The Economic Basis of Reciprocity in International Trade.

"COMPROMISE," as a great political philosopher has said, "instead of being the dishonor is the test as well as the glory of practical Statesmanship." Reciprocity is a compromise between two great schools of economic thought---free trade and protection.

Free traders hold that State interference with the free flow of imports and exports will prove injurious to the trade interests of a country. According to them there are certain general laws governing the industry and commerce of nations, the contravention of which is an economic sin, and the price of transgression a diminution of the productive powers of the offender. A statesman's proper function is therefore to work according to the principles which underlie foreign trade and to aim rather at removing than placing impediments.

Protectionists on the other hand advocate restrictive duties on imports or on exports or on both when ever the trade interests of a nation or that of any class in it are endangered by the aggressiveness of foreign competition. The well being of a nation is a greater consideration than national wealth. The calculation of mere mercantile losses and gains seems to them a mean and sordid occupation for those to whom the destinies of a nation are entrusted; or as Bacon would put it, "a consideration of power" should be preferred to "a consideration of plenty."

Those who favor Reciprocity in the exchange of national products regard these two views as the "Antithesis of controversy," which arises out of the abstractions of mere theory on the one side, and the prejudices of nations on the other.

All the English classical economists such as Adam

Smith, Ricardo, Mill and Cairns favor the laissez faire method, while the practice of most nations since the seventies has shown a strong prejudice of popular opinion in favor of protection.

To take one European country as an example of this divergence between theory and practice, we find that the whole life and literature of the French people during the nineteenth century was one continuous protest against restraints on natural liberty. The Dictionaire d' Economie Politique (Paris 1903) sums up the economic teaching of the period in one word Liberty; "All goes well where nothing is regulated." In economic practice however France is avowedly protective; so much that even protectionist Germany can point to her as a "protection-mad" nation.

All great trading communities, Great Britain excepted, are imbued with the "heresy of protection." There is Russia, United States, France, Germany, Australia, Canada, Spain. etc. This solid phalanx of national opinion cannot be disregarded by present day economists---Securis judicat orbis terrarum---and to quixotically attack it might be as hazardous as it would be inconsiderate to disregard it. On the other hand one should not be too ready to follow example for fashion's sake, for the possibilities of human stupidity are limitless and the introduction of protection may be due to far other causes than those of national welfare and social well being.

The classical economists, it is now generally admitted, owing to special conditions of their time were too much given to dogmatizing and universalizing, and although their arguments may be valid in the abstract they may fail to carry conviction in the consideration of concrete cases. It is possible for a stateman to conceive the beneficence of freedom of trade in a free trade world and yet to recommend protective measures in cases where the prospective advantages of free trade are counter-balanced by other considerations.

The tariff problem is one which must be dealt with on a balance of considerations. We have arrived at the stage where the casuistry of international trade must be studied as carefully as the first principles.

The talented Bastiat in his witty satire, "The petition of the candle makers against the sun," gives a lively refutation of crude protectionism. But there are times when one need not put out the sun to create the utility of candle light.

Having suggested the possibility of error in hasty generalizations and one sided views on the complex question of foreign trade, and before attempting to examine the "considerations" whereby a correct opinion may be formed, we shall for the sake of clearness in our analysis enquire what is the nature of international trade at all, and see wherein its principles differ from the rules and regulations of domestic trade.

In the economic sense a nation is a community of producers so sensitive in its organization and industrial equilibrium that labor and capital flow freely from one trade to another, and at the same time it is so segregated from other such communities by political, racial or other features that there is practically no transfer of these agents of production. In the "Economic Studies" of Walter Bagehot we find this definition implied in the following words: "English political economy, as we know, says that capital fluctuates from trade to trade within a nation and it adds that capital will not as a rule migrate beyond the nation." The restrictions which circumscribe the labor and capital of a nation may be natural or artifical; for our present purpose it is sufficient to recognize their existence. The difference in theory between domestic and foreign exchange depends on the ease with which labor and capital flow from trade to trade within a nation and the aversion with which they emigrate. The mobility of productive agents at home tends to equalize the profits and wages in all trades, for if there were any trade with high profits, capital seeking investment would flow into it till the profits were lowered to the level of other trades; labour too would seek it out in virtue of the increased production caused by the new investments and increased plant.

In domestic exchange therefore the prices of commodities depend on the relative quantities of labour and capital used up in their production. This is not the case in international exchanges as we shall see. The prices depend not on absolute but on comparative cost.

The raison d'etre of international trade is international gain. Some nations have peculiar natural facilities for some sorts of manufactures and are at a great disadvantage in the production of other commodities. It is to the advantage of such nations to concentrate their powers of production on commodities in whose manufacture they excel, and to barter these for articles which they can produce only at a comparative loss.

"The importation of foreign commodities in the common course of traffic never takes place except when it is economically speaking a national good, by causing the same amount of commodities to be obtained at a smaller cost of labour and capital to the country." (Mill's Principles).

Let A and B represent two countries. Let a unit of labour and capital in A produce 3 pairs of boots or 2 webs of cotton, and a unit in B 2 pairs of boots or 3 webs of cotton. It is quite clear that if A devotes its productive powers to boots and B to cotton both will gain by international exchange. A and B have an absolute advantage respectively in boots and cotton. Before trade two units in A produce 3 pairs of boots and 2 webs of corton, and two units in B 2 pairs boots and 3 webs of cotton, a total of 5 pairs of boots and 5 webs cotton. After trade two units in A produce 6 pairs of boots and two units in B produce 6 webs of cotton, a total of 6 pairs of boots and 6 webs of cotton.

International trade has increased the general productive powers of the two countries or rather has permitted their being more effectively applied.

It is quite evident from this illustration that anything such as freights, duties, etc. which hinders this exchange will render the productive powers less efficient, and cause a loss of that amount of productive power necessary for the home production of a commodity over and above what would be required to purchase it from abroad. In this way protection diverts industry from the more to the less advantageous employments, but as Adam Smith says, "What would be poor economy for a family can hardly be good economy for a nation."

We shall now take another case where one country has not an absolute but only a comparative advantage.

Suppose A produces with a unit of labour and capital 5 pairs of boots or 3 webs of cotton and that a unit in B turns out 4 pairs of boots or 2 webs of cotton. It is evident that A has an absolute advantage in both trades but a greater comparative efficiency in the manufacture of cotton, as B in boots.

This case is more confusing than the first and the argument more subtle yet none the less valid for international exchange. Let us reduce the terms to a common denominator. We find that it requires 4 units in A for the production of 20 boots but that A can manufacture with the same expenditure 12 webs cotton. In B 5 units of production are used up over 20 pairs of boots; this productive power if applied to cotton would furnish only 10 webs.

It clearly is to A's interest caeteris paribus to leave the boot manufacture to B, and concentrate its industrial power on cotton.

If B sends its 20 boots, the product of 5 units, to A, it can exchange them for twelve webs of cotton, which would require an expenditure of 6 units of production at home, B would thus economise to the extent of 1 unit of labour and capital.

Consider now A's side of the exchange: Let A export its 12 webs of cotton, the product of four units of labour, to B. Since B, according to our hypothesis, produces 2 pairs of boots at the same expenditure as 1 web of cotton, it can give A in exchange 24 pairs of boots---the product of 4 4-5 units of labour in A. As a result of exchange A saves 4-5 of a unit of production and B a whole unit.

We may look at it from another point of view. Before trade is opened up two units in A and two units in B produce 9 pairs of boots and 5 webs of cotton. After exchange if A produces cotton and B boots the same number of units turns out 8 pairs of boots and 6 webs of cotton. There is a gain of one web of cotton and a loss of one pair of boots, but the web of cotton in both nations is worth more than a pair of boots. It is worth 100 p. c. more in B and 60 p. c. more in A. This increase of production will be a benefit to both nations, for the gain will be distributed according to the comparative demands of either country for the products of the other. In the last method of working out the example, one might think that B would be at a disadvantage in the exchange, but a closer examination shows that this is not so.

If the demand for boots in A be greater than B's demand for cotton, A must give more cotton in exchange than it otherwise would. If the demand is very pressing the case may arise where B would gain all the advantage of the cheaper production, but outside of conditions of monopoly this is very improbable for before this point is reached other nations producing boots will come into competition with B in A's market.

In the working out of the examples we have left out of consideration the cost of transport and other trade expenses which must be deducted in practice to ascertain the net gain. Should it happen that the expenses of transfer counterbalance the gains, then the international exchange would automatically cease.

It may be pointed out here that the import and export duties of Protection by increasing the expenses of transfer tend to render the act of exchange unprofitable and in some cases prevent it entirely. As a result of this diminution or extinction of trade two effects follow:—firstly as was noted above the productive powers are directed to less profitable undertakings and so the economic efficiency of the country is partially destroyed, and secondly the cost of the protected article is raised to the consumer.

If the protected article be a manufactured product the difference of cost goes to indemnify the producers for waste of labor and capital, for ex hypothesi they are making a commodity for whose production they are not so well situated economically as the manufacturers in other trades which may have grown up under natural conditions. The result is a clear loss to the nation considered as producer and as consumer. We shall discuss later the results when the protected commodity is a product of agriculture.

