

# British protectionism and the international economy: overseas commercial policy in the 1930s

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# Contents

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<i>Preface</i>	page xi
<i>List of Tables</i>	xiii
Introduction	1
1 Britain's international economic position in the 1920s	9
2 The political economy of protectionism	35
3 Imperial preference and the Ottawa Conference	71
4 The Scandinavian negotiations: formulation of policy	101
5 Completion of the first phase of negotiations: Scandinavia, Germany and Argentina	126
6 The world economic conference, Finland and Japanese competition	159
7 The Baltic states and Poland	189
8 British agricultural policy and imports during the 1930s	212
9 British exports to the trade agreement countries	239
10 Appeasing Germany and the United States	275
11 Some general conclusions	307
<i>Appendix A</i> United Kingdom: payments, clearing etc., Agreements in force 1931–1938	322
<i>Appendix B</i> Miscellaneous trade and payments agreements	324
<i>Appendix C</i> Imports into Britain from foreign agreement countries	330
<i>Appendix D</i> Total exports from Britain to foreign agreement countries and four dominions	331
<i>Appendix E</i> Imports of selected commodities into UK, 1931, 1937, showing percentage from Empire sources	332
<i>Bibliography</i>	334
<i>Index</i>	347
	ix

## Tables

	<i>page</i>
1.1 Percentage shares in world exports of manufactures, 1913	11
1.2 1913 percentage share of trade in manufactures grouped by rates of growth, 1913–1929	12
1.3 Market shares held by UK of selected commodities in dominion markets 1913–1929: percentages	14
1.4 Shares in world trade held by UK, 1913–1929	16
1.5 Unit values of manufactures from the main industrial countries and from their competitors (in terms of \$US) 1913–1929	22
1.6 Bilateral trade balances, 1913, 1924, and 1928	29
1.7 Percentage share of the Empire in British trade	31
1.8 Percentage share of British exports to Empire by commodity groups, 1913, 1925, 1929	32
1.9 Percentage of total imports of merchandise into British dominions and protectorates supplied by the UK, 1913, 1924–1929	32
1.10 Percentage share of UK in exports of selected dominions, 1913, 1927 and 1929	33
3.1 Rate of change in the volume of imports into the United Kingdom	75
3.2 UK imports of food and raw materials from the Empire, and percentage of total imports of each commodity from the Empire, 1913, 1924, and 1929	76
3.3 Selected UK imports from the Empire: percentage changes 1913 and 1929	76
3.4 Proportion of world imports of selected livestock products taken by UK	79
3.5 Percentage of selected countries' total exports destined for UK, 1928–1933	80
3.6 Percentage of value of beef, veal, mutton and lamb to total exports, 1931–1934	91
4.1 UK exports to selected foreign countries, 1932	103

4.2	The impact of the Import Duties Act and Ottawa Agreements on tariff incidence on Scandinavian imports into the UK (1930 imports)	107
4.3	Principal UK exports to Scandinavian countries, 1930–1932	113
4.4	Imports of coal into Denmark, Norway and Sweden	116
4.5	Principal UK retained imports from Scandinavian countries, 1930–1932	119
4.6	Imports of bacon into the UK – selected suppliers, 1913, 1928, 1931, 1932	120
4.7	Imports of butter into the UK – suppliers 1913, 1928, 1931, 1932	121
6.1	Exports of selected UK produce to Finland, 1929–1932	174
6.2	Selected imports into UK from Finland, 1928–1932	177
7.1	Distribution of exports from the Baltic states to Germany and the UK, percentage of total value 1927, 1930 and 1932	194
7.2	UK retained imports of selected products from Lithuania, 1929–1932	199
7.3	Principal UK exports of domestic produce to Poland, 1929–1933	207
7.4	Selected imports into UK from Poland, 1929–1933	208
8.1	Imports into UK of major groups of commodities by total values and percentages, 1928–1939	228
8.2	Total retained imports into the UK and share of Empire and selected dominions, 1929–1938	229
8.3	Selected UK imports from the Empire: percentage changes 1931–1937	230
8.4	Percentage shares of UK imports of mutton and lamb by volume, 1929–1937	233
8.5	Imports of wood and timber into UK, 1929–1938, percentage share of selected countries	235
8.6	Imports of UK from the foreign trade agreement countries 1929, 1932, and 1937	237
9.1	UK exports of domestic produce to Scandinavia, 1928–1930, 1931 and 1936–1938	241
9.2	Total imports into Scandinavian countries, 1928–1930 and 1936–1938	241
9.3	UK share of imports into Scandinavian countries, 1929–1938	242
9.4	UK exports of domestic produce to Estonia, Latvia and Lithuania, 1928–1930 and 1936–1938	247
9.5	UK exports of domestic produce to four dominions, 1928–1930 and 1936–1938	251

*List of Tables*

xv

9.6	Import content of supplies of manufactured goods	253
9.7	Total imports into selected dominions, 1929–1930 and 1936–1938	253
9.8	Percentage of total imports coming from the UK, 1929–1938	254
9.9	Comparison of UK percentage shares of selected imports, 1931 and 1937	255
9.10	British domestic exports to selected trade agreement countries, average of 1928–1930 and 1936–1938	266
9.11	Shares in world trade held by the UK, 1929 and 1937	269
9.12	Bilateral trade balances, 1928, 1931 and 1937	270
10.1	UK retained imports from the USA, 1929, 1931, 1933 and 1936	292
10.2	UK principal exports of domestic produce to the USA, 1929, 1931, 1933 and 1936	296
10.3	UK assessment of US offers of April and July 1938	299

## Introduction

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On 21 September 1931 the United Kingdom abandoned the gold standard. On 1 March 1932 when the Import Duties Act came into effect, Britain had finally adopted full protection. Thus within less than six months two of the great symbols of Britain's leadership of the nineteenth-century international economy, the gold standard and free trade, had gone. Moreover, the Import Duties Act signified more than simple protection. By temporarily exempting Empire products from the new duties, and by including a bargaining clause, the construction of regional or imperial trading blocs was envisaged.

This accords with a view of how a once dominant economic power behaves in retreat. Robert Gilpin writes of Great Britain

As the periphery advances, as it frees itself from dependence on the core and the terms of investment shift to its advantage, the core retreats into protectionism or some form of preference system. It throws up barriers both to the export of capital and to the import of foreign goods. It favors preferential commercial arrangements.<sup>1</sup>

Robert Skidelsky argues of the emerging economic pluralism before the First World War that the spread of industrialisation created a paradox because it increased global interdependence at the same time as new democratic and nationalist forces were displaying growing intolerance of the *Pax Britannica*. In the face of such a threat to the stability of the international system, adjustments had to be made: either authority had to be raised to a new level, perhaps with international institutions, or interdependence had to be reduced to the level of existing international authority.<sup>2</sup> Ultimately with 'the disintegration of the wider system in the interwar years, there was an increasing tendency to see the economic future in terms of blocks'.<sup>3</sup> Stephen Krasner portrays the years between the wars

<sup>1</sup> Robert Gilpin, *American Power and the Multinationals: the political economy of foreign investment* (New York, 1975), 66.

<sup>2</sup> Robert J. Skidelsky, 'Retreat from leadership: the evolution of British economic foreign policy, 1870–1939', in B. M. Rowland (ed.), *Balance of Power or Hegemony?: the interwar monetary system* (New York, 1976), 164.

<sup>3</sup> *Ibid.*, 178.

as an interregnum between British nineteenth and American twentieth-century leadership of the international economy. Since in his view it is a hegemonic distribution of power that encourages an open trading system, the transitional period between the eras of British and American predominance saw the closure of the system.<sup>4</sup>

An open world economic system had been in Britain's interests in the mid-nineteenth century. It had enabled its industrialists to capitalise on Britain's technical and industrial leadership, and, of crucial importance to those familiar with the ideas of Malthus and Ricardo, it gave access to low cost foodstuffs and raw materials. The opening up of the international economy was in considerable measure a result of British action, including its unilateral adoption of free trade from the 1840s. The UK, as a potentially dominant state, had symbolic, economic and military capabilities to entice or compel less powerful countries to join the system.<sup>5</sup> By 1870 Britain's position at the apex of the international economy was unchallenged. The era of free trade was reaching its zenith, although with the United States standing conspicuously outside the movement. Britain had harnessed and was continuing to harness the productive resources of the regions of recent settlement to meet the burgeoning needs for foodstuffs and raw materials. In return, and as part of the process, it supplied manufactured goods and long-term investment. Capital exports were a vital component in the weaponry of an ascendant economic power seeking to shape, police and stabilise the international system. But they may also have played the paradoxical role of undermining Britain's pre-eminent international position. By nurturing its overseas competitors, Britain's capital exports may have contributed to its own demise. Skidelsky suggests that UK overseas investment diffused industrialisation and shifted the capacity to innovate from Britain to other countries.<sup>6</sup>

It is doubtful, however, whether British funds played such a direct role in financing industrialisation overseas. Sometimes, it is true, British entrepreneurs established textile or iron-works in Europe, especially in the first half of the nineteenth century, and some of these investments had an impact out of all proportion to their size. But for the most part British funds did not make an important direct contribution to the indus-

<sup>4</sup> Stephen D. Krasner, 'State power and the structure of international trade', *World Politics*, 28 (1976), 317-47. For similar views, see Robert Gilpin, *The Political Economy of International Relations* (Princeton, 1987), and Robert W. Cox, *Production, Power and World Order: social forces in the making of history* (New York 1987).

<sup>5</sup> Krasner, 'State power', 335-7; Gilpin, *American power*, 79-85; Skidelsky, 'Retreat from leadership', 154-8.

<sup>6</sup> Skidelsky, 'Retreat from leadership', 163. In similar vein Gilpin writes that though 'foreign investment is not the primary cause of the shift in the locus of industrial power from core to periphery, it both accentuates this tendency and tends to abort any effort to invigorate the core's industrial base'. *American power*, 77.



trialisation of its overseas rivals. If the industrial development of Western Europe or the United States had depended on British finance, it would have been long delayed – only a small proportion of these countries' total investment was supplied by the UK, and a minute fraction was channelled to industrial enterprises. Where British funds did supply a greater proportion of total investment needs, as in Canada, it has been argued that the net effect may well have discouraged industrialisation.<sup>7</sup> For many primary producing countries, borrowing from abroad served only to lock them more firmly into the international economy, and did little or nothing to stimulate diversification of their economies.

Instead, the connection between Britain's overseas lending and the industrial growth of its rivals was an indirect one. British funds contributed to their development in two major ways. The first of these lay in the boost they gave to primary production, sometimes through investment in land and mines, but principally through the construction of railways, port facilities and urban infrastructure. This helped ensure plentiful and cheap supplies for rivals as well as itself. The maintenance of free trade by the UK was an integral part of the growth-inducing process. Access to the British market enabled borrowing countries to service their debts, and it provided West European countries with the sterling to buy food and raw materials. The second vital contribution was the reinvestment of Britain's current account surplus. Counter-cyclical investment meant that the international system as a whole was never short of sterling. Charles Kindleberger lists this, together with the maintenance of an open market for 'distress' goods at times of overproduction, and the fulfilment of a lender of last resort function (discounting in a crisis) as the three major ways in which the UK stabilised the international economy before 1914.<sup>8</sup> Whether the gold standard also contributed to stability may long remain a matter of debate. If it did so, it was powerfully supplemented by other factors, and was confined to the industrial powers; for the periphery the gold standard mechanism was almost certainly a destabilising agent.<sup>9</sup>

<sup>7</sup> The increase in the money supply from imported capital is likely to be inflationary, even when in a country such as pre-1914 Canada a fairly sophisticated banking system provides some offset. A. K. Cairncross, *Home and Foreign Investment 1870–1913* (Cambridge, 1953), ch. 3. The corollary to this is that inflation is likely to be greatest in 'non-traded' and 'domestic' goods, as opposed to internationally traded goods. Therefore import substitution may be checked when capital imports are high because domestic capital is diverted into the non-international sectors. A. R. Hall, 'Capital imports and the composition of investment in a borrowing country', in A. R. Hall (ed.), *The Export of Capital from Britain 1870–1914* (1968), 143–52.

