CHAPTER IV

The Effect of a Protective Tariff on National Wealth

§ 1

The Effect of a Protective Tariff on a Country's Export Trade

In discussing the protective tariff, a natural starting point is the question of its effect on the supply of goods brought from foreign countries. A purely revenue tariff is intended to have the least possible effect on the flow of trade. A protective tariff prevents goods from coming into the "protected" country, is, in fact, particularly intended so to do, by, in effect, fining the importers. Thus, a Canadian tariff on linen of 50 cents a yard may be said to fine the importers of linen to that extent. This discourages importation and so tends to decrease, in Canada, the supply of linen. In consequence of the decreased supply of linen in Canada, the price advances. Either it must advance by about the equivalent of the tax,[1] or the linen will not be imported. This high price, however, causes a falling off in the demand for linen brought from abroad, and a shifting of this demand to the home product. If linen from Ireland was $1.00 and cannot now be sold for less than $1.50, and if Canadians can manufacture it profitably for $1.43, the sales

[1] See, however, discussion in this chapter (IV of Part II), §§ 6 and 7. Cf. Ch. III (of Part II), § 3.

of Canadian linen in Canada will increase. Canadian production is thus encouraged, by government aid, to follow a line which it otherwise would not.

This purposeful interfering with importation disturbs the previously existing equilibrium of trade conditions. Canada, for a time, continues to export wheat or other goods, though refusing to import much linen. Gold, therefore, flows out of Ireland and into Canada. This raises Canadian prices and lowers prices in Ireland.[1] The prices, therefore, of goods which Canada has exported, *e.g.* wheat, may rise so high that the Irish and other foreign demand, if it does not cease, will at least grow smaller. Or, if some of these goods, such as wheat, cannot be sold abroad even in smaller quantities for a higher price than before, because of competition from other sources of supply, then the higher money cost of production in Canada will cause production for a foreign market to decrease. In the long run, by so much as a protective tariff directly limits imports, by just so much will it indirectly injure the levying country's export trade.[2] This is true whether the different trading coun-

[1] Or, if there is a general tendency for prices to fall, as from a more rapid increase of trade than of money, Canadian prices fall less than do Irish prices; while, if there is a general tendency for prices to rise, Canadian prices rise more than Irish prices. The essential fact is, that Canadian prices rise by *comparison* with Irish prices, while Irish prices fall by *comparison* with Canadian prices. It would complicate and make harder to follow our arguments to add this explanation in each chapter throughout Parts I and II, but the reader may, with advantage, bear it in mind.

[2] Whatever goods continue to be exported until Canadian prices have appreciably risen, would more probably be goods produced under conditions of increasing cost and goods in which competition from other sources of supply would not prevent Canadian sales even at somewhat higher prices than before. If all goods were produced under conditions of absolutely constant cost and could be secured equally well from other sources, if society were in a state of economic equilibrium, and if there were no economic friction, then Canadian prices could change only infinitesimally as a result of money inflow caused by the tariff. For

tries have a common standard of value, or unrelated monetary systems, or no monetary systems. The Irish manufacturers of linen will be forced by the more direct action of the tariff to seek markets elsewhere than in Canada. The Irish consumers of wheat will soon make use of the alternative, in case an inflow of gold into Canada raises wheat prices there (or, if the currencies are unrelated, in case more Irish money than before is required to buy a given amount of Canadian money), of buying their wheat elsewhere. The result, to Canada, is the loss of what had been a profitable trade.

The establishment of a few protected industries may serve to discourage or cripple many unprotected industries, for it means higher money prices and a consequent disadvantage to all lines of export trade. Among other things, the services of a country's mercantile marine may be regarded as exports of that country, in so far as these services are rendered to and are paid for by, the people of other countries. This, like other parts of a country's export trade, is affected unfavorably if the country follows the protective tariff policy. Besides the injurious effect resulting from the general rise of money prices in the protected country, on the exportation of any of that country's products, there is the special discouragement which results if the production of these exportable goods requires the use of machinery or raw material directly raised in price by a tariff upon it.

the least tendency to rise of costs would at once turn all producers away from lines of production for a foreign market in which prices could not be made to rise equally fast, and prices in foreign markets, of the goods in question, would not rise if the goods could be secured in larger quantity from other sources, at no greater cost than before. A protective tariff which prevented imports would immediately stop exports. Under existing conditions, exports would be correspondingly decreased by an import tariff only after an appreciable lapse of time.

A high export tariff, intended to prevent exports, would eventually, like a protective import duty, decrease both exports and imports, but the export duty would decrease exports first. The diminution of exports would mean a temporary net outflow of specie from the duty-levying country. Finally, prices in that country would be so low that its people would more largely supply themselves with desired goods and would buy less goods abroad.[1] It is not essential, however, that we should consider at length the effects of high export duties, because, while there have been examples of such, they have been much less common than high import duties, and are, at present, almost unknown.