The result of this analysis can be summed up in the words of Adam Smith: "No regulations of commerce can increase (Mark the word. It may influence or control the paragraphs on the matter in Laurier's speech of March 7th and Borden's of March 9th) the quantity of industry in any society beyond what its capital can maintain. It can only divert part of it into a direction in which it might not otherwise have gone."

The very fact that protection is necessary for an industry means that the article cannot be produced as cheaply at home as abroad; it means that the consumer pays more than he would if he were allowed to buy the foreign article; and lastly it means waste of national labour which were better employed in some other trade in which the country has an advantage or at least an equatity of opportunity.

So far, we have tried to explain the basis of the general argument for freedom of trade between nations. We shall now examine into some concrete cases where the balance of considerations seem to favor protection.

In the "Wealth of Nations," bk. IV, ch. II, Adam Smith makes the following concessions: "There are two cases in which it will generally be advantageous to lay some burden upon foreign for the encouragement of domestic industry;" "There are two cases in which it may sometimes be a matter of deliberation."

Of the two cases where it is "generally advantageous" the first is when some tax is imposed at home on the produce of domestic industry. Take for example the case of our excise duty on tobacco. All reasonable persons admit that at least an equal tax should be levied on the importations of tobacco in order to protect the home manufactory.

The second case of the expediency of protective tariffs has reference to national defence. "It will be advantageous to lay some burden upon foreign for the encouragement of domestic industry when some particular sort of industry is necessary for the defense of the country." This is not an economic but a political argument in favor of protection and has a very limited application. Such a case was the English navigation laws of the seventeenth century, which endeavored to give English sailors and shippers the monopoly of the carrying trade of the country in order to have always on hand an experienced body of men to man the marine and navy. France later tried to legislate a navy into existence but failed. There must therefore be a real probability that the proposed measures will attain their object, for this sort of legislation amounts to a tax on the country for the purpose of national defence and should it fail to achieve the aim of the legislator, the country would endure a loss and a privation.

Under this case comes the protected and subsidized manufacture of war equipments---artillery works, gun factories, ammunition supplies, etc.

We now come to a consideration of the less positive cases. The first case is where retaliation duties are imposed for the purpose of negotiating a freer trade with a nation which prohibits the importation of some of our goods. Two limitations are placed on this policy: firstly there must be a probability that the duties will prove effective in negotiating away the restraint, and secondly the tax on the consumer must be of the shortest duration possible, "for it would be a bad method of compensating the injury done to one class of the people to do another to almost all classes of the community."

There may be good policy in retaliations of this kind when there is a probability that they will procure the repeal of the high duties or prohibitions complained of. The recovery of a great foreign market will generally more than compensate for the transitory inconvenience of paying dearer during a short time for some sort of goods." (Wealth of Nations B. IV Ch II) Smith admits that the case cannot be governed by general principles but should be left "to the skill of that insidious and crafty animal vulgarly called a statesman or politician."

This seems a legitimate use of tariffs. It is supported by economists of great authority and is practised by almost all modern nations. Professor Gustav Schmoller of Berlin University, the leader of the German historical school of economists, values tariffs for just this very purpose.

"The new era of protection has arisen not because economists and statesmen have not been able to understand the beautiful argument of free trade, nor because a few monopolists and manufacturers have dominated the government; it has arisen from the natural instinct of nations. It arises from a motive which is rather instinctively felt than clearly understood, viz. that tariffs are international weapons (macht mittel) which may benefit a nation if skilfully used. Such tariffs (verhandlungs zollen) are weapons for negotiation---means to an end and not an end in themselves, and "they may as often as not be used unskillfully. And Russia, United States and France have fallen back on the extravagantly high protection system."

This was also the view of the tariff on farm produce taken by Sir John A. McDonald in introducing the tariff Act of 1878. It was intended as a weapon to cut down the high American tariffs of that day.

Section 6 of the tariff Act, after enumerating almost all the products of the farm, the dairy, the mines, the seas, and the forests, states "that they may be imported into Canada duty free or at a less rate of duty than is provided for by this Act. upon the proclamation of the Governor in Council, which may be issued whenever it appears to be satisfactory that similar articles from Canada may be imported into the United States free of duty!"

The history of the reciprocity question affirms with repeated emphasis that the negotiation function of tariffs was before the minds of all the "crafty and insidious animals" who have held power at Ottawa. In '68 Canada made a standing offer of reciprocity; in '69 Sir John Rose tried to barter a tariff for free trade, and similar attempts were made in '70, '71 and '74.

