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# Bilateralism, Trade Agreements and Political Economists in the 1930s: Theories and Events Underlying Hirschman's Index

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1. Ever since 1939, quantitative studies on interwar economic policy have emphasized the growing importance of bilateralism in international trade relations.<sup>1</sup> Bilateralism was the way trade relations survived and the vehicle through which trade restrictions and *ad hoc* discriminatory policies were imposed. As a consequence of the depression the average duration of trade treaties was significantly reduced, renewals or abrogations usually occurred at less than 12 monthly intervals, while all most-favoured-nation obligations were more or less formally dropped.

At a theoretical level too both the realistic free-trader and the ardent protectionist were often found united in advocating reciprocity as the optimal post-1929 trade policy, and the failure of ambitious multilateral Conferences gave credit to their opinion.

By the end of the decade international institutions were actively sponsoring scientific research on the nature of the new policy, and ambitious research-projects on exchange control, bilateralism and import restrictions were being launched. The starting point was the impressive amount of data collected by the League of Nations' economic and financial service, and the most distinguished international economists offered their assistance to unravel the changed nature of international economic relations.<sup>2</sup>

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<sup>1</sup> A useful quantitative survey of commercial policy based upon a study of over 510 bilateral conventions is R. SNYDER, "Commercial policy as reflected in treaties from 1931 to 1939", *American Economic Review*, December 1940, pp. 787-802.

<sup>2</sup> See, among the others, INTERNATIONAL CHAMBER OF COMMERCE, *Separate memoranda from the economists consulted by the Joint Committee on the improvement of commercial relations between nations and the problem of monetary stabilization*, Paris, 1936, whose final report was written by T. E. Gregory, D. E. Bohler, B. Ohlin, L. Pasvolsky, A. Predoehl, C. Rist; LEAGUE OF NATIONS, *World Economic Survey and Review of World Trade* (annual publications usually drafted

The idea of constructing a statistical representation of bilateralism after hundreds of bilateral agreements had been concluded, and of comparing it with the post-depression readjustment process, was advanced by Albert Hirschman, at that time a free-lance economic researcher with a specialty in the Italian economy, living in Paris.<sup>3</sup>

The results of his calculations — which are published hereinafter — revealed two rather striking facts.<sup>4</sup> First of all, the postwar acceleration in the trend toward bilateralism was not tantamount to achieving a second-best level of trade somehow stabilized around a new equilibrium. Bilateral barter negotiations and the collapse of international loans, direct investments and invisible transactions, had not eased the process of international readjustment. In the early 1940s, in fact, other economists integrated Hirschman's work and different indicators of bilateralism were examined in order to show how possible adjustment-related facilities — such as differential clearing rates, or the way clearing arrears were financed — had never been systematically analysed.<sup>5</sup> Hence, after 1929, the generalized

by J. B. Condliffe and F. Hilgerdt respectively); LEAGUE OF NATIONS, *Enquiry into clearing agreements*, II. Economic and financial, 1935, II. B.6; LEAGUE OF NATIONS, *Report on exchange controls*, II. Economic and financial, II.A.10, 1938; LEAGUE OF NATIONS, *Commercial policy between the wars*, II. Economic and financial, II.A.6, 1942; F. HILGERDT, *The network of world trade*, League of Nations, 1942.

<sup>3</sup> A collection of Hirschman's early works is now available in A. O. HIRSCHMAN, *Potenza nazionale e commercio estero. L'Italia, gli anni trenta e la ricostruzione*, a cura di Pier Francesco Asso e Marcello de Cecco, Bologna, Il Mulino, 1987. On Hirschman's early works and political activity, see also L. MELDOLESI, "Alle origini del possibilismo: Albert Hirschman, 1932-1952", in A. O. HIRSCHMAN, *L'economia politica come scienza morale e sociale*, Napoli, Liguori, 1987; and F. FERRARESI, "Laudatio", in *Notiziario dell'Università degli Studi di Torino*, n. 8-9, ottobre-novembre 1987.

<sup>4</sup> Hirschman's paper on bilateralism was part of an International Studies Conference on "Economic policy in relation to world peace" which met at Bergen at the end of August, 1939. The Bergen Conference was the ideal continuation of previous League of Nations Conferences on "The state of economic life" (Milan, 1931 and London, 1933), "Collective security" (Copenhagen, 1935) and "Peaceful change" (London, 1937). The President of the Conference was Frede Castberg, Professor of International Law at the University of Oslo, while the General Rapporteur was J. B. Condliffe who wrote the general report then published as *The reconstruction of world trade. A survey of international economic relations*, New York, Norton, 1940. A. Piatier, Secretary-rapporteur to the Conference, published the summary report on *Exchange control. A general survey*, Paris, 1940, while 82 case studies on single national experiments provided the factual outlook on the legal, administrative, economic and political factors which had influenced external economic policy. The materials circulated in mimeographed form, and most of the papers — Hirschman's included — were never published. Hirschman also contributed with a *Memoir sur le control des echanges en Italie*, now included in A. O. HIRSCHMAN, *Potenza nazionale e commercio estero*, *op. cit.* For a history of the Conference and for the List of Memoranda presented there, see J. B. CONDLIFFE, *op. cit.*, Appendix, pp. 395 ff. At Bergen the Programme Committee also invited economic experts to submit international studies of related interest. Among them, see L. BAUDIN, *Free trade and peace*, M. HEILPERIN, *International monetary organization*, M. J. BONN, *Wealth, Welfare or War*, H. J. TASCA, *World trading systems*.

<sup>5</sup> That the way the Great Powers successfully concluded clearing agreements was becoming incompatible with the process of readjustment either of financial or commercial arrears was a fairly widespread conclusion among the economists of the time who often pointed to a cause-effect relationship. See, besides Condliffe's book and the works there cited, C. BRESCIANI TURRONI,

tendency to engage in bilateral negotiations had not entirely coincided with a prudent desire to deal more directly with balance of payments disturbances and their effects on exchange rates, official reserves or hyperinflation. The suspicion grew that they were mainly directed at alternative targets which varied according to more general macroeconomic, microeconomic or merely political strategies.

The second and perhaps more unexpected result that Hirschman's indices showed was the rather uniform pace shared by such different policy-oriented countries in the trend toward bilateralism. Totalitarian Germany, which a rough knowledge of the 1930s literature has often identified with bilateralism, not only did not emblematically stand out to lead Hirschman's intercountry bilateral ranking, but throughout the decade systematically lagged behind her European rivals. Quite significantly Great Britain — the utmost upholder of multilateralism — had taken Europe's lead toward bilateralism: the very country that no less than three years previously had pompously replied to a League of Nations' inquiry that she could provide no useful information on bilateralism since "no clearing agreements had been concluded by H. M. Government".<sup>6</sup> In this respect, Hirschman's statistical calculations usefully supplemented an already accepted view that the "outstanding fact about British external trade policy since the adoption of full-blown tariff protectionism is its strong bilateral flavour".<sup>7</sup>

2. The reference to bilateralism as one distinctive feature which had characterized the new mercantilistic policy at the turn of the 1930s was indeed common among contemporary observers. Many economists shared Ohlin's view that, if compared to other stages of commercial history, "perhaps the most characteristic feature of international trade policy of the present day is the effort to balance the value of imports and exports from country to country". By the mid-1930s economists at the League of Nations — such as J. B. Condliffe and F. Hilgerdt — had already provided

"La funzione del regime aureo e del regime dei 'clearings' e la ricostruzione dei rapporti commerciali internazionali", *Giornale degli economisti ed Annali di economia*, luglio-agosto 1941, and P. NYBOE ANDERSEN, *Bilateral exchange clearing policy*, London, Cumberledge, 1946. Bresciani's overview goes back to Cournot's *Recherches*, where the additional constraint imposed through bilateralism first proved to be inconsistent with international equilibrium. For a history of how clearing rates were set, see Andersen, pp. 41 ff, whose closing remarks confirm how "it is not to be denied that the policy of clearing rates has got the lion's share of clearing discussions in the course of time. But at no moment can it be said to have constituted a predominant component of the clearing policy actually realised". Andersen also critically examined the various statistical attempts to measure bilateralism, Hirschman's included (pp. 68 ff).

<sup>6</sup> See LEAGUE OF NATIONS, *Enquiry into clearing agreements*, *op. cit.*, p. 9.

<sup>7</sup> See H. J. TASCA, *World trading systems. A study of American and British commercial policies*, Paris, International Institute of International Cooperation, League of Nations, 1939, p. 146. Subsequent statistical elaborations all generally confirm Hirschman's findings. See P. N. ANDERSEN, *op. cit.*, pp. 81 ff; M. MICHAELY, "Multilateral balancing in international trade", *American Economic Review*, September 1962, 685-702; P. FRIEDMAN, *The impact of trade destruction on national incomes. A study of Europe 1924-1938*, Gainesville, University of Florida Book, 1974.

useful insights on how the postwar trend towards bilateralism had been accelerated by the almost universal adoption of bilateral agreements.<sup>8</sup>

The measurement of its extent, however, required the solution of specific methodological problems. The League's index, for instance, identified reciprocity with bilateral equilibrium, an assumption which was unrealistic. By contrast, Hirschman's use of the standard deviation — as a method to quantify the pervasiveness of bilateralism — was by no means a neutral indicator of the new policy turn, being dependent on what had happened to the business cycle since 1929. In fact, the dramatic contraction of the levels of trade and their comparatively slower recovery after 1933 had probably caused by themselves a lower trade variance and a greater similarity between bilateral and global balances. Hirschman himself was well aware of the "proxy" nature of his calculations having made numerous references to it in his parallel work on the Italian trading system.<sup>9</sup> The influence of bilateralism could not be easily separated from the general evolution of international trade, while the tendency of bilateral trade balances to become more evenly dispersed around a more or less equilibrated path was probably the result of more structural factors which required further investigation.

In this perspective Hirschman's index of bilateralism must be viewed as a "work in progress". In fact the need for a more structural approach to the study of international relations, which would focus on intercountry preferences, the concentration of imports and exports, and commodity composition, may have offered to the author the occasion to relate the changing nature of foreign trade to the possibility of its manipulation through bilateralism and similar devices.

Whatever its "internal" history, and although it has never been published before, Hirschman's index is sometimes found to give statistical support to part of the literature on 1930s trade issues. This paper seeks to provide some historical "humus" for Hirschman's calculations. Widely borrowing from Hirschman's conclusions, we will first analyse some peculiar aspects of 1930s bilateralism; particular stress will then be laid on two so far rather neglected aspects: the way the British authorities adopted bilateralism as an instrument for influencing the country's economic and diplomatic policy; and finally what weight contemporary economists attached to this new commercial weapon and how much Hirschman's results contrasted with or supported the economists' interpretation.