<sup>8</sup> C. P. Kindleberger, *The World in Depression, 1929–1939* (1973), 293–8. He added some more functions in the paperback edition and in subsequent work.

<sup>9</sup> A. G. Ford, *The Gold Standard 1880–1914: Britain and Argentina* (Oxford, 1962), where the gold standard mechanism is seen as reinforcing expansionary and contractionary movements in the Argentine economy.

In the course of the nineteenth century the UK shaped the international economy to its own particular needs. Britain also helped keep the system relatively free of crisis, and thereby further facilitated its integration and growth. Ultimately Britain contributed to its own demise as the pre-eminent power. In part this may have occurred because the international economy acted as an agent in the transfer of technology and in the transmission of industrialisation. Perhaps overseas investment fatally weakened the domestic economy. Certainly the scale of international investment was unprecedented, and in relation to national income dwarfed the foreign investments of the USA in the twentieth century.<sup>10</sup> An institutional bias in the London capital market might have deprived British industry of funds and have inhibited necessary structural change.<sup>11</sup> If so, evidence nonetheless suggests that overseas investment yielded higher returns than home investment, even when allowing for their greater risk.<sup>12</sup> Perhaps the City missed the more profitable ventures in Britain, but otherwise, judged by the criterion of private returns, the market acted rationally and overseas investment may have postponed a decline in the rate of profit. From the perspective of maintaining British power the problems were not merely the domestic costs of heavy overseas lending but the fact that the social return on these investments was shared by potential rivals.

Whatever the mechanism, British industrial hegemony was seriously challenged during the last quarter of the nineteenth century. UK steel output was exceeded by that of the USA in 1890 and by Germany in 1893. Britain's share of world exports in manufactures declined from 40.7 per cent in 1890 to 29.9 per cent in 1913.<sup>13</sup> In the half-century before 1914 imports, both in terms of value and volume, were growing faster than

<sup>10</sup> United States of America Department of Commerce, *Survey of Current Business* August 1982. By 1981 the stock of US private long-term international investments stood at \$290.3 billion, approximately 9.9 per cent of gnp, a ratio which fell later in the decade. Britain's overseas assets stock of about £4 billion in 1913 was probably about 160 per cent of gnp. Even allowing for the scaling down of British overseas investments suggested by D. C. M. Platt, 'British portfolio investment overseas before 1870: some doubts', *Economic History Review*, 2nd ser., 33 (1980), 1-16, the discrepancy remains enormous.

<sup>11</sup> J. Saville 'Some retarding factors in the British economy before 1914', *Yorkshire Bulletin of Economic and Social Research*, 13 (1961), 51-60; W. P. Kennedy, *Industrial Structure, Capital Markets and the Origins of British Economic Decline* (Cambridge, 1987).

<sup>12</sup> M. Edelstein 'Realised rates of return on U.K. Home and Overseas portfolio investment in the age of high imperialism', *Explorations in Economic History*, 13 (1976), 283-329. But see Sidney Pollard, 'Capital exports, 1870-1914: harmful or beneficial?' *Economic History Review*, 2nd. ser., 37 (1985), 489-514 for a critique of these results as well as a wide-ranging survey of the debate.

<sup>13</sup> S. B. Saul 'The export economy 1870-1914', *Yorkshire Bulletin of Economic and Social Research*, 17 (1965), Special Number *Studies in the British Economy, 1870-1914*, ed. J. Saville, 12.

exports.<sup>14</sup> By the 1880s there was widespread concern in industry about foreign competition, and particularly about German rivalry. E. E. Williams, *Made in Germany* (1896), reflected and fed a growing awareness of the conditions faced by British producers. Anxiety was all the greater because wages appeared to be eating into profits.<sup>15</sup>

The problems faced by British entrepreneurs were greatly aggravated by the revival of protectionism among the larger European states after 1878, and by higher American tariffs from 1890. Industrial protection in the more sophisticated North American and West European markets was high and often aimed specifically at British exports. Roderick Floud has suggested that two courses of action were open to British businessmen: to develop new products, or to find new markets.<sup>16</sup> Again, British entrepreneurs acted rationally by taking both courses. They concentrated on higher quality exports to the industrial countries of Western Europe and the USA, and for the older products they sought new and bigger markets among the semi-industrial and primary producing countries of the southern hemisphere. The second response, however, was the predominant one.

The return to protection in the late nineteenth century meant that the European countries were in some measure detaching themselves from an international economy dominated by Britain who now lacked the power and resources to prevent them doing so.<sup>17</sup> A close assessment of the interest of the state at this time might have suggested that since Britain's hegemony was now threatened, Britain should leave the system.<sup>18</sup> One answer for the UK was to move to greater self-sufficiency, or to seek closer ties with the Empire and client states, thus perpetuating its dominance within a more restricted sphere. The main thrust of the Fair Trade movement of the 1880s was towards protection. In the early years of this century Joseph Chamberlain revitalised the movement and gave it a clear and explicitly imperial dimension. A formidable campaign came close to success. It probably failed because it embodied too many contradictions as well as threatening strongly entrenched interests. Not the least of its difficulties

<sup>14</sup> M. Kirby, *The Decline of British Power Since 1870* (1981), 2.

<sup>15</sup> J. Saville, 'Review article: the development of British industry and foreign competition 1875-1914', *Business History*, 12 (1970), 62.

<sup>16</sup> R. C. Floud, 'Britain 1860-1914: a survey', in R. C. Floud and D. McCloskey (eds.), *The Economic History of Britain since 1700, II, 1860 to the 1970s* (Cambridge, 1981), 20.

<sup>17</sup> The process of detachment should not be exaggerated however - the multilateral economy evolved a new degree of refinement in the twenty years or so before 1914. S. B. Saul, *Studies in British Overseas Trade 1870-1914* (Liverpool, 1960), ch. 3.

<sup>18</sup> Krasner, 'State power', 341. He argues that vested interests and inertia delayed such a change. The response will be delayed until a cataclysmic event (war, famine or severe depression), forces a reassessment.

was having to create new forms of conceptualising the economy.<sup>19</sup> The vision of maintaining an old complementarity between Britain and the Empire was probably already false: economic nationalism was apparent in the dominions, certainly in Canada and Australia, and it was unlikely they would have been prepared to sacrifice their secondary industries. It is also questionable whether protection and preference would really have helped solve Britain's economic problem. Apart from iron and steel, import penetration was not a serious threat, and even in the steel industry many of the imports were of semi-manufactures which other sectors of the industry processed further. The outstanding problem was of competition in overseas markets, and the imperial solution hardly helped here. Even in the peak year of 1902 the Empire absorbed only 38.5 per cent of UK exports.<sup>20</sup> Not only were tariffs likely to raise costs and jeopardise exports to non-Empire markets, but they also carried with them the danger of retaliation, particularly if Europeans had greater difficulty in earning in Britain the sterling they needed for their imports. Here lay the fundamental problem of the imperial solution – it cut across Britain's global interests. This was most apparent in Britain's role as world shipper, and in the City of London's role as world banker and financier: the 'gentlemanly capitalists' were hostile to any policy that by restricting access to the British import market would have impaired their role by threatening the servicing and redemption of overseas debt.<sup>21</sup>

In effect Britain continued at the centre of the international economy, playing the part of stabiliser even while its predominance faded. The UK could still perform this stabilising function because it managed to avoid any external economic crisis. But despite signs of external strength the domestic economy was weak in the early years of the twentieth century. Gross domestic product per man-year grew at only 0.5 per cent a year between 1899 and 1913<sup>22</sup> and industrial productivity at a lower rate still. This was not only a slower growth rate than in late Victorian times, but was comfortably exceeded by Britain's competitors. Testimony to poor economic conditions is that by the early years of the twentieth century Britain alone among the countries of North-west Europe experienced substantial emigration. The UK merchandise trade balance had widened until 1904. During the next ten years it narrowed. Partly this was because

<sup>19</sup> Jim Tomlinson, *Problems of British Economic Policy, 1870–1945* (1981), ch. 3.

<sup>20</sup> F. Crouzet, 'Trade and Empire: the British experience from the establishment of free trade until the First World War', in B. M. Ratcliffe (ed.), *Great Britain and Her World, 1750–1914: Essays in Honour of W. O. Henderson* (Manchester, 1975), 221.

<sup>21</sup> P. J. Cain and A. G. Hopkins, 'Gentlemanly capitalism and British expansion overseas, 11: new imperialism, 1850–1945', *Economic History Review*, 2nd ser., 40 (1987), 1–26.

<sup>22</sup> R. C. O. Matthews, C. H. Feinstein and J. C. Odling-Smee, *British Economic Growth 1856–1973* (Oxford, 1982), 31.

of the sluggishness of the domestic economy; but exports received a stimulus from the rising incomes of the primary producers and from a great burst of overseas investment. The current account was helped by the growth of income from services: shipping receipts, especially high with rising freight rates and expanded world trade, were supplemented by income from investments that grew to around £200 million annually on the eve of the First World War. Britain's long-term creditor position was immensely strong and confidence in the pound remained high. A crisis at the centre was avoided and the British market remained open.

The cost was not immediately apparent. With hindsight it is clearer: failing to make much headway in the markets for newer and more sophisticated products in Western Europe and North America, Britain came to depend more heavily on the less industrial countries as an outlet for its manufactures. Capital exports had accentuated this process, giving the economy a curiously lopsided appearance. Before the war, textiles, iron and steel and coal accounted for 70 per cent of British exports.<sup>23</sup> The UK was supplying 70 per cent of world cotton textile exports, 80 per cent of coal, and had a virtual monopoly of world exports of ships. This dependence on a narrow range of export products was dangerous. Business decision-making had in many ways been rational in its own terms. It had meant exploiting Britain's comparative advantage in skill or labour-intensive technologies: shipbuilding exemplifies this. But what was rational, judged by immediate private returns, did not always accord with broader conceptions of social or national interest, all the more so when viewed in longer perspective. This is true of the slow progress of new production techniques, particularly those involving a deepening in capital, the structural rigidity of the economy reflected in the commodity composition of exports, and in heavy overseas investment, none of which necessarily met broader national interests, especially in the long term. In retrospect the dangers were apparent enough. Like any export economy with a narrow base, Britain was vulnerable to unfavourable shifts in demand, to the development of substitutes and to the emergence of new sources of supply. Above all, the ability to remain competitive in the supply of these products was to be crucial to its future prosperity. Before 1914 there were intimations of failing competitiveness and of unfavourable trends in world demand and supply conditions, but these were either muted or were masked by the overall expansiveness of the international economy. However, the war and the 1920s saw an acceleration in the pace of developments that undermined the internal stability and external balance of the UK economy. By the end of the 1920s the British economy no longer

<sup>23</sup> H. W. Richardson, 'Overcommitment in Britain before 1930', *Oxford Economic Papers*, 17 (1965), 240.

possessed the resilience to withstand an international crisis. Ultimately the pressures generated by the slump forced Britain off the gold standard and delivered the final blow to free trade. With their abandonment, Britain relinquished its pretensions to global economic leadership, seeking instead regional and imperial trading and monetary arrangements within the framework of a protectionist regime.