§ 2

How a Protective Tariff Sets Up Unprofitable Industries at the General Expense

The fairly direct and practically immediate effect of a protective tariff is to raise the prices of protected goods by not more than the amount of the tariff. As we have seen, if Canada levies a 50 cents tax per yard on linen, to protect Canadian linen production, an almost immediate result is that Canadian linen manufacturers can charge more for linen than otherwise they would be able to. For the 50 cents tax has, as a first consequence,[2] that linen from Ireland must sell for $1.50 instead of $1 a yard. The tax, therefore, makes it possible for Canadian linen producers to charge prices (except as hindered

[1] With a combination of high protection on all importable goods, and high restrictive export taxes, the prices of protected goods would rise because of their greater scarcity, but there would be no rise of other prices due to inflow of gold nor any fall of prices due to its outflow.

[2] See, however, §§ 6 and 7 of this chapter (IV of Part II).

by competition with each other) higher in about the same proportion. Without the tariff protection, Canadian linen producers must sell for $1 a yard or less, if they would have the home market. If all of them were willing to do this, if employing manufacturers and their employees were willing to manufacture linen for an average return of $14 a week, or less, they could carry on a large business and perhaps almost monopolize the home market, even without a tariff. But the tariff, by compelling a rise in the imported linen to $1.50, enables the now protected Canadians to charge (say) $1.43, and still be sure of most of the Canadian market. Under Schedule K of the late Payne-Aldrich tariff law, it was found by the Tariff Board that an average duty of 184 per cent levied by the United States on 16 varieties of woolen fabrics, resulted in an average price for the home-produced goods 67 per cent higher than the price of like goods abroad.[1] The tariff has in this regard about the same effect as natural barriers and resulting high cost of transportation. Either natural barriers or the artificial barriers of a protective tariff act tend to make more difficult to get and more expensive in one country, the products of another, and, therefore, to enable the home producer to charge higher prices. The late Professor William Graham Sumner of Yale college called attention to the fact that, after the St. Gothard tunnel was opened, the people of southern Germany petitioned for higher taxes on Italian products so as to offset the greater cheapness made possible by the tunnel.[2]

The protective tariff on linen makes Canadian manu-

[1] Report of the Tariff Board on Schedule K of the Tariff Law, 1912, Vol. I, Part I, p. 14.

[2] *Protectionism*, New York (Holt), 1885, pp. 75, 76.

facture of the linen much more profitable than it would else be, since it enables the Canadian manufacturers to charge much higher prices. It therefore diverts a certain amount of Canadian labor and capital, from the production of wheat and from other lines, into the production of linen. As has already been suggested, if Canadians want to go into the linen making industry and take what the industry will yield them in open competition, they can do so without the tariff. But though they can, it is obvious that they will not. For, by our familiar assumption, a week's labor in Canada will produce 20 bushels of wheat, and will therefore earn, if wheat sells for \$1 a bushel, \$20. A week's labor will produce, however, but 14 yards of linen. If linen is but \$1 a yard or less, the week's earnings are but \$14. Without the tariff, therefore, Canadians can go into linen production if they want to, and they may be able to make a fair living at it; but they will not want to, for the reason that they can make very considerably more in another line, viz. the production of wheat. The tariff, by enabling them to get \$1.43 a yard or more, though at the expense of 43 cents a yard to every Canadian purchaser of linen, makes the business as profitable as the other, or more so, and induces some Canadians to take it up. A protective tariff, therefore, causes the development of an industry in a location or country where it would not otherwise exist, by making possible higher prices and correspondingly higher returns to that industry, and in that way alone. Under free trade conditions, the location of various industries within different countries is determined, as we have seen, by the principle of relative efficiency in production. The greatest profitable degree of geographical specialization results. Under protection, this specialization is purposely interfered with, and what industries shall be developed and maintained in the protective tariff country depends, in large part, on governmental favor.

The general principle of free trade follows directly from what we have learned of the benefits of international trade. Geographical specialization, so far as it develops naturally under free trade conditions, yields a larger total product than local or national self-sufficiency; and of this larger product the several trading nations secure each a share. Protection prevents this specialization, makes impossible the securing of the larger total product, and, therefore, makes the protected country in so far poorer.

To illustrate, consider again Canada's 50 cents protective duty on linen. Before the laying of this duty, the average Canadian could produce, in a week, 20 bushels of wheat, worth $20, and get, by sale and purchase, 20 yards of linen in return.[1] With two weeks of work, he could secure 20 bushels p us 20 yards. After the protective tax is laid, he is practically compelled to buy linen in Canada at $1.43 a yard. He can still produce 20 bushels of wheat in a week and get his $20, but for the $20 he can get only 14 yards of linen. Two weeks of work will net him 20 bushels plus 14 yards, which is 6 yards less[2] than if the tariff did not exist.

Neither can it be said that the Canadians who are tempted into linen manufacturing gain any more than, or as much as, the wheat producers lose. For we have seen that those who care to manufacture linen, employers and employees, can have all the business they want and all

[1] Minus cost of transportation, etc.

[2] Ignoring cost of transportation, etc.

the employment they want, without the tariff, if they will sell the linen at a low enough price, say $1 or less a yard, and take what the business will earn, as wages and profits, viz. about $14 a week (or perhaps, if they wish to keep linen from Ireland entirely out and monopolize the market, somewhat less). If the tariff enables them to get $1.43 a yard instead of $1, the best that can possibly be said for the tariff is that it gives the linen makers 43 cents for every 43 cents it takes away from the wheat raisers or others who buy the linen. If there is any way by which protection can give 43 cents to any protected interest, without taking at least 43 cents away from some person or persons buying the taxed article, the exact manner in which protection does this should be carefully set forth by defenders of the policy. The late Professor Sumner said:[1] "If Protection is anything else than mutual tribute, then it is magic."

But protection does worse than take from one person in the protectionist country exactly what it gives to another. In our illustration, protection does worse than take from the Canadian wheat producers exactly what it gives to the Canadian linen manufacturers. It takes *more* from the wheat raisers than it gives to those who become linen producers. The wheat raisers have to pay 43 cents extra on every yard bought, in order that the linen makers may receive $1.43 for what would otherwise be $1 worth of linen, or $20 a week in an occupation that would otherwise yield only $14. But, by hypothesis, they could earn $20 anyhow, if they would remain in the business of wheat production. Therefore, the people who do engage in wheat production have to lose $6 on 20 yards of linen in order that others may

[1] *Protectionism*, p. 160.

secure $20 a week at linen manufacturing, when these others could secure $20 a week in wheat production without taxing any one else. It would seem certain, then, that the taxed class loses *more* than the protected class gains, if indeed the latter class gains anything at all. What the situation amounts to, in our illustration, is that the people in one industry are taxed to encourage and keep going another industry which pays so ill that no one in the country would go into it if it were not favored by this policy. This is what Professor Sumner had in mind when he said that, by the whole logic of the protectionist system, the industries to be aided are "the industries which do not pay," [1] and that the process, so called, of "creating a new industry" means simply the taking of one industry and setting it "as a parasite to live upon another." [2]

Various facts brought out by the investigations of the Tariff Board would seem to show that the establishment in the United States by the protective tariff, of the wool manufacturing industry, has thus been the establishment of a parasitic industry at the general expense. We have already seen [3] that many woolen goods have been greatly raised in price because of the exclusion, by protection, of foreign goods. The home producers must receive these higher prices in order that they may receive, as a whole, as large returns as they might otherwise have secured in unprotected lines; in particular, they must charge these prices in order that the wages paid to employees may be high enough to keep the latter in the wool manufacturing business, and, therefore, that the wages may be as high as can be got in other employments.

[1] *Protectionism*, p. 48. [2] *Ibid.*, p. 45.

[3] § 2 of this chapter (IV of Part II).

Since wages in general in the United States are high and since American woolen manufacturing concerns seem to have no special advantages either in equipment or in efficiency of labor over their foreign rivals,[1] it follows that the cost per yard of woolen cloth made in this country is high. According to the estimates of the Tariff Board,[2] the cost of turning wool into tops is about 80 per cent more here than in England, of producing yarn from the tops about 100 per cent more, and of manufacturing the yarn into cloth from 66 to 170 per cent more, according to the kind of fabric in question. The effect of protecting the woolen manufacturing industry in the United States has been, therefore, that the consumers, that is, the Americans engaged in all other lines of industry, have had to pay much higher prices for woolen goods than would otherwise be necessary, merely that those engaged in the woolen industries might receive as high profits and wages as they could get even without protection in other lines of activity. Were it not for protection they would have been engaged in these other lines of activity, perhaps largely in the production of articles for export, in transportation, and in various commercial pursuits. Protection has drawn them out of these lines at a very considerable loss to the rest of the nation and with no appreciable permanent gain to them, if indeed they have not eventually shared in the general loss. It would appear certain, therefore, that in this instance, as in general, protection has imposed a cost upon those in unprotected industries, greater than any gain which it can be asserted to have brought to those in the lines protected.

[1] Report of the Tariff Board on Schedule K of the Tariff Law, Vol. I, Part I, p. 16.

[2] *Ibid.*, pp. 16, 17.

§ 3

The Effect of Protection on the Money Prices of Protected Goods and on the Money Prices of Unprotected Goods

For a brief time after a protective tariff is levied on imports, the protected country, *e.g.* Canada, will export about as much as if trade were free;[1] but such a flow of exports will not be continuous. When, as a result of the tariff, Canada diminishes its importations, there will be, as has been sufficiently explained, a net inflow of gold. Canadian prices rise as compared to foreign prices, and, if the amount of trade and other factors remain the same, rise in exact proportion to the increase of money. If, for any reason, prices do not at once become higher than before relatively to prices abroad, the gold inflow will continue until they do. And when, because of the increase of money, prices rise, this rise of prices will affect protected and unprotected goods alike. The increase of money, with no corresponding increase of other wealth, must mean rise of prices of other wealth, else, with the greater amount of money, the demand for this wealth would exceed the supply. And as far as the increase of money *by itself* is concerned, it would affect all prices in Canada to the same extent. The primary effect, then, of the assumed tariff, is to raise the price of linen, in Canada, from $1 to $1.43 a yard, while not affecting the price of wheat. The secondary effect results from the inflow of money.[2]

[1] See § 1 (and footnotes) of this chapter (IV of Part II).

[2] Cf. *The Purchasing Power of Money*, by Irving Fisher assisted by Harry G. Brown, New York (Macmillan), 1911, p. 94. In justification of the above mode of presentation, it may be said that the drawing of labor into the protected industry (linen production), cannot permanently raise the prices of unprotected

Suppose money in Canada increases, because of the tariff, by 10 per cent. Then the price of Canadian wheat, assuming it to be produced at approximately constant cost per bushel [1] regardless of whether somewhat less or somewhat more is produced, would tend to rise from \$1 to \$1.10 a bushel; [2] and the price of linen would rise, in addition to the rise directly occasioned by the tariff, from \$1.43 to \$1.57 a yard, *i.e.* in the same ratio as the price of wheat. How largely the prices of unprotected goods produced in the United States have thus been made higher by this indirect action of the tariff, it is impossible to say, but that the prices of many such goods have been so raised to some extent, we may reasonably conclude.

Here we are brought again, by a somewhat different route, to the conclusion that a protective tariff tends towards national poverty. For, while the increased quantity of money tends to raise all money incomes in the same ratio that it raises the prices of goods, and so tends to leave people in the same relative position; yet the original and special rise in the prices of the protected

goods, *e.g.* wheat, by decreasing the supply of these goods, unless there is this inflow of specie. For no one, by our hypothesis, will leave the production of wheat at \$1 a bushel unless he can get \$1.43 a yard for linen, and no one would leave the production of wheat at any *higher* price than \$1 unless he could secure *more* than \$1.43 for the cloth. But a rise of wheat above \$1 a bushel and of cloth above \$1.43 and of other things in proportion, could not take place without a changed relation between currency and goods, without, that is, in this case, an inflow of money metal. A continued foreign demand for the now less produced wheat might cause a rapid readjustment, but could cause such readjustment only through purchases of the wheat (or other Canadian goods), and, therefore, only by influencing the flow of gold.

[1] At the margin of cultivation.

[2] We are supposing that the inflow of money takes place to such an extent as to have this result, either because Canada continues to export wheat until the price of Canadian wheat has thus risen 10 per cent, or because Canadian exports of other goods, perhaps goods less subject to the competition of other sources of supply, do not at once cease.

goods is due solely to the greater scarcity of those goods and the greater cost of their production, and is not counterbalanced by any increase of money incomes. There is here a net loss. The country is poorer because of the tax.

If Canada has an inconvertible paper money, then the protective tariff will have the same primary effect but a different secondary effect. It will raise the price of linen from $1 to $1.43 without changing other prices. There will be no increase of money due to a surplus of exports. Linen will rise in price because of the greater cost of production required and the greater scarcity of it in relation to other goods and to money. But wheat and, in general, goods other than linen will not rise in price.[1] Instead of a general rise in money prices bringing eventual equilibrium by discouraging purchase of Canadian goods from abroad, this equilibrium will be brought by a change in the relative values of currency, of such a sort that it requires more foreign money to purchase a given amount of exchange on Canada or to purchase the gold equivalent of a given amount of Canadian money.[2]

As we have already seen,[3] a high export tariff would act in a way directly contrary to the operation of protection, on the flow of specie and on money prices in the tax-levying country. While protection causes an inflow of specie and a rise of money prices, high export duties would cause an outflow of specie and a fall of money prices. But in its effect on national prosperity, a high export tariff would not require to be thus sharply dis-

[1] Assuming production under constant cost.
[2] See Part I, Ch. VI, §§ 6, 7, 8, 9.
[3] § 1 of this chapter (IV of Part II).

tinguished from protection. It would, as protection does, turn industry out of its natural channels into less productive channels. The difference is that, while the method of protection involves a selection of industries to be established at the general expense, a high export tariff would secure the establishment of new and less profitable industries, indirectly, by preventing production for export in the industries most profitable. Export restrictions have been applied, in the past, along with restrictions on imports, to divert labor from a relatively large production of raw materials, into the manufacture of those materials. England's statutory law, from the time of Edward III through many generations, forbade the export of sheep or raw wool, while aiming to prevent importation of woolen cloth.[1] The desire was to stimulate the making of woolen cloth in England.

It is worth pointing out that a high tariff levied by a country upon its exports, affects that country as to money prices and general prosperity, in the same way as high import duties levied on the same articles of its production by all the countries with which it trades. A high export duty levied by Canada on wheat, would have the same effect as high import duties on this wheat levied by other countries; it is indeed equivalent to a combination of all possible consuming countries to levy such an import duty against Canada. Similarly, a high import tax, *i.e.* a "protective tariff," is equivalent to high export duties levied by not one only but all other countries from which the taxed goods might come.

[1] Levi, *The History of British Commerce*, second edition, London (John Murray), 1880, pp. 22, 25, footnote; also Day, *A History of Commerce*, New York (Longmans, Green & Co.), 1907, p. 215.

§ 4

Protection to Industries in which Large Scale Production is Advantageous

When a protected industry is one of those in which large scale production is advantageous, there are, as regards the carrying on of the industry in the protectionist country, two possibilities. The first possibility is that the encouragement and further extension of home production in that industry will mean home production on a larger scale than formerly, *i.e.* few, if any, more plants, but larger product turned out by each plant. If the tariff has this effect, it means cheaper home production than before, and, if the improvement is great enough, cheaper production at home than abroad.[1]

The second possibility is that the size of establishment having the greatest efficiency is, on the average, already

[1] There is another conceivable case, which may properly be mentioned at this point, where protection might really increase national wealth. Suppose a country to be carrying on only one or a few industries and to be the only country where these industries are carried on. Those engaged in them, however, we shall assume to be subject to competition from others in their own country. In such a case, a protective tariff which should divert labor into a line unprofitable without such aid, might so restrict the supply of the goods of which the country had a monopoly, as to raise very greatly the prices of those goods abroad and so increase the country's prosperity at the expense of foreigners. But unless the country had a monopoly of the industries from which labor is turned, it could not appreciably raise the prices of the goods by so doing, for the competition of other sources of supply would keep the prices down. Furthermore, unless most of the industries in which the protectionist country is engaged are industries in which it has a monopoly, the establishment of new industries by protection will draw from other lines as well as from the monopoly lines, and will therefore not so much decrease the supply of goods in the monopoly lines and not so much raise their prices. If a country has a monopoly of only one or a few lines and those not important, *and the situation is almost certain to be no more favorable than this to the protectionist country*, then the effect of protection will so little decrease the supplies of the monopolized goods as to have slight appreciable effect on their prices. In short, as things are in the actual civilized world, the circumstances under which protection can be reasonably expected to increase national wealth probably nowhere exist.

reached before protection is granted, or, if it is not, that lack of a tariff is not the difficulty. On this assumption, the imposition of a tariff would very probably result in an increase of the number of plants engaged in the industry within the protectionist country, but not in any saving through more efficient plants. By hypothesis, increased size of plants, beyond that already reached, is no longer a saving, or will not be brought about by protection. If the industry was being carried on within the country to any appreciable extent, before the adoption of a protective policy, a change in the average size of establishments, as a result of that policy, cannot be regarded as assured. In any case, the development of efficiency resulting from larger scale production must, if it is to yield any net gain to the nation in question, be so great that the desired goods can be secured at home more cheaply than they could otherwise be imported. Large scale production in other countries and purchase of the goods from them may, in practice, better secure the national welfare.

§ 5

Protection to Industries of Increasing Cost

When commodities for home consumption must be produced within a country under conditions of sharply increasing cost and, because of limited resources, under disadvantageous conditions at the margin of production, the opportunity to import these commodities from abroad is, perhaps, particularly to be desired. The policy of protection to the home production of such goods causes, in the protectionist country, production at an increasingly greater cost according as the protection succeeds in its object. Thus, Germany's policy of protection to agriculture, favored by the owners of agricultural land, undoubtedly means the production of food at a progressively higher cost in proportion as the protection is effective. A high tariff protective to English agriculture would probably raise the cost of food so high as to starve to death millions of the English people. An analogous consequence follows from protection to manufactures when the tariff wall safeguards the more inefficient plants against loss from foreign competition, compelling consumers to pay prices for the goods desired, which will remunerate the inefficient as well as the efficient home producers. Protection, then, forces consumers to get many of the goods they require, at greater cost, either because the production cost at home is uniformly greater, or because protection compels the use of the poorer soils, the poorer mines, the poorer sites, or because it compels the giving of patronage to establishments which are relatively inefficient.

But may it not be desirable, in case a country has a large export trade in goods produced under conditions of increasing cost, *e.g.* wheat, to establish manufactures by protection in order to draw capital and labor away from the poorer or marginal lands? Even here the protectionist policy involves a loss, though perhaps not so great a loss. It is only if and because even the poorest lands in use, following the terms of our illustration, yield 20 bushels or $20 a week in Canada compared with a possible 14 yards or $14 in the unprotected linen industry, that protection is required to establish the latter.[1] If it were more profitable than agriculture, even than agriculture on the poorer lands, it would be established without protection. If it requires protection, it is a less

[1] Cf. what is said regarding protection of this sort, in Ch. V (of Part II), § 5.

profitable business from the standpoint of the whole Canadian people, than agriculture on the best available land and, therefore, than agriculture on the poorest land actually used.

§ 6

Effect of a Country's Protective Tariff System on the Cost to it of Unprotected Goods Got from Other Countries

A protective policy, however, may conceivably give to the nation which enforces it, indirect advantages compensating in part or in whole for the losses incurred. Though the conditions under which such advantages would be at all comparable with the losses, could seldom if ever occur in practice, it is perhaps worth while to show what these conditions are. If Canada levies a high tariff on linen from Ireland, and, as a result, following the flow of gold to Canada, Canadian prices rise and Irish prices fall, then other goods, *e.g.* laces, silks, etc., may be produced in Ireland more cheaply than before. In practice, the effect would be more largely a rise of Canadian than a fall of Irish prices; for the fall of prices due to outflow of gold must eventually be distributed over many countries and would be slight in each, while the rise of prices would be felt in Canada alone. But, at any rate, since Canadians receive more for their wheat, the silk, etc., from Ireland (or other countries) can be better afforded than formerly.[1] If, therefore, the result of protection is that Canada receives more for her exports, and, while shutting out linen, gets certain other

[1] This point is stated in relation to the protective policy by Taussig, *Principles of Economics*, New York (Macmillan), 1911, Vol. I, p. 525. The principle is exactly the same as was shown to apply to import revenue duties by Mill, *Principles of Political Economy*, Book V, Ch. IV, § 6, and by Bastable, *The Theory of International Trade*, fourth edition, London (Macmillan), 1903, p. 118. Cf. also *supra*, Ch. III (of Part II), § 3.

foreign goods for a less price than formerly, so getting, for example, more silk than previously for a given amount of wheat, it is not entirely certain that Canada has lost greatly by her tariff policy.

Needless to say, this is not an argument for protection that would win it many votes. For a political campaign speaker to tell the voters of Canada that a proposed tariff will hinder a profitable trade and prevent their getting linen cheaply from Ireland, but that in consequence they may be able to buy silk somewhat more cheaply than before in terms of wheat, would not be likely to arouse any great enthusiasm. A more probable result would be a demand from silk manufacturers in Canada, or from would-be silk manufacturers, that they also receive protection. The rising money cost of production in Canada, and the tendency to falling cost in Ireland, would imperil the Canadians' home market. Especially would silk manufacturers in Canada be injured, if they had to use machinery or raw material directly raised in price by the tariff system. But if the silk manufacturing and other lines of production should also be protected, Canada would no longer gain from the protection of linen the indirect benefit suggested. The higher money incomes received in Canada are no advantage if they must be spent *in Canada*, where prices, counting prices of protected goods, have been raised even more by the tariff, than have money incomes. A consistently protectionist country can hope to realize this indirect gain from protection, only on goods not producible at home and, therefore, not protected. And the direct loss in higher prices of protected goods may be very great indeed. As we have already seen,[1] many kinds

[1] § 2 of this chapter (IV of Part II).

of woolen goods have been costing Americans some 60 to 70 per cent more because of the tariff.

In the actual commercial world, Canada is the less likely to realize much, at Ireland's expense (or at the expense of other countries), through this indirect action of the tariff, because Ireland (or any other country) has the alternative of trading elsewhere, and is not obliged to offer reluctant Canada bargains, in order to force a trade, except as Canada may have a substantial monopoly of the production of certain goods.[1] Canadians can get little, if any, more for wheat or other exported goods than before, else Ireland will refuse to buy. And rather than accept a low price for silk and other goods, Ireland may sell them elsewhere than in Canada. It is the more unlikely, therefore, that Canada will gain, thus indirectly, as much as she loses directly, through the tariff.

In so far as a protective policy results in a larger quantity of money and higher money prices in the protectionist country, it is likely to lead to a demand for a progressively higher and higher tariff. Assume, as before, a 50 cents duty per yard levied by Canada on linen. This at first makes linen cloth from Ireland \$1.50, while Canadian cloth can sell for \$1.43 and still yield as large a money return as the production of Canadian wheat. This enables a Canadian linen manufacturer to undersell his rival of Ireland by 7 cents a yard. But the flow of gold into Canada, resulting from the tariff, will raise, among other prices, the money cost of

[1] Even without a monopoly, if Canada supplied so much of the wheat used in Ireland and other countries that for them to substitute wheat from other sources would lower the margin of cultivation and raise wheat prices, Canada could continue to sell some wheat at slightly higher prices than before the tariff was laid. There would remain, however, the probably much more important effect of the tariff, for Canada, in the direct loss caused.

producing linen. In Ireland, on the contrary, the tendency will be towards a lower cost. Soon, therefore, the Canadian manufacturer may find that $1.43 is not a high enough price, while the linen manufacturer of Ireland, even with the tax, may sell for less than $1.50. Unless the tariff is further increased, some linen will soon be secured from Ireland; there will no longer be a net flow of gold into Canada; and Canadian prices will no longer rise as compared with Irish prices. Or, as we have seen, the same result is reached by Canadian purchase of other Irish goods. Suppose, however, that the Canadian tariff is progressively raised so as to maintain the 7 cent margin, and is raised on other Irish goods as well, and suppose that Ireland's demand for Canadian goods is not checked until money in Canada is $\frac{10}{9}$ of its former amount and in Ireland slightly less than before. Then, assuming conditions of approximately constant cost, Canadian wheat will sell for about $1.10 a bushel and Canadian linen for $1.57, while linen made in Ireland will sell, not counting the tariff, for slightly less than $1 (not much less, since any considerable fall of prices in Ireland would cause an inflow of specie from Germany, France, and elsewhere, so distributing over many countries the effect of the outflow of money to Canada). To give Canadian producers a 7 cents margin, the tariff will now have to be so high that linen made in Ireland can sell, in Canada, for not less than $1.64. Since this linen sells, without the tariff, for $1 or less, the tariff will have to be $0.64 a yard [1] instead of the original $0.50. Even a tariff to "equalize the cost of production" would need, after this change in relative amounts of money, to be $0.57 instead of $0.43.

