

# ***Trade policy research in the 1930s and 1940s: Geneva doctrine and the Scandinavian connection***

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## **1. Introduction<sup>1</sup>**

The rise of trade policy interventions in the interwar years has been well documented (eg. Kindleberger 1989). By contrast, the intellectual history of trade policy doctrine for this period has been accorded scarcely any attention. Recent contributions have emphasised the authority and momentum given to trade policy interventions by J.M. Keynes's putative apostasy on free trade dating from the early 1930s. Thus Jagdish Bhagwati (1994: 234-5) maintains that 'Keynes's renunciation of the doctrine of free trade remained a potent source of disbelief in the doctrine...[and his] apostasy turned the 1930s into the most deadly episode among the challenges to the doctrine of free trade.' And Douglas Irwin (1996: 206) concludes that 'Keynes succeeded for many years in placing the free trade doctrine in doubt and putting its advocates on the defensive.'

In this paper we present evidence suggesting that there is much more to the intellectual history of trade policy discussion from the late 1920s to the mid-1940s than is available in Keynes's fragmentary remarks on the subject. There was a potent source of belief in *freer* trade at least, emanating from significant research undertaken in Geneva during the period under

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review. There is evidence linking much of this research with Ohlin's pivotal publications in international economics in the interwar years. Unlike Keynes, Geneva economists remained consistent advocates of freer trade. Geneva was the centre of research on international economic policy questions, combining the work of the League of Nations, International Labour Organisation and the Geneva Institute of International Studies (De Marchi 1991; Endres and Fleming 1996). A vast array of research reports on trade policy matters were forthcoming from these organisations.

The purpose of this paper is to assess the content and intellectual significance of the Geneva research program on trade policy mostly with respect to real trade flows (the international monetary dimension demands separate treatment). We consider that program in terms of its logical coherence and development; these are separate questions from whether or not it exerted an influence on economic policy in any country or on international economic policy. Indeed, if the course of world trade policy up to the mid-1940s is anything to gauge 'influence' by, then the Geneva emphasis on freer trade failed. Dearth of immediate policy influence notwithstanding, we submit that a distinctive stream of economic thought originating in Swedish economics is discernible in Geneva research and is worthy of consideration in its own right. The Geneva advocacy of freer trade was largely independent of, and was unmoved by, Keynes's apparently authoritative, often shifting position on the subject.<sup>2</sup>

In section 2 we consider the source of the term "policy of Geneva" and Ohlin's influential 1931 League of Nation's study which gave impetus to subsequent Geneva research. League trade policy analysis in the 1930s is surveyed in section 3 against the background of Ohlin's contemporary contributions to international economics. Folke Hilgerdt's attempt to operationalise the 'network of world trade' concept is examined in section 4 along with subtle revisions in Geneva trade policy doctrine which underscored the need for international agreements to effect freer multilateral trade. In section 5 we examine the proposals of Ragnar Nurkse

<sup>2</sup> Eichengreen (1984: 364) refers to 'Keynes's repeated shifts on the need for protection.' We note Keynes's conviction by the 1940s that to 'restore the balance of international commerce by restriction and discrimination' was a 'false approach' afterall (Keynes 1980: 223).

and others in the 1940s which necessitated a fundamental reassignment of the instruments of commercial policy. Our conclusions favour the view that the Scandinavian connection in Geneva was pivotal in bestowing intellectual foundations for postwar freer trade agreements ultimately culminating in the GATT.

## **2. The World Economic Conference and Ohlin's League of Nations Report**

The phrase 'policy of Geneva' was first used in a Romanian publication which railed against the League of Nations' dependence 'upon the classic doctrine of free trade' (Manoilescu 1931: 205). Manoilescu made extensive reference to discussion papers and reports of the 1927 World Economic Conference (hereafter WEC) in the course of submitting a case for a program of general tariff protection to avoid mass unemployment and employment at low wages. If correct, his claim ran counter to the League's original Covenant, Article 23, which made provision *only* 'to secure and maintain freedom of communications and of transit and equitable treatment for the commerce of all members of the League'.<sup>3</sup> This provision did not amount to recommending removal of all extant trade restrictions; if anything it merely idealised the notion of equity in trading opportunities between nations.

The League of Nations (hereafter LON) convoked the 1927 WEC in Geneva; it surveyed the whole field of trade restrictions and was practically unanimous regarding the necessity for a pause and then gradual reduction in the range and extent of trade controls. The official WEC report declared unconditionally that 'the time has come to put an end to the increase in tariffs and to move in the opposite direction' (LON 1927: 32). Conference memoranda and subsequent discussion were well-aware of contemporary realities; they were adamant for instance, that 'stability' of tariff systems was paramount although it was recognised how rapidly changing exchange rates gave impetus to change tariff regimes (Rappard 1930: 143). An undeniable implication of the 'stable

<sup>3</sup> Quoted in Heilperin (1946: 147).

tariffs' argument was that the volume and value of trade can expand without altering existing tariffs in an upward direction.

To reorganise *ab ovo* international protectionism and by implication world production was not on the WEC agenda. Containing and reducing existing levels of protection was, however, the essence of the conference final reports. In addition the conference attempted to clarify the meaning and practice of dumping (conceived pejoratively), assisted by important technical input from LON adviser Jacob Viner (1926). The conference also urged greater international uniformity and modernisation of tariff nomenclature (LON 1927: part vi).

Altogether, the WEC discussions, resolutions and reports culminated in a manifesto in favour of moving, through a process of non-binding international cooperation, toward *freer* trade. That is what the WEC final report meant by 'liberty of trading' (1927: 22).<sup>4</sup> The direction rather than the timing and extent of the movement toward free trade seemed paramount. Three lines of action were envisaged in that movement: unilateral tariff reductions, bilateral treaties and multilateral conventions. An Economic Consultative Committee was established at the LON in Geneva to monitor these actions. An underlying current of censure and moral approbation, as the case demanded, pervades its annual reports. In its early reports it expresses general satisfaction, after some quite detailed international surveys, that upward movement in tariffs had been arrested (LON 1928, 1929). An implicit presumption in these post-WEC League discussions was that tariffs confer a reduction in living standards in all countries - and not that some may lose and others gain by a tariff change. The notion of optimal tariffs designed for one country was either not at this stage understood in Geneva or more likely it was disregarded as impractical.

A systematic tendency to support free trade is noticeable in all LON research reports, including the work of researchers at the International

<sup>4</sup> The eminent Italian economist, Carrado Gini, captured the spirit of the WEC. He remarked portentously in conference discussion that the 'complete execution of the free trade solution... would not be opportune unless a "Super State" could guarantee the continuity of such a policy, even in times of economic crisis' (Quoted in Manolesco 1931: 223 n. 1).

Labour Organisation. Furthermore, the League's annual *World Economic Survey* (hereafter *WES*) produced by LON economists J.B. Condliffe and later James Meade, did not desist from dealing with problems of international trade policy that involved value judgements.<sup>5</sup> Bertil Ohlin prepared a study which was the forerunner to the *WES* (Ohlin 1931a). He collaborated with the Economic Intelligence Service of the League and ILO economists in surveying the course of the economic depression up to mid-1931. Another principal set of intellectual inputs for this survey were submissions by eighteen economic research institutes and advisory councils from League member countries.<sup>6</sup> Ohlin held the requisite outlook for Geneva: he had already aligned himself with the 'policy of Geneva' in his 'Plea for Freer Trade' (1927).

The Ohlin (1931a) report made three main points in respect of world trade policies. First, the rise of import duties evident from 1929 had increased 'the general feeling of uncertainty' (p. 222), with deleterious effects on investment expenditure and employment. A study commissioned by the ILO supported this conclusion: commercial policies can 'beget uncertainty' when continual 'changes in tariffs make it impossible to place long contracts'. As well, upward shifts in protective duties tended to raise domestic production costs in some countries imposing those duties to the point of neutralising the protective employment-effect of the tariff. A subsequent assertion that 'it does not seem to be in the least doubtful' that, following such upward shifts, the net outcome for all countries since 1927 was a contraction in (some vaguely defined) aggregate world output and employment could not be corroborated (Ansiaux 1931: 148, 151, 155, 170-71); the assertion contained a normative comparison of well-being between losing and gaining nations.

The second finding of the Ohlin report derived from careful empirical work which illustrated that 'Belgium, Holland and Scandinavian countries

<sup>5</sup> Roy Harrod (1937: 707) noted that the author of the *WES* embarked upon 'occasional essays in interpretation', exposing the 'fallacies and excesses' in international economic policy.

<sup>6</sup> Ohlin worked on the report in Geneva from January-August 1931. A list of institutes and councils is contained in Ohlin (1931a: 9-11). Notable individuals consulted included: Hayek and Morgenstern (Austria); Ernst Wagemann (Germany); Verrijn Stuart (Netherlands), and H.D. Henderson (U.K.).

whose domestic markets are the least sheltered against the varying forces of international competition' had, by mid-1931, been the least affected by depression conditions (p. 235). This historically contingent evidence indicated that by not reacting to greater foreign protectionism nations may avoid damaging their domestic economies twice-over: simply retaliating by raising tariffs or using other trade restrictions can reduce the efficiency of local production.

Thirdly, the Ohlin report demonstrated that terms of trade had moved in favour of nations producing tradeable manufactures as opposed primary products (p. 233). At first glance, the terms of trade data in the report suggested support for the views of Graham, Manoilescu and other contemporary economists whose work pointed to the need for permanent protection for nations wishing to sustain an import-competing, labour intensive manufacturing sector. Protection, under certain conditions, could transfer labour (and other factors) from low wage (eg. primary activities) to high wage industries.<sup>7</sup> In the League's and Ohlin's view, the policy implications of terms of trade arguments for protection were not obvious. At least three grounds were presented in League research for demurring from the protectionist implications of the data in Ohlin's report. The first ground derived from close study of real cases and country experiences and of data produced by the Economic Intelligence Service of the League; the second turned on monopolistic phenomena evident in different countries and the third concerned the relationships, if any, between trade restrictions and international transmission of the business cycle. We will discuss these matters *seriatim*.

In taking an ardent internationalist perspective on the economic conditions prevailing in the early 'thirties, Ohlin's report observed a world which was heterogenous with countries in markedly different stages of development, with different degrees of dependence on tradeable goods and exhibiting asymmetries in economic response to tariff changes. Therefore the differential effects of a downturn in the international business cycle could not be easily forecast, and the extensive use of trade

<sup>7</sup> Of course, the subsequent income-distribution consequences were later analysed and formalised by Stolper and Samuelson (1941).

restrictions to create a viable manufacturing sector in any country was no guarantee of immunity from depression:

Some economists...argue that countries in which a balance between the different industries exists - for instance between agriculture and manufactures - are able to resist better than others the disturbing effects of a worldwide depression...It is difficult to see how one relationship between various industries should be more natural or ensure greater stability than another. