculture. Typically agricultural countries such as Australia, Argentina, New Zealand and Canada have a smaller percentage of agricultural population than Poland, Roumania, Jugoslavia or Bulgaria.

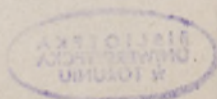
For the purposes of the present study we may consider three separate groups of countries: (a) Highly industrialised European countries, such as Germany and France; (b) Vast but sparsely populated countries, such as Canada, Australia and Argentina; (c) the Eastern European countries lying between Germany and the U.S.S.R. From this latter group, however, Czecho-Slovakia must be excepted because, economically, it resembles the first group rather than those countries to which it is geographically related. I believe, incidentally, that all, or most, of the members of the third group could ultimately attain the same standard of industrialisation as Czecho-Slovakia.

Before turning to a study of these three separate groups, we may with profit quote a further series of statistics from the above mentioned work:

#### Agricultural Production by Countries

Group I	Cereal Production per head (Thousand Zlotys)	Cultivated Area per head (Hectares)	Value of Produce per Hectare (Thousand Zlotys)
Germany	.67	1.08	.62
France	.62	1.06	.58
<b>Group II</b>			
Canada	2.62	6.03	.43
Argentina	2.67	6.08	.44
Australia	1.78	5.67	.31
<b>Group III</b>			
Poland	.30	.72	.42
Hungary	.51	1.07	.48
Roumania	.35	.98	.36
Other Balkan States	.26	.58	.45

Since the countries of Group II—Canada, Argentina and Australia—have five or six times as much land under cultivation, per head of the population, as those of Groups I and III, it is obvious that the states of Eastern Europe are not comparable in character with those of the overseas group. Productivity, per acre, is no higher in the





latter group than in Eastern European countries: if the agriculturalists there are better off it is only because they have so much more land at their disposal.

It is because the high level of agricultural productivity in such countries as Canada, Argentina and Australia where the rich agricultural population is a considerable buyer of industrial products that a larger percentage of the population is set free for industrial production than is possible in Eastern Europe where the agricultural population represents a poor market for industrial products. Even in France and Germany the position is relatively favourable; for these countries have a greater area under cultivation per head of the agricultural population, and a higher productivity per head than is the case further East. It is an obvious deduction that, if they are to preserve their independence, the countries of Eastern Europe must rise to the economic level of France or Germany; and the example of Czecho-Slovakia shows that this goal is by no means unattainable.

A comparison of the value of livestock production per head of the population in these countries yields similar results:

#### Value of Livestock Production

(Thousand Zlotys per head of Agricultural Population)

##### Group I

Germany	1.52
France	.79

##### Group II

Canada	2.10
Argentina	1.93
Australia	5.67

##### Group III

Poland	.35
Hungary	.59
Roumania	.33
Other Balkan states	.24

The size of the domestic market for livestock products is dependent upon the wealth of the country—for the poorer the population the higher the consumption of bread in proportion to animal products. The exportation of meat and animal products from predominantly agricultural countries to more highly industrialised states is becoming increasingly difficult as the latter foster their own agriculture and livestock industries; and imports into these markets are frequently regulated by customs duties, quotas and other means. Even if the countries of Eastern Europe were to double the per capita value of their livestock production they could not hope to attain the German level; and for them to follow the example of Denmark is out of the question, since an external market with a capacity sufficient to absorb the surplus produce of a small country like Denmark would be quite inadequate for their needs.

We may continue our study by considering a table showing the value of foreign trade per head of the population. The figures are taken from the League of Nations Statistical Yearbook for 1926, 1927 and 1928:

**Foreign Trade per head of the Population**  
(Dollars)

Group I	Imports	Exports
Germany	47.5	39.3
France	49.6	49.4
Czecho-Slovakia	35.5	40.0
Group II		
Canada	117.0	134.5
Argentina	74.9	82.0
Australia	115.9	109.0
Group III		
Poland	9.6	8.9
Hungary	22.1	16.8
Roumania	10.5	10.5
Bulgaria	8.2	7.7



Greece	24.1	12.3
Jugoslavia	10.0	9.1
Turkey	8.1	6.2

As might be expected, trade per head is greatest in countries such as Canada, Argentina and Australia, which are large-scale exporters of agricultural produce and large-scale importers of manufactured goods. Britain, too, imports a high proportion of the foodstuffs and raw materials which she consumes. While the states of Eastern Europe may endeavour to reach equality in foreign trade with those of Western Europe, it is obvious that they cannot hope to attain the level of the overseas group.

The above statistics suggest the rather surprising conclusion that Eastern Europe has few of the characteristics attributable to typically agricultural countries. Their export balance in agricultural produce is explicable mainly in terms of under-consumption at home. We may learn, for example, from the League of Nations publication "The Problem of Nutrition" that consumption of dairy produce per head in Poland is only one-half, and that of meat no more than a quarter, as large as in Australia and New Zealand. More wheat is consumed per head in Canada, Australia and New Zealand than in Roumania, while the per capital consumption of eggs is twice as high in Canada as in Poland. These figures are sufficient to establish the contention that the export of agricultural produce from Eastern Europe is primarily the outcome of under-nourishment in those countries.

Among world exporters of agricultural produce the countries of Eastern Europe lag far behind such important primary producers as Canada, Argentina and Australia. For example, the annual average export of wheat in the years 1930 and 1931 was about 3,000,000 tons for Argentina, 4,000,000 tons for Australia and over 6,000,000 tons for Canada. On the other hand, Hungary exported less than 500,000 tons a year in the same period and

Roumania only 700,000 tons. Indeed, the Eastern European countries under review have far more in common with China and some of the states of South and Central America than they have with such important agricultural producers as Canada, Argentina and Australia. True, the value of agricultural output per head is higher in Eastern Europe than in China, because the latter is even more overpopulated than the former, but productivity per acre is higher in China on account of the large output of tea. But some of the leaders of Eastern Europe are haunted by the fear that the standard of living in their countries may fall to the Chinese level should the policy of increased industrialisation fail.

For the inadequate industrialisation and consequent overpopulation of Eastern Europe various remedies have been put forward. One such suggestion is that the countries should be combined into a single economic area, on the assumption that economic planning on a sufficiently large scale would do much to raise the standard of living above the present low level. In some quarters, indeed, miracles are expected from a planned economy. Others simply suggest emigration. It will be our endeavour to show that, in fact, the economic unification of the area in question is no adequate solution of the problem. We shall study the limitations of economic planning in the case of Eastern Europe and shall try to demonstrate that, within the strategic and political framework, economic differentiation should be allowed to remain. Nevertheless, the investment of adequate amounts of capital is clearly of paramount importance in raising the economic efficiency of these backward lands.



## CHAPTER IV

### IMMIGRATION AND EMIGRATION

The absence of restrictions on the movement of persons, raw materials, capital and manufactured goods from one country to another was characteristic of the free trade era of the nineteenth century. During this period workpeople and capital flowed freely into countries having an abundant supply of uncultivated land and undeveloped natural resources. But drastic changes occurred after the close of the last War and the position has now been completely transformed. In no respect is the change more apparent than in the case of migration.

For a number of years past the restrictions imposed upon immigrants in most countries of the world have been steadily tightened up. One reason is not far to seek. Even in a fairly homogeneous society harmony is often not easy to achieve—and a large scale immigration of aliens will clearly render the process of unification considerably more difficult. Generally speaking, the emigrant is a person who is dissatisfied with his lot in his own country, the principal motive for his migration to foreign parts being his desire to raise his standard of living. But the native population, fearing that their standards will be undermined or their jobs taken from them, seek to protect themselves against the competition of alien workers in various ways. Hence the opposition to immigration and the many restrictions upon it, which are characteristic of the days in which we live: even the British Dominions have in some cases imposed restrictions upon immigrants from the Mother Country.

It is generally the country with the higher rate of employment, lower rate of unemployment or even lower birth-rate which is opposed to the unfettered entry of immigrants into its territory; and there thus arise what may be termed "immigration frontiers." But in this connection it is perhaps worth pointing out that, whereas the absence of anti-immigration laws or regulations is clearly a necessary prerequisite of population movements, it is not by itself sufficient to ensure that such movements will take place. Before the war, for example, Polish citizens undoubtedly possessed the legal right to settle in Danzig; but as the employers in the free city usually refused to take on Polish labour, while house-owners would not let accommodation to Poles, the right was nugatory. The consent of the government and of the majority of the community must be secured before migration of labour can become an accomplished fact.

So far as migration is concerned, the policy of Russia and Germany is in striking contrast with that of the majority of governments. Having at its disposal the necessary natural conditions—abundance of territory—the Soviet government conducts a policy of planned migration on a grand scale; and in this respect its policy differs only in degree from that of the Tzarist government. Thus, before the last war it was difficult for Poles to obtain administrative posts in that part of Poland which was incorporated into the Russian empire, for all the best jobs went to Russians. But the government gladly accepted Poles for employment on the railways or for positions in offices or factories in Central and Asiatic Russia.

That the Russian authorities should seek to locate their strategic industries as far from the frontier zones as possible is a natural consequence of the country's structure. In building up great industrial centres in the Urals, on the Volga or in Siberia the authorities are drawing labour into these remote and hitherto sparsely populated regions. A



high proportion of the settlers in these newly developed areas consists of Ukrainians, White Russians, Tartars from the Crimea, Finns from Karelia—and recently Poles from the eastern provinces of Poland. In this connection a personal reminiscence may not be out of place. In 1931, when I happened to be travelling in the neighbourhood of Minsk, I met some Polish peasants who told me of their compulsory eviction from their homeland and of their journey to distant Russia. This is but one example of the deliberate policy of mixing people of various nationalities, in the hope that those who have been expelled from their homeland may ultimately be absorbed into the Russian nation. I venture to think that the greatest cruelty that can be inflicted upon any people is to be banished from its homeland. Even the severest and most ruthless oppression does less to undermine the basis of national existence than the uprooting of populations from their native soil and the settling of foreigners in their stead.

When Russia occupied Eastern Poland in 1939 she embarked upon the mass deportation of the Polish and Ukrainian population and brought in Russian settlers to take their place. It is possible that the Soviet authorities may ultimately abandon this brutal practice of expulsion, but it is highly improbable that the principles underlying their population policy will undergo any fundamental change; for this is part of an ingenious and carefully worked out plan of unification which is of great importance for Russia. In states which have not the same vast territory at their disposal such a policy would be impossible.

That the human implications of this policy of compulsory mass migration are not always understood is obvious from a perusal of such a book as "Eastern Europe after Hitler," by Doreen Warriner, published by the Fabian Society in June, 1940. Miss Warriner there suggested that if the U.S.S.R. remained at peace it might embark on a great re-settlement programme, moving population out of Polesia

and Wolyhnia into the Ukraine, as had already been done on the Russian side of the frontier; "for that is the only solution for these wretched regions." That such a suggestion should be put forward by a social reformer at a time when the Nazis are causing untold misery by transplanting masses of people to foreign parts is monstrous.

Incidentally, the same author criticises the anti-immigration policy of the British Empire and advocates the emigration from Europe to overseas countries of 300,000 to 500,000 persons a year, adding that she sees no reason why the emigration of workers from Britain and Germany should not be encouraged; for this would enable the agriculturalists of Eastern Europe gradually to move into agriculture or industry in Western Europe. But it seems improbable to us that when Canada, Australia and other British Dominions become highly industrialised they will be able to absorb immigrants on a scale comparable to the influx of population into the United States during the past century. It is extraordinary that the Fabian Society should cling so closely to the conception of economic man as to be blind to the ties between a nation and its land.

The actual exchange of population between two states is by no means unknown. It was in fact done after the last war in pursuance of a treaty between Greece and Turkey and of another between Greece and Bulgaria. As to the rights and wrongs of treaties of this sort opinions may differ. But they clearly have little in common with the methods adopted by the German and Russian authorities.

Before their attack upon Russia the Nazis had no sparsely populated territories to which they could transplant the Polish population, but they have since been conducting an extremely ruthless policy of compulsory migration. They have transferred the Polish population mainly to the central provinces and have settled Germans in their place. Nationals of the conquered states toil as slaves in Germany, separated from the German population by many barriers.

Thus in the so-called Government-General there is an enormous concentration of Poles who, as soon as victory is attained, will doubtless be anxious to rush westward and eliminate by force the Germans who have been settled in that part of their land.

It is undoubtedly true that the dearest desire of the peoples who have been deported by both the Russians and the Germans is to return to their homeland. And it would appear that the time is now passing when people will move freely into sparsely-populated foreign countries, rich in land and minerals. It is, of course, untrue that people were always willing to leave their homeland in order to better themselves in a foreign country—though that was often the case. In consequence of social and economic progress, and of the increasing participation of the lower strata of society in the cultural life of the nation, emigration is losing much of its attraction. In a foreign land the emigrant today is generally unable to participate in the social life, being in fact deliberately excluded from it. Thus a Polish worker who emigrated 40 years ago would have felt far more at home in a foreign country than one who emigrated during the past decade.

With this change in conditions, the majority of people will prefer to remain in the land of their birth—and this being so, it is better to bring the raw materials and machinery to the workpeople than to attempt to move the labour to the materials. More importance should be attached to satisfying man's desires than to the quest for mere efficiency in production. (Economic progress depends of course, upon increasing efficiency; but what is progress if it does not permit some industrial inefficiency for the sake of non-material ends?) With the progress of industrial technique the part played by the raw material in determining the cost of the finished product is diminishing; for example, a cwt. of special steel costs from 1,000 to 2,000 times more than a cwt. of ordinary iron. This is indicative



of the fact that the principal determinant of the location of industry is no longer the availability of the necessary raw materials, but rather the supply of labour in the locality—and especially the quality of the latter. Needless to say, the quality of human labour may be raised by education—and the educational requirements of industry and agriculture are nowadays playing an increasing part in determining the curricula of schools and even of universities.

We may conclude that for the future the primary importance of the nation and of the individual human being must be recognised. Economic policy should be subordinated to people's increasing reluctance to emigrate and growing desire to remain in their homeland. Instead of transplanting the labour to the raw materials, the latter must be brought to the homes of the people who will work upon them. The attainment of this objective has been greatly facilitated by recent progress in industrial technique and in transport facilities.

## CHAPTER V

### PROFITABILITY AS AN INSTITUTIONAL PHENOMENON

From the standpoint of liberal economics, the profitability of the undertaking is the sole justification for production. But the proposition that certain goods or services should be supplied to the consumer at below cost price clearly rests upon quite different social and economic criteria. Where the children of the poor are provided with cheap or free milk, for instance, it is the tax-payer and not the consumer who must bear the cost. The adoption of this principle revolutionises the basis of liberal economics.

Economic policy in the free trade era rested on the assumption that the profitability of industry was primarily dependent upon such so-called natural conditions as proximity to coal, raw materials, etc. But with the progress of industrial technique and the cheapening of transport services the relative importance of these elements began to decline. An illustration of the change is provided by the fact that the industrialised states of Western Europe have to import from overseas the petroleum products upon which their economic life partially depends. It is apparent, moreover, that many branches of industry cannot hope to pay unless the authorities provide a suitable system of education, an adequate network of roads, electricity supplies, telephone services, and the like. In fact the state has set itself the task of providing many of the prerequisites of industrial profitability.

In a large number of cases therefore it is state policy

which now determines whether or not any particular undertaking will be a commercial proposition. Cases of natural profitability, unaffected by government policy or that of public bodies, are becoming increasingly rare. A business situated in an area devoid of natural advantages may nevertheless be made to pay by the suitable adjustment of other conditions. For example, in areas remote from the main centres of consumption farming may be made profitable by the grant of low railway freight rates. Again, in many countries whole branches of production would be unremunerative were it not for the existence of suitable protective customs duties. And cartel organisations are another device by which producers are enabled to secure a price sufficient to provide an adequate profit margin.

In short, profitability is becoming more and more an institutional phenomenon, dependent upon economic policy, the standard of education, railway rates, customs duties, trade associations, collective wage agreements made under state auspices—sometimes by means of state arbitration—and subsidies of various kinds, not to mention the adjustment of taxation and other measures.

One might suppose that in predominantly agricultural countries agriculture at least would be a commercial proposition, regardless of institutional factors; but this is by no means always so. The governments of countries with an export surplus of agricultural produce have in recent years frequently had to adopt various expedients to raise their farmers' competitive power. The methods employed include the reduction of debt charges, the remission of import duties on foreign materials used in agriculture and the grant of subsidies or export bonuses so as to facilitate a reduction in selling prices at home or abroad.\* (It is perhaps scarcely necessary to point out

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\* The aid granted to agriculture in Australia, Argentina, France, Germany, Italy, Britain and the United States in the period 1930-38 cost the governments of those countries the equivalent of no less than \$4,000 millions.



that the assistance given to agriculture in Great Britain and other countries with an import surplus of foodstuffs is of a different character).

In practice there is little to choose between the grant of direct state assistance in the shape of subsidies and credit facilities and the other methods of assisting industry mentioned above. Suppose, for example, that the Polish iron industry had not been protected by customs barriers, that railway freight rates had not been differentiated in its favour and that domestically produced iron products had had to be sold on the home market at prices no higher than those at which similar articles produced abroad could have been sold in Poland. But suppose that instead the government had paid the local concerns a bonus in respect of every ton of iron goods produced. This would clearly be but another means of attaining the same end, namely the assistance of the local iron industry. True, it would be a more cumbersome and complicated system than that actually adopted, but from the economic standpoint the results would be precisely the same. There are, in fact, all manner of expedients by which economic policy can create a certain price structure in the national economy.

The opponents of *laissez faire* economics maintain that production should not be undertaken merely for profit, but in order to satisfy consumers' needs; and if it is said that under a *laissez faire* system production is also undertaken to satisfy consumers' needs, the obvious reply is that it takes account only of the needs of that section of the community who can afford to pay a price sufficient to cover the cost of production. Profit, of course, is the surplus remaining after all costs have been covered, and relatively to those costs it is generally small. If production according to need is to be the criterion then the state must obviously offer a subsidy of some kind in cases where the price fixed does not cover all the costs involved; and in fact this is often done nowadays.

It is an established fact that in respect of enterprises which are in a monopolistic position there exists a most advantageous rate of turnover as well as a most advantageous price, the latter yielding a larger profit than the highest price which could be obtained; and in my opinion there is for every product produced by the various branches of industry a most advantageous price. If a certain group of industrialists, being in a strong position, can force their suppliers to furnish raw materials at a much reduced price then they will, initially, realise larger profits. Later, however, a deterioration in the economic position of those suppliers may force them to curtail their purchases, with the indirect result that the group of industrialists who were able to exploit their monopolistic position find themselves with a reduced turnover. If the reduction is considerable, their profits may be followed by losses—a situation which is by no means uncommon in practice.

In the sphere of international trade similar circumstances may arise. A state producing raw materials and agricultural produce may be forced to sell to a more industrialised country at inadequate prices and the latter will enjoy an immediate advantage. But it may then have to face a reduced demand for its own goods by the other country. Although it is true that the purchasing power saved in this way may be spent on the home market or in some other foreign country. Such adjustments often take so long that the immediate effects will be adverse.

It may therefore be claimed that in international commerce there are most advantageous, or optimum, terms of trade. But the optimum level of prices and their mutual relationship can be determined only by empirical methods, and it should be observed that if the existing price structure is violated various disturbances are likely to occur. In relation to prices a certain tendency towards inertia is therefore discernible. Britain began to feel the adverse effects of the fall in prices of raw materials and agricultural

produce when the countries producing these goods found themselves unable to purchase British manufactures or to pay interest on their debts. The British authorities then realised that it was in their own interest to raise the prices of the raw materials and foodstuffs which they purchased abroad. Had the British government decided to pay a direct subsidy to the Argentine farmers the effect would naturally have been the same as that of an increase in the selling price of Argentine meat; but there would assuredly have been objections from the British taxpayer. There exists, in fact, a certain hierarchy of economic and political measures: the British public cannot, for example, be directly taxed for the sake of the Argentine meat producer, but the British consumer of meat can be made to shoulder the burden.

We have seen that the optimum price level for any particular industry may be secured by means of such devices as customs duties, freight rates, adjustments, remission of taxation, subsidies, export bonuses, import restrictions and the like. Because of the great importance of international trade, the economic policy of some states is also directed towards securing optimum relations between the price structures of different national economies. It is not necessarily in the best interests of any country to buy foreign goods at the lowest possible price, but rather at the optimum price. The distribution of income, both nationally and internationally is not merely a question of justice, but also a matter of securing optimum turnover and optimum consumption.

In a free economic system the price structure—i.e. the relationship between the prices of different goods and services—is determined by the interplay of various economic forces. But the more planned and regulated the national economy becomes the larger is the number of the prices fixed by the national authorities and the more does the price structure depend upon government policy. In a freely



competitive system the price structure is highly variable and elastic, but in a planned economy it tends to be rigid. As usual in such cases, some sections of the community benefit, while others suffer from the change; and a certain conflict of interests is the inevitable result. There is no infallible test for determining the "just price" and few people today would care to defend the criteria of St. Thomas Aquinas. Where some prices are fixed below the cost of production the taxpayer must foot the bill.

In the close co-ordination of different national economies two problems must necessarily arise. In the first place prices must be fixed for the goods produced and supplied by one to the other. Secondly, in the event of a common social policy being established the question arises whether the taxpayers of one country are willing to bear the cost of delivering some goods to the other at less than the cost of production. For example, would the Czech taxpayer be as ready to meet the cost of supplying free milk to Hungarian children as to Czech children?

The extent to which profitability has become an institutional phenomenon may be seen from the fact that even the most efficient and able producer will be unable to make his undertaking pay if the institutional conditions are unfavourable; whereas a less efficient producer may make a handsome margin of profit in a favourable institutional environment. High costs of production in countries or districts which are ill-equipped with railways, electric power, etc., are not therefore attributable to inefficiency on the part of the producers. In backward areas it may be the deliberate policy of the state to encourage the establishment of high-cost enterprises because of their importance as pioneers.

In the circumstances it is not surprising that the general attitude towards bankruptcy has been modified. In a free economy bankruptcy was the means of eliminating inefficient producers, but with the growing importance of

institutional factors it is coming to be regarded as evidence of the incorrectness of state policy. Steps are often taken by the government to raise the efficiency and restore the profitability of industrial undertakings which find themselves in difficulties, especially where their continued existence is considered to be in the public interest, or where they are responsible for the bulk of the output of a given commodity.

Regardless of all questions of profit, the state and other public bodies must from time to time undertake to satisfy certain wants, in respect of which no payment will necessarily be required from those whose needs are thus covered. Those who pay the costs inevitably involved in the provision of such a service may be termed the forced, or indirect, consumers of it, while those whose wants have actually been satisfied may be called the direct consumers.

To a large extent the progress of civilisation consists in enabling citizens to utilise certain services freely provided by the government—and it seems likely that in the post-war world the number of commodities and services provided gratis, or at prices below production costs, will be larger than it is today. Civilian needs could in fact be covered in the same way as war requirements are at present—flats could be provided for the people just as the enemy is now being supplied with bombs free of charge.

The establishment of a planned economy would make full employment as readily realisable in peace as in war. But production would have to be highly standardised, with the result that the consumers' freedom of choice—e.g. in matters of clothing—would be considerably curtailed. Such a standardisation would be necessary in the interest of efficiency of production, but whether even the consumer of limited means would be satisfied with such a system in the long run seems very doubtful. The example of Russia is instructive here. Although the standard of living in that country is low, I have several times been told that the Russian consumer would prefer a larger range of goods



from which to choose, even though this involved some sacrifice of total consumption.

As will be shown in more detail in the following chapter, the planning of production is practicable only in the case of certain necessities of general consumption. With economic progress, however, the output of goods which cannot be classed as necessities must increase—and in this large, unplanned sector of the economy all the indeterminateness of a free economic system must inevitably appear. Assuming that the necessities of life are supplied at prices below their cost of production, the burden must be shouldered by the taxpayer—and the question therefore arises as to what extent the latter will agree to such a course. In most countries it seems likely that the provision of necessities such as milk to poor children at the taxpayer's expense would be readily accepted, but that any proposal to supply chocolate on the same basis would be strongly resisted. But the general conception of what is necessary will change as the standard of living rises or the social conscience becomes more enlightened. Incidentally, it should not be assumed that opposition to increased taxation for social services of this sort will come from the more wealthy taxpayers alone. In my opinion increases in taxation will, in normal times, provoke no less strenuous opposition from the working classes than from the well-to-do. Nor is it always advisable to take too much from the workers in the form of taxation; for if taxes are too steeply progressive they may be disinclined to increase their hours of work, feeling that the net return received is insufficient to justify the extra effort. It may be mentioned here that in Soviet Russia the principle of payment according to need has been replaced by a system of payment by results.

It is now generally accepted that the unemployed must be insured and must be provided with at least the minimum of subsistence while they are out of work. But such a



course has its dangers. Thus the Archbishop of Canterbury pointed out in the House of Lords on June 10th 1942 that in an inquiry which he and others had carried out it had been discovered that in many industries it was more profitable for a man with a large family to be unemployed than to be in work. Such a situation is clearly undesirable from every point of view.

In order that idleness should not be more attractive than employment, it is necessary first that the employed man should be materially better off than the unemployed and, secondly, that there should be dissatisfaction with unemployment on moral grounds. It is not denied that in fact most unemployed people are acutely dissatisfied with their lot.

We have been considering cases in which the government may undertake to provide goods or services free of charge or below cost of production, which involve what we have termed forced consumption. These services are regarded as of such importance that no attempt is made to calculate whether they "pay" or not—even from the social point of view; it is impossible, for example, to assess the economic value of national security or public health. Town councils which spend money on the collection of refuse may reasonably hope to save on hospitals—but even if the saving on the one were less than the expenditure on the other the removal of refuse would still be undertaken. Such services cannot, in fact, be put on a profit and loss basis, for they are rightly regarded as indispensable, irrespective of whether or not they can be made to pay. But the introduction of criteria of this character constitutes a denial of the liberal principle of profitability, which sees the justification of any enterprise in the fact that it can be made to "pay."

## CHAPTER VI

### ECONOMIC PLANNING OF PRODUCTION AND DISTRIBUTION

If government assistance is given to a particular district or branch of industry this will generally entail costs, which must be borne by other sections of the community. For this reason it is preferable that a social economy should comprise a true community—perhaps best of all a single nation. In a lengthy period of time economic policy may favour first one district, or social group, or branch of industry and then another. When the district, group or industry not so favoured lodges a protest it may justifiably be argued that the discrimination shown is for the good of the community as a whole—and in a true community such an argument is usually convincing enough. But it may be much more difficult to persuade one national community to bear heavier burdens for the sake of another.

In a free economy the producer has the right to decide what he will produce and how he will produce it; the consumer to choose what he will purchase, and the capitalist how he will invest his savings. But in a planned economy freedom of choice in each of these cases will be restricted in greater or lesser degree. If, under a policy of *laissez faire*, one district or branch of industry shows a more favourable development than another the difference is attributed to the free play of economic forces and the government is not responsible. In a controlled economy, on the other hand, such diversities of development are attributed to state action and the neglected district or indus-

try begins to complain and to demand a change of economic policy. It is not difficult to envisage the conflicts that might arise in the administration of a complex territory such as a combination of several national economies. Let us consider certain aspects of this ramified problem.

During the nineteenth century the state attempted to encourage certain branches of production, but it never sought to regulate the volume of output or conditions of sale. The methods employed were the imposition or removal of customs duties, adjustment of freight rates, remission of taxes and the like. No attempt was made to introduce quantitative control over foreign trade, and the government looked with suspicion on the activities of cartels whose object was the regulation of production or sales. Needless to say, there were exceptions—for it is never possible to draw a clear line of demarcation between successive historical periods—but, broadly speaking, these were the characteristics of nineteenth century economic policy.

The twentieth century has witnessed a striking transformation. The large-scale control of production and sales on a quantitative basis, not only for whole branches of production, but for individual concerns as well, has become a common feature of economic life. Planning is increasingly taking the place of *laissez faire*. When speaking of economic planning one has in mind the government as the central directing authority. But when a particular branch of the national economy organises itself—e.g. into a cartel—and agrees to recognise the authority of a management which it duly constitutes, a private planning centre comes into being. And the question of the relationship between the state and the private planning authority then arises.

The drafting of a plan implies that the planners have an objective in view; but it seldom happens that a plan has only one aim, to which everything else is sub-ordinated. Even in war-time a variety of aims must generally be taken



into account. The leaders of a homogeneous social group are often by no means unanimous in their choice of objectives. Among socialists, communists, social-democrats and fascists there are obviously wide differences of opinion as to the choice of aims and the means of attaining them. In Soviet Russia disputes between the advocates of various plans and between the protagonists of different means of carrying them out take on a particularly stubborn form, while criticism of the official programme is regarded as a heresy—and punished as such. Repentance is demanded of those guilty of such a sin. And no wonder; for if any particular plan is considered to be the highroad to salvation any criticism of it must necessarily be a dangerous heresy!

In some countries where public ownership and planning has reached an advanced stage of development those branches of the civil service which deal with economic matters, and the staff of state-owned enterprises, seem to have established a species of church militant. But it is curious to note that, even within this church, heresies may arise. For instance, the manager of a government works will often be opposed to too much interference by civil servants, being at one and the same time a supporter of state ownership and an opponent of state intervention. The managers of private undertakings who favour government ownership because it would end their conflicts with their share-holders would find in practice that they had merely exchanged one set of supervisors for another.

If a plan which constitutes the doctrine of such a church militant fails to achieve its objective a scapegoat must be found to take the blame. For the idea that "scientific" planning could possibly be wrong is out of the question. Hence the famous series of trials of saboteurs in the Soviet Union.

