CHAPTER VII

The Nature and Effects of Bounties

§ 1

Bounties as Compared and Contrasted with Protection

Somewhat similar in principle to an import protective tariff is a bounty. A bounty is a payment made at intervals by government to the persons engaged in some industry which it is desired to encourage, in proportion to the quantity of goods turned out or sold or in proportion to the quantity exported. The purpose is, or purports to be, the encouragement and development of the industry receiving the periodic payment. A bounty is like protection in that it tends to divert industrial activity into a different line or lines than such activity would otherwise follow. Thus, to use our previous illustration, Canada could, by means of a bounty as well as by protection, encourage Canadian production of linen. The beet sugar industry in continental Europe has been, largely, so encouraged. Likewise, by means of bounties or so-called shipping subsidies, a number of countries have endeavored to build up their shipping interests.[1]

On the other hand, the bounty differs in several respects, in its application, from protection. To begin with, a protective tariff encourages an industry by guaranteeing it the home market, *i.e.* by shutting out goods from abroad. But a bounty does not attempt to inter-

[1] See discussion of shipping subsidies in Ch. VIII (of Part II), § 2.

fere with foreign competition. It endeavors, rather, to enable the home producer more easily to meet foreign competition.[1] The one method, protection, directly *shuts out* rivals. The other method provides home producers with the means to *drive out* rivals.

It follows, as a second and related distinction, that, while a protective tariff enables the protected producers to charge more for their goods, a bounty puts the favored producers in a position to sell their goods for less than they could otherwise afford to take.[2] It is thus that these producers are enabled to capture the business. A bounty may, because of this difference from protection, divert industry out of its natural channels to a greater degree than a protective duty. For the latter can do no more than guarantee the home market to producers who, since they need protection at home, are unlikely to get any considerable business elsewhere; and in fact, protection, by causing inflow of money and higher money costs, is likely to have the effect of making invasion of foreign markets more difficult than before. But the former, a bounty, may make it possible for an industry, through competition in lower prices, to capture the markets of the world, though very probably at great expense to the taxpayers of the bounty-paying country.

Third, the burden of protection falls upon the buyers of protected goods in proportion to their purchases of these goods; while the burden of a bounty falls upon taxpayers in proportion to their respective contributions to the tax fund. Protection compels consumers to pay higher prices. A bounty compels citizens to pay higher taxes.

[1] Cf. R. Meeker, *History of Shipping Subsidies* (in Publications of the American Economic Association, August, 1905), p. 172.

[2] Cf. *ibid.*, p. 173.

§ 2

The Various Possible Effects of Bounties on the Level of Prices

The effect of a bounty on the general level of money prices in the bounty-paying country is similar to that of protection. We may, for the purposes of our discussion, distinguish three cases. In the first case, the bounty acts like a protective tariff in that it decreases imports. Thus, Canada might have a bounty of 43 cents a yard or slightly more, on linen cloth, which would enable the Canadian cloth producers to sell at home for $1 or slightly less a yard, instead of $1.43. As a consequence, we may suppose, the Canadian cloth producers would be able to get complete control of the home market. Then, as in the case of protection, no money would flow to Ireland or elsewhere, for linen. But foreign consumers would still buy Canadian wheat, and there would be a tendency for prices in general, in Canada, including the price of linen, to rise.[1] Eventually Canadian prices would be enough higher than before, as compared with foreign prices, to bring back equilibrium in trade. If Canada's currency system were unrelated to the systems of other countries, if, for example, it were based on inconvertible paper, the rise of money prices would not take place, but equilibrium of trade would eventually result through a change in the relative values of Canadian and other currencies.[2]

In the above assumed case, we have supposed a bounty not quite high enough to make it easy or perhaps possible,

[1] This might lead, as in the case of protection, to a demand for a greater bounty, or to a demand for bounties to industries previously not encouraged. See Ch. IV (of Part II), § 6.

[2] See Part I, Ch. VI, §§ 6, 7, 8, 9, and Part II, Ch. IV, § 3.

for Canadian linen producers to meet transportation costs and invade foreign markets. Let us now suppose a bounty of 60 cents a yard. With a production cost of $1.43, this bounty would reduce the net cost to 83 cents a yard. Even after paying transportation costs, Canadians could then perhaps sell linen abroad for 85 or 90 cents a yard, thus greatly increasing their business and driving out foreign competitors. In this case, not only would Canadian importation of linen be decreased, but Canadian exportation of linen would be greatly increased. As a consequence, there would be a net inflow of money into Canada and a relative rise of Canadian prices. This rise would continue until equilibrium became established either by larger purchases of Canadians abroad, or by smaller purchases of foreigners in Canada, or by both. Thus, Canadians might even, if prices should rise sufficiently, buy goods abroad which they had previously produced at home. If so, other Canadian producers would clamor for bounties or for protection. Nevertheless, an equilibrium of trade must eventually be established.[1]

The third case would be realized if, at the time of establishing a bounty on linen manufacture, Canada was already largely supplying the world with linen and could not hope greatly to extend her foreign market. In this case, the effect of the bounty (assuming free competition among present and potential Canadian linen producers) would be to lower the price of linen without correspondingly increasing its sale. Less money would therefore flow into Canada, while as much as before would flow out. Other things equal, there would be a net outflow of money, and money prices would fall. It hardly needs

[1] Cf. Ch. IV (of Part II), § 6.

to be stated that, if Canada's money system is assumed to be different from those of other countries, there would be a change in the value of Canadian money in terms of other money, rather than a fall in Canadian prices.[1]

§ 3

The Various Possible Effects of Bounties on the General Welfare in the Bounty-paying Country and in the Countries with which it Trades

Consideration of the effects of a bounty on the general welfare of the bounty-paying country and of the countries with which it trades, may profitably follow the line of the above three cases. In the first case, where it decreases imports by enabling the home producers to gain the home market but does not enable them to gain a foreign market, the bounty acts substantially like a protective tariff. It tends to prevent imports but not to stimulate exports. It conduces to national self-sufficiency. It prevents what would else be a profitable trade. Like protection, it turns labor and capital away from the channels they would naturally follow, away from what are presumably the most profitable channels, into channels favored by law. The effects on total production are obviously the same, whether diversion is caused by protection or by bounty.

Not only is the bounty-paying country injured, but also the countries with which it trades are, presumably, to some extent injured. These other countries lose a profitable export trade, and they do not secure goods more cheaply from the bounty-paying country since the bounty is not high enough, in the first case discussed,

[1] See, particularly, Part I, Ch. VI, §§ 6, 7, 8.

to encourage sales abroad by the recipients of this bounty.

The second case to be considered is that in which the bounty encourages export by the bounty-paying country, of the goods on which the bounty is paid. If desired, the bounty may be paid only on exported goods. In this second case, as in the first, the prosperity of the bounty-paying country is made less than it otherwise might be. Industry is turned from more profitable into less profitable channels. Trade with other countries is not prevented to the extent that it is in the first case or in the case of protection, and may be actually increased. But the trade stimulated is not relatively a profitable trade. The export of linen by Canada, in our illustration, takes the place of other exportation more profitable to Canada or of internal trade which would be more profitable. It is as uneconomical to encourage a trade which would not otherwise take place, as to discourage, by protection (or by high export taxes), trade which otherwise would take place.

The effect of the bounty on other countries than the one which pays it, is, in this second case, beneficial. We know that other countries would gain by the trade if the new industry were one which became established in the bounty-paying country because of suddenly discovered natural resources or because of acquisition of skill. And as far as other countries are concerned, the bounty has the same effect as either of these other causes of development of the favored industry. It is no longer desirable for them to produce the goods in question for themselves. These goods can be got more cheaply at the expense of the taxpayers of the bounty-paying country. The persons in other countries, who formerly produced these goods, must, it is true, change their occupation.[1] But there are presumably other occupations equally or almost equally, profitable, and the consumers of these other countries gain, therefore, more than the producers lose.[2]

In the third case, the bounty does not appreciably increase the sales abroad by the favored producers of the bounty-paying country, but simply results in their selling about the same quantity of their goods at lower prices. In this case, the loss to the bounty-paying country is more obvious than in the other cases, while it is even clearer than in the second case, that foreign countries gain. Since the bounty simply lowers prices without extending trade, it benefits foreign consumers without driving any foreign producers from the line of production favored into other lines.[3]

[1] The trade between second and third countries and their relative gains from trade, may be affected. A bounty on the production of linen in Canada may, by encouraging export of Canadian linen, drive Irish manufacturers out of, say, the German market. Irish linen producers are injured. German linen consumers are benefited. But Ireland can get its own linen, thereafter, more cheaply by importing it from Canada, and gains in so far as linen is desired to use. Ireland is injured in so far as Canada enters trade as her competitor in selling linen to Germany, but this loss is balanced by Germany's gain. Ireland gains in so far as she secures linen from abroad more cheaply than she could make it herself. It becomes more economical for Ireland to devote herself to some other line or lines. If the new products which she now endeavors to export are less desired abroad than the old, the rate of trade will tend to become somewhat less favorable to Ireland and more favorable to these other countries, than before. Ch. II (of Part II), § 2. Ireland will also, probably, become somewhat more self-sufficient. But the conclusion remains that when all other countries except the bounty-paying country are considered, the general result is favorable. See, however, Ch. IV (of Part II), § 6.

[2] See Ch. IV (of Part II), § 2.

[3] There is a tendency, also, for the rate of trade to become more favorable to other countries and less so to the bounty-paying country. Money flows out of the latter and into the former. Prices fall, relatively, in the latter and rise, relatively, in the former, though this change would probably be slight in the case of a bounty on only one kind of goods. Hence, foreign countries may be

England was for a long time a very great gainer by virtue of the export bounties paid on beet sugar until 1903,[1] by the beet sugar producing countries of continental Europe.

Had only one such country adopted a bounty-paying policy, the effect would have been much larger exports of sugar for that country and a slightly lower price of sugar for buying countries. This is the kind of situation discussed in our second case. But when all the European beet sugar countries were simultaneously paying bounties on exported sugar, the net result was that no one of them could extend its export trade to anything like so great a degree, while all of them had to accept very low prices for their product. There was then a closer approximation to the conditions described in our third case, though probably, since beet sugar largely displaced cane sugar from the West Indies and elsewhere, the conditions of case 3 were not realized.

However this may have been, it is obvious that the sugar consumers of other parts of the world were great gainers by virtue of these bounties, and gainers at the expense of the bounty-paying countries. Particularly did the bounties redound to the profit of free-trade England, whose people were not prevented by tariff restrictions from securing the sugar cheaply.[2] So it resulted that the English were able to consume several times as much sugar per capita as, for instance, the

able to buy other goods than the favored kind more cheaply than before from the bounty-paying country, while having higher money incomes with which to buy.

[1] Fisk, *International Commercial Policies*, New York (Macmillan), 1907, p. 137.

[2] Although eventually, because of colonial sugar interests in the West Indies, England supported the general agreement to discontinue the bounty competition. It does not follow, of course, that England acted wisely in so doing.

bounty-paying Germans.[1] Furthermore, all those British industries which depended upon the use of sugar prospered in a large degree.[2] In the confectionery and preserving trades, thousands of persons were employed and many thousands of tons of sugar were annually used.

If, in some distant future, the philosophy of protectionism comes ever upon the discredit which it deserves, the descendants of those whose taxes supported the favored business of sugar production may at least console themselves with the thought that many foreigners were benefited. Though the bounties turned industry from its natural channels, though they caused the consumption of beet sugar, when cane sugar would have involved a less labor cost, though they diminished the economic well-being of the world as a whole, though part of the taxpayers' burdens was therefore in every sense a net loss; yet another part of their burdens was compensated for by extra gains, in the form of cheaper sugar, to the people of a neighbor nation.

§ 4

The Various Possible Effects of Bounties on Wages and Rent

A bounty, or system of bounties, would usually affect money wages as compared with real wages, just as does a protective tariff. The immediate effect of a bounty would be to tax the people more than it lowered the price of the goods favored. For illustration, suppose that Canada can buy linen, in Ireland, for $1 a yard, while the cost of linen produced in Canada is $1.43. By granting a bounty of 43 cents or of 53 cents, the

[1] Sumner, *Protectionism*, New York (Holt), 1885, p. 81.
[2] *Ibid.*, p. 86.

Canadian government enables home manufacturers to sell linen at $1 or at 90 cents a yard. The people of Canada lose, as taxpayers, 43 cents to gain nothing, or 53 cents to gain 10 cents. Unless the taxes are so levied that they do not fall upon and cannot be shifted to wage earners,[1] real wages must be lower.[2] This remains true after the inflow of money which raises prices (or the outflow — case 3 — which lowers prices). For money prices and money wages will tend to be affected in equal proportion by the change in money supply. A bounty on exports only, may lower the price of the favored goods, to foreign consumers, at the expense of taxpaying citizens of the bounty-giving country, while it will not lower the price to domestic consumers.

§ 5

Why Bounties may be Less Objectionable than Protection if Encouragement of Infant Industries is in Any Case to be Attempted

The bounty method has sometimes been recommended as superior to the method of protection, for the establishing and developing of an infant industry. Since the bounty system is more clearly seen to involve taxation, public support is less likely to be given to schemes for its widespread application. It is perhaps not quite so unlikely that care will be used in deciding upon the industry or industries to be favored. For the same reason, the likelihood that the bounty will remain a permanent burden upon the general public may be somewhat less.

[1] Even if the necessary taxes fall in no sense upon wage earners, and so really raise wages, they raise wages less by turning labor into unprofitable lines than if the money were directly paid to wage earners, as a forced charity.

[2] There is, however, as with protection, a conceivable exceptional case. Cf. Ch. V (of Part II), § 5.

§ 6

Summary

A bounty, like protection, is a special favor granted by government to some industry or industries. It differs from protection in that it does not tax foreign competition, but enables the domestic producer to meet it, in that it lowers instead of raises the price of the favored goods, and in that the burden falls upon taxpayers as such rather than upon consumers. A bounty may simply insure domestic producers their home market, or it may be high enough to enable them to meet transportation costs and increase their foreign business, or it may enable them to sell the same amount of goods abroad as before, at lower prices. In the first two cases, the level of prices in the bounty-paying country will rise as compared with the levels in the countries with which it trades. In the third case, the level of prices in the bounty-paying country will fall. In all three cases, the effect on the national prosperity of the bounty-paying country will almost certainly be unfavorable. In the second and third cases, other countries will be likely to profit to some extent at the expense of the taxpayers in the bounty-paying country. Since a bounty system tends to burden the taxpayers, with no corresponding gain to the general public, it tends to lower real wages, for it can hardly be supposed that wage earners will be unaffected by the level of taxation. If an infant industry is in any case to be established, however, the bounty method may be better than the method of protection.