<sup>8</sup> See B. OHLIN, "Report on the problem of international economic reconstruction", in Joint Committee, Carnegie Endowment, INTERNATIONAL CHAMBER OF COMMERCE, *International economic reconstruction. An economists' and businessmen's survey of the main problems of today*, Paris, 1936, p. 93. F. HILGERDT, "The approach to bilateralism. A change in the structure of world trade", *Index*, X, 1935, pp. 175-188; LEAGUE OF NATIONS, *World Economic Survey, 1935-36*, pp. 183 ff.

<sup>9</sup> A. O. HIRSCHMAN, "Memoria sul controllo dei cambi in Italia", in A. O. HIRSCHMAN, *Potenza nazionale ...*, *op. cit.*, pp. 221 ff.

3. In the 1930s the almost universal resort to bilateral trade agreements as the instrument of trade negotiations reaffirmed two recurring features in the history of economic policy.

On the one hand, as had often happened before with other protectionist measures, the success of bilateral trade agreements had nothing to do with the emergencies which favoured their introduction. While clearing agreements were first inaugurated by the Swiss-Austrian and Swiss-Hungarian treaties (November 1931) as the natural subterfuge to by-pass the post-1931 trade deadlock, prevent panicky pressures on the balance of payments, and rationalize the allocation of international liquidity,<sup>10</sup> they soon became part of a more complex strategy of import substitution, or extensively used as a means to impose upon one's trading partner the opening of new credits in times of virtual capital immobility.

Secondly, the trend toward bilateralism was further evidence of the highly creative powers of worldwide depressions. The 1929-1931 events can perhaps be considered as the most fruitful single source of institutional and administrative changes. And it is all too obvious to point out that such events were reflected in both a greater inventiveness in the use of policy instruments and in the rise of potential institutional needs that formed much of the basis for postwar innovations.

Indeed major changes in intra-European protectionism had made their appearance since the War, with an increase in the number of customs regulations and the failure of international cooperation plans; and even more numerous were the protectionist signals which pervaded postwar industrial relations. If however a comparison is made with the no less turbulent 1920s, we could generalize and say that traditional arguments had supported both the high supply of, and demand for, restrictive interventions. The highly active protection of the 1920s seems, in fact, part of a different protective cycle and mainly aimed at the safeguarding of numerous War-derived "infants", and at obtaining revenue, tax consumption, and labour-intensive goods. As to its instruments, wartime trade instruments were soon set aside and despite the exception of a few underdeveloped agrarian countries, 1920s real protectionism coincided with the reshaping of tariff policy and legislation.<sup>11</sup>

On the contrary, in the 1930s, the blatant comeback of wartime direct controls helped to introduce a new era of economic policy experiments where protectionism was more directly linked to the evolution of macroeconomic

<sup>10</sup> The technical inventor of the first clearing agreements was the President of the Austrian National Bank, Dr Reisch, who had first advocated them at the 1931 Prague Conference of Central Banks.

<sup>11</sup> On interwar protectionist practices and levels see, among other, H. LIEPMANN, *Tariff levels and the economic unity of Europe*, London, Allen & Unwin, 1938; A. ISAACS, *International trade, tariffs and commercial policies*, Chicago, Irwin, 1948; C. P. KINDLEBERGER, *The world in depression, 1929-1939*, London, Lane, 1972; and A. G. KENWOOD - A. L. LOUGHEED, *The growth of the international economy, 1820-1960*, London, Allen & Unwin, 1977.

magnitudes until, as the decade wore on, the faltering boundary that exists between trade and foreign policy was further narrowed.<sup>12</sup>

However, as the first pioneering studies were already beginning to reveal, a tendency toward bilateralism was so deeply entrenched in the network of world trade that its emergency-oriented interpretation needed to be dealt with cautiously.<sup>13</sup>

From a global perspective, as Hirschman's index also shows, all countries shared the trend toward bilateralism, despite the sometimes radical differences in the way their foreign exchange and import markets were regulated. This was probably the consequence of a long term structural development. Historically, multilateralism was something peculiar to a certain network of trade which the first three decades of the new century had seriously compromised. The diffusion of technology had brought about processes of substitution and economies in the use of raw materials which, it was feared, would have reduced purchasing power in important markets and increased the vulnerability of the industrialized world. The growing relevance of horizontal trade and the need for greater self-sufficiency in the face of international fluctuations were also potential hindrances to closer multilateral links.

Multilateralism also required high capital mobility and investment opportunities; and the War first and the depression later greatly interrupted the process of financial integration.<sup>14</sup> In this perspective, the reparations issue, the extreme volatility of short term capital, and the first alarming signals of a dollar shortage had greatly undermined the stability of multilateral trade relations; Britain's strategic surplus with the third world dramatically shrank in the 1920s and turned into a deficit in the 1930s, while developing countries were no longer performing a stabilizing role in international trade and suffered terms-of-trade deterioration due to the slow pace of recovery of world demand. To most European countries, the settling of international payments on a bilateral basis seemed, if not more convenient,

<sup>12</sup> As we shall later see in greater detail, the distinction between the micro or macroeconomic foundations of 1930s protectionism is difficult to assess. For instance, the history of U.S. tariff policy together with the making of its implementation would not necessarily lead us to agree that "the outstanding event in protection history and macroeconomics is often thought to be the 1930 Smoot-Hawley tariff". Cf. R. DORNBUSCH and J. FRANKEL, "Macroeconomics and protection", in R. M. STERN (ed.), *U.S. trade policies in a changing world economy*, M.I.T. Press, 1987, p. 79.

<sup>13</sup> See F. HILGERDT, "The approach to bilateralism ...", *op. cit.*

<sup>14</sup> In the search for a cause-effect relationship, Hilgerdt dated back to the 1920s European monetary reforms the spurt in the trend toward bilateralism. See F. HILGERDT, "The case for multilateral trade", *American Economic Review*, 1943, Supplement, pp. 400 ff. On the structure of foreign trade see also A. O. HIRSCHMAN, *National power and the structure of foreign trade*, Berkeley, University of California Press, 1945; F. HILGERDT, *Industrialization and foreign trade*, League of Nations, Geneva, 1945. On developing countries and the depression see A. J. H. LATHAN, *The depression and the developing world, 1914-1939*, London, Helm, 1981.

certainly less risky, and a policy of strict reciprocity was well suited to the changed nature of international economic relations.

Finally, as has more recently been argued,<sup>15</sup> multilateralism often needs a pivotal agent which, despite its more or less bilateralistic attitudes, can strengthen the transfer-links with its own injection of confidence and liquidity into the network, thus acting as a reference point for the survival of triangular relations. Even in this perspective the interwar years bear witness to both the British decline and the U.S. refusal to wed this cause.

Since the end of the 1930s, however, both contemporary observers and historians have put more effort into explaining the switch to bilateralism as a policy result where mutual consent is arrived at only after a strenuous bargaining process and the imposition of specific sets of rules. On welfare grounds — especially if bilateralism is modelled as a forced balancing of trade flows — their effects were clearly negative, as specific studies on German trade diversion have shown.<sup>16</sup> On the other hand, bilateral negotiations in their various guises were one of the few possible forms of trade in times when the formation of customs unions and regional blocs had turned out to be either unsatisfactory or vetoed by interested third parties.<sup>17</sup> As all international conferences failed, bilateral agreements were deliberately underwritten as a way of overcoming the impasse created by the lack of an international solution to the crisis; they then became the technical lever for implementing and perfecting the working of quantitative restrictions, voluntary export restraints and multiple exchange rates.

Therefore, although it is hard to distinguish between structural and policy-derived effects,<sup>18</sup> the trend towards bilateralism was, to say the least, reinforced as the device of last resort against the shrinkage of trade and

<sup>15</sup> M. MYCHAELI, *op. cit.*, p. 701.

<sup>16</sup> H. S. ELLIS, *Exchange control in Central Europe*, Cambridge, Harvard University Press, 1944; P. FRIEDMAN, "The welfare costs of bilateralism: German-Hungarian trade, 1933-1938", *Explorations in Economic History*, XIII, 1976, pp. 113-125, and L. NEAL, "The economics and finance of bilateral clearing agreements: Germany 1934-38", *The Economic History Review*, 1979, pp. 391-404. For a general equilibrium approach to bilateralism with some applications to the interwar economic history, see P. FRIEDMAN, *The theory and measurement of bilateralism*, University of Florida, Working paper, 73/09.

<sup>17</sup> Beyond other wellknown precedents, Belgium, Luxemburg and The Netherlands attempted in the early '30s to launch a Western European Customs Union. Their efforts, culminating in the Ouchy Convention (July, 1932), were frustrated by Britain's veto. See, among the others, W. McCLURE, *World prosperity as sought through the economic work of the League of Nations*, New York, Macmillan, 1933, pp. 320 ff; C. RIST, "The past and the future of the most favoured nation clause in its limited and unlimited forms", in INTERNATIONAL CHAMBER OF COMMERCE, *Separate memoranda ...*, *op. cit.*, pp. 118 ff; J. B. CONDLIFFE, *op. cit.*, ch. IX; NATIONAL INSTITUTE OF ECONOMIC AND SOCIAL RESEARCH, *Trade regulations and economic policy of the United Kingdom*, Cambridge University Press, 1943; and F. MACHLUP, *A history of thought on economic integration*, London, Macmillan Press, 1977. On British imperial preference, see the very detailed I. DRUMMOND, *Imperial economic policy, 1917-1939*, London, Allen & Unwin, 1974.

<sup>18</sup> Hirschman's index, however, clearly shows that accelerations of the trend (such as Great Britain's after Ottawa and Germany's after the four-year plan) were concomitant on specific policy events.



the deflationary pressures which the withdrawal of financial flows and the highly erratic fluctuations in the terms of trade had exacerbated. Given both the desperate need to reflate and the desire not to see the financial means thus created leave as capital flight, bilateral agreements generally operated through the imposition of an additional constraint upon the external economic relations of the two trading countries. Up to now many specific contributions on the most relevant bilateral clearing agreements have clarified the nature of bilateralism. To investigate the specific nature of this constraint — as well as the type of payments covered by different agreements — we would need to go beyond the object of this paper.<sup>19</sup> Here it is sufficient to broadly distinguish between the two different typologies of bilateral agreements which varied both according to the financial status of the more powerful players and according to the way British policy authorities controlled their international economic policy after 1931. At a later stage I will briefly analyse the spectrum of positions taken by economists on the bilateralization of international trade.