With the growth of democracy and the uprise of parliamentary institutions, one of the problems confronting governments in the nineteenth century was how to prevent

the army from interfering in political and economic matters which fell outside its proper sphere. In France the army was known as "La Grande Muette," which indicated that, though silent, it definitely had a voice in many affairs. The rise of military dictatorships proves that in many countries the problem was not solved. Nowadays the growth of state intervention in economic matters, together with an increasing tendency towards the nationalisation of industrial undertakings, has created, or is in the process of creating, a government economic machine with immense powers at its disposal. Any such body is inclined to pursue an independent policy of its own; and in this particular case there are many candidates for the dictatorship—the military hierarchy, the workers, nationalists or fascists. The problem today is to find means of subordinating this powerful administrative machine to parliamentary and democratic governments, so as to prevent it from becoming the instrument of some dominant section of the community.

To return to the question of the aims of economic planning, it may be pointed out that the maximum efficiency of organisation and technical methods may be an end in itself. Sometimes people are thrown out of work because of technical progress—e.g., by the invention of a machine to perform operations previously done by hand. On the other hand, a conflict may arise between the twin aims of stability of employment and maximum technical progress. Even the most ardent advocates of technical improvements and maximum productivity of labour must recognise the desirability of fairly stable employment. Thus, when automatic telephones were introduced in Poland a few years ago even some of the supporters of technical progress were of opinion that the measure was premature, for it resulted in many telephone operators losing their jobs. On the other hand, those who most strongly advocate stability of employment as an objective of planning understand that fluctuations in the demand for labour are an inevitable



consequence of technical progress. In short, a compromise is necessary between the two objectives.

A similar conflict may arise between the desire to utilise plant to the full and the need to maintain a reserve capacity to meet sudden increases in demand. Producing costs are generally at their lowest when plant is fully utilised; but in this situation surplus productive capacity is negligible, for while it may be possible to increase working hours it is often by no means economical to do so. Armament firms—to quote one example—must have a surplus capacity available in case of war, which means that they cannot work to capacity in time of peace. This, in turn, implies that their costs of production must be higher than they would be if optimum production could be achieved. Again, much redundant capacity in the British shipbuilding industry was destroyed ten years ago, production being concentrated in the most efficient yards. The consequent loss of reserve capacity has proved a serious handicap to increased shipbuilding activity during the war. Here again, a compromise must often be found between the incompatible objectives of optimum utilisation of plant and the maintenance of a reserve capacity.

In order that costs may be reduced it is sometimes necessary that production should be transferred from certain districts or business firms to others, to the detriment of the former and the advantage of the latter. But such an expedient may be particularly difficult to adopt during a period of depression and unemployment. It involves, *inter alia*, increased unemployment in one district or group of firms, for the sake of increased employment elsewhere. Fearing this result, the government may adopt the policy of spreading unemployment as evenly as possible—an objective which clearly conflicts with the aim of reducing costs by concentrating production. In this case, too, a compromise solution may have to be found.

In order that production may be controlled at all it is



clear that some convenient unit for the measurement of output must be available. It is easy, for instance, to control production of such commodities as ordinary iron, copper, zinc, sugar, cement and the like, for output in these cases can be measured in terms of weight. Moreover, these commodities are pretty uniform in character and the consumer is rarely interested to know in which particular establishment they were produced.

It is far otherwise in the case of products with individual characteristics or variable quality. Examples are machines, industrial equipment, tools and the better class of consumption goods. Machines are generally manufactured to order—and some makers turn out better machines than others. Quantitative control of production is extremely difficult to apply in such cases, for different variants of a commodity (e.g. clothes) cannot easily be reduced to a common denominator. Sometimes, however, the difficulty may be surmounted. For example, the producer of sheet-iron under the iron and steel cartel are allocated quotas in tons, a certain variety of sheet-iron being taken as the basis and all others expressed in terms of this; thus one ton of thin sheet-iron counts as two tons in the quota, a ton of still thinner sheets as four tons, and so forth. Similarly, in the Polish coal cartel one ton of coal dust was counted as only half a ton for quota purposes.

The fixing of prices is always a difficulty in cartel organisation. The Rhineland and Westphalian coal syndicate dealt in almost 1,000 varieties and qualities of coal, while the Welsh coalfields produce some 840 grades. The layman who thinks of coal as being a fairly uniform commodity is amazed at this infinite variety and is unaware of the difficulties consequently encountered in any attempt to fix coal prices. And if a comparatively simple product like coal gives rise to such difficulties, one can imagine the impossibility of reducing neck-ties to a common denominator! At all events, it may be readily appreciated that

attempts to control goods with individual characteristics are generally doomed to failure.

Before proceeding, a few words on the problems of production control in general may not be out of place. There is no need to dwell upon planning which is unavoidable owing to technical conditions: Thus it is evident that the distribution of gas and electricity, transport, the telephone service, etc. must be planned by a central body. Apart from such cases as these, planning must aim at reducing consumption when productive capacity is inadequate to cover demand, or at restricting production where there is excess capacity. Many examples of planning of the first type may be seen in war-time, and they generally take the form of rationing schemes or the granting of priorities. When once the details of production have been decided, there remains only the financial problem of how best to " mop up " the surplus purchasing power. In a situation where rationing and priorities have to be introduced the general economic problem of unemployment has been solved. We may therefore pass on to a consideration of planning of the other type, aimed at restricting production.

One of the most important instruments for this purpose in present circumstances is the cartel. On the Continent cartels were subject to strict State control in the decade before the war. Cartel courts existed in almost every country and it was by no means uncommon for the government to take legal proceedings against a cartel. To a greater or lesser degree, cartels were the instruments of state planning. Cartels were often formed on the initiative of the government, not of the industry in question, the state in some cases exercising a more powerful influence than the business men. More often, however, the opposite was the case, if only because the industrialists knew more than the civil servant about the problems in question. When this war is over state control of industry will doubtless be more far-reaching than ever before; e.g. any international



production plan implies of necessity the restriction of production in certain commodities in certain areas or the export of certain commodities from certain areas. Therefore the problems with which it is faced will be similar to those previously confronting the organisers of international cartels. This is our justification for dealing with cartel policy here.

Cartels have often had a bad name, for they secure unearned profits for their members; and in the past cartels have often been badly and short-sightedly managed. Their main function is to fix total production or sales of a product for a given period and to allocate quotas to individual undertakings. No matter what transformations the present economic system may undergo, this problem will remain; so that an examination of this aspect of economic planning is of more than passing interest.

During the past two decades governments began to look with favour upon cartels and even to enforce their introduction; and at the present time all cartels have the open or tacit approval of the government concerned. In the past, when the official attitude to cartels was either hostile or neutral, their structure tended to depend upon the comparative economic strength of the individual firms in the business, and the relations existing between them. If these relations underwent a change the quotas were revised or the cartel was dissolved. Generally, moreover, the position was complicated by the presence of "outsiders," which prevented the members from monopolising the market. The cartel organisation was, in fact, in the nature of an armistice between competing business firms. But when the state began to favour the formation of cartels—and even to establish them itself—their monopolistic position was consolidated. Thus in many cases the position in which a number of manufacturers competed with one another for government contracts has now been replaced by a cartel of suppliers, formed under government auspices—examples being found among armament manufacturers and suppliers



of railway rolling stock in Continental countries.

The cartel organisation is not, however, confined to the purely national sphere—for there are a number of international cartels. The object is the same as with national cartels—namely to adapt supply to demand at a given price. Whereas the membership of a national cartel is confined to manufacturers of one country, the members of an international cartel are of different nationalities. As a rule, the membership of international cartels is made up, not of individual firms, but of national cartels. We shall not embark upon an examination of such cartels as those concerned with controlling the production of nickel, tin, tea and rubber, in which a few exporting countries monopolise the world market; for by their very nature these must be international in character.

A national cartel is complete if it comprises all the producers in one line of production in a given country. With the aid of customs barriers such a cartel may obtain a monopoly on the home market, but without this aid a monopoly position may be unattainable. Where an individual firm has a fixed sales quota, guaranteed for the duration of the cartel, it is in a kind of monopolistic position, which has much in common with that of a public utility undertaking. The latter term is, of course, applied to such undertakings as gas, water and electricity companies. But in my opinion the characteristic feature of public utility undertakings is not their social importance (as is commonly supposed) but rather the fact that on account of their technical nature they must be given a monopoly position in a certain sector of the market.

Because of this monopolistic element the activities of public utility undertakings are regulated by certain standards, designed to protect the interests of the consumer. For example, a public utility undertaking is prevented from discriminating in an arbitrary manner between different consumers of the same class. Again, the prices charged

are required to be reasonable, for it would be intolerable if a monopolistic position were exploited to the detriment of the consumers' interests. These are known as public utility standards, and the activities of complete national cartels, with a monopoly of the home market, are frequently regulated by similar standards. Thus cartels cannot as a rule refuse to supply any particular consumer and may not discriminate between different buyers in the same category. There is no doubt that the selling prices of complete national cartels should be fixed and controlled by the government. Where—as in the case of certain cartels—the customers consist of a large, unorganised, group of persons whose interests must be protected by the state, this aim may be realised by subjecting the cartel to public utility standards.

The rights of manufacturers under a cartel agreement have much in common with feudal rights of production. They have an economic value and are occasionally sold by one member of the cartel to another.

All measures aimed at stabilising the economy tend to ossify its structure. In European countries a new social class is coming into being, consisting of the managers of state undertakings, directors of private monopolistic enterprises and members of the government economic administration. Within this class a certain interchange of personnel takes place: members of the government economic administration become managers of state or private undertakings, while the latter may obtain posts in the state administration. Trade union leaders and the members of working class political organisations are gradually admitted to this class, and sometimes assimilated by it. Strong and wealthy trade unions thus become constituent parts of the capitalist economy.

It should not be forgotten that one of the main causes of the French Revolution was the general aversion to monopolistic rights. However, the process of concentrating



production, which has continued since the end of last century, is giving rise to a number of monopolistic situations.

In our day the monopolistic position of certain branches of industry, especially "big business," is very rightly the subject of severe criticism. It must not, however, be overlooked that regular employment is generally possible only for the employees of works which are not exposed to the dangers of "ruinous" competition—i.e. those that are in a monopolistic position. It is necessary to point out in this connection that regularity of employment is a very different matter from full employment. Though conditions of virtually full employment existed in the second half of the nineteenth century, willingness to change one's job or to move from one part of the country to another was a condition of work. But this is a condition which is generally acceptable only to workers with a low standard of living. Where the worker owns a house, furniture, etc., he will be very reluctant to move to another part of the country. The huge migrations of labour to Siberia, Turkestan or other remote parts, which are a regular feature of Russian life are undoubtedly possible only because the average worker possesses little in the way of household chattels save a few items of clothing. Nowadays, the worker generally desires not merely full employment, but regular work in the district in which his home is situated. This can be guaranteed only if his employer enjoys some kind of monopolistic position. Those who are in favour of more stable employment, but opposed to the monopolies of "big business," should explain that what they really want is to exchange a private monopoly for a public monopoly as a means of attaining stability.

It should be noted that a government monopoly is necessarily in a stronger position than a private one. Even so, a government concern must generally be a paying proposition; for in order to build new factories, etc., the authorities must raise capital, upon which interest has to be



paid. And where the state does not want to float a loan for the purpose, the profits of the undertaking must be sufficient to provide funds for maintenance and capital expenditure.

A special kind of cartel is that which comprises the various suppliers of one consumer. Since the government is the sole consumer of armaments, it then forms a cartel of armament manufacturers so that its orders may be evenly distributed. Again, where the railways are state-owned, a cartel of rolling-stock manufacturers is generally set up; and if some of the railways are not in public ownership the government may, by means of such a cartel, induce the private concerns to place their orders on a specified basis. In cartels of this type, which present a strong contrast to those in which the producers are in a monopolistic position, it is the buyer who is the more powerful party.

In war-time the role of the state in economic matters increases greatly in importance, for government armament orders are practically unlimited. And it may be noted here that the placing of government orders is the surest means of creating full employment. This is as true in peace as it is in war, though, as we have already seen, such state planning is scarcely possible in the case of non-standardised goods. In normal times moreover, the satisfaction of the consumer's particular preferences must be considered as well as the creation of full employment; thus, rather than have a standardised pair of shoes every three months, many women would prefer a pair to satisfy their own particular taste at less frequent intervals.

Let us examine the problems that arise in allocating to each member of a cartel his sales or production quota. Though this is one of the more elementary tasks of economic planning, it may become extremely complicated when a number of incompatible objectives have to be taken into account. As has been pointed out above, if costs are to be reduced to a minimum, production may have to be con-

centrated in the most efficient units; but the closing of high-cost establishments will throw people out of work and so violate the principle of regular employment. Again, strategical necessity sometimes requires the placing of works in districts which are unsuited for the purpose, while the need for a reserve capacity to meet possible contingencies means that costs cannot be reduced by working the available plant to capacity.

Finally, the need to maintain exports sometimes makes it necessary to fix a higher price for the home market than for sales abroad. If a surplus is to be available for export the producing capacity of an industry must obviously be greater than if it were intended to cater for the domestic consumer alone. Where the export price is below that ruling on the home market the cartel must fix the relative quantities to be sold at home and abroad. In this way the inland consumer has to subsidise exports, paying a higher price than he would have done if some of the productive capacity had been closed down and the most efficient units used to supply the home market. There is in such cases a conflict between the policy of fostering exports and/or increasing employment, on the one hand, and the desire to reduce the domestic price to a minimum, on the other. Each of the objectives may be important and the final decision must therefore be a compromise.

Another problem encountered in fixing the production or sales quotas for individual firms is what period to take as a basis. It is usual to take into account the firm's share of the market in some past period, but it is by no means easy to decide whether the past year, or a three- five- or ten-year term should be taken.

In advocating any particular criteria for the fixing of quotas the producers will be guided by their own self-interest, but if the government has to take a decision in these matters it must bear other considerations in mind—including the interests of the workers, for instance. Nor are

these considerations exclusively economic or administrative in character. There are some places, for example, where even the drawing up of a railway time-table may raise political problems.\* To fix production quotas purely on the basis of past performance is a one-sided procedure, since it fails to take account of the possibilities of development inherent in certain businesses or districts. Though it may be desirable to maintain the output of a district where producing costs are high, it does not follow that such a district should be given its proportionate share in any increased demand that may arise in the future. It goes without saying, however, that to formulate these principles is much easier than to apply them. Thus the task of estimating a particular undertaking's development possibilities is much more difficult than that of allocating quotas on the basis of past production. For these reasons quotas are almost always distributed in a conservative fashion, stabilising past conditions and favouring vested interests—perhaps at the expense of producers with lower costs.

When fixing quotas for a given undertaking it may be possible to take into account the importance of a certain industry in the economic life of a particular district. Thus, in Poland, an attempt was made to correlate the allocation of alcohol distillation quotas with that of the sugar manufacturing quotas. For example, in areas unsuited to sugar beet production the object would be to encourage the cultivation of potatoes by granting a higher alcohol distillation quota. The attempt was, however, largely frustrated

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\* Thus, if an international train makes a lengthy stop at a given station it may, directly or indirectly, bring business to the town in question. If, on the other hand, it does not stop, or passes through during the night it obviously cannot do so. In this way a clash of interests may arise between different potential stopping places en route; and if (as might happen in a country like Czecho-Slovakia or the old Austro-Hungarian Empire) the rival towns are situated among different social or political groups the central government may be accused of unduly favouring the one at the expense of the other.



by vested interests—and if the sugar factories and alcohol distilleries had been owned by the government the position would probably have been much the same.

Economic life is dynamic. If a plan is too rigid it may hamper economic growth; if it is too elastic it may be difficult to apply. The more factors a plan has to take into consideration the less clear-cut it becomes, and the more difficult will it be for an individual firm to forecast its permissible production—and therefore how many work-people it will be able to employ. The unreliability of the forecasts made by the various institutions studying market conditions is common knowledge. To draft a plan which makes allowance for diverse economic factors one must have adequate data at one's disposal—which should, of course, be as up-to-date as possible. Thus, when fixing the production quota for December it is much more important that one should have data for November than for October or September; but figures for November are generally unobtainable when the December quota is being decided. In some branches of economic life the relevant statistics are available only after considerable delay, and it therefore follows that certain economic factors cannot be taken into account when a plan is being drawn up.

The better potentialities for expansion possessed by one concern may be studied by comparing its activities with those of other firms in the same industry. But the establishment in question may be one unit in a vertical combination, whose existence has facilitated certain economies which have brought about a reduction in costs for the group as a whole. To study the advisability of continuing production in a particular establishment from the standpoint of a comparison with conditions in similar firms, from the point of view of its importance for the industry or district in which it is located and, finally, with reference to its vertical relationship with other undertakings, is an extremely difficult matter; and experience proves that the results may be

incapable of statistical representation. It seems to me, therefore, that these various points of view can be only superficially considered, that the final decision must be a compromise and that it should be based upon common sense rather than upon statistics. The risk of error is, of course, ever present. But just as perfect equity cannot be attained in the sphere of taxation, because taxes must in practice be simple, easy to collect and high-yielding, so an economic plan may have to be rough and ready, avoiding the complications which would be inevitable if too many economic factors were taken into account.

If, in order to maintain equilibrium in its balance of trade, a country begins to control its import trade similar problems arise in the allocation of import quotas. For example, if a fixed amount of cotton or wool is to be imported this total must be distributed among the various textile undertakings. By this means production may be controlled even in those industries which are unsuitable for cartel organisation; in the textile industry, for instance, it would be difficult, if not impossible, to reduce all varieties of cloth to a common basis, but production may nevertheless be regulated through the allocation of raw materials. In the distribution of import quotas, as of production quotas, a variety of conflicting principles may be involved—the maintenance of activity in a particular district, the equal distribution of unemployment, the productive possibilities of different undertakings, their technical efficiency, their financial position, the desirability of encouraging small undertakings, or large, as the case may be. Again, there is the same difficulty of fixing the base year—and it will probably be found in considering the merits of different base years that there is much to be said on both sides.

If exports from one country are restricted by the introduction of import quotas in another, the authorities in the exporting country have the task of dividing that country's quota among the various exporting firms; such was the

position in respect of various exports from Poland. Once again, various arguments may be adduced for allocating the quotas in different ways.

So far as wartime conditions are concerned, the need for economic planning is generally recognised; and in some respects it is less difficult in time of war, because the objective is clearly defined. Even so, there may be conflicts between different departments of the government; and such conflicts have, in fact, been reported in the British press during the present war.\* On a certain occasion, which has been so reported, one department demanded an allocation proportionate to that which it received in the last war, and *The Times* commented ironically that an allocation equal to that received in the Crimean War might have been requested with equal justification.

Current opinion as to the importance to be attached to various principles in economic planning varies at different periods as a result of changes in political and economic conditions; and there is a clash of interests between different sections of the community on this point. The liberal school of economists believed that free competition would lead to economic harmony, but in fact nothing of the sort occurred. The more serious advocates of economic planning are aware that the choice of a particular plan amounts to a decision to undertake certain tasks and to set certain others on one side; whereas the extremists insist that the introduction of planning will initiate a new era of universal happiness and harmony. But the adoption of a plan involves a choice of the order in which various tasks are to be carried out, and conflict is inevitable before decisions on these matters are reached.

For this reason politicians who suppose that a planned economy must necessitate a one-party or totalitarian system are mistaken. In a planned economy there will certainly be a conflict of interests between those who would benefit from

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\* See, for example, *The Times* of June 19th, 1941.



stability and monopoly and those who are in an unsheltered position or who favour free competition. Members of the former group would probably include the majority of the trade unions and the personnel of sheltered and stable undertakings. The second class would be made up of the intelligentsia, writers, artists, unsheltered trade unions and certain artisans, such as tailors, whose production is difficult to regulate on account of its diversity. This latter section of the community bears the costs involved in guaranteeing a stabilised and monopolistic position to the former; and it is this group which is generally in mind when one speaks of the exploited consumer.

With the exception of the unemployed, every man is at one and the same time both producer and consumer, so that as a rule the consumer proper is merely an abstraction. The exploited consumer is the worker who pays monopolistic prices for the goods he buys, without receiving monopolistic wages for the labour he sells. On the Continent acute conflicts have arisen from time to time between monopolistic and non-monopolistic industries, as for instance between the iron and coal trades on the one hand and the engineering industry on the other. Within the unsheltered, non-monopolistic section there must be a small group who, through temperament and character, are either unable or unwilling to join the stabilised, monopolistic section. The sociological importance of this group is great, for here are sown the seeds of progress. It is much less common for progressive tendencies to have roots in the monopolistic, stabilised section, which usually runs to conservatism and "red tape."

As regards this conflict of interests involved in the drafting of an economic plan, it must be pointed out that the touchstone by which the conflicting solutions are tested must be the public interest. Special cartel courts which exist in many countries are empowered to reverse the decisions taken by cartel managements if these are anti-social—

and there is much literature on the subject of the public interest in relation to cartels. As to what the requirements of the public interest are in such matters the interpretation given by the cartel courts or by the government may differ at different periods of time. Nor is this all. Small concerns and large ones will have different ideas on the subject of the public interest, and there will be no agreement between firms in different regions or with different potentialities for development. Very often, the cartel courts were unable to cope with the number of alleged infringements of the public interest and the right to initiate an action was accordingly reserved in some countries to the government.

The framers of government policy may be unable to take a decision in the interests of the community as a whole, because the criteria for judging the public interest in that particular situation may be unknown to them; and their decisions must therefore often be arbitrary. Moreover, economic conditions are so complicated and variable that a line of action which would benefit the community at one given time may be positively harmful at another.

The attitude of the working classes and its representatives is mainly determined by its sectional interests. Trade union leaders and employers may work together in harmony, and in some cases the horizontal cleavage between the employers and the working class may be replaced by a vertical cleavage between those in different branches of economic activity. To give an example: the coal miner may be reluctant to surrender the higher wages he receives when the coal cartel is exploiting its monopolistic position in order that the consumer may get his coal more cheaply.

The central planning authority may relinquish control of a number of fields and leave the necessary decisions to private enterprise, not merely because business men are often sufficiently influential to induce it to do this, but because, as we have seen, the public interest is not always discernible. This inability to decide what to do in the

interests of the community at large is no evidence of ignorance or inefficiency, but results from the fact that the implications of a particular line of action may not be calculable in advance, but only after a certain amount of experience.

The choice of methods of production should not, in my opinion, be made by the government and there would seem to be no reason for setting up a central body to decide what machines and tools are to be used in the productive process. On the other hand, as will be shown later, investments in machinery and tools may have to be controlled if employment is to be more nearly stabilised.

In the modern national economy there are many industrial forms. On the one hand, monopolistic tendencies are represented by public utility undertakings, cartel agreements and the control of foreign trade; on the other hand, there are survivals from the liberal, free-trade era. The commodities produced by industries which lend themselves to the cartel type of organisation—coal, iron, the precious metals, and so on—are raw materials for numerous other industries. An infinite variety of articles can be made from iron in engineering establishments smaller than foundries and rolling mills. Craftsmen's shops are also still to be found, though they are very different from those which existed before the Industrial Revolution; for the craftsman of today generally works up products supplied to him by large-scale industry. Technical progress has enhanced the importance of the manufacturing industries. Thus, a few decades ago the output of iron and steel was regarded as an accurate index of general economic activity; but today, when the prices of certain special steels may be anything from 1,000 to 2,000 times greater than that of ordinary iron, the mere tonnage of iron produced is a very inadequate measure. It is the position of the secondary and tertiary industries which is becoming increasingly representative of the general business position. But the



truth of the statement is often obscured by the fact that the heavy industries have a wealth of statistics demonstrating the magnitude of their own operations, whereas similar data are not so readily obtainable for the secondary industries.

Local industries with local markets cannot readily be controlled by a central authority, nor would such control be of much use if it were possible. Sometimes local agreements do exist, but they are generally rather loose in character. Similarly, control is easier when production is concentrated and when the number of units is small; it is almost impossible where the number of units is as large as in small industries or crafts. Some industries again—e.g. agriculture—are difficult to control because results depend as much upon the weather or other natural conditions as upon human effort. Control may also be more easily applied in industries where producing methods are static than where methods change frequently as a result of technical progress. In the latter case, patent agreements are commonly reached, by which the individual firm is kept informed of new inventions or methods of production adopted by other firms. Such agreements may be regarded as a kind of mutual insurance against the risk of the introduction of new inventions by rival firms. In some branches of industry international concerns are based upon agreements of this kind.

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Government intervention in the economic sphere sometimes has a legal basis, but often rests merely upon confidential instructions or advice, which is supposed to be unofficial. This sometimes occurs when the authorities are not sure about the correctness of their decision and do not wish therefore to become too much involved in the action taken.

It would seem, however, that the government's attitude in such matters ought to be unequivocal and based upon the law. Thus, in economic affairs the government should have the legal right to enforce certain lines of conduct and to forbid certain others but the public should be free in respect of all matters not specifically dealt with in this way. But whereas the state compels its citizens to pay taxes and passes legislation to restrain theft and other crimes, it often contents itself in the economic sphere merely with encouraging, dissuading, or tacitly conceding instead of enforcing or forbidding various activities. Yet—to say the least—government "recommendation" can be disregarded only at the risk of incurring unpleasant consequences. In pre-war Britain, for example, there was no legislation controlling the export of capital, but the Treasury nevertheless exerted considerable influence over the investment of funds abroad.

On this point a passage from the P.E.P. Report on International Trade is worth quoting. "It is important," the authors state, "to remember that this financial dictatorship of the Treasury over the operations of the City of London has no legal basis and depends upon the goodwill of financial institutions in respecting the observations, informal requests and expressions of opinion which the Treasury may see fit to make. But in so far as the policy of the Bank of England is likely to conform to the Treasury's views and in so far as the Committee of the Stock Exchange is also amenable, powerful pressure could be put indirectly upon any individual or institution who presumed to neglect the Treasury's advice." In countries where high traditions of public service are lacking such a wide discretion is very undesirable, for citizens have sometimes been blackmailed with the threat of increased taxation in the event of their non-compliance with such official "advice."

Here it is also worth quoting the words of Mr. H. W. Prentis at a conference of the National Association of Manufacturers in the United States. In reference to such

practices, he said: " How many times have I been warned against putting my neck out? How many times do business men decline to take a public stand regarding governmental measures to which they are secretly opposed for fear of what might happen to them if they did so? Fear of persecution from the tax collector, the factory inspector, the Wage and Hour Administration, the National Labor Relations Board, Congressional investigating committees or fear of discrimination in the placing of government contracts . . . . "

The question arises why governments ever embark on the invidious task of seeking to encourage certain activities and to discourage others, introducing penalties for non-compliance, when in fact they have no legal right to do so. The reason is usually to be found in the fact already noted that it is often impossible to know just where the public interest lies. That the existence of this discretionary zone may be abused by government departments in some instances is undeniable; but the danger may be avoided by insistence on a high moral standard among civil servants and by proper democratic supervision. Totalitarian enthusiasts point to the growing intervention of the state in economic matters and argue that democratic methods are suited only to the conditions of a bygone age. It seems to me that one of the reasons for the uprise of democracy was the fact that the monarch found it necessary to get the consent of the people to the payment of taxes, as a result of which the taxpayer gained control of the budget. With the continuous growth of government intervention in the economic sphere, supervision becomes necessary; and only high ethical standards coupled with public supervision will suffice to safeguard the citizen against abuse of the government's discretionary powers.

We are at the present time witnessing the gradual formulation of such ethical standards relating to state control, but it cannot, unfortunately, be said that the process



is proceeding altogether satisfactorily. Economic conditions are, of course, so complicated and so variable that it would be impossible to lay down definite rules to regulate government policy in this field. An attempt to do so was made in Poland, where laws were passed empowering the executive to issue instructions; but the instructions provided for were never promulgated, for the simple reason that the problems involved in drafting them were too difficult. An example was the passage of an act regarding the conversion of agricultural debts. When the matter was examined it became apparent that the circumstances of both debtors and creditors varied so widely that it was impossible to formulate definite rules or instructions of general application.

Some economists are of opinion that the nationalisation of industry would eliminate such difficulties as these; but it is not so. The processes of production and exchange are so complex that the government is compelled to grant a wide degree of autonomy to state undertakings, for the latter have to deal constantly with unexpected and changing situations which call for immediate decisions without reference to the controlling authorities. If government interference in the day-to-day working of such a business is too frequent, those managing its affairs will become hostile to government ownership. Thus there was a strong antipathy to state control among the managers of publicly owned undertakings in Poland—who frequently urged that state concerns should be placed on the same footing as private enterprise.

The vertical combinations found among industrial concerns have their parallel among state enterprises. A business firm belonging to a combine of this nature is generally obliged to obtain its raw materials from a firm belonging to the same group, even if these are of inferior quality to the materials offered by a competing concern outside the combine. There is often a similar relationship between state undertakings or government departments: state-owned

railways, for instance, may be forced to buy their coal from government collieries and their rails from state-owned foundries.

Vertical integration of this sort eliminates that conflict of interests between consumer and supplier which often acts as a powerful incentive to increased efficiency in the economic process. If an economic plan binds the consumer too closely to one supplier, taking away his freedom of choice in this matter, then the relation existing between them is akin to that between the units of a vertically integrated industrial combine; and this elimination of the conflict of interests between consumer and supplier frequently makes for inefficiency. The fact was recognised in Germany during the period of industrial amalgamations and there is no doubt that, within certain limits, this conflict of interests should be maintained in a planned economy.

Economic planning in Soviet Russia has given rise to some interesting ideological problems. Consider, for example, a case such as the following: According to the plan, one undertaking, A, is to purchase a certain product from firm B. But B has delayed delivery, thus exposing A to the danger, if not of an interruption, at least of a delay in production. If the manager of A is enterprising, he may on his own initiative find another plant, C, which, in violation of the plan, furnishes him with the necessary supplies, or rushes production of the required article in its own works. Here there is an obvious clash between the plan and the individual initiative of the manager concerned. Ideological motives require that the plan should be adhered to, but, on the other hand, the urge to produce the maximum output may favour individual initiative. According to Socialist theory, however, individual initiative is a source of economic anarchy characteristic of a liberal economic system. In a socialist economy every undertaking strives for maximum efficiency and if its performance is bad the manager will come in for severe criticism.

The president of the state bank in Moscow told me in 1931 that he did not hesitate to allow inefficient state undertakings to go bankrupt. Indeed, he cited a few cases by way of example—small ones, of course, for no government, capitalist or socialist, ever closes establishments which it considers necessary to the community, but tries to reorganise them instead. A government which owns an industrial undertaking behaves in exactly the same way as a private proprietor to this extent that it strives to run the concern so as to avoid the necessity for subventions from the exchequer or the risk of default on its loans from the state bank.

It remains to ask what is the difference between the initiative exercised by the manager of a private concern in a liberal economy—which is a source of economic anarchy—and the initiative shown by the manager of a state undertaking in a socialist economy? A prominent Soviet leader explained to me in Moscow in 1931 that Russian ideologists were having great difficulty in answering this question. They do not appear to have solved the problem since, and one may hazard the guess that they never will.

We have already seen that the drafting of a plan involves choosing between various conflicting motives and interests, and also that many aspects of economic life are not susceptible to economic planning. In fact, planning is most easily applied to public utility undertakings, such as railways, power stations, gas works, etc., and to those industries which lend themselves to the cartel form of organisation.

Agreements for the fixing of export quotas are often made between cartels operating in different countries, the general rule being that each cartel has a monopoly on its own home market. Such agreements in respect of export quotas obviously present fewer difficulties. The common planning centre will inevitably be the scene of conflict and discussion as to how the public interest is to be interpreted. The more restricted the matter under discussion the easier will it be



to reach agreement.

Economists and politicians devote much attention to the question of the production of so-called capital goods. It must be realised that there is a sense in which finished goods contain not only the raw materials from which they have been made, but also a certain proportion of the machinery and tools—i.e. capital goods—used in their manufacture. If the volume of productive equipment remained unchanged and if worn-out machinery etc. were steadily replaced by new, then production would automatically equal consumption. Production will, however, exceed consumption in cases where plant is being expanded. On the other hand, consumption will exceed production if equipment is allowed to wear out without being replaced. In periods of depression and unemployment part of the productive machine is not in use and replacements are inadequate, with the result that the national economy is consuming more than its current output of finished goods. In boom periods, on the other hand, production outstrips consumption. (In Great Britain on the average about 80 per cent. of the output of capital goods is needed for replacement purposes and the remaining 20 per cent. for increasing productive capacity.)

Let us imagine a national economy in which the following conditions prevail: production is limited to 50 per cent. of capacity; no new investments are being undertaken; inadequate replacements of existing equipment are being made. Consumption will then settle down on a slightly higher level than production. Now let us suppose that, with the encouragement of state planning, investments in capital goods are being made. Market conditions become more active and production rises to 100 per cent. of capacity. Suppose that 10 per cent. of the output consists of capital goods needed to extend the apparatus of production, then consumption will be equivalent to around

90 per cent. of the output.

It would seem to be preferable to produce to capacity and to consume 90 per cent. of the output than to produce at only 50 per cent. of capacity and consume at the rate of 55 per cent.; and the correctness of the assumption is borne out in practice. Thus the granting of Lease-Lend facilities by the United States to Great Britain may be regarded as uneconomic in the sense that no payment is made; but it had the effect of expanding production, increasing employment and raising consumption in the United States during 1941, the limit being reached when it became necessary to restrict consumption.

Increasing importance is being attached by economists to the question of plant renewal and the extension of productive capacity. In this field mistakes may, of course, be made: necessary extensions may not be undertaken, while unnecessary ones may. Some investments therefore turn out to be uneconomic and the people making them sustain losses. With the object of reducing such losses to a minimum the suggestion has been put forward that a state investment bureau should be set up, and that the consent of this bureau should be required before new securities may be placed on the market. It has been further suggested that stock exchange committees do not discharge their functions adequately and that a state authority would eliminate the middleman (e.g. the banker) in transactions between the investor and the body issuing the securities. Some economists have gone so far as to suggest that where the issue of securities has been authorised by the state bureau they should be guaranteed by the Treasury. (This would, of course, be an important step towards the nationalisation of industry.) The losses involved in misplaced investments would thus be passed on to the general taxpayer. The policy is advocated on the grounds that it would reduce the risk of unprofitable investments and would protect the public from the risk of loss

when investing its savings. Many economists, however, are not unduly concerned at the danger of misplaced investment, pointing out that the creation of employment is a sufficient compensation for the losses thus sustained.

The essentials of public life on the Continent have undergone considerable modification during our lifetime. Previously, nationalisation of industry had been advocated because private industrialists were making excessive profits, whereas the same course is often demanded nowadays on the grounds that the industrialist is making insufficient profits to enable him to reopen a closed establishment.

In periods of trade depression unemployment is most severe in the industries producing capital goods. An increased production of capital goods can be brought about by accelerating the substitution of new equipment for old—a process which is retarded in times of depression—or by increasing productive capacity in general. In periods of prosperity there is always a tendency for obsolete equipment, machinery, etc. to be replaced with new and for productive capacity to be enlarged, though it is not possible to draw a clear line of demarcation between these two processes. In periods of depression, on the other hand, industrialists refrain from purchasing new machinery etc.—which is scarcely surprising in view of the fact that even their existing plant is not fully utilised. Employment in capital goods industries is therefore subject to wide fluctuations; and the more highly developed the economy from the technical standpoint the greater is the output of capital goods, and the more serious are the fluctuations of employment in the industries which produce them.

This being so, the importance of regularity in the replacement of equipment and the installation of new plant will be readily appreciated. This objective could be attained by compelling firms to install new equipment during periods of trade depression and by checking the process during boom periods. Action along these lines was considered in



Sweden during the depression years. It was recognised that public works can hardly be sufficient to absorb the unemployment created by the falling off in the demand for new equipment by private industry. It was therefore suggested that industrialists should be persuaded by the government to extend their demand for capital goods in times of depression; and the view is now gaining ground that, should government persuasion prove ineffective, official powers of control should be extended. If it is correct, as some economists assert, that private industrialists would not agree to co-operate on these lines then this must be recognised as one of the most powerful arguments in favour of nationalising certain branches of industry.

Regularity in the purchase of capital equipment would be relatively easy to achieve in the case of industries whose sole, or principal, customer is the state—e.g. the manufacture of armaments and (in some countries) railway rolling stock. In practice, however, so far from maintaining or even increasing its purchases of capital equipment in periods of trade depression, the state usually does the reverse; in order to balance the budget, government orders are reduced during a depression and the crisis is thus aggravated. The Polish Government, for example, reduced its purchases of railway equipment during the trade depression which preceded the war.

Whereas cartels often control the purchase of the raw materials needed by their members, they seldom have any control over the buying of machinery, etc. In some countries, however, where compulsory cartels exist, or where they have the active support of the state, new undertakings cannot be established without government consent; for otherwise they would not receive a sales quota. In these circumstances the cartel organisation becomes the means of restricting investment in new equipment, though never of encouraging investment during a depression.

Organisations of the cartel type are sometimes formed

with the object of eliminating redundant productive capacity. This occurred in the British cotton industry, as well as in shipbuilding and flour milling, and there was an obvious effect on the demand for capital goods.

It is obvious that if means could be found to restrict the purchase of capital goods in times of prosperity and to stimulate it in times of depression the fluctuations of employment could be considerably reduced. In connection with this problem it is of interest to note that the German government reduced the taxes levied on firms which purchased capital equipment during the depression of 1931.

We have already pointed out that as a result of technical progress worn out machinery is often replaced by equipment of a different type, while the character of production may itself change. The purchase of machinery may therefore be a risky venture, especially in periods of depression, and the industrialist is naturally reluctant to incur the risk while part of his existing plant is idle. It might be urged that the state should share the risk, or even assume the whole burden in certain cases. In cartelised industries, however, the manufacturer can be sure of selling his goods at a profitable price, a factor which considerably diminishes this risk. In this respect the position of cartelised industries is similar to that of public utility undertakings which have a monopoly of one section of the market. These are generally required to keep their plant up to standard and to renew it when necessary. And, by analogy, it may be argued that undertakings which are members of a complete and effective cartel should be obliged to observe certain minimum standards of plant maintenance and renewal, which should be carried out according to a plan, the undertaking concerned bearing the risk that the investment may prove fruitless. The same might also be applied to large businesses which have a *de facto* monopoly.

As control over the purchase of capital goods is readily applicable only in industries which are in a monopolistic



position, its field is generally limited. In such circumstances great importance may be ascribed to public works—undertaken by the state or with assistance from the exchequer—as a means of reducing fluctuations in employment. Even in a free economy the exchequer often provides the means of payment for requirements considered essential from the standpoint of public policy. Sometimes the government undertakes to provide the necessary service regardless of any consideration of profit and with the knowledge that it must bear the expenses incurred. This, however, is not a decision to bear a risk but to shoulder a cost.

Some of the public works recently undertaken have not, however, been embarked upon primarily in order to cover essential requirements; the reason why the government decides to build roads in times of depression is not that the existing highway system is necessarily inadequate; nor do state railways order new rolling stock at such times because it is impossible for them to manage with their existing supplies. Such public works as these are undertaken with the primary object of relieving unemployment and the works chosen for the purpose may not become a profitable investment for many years. Since the production of capital goods forms so important an element in the national economy, such a policy is sound if it creates a demand for goods of this class. In a planned economy it is essential to risk making investments which may turn out to have been misplaced, for the sake of stimulating economic activity as a whole.

The argument applies not merely to the national field, but to the international as well. As we shall see more clearly later, the equipping of economically backward countries by those which are in a more advanced stage of development is an essential process. The great depression of the 1930s was largely caused by the fact that wealthy countries such as the United States ceased to make investments in foreign lands. When the present war is over, the



re-equipment of certain countries will obviously have to be undertaken with the help of nations that are more fortunately placed. Obviously, the process will involve risks—which no amount of economic planning will be able to remove. But it is better to undertake investments which are unprofitable from the purely economic standpoint, and thus to increase production and international trade, than to be over-cautious. Consumption grows with increased production, which is thus worth while even if part of the investment turns out to have been unremunerative. Naturally enough, however, people will be much more ready to take such investment risks at home than in foreign countries.

Here we can appreciate one of the main advantages of a planned economy, which is, that the state bears the risk of an investment proving unprofitable.

Foreign investments may be readily regulated in a planned economy, especially investments in public utility undertakings or industries suited to cartelisation. This applies also to credits granted for the purpose of foreign investment. Investments in countries with inferior credit capacities may turn out to be both justifiable and advantageous from the general economic standpoint.

## CHAPTER VII

### CREDIT POLICY

During the nineteenth century prices in most countries of the world were linked together through the operation of the international gold standard. Though we do not propose to deal with this question at any length, it is worth pointing out that the extent to which prices were equated by this mechanism has been greatly exaggerated. In some countries, for example, potatoes were cheap while clothes were dear, whereas in others the reverse was true. Again, unskilled labour is certainly cheap in Eastern Europe, and there is generally a large reservoir of unemployed workers from which it can be drawn; but wages in certain skilled trades are actually higher than in Britain. In such circumstances the equation of prices in an area where agriculture is intensive and agricultural prices high with those of a country where agriculture is carried on extensively and prices are low is naturally difficult. In fact, the tendency towards equalisation is strong only in the prices of those goods which are the subject of international trade.

When the regime of free exchanges was abandoned and foreign exchange restrictions began to be imposed, the central banks were no longer compelled to protect their gold reserves by raising interest rates; and it was realised that the restriction of credit by means of a high rate of interest imposed unnecessary burdens upon industry, and that the same result could be better accomplished by direct control of the capital market. The raising of interest rates in a

country which is on the gold standard may in fact affect industrialists adversely but leave the speculator entirely untouched, for the latter may be anticipating a much bigger margin of profit on his financial transaction. Under a policy of credit control, on the other hand, it is possible to discriminate against borrowers of this sort.

Those who favoured changes in the rate of interest as a means of controlling the economy urged that the producer whose goods were rising in price owing to an increasing demand would be prepared to pay a higher rate of interest on his loans than a producer whose products were falling in price owing to a contracting demand. The rate of interest was thus regarded as a kind of selective apparatus automatically dividing producers into two classes—those who could, and those who could not, afford to pay a given rate. But the matter is not so simple as this. A producer does not consider each transaction separately but often attaches greater importance to remaining on the market over a period of time than to making a profit on every transaction.

The rate of interest on short-term loans is, in fact, only one—and by no means the most important—of many elements which enter into the cost of production. Some economists, however, while agreeing that the rate of interest has little bearing on the calculations of the industrialist, are of opinion that it is important in commercial transactions. It is true, of course, that the rate of interest plays a proportionately greater role in commerce, where other costs are fewer; but this is counterbalanced by the fact that the working capital of the trader is turned over far more frequently than that of the industrialist.

In point of fact, the industrialist is sensitive to changes in the rate of interest, not so much because of the direct effect which such changes have upon his costs, but rather because he regards them as harbingers of easier or tighter credit conditions, as the case may be. If he does not adapt



his operations accordingly he knows that the banks have means of enforcing compliance; they may, for instance, tighten up the conditions upon which they will discount bills of exchange, by inquiring more closely into the standing of the parties concerned, or by other means. Movements in the discount rate thus provide an indication of the central bank's intentions in the matter of credit policy.

On the basis of the Bank Rate—the discount rate of the central bank—there is erected a whole structure of interest rates, which differ according to the period for which the loan is granted, the financial standing of the debtor, and other factors. The status of the various classes of bonds is nicely calculated, government bonds having a higher standing than those of a borough, and so forth.

Among the factors determining these various rates of interest public opinion cannot be ignored, and this is often quite capricious. It is sometimes argued that the rate of interest falls in periods of depression (on account of a decline in the demand for credit) and rises in periods of prosperity; but this is not always so. Business firms may raise capital by issuing shares to the general public and subscriptions to these shares are in fact in the nature of a credit granted at a variable rate of interest, depending upon the dividends paid; for the shareholder is often merely a creditor who has no real influence on the running of the business. Hence a company which issues shares at a high price to an optimistically disposed public during a trade boom actually obtains a long-term credit at a variable rate of interest—which may fall almost to nothing in times of depression. By this means the entrepreneur may be able to raise credits very cheaply in periods of general prosperity.

The rate of interest may also be influenced by government policy. Thus, if the Treasury guarantees the bonds of a particular undertaking it will enable that concern to borrow on cheaper terms than would otherwise have been possible. This may be done, for example, in the case of railways,

building societies facilitating the erection of cheap houses, and so forth. By its influence on the investment policy of savings banks, insurance companies and other institutions, moreover, the government creates a demand for certain securities, which has the effect of reducing the rate of interest on the securities in question. Again, there are ways in which the Treasury can influence the market price of securities—especially government bonds. This is usually done through the central bank and forms part of the "open market policy" which was used to supplement or replace changes in Bank Rate as a means of credit control.

It is most important to realise that the gold standard system could function only on the basis of a stabilised international exchange of both commodities and capital. So far as the international investment of capital is concerned, there are two groups of countries, though the line of demarcation may not be clearly defined. The first group consists of economically advanced communities where there are only limited opportunities for certain kinds of investment—where railways, telephone system and electricity supply service for instance, are so highly developed that there is comparatively little scope for fresh investment in these fields; the second group consists of undeveloped countries.

It was in circumstances such as these that the more wealthy countries participated in the development of the more backward lands. During the nineteenth century the influx of capital into countries of the latter class was more or less continuous and often lasted for long periods of time; indeed, the debtor countries were often able to meet their debt charges only because fresh capital was continually raising their economic efficiency. The creditor countries, for their part, generally refrained from withdrawing their capital, and even granted fresh credits to those debtors who met their obligations satisfactorily.

This process of foreign investment for the development



of backward areas was one of the most characteristic features of the nineteenth century world economy; and the flow of capital was often accompanied by the migration of workpeople to sparsely populated areas rich in raw materials. Thus both capital and labour moved from more developed areas to less developed ones. As soon as restrictions on immigration were introduced there should have been a change in the direction of capital movements; more capital should have been invested in the densely populated areas which were, before the last war, the world's emigration reservoirs; but in fact this did not occur.

In the nineteenth century, as we have seen, there was a tendency for labour to flow towards the areas rich in natural resources. But with the improvement in transport facilities and the progress of industrial technique, men became largely independent of the natural advantages which had hitherto played such an important part in the location of industry; and it now seems likely that raw materials and industrial equipment will in future tend to flow to the densely populated regions, rather than vice versa.

Before 1914 the principal creditor countries were Britain, France, Holland, Belgium and Switzerland. The debtor countries met their debt charges mainly by the export of commodities to their creditors, the latter having a passive trade balance because they paid for part of their imports by means of "invisible" exports.

Some economists consider that the main advantage of foreign investments is that they provide the creditor country with an income; but the fact that they contribute to the expansion of international trade would appear to be a much more important point. Consider, for example, the case of Great Britain. Before the last war the interest received by this country on its overseas investments amounted to some £200 millions annually, while a similar sum was invested every year in foreign countries. In other words, Britain did not consume the income she earned on her



foreign investments, but re-invested it in the development of more backward foreign lands. During 1914-18, however, Britain was compelled to realise much of her foreign assets in order to raise dollars to pay for the war. Suppose that there had been no war, but that British overseas investments had been reduced by a similar amount through the default of her debtors. Is it certain that the British would then have recorded their century-old policy of foreign investment as a mistake? Would they not rather have concluded that the policy which had functioned for scores of years with good results was a correct one?

It seems to us that if the investment of capital facilitates profitable trading relations between the two parties over a lengthy period of time it is justified even if the capital is ultimately found to be irrecoverable. This opinion is borne out by the attitude adopted by the creditor nations towards Soviet Russia. Despite the fact that the Soviet government repudiated the country's foreign obligations after the revolution, fresh credits were extended to it by the capital exporting countries, who were thus able partially to maintain their export trade. (The same policy may be adopted by an individual creditor towards his insolvent debtor if he is of opinion that the reduction or cancellation of the debt will enable them to continue trading as before.) There is nothing surprising in this. For the creditor countries were only able to make loans at all because they had been able to trade on advantageous terms with foreign countries and so to accumulate balances out of which investments could be made. If the capital is lost it may nevertheless be worth while to make a fresh loan in order that the process of international trade may be continued.

The view that the continuance of the trading relation is of greater importance than the recovery of the capital invested found weighty support in an article in *The Times* of September 12th 1941. This is what it said: "When peace is re-established at last, most of the countries of

Europe will find their stocks exhausted, their industries dislocated, and their whole economic life at a standstill. Even to carry on—to say nothing of reconstruction—they will need supplies in great quantities—foodstuffs, raw materials and machinery. Unless some far-sighted application of the Lease-Lend principle is devised in time these countries will have to borrow money in large sums, which their creditors will expect to be repaid in money, across the exchanges. They will be driven to strive desperately for active balances of trade by exporting all they can, even if they have to subsidise their export, and by cutting down their imports to the minimum. By their competition with one another they will drive down the prices they receive for the goods they export, and by cutting down their imports they will cause widespread unemployment among their customers, and thus destroy their own markets.”

“ This is what happened after 1918. It will happen all over again unless in the meantime we can learn to think less in terms of money and more in terms of real goods and services, and to indulge less in international competition and more in international co-operation for the common good. The sacrifices for which this will call will not be nearly so great as may appear on the surface. It must not be forgotten that a very large proportion of the loans made to foreign countries have resulted in loss for the investor through partial or complete default, and this has been especially true of the loans made after the end of the last war. Even from the business point of view it may prove more profitable in the long run to put valuable potential customers on their feet, without exacting a return, than it would be to load them with monetary obligations which they will ultimately be forced to repudiate and which in fact they will not be able to discharge without ruining themselves and their neighbours.”

Moreover, **The Times** commented upon an article by Mr. Feis in **Foreign Affairs** in these words: “ Reduced to its



simplest terms his proposal is that at the beginning of each year the American government should set aside a designated sum of dollars, say three or four billion, which would be allocated among the various countries for specified purposes. To the extent that each country drew upon its allocation it would in return make available to the United States a corresponding sum in its own currency at a fixed rate of exchange. If at the end of a specified period, say two years, any of the foreign countries had not used all the dollars allotted to it, the unused remainder would be cancelled. Similarly, if the United States had not used the full amount of the credits in foreign currency received in exchange the remainder would be cancelled. The arrangement would be self-liquidating and—what is most important—no permanent debt would come into existence.”

This is all very well, but it seems probable that the anonymous author of a memorandum entitled **A Twentieth Century Economic System** (published by the Economic Reform Club) is more realistic in saying: “It is unlikely that the workers of any country would for long be content to export their real wealth and receive nothing whatever in return—not even an admission of unpayable indebtedness.” Again, Mr. Green, president of the American Federation of Labour, asserted some time ago that the investment which labour makes in social security, retirement benefits, health, accident and life insurance, reflects the very definite interest which labour in general has in the maintenance of healthy conditions in the investment field.

On the other hand, the idea that the prosperity of other nations is an interest of the United States is found in an American National Planning publication, entitled **United States Co-operation with British Nations**. It says: “In any case, the Lend-Lease Act, among other innovations, has already had the effect of demonstrating that the people and Congress have grasped the idea of exchanging goods and services on extremely flexible credit terms. Will it



seem feasible, in peace time, to trade capital goods and technical skill to needy peoples to enable them to restore themselves to prosperity or to begin their development of their local natural resources? The meaning of Lend-Lease may be that Americans are coming of age in their foreign policy, that they are prepared to use their preponderant economic power in their national interest, broadly conceived, and that to this end they are envisioning a new "balance of payment" concept, based on a long-term reckoning of economic and social benefits."

Investment abroad is, of course, considered to be more risky than investment at home. When overseas investments turn out to be unremunerative they are criticised far more severely than similar failures at home; for in the latter case, even if the investment does not yield an adequate monetary return it may nevertheless have been worth while. Thus a home railway which has to be run at a loss does at least bring tangible advantages to the national economy, whereas a similar railway in a foreign country brings no benefit to the creditor nation. If, however, a foreign railway built with British capital assists the economic development of the country concerned, and thus creates a favourable market for British goods, the indirect advantage may far outweigh the loss sustained by the British investor whose capital brings in no interest.

The enormous economic progress of the nineteenth century is rightly attributed to free trade, but it should be remembered that the rapid expansion of international commerce was made possible only by foreign investments—i.e., by the movement of capital from the creditor nations to more backward countries.

After the last war there were radical changes in the economic scene. Important creditors such as Britain and France lost much of their former importance, while a new creditor nation arose, which had previously been among the debtor countries—the United States. Unfortunately,

the American authorities, did not adapt themselves to the new situation, but played the proper role of a creditor country for a short while only. Britain and France paid their war debts to the United States so long as they received reparations payments from Germany. But these changes in the position of the creditor nations, the existence of reparations and inter-allied debts exercised a powerful influence on international capital movements. Moreover, the position was complicated by the existence of large short-term balances—so-called "hot money"—which flitted from country to country in the endeavour to escape from areas of political or economic insecurity to safer resting places.

A few years after the close of the last war the United States began to make investments abroad, and it is of interest to note that it granted credits to a number of European countries in order that these might go back to the gold standard. Until 1930 Britain was still making foreign investments, though to a much smaller extent than before 1914.

It is an interesting characteristic of creditors that they generally prefer to make large loans rather than small ones. In creditor countries the public has a preference for buying securities it knows—and to be well known securities must be issued in large amounts; but the smaller states cannot afford to borrow in large amounts. When some of the smaller countries began to negotiate for loans in the United States the American bankers would, as often as not, advise them to apply for larger sums; and it is, of course, plain that the costs of issuing, advertising and so forth may hardly be covered if the loan is a small one. Like the advocates of economic planning, big bankers have a preference for large-scale transactions; this being so, it is hardly surprising that of all European states Germany was most successful in obtaining accommodation during the inter-war years.

After the present war conditions will in all probability



be so uncertain that the prospects of debt repayment by foreign countries will be impossible to assess. In these circumstances, foreign investment will be a risky business and it is doubtful whether individual investors in the more wealthy countries will be willing to bear this risk. If this is so, foreign credits will have to be granted or loans made with the backing of the creditor state's Treasury. This means that foreign investment will have to be planned, though the planning will not, of course, eliminate the risk—it will merely shift it on to the shoulders of the Treasury.

In my opinion the most important advantage of state planning is that it enables projects to be undertaken which would not otherwise have been embarked upon for fear of loss. The private entrepreneur cannot afford to put his money into investments which seem likely to be unremunerative; though he often takes risks which he hopes will turn out to his advantage. If the Treasury undertakes to bear the risk—by offering the entrepreneur some compensation in the event of loss or by paying him a subsidy—the role of the entrepreneur is fundamentally changed and the government should in justice limit his profits. This principle was, in fact, applied during the nineteenth century; when, for instance, the government guaranteed railway bonds it also fixed railway rates.

Considerable importance attaches to the question which social strata participate in foreign investment: public opinion reacts quite mildly to losses sustained by the well-to-do, but strong feelings are aroused if other classes are affected—and those responsible for the promotion of the investments concerned may come in for severe criticism. Thus the Paris banks were taken to task during the inter-war years because they had placed foreign securities—including Russian ones—among the general public. British public opinion, on the other hand, was more ready to put up with losses in foreign investments for, whereas the French people affected were mostly small rentiers, the principal investors in the case of



Britain were the richer classes.

As has already been pointed out, private investors are often averse to placing their capital abroad owing to the risks involved, and in such cases the Treasury may encourage the process of foreign investment by guaranteeing the securities in question. But a government is generally more cautious in such matters than a private investor, who is risking his own money, so that increased state intervention may act as a restraining influence. Again, if a foreign loan is not taken up by the general public the capital may be subscribed by the banks or insurance companies, but in such cases the need to safeguard the public's savings may lead the government to impose some limitations on this process. In the matter of foreign investment policy, the governments of the creditor nations are in fact, faced with the necessity of trying to hold the balance between undue risk and excessive caution. It would be a great mistake to be over-cautious, for both theory and practical experience suggest that there are many occasions on which it is better to invest and run the risk of loss than to refrain from investing at all.

Cases have been known in which the government of a creditor state has guaranteed the bonds of another government. Thus the Polish tobacco loan was floated in Italy and guaranteed by the Italian government. The effect is then the same as if the one government had granted a loan to the other.

Sometimes financial companies enter the field of foreign investment; they raise the capital to buy up foreign government securities by issuing shares and bonds of their own. An example is provided by the International Match Company, associated with the famous name of Kreuger, which financed many loans to foreign governments. Similarly, electrical companies may specialise in purchasing the shares of electricity undertakings in various countries. Whereas, for example, in the United States—the general public

is reluctant to purchase foreign bonds, issued in small amounts, it may readily subscribe capital to finance Corporations which, in turn, finance the foreign loan.

A policy of economic self-sufficiency is commonly condemned—and rightly so, for the economy of one country cannot be made independent of those of others; and this general principle is certainly applicable to the field of investment policy. When the war is over the creditor countries will be a good deal worse off than before. Despite this, they will have to undertake their post-war reconstruction in concert with other states and should in their own interest, extend credits to countries whose need is greater than their own. The impoverished countries of Europe will, for instance, have to obtain supplies of raw materials on credit. But it does not follow that the raw material producers will be willing to grant credits to these needy potential customers and, in these circumstances, it may be desirable for Britain to step in and to finance the export of raw materials from the Dominions to Europe. If the problem is not solved in some such way as this the countries which have no capital to finance their own reconstruction may be forced to adopt a policy of economic self-sufficiency, which would have adverse repercussions on the foreign trade of the creditor nations.

In 1930 the Viennese banking system, which had transacted a great deal of business in the countries of Eastern Europe, suffered a breakdown. Large-scale withdrawals of credit were made from Continental countries and later on from Britain as well until, unable any longer to withstand the strain, Britain was forced off the gold standard. The new channels along which capital had begun to flow between 1925 and 1930 were now abandoned;—indeed, the direction of the flow was actually reversed. As a result of the crisis of 1929-31 capital began to move from South America and certain European countries to the principal creditor states.

From 1930 onwards a large-scale repatriation of American capital took place; nor was that all. As a result of political unrest and economic insecurity elsewhere, foreign countries began to invest their balances in bank deposits or stock exchange securities in the United States, which became a debtor on a colossal scale. This abnormal movement of funds considerably weakened the debtor countries, especially those of Latin America and Eastern Europe.

It was pointed out in the 1937 edition of the League of Nations' publication, **Balances of Payments**, that since 1928 the creditor nations had been granting loans principally to countries with which they had political ties. Great Britain, for instance, made loans mainly to Empire countries; the United States, France and the Netherlands largely to their respective overseas possessions; and Japan to Manchukuo. In some instances, however, geographical proximity or close economic collaboration was a sufficient basis for the grant of a loan. Thus the United States granted credits to Canada; Sweden to the other Scandinavian countries; Switzerland, Belgium and Holland to France. 'Apart from the Empire, the only countries to receive loans from Britain were the members of the sterling bloc. For a number of years most of the states of Latin America and Eastern Europe had no access to the capital markets of the creditor countries.

Because capital movements are closely related to imports and exports, the movement of goods must adapt itself to changes in the flow of capital. When it was no longer possible for them to raise loans abroad, the debtor countries began to subsidise their export industries and to restrict their imports. Exports were also regulated in order to acquire the foreign exchange needed to meet the countries' debt charges. To maintain their reputation for solvency, moreover, the debtor states parted with their gold reserves to their creditors—Poland being an example of a state which practised this policy for a long time. As was pointed out in 1932 in the Report of the Stresa Conference on



Economic Reconstruction in Central and Eastern Europe\*, the economic structure of the states in question was adapted for a steady influx of capital; when this inflow ceased—even being replaced in some instances by an outflow—economic dislocation was bound to result and the control of imports became inevitable. The withdrawal of capital from Central and Eastern Europe is regarded as one of the main causes of the great depression by the authors of the League of Nations publications, **World Economic Survey 1931-32** and **The Course and Phases of the World's Economic Depression.**"

This policy of subsidising exports and restricting imports naturally provoked much criticism in the creditor countries. But it is of interest to note that after a time the United States government was itself forced to pay export premiums in respect of certain commodities—cotton and cotton manufactures, for instance. So the whirling of time brought in its revenges. Having ceased to make investments in foreign countries, Americans were forced to subsidise exports to the countries they had impoverished. It should hardly be necessary to point out in connection with international trade that it is fatal for one country to impoverish another. As we suggested in Chapter V, optimum terms of trade exist; if these are not adhered to the products of the exporting country have to be sold at prices lower than those ruling on the home market. If American capital had not been withdrawn, the countries importing cotton from the United States would have been able to pay the same price as the American domestic consumer.

During the 1920s the creditor states showed their inability to cope with the problems of German reparations. It is worth making the point here that in fact the Germans

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\* Rapport de la conference de Stresa pour la reconstruction economique de l'Europe Centrale et Orientale, presente a la commission d'etude pour l'union europeene, N. officiel : c. 666.M. 321. 1932. VII.

made no net payment at all, for they received in foreign credits more than they paid in the shape of reparations. From 1924 to 1929 the German balance of payments was passive. A negligible surplus appeared in 1929 and in 1930 there was a surplus of over RM1,600 millions. In 1931-32 the active balance amounted to more than RM2,800 millions.\* These figures do not, however, take into account reparations payments made in kind. Thus, during the period 1924-1930, reparations payments in kind were represented by goods to the value of 4,500 million marks; but since the passive balance, excluding these special exports, amounted during this period to 6,300 million marks, it is apparent that imports exceeded German exports, including reparations payments in kind, by close on 2,000 million marks. Up till 1929 the Germans were increasing their stock of gold.

During the period 1924-1930, as we have said, reparations payments in kind amounted to around 4,500 million marks, while cash payments across the exchanges amounted to almost 6,000 million marks. But the long-term foreign credits granted to Germany during the same period totalled 9,000 million marks, short-term credits amounted to anything from 5,200 to 5,500 millions, while the influx of capital on miscellaneous accounts that cannot be more closely defined amounted to between 3,000 and 4,000 million marks. There can be no possible doubt therefore that the influx of capital into Germany during the period in question was substantially in excess of German reparation payments.

The upshot was that the Bank of France increased its gold reserve from 20,400 million francs in 1924 to 53,600 millions in 1930 and its short-term foreign assets from 300 to 26,200 millions. The receipts from reparations were therefore offset neither by increased imports of goods nor by exports of capital, but hoarded in the form of gold and

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\* Memorandum on Foreign Short-Term Loans in Germany 1919-1932. Issued by the Information Department of the Royal Institute of International Affairs.

foreign balances. A large amount of these short-term balances was held in London—to the embarrassment of the British authorities who realised the difficulties which would be created if they were suddenly withdrawn. By contrast with the behaviour of the French, who neither encouraged imports by spending the reparations' receipts nor exports by lending abroad, Britain admitted German goods to her unprotected markets. Small wonder that the British began to complain that they were financing the reparations which France received.

Part of the reparations payments received by the ex-allies were passed on to the United States as interest on war debts. The latter accumulated bigger and bigger gold reserves, surrounded itself with a high tariff wall and ceased in 1929 to make loans abroad. The Americans thus contributed even more than the French to the breakdown of reparations.

How can the reluctance to accept German goods free of charge—which was characteristic of the period under review—be explained? Industrialists of every country quite naturally claim a prior right to supply the home market; and the claim is supported by the working classes who are obsessed by the fear of unemployment. The belief that a flood of German goods would create unemployment and undermine the profit structure of British industry was responsible for the hostile attitude to German imports already noted. But the fundamental absurdity of the argument was underlined by the wag who suggested that the best solution of the problem would be to compel the Germans to accept reparations payments and so force them to shoulder the burden of unemployment.

The fact, of course, is that in every country there are various necessary works which are not undertaken because they are not a commercial proposition. But if capital equipment for the purpose were obtained from Germany free of charge such works could probably be made to pay; and if they did not yield a profit they would at least have a social



utility; the home producer would lose nothing from German "competition" in such circumstances, for he would have had no opportunity of supplying the equipment if it had had to be paid for at market prices. By way of example, it may be pointed out that in Poland there are many towns without electricity supplies because the demand is not sufficiently large to cover the overhead expenses which would be involved in equipping them for the purpose. But if the generators, cables and other equipment were supplied free of charge by the Germans, the undertaking would naturally be a paying proposition. Electrical manufacturers in Poland, or Britain, or France, would lose nothing by the transaction, for they would have had no opportunity of supplying the equipment in any case. And even in more highly developed countries works may always be found which would not pay if the necessary materials had to be purchased at market prices, but which it would be well worth while to undertake if the capital equipment were received free of charge.

If during the decade after the peace Britain and France had realised the importance of the Baltic-Bosphorus-Baghdad belt, German reparations payments in kind could have been turned to good account in building up a strong political and economic structure there. But the idea of employing German capital equipment for the development of economically backward areas in this manner was only once suggested—and then the area proposed was Russia. One more example of the importance attached to large units!

The British constructed railways, power stations and other public works in their overseas possessions only when there was a prospect that the undertakings in question could be made to pay. But some of the undertakings which could not have yielded a profit if constructed in the normal way would certainly have become an economic proposition if they had been carried out with German goods obtained

free of charge; and the shares could have been retained by the British or French governments. The opportunity was lost partly because the authorities had a one-sided view of profitability and partly because of the aversion to state ownership then prevalent. The extent to which profitability had already become an institutional phenomenon was not appreciated.

In the 'thirties credit conditions were very uncertain, capital movements had dwindled and international relations were very unstable. Entrepreneurs were reluctant to extend credit to debtors in many foreign countries. (For this reason the Export Credit Guarantee Department was set up in Britain to provide British exporters with insurance against the risk of default by their foreign customers.) As a general principle it may be said that the grant of credits overseas should be co-ordinated with the exchange of goods—though there need be little fear that European states after the war will hoard any credits they receive, in the misguided belief that the restoration of the gold standard is their primary duty.

The co-ordination of foreign trade with the movement of capital should not, however, be too rigid. For example, a country making a loan to another to finance the construction of a railway should not insist upon supplying the rails and rolling stock if the borrowing country is in a position to make them for itself. But if the debtor country has inadequate supplies of cotton and wool to clothe its workpeople (including those engaged in constructing the railway) then it would be reasonable to co-ordinate the railway loan with the supply of textile raw materials—assuming that the creditor country is able to export these. Nevertheless, because the practical difficulties encountered in applying this policy might be considerable, the debtor state should be granted a certain freedom of choice in the purchase of goods from the creditor state. This would have the incidental advantage of encouraging the debtor's sense



of responsibility: if the debtor is forced to buy one type of goods in preference to another he may argue that the creditor is equally responsible for the outcome of the transaction, but if he is free to choose his sense of responsibility is increased.

The view was commonly held after the last war that, whereas it was legitimate to grant credits to start a productive enterprise, this should not be done to finance the production of durable consumption goods; the construction of houses, for example, was considered to fall within the latter category. But, as we have already pointed out, consumers' goods must be regarded as including not only the raw materials out of which they are made, but also a certain proportion of the machinery and equipment used in their manufacture. Conversely, capital goods—machinery, factory buildings, etc.—contain not only the materials out of which they have been constructed, but also a certain proportion of the clothing, board and lodgings of the workpeople employed in their construction. Thus the building of decent housing accommodation may contribute to the increased efficiency of workpeople engaged in building a factory.

The government of a creditor state is naturally anxious to know what goods its debtors will export to meet the interest and amortisation charges on its loans. And this brings us face to face with one of the difficult problems which arise in connection with the planning of the post-war world. With what goods will the countries now devastated by war be able to repay their creditors? The question is by no means easy to answer; for even in the case of countries with a comparatively small range of exports, there are a considerable number of commodities which may be sold abroad, even if the quantities involved are small. It is extremely difficult to forecast which lines of production will most easily be restored and which will be in most demand when the war is over. This is one



reason why loans to countries which have suffered much war damage must necessarily be a risky venture.

It has happened in the past that countries which have had every intention of meeting their obligations have been forced to suspend service on their debts because they were unable to forego the importation of certain essential commodities; and to pay for those commodities they have been compelled to use the proceeds of their own exports, which might otherwise have gone to meet their debt charges. It is, indeed, useless to ignore the fact that certain imports may be of such vital importance that they must have first claim on the proceeds derived from a debtor country's export trade; only when they have been paid for can foreign exchange be set aside to meet debt charges.

Paradoxical though it may seem, it is sometimes true that the greater the risk of overseas investment may appear to the creditor the more likely is it to diminish as time goes on. The explanation is that a large credit may improve the economic efficiency of the debtor state and thus enable it more easily to meet its obligations. Meagre doses of credit, on the other hand, will not have much effect. But in any case the process of developing a backward state with foreign capital must inevitably be somewhat risky.

After the economic crisis a number of countries began to tackle the problem of recovery from the depression in isolation, abandoning the system of international price co-ordination represented by the gold standard. Such a self-sufficient policy was favoured by the fact that services—which were in increasing demand owing to the gradual rise in the standard of living—can as a rule be supplied only by the domestic producers. Recreation and medical attention are obvious examples: they cannot, generally speaking, be imported, but must be provided at home. The self-sufficiency policy was not, however, confined to this sphere.

The endeavour was made to produce at home as much as possible of the commodities needed to satisfy the require-

ments of domestic consumers. In Great Britain, for example, agriculture was subsidised with this end in view. Countries where unemployment was high and industry inadequately developed naturally attempted to build up industries of their own—often at a high cost in terms of money and human effort. When the monetary system of most countries was tied up in the gold standard economic policy had of necessity to aim at keeping one national economy in step with the rest. But in the changed circumstances brought about by the shift in international capital movements new methods have been developed during the past decade for establishing equilibrium in the country's balance of payments; the main tools of the new policy are foreign exchange control, the regulation of imports and the subsidising of exports. Thus exchange equalisation funds were established to eliminate the most violent fluctuations in the rate of exchange. When the domestic price level began to rise as the result of an expansionist credit policy designed to encourage business activity—thus attracting imports but rendering the export trade more difficult—the government would restrict imports and subsidise exports; and the exchange equalisation fund would also operate in the foreign exchange market. Thus the co-ordination of the domestic price level with world prices was accomplished in a complicated and roundabout fashion.

In these circumstances considerable latitude was possible in the grant of credit facilities to new businesses; and credit policy began to operate on a longer-term basis. The old criteria of credit policy were no longer applicable, but the problem of defining the standards which were to govern the operations of the new had not yet been solved.

Increased Treasury participation in the formulation of credit policy was a revolutionary innovation. Governments began to establish state credit institutions with wide powers. One motive was to facilitate the making of loans to those classes which had no direct access to the commercial banks;



and special state credit institutions catered for the needs of small farmers, builders erecting working-class houses and flats, small industrialists and such-like. At first the policy was administered with considerable caution, for it naturally encountered much criticism from the conservative banking interests. During the crisis of 1929, however, the governments of many European countries were forced to give assistance to the commercial banks, and in my opinion it was the necessity of rendering aid to private business which sanctioned the enormous growth of state activity in the sphere of credit policy.

During the depression years many debt ridden businesses in all parts of Europe and the United States were unable to meet their obligations; and this meant that many of the assets of the commercial banks—which had made advances to these businesses—were of doubtful value. Governments frequently came to the aid of the banks by taking over their doubtful assets and replacing them by good ones. To this end the governments concerned created institutions with power to raise capital by the issue of bonds and to use the resources so obtained to purchase the dubious assets from the banks. In some cases banks received the bonds of these institutions in exchange, the bonds often being backed by a Treasury guarantee. Bodies of this character created in the United States included Reconstruction Finance Corporation, the Commodity Credit Corporation, the United States Housing Authority, the Home Owner's Loan Corporation and the Federal Farm Mortgage Corporation. The first named has power to extend credit to banks, insurance companies, public utilities, agricultural co-operatives, etc., and to take over their bad assets. Starting with Treasury funds, it is authorised to issue bonds with Treasury backing, and the Treasury and the banks of issue have the right to purchase the bonds of the Reconstruction Finance Corporation.

In Britain the Bank of England extended financial



assistance to certain industries which had been obliged to make considerable capital investments in order to modernise their plant. To rid itself of these somewhat doubtful assets, the Bank of England in 1929 created the Bankers' Industrial Development Company, which took them over. The capital of this company was subscribed by the Bank of England itself and the joint-stock banks, and it operated on a fairly considerable scale for a number of years.

Institutions of a similar type were created in Italy, Belgium, Poland and other countries. Their main purpose was to facilitate the economic reconstruction made necessary by the trade depression; and it is not surprising that, having gone thus far, governments began to sanction the grant of fresh credits by these institutions to industrialists regardless of the cautious principles of "sound finance" which had previously been applied. The supremacy of economic aims over mere financial considerations was gradually recognised and it came to be realised that in periods of expanding business activity even doubtful credits become sound, whereas in periods of depression even the most reliable debtors may be unable to meet their obligations.

In the United States no less than elsewhere the criteria governing the grant of credits by the banking system underwent considerable modification. The Act of 1935 empowered the Federal Reserve Banks to make advances to the member banks against almost any good asset, whereas the legislation previously in force had prescribed rigid conditions for the grant of such credits. The only condition now enforced is that the Federal Reserve Bank must be satisfied that the security offered is adequate, but it may exercise its own discretion in determining the worth of the collateral. The legislation of 1935 was intended at first to be purely temporary, but it was later embodied in the statutes of the Federal Reserve Banks. It was laid down in 1937 that loans to member banks might be made against

the security of real estate loans and instalment papers.\*

The books of the American banks are subject to periodical government examination and it has been customary on these occasions to inquire into whether the assets are correctly valued, and whether they are sufficiently liquid. New criteria to be applied to the balance-sheets of the member banks were, however, published in the **Federal Reserve Bulletin** for July, 1938. It was then laid down that the banks, in granting short-term advances or long-term loans, should be encouraged to pay more attention to the intrinsic value of the security offered than to the criterion of liquidity. Securities should be assessed not so much on the basis of their market price as on the inherent soundness of the undertaking concerned. Banks were given the right to purchase securities which were not quoted on the stock exchange or held by the general public. In other words, the banks were empowered to disregard the question of liquidity and to make loans for a fixed term. It was pointed out that the stability of the banking system is ultimately dependent upon the prosperity of the country. In order to restore prosperity one should continue to give credit to borrowers who are, necessarily, often temporarily insolvent during a crisis. The right was also given at this time to enter securities in the balance-sheet, not at their current stock exchange valuation, but at their purchase price, or at a valuation determined by any other method. And the hope was expressed that if the banks adopted these principles there would be less need for the creation of state institutions to supply credit which should have been provided by the private banks.

All who believe that the banks should adhere to established principles of liquidity and that their assets should be valued strictly on the basis of stock exchange prices naturally criticise these decisions.

It is apparent that if, in following these new principles,

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\* See Federal Reserve System Report for 1937, page 207.

the banks suffer losses on their investments they will have to be aided by the government through credit institutions of the type described above; the Treasury would continue to give its backing to the bonds of the institutions taking over these bad assets from the banks. In this way a large number of extra-budgetary government activities—embracing the bank of issue, the state credit institutions and various government funds—come into being.

The old theory that the banks should refrain from granting long-term credits was abandoned under pressure of changing circumstances. With their wealth increasing, entrepreneurs had at their disposal a growing volume of liquid assets which they had readily invested in Treasury bills, while the classical short-term bill of exchange gradually went out of use. Hence opinions previously entertained with regard to the floating debt had to be modified. It had been thought that if the holders of short-term government paper did not renew their credits as they became due for repayment inflation would result; but experience taught that Treasury bills are always in demand on the money market. Gradually the life of Treasury bills was extended, and five-year Treasury bonds made their appearance. The price of these latter securities is maintained at a steady level by the central bank, which is no longer afraid of including long-term government securities among its assets. In the case of the London joint-stock banks, indeed, government securities nowadays form the largest item on the assets side, ranking before loans to private business.

According to the statement in the **Federal Reserve Bulletin** for March 1940, *the long-term government bond market has in fact become the central money market of the United States.* If such a state of affairs had been predicted fifteen years ago, it would have been regarded as down-right heresy; for the money market was then concerned almost exclusively with the short-term bill of



exchange. Nowadays banks may hold hardly any bills of exchange at all, their portfolios containing increasing numbers of Treasury bills and long-term government bonds.

With this change in the composition of its assets, the role of the banking system has been radically altered. Before the last war the banks had to be ready to adapt themselves at short notice to the vagaries of credit conditions, and their substantial holdings of liquid short-term bills enabled them to do this. But as their portfolios came to include more and more long-term assets so their policy took on a long-range character and they became increasingly involved in State economic policy. An eloquent example is provided by the Treasury acquisition of the banks' gold reserves, as a result of which Government bonds and securities guaranteed by the state became the principal cover for the note issue. Currency stability thus became dependent upon the success of the government's long-range economic policy rather than upon the central bank's gold reserves or its ability to adapt itself to short-term changes in economic conditions.

A parallel change occurred in the attitude to budgetary deficits. It was gradually realised that deficit financing might be necessary in order to avert a crisis or combat the effects of trade depression. If such a policy is consciously adopted and properly co-ordinated with other measures it may bring about a revival of business activity and so increase the yield from taxation. During the inter-war years this method was tried in the United States, Germany and Sweden, where it was realised that in times of depression it is necessary to stimulate industrial activity by means of a public works programme, even at the expense of a budget deficit. This realisation represents a radical departure from the traditional belief in the necessity of maintaining a balanced budget from year to year; but the view is now widely held that if capital investment is unduly restricted, because the public is for one reason or another reluctant

to take the risk, the Treasury should redress the balance by issuing bonds and selling them to the credit institutions, using the funds so raised to finance public works.

With the extension of government economic activity through credit institutions, special funds (e.g. the unemployment insurance fund), etc., the task of calculating whether or not there is a true budget deficit in any particular year and, if so, how large it is, is becoming increasingly complex. An example may make this clear. Thus, in one financial year the Treasury may float a loan and transfer part of the proceeds to a state institution; in the following year the latter may issue a loan on its own account, in the form of bonds with Treasury guarantee, and may use part of the sum raised to pay off its debt to the exchequer. These operations may produce first a budget deficit and then a surplus, though there will, in fact, have been no real change from one year to the next. Again, in a period of expanding business activity the unemployment insurance fund may enjoy a surplus of income over expenditure; in order that the fund may be enabled to invest its surplus resources at a profit, the Treasury may allot government bonds to the fund, though an increase in the national debt due to such a cause is not regarded as a budget deficit. With the growth of extra-budgetary activities, this kind of situation becomes more and more common and it is thus obvious that the old principle of budgetary unity is now a thing of the past.

The last few decades have also witnessed the passing of another old-established principle, that credits should be granted only out of accumulated savings. To understand what has happened it will be necessary to inquire how this view originated. When the banks were mainly concerned with the grant of short-term credits the principal means by which a firm could obtain a credit for a longer term, or for an indefinite period, was by putting on the market shares or bonds, which were purchased by the public out

of their idle bank balances.

Because they had to keep their resources as liquid as possible, the ordinary commercial banks were reluctant grant long-term credits; the ability to obtain money to pay out depositors who wished to withdraw their balances depended on the assistance of the central bank, which, as we have seen, granted credits mainly on the basis of short-term bills of exchange so as to maintain its own liquidity. The commercial banks were, however, able to grant loans for a longer term if their depositors left their funds on deposit for a longer period—i.e. in the form of savings deposits. Not only so. The banks gradually found out by experience that a certain proportion of the money deposited on current account always remained with them and that they could safely use part of these funds to make longer-term loans without jeopardising their liquidity. Since the introduction of foreign exchange restrictions and the suspension of the obligation to pay gold on demand the principal motive for withdrawing bank deposits has disappeared. Less attention need therefore be paid to the maintenance of liquidity—especially in view of the willingness of the central bank to assist the commercial banks by granting them loans on much less stringent terms than would have been imposed a few years ago. In such circumstances the banks are able to hold increasing quantities of long-term assets, including government securities, and are being drawn more and more into long-range economic activities.

The contention that if the banks grant loans too freely they "create credit" and outpace the influx of savings, so diminishing their own liquidity, cannot be sustained in conditions such as these. All that is necessary is that the creation of the additional purchasing power should be accompanied by a corresponding increase in production; otherwise its effects will merely be dissipated in the form of higher prices and the additional credit will be seen to be an illusion. This is the basis of the belief that additional credits



may be granted by the banks up to the point at which prices begin to rise. Strictly speaking, the purchasing power created by the grant of a credit, and manifested in the form of bank deposits, should be accompanied by a larger supply of the commodities towards which this purchasing power is directed. If the production of these goods is not increased, the larger purchasing power will merely have the effect of pushing up their prices; in other words, inflation will occur. There may, however, be an increased output of commodities other than those towards which the newly created purchasing power is directed. The government may, for instance, construct a railway, but the purchasing power which is, directly or indirectly, placed in the hands of those who are engaged in the work may be spent, not upon railway travel, but upon the purchase of clothing, production of which does not increase because there is a shortage of textile raw materials.

As a rule, an inflationary price rise begins in a few sectors only and later becomes general. The methods which may be used to counteract such a tendency towards inflation form an important branch of economic study; the control of prices and the rationing of the goods in short supply is sometimes suggested. Another suggestion is to encourage the production of the scarce goods by government action, or to import them from abroad. But while increased supplies will, of course, ultimately solve the problem, there may still be a deficiency in the short run; and this is one of the dangers of an expansionist credit policy.

A tendency towards rising prices is, in my opinion, an inevitable accompaniment of an expansion of business activity because workpeople who have been newly brought into the productive process will be temporarily less efficient than those who have been working at the same job for some time. True, such a price rise may be disguised by technical improvements, by a decline in overhead expenses due to the fuller utilisation of plant capacity, or by a fall

in the price of imported raw materials; but the tendency will remain. It must, however, be pointed out that a price rise attributable to higher costs of production cannot be regarded as inflationary.

In my opinion, the principle of the optimum price structure should be adhered to in the first instance. This matter has already been discussed in Chapter V and it will suffice at this juncture to point out that the central bank, which is the organ of government policy, should assist in the establishment of the optimum price structure. The character of the latter should be defined by reference to the objectives of government policy in the existing economic conditions, each separate economy requiring its specific optimum price structure.

Since the principles which were venerated in the *laissez faire* era have lost their authority, new principles have been established, permitting the commercial banks to pursue a long-term credit policy. The view that the co-ordination of prices could best be brought about by the free-play of economic forces has been superseded by the realisation that these matters are a legitimate field for government intervention.

A planned credit policy must set itself specified aims, directing definite supplies of credit towards certain objectives. If a particular enterprise is to be carried on it may be necessary to grant a credit to the person who is willing to undertake the responsibility of doing so; but the credit may have to be granted without adequate security. Thus, if a farmer without any means of his own is required to intensify his productive effort he must be granted a loan so that he may purchase fertilisers, seeds, agricultural implements, roofing materials or fruit trees, etc. And if the poor are to be provided with suitable housing facilities, credits may have to be granted irrespective of the security offered; for the construction of good quality houses at a low cost may not be undertaken by a private contractor

because it is not a paying proposition and the task may not be possible at all unless the necessary capital can be raised at a reduced rate. Under a planned economy, therefore, the government must allocate specific sums for such purposes.

It is very difficult, however, to reach agreement on the relative urgency of different objectives. The manual workers will maintain that the most important objective of government policy must be the provision of cheap, adequately equipped dwellings for them. The clerical workers will make a similar claim on their own account. Smallholders may claim that the most urgent task is the breaking up of large estates and the intensification of agricultural production on small holdings; and so on. Since each of these aims could be supported by convincing arguments, but since everything cannot be accomplished at once, there will be considerable disagreement as to the order in which the various tasks are to be carried out. And the final decision will generally be dependent upon the configuration of political forces.

Governments generally create special institutions for supplying credit, and in this way state agricultural banks, municipal banks, etc., come into being.

The small farmer, or the person building himself a cheap dwelling house, cannot have access to the central agricultural bank and in order that these classes may be assisted local institutions—e.g. various types of co-operative society—must usually be established. Very interesting experiments were made in Poland in supplying credit to farmers at specially reduced rates; and in such cases the Government naturally stipulated that the sums in question must be used for the purpose for which they had been earmarked.

So far as agriculture was concerned, a long list of objects for which credits might be granted was eventually drawn up by the Polish government. This included such



items as fertilisers, special crops, livestock breeding, roofing, drainage, and so forth. A certain sum was earmarked for each of these purposes, the total being divided among numerous local institutions such as the various co-operative societies, communal savings banks, etc., so that each of these had a number of funds out of which credits could be granted for the particular purpose specified. In such circumstances it sometimes happened that a farmer would apply to one of these bodies for a credit to purchase (e.g.) fertilisers, but would be told that the fund for that purpose had been exhausted, but that a credit could be granted (e.g.) for the purchase of sheet iron for roofing purposes. The story is also told of the farmer whose cow had died and who, applying to the authorities for a credit to purchase another, was informed that no money was available for the purpose but that, if he so desired, he could be given help to purchase a fruit tree!

Though great ingenuity was displayed in overcoming difficulties of this nature, it is clear that if the purposes for which specific sums may be utilised are enumerated in too much detail the farmer will often be unable to obtain money for the required purpose. It is better therefore to grant a sum in general terms for productive purposes, leaving the choice of the particular object to the discretion of the local body. It follows that an agricultural plan should be drawn up in general terms, since it is not possible to foresee in detail what future requirements will be; in other words, there are limits at which the planning authorities must relinquish control—and this is valid for any kind of planning. A detailed plan would be practicable only if farmers could be compelled to purchase the implements, etc., indicated by the government. Here again, we come up against the important question whether the producer is to have the right in a planned economy to choose his own methods of pro-

duction; this problem will arise whether or not the producer is deprived of the right to decide what goods he is to produce. In Poland, for instance, the government sometimes wanted to force the farmer to adopt certain methods, which it considered to be the most efficient for the purpose, whereas the farmers themselves insisted upon using other methods which the government considered to be inferior.

When loans are granted under government auspices the usual practice is to allocate a fixed sum for each particular purpose, the rate of interest being kept below the current market rate by means of a subvention from the exchequer. Since the amounts are fixed, we have here another example of quantitative planning, which contrasts strongly with the qualitative planning sometimes encountered in similar circumstances in a liberal economy. The people to whom such cheap credits are granted are generally of small means, and the policy consequently involves the running of certain risks.

Small investors often deposit their surplus funds in savings banks, and governments often exercise control over the investments made by institutions of this nature, with the object of safeguarding the small investors concerned. In some countries, however, the state has sometimes endeavoured to secure these savings to further the objects of its economic policy. The way in which the funds of savings banks and friendly societies are invested is dependent upon the general investment policy of the state. Thus, if the government wishes to encourage the building of cheap working-class dwellings the savings banks and friendly societies may receive instructions to purchase the securities of institutions engaged in the building of this kind of house. Again, if the policy of the government is to encourage production on small farms, or to introduce some agricultural reform, the funds of the savings banks, etc., will be directed into these channels. When the

government's investment policy is being framed a conflict housing and the supporters of a policy of land reform.

When the government investment policy is motivated by the two-fold desire to safeguard the savings of the poorer classes and to direct resources into channels dictated by its economic policy, the possibility of a clash between these two objectives cannot be excluded. Indeed, such a conflict of interests was not infrequently exemplified even among the members of the co-operative credit institutions in Poland.

Among the members of such co-operatives there will be thrifty persons with considerable sums on deposit side by side with others who are less thrifty or who may possess more energy or initiative and who are anxious to extend their own businesses with the help of borrowed funds. Members of the latter type are often in debt for considerable periods of time. In such circumstances, the members with money on deposit may be expected to advocate prudence and caution in the granting of credit; in other words, they will be opposed to the making of excessive loans to the more enterprising persons who are desirous of extending their activities. Here is a fundamental conflict of interests. Does the credit institution exist primarily for the purpose of supplying credit on easy terms to persons who may perhaps be unable to repay, or is the principal objective the safeguarding of the depositors' money? In Poland, it sometimes happened that those who held the latter view proposed that only those members who had a credit balance with the co-operative society should be allowed to vote at general meetings and that those who had debts outstanding should have no voice in the management; in other words, their view was that control should vest with those who had the money. But such a view-point is diametrically opposed to the principles upon which such a co-operative society is based.

The influence exercised by the government over the



investment policy of savings banks, insurance companies, etc., is continually growing and it is difficult to imagine that the directors of such institutions could now flout the instructions of the authorities in such matters.

During recent years the public has been less ready to purchase securities and has shown a preference for leaving its funds on current or deposit account with the banks. This means that more stocks and shares are being placed with the banks than was the case formerly. In the United States, for instance, time deposits are growing more rapidly than demand deposits, while the volume of securities held by the banks is steadily increasing.

If the public has become rather reluctant to purchase domestic securities it is even less willing to acquire the securities of undertakings in foreign countries. But as the role of the general public in foreign investment has declined, so the part played by banks and insurance companies in this field has increased; and in some of the more wealthy countries the insurance companies have become important purchasers of foreign securities. The Prudential Assurance Company, for instance, has Polish securities among its assets.

During the last two decades, therefore, important changes have occurred in the principles underlying credit policy. The quantitative allocation of credit has taken the place of changes in the rate of interest as a means of regulating the activities of credit granting institutions. A regime of cheap money has thus been made possible, even outside Britain and the United States. Credit is granted for specific purposes—and more often than not the question of security for the loan is pushed into the background. The principal objective is to stimulate business activity. Such a credit policy involved risks, which were studiously avoided in earlier days when the criterion of security played such an important part in the granting of loans.

Naturally enough, people will be much more ready to

bear such risks to further the interests of their own country than to carry out the policy of another. True, foreign investment is an extremely important factor in international economic relations. Its principal object is to increase the volume of international trade and to raise the productive capacity of the more backward countries; and more importance is to be attached to these aims than to the rate of interest received or the certainty of repayment. This, however, is no great consolation to the individual investor who is anxious to receive an income from his foreign holdings. The question therefore arises, who is to bear the risks of foreign investment?

In the immediate post-war years, for example, the loans granted to European states may be rather doubtful assets and the general public in Britain or the United States may therefore be reluctant to purchase foreign securities without a guarantee from their governments. Governments, however, are more willing to guarantee internal than external loans; and the more a country has been devastated by the war the more reluctant will a foreign government be to back that country's loans. On the other hand, the greater the caution exercised by creditor countries in this matter the more autarkic will the policy of the debtor countries have to be. If they cannot import commodities from abroad on credit terms, they will have to undertake the gradual reconstruction of their national economies from their own resources; and for this purpose they will be compelled to cut down their imports of consumption goods and to devote a high proportion of the proceeds of their exports to the purchase of capital goods and raw materials.

Some economists are of opinion that the amalgamation of a number of national economies into one unit would remedy the troubles likely to be encountered by individual states. For the purpose of stimulating trade they advocate the adoption of a common currency and therefore of a common central bank. As we have shown, however, the

central bank is more and more becoming the instrument of the government's long-range economic policy; its assets include ever-growing quantities of government securities or securities backed by the government, while its holding of commercial bills is shrinking in importance—and it is these which represent the volume of trade. A common bank of issue would therefore necessitate a common long-term policy—e.g. co-ordinated encouragement to agriculture, public utility undertakings, small industrialists or the construction of working-class dwellings, etc. Thus the risks inherent in the creation of undertakings to carry out such long-range works in backward areas would have to be shared by the other parts of the amalgamated national economy.

The poorer, economically backward countries can best be aided by investments from the industrially more advanced and wealthier countries. Such investments would be better made not in the form of single large loans, but spread over a term of years, in order to maintain a stable flow of capital into the assisted country's economy. To achieve this it would seem highly desirable to set up an International Investments Board, with the leading participation of Great Britain and the United States of America.

During the era when fresh unpopulated regions were constantly being brought within the world economy, the relative importance of international trade was much greater than it is today. This period—which may be termed "the era of spacial expansion"—is now over and there is a growing tendency towards the more intensive development of each national economy. This change is reflected in the nature and functions of the banks of issue; and we have already seen that government securities are tending to take the place of commercial bills in the banks' portfolios. Though I do not underrate the importance of international trade it seems to me that, in these circumstances, the revival of business activity within the domestic



economy is now assuming greater importance than the expansion of external trade.

We may repeat that the most marked feature of the *laissez faire* era was the inclusion of virgin, sparsely populated areas into the capitalist economy. But we have now reached the stage when practically the whole world is included in the capitalist system. The motive behind this territorial expansion was the urge to open up new sources of agricultural produce and industrial raw materials. When, after the last war, a situation was reached in which the former purchasers of these primary products were unable to absorb the available supply the producers tried to introduce restrictions on production. Formerly, the high rate of interest paid in such countries had attracted foreign capital, but now they became defaulters. Thus, whereas territorial expansion was the motive in the past, our problem today is to find means of including within the economy large numbers of unemployed, or partially employed workpeople. This is the century of the common man.

The first steps towards the objective should probably be taken in such poor and densely populated lands as China, India and Eastern Europe, since a slight improvement of the low standard of living in those parts would be of much greater importance than a much larger improvement in the (high) standard already attained in Great Britain. For instance, the fact that every Chinese peasant could buy one more shirt a year than he does now would have more far-reaching effects than the purchase of a radio set by every English family which does not yet possess one. To quote Sir Frederick Leggett, the British representative on the Emergency Committee of the International Labour Office: "We might often do more good by spending money on building railways or roads in another country than on building a new town hall in our own."\*

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\* Reported in the British Press, April 24th, 1942.

It must be pointed out, however, that even if the demand for raw materials and agricultural produce were sufficient to absorb the available supply this would not provide full employment for the labour available in the densely populated areas concerned. To provide an adequate volume of employment, on the one hand, and to meet the demand of these backward countries for consumers' goods, on the other,—an aim which could not be achieved by the sale of their primary produce abroad and the importation of the consumers' goods—the lands in question must be industrialised. Such a process of industrialisation would inevitably necessitate the importation of capital goods.

Some writers and politicians seem to cherish the illusion that it would be possible to create an international planning authority with power to stipulate what every country should produce and in what quantity. But the nature of the proposal becomes clearer if it is expressed thus: Every country would be forbidden to produce any commodities other than those allocated to it; and it would be forbidden to exceed its quota. Within certain limits, restrictions as to what they may export are already imposed upon countries by cartel agreements, but to fix production in advance by means of a plan would be a matter of extreme difficulty and complexity. For my part, I certainly believe that it would be impossible to prevent any country with a large number of unemployed from trying to produce as many commodities as possible. Even international cartels generally attempt to restrict only exports, leaving production for the home market uncontrolled.

On the question of foreign investment, it must be obvious that while the amount of reconstruction called for in Eastern Europe after the war will be very great, the creditor countries (apart from the United States) will have only limited resources available for investment abroad. Germany will presumably have to make reparations payments, but there will be many countries with competing

claims to receive them. And if Poland—to take only one example—were granted priority the sums so received would be inadequate to cover Polish requirements. The more reconstruction work has to be done by such a country on its own account, the greater will be the efforts and sacrifices it will have to make; and it is at least open to doubt whether the proof given above of the proposition that it is in the interests of the creditor countries to make substantial loans to the debtor countries, irrespective of the security offered, will have much influence on policy save in the immediate post-war years.

Loans granted to countries devastated by the war will not be good assets—and account must be taken of the possibility that they may never be repaid. There are those who believe that some form of "Lease-Lend" arrangements will form the basis of economic policy after the war, but I very much doubt whether in fact such arrangements will survive for more than a short period after the armistice. It seems probable that only those raw materials which have been accumulated during the war owing to transport difficulties will be supplied on credits of the "Lease-Lend" type, and that similar arrangements will not be extended to raw materials of current production.

Some idea of the attitude which may be expected to prevail in the creditor countries may perhaps be gained from the example of the Colonial Development Fund, which was set up by the British Government in 1929. It was established so that advances might be made from the Imperial Exchequer to develop agricultural and manufacturing industry in the colonies and mandated territories and so foster trade with the United Kingdom. The advances may take the form of loans or grants. The Fund is fed from sums voted by Parliament, which must not exceed £1,000,000 in any year. Sums received by way of interest or amortisation charges on loans previously granted are paid, not into the Fund itself, but direct to the



Exchequer.

Referring to this Fund in its report to Parliament in 1931, the Committee on National Expenditure said: "On reviewing the schemes which have so far been assisted we find that in a fair number of them the element of benefit to the trade and industry of this country, which is an essential condition of advances under the Act, is somewhat remote. Under existing financial conditions, this country cannot afford to adopt a policy of mere subsidy by relieving the local government of its obligation to provide a decent and reasonable standard of administration in the matter of public health, housing, transport, etc., nor yet a policy of development which will bring no appreciable benefit to this country for a long time ahead. We recommend that the grant to the Fund be limited to £750,000 a year in future and that the schemes to be aided therefrom should be those that will give the greatest and speediest benefit to this country in the near future. This will effect a saving of £250,000 per annum."

Here we have a vivid contrast between two policies—the "Lease-Lend" principle, on which loans are granted without regard to questions of security and repayment, and the policy of rigid economy to the extent of £250,000 a year. And the fact that even internationally minded members of the Labour Party have adhered to similar conservative financial principles may be illustrated by reference to the first Hague Conference in August 1929. Viscount Snowden (then Mr. Snowden), who was Chancellor of the Exchequer at the time, strongly criticised the proposals for the allocation of reparations payments between the creditor countries and emphasised the loss which Great Britain would sustain. The other delegates could scarcely believe that he was willing to risk the breakdown of the conference for the sake of two and a half millions sterling, and were reluctant to admit that Britain's moral case was so strong that she should be ready to stake all upon it.

The Prime Minister, Mr. MacDonald, sent a telegram to Mr. Snowden, which included the following passage: "Irrespective of party or section, the country supports the case you have made. Every newspaper, so far as I have seen, backs you. All parties in the House of Commons stand by you."

It is true that 1929 now seems rather remote, but it would be a great mistake to imagine that we are entering an era when the old ideas of the sanctity of international loans will be completely abandoned. For this reason I am convinced that all projects for the amalgamation of separate national economies will encounter difficulties due to the fact they will have to take account of sums such as £250,000 a year to which so much importance was attached, even in a wealthy country like Great Britain. In fact, those who pin their hopes on the continuance of some form of "Lease-Lend" arrangement after the war may discover that they are doomed to disappointment.

It is worth pointing out in conclusion that, with the progress achieved in the financial sphere during the past few years, it is now possible to devise a credit policy which will bring about conditions of virtually full employment. If such a policy is properly applied, it should render general restrictions on production such as those imposed by cartels and certain kinds of restrictive planning, largely unnecessary. For, as we saw in Chapter VI, the latter restrictions are appropriate to an economy in which there is a substantial measure of unemployment. When, as in war-time, there is no surplus of unemployed labour the only problem is the determination of priorities. It may be necessary to impose restrictions on the output of certain (luxury) goods, because the productive resources concerned are needed for more urgent tasks, but no general restrictive measures will be necessary in these circumstances.

## CHAPTER VIII

### ECONOMIC BLOCKS

As a result of the war there has come into existence a number of vast strategic zones, of which the most important is the Anglo-American zone, comprising an even larger part of the earth's surface than that covered by the British Empire and the United States. Small countries, whether they like it or not, now fall within the boundaries of one or other of these main strategic areas which means, in all probability, that the doctrine of neutrality has become a dead letter. In such circumstances, it is not surprising that the idea of forming vast economic zones—perhaps coterminous with the existing areas of common strategy—has been attracting increasing attention. The conception is of considerable interest, and in order to bring out its implications we must first examine those economic blocks which are already in existence. Of these the greatest is the British Empire.

A definite step towards the economic co-ordination of the British Empire was taken in 1932, the process being hastened by the introduction of protective duties in Great Britain. Apart from revenue duties on such commodities as alcohol, tobacco, sugar, coffee, cocoa and occasionally tea, all imports into Britain had been duty free before the last war. This free trade policy was justified on the grounds that it lowered the cost of living in this country and created more favourable conditions for British industry than those existing in countries whose costs had been



raised by protective tariffs. The foreign competition which it encountered both at home and on the world market compelled British industry—so it was argued—to seek continuously for increased efficiency, whereas industries whose home market was safeguarded from such competition by protective duties had no such incentive.

This liberal viewpoint was rooted in certain conditions existing in the world before 1914. During the first half of the nineteenth century Britain was the only country which was industrialised on a large scale and she consequently had no difficulty in finding markets for her products. When other countries began to build up their own industries and to secure them from competition on the home market by the introduction of protective duties, the picture, though still favourable, began to change; British exports of certain general commodities, such as iron and ordinary textiles, to those countries began to decline, whereas sales of other British goods—machinery, for instance—continued to increase. This movement reflected the fact that a more highly industrialised country tends to import more than a less industrialised one—the volume of commerce per head of the population being about four times as high in Western Europe as in Eastern Europe. Industrialised countries import not only more raw materials, but also more manufactured goods than their more backward neighbours—though the **proportion** of manufactures in the total may be lower. The explanation, of course, is that even the most highly industrialised state will never be in a position to cover all its own requirements. On the contrary, its needs increase in number and variety as its economic life develops. Thus, during the second half of the nineteenth century there was a rapid increase in British exports to those European states which were themselves becoming industrialised and which were beginning to surround themselves with tariff walls.

Before many decades, however, important changes

occurred in the structure of industry. Certain kinds of industrial equipment became very expensive and maintenance and amortisation charges on this equipment therefore began to play a role of growing importance in overhead charges. Since for the plant as a whole, overheads of this type do not vary in proportion to the volume of production, it paid to expand the output and sell the surplus above domestic requirements on foreign markets at prices lower than those ruling at home.

To make it possible to sell at a higher price at home than abroad the producers must enter into some kind of cartel arrangement in order to eliminate price cutting on the home market. Conditions in Great Britain were not, however, favourable for the formation of such cartels until fairly recently, because the home market was not safeguarded from foreign competition by a protective tariff.

The practice of "dumping" surplus produce abroad at prices below those ruling on the home market, which had previously been of comparatively little significance,\* became very common during the trade depression which began in 1929. When in 1932 the British market was flooded in this way with cheap foreign iron, to the detriment of the domestic producers, the government decided to adopt a protectionist policy. The Import Duties Act of 1932 imposed a general customs duty of 10 per cent. ad valorem on all imports not specifically exempted from its provisions; and additional duties were imposed on many commodities. By thus abandoning its traditional free trade policy, Britain recognised the principle that a primary condition of an ordered system of international trade is the proper organisation of production in each national economy. When once its home market was protected the British iron and steel industry was in a position to join the

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\* An investigation into the position of dumping was actually undertaken in England more than 40 years ago, but the practice was found to be of only minor importance.

international cartel; imports of certain types of iron into the United Kingdom were permitted on a quota basis, with the proviso that imports in excess of the quota should be subject to prohibitive duties, while British producers naturally received a substantial export quota.

At this time Britain generally favoured the use of quotas to regulate the import of agricultural produce, but not for imports of manufactures. Nevertheless, it may be recalled that an Act to regulate the importation of dyestuffs had come into force as long ago as December, 1920, this industry having been classified as one of the key industries on account of the fact that the materials required for the production of dyestuffs are also used in the manufacture of explosives. In thus deciding to protect the domestic dyestuffs industry, Britain was probably one of the first countries to introduce import control for manufactured goods.

So Britain abandoned free trade, prohibiting the importation of dyestuffs, subsidising agriculture and introducing protective customs duties. The authorities had realised that in the long run foreign countries would purchase British goods if Britain refrained from restricting imports. But their problems were aggravated by the action of the American and French governments, both of whom accumulated gold instead of using it to purchase goods, while America also raised her customs barriers; and, like the little girl who had been assured by her mother that her brother would grow out of the habit of kicking her, Britain could not afford to wait so long. Even Britain could not support a passive trade balance for an indefinite period until the American and French buyer was constrained to enter the market.

Before we can proceed to a consideration of Imperial preference, as practised by Britain and her Dominions, we must examine the problems associated with the most-



favoured-nation clause and with preferential tariffs in general.

The most-favoured-nation clause in commercial treaties (hereafter referred to as the M.F.N. clause) may be either conditional or unconditional. If unconditional, it guarantees that any duty concession made by an importer to a particular country is automatically extended to all other countries with which the importer has most-favoured-nation arrangements. Any importing country granting such a concession consequently endeavours to restrict it to the commodity of which the beneficiary is the chief supplier. Thus a duty reduction will not be granted for "pigs," but for "fat pigs" or "store pigs," so as to prevent a country producing a different type of pig from enjoying the same concession. Similarly, before the war Germany reduced the import duty payable on milk produced at certain altitudes—a concession from which the Swiss derived no benefit since their milk was produced at a higher altitude than that specified.

When once a protective tariff has been introduced the tendency is for customs rates to undergo constant differentiation, a separate being fixed for almost every article. Whereas forty years ago the customs tariff could generally be printed in a slim booklet, the general rule now is for it to occupy a stout volume. If a given state grants a concession to another state in respect of the duty payable on a certain article, it generally attempts to distinguish this from similar products, or different varieties of the same product, so that other countries will not be able to benefit from the reduction; and with the growth of this process and of specialisation in production, it is becoming increasingly difficult for one country to take advantage of duty concessions granted to another. For example, despite the existence of most-favoured-nation arrangements, Britain may be unable to take advantage of a reduction in the import duty on a certain kind of machine granted by

France to the United States, because she does not produce that particular machine herself.

Certain provisions which are of interest in this connection are to be found in the commercial treaty signed by Britain and the United States on November 17th, 1938. Article 19 of this treaty reads as follows: "Each High Contracting Party reserves the right to withdraw or modify any concession granted in any territory of that High Contracting Party on any article enumerated, or described, or specified, in any of the Schedules annexed to this Agreement, or to impose quantitative regulations on the importation of any such article into that territory if, as a result of the extension of such concession to other foreign countries, any such country obtains the major benefit of the concession, and if in consequence imports of the article concerned increase to such an extent as to threaten serious injury to producers in the territory of that High Contracting Party; provided that before any action authorised by this Article is taken, the High Contracting Party proposing to take such action shall give the other thirty days' notice therefore in writing and shall consult with that High Contracting Party concerning the proposed action." In fact, reductions in customs duties should be in the nature of a preference granted to the chief supplier of the commodities in question.

Countries with a diversified production and widely ramified foreign trade are keen supporters of the M.F.N. clause. Britain is a case in point. Before introducing a protective tariff of her own Britain was not in a position to obtain duty concessions from other countries, for she could offer nothing in exchange. Britain therefore had to derive what advantage she could from the concessions granted to other countries—and this, of course, is the purpose of the M.F.N. clause.

Other things being equal, the United States frequently has an advantage over other countries in the sphere of foreign trade, because it is able to grant cheap credits

which may be used to purchase American goods; Although it never granted unconditional M.F.N. treatment before the last war, the United States has been one of the principal advocates of this policy in the inter-war years.

When any country introduced quantitative restrictions on the importation of a particular commodity, the U.S. State Department demanded a quota proportionate to the share taken by the American exporters in that market before the introduction of the restrictions in question. In this way the Americans sought to preserve the *status quo* and to protect vested interests—a policy which has nothing in common with the principle of the unconditional M.F.N. clause, which was designed to give everyone an equal opportunity. Sometimes the American authorities proposed that import quotas should be proportionate to the productive capacity of the participating countries, an arrangement which would naturally be to the advantage of the United States.

The quantitative regulation of imports by means of quotas has become more and more common during the past decade; and, as suggested above, this has largely outmoded the M.F.N. clause, which was characteristic of the *laissez faire* era, and which aimed at giving undiscriminating treatment for all. If a state has a central marketing board for a given commodity that board may claim that its buying policy is dictated by purely commercial considerations—but in fact it is almost certain to discriminate between one exporting country and another. And if cartel agreements are made between boards of this character in different countries, such agreements must by their very nature be discriminatory, allocating shares of the market to the various suppliers. Their terms will depend largely upon the bargaining power of the parties concerned and will often aim at the safeguarding of vested interests. This is quite out of keeping with the principle of the M.F.N. clause. But quantitative planning must, by its



very nature, be discriminatory.

As regards the allocation of quotas between the various supplying countries, the view held by some is that all the exporters of a given commodity should be allocated equal quotas, whereas another view is that total imports of that commodity into the regulating country should be distributed among the exporters in proportion to their previous share of the market. In the latter case the question arises whether the base period should be the past year, or a period of years, and whether the upward or downward trend in supplies from a particular country should be taken into account. Thus, in the Anglo-American Treaty of November, 1938 article 3, which deals with the distribution of quotas among the different exporting countries, states that these should be allocated on the basis of actual imports in former years. It does not, however, give any indication as to which years are to be used for the purpose, though it recommends that any special factors should be taken into account in direct consultations between the High Contracting Parties.

The whole question of import control becomes much more complex if two or more countries grant one another import quotas for different commodities—as, for example, if Italy and Spain each receive from Poland a quota for the importation of oranges into Poland, in exchange for a given share of Italian coal imports and Spanish egg imports. The M.F.N. clause cannot be reconciled with clearing agreements or bi-lateral trade treaties nor does it help in deciding the respective orange quotas to be allocated to Italy and Spain. In fact, clearing and bi-lateral trade agreements, like quantitative control by quotas, limit the sphere of application of the M.F.N. clause.

Quantitative restrictions on the importation of agricultural produce into the United Kingdom have been in force since 1932, while similar methods of control have been adopted, albeit somewhat informally, in the United

States. The American government suggested—discreetly, but none the less firmly that the countries exporting bacon and ham to the United States should themselves limit their exports to America, in default of which the U.S. authorities would have to open an investigation into the question whether or not these countries were “dumping” their produce on the American market. It should be explained that if “dumping” can be proved the U.S. government has powers to impose a higher rate of duty—so that the threat of an investigation was sufficient to compel the exporting countries to toe the line.

Just before the war broke out in 1939, moreover, the United States and Great Britain signed a special agreement covering raw cotton supplied to Britain by the United States and rubber exported to the United States from Empire countries.

Since a large measure of economic planning will be necessary after the war, we may expect that the quantitative control of imports will have to be continued. If so, it follows that the M.F.N. clause will be relegated to a position of lesser importance.

To return to the question of preferential treatment. It is clear that the essence of such preferential treatment granted by one country to another is that the concession offered is denied to others. But where any particular country which has been excluded from preferential treatment is in a strong enough position to retaliate the proposed preference may have to be dropped; and cases have been known in which the threat of reprisals was sufficient to cause the abandonment of a proposed preference scheme.

A number of countries—e.g. the members of the British Empire—may combine to form a preferential block, though it does not follow that every member of the block will necessarily take advantage of any particular preference granted by one of the countries concerned.

Thus, under the Ottawa Agreements Act (First Schedule, Part I, Article 8) it is specifically laid down that "any preferences accorded by Northern Rhodesia to the Union of South Africa, Southern Rhodesia and the Territories of the South African High Commission by virtue of the Customs Agreement of 1930" should not be expected to be extended to Canada.

Preferential treatment confers definite advantages as is proved by the growth of inter-Imperial trade since 1932.

Before the advent of the Soviet regime, Tsarist Russia and Finland accorded one another preferential treatment and this was considered in Russia to be sufficient to bring about a Russo-Finnish economic rapprochement.

The mutual preferences proposed in the Oslo Convention of 1930, between the Scandinavian countries and Holland and Belgium, and in the Ouchy Convention of 1932 between Belgium and Holland were opposed by Great Britain, which also objected to similar arrangements being made between the Danubian states. Hence these countries were often driven to granting each other preferential treatment in various disguised forms.\*

At various times Britain admitted the possibility of preferential treatment between specified countries. Great Britain in her treaty with Portugal admitted the right of Portugal to give preferences to Brazil and in her treaty with Denmark that Denmark can grant special privileges to Sweden. It has become a common, though not universal, practice to recognise that certain groups of countries, which are situated in the same geographical region and connected by close economic conditions, or which are historically or politically associated by common descent, language or other factors, may accord each other customs, etc., favours.

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\* One such method which was fairly commonly adopted was for the chambers of commerce in the two countries to subsidise exports by their nationals to the other country and to offset the costs incurred by means of a clearing arrangement.



Before the outbreak of war, there were a number of these exceptions, which had met with varying degrees of acceptance:

1. The "Baltic exception" between Finland, Latvia, Lithuania and Estonia.
2. The "Central American exception," between Central American Republics.
3. Certain exceptions between contiguous South American Republics.
4. The "Iberian exception" between Spain and Portugal.
5. The exception between Portugal and Brazil.
6. The "Scandinavian exception" between Norway, Sweden and Denmark.

But the degree of recognition accorded to these exceptions is by no means uniform. The United Kingdom has recognised (1) and (4) and sometimes—though not always—(2) and (3). In her treaty with Portugal, as we have already seen—though not in her agreement with Brazil—Britain also recognised (5). So far as (6) is concerned, this has been recognised only in certain seventeenth century treaties with Denmark, and then only as regards special favours accorded by Denmark and Sweden.

It was reported in the Bulletin of the Chamber of Commerce of the United States for March, 1933, that the United States had agreed not to ask concessions on the basis of the most-favoured-nation clause in agreements between the following countries: 1. the Scandinavian states; 2. the Baltic states; 3. Spain and Portugal; 4. Brazil and Portugal; 5. Turkey and the states which had formed part of the Ottoman Empire; 6. Russia and countries formerly comprised within the Russian Empire. On the other hand, the United States reserved for itself the right to enter into preferential agreements with Alaska, Hawaii, the Philippines and Puerto Rico.

Again, in a commercial treaty signed by the United

States and Czecho-Slovakia on March 7th 1938, paragraph 2 of Article XIV reads as follows: " The advantages now accorded or which may hereafter be accorded by the Czechoslovak Republic to Austria, Hungary, Rumania or Bulgaria for the purpose of closer mutual economic co-operation between the Danubian countries, in respect of those commodities benefiting from special advantages now accorded by the Czechoslovak Republic to such countries, shall be excepted from the provisions of this Agreement. However, in the event that such advantages should have the effect of impairing materially the value of any concession provided for in Schedule I of this Agreement, the Government of the United States of America reserves the right to reopen negotiations with a view to the modification of this Agreement." The United States thus agreed to the Danubian countries forming themselves into a special customs block, whereas Great Britain had protested against such preferential arrangements.

One more example may be given of the admirable attempts of the U.S. Administration to liberalise international trade by stages, without altogether destroying the existing framework of commercial treaties. On July 13th 1934, the United States, Cuba, Nicaragua, Belgium, Guatemala, Greece and Colombia signed an agreement " to refrain from invoking the obligations of the M.F.N. clause in respect of certain multi-lateral conventions," which was deposited with the Pan-American Union for signature by any state. Any signatory to this agreement binds himself not to invoke the obligations of the M.F.N. clause in the general applicability, which include trade areas of substantial size, which have as their objective the liberalisation and promotion of international trade or other international economic intercourse, and which are open to adoption by all countries." In effect, the signatories would undertake to waive their M.F.N. rights in the case of conventions

such as the proposed Ouchy agreement.\*

We may thus conclude that the existence of close political ties between a group of countries is generally held to be sufficient to justify those countries granting one another special concessions in the matter of customs duties; and that even if political connections formerly existing have now been severed the grant of preferential treatment may still be accepted by other Powers. It is thus reasonable to hope that in the event of the countries of Eastern Europe forming themselves into a confederation after the war other nations would consent to preferential treatment among the countries concerned.

We have already dealt with the unconditional most-favoured-nation clause and with the question of preferential customs tariffs. The so-called conditional M.F.N. clause occupies an intermediate position, though it is closer to the latter than the former; here the obligation to extend any duty preference to all countries with whom M.F.N. agreements have been signed is made conditional upon the grant by such countries of an adequate *quid pro quo*. It can best be explained by means of an example. Let us suppose, for instance, that Britain admits French vegetables at a preferential rate of duty, in return for the right to export coal into France on special terms. The grant of similar preferential treatment by Britain in respect of Polish vegetables might be made conditional upon Poland offering adequate concessions in exchange. But since Poland has a surplus of coal she could not offer to admit British coal at all, though she might offer to reduce the rate of duty charged (e.g.) on British motor-cars entering the Polish market. It would be difficult, however, to determine whether the concession granted by Poland in respect of British motor-cars was equal in value to the concession granted by France in respect of British coal; and this might

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\* See *Report on International Trade*, published by PEP (Political and Economic Planning), May, 1937.



be used as a reason for refusing to extend the preferential duty to Polish vegetables.

Before the last war the principle of the conditional M.F.N. clause was adhered to by the United States. The reason was that the Americans did not at that time have as diversified an export trade as they have today. In fact, they exported only certain specialities, so that only concessions granted by other countries in respect of these particular commodities were of any practical value to the United States.

It will now be appropriate to consider the system of Imperial preference practised by the British Empire, which had its origin in the Ottawa agreements of 1932. The signatories agreed to introduce customs duties on a number of imports from foreign countries, but to admit imports from Empire countries either at a reduced rate, or free of duty altogether. The agreements provided for the quantitative control of imports of meat, bacon and ham into the United Kingdom and for the fixing of Dominion quotas. And since the British government reserved the right to abolish restrictions on imports from foreign sources should the Empire producers supply less than their quotas, it appears that the quotas not only afforded the right to supply certain quantities, but also imposed an obligation to do so. Incidentally, by admitting cotton thread and jute goods produced in India at the preferential rate Britain admitted that the industrialisation of the Dominions was inevitable.

By the Ottawa agreements Britain recognised that her own interest required that the Dominion exporters should receive satisfactory prices for their products—otherwise they would be unable to purchase British manufactures. It may appear paradoxical to suggest that a fall in the price of the raw materials or agricultural produce imported by Britain is against the latter's interests; for the purchasing power thus set free can be used to buy supplies of other

goods. Nevertheless this advantage may be offset by the inability of the Dominion exporters to maintain their purchases of British goods. In general terms we may say that continuity in economic life and the maintenance of higher prices of imported goods are sometimes valued more highly than the opportunity of buying at lower prices; and that there is, in fact, an optimum price, which will bring the most benefit to both parties. Thus, although the economic life of Britain has been built up on the basis of cheap raw materials and agricultural produce the British government suggested at the World Economic Conference, held in London in 1938, that means should be found to raise the prices of such primary products.

The Ottawa agreements were concluded between the governments of the United Kingdom, the Dominions and India; though the Colonies did not take part, the British government extended the system of duty preference to Colonial produce and received from certain of the Colonies—e.g. Ceylon and the Malay states—an import quota for British textiles.

This policy of Imperial preference was responsible for a sizeable increase in inter-Imperial trade. Of the total trade of British Empire countries, the percentage of inter-Imperial trade rose from 25 per cent. in 1931 to over 31 per cent. in 1937. In the case of individual members of the British Commonwealth, the percentage of exports directed to Empire countries naturally showed an increase, the proportions reached just before the war being roughly as follows: for the United Kingdom and for Canada, about one-half; for Australia, two-thirds; New Zealand, five-sixths, South Africa, over one-half; India, two-fifths and Ireland nine-tenths.

It is not only the countries of the British Empire which are drawing more closely together: the same process is discernible in the case of all Imperialist powers, as the following table shows:

## IMPORTS INTO VARIOUS COUNTRIES FROM THEIR OWN COLONIES\*

(As a percentage of their total imports)

	1928	1938
United Kingdom	38	54
France	23	41
Belgium-Luxemburg	8	19
Holland	15	22
Italy	1	4
Spain	5	13
Portugal	30	31

The figures clearly demonstrate the universal tendency in the decade before the war for countries to increase the volume of their trade with their dominions and colonies, and it would thus appear that we are entering into an era of great economic blocks. The boundaries of such blocks sometimes extend beyond the confines of an Empire, however. Thus Argentina and the Scandinavian countries were to some extent brought within the British economic block by being included in the quotas schemes for agricultural produce.

From the standpoint of economic blocks, the example of the British Empire is very instructive. It is sometimes held, for example, that it is only between countries whose national economies are complementary that close economic ties can be created: thus, the highly industrialised community importing raw materials and agricultural produce in large quantities is the natural economic complement of the primary producer. Yet this principle can hardly be applied to the relation between Britain and the Dominions; for the latter are desirous of building up their own industries—and have in many cases introduced protective tariffs with this aim in mind—while Britain is fostering and protecting her agricultural production. And though the Dominions promised that the duties they introduced would

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\* See *Europe's Trade*, League of Nations, Geneva, 1941.



be only sufficient to cover the difference between the costs of production of economically worked undertakings in the United Kingdom and similar undertakings in the Dominions, they made the reservation that this limitation should not apply in the case of "infant" industries. Thus the trading relations between Britain and the self-governing Dominions cannot be described as of a simple complementary character; and it may be said in general that, with the growth of industrialisation in many countries of the world, the simple complementary relation described above is becoming less and less common.

The desire on the part of economically backward nations to become industrialised cannot be understood if it is attributed merely to the urge to find work for the unemployed or to raise the standard of living. The fact is that questions of national prestige are involved. In this age of motor cars, aeroplanes and mechanised warfare it is not surprising that a non-industrialised nation feels itself to be inferior; and a foreigner visiting the Balkan countries before the war would have noted the pride with which a Rumanian, Serbian or Bulgarian engineer would point out that a quite ordinary piece of iron pipe or sheet iron had been produced in his own country.

The fact that the British so often advocate a trade policy based on the complementary relation between an industrialised country and a primary producer is one reason for the lack of confidence which certain Continental countries feel towards Britain. British observers sometimes think that this feeling of suspicion is attributable to the fact that handsome profits are earned on British capital invested in these lands; but the fact is that foreign investments which have helped to raise the standard of living in these countries are almost always regarded with favour.

Exchange between countries whose economies are complementary is often contrasted with competitive exchange, which occurs when the imported commodities compete with

those produced at home. There is a tendency to regard trade between two industrialised countries as competitive trade in this sense, but quite obviously it is not necessarily so. No country can produce the whole range of manufactured goods—and those which it does not manufacture for itself it will import from abroad. In practice it is often difficult to say whether a given import competes with a home product or not. With such commodities as sugar, cement or pig iron there is little room for doubt: the imported produce will compete with that turned out at home, for the consumer does not, as a rule, distinguish between (e.g.) sugar produced in one factory and that produced in another. But it is different where goods possessing individual characteristics are concerned—e.g., the better class consumers' goods or such capital goods as machinery and tools. One may speak, for instance, of ladies' handbags—and the home producer of handbags will argue that imported luxury handbags will compete with his own product; but there are many varieties of handbags, not all of which will suit any one consumer.

Again, different varieties of machine may require a description covering several pages in a catalogue and there are, for example, innumerable varieties of steam pump. The home producer will naturally feel that the importation of any kind of pump from abroad will create competition for him, even though he does not produce that particular kind of pump himself.

It is often difficult to say whether two particular commodities are competitive or complementary in a given situation. In Poland there appeared to be a competition between oranges and sweets, for when imports of oranges increased there was a decline in the demand for sweets. It was thought not long ago in Britain that cheap books would compete with more expensive ones, but it appeared in fact that the publishing of cheap books created a new class of book buyer, who subsequently began to buy more

expensive books. Again, it used to be supposed that the radio set would compete with the gramophone, but it was found that owners of wireless sets began to purchase gramophones as well. In international trade there are similar difficulties in forecasting whether two commodities will be competitive or complementary, but we cannot deal with the matter in detail here. Suffice it to say that the exchange of industrial goods—and in particular, as we have already suggested, in the case of better-class consumers' goods and certain capital equipment—has a two-fold aspect, both complementary and competitive.

As a result of economic progress the elementary complementary relationship between industrial countries and producers of primary products is bound to disappear. Countries in the initial stages of industrialisation develop such industries as textiles and tanning, which requires relatively unskilled labour; and products requiring highly skilled labour—e.g. machines and tools—are consequently playing an increasing part in international trade. According to statistics compiled by the League of Nations, relating to 24 countries and covering nearly three-quarters of world trade, the value of capital goods entering into international trade increased between 1932 and 1935, whereas the value of other goods traded decreased. An interesting example is provided by dyestuffs, which entered largely into international trade in the years before 1914. After the war, however, many countries began to produce this class of products at home, with the result that only dyestuffs of high quality now enter international trade. Statistical research undertaken by the League of Nations has shown that in times of depression trade in raw materials and agricultural produce does not fall off a great deal, whereas exports of capital goods show a substantial contraction, though their prices remain more or less on their former level. This is an indication that capital goods enjoy a certain monopolistic position which raw materials certainly



do not share.

During the nineteenth century much British capital was invested in foreign countries, particularly in the construction of railways. This is another example of a complementary relationship in which a highly industrialised country supplies capital goods on credit terms to another country in process of developing its own industries. It may be noted here that when machinery or industrial equipment are being purchased the trustworthiness of the supplier and the reliability of his goods are generally of more importance than the price charged, so that the producer of such capital goods enjoys a kind of monopolistic position. From the standpoint of the exporting country the chief disadvantage of a trade in producers' goods of this character is the fact that demand tends to decline steeply in times of depression—when requirements on the home market also dwindle. For this reason alone it is highly desirable that periods of trade depression should not be allowed to impede the industrial development of backward countries, but that the process of industrialisation should, if possible, be speeded up during an economic crisis.

It must be noted here that in the newer branches of economic activity, in which demand is increasing on account of technical progress, Britain does not enjoy the pre-eminent position which she occupied in railway and ship construction in the nineteenth century. A comparison between the export trade of the United Kingdom and that of the two other great industrial Powers, the United States and Germany, discloses that textile products occupy a position of far greater importance in the case of Britain. On the other hand, the relative importance of machinery exports is rather less in Britain than in either America or Germany. The following figures, taken from the League of Nations' publication, **International Trade Statistics**, speak for themselves:

## EXPORTS OF TEXTILES AND MACHINERY

(Expressed as a Percentage of Total Exports)

	1930	1931	1932	1936	1937	1938
<b>Textiles</b>						
United States	3.7	4.1	4.0	1.8	1.8	1.9
United Kingdom	25.5	24.4	27.1	23.4	22.3	18.3
Germany	12.2	12.7	11.0	10.2	3.0	8.2
<b>Machinery</b>						
United States	21.9	20.3	14.0	25.5	27.2	28.0
United Kingdom	18.2	16.7	14.0	18.0	18.8	23.8
Germany	16.1	17.3	17.6	22.7	24.2	28.0

For a considerable time, therefore, Britain retained the characteristics of a nineteenth century industrialised country, exporting a large proportion of consumption goods, whereas the relative importance of textiles was much less in the case of the United States. On the other hand, machinery forms a much larger proportion of American and German exports than of British. It is difficult to resist the impression that the economic and political views of many enlightened and prominent Britons are influenced by these characteristics of British exports; and there appears to be a tendency in some quarters to attach too much importance to exports of ordinary consumers' goods.

An extremely important characteristic of imperialist powers is their inability to absorb the entire output of food-stuffs and raw materials from their colonies and dominions. Thus, Britain, with a population of less than 50,000,000, will never be in a position to absorb the Empire's total output of primary products. A large proportion of the latter is exported in normal times to Continental countries, and it therefore follows that the prosperity of Europe is a direct interest of the British Empire; and as British prosperity, in its turn, is largely dependent upon that of the Empire it follows that conditions on the Continent must be a matter of vital concern for Great Britain. This provides an important clue to the British attitude towards Germany after

the last war: because Germany was the most important economic unit on the Continent, British policy aimed at the rehabilitation of German industry, despite the fact that Germany had been regarded before the war as Britain's most serious competitor. But it was found by experience that the impoverishment of Germany as a result of the war led to a sharp reduction in the German demand for wool and jute from British Empire countries.

The Continent of Europe stands in the same complementary relation to the primary producing countries as Great Britain herself. How then is the relationship between Britain and the Continent to be defined? It is a peculiar kind of parallel complementary relationship. Europe complements Britain in her relations with her raw material producing dependencies overseas. British industrialists complain of the competition of German industry when the latter is functioning normally, but when it is in a depressed condition its revival appears as a British interest. It may therefore be said that the relationship between Britain and Germany is at the same time complementary and competitive.

A mistake made by British policy after the last war was to underrate the importance of other Continental countries outside Germany. Instead of seeking to raise the industrial importance of these, and so diminish the relative power of Germany, Britain concerned herself mainly with the rehabilitation of German industry. Yet Germany purchased less than one-third of the Continent's total imports of textile raw materials, and a similar proportion of its mineral oil purchases. If the countries lying between Germany and Russia had been assisted to develop their industries, this would inevitably have diminished the economic importance of Germany on the Continent.\*

The importance of the Continent for British policy is thus apparent. Yet Britain did not realise that the Germans

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\* See *Europe's Trade*, to which reference has already been made.



were anxious to create an empire of their own, on the ruins of the British Empire, and to allot to Britain the role of a country complementing the European Continent under German direction.

Empires or great economic blocks are centred on densely populated and highly industrialised countries, such as Great Britain, France, Belgium and Holland. Though a formal American economic block has never been created by the United States, such a block is in fact in process of formation. It is based, not upon preferential tariffs, but upon the financial influence of the United States: a powerful state bank—the Export-Import Bank—was established for the purpose of granting credits to American countries at very favourable rates.

Japanese policy aims at the creation of an economic block in Eastern Asia, while Germany, with Italian aid, is trying to make the conquered European countries the basis for an extensive economic block. It may be noted in this connection that the European Continent is superior to Britain in population and industrial resources.

As a result of the policy of close collaboration with the Empire countries, Britain is, economically, drifting away from the Continent, as the following statistics show:

### BRITISH OVERSEAS TRADE

(£ millions)

	Imports			Exports		
	1913	1932	1937	1913	1932	1937
Trade with:						
Empire countries	135.4	221.0	364.6	195.3	165.5	251.9
European countries	255.1	212.6	279.0	165.6	111.6	152.1
Other Foreign countries	268.8	217.1	309.0	164.4	87.9	117.3

British imports from these three groups of countries as a percentage of her total imports are shown in the table below, which further emphasises the decline in trade with Continental countries:

**BRITISH IMPORTS**  
(Percentage figures)

From:	1913	1932	1937
Empire countries	20.4	33.9	38.2
European countries	38.7	32.6	29.2
Other foreign countries	40.8	33.3	32.4

This drift of Britain away from intercourse with the Continent has been reflected in the loosening of relations between the British Empire and Germany and, on the other hand, in the tightening of connections between the latter and the countries of Central and Eastern Europe and of South America. German purchases in the British Empire showed a relative decline in the inter-war years (see **Europe's Trade**, p. 25) but she bought increasing quantities of goods from South American producers, exporting her own products to South America in competition with British goods. According to the League of Nation's publication **International Trade Statistics**, Germany's purchases in Australia, Canada and India have shown a reduction, whereas her imports from British South Africa did not share in this general movement; the reason for this exceptional treatment in the case of South Africa probably was that the Germans wished to take advantage of the involved national problems of the Union. German imports from Argentina, Chile and Brazil have registered a marked increase, this movement being part of a ramified plan by which the Germans hoped to increase their influence in South America. Meanwhile, German and Italian relations with the Danubian states were also becoming closer.

From the purely political standpoint, therefore, it would seem that the British economic block is too restricted; for the drift of British policy away from Europe created circumstances in which Germany was able to proceed with its own plans to unite the Continent under German hegemony.

## CHAPTER VIII

### EUROPEAN BLOCKS

We must now return to the question of the division of Europe into broad economic blocks. Three natural divisions suggest themselves, of which the first would include the countries of Western Europe, bordering the Atlantic. After the war there will in all probability be an economic agreement between Great Britain, the United States and the West European countries; and we may hazard the guess that it will also embrace West Africa.

The second main block will comprise the countries of Central and Eastern Europe, namely Poland, Lithuania, Czecho-Slovakia, Hungary and the Balkan states, and will extend through Turkey and Asia Minor to the borders of India—and perhaps through India to Burma, Thailand, etc. The states in question have territorial ambitions which are, in the main, limited to this zone and which therefore have the nature of internal disputes—though they are sometimes very acute none the less. During the last twenty years these conflicts between the different nations in this part of the world have been encouraged by Germany, Italy and the U.S.S.R.—a policy which was all the easier on account of Britain's lack of interest and of the gradual withdrawal of French influence, largely as a result of British policy. Indeed, the disputes in Eastern Europe grew *pari passu* with the gradual withdrawal of the Western Democracies, so that it became possible for Italy and Germany to smash the Little Entente and the Balkan Entente. These combina-



tions of powers had been formed with French encouragement, but France later ceased to interest herself in this region, influenced largely by Britain which took little or no interest in Eastern Europe until 1939. An indication of earlier British policy is given in a letter addressed on February 16th 1925 by Sir Austen Chamberlain, then Foreign Secretary, to the British Ambassador in Paris. It contained the following passage: "A form of guarantee which is so general that we undertake exactly the same obligations in defence, shall I say, of the Polish Corridor (for which no British Government ever will or ever can risk the bones of a single British Grenadier . . ." Fourteen years later, however, the wheel had turned full circle and Austen Chamberlain's brother granted Poland a guarantee against German aggression, which involved the defence of this very "Polish Corridor."

The entry of Japan into the world conflict has served to emphasise the importance of the stretch of territory which includes India, Burma and the Malay Peninsula. The strategic importance of the Near Eastern zone which embraces Turkey, Persia and Iraq is also widely recognised. In my opinion, the Central European zone of which we are speaking is at least equal in importance to these Far Eastern and Near Eastern territories.

One of the reasons for the backward economic development of Eastern Europe has been the political insecurity resulting from lack of support by the Western powers. As a result of this neglect, the countries in question have been forced to come to terms with either Germany or Russia. But this has prevented any political accord between the separate states of Eastern Europe, since some are more afraid of Russia than of Germany and have accordingly been driven to seek German support, while in others the reverse conditions have existed. If these states could have looked for support to some third power, this unfortunate choice between Russia and Germany would have been

obviated. It may be taken for granted that in the future some of the states in question—e.g. Turkey and Greece—will have the support of Great Britain. But in an age when defence requires a vast hinterland of air bases will it be possible to protect these Mediterranean powers without also safeguarding the states which lie further North? Can the Balkan states be defended without safeguarding the Danubian countries and can the latter be defended if the safety of Poland is ignored?

These states have no territorial aspirations outside the area in which they are situated and they therefore possess the natural qualifications (assuming that a suitable policy is adopted by the Western Powers) for acting as a stabilising factor in European affairs. (Between the Western Powers and the countries of Eastern Europe, on the other hand, lie Germany and Italy, which form our third main block and which are certainly not content to remain within their present frontiers, but are always seeking opportunities of expansion.

As part of the post-war policy of the Allies, the economic position of the countries lying between Germany and Russia should be strengthened so that the relative importance of Germany may be reduced. The only way in which this can be done is to encourage their industrialisation, for the more industrialised they become the less will the Germans seek to exploit them as a source of agricultural produce and of raw materials for German industry. It is dangerous to suggest that a straightforward complementary relationship—as between an industrialised power and a primary producer should exist between Germany and the countries of Eastern Europe. For such a policy would condemn the latter to endless misery, their populations, which have only a small surplus of agricultural produce available for export, being seriously under-nourished. Such a condition of poverty creates a situation highly favourable for German political and

economic expansion into the lands of Eastern Europe.

Thus the relationship between Germany and Eastern Europe should no longer be the complementary relationship existing between an industrialised power on the one hand, and raw material and agricultural producers on the other. In Central and Eastern Europe only Czecho-Slovakia is at a high level of industrial development, and her relationship to Germany is of a competitive-complementary nature; in this respect Poland lags behind Czecho-Slovakia. The aim should obviously be, not to isolate these countries from Germany, but to enable them to develop competitive-complementary relations with the latter, i.e., the relations which exist between industrialised states. The three regions should, in fact, be able to play a parallel part in world economy. If Eastern Europe were industrialised, smaller quantities of agricultural produce and industrial raw materials would be available for export to Germany and this would mean that the latter would be compelled to draw to an increasing extent upon overseas sources of supply. This, in turn, would make Germany more dependent upon the sea routes; and, if she were prevented from building a navy, she would be held in check by the countries having Atlantic fleets at their disposal.

In point of fact, it is only in very recent years that Germany has become a substantial buyer of agricultural produce in Eastern Europe. In 1929, as the following figures show, it was only barley which figured largely in German trade with the Danubian countries:

#### GERMAN IMPORTS, 1929

(Thousands of Quintals)

	Wheat	Maize	Barley
From overseas	20,560	6,150	10,400
From Danubian states	410	430	6,310
From other European countries	440	110	940



After the last war Germany embarked upon a policy of self-sufficiency in food supplies and was able to achieve a fair degree of success. Only in respect of oleaginous plants, indeed, could the policy be described as unsuccessful.

Contrary to the opinion widely held, Austria was far more important as a market for the produce of the Danubian states than was Germany until very recent years. As the following table shows, it was only in maize and barley that German imports from these countries exceeded those of Austria:

**EXPORTS FROM HUNGARY, RUMANIA,  
CZECHOSLOVAKIA & YUGOSLAVIA**  
(Annual Average 1928-1930 in Thousand Quintals)

	To Austria	To Germany
Wheat	1,819	224
Wheaten flour	1,663	23
Maize	869	1,579
Barley	568	5,869
Rye	1,101	113
Oats	675	136
Eggs*	100	125

\*Figures for eggs relate to the year 1929 only.

Austria, then, and not Germany was the principal market for Danubian wheat, rye and oats; and the *Anschluss* of Austria with Germany consequently greatly increased the economic dependence of the Danube states upon the German Reich.

Future policy should aim at the erection of a kind of economic and political dam to the East of Germany, and the countries of Eastern Europe should seek to follow the example of Czecho-Slovakia in their dealings with Germany. Czecho-Slovakia's exports to Germany consisted principally of manufactured goods such as cotton and woollen textiles, metal goods, sugar, coal, wood, glass-

ware, etc., for which Czecho-Slovakia received in exchange German textiles, paper, machines, ironware, coal and chemicals. The contention which we advanced earlier, that trade between an industrialised and agricultural country, is well illustrated here, for Czecho-Slovakia was the Danubian state with which the Germans had the largest volume of trade. This is competitive, rather than complementary trade. It is perhaps worth mentioning that Polish exports to Germany before the war consisted mainly of timber and its products, zinc, benzole, iron products, grain, butter and meat.

It seems to me that any political or economic programme which makes the welfare of Eastern Europe dependent upon the export of agricultural and pastoral products to Germany must be pernicious. For such a programme would condemn these lands to continued poverty. Rather, the pre-war relations between Germany and Czecho-Slovakia should serve as the model.

In spite of the view that the Continent should be regarded as a whole, it seems obvious that the principal component parts must be treated differently. The plans made for the whole Continent should aim at avoiding a repetition of that neglect of Eastern Europe which was characteristic of the years following the last war; and when credits are granted to Europe the claims of this part of the Continent should not be overlooked.

In Chapter I we quoted the words of Sir Halford MacKinder. If the belt of territory suggested by him is to play the part of a buffer against German aggression—if it is to separate Germany from Russia effectively—then it must be wide. Should Poland and Rumania lose their Eastern provinces to the U.S.S.R. the buffer states would be deprived of their vitality. The delimitation of frontiers within this tract of territory is rather a secondary matter, but it is most important that it should not be curtailed in favour of Russia. And it is impossible to imagine how

the integrity of this block of countries can be preserved without a strong Poland.

Unfortunately, many politicians are apt to be influenced by the vast size and rich natural resources of Russia. Plans for the development of Russia and for the exploitation of her natural wealth are far more attractive than proposals for the investment of capital in the over-populated, impoverished and politically insecure countries of Eastern Europe. Should these countries come within the Russian orbit there would certainly be a large-scale migration of their population to the U.S.S.R., for the Soviet authorities are attempting to create industrial centres as far as possible from their western frontiers and are glad enough to attract foreign labour to these parts. As we saw in Chapter IV, Mrs. Warriner, in her Fabian Society publication, approves of the transfer of population from Eastern Poland to central Russia, the Caucasus and Siberia.

Some British politicians believe that Britain must agree to Russian hegemony in Eastern Europe, being of opinion that it is impossible for these countries to exist independently of Russia and Germany, even with the assistance of Britain and France, and even of the United States. They probably do not desire that Russian influence should extend as far West as the German frontier, but only that Polish and Rumanian territory should be "justly" curtailed. But it would appear that the advocates of such a policy have not thought the matter out sufficiently. If the territorial integrity of the countries bordering Russia is impaired they will inevitably be weakened, and other Eastern European states will be weakened too. Some of these states will then try to obtain Russian support, while others will turn to Germany, thus reproducing the conditions which existed before the war.

The present position of Rumania, Bulgaria, Hungary Slovakia and Finland within the German camp is very



significant, and there seem to be two ways in which such states may be prevented from seeking German assistance in the future. The first is to extend Russia's sphere of influence and the Soviet régime to the frontiers of Germany; the second is to make this whole vast area independent of both Russia and Germany, with the support of the Western powers, including the United States.

Should the Russian sphere of influence spread to the West, the industrialisation of these buffer states would come to a standstill, they would probably be depopulated in favour of the U.S.S.R. and from the economic point of view they would become even more backward than at present. Agriculturally and industrially they would become potentially the complement of Germany, and circumstances would favour a new phase of German expansion.

If the belt of states between Germany and Russia is not sufficiently wide it will inevitably be divided into a Russian sphere of influence and a German sphere of interest. In this connection, some extremely interesting remarks were made in an article which appeared in *The Economist* for August 16th, 1941. "Those who are most enamoured with the 'inevitability' of Great Power domination," says the writer, "see a solution in Russian leadership. But Russia has so far given little evidence that the fate of a state closely associated with her would be anything but absorption—absorption into an ideological framework quite incompatible with Europe's traditional conception of freedom. 'Realism' must not be used to gloss over the fact that the fate of the Baltic States is exactly what Britain is fighting to prevent."

"Again, the Russian economy—a centralised planned system of national autarchy—is much nearer to *Wehrwirtschaft* than to the type of co-operation between free economies which can perhaps be developed in the West. The difference between Nazi and Soviet planning in trade and production has been the verbal difference between Four

Years and Five. Externally, the danger of Russian economic 'leadership,' unless a radically new economic policy were to be adopted by the Soviets, would be an isolation of Eastern Europe from the markets and resources of the world as effective as their present attachment to German self-sufficiency. The peoples of Eastern Europe have the right to plenty as well as to order; and Russian planning in its present form would leave Eastern Europe, like Germany yesterday and German-Europe today, in the position of being blockaded by its own policies. Internally, Russian leadership in the agrarian East of Europe would carry with it a programme of collectivisation. It is not that Britain has any interest at all in preserving a system of feudal estates and landless peasantries. But neither can it be British policy to forward enforced collectivisation under autocratic and centralised control. In economics, or in politics, the aim of British policy must be to avoid the facile 'either-or' of rival ideologies, and there are working models of a middle way in the land-holding and co-operative farming of Denmark or Croatia before the Teutonic deluge."

"The assumption of unlimited Russian leadership is not only incompatible in the long run with Britain's pledges. It is inexpedient now. It throws doubt upon the honesty of British intentions and on the seriousness of Britain's desire to build a better Europe after the war. It raises the question in a number of minds whether, if the issue is between German and Russian domination, the known evil is not preferable. Europe is struggling and hoping, not to exchange tyrannies, but to be free—a fact that was confirmed by the violent re-action in some quarters to the hint of Russian leadership which appeared in *The Times*. The Russians themselves are not so naive. The themes of their propaganda are freedom and self-determination; and at least one broadcast from Moscow has assured the German people that they need have no fear of the bolshev-

isation of Germany when Hitler goes."

"Belief in the 'inevitability' of Russian hegemony is a species of inverted Munichism. Isolation is isolation, whether Germans or Russians are dominating Eastern Europe, and isolation is a policy which has brought Britain and the United States into two major wars, in the course of thirty years. It is not as though the 'either-or' of German or Russian leadership is absolute. From the Baltic to the Balkans runs a separate block of Slav peoples, with Turkey to the South and Scandinavia to the North. Can it be established as a common interest of Britain and Russia that this block shall be strong, independent and economically prosperous? Britain's interest is obvious, and a measure of direct economic contribution in the shape of credits and gifts would bring in ample returns if new, expanding markets could be set up in Europe's principal distressed areas. And Russia? It can at least be said that, while the last two years have thrown the gravest suspicions on Soviet policy, the direction of Soviet diplomacy over the stretch of twenty years from the Civil War to the German Pact is far from discouraging."

"The test of Russia's sincerity towards an independent East European block will undoubtedly be Finland. Whether Finland would have actively co-operated with Germany if Russia had not first attacked her is certainly open to doubt. Now Finland is officially the enemy of both Russia and Britain. Yet if any state has proved its ability to exist independently as a civilised community and to develop its national economy, it is Finland."

We have endeavoured to show that British policy after the war should not aim at uniting Europe in the sense that the agricultural and raw material producing states of the East would have to complement industrial Germany; and that Britain should not aim at placing Eastern Europe under Russian leadership, but at creating a separate block, which would be developed with the aid of foreign loans



and German indemnities. As the leading European power, Great Britain should undertake the task of acting as an intermediary between the United States and the Continent of Europe.

We may now examine the political ties between the countries of Eastern Europe. It is obvious that their foreign policies should be co-ordinated in the future; but this may be difficult in view of the fact that some are traditionally anti-Russian and pro-German, whereas others are pro-Russian and anti-German. In consequence of this political disunity a common military policy would be difficult to achieve. In all probability it will be impossible to overcome this difficulty without the co-operation of Great Britain. Britain has been traditionally reluctant to assume obligations in this part of the world, but it seems to us that she must be persuaded to recognise Eastern Europe as a sphere of British interests. Economic collaboration in the form of a customs union between the countries of Eastern Europe would not, in our opinion, lead to political co-ordination, but rather to a deterioration in political relations. The preservation of separate national economies would be far more likely to lead to economic collaboration of a genuine character. The first objective must be to raise the standard of living in these Eastern countries, whatever the efforts and sacrifices involved; and we shall endeavour to prove that the easiest way of doing this is to preserve the individual national economies. It is scarcely necessary to add that good political relations cannot exist without good economic relations; it is therefore necessary to bring about a healthy economic co-operation between the countries in question.

There is a fascination about vast areas and central management of such extensive territories, to which we all too easily succumb. During the last war Germany had plans for a great "Mitteleuropa," of which the principal advocate was Naumann. When a few new states had been

established, the Germans initiated a large-scale propaganda campaign against the creation of new customs frontiers. They pointed out that the prosperity of the United States is directly attributable to the existence of a large and unified economy and suggested that Europe's troubles were due to the existence of her numerous frontiers. During the trade depression which began in 1929, however, the experience of the United States clearly demonstrated that mere size is not a necessary guarantee of prosperity. The naive and primitive view put out by the Germans has therefore ceased to carry conviction.

Despite all evidence to the contrary, a view is now gaining ground that a highly industrialised economy can be developed only on the basis of a large, amalgamated territory. True, industrial power necessitates a numerous population on a suitably developed territory, but it does not follow that this territory must necessarily be a unified and amalgamated economy. Thus, though we are of opinion that the countries lying between Germany and Russia should be industrialised, and that policy in regard to those branches which are of particular importance from the standpoint of national defence should be co-ordinated, it does not by any means follow that the complete fusion of the separate economies into one unit is the most suitable means of achieving the desired end.

It is sometimes naively assumed that the best means of avoiding political or economic disputes between different countries is to combine them into one national economy. This seems to differ little from the suggestion that the best means of avoiding disputes between neighbours living in different flats would be to compel them all to live in one very big flat; but it may be conjectured that the disputes between the householders would increase considerably if this solution were adopted.

In his recent book *The Lost Peace*, Harold Butler says: "The idea of a Danubian Confederation was attractive

as an abstract proposition, and if it could have been realised it would probably have proved the best recipe for bringing peace and plenty to South-east Europe. But unfortunately in the first years after the war it was quite impracticable. To expect that the Czechs, the Yugoslavs and the Rumanians would agree to guarantee the continuance of the economic supremacy of Vienna when they were enthusiastically celebrating their liberation from the Austrian yoke was asking too much of human nature. It was easy enough to condemn the peace settlement as "the Balkanisation of Europe" from armchairs in London. It was all very well for the economists to demonstrate by industrial and banking statistics that the new grouping of the states was unworkable, and to a large extent they were right. But national sentiment takes little account of statistics. To the traveller who witnessed the ecstasy with which all the liberated peoples were revelling in their newly-won freedom, it was obvious that the peace settlement was in its broad lines not only right, but inevitable. The Austro-Hungarian Empire was not broken up by the Peace Treaties. It had already disintegrated before a line of them had been written. The peace makers were confronted by a **fait accompli**, brought about by one of those irresistible surges of spontaneous mass action, which cannot be checked by any appeal to reason or to considerations of long-range policy. After all, the Allies had fought the war for the principle of self-determination, and no other principle would have been accepted by the Western Democracies. The right of nations to cherish their own traditions, to speak their own languages, to guide their own destinies without alien interference, is still a fundamental postulate of democracy. If anyone doubted it, he had only to go to Belgrade or Zagreb, Bucharest or Cluj, Prague or Pilsen, Warsaw or Cracow, in the first flush of their national resurrections. The new energy and self-respect which freedom breeds were plain to be seen on all hands.



Every peasant and every crossing-sweeper somehow felt himself a better man, however far he might be from having achieved political equality or economic security. The new nations had attained self-consciousness for the first time: they had won a distant prize for which their heroes and martyrs had struggled for centuries. In their mood of exaltation they would have laughed at the suggestion that they should exchange a single particle of their national independence in return for better banking facilities or more assured markets for their produce. Those were the problems of tomorrow, for which their newly-found national enterprise would find a solution. It might not be the ideal solution, but it would be better than submitting a moment longer to Austrian tutelage, however attenuated."

Some writers seem to regard national independence as an outmoded ideal and to believe that in modern conditions it should be sufficient to grant cultural autonomy to small nations. But it is now generally acknowledged that democracy of the nineteenth century type has ceased to be sufficient and that the common people wish to have a voice in economic matters as well as in political. We may readily grant that a single economy extending over a wide area will be more efficient than a small one which is separated from its neighbours by tariff barriers, etc. We might go further and point out that it would be even more efficient if certain rivers could be diverted from their courses and certain mountains levelled. It is more realistic to regard the fact of nationality in the same way as any natural obstacle to improved economic efficiency.

Even the *New Statesman and Nation*, (October 17th, 1942), which advocates the creation of great areas, has remarked in discussing the proposal for a union of the United States and Great Britain that the first and most obvious objection to this particular proposal for the restoration of capitalism is that it violates the principle that areas of political sovereignty should coincide with

areas of economic system. It may be that this principle will emerge from the upheavals of our days in the same way as the analogous principle of *cuius regio eius religio* emerged from the period of the wars of religion. We may have to recognise a principle of *cuius regio eius economiam*.

The doctrine that great economic spaces are beneficial is regarded as an expression of the needs and desires of the approaching economic era; the opponents of the doctrine are treated as reactionaries who are unable to understand the spirit of the new era; their attitude is compared with that of the advocates of feudal and mediæval corporation economy during the formative period of national economies.

Meantime, in fact the doctrine of the benefit of great economic spaces has developed out of a reality that is already past.

During the liberal-capitalistic era a great space was regarded as beneficial, as it facilitated the distribution of the various branches of production in various areas, so as to ensure the lowest possible prime costs; in those days it was rightly considered that the proximity of coal and raw materials and therefore a convenient communication situation was of decisive importance; the distribution of production achieved under the pressure of these geographical conditions was regarded as 'natural'; as in its researches political economy endeavoured to apply methods derived from the natural sciences the 'naturalness' of the distribution of production in this sense acquired the quality of an inevitable natural necessity; to resist the laws of nature was regarded as harmful. The advocates of the view that production should be located in areas in which the lowest production costs can be obtained even declared themselves in favour of complete world free trade and the universal abolition of customs tariffs; in other words, they considered that the entire

world should be turned into one great free economic area. The English pioneers of free trade in the middle of last century hoped that the good example set by Great Britain would encourage other States to follow suit. The advocates of great spaces regard this doctrine as an original conception, which only proves their inadequate acquaintance with history.

What was the situation out of which this free trade view developed a century ago?

Before the development of railways distance was a factor of decisive importance. It cost twice as much, and often even more, to transport goods a hundred miles as fifty miles.

The geographical factor was overcome when a single postal tariff was introduced for the entire area of a State, thus to some extent freeing the costs of postal communications from their dependence on distance. A man residing some distance from the town paid the same rate for a letter to the town as one sending a letter from one part of the town to the other.

The entire existing system of railway tariffs largely ignores the geographical factor. Goods transported greater distances are charged proportionately less than those transported shorter distances. The transport of goods for 300 miles does not cost three times as much as for 100 miles, but only twice or one and a half times as much. Numerous special and reduced charges render it possible to make the transport of coal and other commodities to certain places much cheaper than should follow from their distance from the centres of production; reduced rates render it possible to transport commodities cheaply from inconvenient or distant centres of production to the great centres of consumption. Typical in this regard are the rates charged for transport of agricultural produce to the



large towns in areas geographically remote and inconveniently situated.

It even happens at times that the charges for transport over a greater distance are absolutely less than that over a shorter distance. In Poland charges for the transport of coal to the eastern areas of the country were less than those for its transport to Warsaw; this was done to ensure that the poorer eastern areas, situated a long distance from the coalfield, could obtain coal at a lower price than that charged to the inhabitants of the richer, central part of Poland.

Thus the arrangement of railway tariffs facilitates and to some extent compensates for the disadvantages of areas geographically inconveniently situated.

But the matter does not end there. Usually less is charged for the transport of less costly, than for more costly freight, even when the transport costs are identical. The cost of transporting a ton of cotton over a certain distance is approximately the same as the cost of a ton of cotton fibre or cotton piece goods, whereas the transport charges for raw cotton are much less than for cotton piece goods. When transport charges are arranged the commodity's payment capacity is taken into account; a hundred years ago a carter took into account only the actual weight plus any costs connected with the necessity to take more care over certain categories of commodities, and paid no regard to the commodity's payment capacity.

Here we have to deal with a fact of far-reaching economic importance; when reckoning the costs of transport of various categories of freight one might take into account only the technical conditions of transport, and leave out of account the question whether certain commodities could meet the prime costs thus involved; but if the charges were fixed in accordance with this purely technical method, numerous categories of freights would

be unable to pay the rate and would not use the railway facilities. But it pays the railways to attract these categories of freights, and to charge them less than the costs of transport reckoned on a strictly technical basis, for otherwise the rolling stock would not be used to its full capacity; freights capable of paying the real costs of transport would not fully utilise the carrying capacity of the railways. So it pays the railways to carry certain commodities at a lower rate than their real costs of transport would involve, as thus they avoid partial inactivity.

It is customary for state authorities to impose a certain system of tariffs on privately owned railways, and, utilising this instrument, to endeavour to develop areas disadvantageously situated. If the railways suffer losses on this account, the state meets the deficit.

So we see that the tariff system largely ignores the geographical factor, with the object of economically developing inconveniently situated areas.

The state subsidization of shipping and air lines also enables the geographical factor to be overcome.

More and more commodities are sold at single prices everywhere in the State; this applies first and foremost to commodities produced under State monopolies, such as that of tobacco and matches, which are sold at the one price throughout the state territory. A few years before the war the Polish Government compelled the sugar industry to draw up single prices for sugar in Poland, and thus the inhabitants of the poorer eastern areas obtained sugar at the same price as the inhabitants of a village in which there was a sugar refinery. A further case of overcoming the geographical factor.

The 'Economist' has justly remarked that the fact that a country possesses skilled workers and the requisite installations is of more importance than climatic conditions and mineral wealth. The more and better the

production of any country, the greater are its possibilities of cheapening certain commodities.

In an industrialised area technical aid is at hand, and any necessary repairs to machinery can be carried out more easily and quickly than they can be in an economically backward area. Whether any area is advantageously situated in regard to production depends more and more on the level of civilization in the country or area, and less and less on the proximity of mineral wealth or the influence of climatic conditions. The doctrine of the natural distribution of production on a world scale, understood almost as a natural law, is thus administered a serious blow, and is fundamentally undermined. The advantages of any areas and countries depend less and less on so-called natural geographical conditions and more and more on man himself, his creative intelligence and technical equipment. When before the war Japan was flooding many markets with cheap goods, this was not ascribed to her convenient geographical situation, but to her technical development, the qualifications of the Japanese workers, and, of course, to her low wage standards.

This tendency to assure predominance to great industrial areas, or in other words to so-called convenient areas of production, is accompanied by converse tendencies. The convenient area of production frequently results in a great aggregation of population; only comparatively recently, even in the civilised states the inhabitants of such areas lived in unhygienic conditions; during the period of emergence and development of these areas social considerations played hardly any part. With the extension of the scope of social policy, with the emergence of a policy of **urbanization**, the production costs in these convenient areas began to go up. Workers' houses with their own gardens in the suburbs, with low rents or low purchasing price,



also cost money, and someone has to pay for them. Therefore a phenomenon operating in the converse direction to the tendency for industry to be absorbed by the industrial areas comes into play. Under the influence of social considerations a tendency develops to distribute production into unindustrialised areas; in such areas labour is cheaper, though at first of course less efficient; but it has more healthy living conditions.

The modern state definitely takes the line of developing the economically backward areas; for instance, in Great Britain plans have been drawn up for the electrification of the Scottish highlands. State policy aims at uplifting the so-called unfavourably situated areas economically, and creating satisfactory production conditions for them; the policy of eliminating the unfavourable production conditions in the so-called inconveniently situated areas is a further development of the universal process of overcoming geographical factors.

The naturalistic attitude in dealing with economic phenomena yields place to the humanistic attitude.

State policy works to hinder the growth of large aggregations of population in so-called conveniently situated areas, and tries to endow the so-called inconvenient areas with advantageous conditions.

A far-reaching change occurs in economic thinking. Economic policy begins to cramp the operation of the so-called natural economic forces in the area of the great economic space, and begins to think in terms of areas and districts, and sets to work to develop the economically inconveniently situated areas.

In face of these modern tendencies the smaller States become fundamentally only more differentiated areas. By the very nature of things it follows that the smaller States are not in a position to allow themselves the self-sufficiency, which the larger states can enjoy. For instance,

in 1927/29 trade in dollars per head of the population was as follows:

	Imports.	Exports.
Russia	2.71	2.70
U.S.A.	34.10	40.40
Belgium	110.90	103.00
Denmark	123.90	116.00
Holland	135.00	99.30
Norway	91.80	66.90

The smaller States participate far more in world trade than do the great states; for instance, Belgium's foreign trade is almost twice as large as that of Russia; the United States import only four times as much as Holland. Fundamentally the smaller states are only differentiated areas in the sphere of world economy. So it is not surprising that it is the small States, such as Belgium and Holland, which talk most of the need for world economic co-operation, while the U.S.A. talk far less, and Russia least of all, of that need.

In economic policy greater importance is attached to the man, his desires and capabilities, than to the 'natural' geographical conditions in which he lives. The policy which declares that the flow of industry into the so-called convenient areas of production is beneficial is more and more opposed by the policy of encouraging industry in the so-called inconvenient areas. The maintenance of the small states as component parts of great political and economic blocs is in correspondence with the modern tendencies of development. The doctrine of great spaces has grown out of an already past reality.

Economic union between countries is considered in some quarters to facilitate a political rapprochement; but it seems to me that relations between states whose national economies remain separate are no worse than those between different nations living within one unified economy. Had

the peoples of Eastern Europe been separated by clearly defined ethnical frontiers, instead of being so intermixed, then I should have held that the best means of achieving friendly relations between them would be by the separation of their national economies. In all human relations, co-operation consists in keeping at a suitable distance and determining a suitable zone of contact. If the distance is not sufficient and the area of contact too large a clash of interests will ensue. Contacts should be confined to special, pre-determined matters; some things are best settled in isolation. So in relations between different national groups the principle of independence should be adhered to.

If I had to choose between two diametrically opposed solutions of the problem of Eastern Europe—one providing for the complete and political fusion of the states concerned and the other providing for an even greater degree of sub-division than at present—I should certainly hesitate before taking a decision. In the end, however, I should probably opt for the latter alternative—the creation of a separate Transylvania, a separate Macedonia, etc.,—because I am of opinion that a rapprochement between the different countries would be more easily attained in this way: the zones of conflict between them would be reduced. There is no evidence that the development of Belgium, Holland, Switzerland, the Scandinavian states, Lithuania, Latvia and Estonia has suffered on account of their small size. The British territories in South Africa comprise four separate states: the Union of South Africa, Northern Rhodesia, Southern Rhodesia and the Territories of the South African High Commission, while Canada is separated from Newfoundland. There were important political reasons for maintaining the independence of Northern Rhodesia, with a population of rather less than one and a half millions, of Southern Rhodesia, with a population of one and a half millions, and of the Territories of the South African High Commission, with only four hundred



thousand inhabitants. Is it too much to ask that factors of no less importance should be taken into consideration in dealing with Eastern Europe?

I find it difficult to avoid the impression that there is an analogy between the hopes entertained after the last war in connection with the League of Nations and the present view that salvation is to be found in vast areas with centralised economic planning. Tired and harassed by the war, humanity is prone to accept all kinds of panaceas—one of which calls for huge territories with a unified, planned economy. It is to be feared that this worship of size may result in the formation of a vast Russian block and a vast German block.

Economic policy is only a variant of pure politics. Even within a single state the allocation of cartel quotas is a political problem. Inequalities in government expenditure between different parts of the same state give rise to political problems, and political issues arise in the grant of loans by the central bank in different districts of one country. In a confederation of national economies every economic problem would have its political aspect. "Politique d'abord" should be acknowledged in economic matters as well. It is an illusion to suppose that economic questions can be used as a means of solving urgent political difficulties. In an article entitled "The Primacy of Politics," *The Economist* for September 6th, 1941, contained the following passage: "One of the most popular fallacies is the belief that the neglect of economic conditions in 1918 was entirely responsible for the political maladjustments of the inter-war years; and from this is drawn the conclusion that if the economic problem is solved this time, politics will look after themselves. This is a gross error. The settlement of 1918 did not work because its political fashioning was unworkable. It was not until after the collapse of French political hegemony, with the final eclipse of the League system, that the nations

to the East of the Axis fell to Germany's *Lebensraum*. The political problem is the primary problem." Journals dealing with special subjects have a habit of exaggerating the importance of that subject. Hence the above view, expressed by one of the foremost economic periodicals of the world, is all the more convincing—and should be taken as a warning.

Economic policy is prompted by political and social, as well as by economic motives. A politician is guilty of inefficiency and indolence if he refuses to take account of the political and social considerations which lie at the foundation of any economic policy.

Only by creating a suitable political basis for an East European block of states can political and economic co-ordination in this area be achieved. As the political ties become closer, so economic rapprochement will develop—though the process will take time. After a while, political rapprochement may be expected to lead to economic rapprochement; but the latter should not be regarded as a means of securing the former, since economic problems are conditioned by political factors.

We discussed the question of immigration restrictions in Chapter IV. There can be no doubt that countries which have little or no unemployment after the war will not admit immigrants from neighbouring states; it is possible that some countries may face a labour shortage, but even then it is doubtful whether they will agree to permanent immigration.

The more the arrears of work and the greater the degree of neglect in any particular country, the greater will be the proportion of unemployed; and the more necessary will it be for the country in question to adopt a risky financial and credit policy in order to create employment. It is no accident that, after the last war, the worst financial disorders were to be found in the countries which had been devastated by the conflict.

Since credit policy and the banking system are largely a reflection of population problems, the degree of employment, economic neglect and arrears of work, it is not surprising that even the most enthusiastic advocates of economic confederations often declare themselves in favour of separate currencies and separate banks of issue for the different parts of an amalgamated national economy. Financial risks cannot usually be avoided when a state is forced to stimulate economic activity under the pressure of unemployment. If a given country cannot develop its resources sufficiently with the aid of foreign capital, it must do so from its own financial resources, which is of course more risky and more expensive. For a poor country which does not receive foreign credits, but which has to pay for its imports by means of its own exports, there is, however, no other course. Its exports may be insufficient, not only because it produces less, but also because other countries are reluctant to buy its products. There can be no doubt that if certain countries started buying goods from other countries, without restrictions, then the demand for their own goods would eventually increase. But the vital question is how long the process will take, and how long the country concerned can afford to wait for foreign customers to buy its goods. As we have seen, Britain could not wait a sufficient length of time in 1932 and had to impose import duties. And the countries of Eastern Europe are even less able to wait. So poor countries may be forced to embark upon hazardous financial and credit policies; and a nation which, owing to conditions in its own country, is not forced to undertake such risks will not be prepared to venture very much for the sake of another, or for the common good.

Considerable risks are involved in the grant of credits for the construction of railways, for the starting of public utility undertakings, for building working-class dwellings or for encouraging agriculture—and may, if things go



badly, endanger the assets of savings banks or insurance companies and even affect the national exchequer and the taxpayer if a government guarantee has been given. Only a united and relatively homogeneous society—in short, a political nation—can consent to assume such risks, and it is very difficult to persuade one nation to undertake such risks for the benefit of another. This does not alter the fact that certain states, by a policy of foreign investment, should—even in their own interests—share the risks of others, therefore the establishment of some kind of International Investment Board would seem called for. But it should not be forgotten that any state will be far more ready to undertake internal risks than external ones; and that it will be far more anxious to limit the risks involved in foreign transactions than in internal ones. A common credit policy and banking system for a number of countries means that all are burdened with a common risk; and since the hazards involved in economic policy are different in different nations, the wealthier countries would raise objections. When the war is over the countries of Eastern Europe will be impoverished; each will have a vast number of needs of its own to satisfy and not one of them will be in a position to contribute anything for the benefit of others. Some economists are of opinion that the post-war impoverishment of these countries will put them all on the same economic level. But even if this were true, it should still be noted that the poorer a country is, the less is it inclined to offer financial assistance to another. Pennies mean more to the poor than shillings do to the wealthy, and it is not generally realised that the small tax-payer is even more affected by tax increases than the well-to-do.

To some, these views may seem parochial and petit-bourgeois. Politicians, in solemn mood as a result of the cataclysm of war, feel that it is at last time to start thinking in really large-scale terms. To a considerable

extent, however, politics is the art of financing intentions—and when accounts are being drawn up even small matters must be taken into consideration. Can it be said that in war-time Britain the problem of wages has been relegated to the background by the ideals for which the British working class is fighting? Is the rationing of eggs, butter and meat not one of the most important problems of the present? Surely the inseparable interconnection and interdependence of great and small matters is one of the characteristics of life. Thus even the astronomer, cut off from the everyday world though he be, must still take care to balance his personal budget and cannot ignore the insignificant penny. When momentous events are occurring people's minds may easily be filled with superficial generalisations which hinder rather than help to solve the real problems at stake.

In some parts of the country the government may collect more in the way of taxes than it spends, while in other parts it may spend more than it collects. Thus even in a unified state, disputes may arise regarding the size of the burden to be borne by different districts. In pre-war Yugoslavia, for example, the Croatian peasants complained about the contribution which they had to make to the expenses incurred in Serbia; and who can tell whether the Serbs and Croats might not have been more united if the government had not over-encouraged centralisation? In a confederation formed by a number of states disputes of this kind are even more heated. Thus in Tsarist Russia the politicians contended that the Polish territories absorbed by impoverishment of the central Russian provinces; in pre-war Austria, Polish politicians contended that Viennese policy was responsible for the impoverishment of Galicia; the disputes between Austria and Hungary were notorious; and in the German Reich the Bavarian politicians were of opinion that Prussian policy was inimical to the interests of Bavaria. A dispute of a similar sort recently took place

between the different provinces of Canada, as may be seen from the Report of the Royal Commission on Dominion Provincial Relations, published in 1940. In view of the fact that inequalities of wealth exist between different parts of a confederation, there is a strong tendency for separate exchequers to be set up and for the central treasury's sphere of activity to be limited to specific matters, such as national defence. Then the more wealthy states will spend more on education, public health and public utility services, each state having its separate system of taxation, financial institutions, etc. All this goes to prove that the immigration, taxation and currency barriers or frontiers should be retained.

It is often said that a large block of countries is more favourably situated to obtain a loan from abroad than is a separate state, and it is true that the bankers and the public in the creditor states prefer to make large loans; but the creditor will have to examine the proposals for utilising the credit and the question of its distribution between the constituent parts of the confederation. The creditors will be more inclined to make large loans to specially created financial institutions, which would be charged with the task of allocating the funds thus obtained among the individual states concerned.

The economic disorders which arose during the inter-war years were often attributed to the existence of numerous customs barriers. But we have already pointed out that the erroneous nature of this assumption was proved by the economic crisis in the United States, where there were no internal customs barriers. The economist with a commercial frame of mind traces the bad relations between different national economies to the existence of tariff walls and trade restrictions between them; and he concludes that if only there were complete freedom of trade all would be well. Now, it should be obvious that the unification of the taxation system would be a necessary accompaniment of



a customs union; for otherwise costs of production would be higher in the area with the higher taxation. There would also have to be a common bank of issue and a common currency. It is difficult to imagine how the restrictions on immigration could be maintained if there were a customs union, a common currency, one central bank of issue and a unified system of taxation. Those who advocate a customs union should therefore realise that this is merely one aspect of a complete economic union and that it could not be introduced on its own.

The opinion that customs unions offer the best solution of the problem is an echo from the bygone era of economic liberalism. The main foundation of this liberal point of view was the theory of the "natural" location of production in different parts of the world. It was held that countries should specialise on the production of those goods for which they were best fitted by natural conditions—i.e. those which paid best. The profitability of different lines of production was to be the criterion according to which production was distributed. Such a criterion is, however, valid only in periods of full employment, when everyone works at the most productive and most profitable jobs. Where there is a substantial measure of unemployment, on the other hand, people and nations satisfy their most urgent needs in what is not the most productive manner and are, moreover, obliged to burden the national economy with considerable risks.

We have already seen in Chapter V that profitability is more and more becoming an institutional matter; the profitability of different branches of production depends just as much upon the particular economic policy adopted as it does on the so-called natural conditions. It is, of course, obvious that if a country has no copper ores, economic policy cannot create copper mines. In the case of manufacturing industries, however, economic policy can have far-reaching effects. With the development of manu-

facturing industry, there is a tendency for more valuable goods to be produced, with the result that there is a relative decrease in the value of the raw materials needed to produce them. In other words, the more valuable the product the greater is the relative importance of the human labour employed in its production and the less the importance of the cost of transporting the necessary raw materials. From this it follows that, as manufacturing industries develop, the importance of certain natural conditions, such as proximity to coalfields, favourable situation from the transport aspect, and so forth, gradually diminishes. Thanks to favourable natural conditions and the right kind of economic policy, the population of countries in process of industrialisation grew considerably in the nineteenth century. In the twentieth century, however, the chain of causation seems to have been reversed; an increasing population compels industrialisation, especially now that the safety valve of emigration is out of action. Consequently, the keenest desire of the one hundred million souls in Eastern Europe is that their countries should become industrialised. Every man whose labour is not required in the country feels the necessity to find employment in the town; the unemployed industrial workers clamour fervently for the further development of industry. Only blundering, half-educated economists—sometimes even socialists—divorced from the needs of the masses consider that the desire to maintain customs barriers is reactionary and prompted by the desire to protect the vested interests of industrialists; and cannot see that the object is to safeguard industry and employment. They succumb momentarily to existing tendencies, proclaiming the desirability of forming vast economic blocks, with a centralised planning authority.

Such superficial observers may be recommended to study **International Conciliation**, number 369, dated April, 1941, published by the Carnegie Endowment for International

Peace. In an article in this number entitled "Nationalism," Carlton J. H. Hayes writes as follows: "The practical example of what a strengthened national state like England or France could do to promote the collective wealth of its citizenry was not lost on other peoples . . . . What prevented general acceptance of the English outlook, however, was in the first place the simple fact that profits from the sale of foodstuffs and raw materials did not keep pace with profits from the sale of machine-made commodities . . . . The remedy for backward peoples was to imitate England, not in free trade but in industrialisation, and to promote industrialisation they needed like England a strong national state . . . . Nowadays, in the latest stage of technological advance, economic production is primarily national and only secondarily international. Economic consumption is international, but far more is it national."

With modern transport facilities, which enable a cheap supply of raw materials to be obtained, it would seem that density of population is becoming the decisive natural determinant of the development of industry. If we are to carry out humanitarian ideals, I think it would be more to the point to industrialise countries which have an overpopulated countryside than to condemn them to misery or their people to emigration—especially now that no country with the sole exception of Russia, is willing to admit immigrants.

Another argument advanced by certain economists in favour of the amalgamation of separate national economies into one unit is that a larger national economy is considered to be better adapted to mass production than a smaller one. It must be noted in the first place that a century ago mass production was production carried on in a large establishment by steam power, based on readily accessible supplies of cheap coal. A typical example of mass production was the British textile industry, which manufactured for export; and in exchange for the exported



textile manufactures Britain imported agricultural produce and raw materials. Nowadays, however, certain kinds of mass production may be undertaken by small establishments using electrical power. Thus an establishment employing a few workers to turn out two varieties of screw for motor cars is engaged in mass production. Thus, the size of the national economy is not so important as before.

The capacity of the home market has in many cases grown to such an extent that almost any country is now in a position to employ mass production methods in a number of large establishments catering for home demand. It is sometimes held that costs of production are lower in a large establishment than in a small one, but this is not the case. In his book **The Conditions of Economic Progress**, Colin Clark, who with G. T. Jones made a study of economic conditions in the United States, France, Canada, Australia and Great Britain, comes to the conclusion that there is no connection between the size of the undertaking and the productivity of the worker.

In the technical conditions of the present day, it is possible for smaller establishments to employ mass production methods to turn out smaller quantities of goods for a smaller home market. It is often true that, while production in larger quantities may lower the unit cost of production, this saving is offset by the higher cost of selling the products on a larger market, or on a number of separate markets. This explains why it may be possible for small establishments which produce at high cost for the local market to survive in face of competition from larger establishments with lower costs of production; they have the advantage of much lower selling costs.

It may happen that in less industrialised countries the size of the average productive unit in a particular branch of production is larger than in a highly industrialised country. A good example is provided by the Polish cotton industry, where there were a number of establishments of

larger size than those found in Great Britain.

Specialised industries turning out valuable products are generally found in highly industrialised states. Their development is often ascribed to the existence of an extensive home market, but it should be noted that Sweden, Switzerland, Belgium, Holland and Czechoslovakia possess such industries, without having very extensive internal markets. Nevertheless, it must be said that the creation of new regions of valuable production is very difficult, for there is a tendency for all new establishments to be set up in an area which is already highly industrialised—the reason being that it is easier to manage an establishment in such an area than in a less developed region, where the assistance of other industrial undertakings is lacking. In a confederated national economy there would probably be a tendency for industry to be concentrated in certain areas; it is for this reason that certain states are opposed to the creation of a customs union with their neighbours. As we have already remarked, the more backward countries are anxious to become industrialised and feel that industrialisation is a token of a higher national status.

Under a system of international planning, the location of industries as between one country and another would be determined by some central authority. Perhaps it would be more accurate to say that a given country would be forbidden to produce any commodities other than those which had been allocated to it, or to exceed its quota in those which it was allowed to produce. In English shipping circles there is talk of restricting the possession of merchant ships by other countries. Thus Poland, which possesses a very small mercantile marine would be prevented from buying or building ships. But it would be difficult for any country with a large volume of unemployed labour to agree to such restrictions on production for the home market. Thus in the case of commercial

treaties, international cartel agreements and such-like, production for the home market is not restricted. There is obviously a great deal of difference between the kind of international planning which is accomplished in successive stages by agreements and commercial treaties and that which would be undertaken by an international planning authority whose word was law. For such a body to work effectively some country would have to have controlling power, the others being subject to its will. It is probable, for instance, that a number of countries would have to agree to British proposals for the restriction of their merchant shipping. In such cases, however, political pressure would be necessary.

For these reasons, the creation of an international planning authority would be fraught with difficulties and it would thus appear preferable to continue to advance along the path of international agreements such as commercial treaties, cartel arrangements and the like. Every such international agreement obviously imposes some restrictions on the liberty of the states who sign it.

Before the last war commercial agreements between different countries were seldom revised and generally had a currency of ten years. After the war, however, many of the treaties concluded gave the signatories the right to revision after one year. During this period there were almost constant negotiations over commercial treaties and cartel agreements, a reflection of the fact that the more complicated life becomes the more difficult is it to fix activities for long periods in advance. Of necessity, planning involves constant negotiation.

Many political and economic writers have been much impressed by the creation and working of the Tennessee Valley Authority, which embraces several American states, and they suggest that the T.V.A. should be taken as a model for some areas of Europe where there are a number of separate states. For this reason I feel that it may be



worth while to discuss the activities of this Authority.

The T.V.A. Act was passed in May, 1933, the main functions of the Authority thus constituted being: control of navigation in the area concerned; flood control; re-forestation; prevention of soil erosion; the securing of supplies of chemicals and explosives; the establishment of a research plant for the production of cheap fertilisers needed in the South; the utilisation of surplus electric power. For constitutional reasons, the legal basis of the Tennessee Valley Authority rests on navigation and flood control.

As the T.V.A. obtains most of its money from Congress, it comes under the control of the President, the Bureau of the Budget and the Estimates Committee of Congress. The Board as originally constituted consisted of three members, appointed by the President with the consent of the Senate. Owing to continued disagreement among the three members and the fact that no special functions had been allocated to each member under the Act—not even the Chairman—many disputes arose. The most important concerned the question of costs and valuation; it became public, Congress set up an investigating committee and finally the President had to intervene.

As a result of these administrative difficulties the work of the T.V.A. was held up. Some of the dams have now been finished, but others have not yet been started. Electricity is being re-sold to the municipalities and to the state authorities in the area. Agricultural research is being fostered by means of grants to the local colleges, while health services are also being subsidised.

In August, 1939, the T.V.A. purchased the properties of the Tennessee Electric Power Company; it thus acquired an outlet for virtually the entire power output from its proposed system of ten dams for navigation, flood control and electricity production and also a number of generating plants. In July, 1941, the President signed a resolution

appropriating an additional \$40,000,000 for the construction of further plant to provide electric power for aluminium production.

The Tennessee Valley area is 650 miles long and about 50 miles wide on the average. It has a population of 2 millions and is one of the poorest, most badly-housed, under-nourished and under-schooled areas in the United States. Originally well-wooded, it became an agricultural area by the process of deforestation and "soil-mining." Its mineral resources include coal, oil and natural gas. Its development dates back a hundred years to the time when local interests constructed canals round the Muscle Shoals section of the River Tennessee. The emphasis then was on developing the river for navigation. Now, as we have seen, the development work is being undertaken not only from the navigational point of view, but with a view to flood control, afforestation, the prevention of soil erosion, the manufacture of fertilisers and the generation and distribution of electricity.

The Chairman of the Board took an interest in all these matters, another member mainly in electric power and the third in agricultural questions. A tug-of-war developed between the three members, which in turn affected the loyalties of the staff. Owing to continual dissensions, half-hearted decisions were taken, small sums of money being spent in fields in which small expenditure was merely wasted. The Chairman, for example, wanted research work to be undertaken into the possibility of setting up co-operative organisations in the area. This the other two members of the Board opposed, on the ground that it was hopeless to expect the average Tennessee farmer to co-operate. The result was that over a period of four years a sum of only \$200,000 was spent to no purpose on this type of research. Similar enquiries were proposed into the possibilities of re-afforestation, but similar disagreements took place and there was the same waste of money. Vital

questions of discrimination between industry and agriculture and between light and heavy industry in the fixing of rates for the sale of electric power were continually under discussion, but have still not been settled. One member was in favour of industrial development in Tennessee; another wanted the farmers to receive electricity for productive purposes but not for amusement—for agricultural machinery, but not for radios.

As time went on, the two junior members of the Board came to a tacit agreement not to oppose one another's plans, in order that they might present a united front to the Chairman. Quarrels occurred in particular over the electricity programme. The members could not agree upon the order in which the various dams should be constructed and they differed on the question of the policy to be adopted vis-à-vis the utility companies. Should the T.V.A. come to an agreement with the utility companies to buy out their plants, should it force them to sell by pressure of competition, or should it agree to divide up the market with them?

The chief dispute came over the question of costs and valuation. The Chairman argued that capital costs should be allocated on the "benefit principle"—i.e. according to the benefit which navigation, flood control, agriculture etc. had derived from the Board's expenditure. It took four or five years for the Board to reach agreement on this matter, but it was finally decided that 52 per cent. of the cost of the dams should be allocated to electricity. This question is of considerable importance, for if the costs are not properly allocated it is impossible to fix charges for electricity on an economic basis or to know whether it would pay best to use coal (of which there is plenty in the Tennessee Valley) or to build more dams for the generation of electricity.

This dispute over the allocation of costs, as we have already noted, became public, each director seeking to



obtain a lobby in Congress and support in the press. The President saw each member of the Board, but unfortunately the interviews were individual, and each went away believing that he had secured the President's support. As majority rule was inevitable with a Board of three members, the two junior directors agreed almost collusively against the Chairman, who finally accused them of dishonesty and misfeasance. Congress set up an investigating committee which is still sitting and which has so far accumulated 500,000 pages of evidence. At last the President dismissed the Chairman—an inevitable step in view of the gulf which existed between the Chairman and the other two members. But the very fact that Presidential intervention was necessary has brought the T.V.A. more under political control.

A dispute has now arisen between the T.V.A. and the Comptroller and Auditor General, who audits its accounts. He has interpreted his power of audit as power to settle and adjust, and has succeeded in getting a virtual stranglehold over the T.V.A. Work has been held up for considerable periods by the Comptroller and Auditor General, and on one occasion he threatened to withhold all funds from the T.V.A. until the latter complied with his requirements in the matter of receipts and vouchers.

It is obvious, therefore, that such undertakings as those of which the T.V.A. is a prototype would have to be restricted to certain special activities, such as Danubian navigation problems. It must be concluded that questions which it is possible for a state to settle independently should be settled in this way without reference to an international authority.

Strategical considerations at one time required that industry should be concentrated in safe areas, but with the growth of air power the criterion of safety requires that vital industries should be dispersed and that the number of industrial districts should be multiplied. This policy

has been well exemplified in British experience during the present war.

From the strategic standpoint it would seem advisable that all the states stretching from the Baltic to the Black and Adriatic Seas should be highly industrialised. I am even of opinion that it would be better to industrialise them intensively without a plan than to industrialise them slowly and according to plan. Though it may seem platitudinous to reiterate that the degree of industrialisation is one of the most important determinants of the power of a state, it is sometimes necessary to stress the obvious, because it is in danger of being overlooked.

Interesting problems arise in cases where great industrial enterprises have at their disposal methods of production which are inaccessible, or almost so, to others. Such concerns will often establish branches in foreign countries where this is more economical than the payment of import duties; and the customs tariff then becomes the means of attracting specialised and highly skilled production to economically backward areas. An example of the process is afforded by a certain British company which established a branch business in Poland; and I was told about the methods by which this company calculated its costs of production. In Britain the management of this firm was concerned with getting the utmost value from the expensive labour employed, even at the cost of wasting material; in the British subsidiary, on the other hand, attention was concentrated on careful use of the raw material, even if this involved some waste of the cheap labour there available. In these circumstances it is scarcely surprising to find that a backward country is anxious to create employment for its citizens with the aid of customs duties.

The customs tariff is only one element in a whole complex of economic barriers, including those relating to immigration, finance, currency, etc., which separate one

country from another. Conditions in the nineteenth century were based upon the free movement of peoples and capital, as well as on free trade. Once restrictions have been imposed upon immigration and the movement of capital, it is difficult to maintain free trade.

Those European countries whose surplus population emigrated to America during the nineteenth century are now compelled to find employment for them at home. The would-be emigrant starts to work in his own country for long hours and a low wage, sometimes depriving the industrial workers in another state of employment; this is a kind of social "dumping." During the inter-war years the industrialised countries protested to the International Labour Office against this kind of unfair competition. British industrialists, trade unionists and even the British government, for example, initiated a campaign against the "exploitation" of Polish coal-miners. But how is the worker concerned to be prevented from accepting this kind of "exploitation" rather than unemployment and destitution? He has to choose the lesser evil.

Thus, although Poland has fairly up-to-date social legislation, the authorities are in a position to enforce it only in the larger industrial establishments; smaller undertakings are often outside its scope. In the smaller businesses, therefore, longer hours are customary—and if the factory inspector discovers that the law is being evaded, and tries to enforce it, he often meets with protests from the employees. In one fairly large industrial centre in Poland the management of a large factory supplied its employees with bricks at a specially low price so that they could build their own houses after finishing work at the factory; in point of fact this was a kind of "bootleg" labour. Again, it sometimes happens that collective wage agreements are evaded by the workers who secretly agree to return part of their wages to the employer. In economically backward countries the small farmer often



works for practically no return, with the result that agriculturalists in countries with intensive agriculture cannot compete. (In this context we are, of course, taking no account of the competition of such "extensive" producers as those of Canada or Australia.)

When the inhabitants of an over-populated country begin to work for low wages and to export their produce at low prices countries with higher wages and costs protect themselves against this competition by means of import duties. In this way there come into existence regions with differing wage, cost and price structures.

The difference in wages, costs and prices as between one national economy and another are a function of the density of population, of the degree of economic development and of the intensity of production. If a given country is not in a position to pay for imports of the goods it needs, it endeavours to produce them at home and does not worry unduly over the fact that its costs of production for that commodity are higher than those ruling in the other country. Because the United States and Great Britain placed restrictions on the import of Polish bacon, Poland was compelled to give up importing certain goods and to produce them at home instead. In such circumstances there is far less co-ordination between the price and wage structures of the various countries than there was before the last war. We can well understand the attitude of those economists who wish to re-establish freedom of movement for both labour and capital, together with freedom of trade. On the other hand, if the advocates of economic planning are in favour of the abolition of customs duties they give evidence of inconsistency; for they declare themselves in favour of state control of production, but against control by means of customs duties—an attitude which would be understandable only if it were possible by means of state regulation to control production and distribution as a whole, so that customs duties could simply be given

up as unnecessary. But as we pointed out in Chapter VI, regulation of production by means of cartels or large combines is practicable only where the product is uniform and output capable of quantitative measurement.

Even cartels, however, must sometimes be organised on the basis of small, limited regions; regional cartels may have to be established within one state since the whole country is too large for the purpose. Thus there are 10 regional coal cartels in Germany and 17 different district organisations in the British coal industry. In January, 1941, Russia embarked upon a policy of decentralisation, nine great zones being fixed and the regional managements being empowered to take decisions in most matters. Only the heavy industries and the chief branches of the engineering trades remain under centralised control. The central management authorities generally come to the conclusion that decentralisation is necessary and that the regional managements should be given extensive powers.

In a confederated national economy the problem of allocating the quotas of a central cartel would be much more difficult to solve than it is in the case of a national cartel. We have already seen how many conflicting motives have to be taken into account in allocating production quotas to individual enterprises in a national cartel, while in a large international cartel such disputes are even more heated; for it is an obvious fact that both employers and employees complain much less when they are asked to make some sacrifice for the benefit of a home producer than when the same sacrifice has to be made for the sake of a foreign producer. International cartels are generally composed of the national cartels, and the principle that the home market should be reserved for the national cartel concerned is generally adhered to, export quotas therefore being the only bone of contention. But such disputes would be far more fierce should an international organisa-

tion control not only exports but sales on the home market as well.

For some odd reason, current discussion on the question of international cartels centres around restriction schemes in which the producers concerned are practically without home markets—as for example in the case of tin and rubber—little attention being paid, say, to the international coal or iron cartels, where the protection of the home market plays a large part. In commercial treaties also there is generally an agreement that one party is entitled to refuse important customs concessions to the other if the home industry can supply the market adequately. It is thus difficult to avoid the impression that planning on a world-wide scale, if not based on national foundations, would be incapable of tackling the difficult and complex tasks that would arise.

To a large extent central management must be bureaucratic and uniform, for only in this way can it be properly conducted. In this it presents a certain analogy to the banking system. Towards the end of the nineteenth century, the big banks with numerous branches began to overpower the provincial bankers. The latter, operating in a small area and being fully cognisant with local conditions, performed very varied tasks. When a branch of one of the big banks was opened in the same locality, it was obliged to limit its activities to those laid down in the regulations, and was subject to control from Head Office. It has been well said that if, at the beginning of the nineteenth century, Britain had been without the services of the provincial banker, and had had to depend upon the big banks and their branches, she would never have attained her present economic standard. Similarly it is sheer illusion to imagine that a central managing authority set over a number of states would be capable of clever and speedy decisions. We are, on the contrary, of opinion that it would merely be the scene of continual negotiations,



as difficult, tiresome and long-drawn-out as those with which we have hitherto been familiar in regard to commercial treaties. As we have already pointed out, it is difficult to determine even in a unified national economy what is required in the public interest; and the task would be much greater in a confederated economy.

The advocates of customs unions are apt to exaggerate the benefits of centralisation and the advantages of large-scale management and to underestimate the importance of the regional motive. After the last war, the value of national sovereignty was perhaps overestimated—and the reaction to this mistake is the present drive for amalgamation and centralised planning. It should not be forgotten that in the British Empire, which is a great economic and political block, the independence and individuality of the component parts is fully respected.

So far as I can see, no significant advantage would be derived from the formation of a customs union between the countries of Central and Eastern Europe. On the one hand, a system of mutual preferential treatment established in the whole area between the Baltic and the Adriatic and Black Seas—or, alternatively, a few smaller preferential blocks—would lead to economic rapprochement between the states in question. We have already pointed out that reductions in import duties are the more readily made if it is possible to eliminate the fear that third parties will, by reason of M.F.N. arrangements, also benefit.

The Treaties of St. Germain and Trianon recognised the right of Austria, Czecho-Slovakia and Hungary to make mutual customs concessions, not based on the most-favoured-nation clause. Again, M. Tardieu's plan of March 2nd, 1932, envisaged a system of mutual preferences between Czecho-Slovakia, Austria, Hungary, Yugoslavia and Rumania; but Germany and Italy opposed this plan at the London conference in the same year.

Later on, Italy used the so-called Rome Protocols as the

basis for a system of preferential customs duties between herself, Austria and Hungary. These preferences were, however, of a secret character, being operated through the chambers of commerce in the respective countries. It is thus apparent that important economic and political uses can be made of preferential treatment. Having first joined with Germany in protesting against the grant of preferential treatment among the Danubian countries, Italy later introduced such preferences between Austria, Hungary and herself.

In the treaty signed with Czecho-Slovakia on March 7th 1938, the United States agreed to the introduction of preferential treatment between Czecho-Slovakia, Austria, Hungary, Yugoslavia, Rumania and Bulgaria.

One of the fundamental principles to be observed in connection with the proposed European preferential block is that no such preferences should be granted to Germany or Russia.

The League of Nations' publication "**Essential Statistics Regarding the Foreign Trade of the Danubian Countries**" shows that 30 per cent. of the combined imports and exports of Austria, Hungary, Rumania, Czecho-Slovakia and Yugoslavia before the war consisted of trade with other members of the same group. It is interesting to note that Austria exported more to Czecho-Slovakia than to any of the other three countries mentioned, and that Czecho-Slovakia exported more to Austria than to any of the others. This affords yet another proof of our contention that trade is more active between two industrialised countries than between an industrialised and an agricultural or raw material-producing state.

Broadly, Yugoslavia, Hungary and Rumania have similar exports. Yugoslavia exports timber, meat, pigs, eggs, maize, fruit and copper; Bulgaria's exports consist of tobacco, eggs and wheat, while those of Hungary include animals and poultry, maize and a certain amount

of machinery. But while the export trade of these countries is similar in general character, it may be noted that Rumanian exports include mineral oil, that those of Yugoslavia include copper and that Hungary also sells manufactured products. There is also a close similarity between these countries' import trade—for they all purchase textiles, iron products and machinery abroad. Hungary's imports also include coal and textile raw materials, which reflects the industrialisation of the country.

The export trade of Czecho-Slovakia includes various industrial products—often of high quality—besides coal and a certain quantity of iron; her imports consist of textile raw materials, metals and various manufactured goods. Poland aimed at building up a similar economic structure. Her main exports were coal, zinc, metal products, meat products and timber, besides a number of highly specialised manufactures such as high quality steel, locomotives, anti-aircraft guns, rayon, pharmaceutical products and nitrates. The quantities of these special manufactures sold abroad were not large, but were none the less noteworthy as an indication of what Poland had achieved during twenty years of independence. While Poland was partitioned between the German, Russian and Austrian empires, her products were generally poor in quality; even in Russian-occupied Poland the quality of the goods produced was inferior to what was turned out in the Moscow or St. Petersburg districts, owing to the policy followed in the allocation of government and municipal orders. A notable improvement in quality has, however, been achieved in recent years.

Czecho-Slovakian agriculture is carried on intensively and consequently at high cost, and her government could not therefore permit the unrestricted import of agricultural produce from other countries where farming was extensive and costs of production low.

All the countries mentioned tried assiduously to develop



their own industries, endeavouring to secure the assistance of foreign loans or credits. After the war Czecho-Slovakia will obviously not be in a position to grant credits to the other Danubian states as the wealthier creditor countries have been able to do.

Though an important importer of wheat in the days before the war, Greece did not obtain much of her supplies from the Danubian countries, but imported the bulk from America by the sea route; and this country is more inclined towards the Mediterranean than to the Balkan mainland.

Economic rapprochement between the countries of Eastern Europe can be achieved only gradually. Apart from the system of mutual customs preferences, to which reference has already been made, an important factor will be the allocation of import quotas—for it must be borne in mind that these impoverished countries will have to pay continuous attention to the balance of trade; in their relations with one another exports will be the principal means of paying for imports. A co-ordinated policy in regard to the export of coal, iron, copper and bauxite could be made to give satisfactory results.

It is difficult to decide whether one or more preferential blocks should be formed among the states of Central and Eastern Europe. Writing in the *Nineteenth Century* for September, 1941, President Benes has something to say on this subject. His remarks are the more clever for not being very specific. He says, "Smaller states will be united in larger units which are either federal or confederate, like the union now discussed between Czecho-Slovakia and Poland. There should be federal or confederate units in the Balkans, in Northern Europe and among the smaller states of Western Europe."

Again, the Czecho-Slovak Minister of State, M. Ripka, wrote in the *European Observer* for May 30th, 1941, that "The Baltic-Aegean area consists of three parts: the Polish, the Danubian and the Balkan. It might be worth

while considering whether the Balkan region might form a special confederation on a smaller scale, and whether there might be the closest measure of co-operation between Poland and the Danubian region, comprising Czecho-Slovakia, Austria, Hungary, and Rumania. Whatever may be the future aspect of Central Europe, it is certainly most desirable that, in any case, the closest possible co-operation should be arranged between Poland and Czecho-Slovakia. It is towards this aim that the efforts of the Polish and Czecho-Slovak governments in London, already during the course of the present war, are being directed." It would appear that Czecho-Slovak authorities would prefer Polish-Danubian relations to be more distant than is desired by some Polish politicians, who consider that the Polish-Czecho-Slovak federation should form the nucleus of a wider federation.

It may be conjectured that after the war the formation of a preferential block would not meet with disapproval. It is important in this connection that the United States agreed to the establishment of such a system in its treaty with Czecho-Slovakia in 1938. Experience has shown that political ties justify the formation of such preferential customs blocks. That, however, is not the most important point.

The principal members of the British preferential block—i.e., the Dominions—make commercial treaties on their own without reference to the Mother Country. London signs treaties only on behalf of the colonies. So far as the states of Eastern Europe are concerned, a matter of supreme importance is the regulation of their economic relations with their two great neighbours, Germany and Russia. The solution of this problem will depend in the main upon the attitude adopted by Great Britain towards Continental questions. If Britain recognises the necessity of dividing the Continent into three zones, as suggested at the the beginning of this chapter, then **Britain's attitude**

towards the preferential block just outlined will, ipso facto, determine that block's relations with Germany and Russia. It is surely unnecessary to add that the countries in question, with the probable exception of Czecho-Slovakia, would prefer British leadership to Russian.

The states of Eastern Europe have suffered a good deal in the past by reason of the fact that each of them has been weak *vis-à-vis* Germany. In the nineteen-thirties these countries tried to form themselves into a so-called Agricultural Block, which was to regulate matters regarding the export of agricultural produce, e.g. to Germany. The effort was a failure, however, because Germany refused to negotiate with these countries collectively. The Germans knew that they would be better situated to obtain favourable treatment for themselves if they carried on separate negotiations with each country than if they dealt with them as a block. This experience is quoted by way of example, though it should be pointed out that in our opinion exports of agricultural produce from the area in question will diminish as the countries concerned are industrialised. Incidentally, when the agricultural exports of Eastern Europe are under consideration it should not be forgotten that Greece imports large quantities of wheat from America in normal times. It is of considerable importance that these countries of Eastern Europe should have a common representation in negotiations regarding international cartels. As they are bound for some time to come to have agricultural surpluses at their disposal, the formation of an agricultural block is clearly indicated, the main purpose being to achieve an understanding in economic matters with Germany.

The important economic problem of these countries therefore seems to centre around the question of finding a suitable part for them in the world economy; and the main object must be to enable them to play a role similar to that of Germany—as Czecho-Slovakia is doing already.



By thus raising Eastern Europe to West European economic standards, the relative importance of Germany will be reduced. If these countries are not politically threatened conditions will be created by which foreign capital will be able to flow in and develop this part of the Continent.

German reparations should be the means by which reconstruction work in the devastated states of Europe will be made possible. The mistakes made after the last war in regard to reparations have led to the present attitude, which almost regards reparations payments as the cause of the economic crisis. But, as we have already explained, the faulty policy adopted in regard to reparations was only one aspect of the faulty economic policy in general adopted by the creditor countries, and in particular by France and the United States. Had the latter continued to play their proper role as creditor powers the position would have been very different. The supply of German goods free of charge will not involve competition for the industries of other countries if they are used to start undertakings which would not have been able to purchase the necessary equipment at market prices. Many countries could still absorb German goods sent to them free of charge even if they received credits from the Anglo-Saxon powers. The better their equipment the more goods will they be able to purchase abroad, paying for their imports with exports of their own goods. It may be reiterated therefore that these countries should be developed with the aid of German reparations.

These reparations payments could theoretically be made in the form of consumption goods, such as textiles, shoes, etc., or capital goods, such as machinery and industrial equipment; but in fact they will have to be made mainly in the form of capital goods.

When the war is over it would be possible for machinery and apparatus of various kinds to be taken away from

Germany and brought to those countries which she has devastated. Such a move would weaken the German productive machine and strengthen that of the other countries; but it must be borne in mind that equipment thus acquired will be partly worn out. The question arises whether a single transfer of this type would satisfy the requirements of the countries which the Germans have laid waste; and the answer probably is that those requirements could be met only if the Germans supplied equipment over a period of at least a few years. However, to enable the Germans to supply the goods required it would be necessary to maintain suitable productive equipment in Germany. On the other hand, it must not be forgotten that the German engineering industry is one of the fundamental factors in the country's military power. The machinery used for civilian purposes may also be used to turn out military equipment; tanks, for example, can be made by the same machines which produce tractors. It follows that the only possible means of depriving Germany of the ability to produce military equipment would be to deprive her of an engineering industry capable of producing machinery; and, short of killing off all her mechanics and technicians, it is difficult to see how this could be done—for otherwise those who remained alive could construct a fresh apparatus of production. It is inevitable that the German will retain industrial equipment which could, if they so desired, be turned over to the production of armaments; and it must be noted that it is not so difficult to disguise the nature of productive equipment. A few years after the last war the Germans set about constructing armament works, which were, however, partly employed on the production of civilian goods. But in order that they might maintain idle equipment suitable for armaments production the works in question received government subsidies and remission of taxation. Some years ago a French colonel who was a member of the inter-allied commission which controlled

the disarmament of Germany industry told me how difficult it was to enforce the ban on the possession of equipment for armaments manufacture. On the other hand, the actual goods produced are much more difficult to disguise or hide, except for short periods.

Should it be discovered in the post-war period that the Germans have been producing armaments in defiance of the ban which is certain to be imposed, the question of sanctions will arise. Some economists believe in the efficacy of economic sanctions—e.g. in the possibility of a central economic board being formed with power to order that, if the terms of the peace treaty are violated, Germany will not be allowed to obtain certain raw materials which she may require.

The application of effective economic sanctions is impossible without blockade or some form of military action.

It thus appears that the only means of stopping the Germans from manufacturing armaments would be to apply military sanctions. A possible solution would be for the Rhine and the Oder to be occupied by Allied forces, the zones East of the Oder and West of the Rhine being demilitarised. This would greatly facilitate the application of military sanctions and would compel the Germans to abstain from the manufacture of armaments. It is perhaps worth noting here that certain German elements have advocated some kind of international control over German armament production, economic sanctions being imposed in the event of any contravention of the treaty provisions. By this means they seek to avoid any territorial concessions and the introduction of military sanctions.

The only real guarantee against further German aggression lies in military measures and territorial measures facilitating the imposition of military sanctions. For these to be effective the industrialisation of the countries lying to the East of Germany would be indispensable; for if the latter are not sufficiently strong their strategic advan-



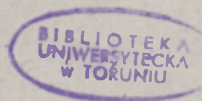
tage would be inadequate to obviate the danger of German aggression.

The fear that the imposition of reparations on Germany—payment being made in the form of equipment for the industrialisation of Eastern Europe—will lead to the strengthening of Germany's productive machine is, of course, quite justified; but in my opinion that is unavoidable. For this reason the recipients of reparations from Germany should receive them in the form of machinery etc., regardless of the fact that the equipment used to manufacture these goods would be capable of adaptation for war purposes. After all, the more the Germans supply to other people the less will they have for themselves; and in this way the countries which must reckon with the possibility of German aggression can be strengthened. Thus, in *The Future of Germany*, published by Political and Economic Planning, the suggestion is made that "reparations can and should be made by the Germans foregoing a certain part of their potential income to export gratuitously machinery and equipment, just as they are now foregoing it to export gratuitously bombs, torpedoes, and crashed Messerschmitts."

If they can be made industrially strong, the densely populated lands of Eastern Europe may become an important factor in the world economy. In the long run, numerical strength is the decisive element in politics; and over a hundred million people, if equipped with modern productive apparatus, would constitute a force that could not be ignored. It may be expected that when the war has been won the primacy of men and nations in their own homelands will be recognised. The object of economic policy must be to supply poor and unemployed populations with raw materials and industrial equipment.

It is therefore of crucial importance that Great Britain and the United States should grasp the political significance of the countries of Eastern Europe, which have

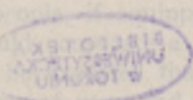
hitherto formed the area of German and Russian expansion. Let there be no mistake: if Britain should agree to territorial expansion on the part of Russia, this would inevitably lead to a German expansion into the same area.



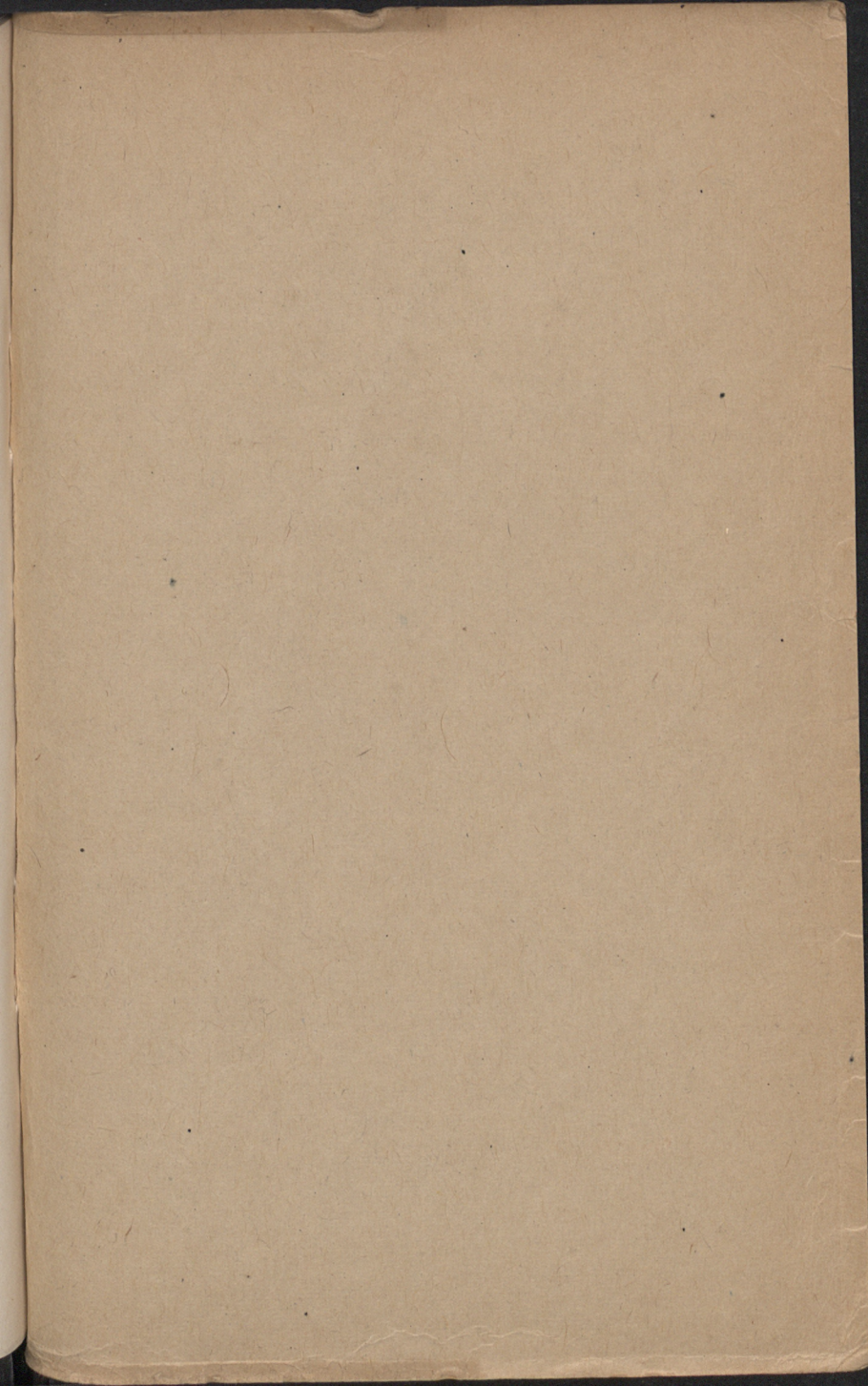
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