In 1890 United States shut out by the famous McKinlay tariff Canadian farm produce, and the following year Sir John dissolved parliament and appealed to the country on the question of "Restricted

Reciprocity." The country gave him a mandate to negotiate with Washington, which he did and failed.

The restricted reciprocity programme of 1891 proposed maintaining the protection of Canadian manufactures but stood for reciprocity in farm products. Again the custom's tariff of 1894 introduced by Foster contains an offer of reciprocity in fish, eggs, pulp wood, apples, vegetables and grains.

This hurried survey is sufficient to show that our tariff on agricultural and forest products was introduced as a negotiation tariff, regarded as such by the Conservatives and Liberals for the past thirty two years and is now about to be used as such by the government of the day.

Before passing to the last of Adam Smith's concessions, we shall attempt an analysis of the economic results of the Protectionist policy on Canada's agricultural interests.

There is a great deal of confusion and vituperation in the arguments of those who oppose reciprocity. One class asserts there can be no real reciprocity at all between the United States and Canada because both countries grow the same natural products and manufacture the same commodities. A second class fears the American products will flood our market, lower the profits of our farmers, and cripple our agriculture. A third view again, diametrically opposed to this, takes the ground that the increased demand of the larger market opened up will raise food values at home to famine prices and do untold injury to our labourers and men living on fixed incomes.

Such sweeping and contradictory assertions are not likely to be correct. It is more probable that no acute affects will follow the introduction of reciprocity. One may look for a stimulus to agriculture on account of the larger market, for a slight rise in prices due to the increased demand for our food products near at home and for an elimination of seasonal fluctuations of prices, for there is less likelihood of a universal bad crop when the area of production is large.

It is calculated that 71 p. c. of the labour and capital in Canada is devoted to agriculture. It is therefore to the nation's interest to see to it that this preponderating share of its productive powers be under no disadvantageous restrictions.

To determine the incidence and affect of the protective duties on agriculture one must note two cardinal features of the matter; in the first place Canada is a food-exporting nation and in the second place agriculture is subject to the law of decreasing returns.

It is a very difficult thing to tax a foreign nation by a duty on imports. To make it possible at all two conditions must be fulfilled. The country imposing the duty must have a buyer's monoply of the taxed commodity. The absence of any other market renders it necessary for the producers to sell at any price within the limits of comparative cost, and so they may be willing to pay the import tax. There must be moreover an elastic demand for the imported article so that a slight elevation of price would be followed by a decreased demand. If the commodity be a necessary article of food people must have it at any price.

To show the difficulty of taxing the foreigner by import duties we leave it to the reader to find an example of a commodity fulfilling these two conditions. One thing is certain that our impost on American farm produce is not a case in point, for we not only do not constitute their only market but we do not even form a calculable portion of it. We ourselves are an exporting country.

Therefore the argument against reciprocity on the ground that the removal of our import duties on the natural products of the United States will cause a great loss of revenue is mere moonshine.

The McKinlay tariff of 1890 is probably a fair example of an attempt to make the foreigner pay the import tax. United States at the time was not indeed our only market, but no one who looks at the tables of Canadian exports for that year can deny she was our best market. On first consideration it would seem that Canada would be compelled, at the price of selling her products, to pay the duty, and in fact this was the principal argument in favor of the introduction of the McKinlay tariff bill and the Dingley bill of 1897.

The results have been far otherwise. The high price of food in the United States shows who is paying the duty and the growth of meat trusts and food trusts which come as a consequence of shutting out foreign competition is an example to statesmen, and Canadians particularly, of the danger of import duties on food products.

The duty proved injurious not only to United States consumers but to Canadian producers as well. Canada was forced to find another market at a great expenditure of money in subsidizing steamship companies, in building systems of cold storage, and in over coming the natural impediments of a long ocean transport.

Apropos of this matter of markets it is not quite clear why we should go on bearing an ever increasing burden of expense to gain a distant market if we can get one nearer home. The expense of transportation facilities is bound to increase with the growing volume of our exports and the shibboleth "gaining the English market" means nothing more than paying the price of the various agents of the carrying trade. We cannot gain it in any real sense of the term, for the English market under free trade is open to the competition of the world. The Argentine Republic, Australia, New Zealand, South Africa, Russia, and the United States all "gain it" in as full a sense as ourselves.

Why aim at removing natural impediments which circumscribe our markets and persist in placing artificial ones at the same time? Why attempt by reciprocity treaties to capture the distant markets of Europe---at what an expense---and stubbornly resist all efforts to "gain" the most suitable market we could possibly have under the sun.

Our considerations so far have failed to make any case for protective duties in so far as Canada is an importer of agricultural products.

For the few thousands of dollars which may have come into our treasury by import duties on the agricultural products of the United States which have trickled over the line, we have paid out millions to gain a market in Europe.

If we are seeking a revenue then by all means let us be business-like and balance the pros and cons of such a policy. A revenue tax should be placed on commodities whose demand is not likely to be lessened by the consequent elevation of price. The true financier aims at getting the maximum of revenue. But a retaliation duty which is avowedly protective, a hindrance to imports, manifestly does not conform to this rule of practical finance and offends against the fourth of Adam Smith's famous maxims, "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state."

"A tax may either take out or keep out of the pockets of the people a great deal more than it brings into the public treasury in four ways." Two of these may be mentioned as having special application to the present subject. (1) "The levying of the tax may require a great number of officers whose salaries may eat up the greater part of the tax, and whose prerequisities may impose another additional tax upon the people." (2) "It may divert a portion of the labour and capital of the country from a more to a less productive employment."

The above analysis of protection, we trust, has demonstrated that our import duties and the complementary duties of the United States have lessened the effective demand for our farm products,---and consequently lessened their price. Now lowered prices mean for the farmer low profits on his outlay of labour and capital and as a result he will not apply as much labour or invest as much capital in the land as he otherwise would. In other words the margin of production is higher, the poorer farms are not cultivated at all, the better not so well.

Just at present in some parts of Canada this description of phenomena is not borne out by facts. The exception proves the rule. We are considering economic laws. But an expensive immigration system and the offer of free farms must, except in a world cf fools, contravene for a time all economic laws.

Two tremendously important consequences arise from the alteration in the margin of production :---(1) rent with fall, and (2) production diminish. With what results? As the European landlord system is not in vogue in this country, a fall in economic rent means a loss to the farmers who own land above the margin of cultivation. The land on the margin of cultivation pays no rent to the owner, it merely recompenses him by its returns for the labour and capital. This phenomenon is spoken of as "economic rent," in contradistinction to the term as popularly used. "When the farmer is his own landlord there is no regular payment. Yet there is rent in the economic sense of the word, whether or not the land is owned by those who cultivate it" (Gide. Principles of P. E.) When there is a rise in the margin of cultivation owing to a diminished demand for the products of agriculture it means that this surplus return in the form of rent has been lessened, because the difference in degree between any certain piece of land and the margin is now less than it was before the elevation.

As this element of rent finds expression in land values, one of the results of protection is a net loss in land value to every owner of fruitful land in Canada, except the few who produce commodities, such as peaches, not intended for exportation. Products of this nature since they do not as a rule supply the home demand, enjoy on account of Protection a monopoly price.

The correctness of this argument seems to be borne out by the fact that farm land in New Brunswick near "the line" is selling for 33 p. c. less than contiguous farms in the State of Maine, though the former is the better land.

The second tendency of Protection is as we noted to diminish production, caeteris paribus. We find here again that in Canada uneconomic and lavish expenditure of public money in "gaining" European markets tends to suspend this phenomenon.

It is a truism of international trade that a country pays for its imports with its exports. "The notion that imports are paid by money which might otherwise be "spent at home" is the crudest of popular fallacies and ought no longer to need refutation." (Professor Ashley.)

How now can we buy our imports if our exports fall off owing to a diminished production? Some persons will be hindered from buying the articles of necessity or decency or luxury, and there will be no corresponding advantage to the revenue as a compensation for the nation's sacrifice of enjoyments. Not only therefore does protection injure the individual farmer, but it diminishes the wealth of the country as well; it is a sort of double-barrelled nuisance.

If the country is to go on giving bonuses to farmers to settle in our great west and subsidizing the carrying trade to sell the products of their toil and labour, we shall create a fictitious atmosphere around our staple industry which may bring ruin to the country in the future.

W. E. Cameron.

(To be continued)

SPRING-TIME.

The south wind sweet has come back to greet
Us again, and it breathes softly low :
Drove the winter away, brought sunshine and play
Over all the land with its airy hand—
Oh beautiful voice of Spring.

The rivers are brimming, now rumbling, now singing,
And their anthems are wild and free ;
Soon the violets will peep—awaked from their sleep,
Ope their cuplets fair to the balmy air
When kissed by the breath of Spring.

Hear the bird song once more—the sound I adore ;
It comes from the birch and the elm ;
The fields too are green, fairy censors unseen
Those sweet odors are sending, harmoniously blending
With the beautiful voices of Spring.

—L. L C.