4. In the early 1930s traditional instruments of international economic policy were soon discarded as possible alternatives to bilateralism and exchange controls. Deflation — under the economists' Cassandra-like prophecies — had already burnt more than a few Prime Ministers' fingers and received only the lukewarm approval of some indomitable representatives of orthodoxy.<sup>20</sup> Because of the growing rigidities of the

<sup>19</sup> For contemporary histories of the various types of bilateral agreements — other than the contributions presented at Bergen — see P. EINZIG, *The exchange clearing system*, London, Macmillan, 1935; H. HEUSER, *The control of international trade*, London, Routledge, 1939; J. B. CONDLIFFE, *op. cit.*; M. GORDON, *Barriers to world trade. A study of recent commercial policies*, London, Macmillan, 1941. A good descriptive and theoretical account is given by P. NYBOE ANDERSEN, *op. cit.* For specific case studies we refer to H. J. TASCA, *op. cit.*; C. KREIDER, *The Anglo American trade agreement. A study of British and American commercial policies, 1934-1939*, Princeton University Press, 1943; P. FRIEDMAN, "The welfare costs of bilateralism ...", *op. cit.*; R. GRAVIL - T. ROTH, "A time of acute dependence: Argentina in the 1930s", *Journal of European Economic History*, 1978, pp. 337-378; L. NEAL, "The economics and finance of bilateral clearing agreements ...", *op. cit.*; T. ROTH, "Limits of leverage: The Anglo-Danish trade agreement of 1933", *Economic History Review*, 1984, pp. 211-228; and G. TATTARA, "An example of countertrade: The Anglo-Italian clearing", *Rivista di storia economica*, 2, 1985, pp. 115-154.

<sup>20</sup> Cf. F. MACHLUP, "Die theorie der Kapitalflucht", *Weltwirtschaftliche Archives*, Bel 36, pp. 512-529; L. VON MISES, *The return to a free foreign exchange market*, mimeographed Report to the Vienna Congress of the International Chamber of Commerce, May 1932, quoted by H. S. ELLIS, *Exchange control ...*, *op. cit.*, p. 9; and L. ROBBINS, *The great depression*, London, Macmillan, 1934. Subsequently Machlup criticised his article on the grounds of its dogmatic perception of the deflationary process and never let it be published in English. Hayek himself wrote an article to criticise the Brauns Committee's proposals to fight unemployment by means of credit reflation. In the paper — which was sent to the most distinguished scholar on the Committee, W. Röpke — he confirmed that, "apart from political considerations I feel you ought not — not yet at least — start expanding credit. But if the political situation is so serious that continuing unemployment would lead to a political revolution, please do not publish my article. That is a political consideration, however, the merits of which I cannot judge from outside Germany, but which you will be able to judge". F. HAYEK, *New studies in philosophy, politics*,

market, the low supply and demand elasticities, and the semiautomatic “goading into reprisal” effect, devaluation — where it occurred in real terms — proved to be too weak and short-lived.<sup>21</sup> Tariff policy, besides the difficulties in its effective determination, was limited both by its legislative encumbrances and by its low discriminatory potentialities. Inflation-phobia and the fear of an increased burden of foreign debt<sup>22</sup> further restricted the field to direct controls.

Not surprisingly, the chaos of financial and commodity markets led to the formulation of a “psychological” theory of exchange controls.<sup>23</sup> In Germany when the choice had to be made, the nightmarish 1922 vision is often said to have been the authorities’ main adviser: devaluation, hyperinflation and social upheavals stood on one side; intervention, direct controls and economic regimentation on the other. Nevertheless, in the midst of the financial crisis, Brüning’s policy was also subjected to more concrete conditioning. In fact there is some evidence that the temporary imposition of a “Devisenbewirtschaftung”, more than devaluation itself, was tolerated by foreign financial circles.<sup>24</sup>

Almost everywhere, bilateralism and *ad hoc* restrictions, as non-tariff barriers were to do after WW2, rendered administrative protection possible and greatly served to take the tariff-revising process out of the hands of the legislative body. The fixing of quotas, the issuing of licenses and the determination of exchange restrictions greatly augmented administrative responsibility and flexibility. In fact, trade agreements merely fixed general

*economics and the history of ideas*, Chicago, The University of Chicago Press, 1978, p. 271. From the same source we learn that Röpke rejected the article. Shortly after (1932) Hayek more bluntly reaffirmed the necessity for the system to thoroughly undergo the process of liquidation and reorganisation of the productive apparatus. See F. HAYEK, “Das Schicksal der Goldwahrung”, in *Deutsche Volkswirt*, 1932, February; n. 20, pp. 642-645 and n. 21, pp. 677-681, now in F. HAYEK, *Money, capital and fluctuations: Early essays*, London, Routledge and Kegan, 1984, pp. 118-135. Röpke’s suggestions were decisively anti-Brüning and supported Government investments at least as a first anticyclical measure. See W. Röpke’s recollection of the Brauns committee proposals in “Trends in German business cycle policy”, *Economic Journal*, XLIII, 1933, pp. 430 ff.

<sup>21</sup> More recent research has confirmed the view that devaluation did not work as an emergency measure. See A. CAIRNCROSS - B. EICHENGREEN, *Sterling in decline. The devaluations of 1931, 1949 and 1967*, Oxford, Blackwell, 1983. For early interpretations, see T. E. GREGORY, “Twelve months of American dollar policy”, *Economica*, May 1934, pp. 121-146 and S. E. HARRIS, “British and American exchange policies”, *Quarterly Journal of Economics*, 1934, pp. 471-510 and 686-726.

<sup>22</sup> In H. S. ELLIS’ interpretation devaluation was quickly dismissed on the simple grounds that in debtor countries “throughout exchange control history the ‘real burden’ argument has deterred devaluations or the recognition of *de facto* depreciation”. See ELLIS, *Exchange control ...*, *op. cit.*, p. 12.

<sup>23</sup> Cf. L. ROBBINS, “The fundamental reasons for increased protectionism”, in INTERNATIONAL CHAMBER OF COMMERCE, *Separate memoranda ...*, *op. cit.*, pp. 27 ff; W. GUILLEBAUD, *The economic recovery of Germany from 1933 to the incorporation of Austria*, London, Macmillan, 1939, and H. HENDERSON, “International economic history of the interwar period”, in *The interwar years and other papers*, edited by Sir H. Clay, Oxford, Clarendon Press, 1955.

<sup>24</sup> See K. BORCHARDT, “Could and should Germany have followed Great Britain in leaving the gold standard?”, *The Journal of European Economic History*, 1984, pp. 471-497.

commercial conditions whose "interpretation and execution was left in the hands of permanent officials".<sup>25</sup> France was a major protagonist of the turn towards neoprotectionism mainly because her anachronistic policy of duty consolidation needed to be bypassed with more flexible administrative devices; and Hicks talked about the lower incidence of tariffs and price instruments as the way the 20<sup>th</sup> century administrative, neomercantilistic revolution became possible.<sup>26</sup>

Financially weak countries or intermediate powers concluded bilateral agreements essentially for defensive purposes and as a device to maintain a certain amount of trade. Their use of clearings assured them against the fear of retaliation, excessive trade volatility, and the risk of capital flight, and allowed them to discount pessimistic expectations on the future of international trade.<sup>27</sup>

Both contemporary observers and historical reconstructions have put great emphasis on how Germany's economic performance was crucially affected by her trade offensive against South Eastern Europe. Generally speaking, through bilateralism, Germany aimed at the twofold objective of securing an automatic credit mechanism (achieved by freezing the partners balance in blocked mark accounts) and maintaining a high level of imports without suffering from the leakage of liquidity means into marginal areas.

Indeed, at least until 1937, German commercial policy was both fairly orthodox and far from being of dramatic importance. In any case, substantial claims by raw materials suppliers were created on Germany through clearings — the claims being later used when Germany had rearmament goods available for export.<sup>28</sup>

<sup>25</sup> J. B. CONDLIFFE, *op. cit.*, p. 270. On how such powerful bureaucrats viewed or retrospectively judged their "creature", see, for Germany, K. RITTER, "Germany's experience with Clearing Agreements", *Foreign Affairs*, XIV, April 1936; for Austria, R. SCHUELLER, "Commercial policy between the two wars", *Social Research*, X, 1943; and for Great Britain, F. LEITH ROSS, *Money talks. Fifty years of international finance*, London, Hutchinson, 1968, ch. XIV.

<sup>26</sup> Hicks himself had contributed as early as in 1931 to the understanding of non-tariff barriers describing their administrative potentialities in a detailed chapter of SIR WILLIAM BEVERIDGE (*et al.*), *Tariffs: the case examined*, London, Longmans, 1931, pp. 210 e ss. The need to understand the working of Import Boards and licenses is perhaps more evident if we quote Keynes' reply to an official questionnaire on the adoption of quantitative trade restrictions as a possible means to readjust Britain's accounts: "I do not yet know much about these. But I am attracted by the idea". See *The Collected writings of John Maynard Keynes*, vol. XX: *Activities 1929-1931: Rethinking employment and unemployment policies*, Macmillan, Cambridge University Press, 1981, p. 380.

<sup>27</sup> See the case of Holland, Belgium and other intermediate powers in H. TASCA, *op. cit.*; M. GORDON, *op. cit.* The greater stability of clearing trade relatively to world trade was in the 1930s a common feature of all different trading blocs. See the disaggregations provided by P. NYBOE ANDERSEN, *op. cit.*, pp. 73 ff.

<sup>28</sup> At least until Schacht was replaced by Goering, German protectionism had followed more old-fashioned paths than contemporary accounts often emphasize. The accumulation of frozen mark balances and the possibility of displacing local agriculture on behalf of Balkan producers, "were not regarded as beneficial by German authorities". See D. E. KAISER, *Economic diplomacy*

Counterintuitive though it may seem, many have observed that German methods succeeded in maintaining a higher level of commodity trade with a historically low record of capital mobility. Little attention was then given on the German side to the adjustment process; on the contrary, clearings allowed the country with an unfavourable balance to increase its liabilities, secure a forced loan, and bring forward all residual balances. In a period when her industrial capacity was both inward-oriented and expanding, the switch to bilateralism did not entail, therefore, the shrinkage either of loans or trading opportunities.

In this light, as a way of interpreting the economic meaning of Hirschman's results, a comparative analysis between German and British commercial policies, should be undertaken. This however would lead us too far, and a greater number of variables would need to be considered. In the case of Great Britain, however, clearing and payment agreements can perhaps be more easily isolated from the global political history of the 1930s, and simply considered as one instrument of self-protection. It is in this perspective that a specific analysis of how British policy-makers first viewed and then used the new instrument may help towards an understanding of how much of Hirschman's intercountry performance depended on the British "new deal".

In the study of bilateral agreements signed by creditor countries Great Britain has been the natural stereotype and contemporaries referred to it as the English system of clearing agreements.<sup>29</sup> Indeed, after 1931, when the attacks on sterling smashed away what was left of Cobden's legacy, Britain made such a resolute turn toward protection that many — perhaps unaware of Britain's more informal ways of dictating policy rules — have been surprised to see that "the quality of being a free-trade country did not hinder the ability to restrict imports afterward".<sup>30</sup>

However, as to bilateral treaties, the way the instrument was introduced within the administrative "gears" of British official policy was, as one may guess, not as straightforward as the German and even the Italian experience might lead one to think; on the contrary, until the failure of the 1933 World Economic Conference, the idea of deliberately abandoning multilateralism and the most-favoured-nation clause encountered remarkable opposition even outside City circles, and the British Government actively intervened

*and the origins of the second world war. Germany, Britain, France and Eastern Europe, 1930-1939*, Princeton, Princeton University Press, 1980, p. 131; moreover the ratio of blocked balances to German imports differed considerably according to the country, and Eastern European Governments by no means passively accepted the idea of having become creditor countries thanks to the financial "innovation": see A. BASCH, *The Danube basin and German economic sphere*, New York, Columbia University Press, 1943, pp. 216 ff; D. KAISER, *op. cit.*, pp. 140 ff; and R. J. OVERY, *The Nazi economic recovery, 1932-1938*, London, Macmillan, 1982.

<sup>29</sup> See J. B. CONDLIFFE, *op. cit.*, p. 154; H. W. ARNDT, *The economic lessons of the 1930s*, London, 1944; see also P. FRIEDMAN, *Impact of trade destruction on national incomes*, *op. cit.*, p. 30.

<sup>30</sup> P. FRIEDMAN, *Impact of trade destruction*, *op. cit.*, p. 45.

to hamper even such minor infringements as low tariff clubs and reciprocity.

The opposition to bilateralism first came from the Board of Trade which paradoxically rejected a policy which would have meant a sudden increase in its departmental powers and prestige; both in Parliamentary debates and in internal memoranda, its President often talked of the "pernicious effects of a system of clearing agreements". Bilateralism was an outright synonym for a smaller quantity of trade and, as was correctly anticipated, conflicts would arise between the servicing of bondholders and current commercial payments. Not without a polemical hint at his colleagues' policy preferences, Runciman adopted a "welfare approach" to warn that "if against our will we are forced to adopt clearing agreements, the effect upon the volume of trade is bound to be bad for everybody concerned. What strikes us is that undue attention is paid to the need for maintaining currency and too little to the need for maintaining trade".<sup>31</sup>

This view was also shared in Whitehall. The City-Bank of England intention to implement bilateral payment agreements as a means of collecting blocked credits was ostensibly opposed. As the Treasury economist, Richard Hopkins minuted to Chamberlain on the eve of the historical change, "the latter (Norman) is, I understand, meditating an alternative method of dealing with the German default and I imagine his plans will be ready before long ... I look upon a clearing arrangement with very mixed feelings. Throughout the world crisis we have strenuously opposed clearing arrangements on the grounds that they are injurious to world trade. They are always devised, as here, in the interest of the creditor and money lender and are generally hampering to trade, particularly entrepot trade which is one of our greatest national resources".<sup>32</sup>

Distinguished economic advisers too spoke against Britain's sympathy for bilateral agreements. The argument was delegated to a Committee on international economic policy whose first report appeared by the end of 1933.<sup>33</sup> Partially opposing official policy, economists advocated full liberty

<sup>31</sup> Public Record Office, Hopkins Papers, T/175/88, "Miscellaneous papers on the budget". Again in 1932 the Board of Trade felt that "Britain's trade was far too diversified and that if the most-favoured-nation instruments were abandoned discrimination against it might bring disaster". See T. ROTH, "Limits of leverage ...", *op. cit.*, p. 212. Further documents against a radical reformulation of trade principles are quoted in D. KAISER, *op. cit.*, pp. 90 ff.

<sup>32</sup> P.R.O., Hopkins Papers, T/175/84, "Monetary policy", letter from Hopkins to the Chancellor, 16.1.1934. In a recent article on the way London banks dealt with the German debts, Neal Forbes cites evidence that "a City source informed the Foreign office that more and more methods of payment outside the standstill seemed to have been found". See N. FORBES, "London banks, the German standstill agreements, and 'economic appeasement' in the 1930s", *Economic History Review*, XL, 4 (1987), p. 577.

<sup>33</sup> CAB 58/183, "Reports, proceedings and memoranda on International economic policy, 1932-1933". The members of the committee were C. Addis, Viscount Astor, B. Blackett, Lord Essendon, J. M. Keynes, W. Layton, A. Salter, J. Stamp, and H. Henderson. Also the Federation of British Industries — perhaps lest the Government bargained bilateral tariff concessions — manifested its doubts about clearing agreements. See T. ROTH, "Limits of leverage", *op. cit.*, p. 212.

in the formation of low tariff clubs with a redefinition of the most-favoured-nation clause in order to “prevent bilateral trade agreements from assuming an exclusive character, by ensuring the benefits of most-favoured-nation treatment to any country willing to adhere to the provisions of the agreement”. Finally regional agreements at the expense of unconditional multilateralism were likewise supported at the Bank of England, which took semi-official steps to investigate what direction British trade policy was taking. At the end of 1932, the economic adviser to the Bank of England, Harvard monetarist O. M. W. Sprague, contacted the *eminence grise* of international trade policy, Frank Taussig, on the possibility of using bilateralism as a tactical weapon against trade restrictions. Here is a rather interesting passage from his private correspondence: “The American Government and the British Board of Trade strongly support the [m.f.n.] clause but that is neither here nor there. Industrial and shipping opinion here is divided, with the balance of opinion leaning toward some modification. I feel the same way though rather uncertainly ... It has seemed to me at times that regional arrangements such as that proposed between Holland and Belgium might be a stepping stone in the right direction. Similarly with arrangements among the various succession states of Central Europe”.<sup>34</sup>

In any case, until 1933, despite both the protectionist turn and a number of exogenous shocks, Hirschman’s index for Great Britain is stable.

During the spring of 1933, coinciding with the devaluation of the dollar and the breaking up of the World Economic Conference, the British government reconsidered the whole matter. When the introduction of clearing agreements within British economy policy was imminent, with the delegation of operative powers from Parliament to the Government, F. Leith Ross — chief economic adviser to the Cabinet — suggested the compromise that “it will of course be desirable to explain that this country remains opposed in principle to bilateral clearings, that it is not intended that there should be any general or immediate use of the powers but that they are designed to place H. M. Government in a favourable position to obtain fair treatment”.<sup>35</sup>

Nevertheless between the summer of 1933 and 1935 new treaties were negotiated with Denmark, Argentina, Norway, Iceland, Sweden, Finland,

<sup>34</sup> Letter to F. Taussig, Bank of England, 19.XII.1932, Taussig Papers, Pusey Memorial Library, Harvard University Archives. Taussig’s detailed answer of January 6, 1933, strongly replied in favour of strict, expansionary reciprocity taking up the arguments that he was shortly to publish as “Changes in our commercial policy”, *Foreign Affairs*, II, n. 3, 1933.

<sup>35</sup> P.R.O., Hopkins Papers, T/175/84, “Monetary policy”: F. LEITH ROSS, *Memorandum on foreign trade and Finance Bills*, 9 May, 1934. As Paul Einzig observed “it is an open secret that the British Government is determined to avoid exchange clearings at all costs”. P. EINZIG, *op. cit.*, p. 113. Einzig supported his conclusion by noting that Leith Ross and Niemeyer were influential members of the League’s Committee that drafted the critical *Enquiry into clearing agreements*, *op. cit.*

Russia, Italy, Latvia, Lithuania, Estonia, Germany, France, Poland, Uruguay, Turkey, and South Africa.<sup>36</sup>

It is perhaps interesting to note that once the clearing act was finally introduced, spokesmen at the Board of Trade ceased to be critical of such an unprecedented novelty: "It is my opinion that foreign countries realize that we do not possess the power with which they have armed themselves and think it is not our policy to impose these powers, just as they appear to have imagined before the imposition of the tariff that the United Kingdom was definitely and forever a free trade country".<sup>37</sup>

5. The decision to lift most-favoured-nation obligations and sign bilateral treaties is perhaps easier to understand if it is seen in the light of the way British economic policy was devised once the forced abandonment of the gold standard had opened new possibilities for influencing the pace of economic recovery. The structure of the British economy was based largely on a few export-oriented sectors (banking, shipping, coal and textiles) and on a very promising building industry. New industries (electrical engineering, motor vehicles, chemicals etc.) far from constituting a "development bloc",<sup>38</sup> were growing at a rather modest rate and probably needed a more vigorous process of import substitution. Since domestic consumption was booming, while imports were low and international confidence in sterling again high,<sup>39</sup> the British government decided not to worry about the country's external accounts, placed a prudent embargo on gold exports and foreign capital issues, and happily started to experiment with such degree of freedom as the new instruments allowed.

Great Britain's early recovery in a still deeply stagnating international environment was basically cyclical and supply-sided. The expansion of demand depended mainly on the growth of domestic consumption induced by the terms of trade appreciation, and only the building industry provided a viable productive alternative to attract the net disinvestment of foreign funds. Neither heavy nor light sectors received immediate benefits from the industrial "rationalization" programme, and the Government, already

<sup>36</sup> For a detailed indication of British agreements, see, besides the already cited works by Tasca, Condliffe and Gordon, F. CAPIE, *Depression and protectionism*, London, Allen & Unwin, 1983.

<sup>37</sup> Unsigned minute sheet, Bt/11/274, quoted by TATTARA, *op. cit.*, p. 147.

<sup>38</sup> See N. K. BUXTON, "The role of 'new' industries in Britain during the 1930s: A reinterpretation", *Business History Review*, 49, pp. 205-222; B. W. E. ALFORD, "New industries for old?: British industry between the wars" in FLOUD and McCLOSKEY (eds.), *Economic History of Britain*, II.

<sup>39</sup> See A. CAIRNCROSS - B. EICHENGREEN, *op. cit.*, pp. 83 ff; S. HOWSON, *Domestic monetary management in Britain, 1919-1938*, Cambridge University Press, and *Sterling's managed float: the operations of the Exchange equalization account, 1932-1939*, Princeton Studies in International Finance, n. 46, November 1980; N. H. DIMSDALE, "British monetary policy and the exchange rate, 1920-1938", in W. A. ELTIS - J. W. SINCLAIR (eds.), *The money supply and the exchange rate*, Oxford, Clarendon Press, 1981.

actively involved in the merging process,<sup>40</sup> seriously considered the granting of selective incentives while still making faces at public works proposals.<sup>41</sup>

Real policy options at the Government's disposal have been scrutinized by recent research and confronted with the way unemployment was fought and the reconquering of British international prestige attempted. The public archival sources have also permitted a comparison with early interpretations.<sup>42</sup> In any case, whether we can retrace in British economic performance unexpected elements of Keynesianism or reaffirm the charge of "overcommitment" on 19<sup>th</sup> century values; whether we can talk of inner coherence and intellectual continuity or of fragmentation and "*ad hocceries*" of British economic policy, it seems indisputable that the Treasury was involved to an unprecedented extent in the destiny of the industrial system. With historically low interest rates, an unchanged faith in Britain's role on the world scene, and a strong bargaining power to throw on the scales, British commercial and international financial policy were thus important means that the government could resort to for reviving depressed trades.<sup>43</sup>

<sup>40</sup> L. HANNAH, *The rise of the corporate economy*, London, Methuen, 1976.

<sup>41</sup> The debate on the nature of British recovery is far from concluded. It started in the 1960s after the works of H. W. RICHARDSON, *Economic recovery in Britain, 1932-1939* (1967), and D. WINCH, *Economics and policy*, London, Hodder & Stoughton, 1969. For more recent references, see M. BEENSTOCK, F. CAPIE, and B. GRIFFITHS, "Economic recovery in the U.K. in the 1930s", *Bank of England Panel of economic consultants*, Panel paper, 23 (1984), pp. 57-85; D. N. WORSWICK, "Economic recovery in the United Kingdom in the 1930s", *Bank of England, Panel paper*, 1984; P. N. SEDGWICK, "Economic recovery in the 1930s", *Bank of England Panel ...*, *op. cit.*; S. BROADBERRY, *The British economy between the wars. A macroeconomic survey*, Oxford, Blackwell, 1986; P. K. O'BRIEN, "Britain's economy between the wars", *Past & Present*, 115, 1987; and A. BOOTH, "Britain in the 1930s: a managed economy?", *Economic History Review*, XL, 1987. On the role of economists in the shaping of Government policy, see S. HOWSON - D. WINCH, *The economic advisory council, 1930-1939. A study in economic advice during depression and recovery*, London, Cambridge University Press, 1977.

<sup>42</sup> A good summary together with an ample bibliography of the debate on British unemployment in the 1930s is now available in S. GLYNN - A. BOOTH, *The road to full employment*, London, Allen & Unwin, 1987.

<sup>43</sup> This argument finds little echo in recent literature. Some authors emphasize "the great importance of the external problem for Britain" (Booth) but largely focus on exchange rate and interest rate policy; many dismiss it on the grounds that the role of commercial policy in English recovery is either: hard to assess (Winch, Richardson, Broadberry, Glynn-Booth); simply a once and for all exogenous stimulus (Sedgwick); or negligible (Beenstock *et al.*, Cain-Hopkins); finally there are authors who more generally question the present of any active involvement on the part of British policy authorities and talk of "the Board of Trade's and the Treasury's long-standing prejudices against Government intervention in international commerce (that) virtually ruled out many steps to increase trade ... London's reaction to the German challenge shows how difficult it was to get the British Government to take any initiatives in commercial policy". (See D. KAISER, *op. cit.*, pp. 184 and 196). This view is also partially shared by Rooth who puts the blame on the Treasury: "there was no evidence that they (clearing agreements) were even subject to a rigorous assessment at Whitehall ... this may reflect a bureaucratic distaste for upsetting the status quo ... but by the late 1930s the Board of Trade and Foreign Office wanted their continuation with the minimum of modification" (T. ROOTH, *op. cit.*, pp. 227-228). Only the National Institute of Economic and Social Research regarded commercial policy as the National Government's "most successful feature" (see *op. cit.*, p. 12).



Although no clear line of demarcation can be traced between different forms of bilateral treaties British agreements, technically speaking, were not simply barter agreements, but payment agreements and the constraint was usually split between specific import quotas and a "sterling clause".<sup>44</sup> The latter was used to establish preferential links with exchange control countries, after the 1931 standstill agreements and the accumulation of commercial arrears had made the collection of frozen assets particularly difficult.

The *ultima ratio* of British trade policy coincided with the strategic safeguard of her socially most valuable assets, i.e. coal and sterling.<sup>45</sup> Like Germany, Great Britain showed no interest in securing through clearings the forced adjustment of her accounts, even when her deficit grew;<sup>46</sup> nor was she interested in promoting actions to stimulate world trade and reflate through a concerted widening of the sterling area. On the contrary, although acquainted with the use of new instruments, her policy appears predominantly backward-looking and still at the mercy of the so-called "overseas alliance" whose strength was undermined by the lower demand for her specialized international functions.<sup>47</sup>

<sup>44</sup> Rethinking British trade policy, D. H. Robertson wrote to Keynes: "whether the Danish sterling is or is not paid into some sort of special Account before being disbursed for coal is a matter of mechanism. In fact a trade agreement of this kind (which was the usual model of our agreements made in the 1930s) is *more* restrictive than our present payment agreements, for it stipulates that Danish sterling must be spent on *British coal* ... and not on *something British*". See *The Collected Writings of John Maynard Keynes*, vol. XXVI: *Activities 1941-1946. Shaping the post-war world. Bretton Woods and reparations*, edited by Donald Moggridge, Macmillan, Cambridge University Press, 1980, pp. 23-24 (letter of May 22, 1944).

<sup>45</sup> A great number of British agreements contained a provision giving Great Britain the right to denounce its obligations whenever the amount of British coal imported by the other contracting party fell below a specific percentage. Sometimes, as in the Polish agreement, a textile clause was undersigned. In her agreements with Scandinavia and Eastern Europe the minimum share of coal exports on a 1929 basis ranged between 47 and 85%. Coal exports with Scandinavia doubled in 4 years while those to Lithuania, from 8% in 1930 and 2% in 1931, reached 78.2% of her total imports in 1934. In exchange, Great Britain guaranteed fixed quotas for bacon, dairy products and timber. One of the best accounts of Britain's administrative machinery is the British Memorandum presented at Bergen, *British external economic policy in recent years*, 1939. The memo had been drafted by a Study Group formed by A. Plant, F. C. Benham, J. F. Cahan, A. G. B. Fisher, F. W. Paish, and P. A. Wilson. From a more general perspective the increase of British staple exports even brought about the introduction of exchange control measures on the part of her partners who were incapable of extending elsewhere their concessions to Britain: many countries set up import control agencies to compulsorily divert their trade into British channels and fill the subscribed coal quotas. See H. J. TASCIA, *op. cit.*, pp. 60 ff. See on this point, W. A. LEWIS, *Economic survey, 1919-1939*, London, Allen & Unwin, 1949, pp. 83 ff.

<sup>46</sup> Judging from the treaties that Great Britain signed between 1933 and 1936 the only valuable exception seems to be that with the USSR (February 1934). Article 3 provided that "the payments of USSR in the U.K. shall bear to the proceeds due the USSR in the year ending December 1934 the proportion 1:1.7; in the year ending December 31, 1935, 1:1.5; in 1936, 1:1.4; in 1937, 1:1.2 and subsequently, 1:1.1". See GREAT BRITAIN, *Treaty Series*, n. 2, 1934, Cmd. 4567 also quoted by SNYDER, *op. cit.*, p. 798. The agreement, however, hardly ever worked: see F. BENHAM, *Great Britain under protection*, London, Macmillan, 1941, pp. 133-134.

<sup>47</sup> "Unlike German clearings (British) agreements did not increase trade; if anything they

From the outset, Great Britain actively bargained to impose bilateral agreements and collect frozen credits, but did not believe in the promotion of additional exports through a policy "to force other countries to accept a greater quantity of British goods, even those countries whose balance was clearly negative".<sup>48</sup> Before the final approval of the Debt Clearing Office and Import Restriction Act (1934), which empowered the Cabinet to enter into agreements with individual countries, Leith Ross convinced the Chancellor that bilateral agreements were the only available device for freezing the proceeds of the sale of foreign imports and ensuring that they were applied to meet the claims of nationals of the exporting country.<sup>49</sup> As much as creditor nations had made the German transfer difficult, exchange controls had rendered the safeguarding of British fair trading practices virtually impossible. Even in her pure barter agreements, British current trade was heavily subordinated to debt collection. It was not infrequent that British exporters who had infringed Board of Trade directives to voluntarily restrain their trade relations with debtor countries, had as a consequence to face official negotiations that specifically cut British exports.<sup>50</sup>

In order to illustrate the different objectives of the leading nations, it may be useful at this juncture to go back to Anglo-German relations by describing the genesis of the 1934 payment agreement. Germany, who was both defaulting on her foreign debt and collecting free sterling, delayed negotiations with Great Britain as long as possible. Under the threat of a unilateral clearing, German officials made use of orthodox arguments to blame their own new instrument as having proved "ruinous to trade".<sup>51</sup>

tended to limit it". See D. KAISER, *op. cit.*, pp. 175 ff. On the City-Industry-Government nexus see J. CAIN - A. G. HOPKINS, "Gentlemanly capitalism and British expansion overseas. II: new imperialism, 1850-1945", *Economic History Review*, XL, 1987, 1-26, and J. INGHAM, *Capitalism divided? The City and industry in British social development*, 1984. Indeed, on her general manufactured trade, British agreements had little influence. Capie sees in that an indomitable faith in British competitiveness and in the most favoured nation clause, although a possible explanation may also lie in the Government bias for sterling and the old staple industries. See F. CAPIE, *Depression and ...*, *op. cit.*, pp. 129 ff.

<sup>48</sup> P.R.O., Phillips papers T/177/8, "International monetary policy", 27.10.32. See also the British Memorandum at the Bergen Conference, P.R.O., Leith-Ross Papers, "Correspondence with Schacht", Letter to Schacht, 25.10.1934, and the history of the highly favourable agreements successively signed with Argentina and Scandinavian countries which are analysed in the articles by Rooth and Gravel-Rooth quoted above.

<sup>49</sup> P.R.O., Hopkins Papers, T/175/84, "Monetary policy", F. LEITH ROSS, *Memorandum on foreign trade ...*, *op. cit.* Article 1 of the Bill did not differ very much from Leith Ross' statement: "in the case of any foreign country payment or transfer to persons in the United Kingdom subjected to official restrictions or prohibitions, or in the case they had been discontinued, a clearing office may be set up. The surplus in the hands of the clearing office had to be used to meet debts due to U.K. residents". The percentages varied according to the agreement.

<sup>50</sup> On these points see again H. TASCA, *op. cit.*, pp. 94 ff.

<sup>51</sup> P.R.O., Phillips Papers, T/177/20, "The Anglo-German clearing agreement", letter from F. Leith Ross to the Chancellor of the Exchequer, 21.10.34: "... They would like at all costs to avoid a similar experience with us as their sterling receipts represent the only free *devisen*

As the bilateral balance with Great Britain went progressively in her favour with no parallel reduction in her international indebtedness, Germany was forced into the agreement: "it seemed to him (Schacht) that the only reason for a clearing was our insistence on the Dawes and Young loans. These he could not pay and if we insisted that they should be paid then we should have to have a clearing as the only means of convincing us of our folly".<sup>52</sup> The agreement was signed and British holders of commercial bonds received preferential treatment at the expense of British bondholders.<sup>53</sup> To make it effective, despite all previous assurances, a credit of £750,000 was granted to Schacht. Both British bankers and Foreign Office officials reacted angrily.<sup>54</sup>

The final recovery-effects induced by British neoprotectionism are yet unclear despite the many attempts to gauge the effectiveness of specific measures.<sup>55</sup> As far as protectionism is generally concerned, macroeconomic historians have recently manifested their skepticism with regard to the long run effects of commercial policy. Many have asserted that the most tangible outcomes of traditional protectionism fall within the domain of political and diplomatic history,<sup>56</sup> and the history of 1930s trade wars could also be viewed in this light. As to its macro or micro effects, the everlasting

they have left and if these dried up under a clearing the whole situation would become untenable". Leith Ross is reporting a conversation with Dr Ritter, the German technician of clearing agreements: see footnote 25.

<sup>52</sup> P.R.O., Phillips Papers, T/177/20, "The Anglo-German clearing agreement", Letter from H. Phipps, 19 October 1934.

<sup>53</sup> Germany agreed to limit her imports to a maximum of 55% of her export proceeds. Of the remaining part, British creditors accepted a funding scheme; priority had to be given to the payment of commercial arrears with more than three months' delay. See F. BENHAM, *op. cit.*, p. 127. The agreement was amended in 1938 when the percentage assigned to the payment of German debts was replaced by a fixed sum (£ 4,500,000) which was liable to be raised or lowered if the excess of German exports differed from £ 7,500,000. See the British memo at BERGEN, *op. cit.*, Addendum, p. 11. Neil Forbes uses unpublished sources to illustrate the intense conflict that originated between the government and the London bankers on whether commercial credits or reparations bondholders should receive what was intermittently arriving from Germany. Apparently, throughout the decade, the bankers never succeeded in turning official policy to their advantage. See N. FORBES, *op. cit.*, pp. 571-587.

<sup>54</sup> See N. FORBES, *op. cit.*, p. 581. Although we cannot take it as representing the Foreign Office official position, at the beginning of 1934 Vansittart considered financial stringency "as the principal safeguard against wholesale German rearmament; and we should do all we can to keep Germany financially lean, even at a cost to certain people here. I have heard lately that there is a slight tendency in the City to increase lending to Germany. I hope this is not the case to any marked degree". P.R.O., Hopkins Papers, T/175/86, "Miscellaneous Correspondence, 1933-1935", From Vansittart to Warren Fisher, 6 January 1934. Since the summer of 1933, Sir Robert Vansittart — the Permanent Under-Secretary of State — believed war with Germany to be inevitable for Great Britain: see IAN COLVIN, *Vansittart in Office*, London, Gollancz, 1965.

<sup>55</sup> See D. WINCH, *op. cit.*; F. CAPIE, *Depression and protectionism*, *op. cit.*; and P. O'BRIEN, *op. cit.*

<sup>56</sup> See A. MILWARD, "Tariffs as constitutions", in S. STRANGE - R. TOOZE (eds.), *The international policy of surplus capacity*, London, Allen & Unwin, 1981, and F. CAPIE, "Tariff protection and economic performance in the Nineteenth Century", in J. BLACK and A. WINTERS (eds.), *Policy and performance in international trade*, London, Macmillan, 1983.

protection versus free trade controversy now appears, to say the least, redundant. Indeed macroeconomic history is sometimes an insufficient complement to industrial history, especially when — at a theoretical level — rent-seeking activities, market imperfections, and the search for strategic initiatives have gained ground as accepted economic rationales for protection.<sup>57</sup> If however we depart from structural models of growth and protection and concentrate on the policy process, we would conclude that in the new British protectionism it was the “ancient industry argument” which prevailed.

Thus, we may agree with many contemporaries that the British system of bilateralism turned out to be harmful both to British and world recovery;<sup>58</sup> we may also share the more optimistic view that British economic policy successfully reacted against the 1920s sacred “commitment” on sterling parity, while also maintaining that her interwar policy philosophy was “still the philosophy of the early 19<sup>th</sup> century”.<sup>59</sup>

When compared with contemporary tariff policy, the greater popularity of *ad hoc* bilateral restrictions seems, therefore, to depend upon its more direct links with those productive sectors which ultimately decided trade policy issues. Blind allegiance to the “coal clause” probably went as far as to penalise all “development blocs” and push the country toward imperial isolation.<sup>60</sup> Britain decided to fight exclusively against debt moratoria and

<sup>57</sup> For a recent overview of these aspects, see B. Eichengreen, “Macroeconomics and history”, in A. J. FIELD (ed.), *The future of economic history*, Boston, Nijhoff, 1987, and P. R. KRUGMAN, “Is free trade passé?”, *Economic perspectives*, I, 1987.

<sup>58</sup> See L. ROBBINS, *op. cit.*, D. H. ROBERTSON, “The future of international trade”, *Economic Journal*, 1938, pp. 1-14, and H. HENDERSON, *op. cit.* Even Keynes, in one of his few hints at direct controls included in the *General Theory*, said that “a policy of trade restrictions is a treacherous instrument even for the attainment of its ostensible object, since private interests, administrative incompetence and the intrinsic difficulty of the task may divert it into producing results directly opposite to those intended”. (CW, VII, p. 399).

<sup>59</sup> See A. W. LEWIS, *op. cit.*, p. 83. From the monetary standpoint, the management of sterling through the Exchange Equalization Account can in no way be compared to the early 1920s monetary policy and Treasury officials took no steps to prepare stable conditions for a return to gold. Continuity even in this sense has been, however, recently reaffirmed and Ham argues that “the gold fever in the Treasury did not die, as might have been expected, with the collapse of the world financial system in the early '30s ... The experts in the Treasury still continued to hanker after gold and after greater freedom for world trade and capital”. A. HAM, *Treasury rules. Recurrent themes in British economic policy*, London, Quartet Books, 1981, p. 56.

<sup>60</sup> During the negotiations with Germany, Schacht had assured Leith Ross that “he would also be ready to give specific quotas for any particular class of United Kingdom exports to which we attached special importance”. See Leith Ross to Chamberlain, 21.10.1934, P.R.O., T/177/20. In 1933 Great Britain had already agreed on an exchange of notes where Germany took an additional license of 180,000 tons of British coal per month (together with sliding scale adjustments if Germany’s domestic consumption increased more than 1% per month) to be exchanged against a 50% nominal rebate of duties on German chemicals and precision instruments. (See H. TASCIA, *op. cit.*, p. 56, and F. BENHAM, *op. cit.*, p. 134). This policy was wildly criticised by Parliamentary opposition (BT/11/310) and when six months later Italy — which like Germany competed with British textiles — applied for the same treatment and offered coal preferences in exchange for concessions on Italian textiles, the proposal was rejected. On these aspects, see G. TATTARA, *op. cit.*, pp. 123 ff, and F. CAPIE, *Depression ...*, *op. cit.*, p. 131.

took a rather equivocal role in the universal manouvres towards import substitution. By the end of the 1930s, opportunities to stimulate new exports and move away from an immiserising growth pattern appeared more unrealistic.

The success of British bilateral policies turned out to be limited and the economic recovery independent of the gains from trade. Even before the United States had imposed the first very restrictive commercial treaty on Britain, economists in Whitehall clearly perceived this flaw in British commercial policy. As early as 1933, when the country's agricultural policy had already been sketched out, Leith Ross directed heavy criticism at the way the Government had used the new policy instrument at the expense of both domestic and international readjustment: "the depression demanded readjustment of production which ought to have been made by restriction of production in the least efficient areas. Our quantitative restrictions of trade, on the contrary, have encouraged production in those areas and aggravated the necessity of readjustment. Vested interests have grown up behind these restrictions and completed the vicious circle".<sup>61</sup>

Therefore, what has been called the "tunnel effect"<sup>62</sup> — to describe the fact that, in times of development or resurgence, the increase of existing disequilibria may sooner or later generate gratifying side effects for the rest of the economy — may have been the unconscious hope hovering about Whitehall corridors. Despite Britain's lead in the recovery process, the export trades had not been able to absorb unemployment and re-establish competitiveness in British industry. Once world prospects seemed brighter, the chief economic adviser, Leith Ross, acknowledged that the Government had paid a heavy debt to traditional sectors, and had failed to exploit the gradual industrialization of primary producing countries and to decisively shift export subsidies to the new industries: "it is to these groups of industries (electrical engineering, mechanical, etc.) that we must look to replace the losses that our export trade has suffered by reason of the progressive closing of overseas markets to the goods of our older industries, and to the increasing competition of semi-industrialised countries, such as Japan ... we should help our new industries to develop the exports side of their businesses and encourage our export trades to maintain efficient organizations abroad and raise special funds to enable them to meet foreign competition".<sup>63</sup>

<sup>61</sup> P.R.O., Leith-Ross Papers, T/188/50, "World Economic Conference: Memo on import restrictions", F. LEITH ROSS, "International trade restrictions", January 1933, p. 35. A detailed account of the American agreement is C. KREIDER, *op. cit.* Tariff reductions on behalf of US exports were considerable thus reversing the tendency of the whole decade. In her previous agreements, Britain's concessions were negligible, and the mere threat of further upward revisions was successfully bargained against new privileges.

<sup>62</sup> A. O. HIRSCHMAN, "The changing tolerance for income inequality in the course of economic development", *Quarterly Journal of Economics*, 1973, then in *Essays in Trespassing. Economics to Politics and beyond*, Cambridge, New York, 1981.

<sup>63</sup> See P.R.O., Phillips Papers, T/177/24, F. LEITH ROSS, "Balance of Payments", 27.11.1936

It is also in this perspective that many authors, despite the many breaches with traditional orthodoxy and the deceptively active performance of the British economy, have found evidence of a substantial continuity in the targets of British policy which the end of laissez-faire did not substantially alter.<sup>64</sup> What was worse, as time went on, the failure of British bilateralism in stimulating economic recovery gradually acquired a political tinge. Britain's efforts to increase her trade flows towards Imperial and quasi-Imperial nations had occurred at the expense of a trade diversion from European commercial routes. By the end of 1937 there are signs that the widespread awareness of having specialized in the wrong commodity was dramatically reinforced by the fear of having chosen the wrong countries. For these reasons too, economic advisers warily suggested that the British Government should reverse policy and increase the dependency on Britain of European countries: "We cannot help feeling that Germany's task has been made easier for her than it would otherwise have been by our tariff policy which has reduced our imports from Europe by something like one half. Any modification in that policy which would tend to increase our trade with the Continent may thus have a beneficial effect politically as well as in the trade field".<sup>65</sup>

6. From a purely theoretical standpoint, bilateralism did not induce any major revision of the theory of commercial policy, and economists did not go beyond Scitovszky's statement that "bilateral trade agreements are a matter of higgling and bargaining and have little interest for the economist".<sup>66</sup>

The 1930s, however, had at various stages made economists reconsider the mechanical equivalence between commercial instruments, especially with respect to their different expansionary attitudes. Resource mobility also seemed to react differently and particular stress was put on the difference between tariffs on one side and quotas and exchange controls on the other.<sup>67</sup>

(pp. 17 and 23). Leith Ross basically endorsed the position of the Committee on Economic Information of which he was a member. In a memorandum on the "Coordination of trade policy" written in 1934, CEI strongly advocated rationalization in the exportables at the expense of the defence *ad infinitum* of traditional sectors. The report is now published in S. HOWSON - D. WINCH, *op. cit.*, pp. 292-319. Cf. in particular p. 307.

<sup>64</sup> See J. INGHAM, *op. cit.*, and P. J. CAIN - A. G. HOPKINS, *op. cit.*

<sup>65</sup> Comments by Phillips on a Report by the Interdepartmental Committee on Trade Policy, P.R.O., Leith Ross Papers, T/188/176, "United Kingdom, Trade barriers and trade policy after the interdepartmental trade policy committee, 1937", Phillips to Hopkins, 31 December 1937.

<sup>66</sup> Cf. T. DE SCITOVSKY, "A reconsideration of the theory of tariffs", in *Review of Economic Studies*, IX, Summer 1942, pp. 89-110, then reprinted in H. S. ELLIS and L. A. METZLER, *Readings in the theory of international trade*, London, Allen & Unwin, 1950, p. 378.

<sup>67</sup> F. GRAHAM, *Protective tariffs*, New York, Harper & Brothers, 1934; J. VINER, *Trade relations between free market and controlled economies*, League of Nations, II. economic and financial, 1943, II.A.4; G. HABERLER, *Quantitative controls of international trade: causes and nature*, League of Nations, 1943, II.A.5; for more recent reformulations, see J. BHAGWATI, "On the equivalence of tariffs and quotas", in R. E. BALDWIN *et al.* (eds.), *Trade, growth and the balance of payments*,

In the presence of foreign trade imperfections, this exercise in comparative efficiency which was later to influence the 1950s debate on direct controls and discrimination, led to a view of bilateralism and trade agreements as a more efficient method of intercountry discrimination.<sup>68</sup>

The economists' debate about bilateralism was basically centred on three aspects: first of all, a search for the devil who broke the golden "rules of the game" led to the rather sterile debate about who lit the first match: either the nationalistic and irrational moves of the mean creditor who, by restricting his own market, caused inevitable repercussions abroad; or the poor debtor countries of Continental Europe who, willing to default on an unjust treaty, switched to barter as the only possible form of trade relation.

The transfer question was often invoked as an explanation for German conduct,<sup>69</sup> and if in the 1920s the Treaty's *diktat* had placed the noose around Germany's neck, the explosion of the capital account strain on the one hand and the sudden U.S. withdrawal from granting further lending opportunities on the other, were the guilty material "hangmen" that put the classical mechanism of adjustment to death.

Where reparations and the movement of short term balances had failed, clearing practices and the forced accumulation of blocked balances had succeeded in becoming the aptest means of linking the transfer of goods to the settling of financial arrears. Thus German economists advanced the opinion that clearing agreements "were called by the foreigners, primarily to secure the payments of current trade debts, but also in connection with the German capital debts ... The system involves in itself the danger of leading to new German debts on current trade accounts".<sup>70</sup>

Chicago, Rand McNalley, 1965, pp. 53-67; J. BHAGWATI, "The theory and practice of commercial policy. Departures from unified exchange rates", in R. C. FEENSTRA (ed.), *Essays in economic theory*, vol. 1, MIT Press, 1983; and J. H. CASSING and A. L. HILLMAN, "Political influences and the choice between tariffs and quotas", *Journal of international economics*, 19, 1985, pp. 279-290 and the bibliography here quoted.

<sup>68</sup> As Scitovszky put it, a bilateral agreement "may be to mutual advantage if it supersedes protective tariffs, provided that it does not increase already existing exploitation but merely makes it more efficient. To the extent that it increases the degree of exploitation it turns political ascendancy to economic account by exacting tribute from defeated, conquered or intimidated countries. As such it is more efficient than, say, the reparations imposed in the Versailles treaties, because it presents no transfer problem ... it imposes tribute in a veiled form" (*op. cit.*, pp. 381-382). The argument had received careful examination in F. GRAHAM, *op. cit.* His starting point was that "protectionism exists only if discrimination exists. The real point at issue is how to discriminate and to what degree".

<sup>69</sup> Many would agree with Kindleberger's remark that Brüning adopted deflation and the control of exchanges as a means to get rid of reparations using as an excuse the foreign exchange bottleneck originated by the sudden shrinkage of foreign lending. See C. P. KINDLEBERGER, *op. cit.*, p. 174.

<sup>70</sup> Cf. F. SCHUMACHER, "Germany's present currency system", in A. GAYER (ed.), *The lessons of monetary experience. Essays in honour of Irving Fisher*, London, Allen & Unwin, 1937, p. 219. See also on this point F. MEYER, "Memorandum on an analysis of exchange restrictions at present in force in Germany", Bergen Conference, 1939.

The discussion then turned to the positive macro effects of bilateralism as the only conceivable policy for increasing the level of trade and decreasing global imbalances. A debate on the hidden orthodoxy of exchange controls and clearing agreements arose, and the common charge that they had caused a relatively greater collapse of trade found distinguished opponents.<sup>71</sup> Given political and psychological constraints, clearings were a subtle method of recognizing devaluation and opening adequate loopholes in the net of controls. Thus they were ultimately conducive to a more equilibrated situation in international relations already upset by incompatible exchange rate regimes and high global imbalances. German experts and a group of Oxford economists did not fail to recommend — even for “normal” times — the relief of implementing some sort of compulsory adjustment mechanism in times of deep-seated disequilibria; and as Balogh put it, international trade would be zero without the black bourses and clearing agreements.<sup>72</sup> From the Western front, economists acknowledged that the process of German exploitation of smaller countries proved to be “of little foundation”; and indeed an impetus to economic development and agrarian modernization of distressed areas has often been connected with the development of clearing practices.<sup>73</sup>

Theoretical contributions also reinforced the assumption that bilateralism could work as an expansionary device by minimising the leakages of the international multiplier. In times of depression, with low income effects and whenever the reaction of greater imports on additional exports is small, bilateralism could be employed to “increase domestic expansion, conserve the stimulating effects on income and protect the balance of payments by insuring that the full amount of the rise in imports is reflected back on exports”.<sup>74</sup>

Therefore, bilateralism was often described as a compulsory mechanism of international settlement, which would have restored barter equilibrium in presence of capital controls. This by itself would have solved adjustment

<sup>71</sup> W. RÖPKE, *German commercial policy*, 1934; P. EINZIG, *op. cit.*; P. JACOBSON, “Comment” to N. CRUMP, “The economics of the third Reich”, *Journal of the Royal Statistical Society*, II, 1939, p. 207; H. HENDERSON, *op. cit.*, and K. MANDELBAUM, “An experiment in full employment. Controls in the German economy, 1933-1938”, in *The economics of full employment. Six studies in applied economics*, Oxford, Blackwell, 1945. See also C. P. KINDLEBERGER, *op. cit.*, p. 238.

<sup>72</sup> See T. BALOGH, “Dynamics of adjustment. Monetary versus direct controls”, in *Unequal partners*, vol. I, Oxford, Blackwell, 1963.

<sup>73</sup> See LEWIS, *op. cit.*, pp. 83 ff. In effect Lewis reports a fairly widespread conviction that the network of clearing agreements had contributed to the reorganization of Balkan countries: see on this point B. OHLIN, “Report on the problem ...”, *op. cit.*; A. BASCH, *op. cit.*; Royal Institute of International Affairs, *South Eastern Europe*, 1939; T. BALOGH, “The international aspects of full employment”, in *The economics of full employment*, *op. cit.*, p. 151 and footnote. For secondary works see L. Neal’s and D. Kaiser’s already cited works.

<sup>74</sup> W. SALANT, “Foreign trade policy in the business cycle”, *Public policy*, II, 1941, reprinted in H. S. ELLIS - L. A. METZLER (eds.), *Readings in the theory of international trade*, London, Allen & Unwin, 1950. p. 210.



related difficulties which had fueled the international transmission of the depression.<sup>75</sup>

Economists and economic advisers, however, chose to investigate the more stimulating topic of the terms-of-trade effects which bilateralism was bringing about.<sup>76</sup> Indeed, not a few authors were tempted, in typical idealistic fashion, to divide the arena between "large" and "small" countries. Probably influenced by one of the theoretical novelties of the moment, a remake of the optimal tariff argument was carried out and Germany was often depicted as applying the theory of bilateral discriminating monopoly to her foreign economic policy thus forcing the foreigner to pay for her rearmament tax.

The starting point was — as Mandelbaum suggested — that at least theoretically "the system could be administered as to maximise the foreign revenue and secure the best terms of trade obtainable".<sup>77</sup> For all these authors, to increase the capacity of imposing forms of discriminating monopoly upon dependent countries was "the real *raison d'être* of bilateralism".<sup>78</sup>

<sup>75</sup> In contemporary textbooks we read that "bilateral forms of exchange control represented more strikingly by clearing agreements, tend to equalize the balance of payments between a pair of countries". See G. HABERLER, *The theory of international trade*, London, Hodge, 1936, pp. 89-90; and similarly Röpke asserted that it is "the main feature and the declared purpose of bilateral trade agreements to equalize trade balances and force one country after another to adjust its commercial relations in the direction of equalizing trade balances ... the tendency toward international economic disintegration contains also *compensatory and self-adjusting elements*". See W. RÖPKE, *International economic disintegration*, London, Hodge, 1942, pp. 40 and 62.

<sup>76</sup> The violent controversy among British economists originated by BENHAM'S book on *South Eastern Europe*, Royal Institute for International Affairs, 1939, is well known. See the articles by Einzig, Guillebaud and Benham himself, in the *Banker* 1940 and *Economica* 1940.

<sup>77</sup> K. MANDELBAUM, *op. cit.*, p. 185. Others in textbook fashion argued that "exchange control which maintains an overvalued currency will improve a country's terms of trade and increase its gains from trade. The essence of the action is monopolistic pricing of the currency relative to the price it would receive in a free market. The international market is thus exploited and a monopolistic nation's economic welfare is improved at the expense of others". (F. CHILD, *The theory and practice of exchange control in Germany. A study of monopolistic exploitation in international markets*, The Hague, Martinus Nijhoff, 1958, p. 82). And more appropriately "if she is bargaining directly with a foreign country, and can arrange a deal at a price which is above the world price for what she imports, but at a competitive price for her exports, she may still be better off on balance than she would be either if the deal did not come off at all, or than if she were to buy at the world price and ... had to sell in markets were it was necessary for her to subsidise her exports very heavily in the face of an inelastic demand". (C. GUILLEBAUD, *op. cit.*, pp. 158-159). While Ellis finally concluded that "Germany enjoyed the advantage of industrial exports and high terms of trade throughout the 30s". (ELLIS, *Exchange control ...*, *op. cit.*, p. 295).

<sup>78</sup> H. S. ELLIS, *Bilateralism and the future of international trade*, Princeton Essays in International Finance, n. 5, Summer 1945 then reprinted in H. S. ELLIS and L. A. METZLER (eds.), *Readings in the theory of international trade*, London, Allen & Unwin, 1950, p. 432. According to the German official representative at the Geneva conference on exchange controls, "exchange control represented a new type of monetary economy. The real difference existing between the two systems is that in one there is the influence of the Government in balancing the clearings and in the other the influence of the private entrepreneur in doing the same thing ... in Germany discrimination is official and in other countries it is private". Geneva Research Centre, Provisional

The great majority of experts, however, stood on the opposite side. Sometimes to their embarrassment, economists recognised in the small countries those who were receiving, through bilateralism, windfall gains from terms-of-trade appreciation at the more dynamic cost of a higher dependence on German trade. Later studies<sup>79</sup> have given their support to this latter interpretation.

This conclusion was also shared within the restricted circle of official economists in Whitehall. After all, the way Germany could impose her economic policy on South Eastern Europe never left British observers indifferent. Of course, at the outset, they may have felt the usual "sense of frustration that can be seen in the attention paid to the economic experiments elsewhere: 'if the excitement of trying to be active is forbidden to invalids by their doctors the milder excitement of watching others may still be permitted' ".<sup>80</sup> The Ottawa agreements, however, had specifically introduced the fundamental principle of bilateralism, and Imperial preference had no longer to be regarded as a concession but as a bargaining weapon to secure reciprocity. Once their trade creation effects proved to be negligible and the rich dominions turned away from British exports as a response to Britain's agreements with Scandinavia and South America,<sup>81</sup> official economic advisers, such as Hubert Henderson, did not restrain their admiration for, and perhaps envy of, German bilateral-led economic growth as compared to other illiberal stages in international economic history. Germany had managed to erect quite a consistent "trading body" that enabled her "despite her internal indebtedness and her lack of monetary reserves, to maintain and to increase the *volume* of her trade. It enabled her, in other words, not to buy cheap and sell dear, but to buy more and sell more. It is a mistake to suppose that her Nazi rulers set out to reduce Germany's external trade to a minimum ... a sufficient volume of trade is much more important than favourable terms of trade for a country in a weak financial position, but possessing a large industrial capacity".<sup>82</sup>

record of the Conference on exchange control, Geneva, May 12-13, 1939 (quoted by ELLIS, *Exchange control ...*, *op. cit.*, pp. 344-345).

<sup>79</sup> C. KINDLEBERGER, *op. cit.*, L. NEAL, *op. cit.* In a comparative fashion Alan Milward has suggested that "the sterling area and the Reichsmark bloc certainly provided better terms for their primary producer goods exporters than the multilateral agreements of 1925-1930". See A. S. MILWARD, *op. cit.*, p. 63.

<sup>80</sup> D. WINCH, *op. cit.*, pp. 199-200. Winch quotes from DALTON'S, *Unbalanced budgets*.

<sup>81</sup> See I. DRUMMOND, *op. cit.*, p. 310.

<sup>82</sup> Memorandum by Henderson later published in H. HENDERSON, *op. cit.*, pp. 268-269. We cannot therefore agree with Larry Neal's generalization that "to date, the economic analysis of the bilateral clearing agreements of the 1930s has been cast in terms of the monopoly-monopsony theory which was perfected at the same time ... Doubts did not occur in the analysis of this problem in the late 1930s, when it seemed that here was a perfect place to apply the recently developed tools of analysis of imperfect competition ... It is the residue of this misapplied analysis which remains in the textbooks of today ... The novel hypothesis offered here is that the bilateral clearing agreements offered them (East European economies) the best means available for financing economic recovery" (*op. cit.*, pp. 391 and 393-394). Apart from the ample margin of doubt on

We could thus say that many writers drew a distinction, as Hirschman did, between the trend towards equilibrium and the one towards bilateralism of commercial exchanges. For them, more than as an equilibrating or a restrictive factor, bilateralism had worked as a factor of growth: its adoption guaranteed the continuity and the stability of markets in a period of high political and economic fragmentation; it served to reduce uncertainty and risk, and shelter domestic recovery from external fluctuations. And it was widely acknowledged that “*purely from the economic standpoint there is much more ‘method’ in the German ‘madness’ than the critics generally give her credit for*”.<sup>83</sup>

Germany therefore did not act as a discriminating monopoly which charges differential prices according to specific market elasticities, nor were bilateral agreements devised to achieve a more perfect separation between intercommunicating areas; rather she proved to be more interested in the manipulation of other variables — such as the length of contracts or the quantity of raw materials — which helped the financing of her domestic expansion and rearmament.

Therefore, many shared the conviction that the ultimate rationale of direct protectionism was not the successful exploitation of existing market imperfections in strategic sectors. On the contrary, economists were more sympathetic with a macro-dynamic view of bilateralism as one discriminating device which could revive domestic demand under the working of price and exchange controls.

Also in this respect the bargains that Great Britain had achieved, of already doubtful advantage to the rationalization schemes of depressed trades, did not seem to be the proper policy to increase the effective demand for British specialties, and proved particularly deleterious to the reshaping of British financial supremacy. Despite its many advocates, it could not be taken as a model for postwar commercial relations. On the eve of Bretton Woods, Keynes repeated his preference for antidiscriminatory instruments that nonetheless could exert more powerful aggregate effects than the driving of specific bargains: “to suppose that a system of bilateral and barter agreements, with no one that owns sterling knowing just what he can do with it — to suppose that this is the best way of encouraging the Dominions to centre their financial system in London, seems to me pretty near frenzy. As a technique of little Englandism, adopted as a last resort when all else has failed us, with this small country driven to autarky, keeping to itself

the validity of the optimum tariff argument that one can find in Ellis, Guillebaud or Child’s works, the conviction was rather widespread that the “charge (of monopolistic exploitation) ... cannot be scientifically altogether maintained”. See T. BALOGH, “The international aspects ...”, *op. cit.*, p. 151; see also Mandelbaum’s rejection of the terms of trade argument (*op. cit.*, p. 186) and A. O. Hirschman’s treatment of the “influence effect” elaborated in *National power ...*, *op. cit.*

<sup>83</sup> C. GUILLEBAUD, *op. cit.*, p. 159.

in a harsh and unfriendly world, it might make more sense. But those who talk in this way in the expectation that the rest of the Commonwealth will throw in their lot on these lines and cut their free commercial relations with the rest of the world, can have very little idea how this Empire has grown or by what means it can be sustained".<sup>84</sup>

7. When Albert Hirschman set about writing his early works on exchange controls and the power policy elements inherent in international economic relations, times were ripe to reconsider exchange control and bilateralism as the instrumental catalysts around which regional blocs were developed and expansionary strategies pursued.

In this perspective Hirschman's statistical exercise, which gave a quantitative substratum to the Bergen research project, helped to undermine the still widespread fallacy that bilateralism acted as a buffer against wild terms of trade fluctuations and to roughly maintain a certain equilibrium in external accounts. Both the statistical and the qualitative evidence indicate that the need for safeguarding the balance of trade was shortly dismissed and basically used as the official justification for the introduction of new measures. *Other things being equal*, clearing agreements would, at best, have guaranteed the reciprocal equalization of payments and not that of trade. Moreover, the greater independence from the vagaries of the international business cycle, that many countries sought throughout the 1930s, allowed the needs of the domestic economy to be disposed of more swiftly. Commercial policy became more inward-oriented thus postponing the reduction of deep-seated external imbalances.

Complementary to this view and anticipating a major theme of *National power*, Hirschman's index confirmed that the nature of bilateralism was not inherently "teutonic", but part of a more universal desire to discriminate in the fixing and freezing of specific disequilibria, tending in the last instance to directly enforce "legal" imbalances. A similar perception had already been anticipated when the Enquiry on Clearing Agreements promoted by the League of Nations reached the conclusion that bilateral treaties were not used as a means to adjust the external accounts in a phase of liquidity crisis. Clearings, the argument thus ran, "have caused the balance of commodity trade to move in exactly the opposite direction".<sup>85</sup>

<sup>84</sup> *The Collected Writings of John Maynard Keynes*, vol. XXVI, *op. cit.*, p. 12. Originally a speech by Keynes in the House of Lords, House of Lords Debates, 23 May 1944. Often-quoted examples of this "little Englandism" are the clauses included in the Danish agreement whereby Danish bacon exporters were obliged to wrap their products in "jute woven in the United Kingdom from yarns spun in the United Kingdom" and that all salt used in connection with commodities exported to Great Britain (butter, ham, bacon etc.) had to be purchased in the United Kingdom. See also the chapter on administrative protection in the British memo presented at BERGEN, *op. cit.*

<sup>85</sup> LEAGUE OF NATIONS, *Enquiry ...*, *op. cit.*, p. 51. Furthermore, "experience shows, however, that over a short period, their effect is not necessarily to equalize the volume of reciprocal trade

As to its "democratic" counterpart, Britain's intention to regain the lost ground in the commercial battlefield appears clear, if we again look at the official records and read that "we have arrived relatively late and our quotas have to be of no general character but devised to control specific goods and hit individual countries".<sup>86</sup>

These conclusions can be linked to a certain extent to future developments in the history of ideas and facts. Hirschman himself probably found in it support for his future reflections that the search for vulnerable partners can be equally exerted by those who rigidly plan their international relations as much as by those who claim to leave the market to decide. The much-cultivated postwar desire to investigate more thoroughly the concept of dependency, and the manifold ways in which it is internationally exerted, can perhaps be ultimately traced back to the variety of responses that the same instrument had stimulated. Finally, the need to devise mechanisms for regulating and "taxing" asymmetric behaviour in intercountry relations may also find its origin in the 1930s history of bilateralism.

The factual lessons of bilateralism can be summarised in its greater comparative efficiency of flexible "end-use" or "by source" discrimination as compared to traditional ways of intervention. In this sense, the importance that the Great Powers had attached to these new protectionist expedients is perhaps clearer if we superficially look at the postwar history of commercial policy and negotiations. The lower incidence of tariffs together with the growing anachronism of GATT clash strikingly with the administrative innovations which have restricted international commodity and capital flows whenever a depressionary shock appears on the horizon.

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between two countries; in some cases it has, on the contrary, been to increase bilateral trade balances". (LEAGUE OF NATIONS, *Review of World Trade, 1935*, Geneva, 1936, II.A.14, p. 66).

<sup>86</sup> P.R.O., T/175/84, LEITH ROSS, "Memorandum on foreign trade and finance bills", *op. cit.* That the U.K. treaties contained comparatively more specific provisions than Germany or the United States for the organization and management of her quantitative restrictions was first emphasised by K. SNYDER, *op. cit.*