[1] We are here neglecting cost of transportation.

But it must not be supposed that continuous extension and increase of its tariff wall can raise prices in a country without limit. Even if, as prices in Canada rise and in Ireland, or elsewhere, fall, protection is given to each article subject to foreign competition, which can be made in Canada, and even if this protection is progressively raised so as to prevent any purchase abroad by Canadians as their money incomes increase, — in short, even if all importation of goods is effectively prohibited, the rise of prices in Canada will nevertheless eventually reach a limit. For, sooner or later, Canadian prices will get so high that no goods whatever will be purchased in Canada by people in foreign countries.

All these conclusions are the same, except as to nominal prices, if we suppose Canada's currency system unrelated to those of other countries. A high tariff would not then raise Canadian money prices, but it would change the relative value of Canadian and other monetary standards so as to make purchase of Canadian goods more expensive to other countries in terms of their own money. This fact has been frequently pointed out in preceding pages. Here it is to be emphasized that it means cheaper purchase of foreign goods in terms of Canadian goods. A smaller amount of Canadian money than before will buy drafts on foreign countries for more foreign money and, therefore, goods than before, or will buy the gold equivalent of more foreign money and goods than before. Hence, Canadians are tempted, unless prevented by a tariff, to buy foreign goods which they did not previously buy and even, unless the tariff protection is increased, to buy goods on which the protection seemed, at first, adequate (though not excessive).

§ 7

A Tariff "Equal to the Difference in Cost of Production at Home and Abroad, together with a Reasonable Profit"

In view of these facts, together with the fact that the same kinds of goods are produced simultaneously at different costs, the proposition, prominently put forth in recent politics, to establish a tariff which shall "equal the difference in the cost of production at home and abroad, together with a reasonable profit,"[1] is chimerical. There is no fixed difference, independent of the tariff, in the home and foreign costs of production. For the difference in these costs is dependent, to some degree, on the relative levels of prices at home and abroad, which are affected by the flow of gold, which is, in turn, at least in some degree affected by the tariff. The tariff itself, that is, helps to cause the very difference in cost of production which is set forth as a justification for it. As we have seen in our illustration, a tax of 43 to 50 cents per yard may be, at the start, the amount necessary to equalize cost of production in the protectionist and other countries, and yield a "reasonable" profit; yet later, if a protective tariff policy has been followed, a higher tax than 43 cents may seem equally necessary to equalize conditions, and this just because the tariff itself has widened the cost difference. In addition, the cost of production may be directly increased by tariff duties on the machinery and raw materials of industry.

Again, "cost of production," if not further defined, may be taken to mean marginal cost, average cost, or cost under the most favorable circumstances. Is a tariff

[1] Republican party platform of 1908, *Republican Campaign Text-Book*, 1908, p. 462.

which equals the difference in cost of production at home and abroad, to be high enough adequately to protect the marginal producer, or the average producer, or only the producer best situated? In manufacturing, is it to protect the struggling factory hardly able to maintain itself, or only the most efficient? If protection is to be given to the producer under greatest difficulties and to the most inefficient producer, the burden on consumers may be very great. Furthermore, inefficiency is in some degree encouraged, instead of being weeded out. The recent Tariff Board found in the cotton manufacturing industry of the United States not only modern establishments, but also some of low efficiency and considerable antiquity.[1] Some 60-year old spinning and weaving machinery was still in use. A system which protects producers the more highly the less efficient they are, though promulgated as a "scientific" solution of the tariff problem, would seem, in view of these considerations, very far from being such a solution. If, on the other hand, the protection is intended only to equalize conditions for the average or best producers, as opposed to foreign competitors, there is still a loss to consumers, and there is also the objection, from the protectionist point of view, that such a policy would leave without adequate protection the very producers most needing help.

§ 8

Relative Advantages in the World's Commerce of Countries having High and Countries having Low or No Tariffs

Before closing our discussion of protective tariffs in relation to national prosperity, there is one general truth

[1] Report of the Tariff Board on Schedule I of the Tariff Law, Vol. 2, p. 416.

to which we may properly give special emphasis. This truth is that, among a number of trading countries, those with low or with no tariff restrictions have the least to lose.[1] If, for example, Great Britain alone adheres to the principles of free trade, while all other nations maintain high import duties (or high export duties, or both), then Great Britain's position in trade is relatively the best. In the first place, purchasers in all other countries will buy of Great Britain rather than of countries where the large quantity of money due to protection (or where high export duties, if such were common) makes prices of goods exported by them high; and this very turning of the demand to Great Britain will enable British producers to get, for what goods they are able, despite foreign protective tariffs, to export, higher prices than if their rivals in selling each special kind of goods in a given market, were similarly untrammelled. In the second place, sellers of goods produced in all other countries, being unable to sell so easily and profitably to countries maintaining protective tariffs against them (or to countries, if there were any such, whose export tariffs make their home prices low), will be the more anxious to sell all they can in Great Britain; and they will make even lower prices in selling to Great Britain than otherwise they would, because it is so difficult to secure a market and to sell at a profit, anywhere else.

Protectionist writers have sometimes hinted that free trade, or tariff for revenue only, might be very good if all nations practised it, but that so long as other countries practise protection, we must do so in self-defence. The truth is that the best possible way for a nation to adapt itself to the conditions caused by the bad policy

[1] Cf. Bastable, *The Theory of International Trade*, p. 122.

(*e.g.* protective tariffs) of the others, is to avoid imitating that bad policy. Then it has an advantage over these others and gains trade and profit which they cannot.[1]

It does not follow that Great Britain is better off because other nations have high duties. So far as other countries become self-sufficient by means of their tariffs, Great Britain also may be forced to be more self-sufficient than would otherwise be necessary. But so far as some trade still persists, despite these interferences, Great Britain has an advantage in getting it and in gaining from it, over all the others. Each country's tariff lessens Great Britain's trade with that country and so tends to decrease the wealth of both Great Britain and the country levying the tariff. But each country's tariff hurts that country as a competitor of Great Britain in trade with third and fourth countries, and so gives Great Britain an advantage over it.

Largely, we may reasonably suppose, through the operation of these principles, the foreign commerce of the United Kingdom long since reached a volume which that of none of her protectionist rivals has yet been able to attain. Not only do the people of the British Isles trade extensively with the English-speaking peoples of their own colonies and with the United States, but their commerce is the greatest with, for example, most of the South American republics,[2] as well as with many other countries. Their ships plough the remotest seas and carry the products of English mines and factories to parts of the earth almost unknown to American exporters. Likewise, from all parts of the world come the raw materials,

[1] Cf. Sumner, *Protectionism*, New York (Holt), 1885, pp. 138, 139.

[2] See comparative statistics in any of the recent annual reports on *Commercial Relations of the United States*.

the food supplies and other goods, which the British people require and which they can buy more cheaply abroad than they can produce at home. Raw cotton they get from the United States, from Egypt, from India, to be reshipped to South America and elsewhere as cotton fabrics, or to be made up into wearing apparel for themselves. Wheat they secure from the United States, Canada, Argentina, and other countries, and they secure it, we must conclude, all the more cheaply because some of the European nations restrict its importation by means of protective duties. Wool is available particularly in South America and in Australia. In short, the whole world is a British market so far as the British people can make it so, and from countries near and far they draw the riches which other nations, by foolish tariff restrictions, shut away.

§ 9

Summary

The general conclusion of this chapter is that a protective tariff reduces, and may reduce considerably, the total wealth of the country which adopts it. By as much as it hinders imports, by so much it must, in the long run, interfere with the development of an export trade. It diverts the productive force of a country from lines in which it is relatively effective to lines in which its effectiveness is less. Even if those who are protected gain some benefit from the policy, they gain less than others in the country lose. Protection tends to raise all money prices, including money incomes, in the protected country. But there is a special rise of price of protected goods, not balanced by any rise of money incomes.

Therefore, prices of goods rise, on the average, more than money incomes, and the general prosperity is reduced. It is conceivable, but improbable, that protection of some industries may result in larger establishments within the protectionist country and a gain in efficiency enough to make home production as cheap as foreign. When an industry of increasing expense (diminishing returns) is protected, the injurious effects on national prosperity are the greater, the more the tariff extends the industry. Protection may give to a country indirect advantages in the form of better rates of interchange on other, unprotected goods, but this gain is not likely to be great, since other countries have the option of trading elsewhere than with the protectionist country. If such a gain were likely to be realized, there would probably be a demand, in the protectionist country, for the taxation of imports of these other goods in so far as they could be produced at home, and so a partial prevention of the gain.

If protection is applied moderately but upon many goods, so that the scale of prices in the protectionist country rises compared with others, even some of the protected goods may come to be imported to some extent from countries whose prices have not thus been artificially raised. If so, there is likely to be a demand for further protection. The proposition to levy a tariff which shall be equal to the difference in cost of production in the protected country and abroad, overlooks the fact that this difference in cost is, to some extent, a consequence of high protection. It overlooks, also, the fact that cost is not the same in all establishments or on all sites, within a single country.

Despite the frequent claim of some protectionists that any one country must adopt a protective tariff system because others do, the truth is that a country which, among others having high import duties (or export duties or both), maintains free trade or only low tariffs, has an advantage, because of this policy, over all the others.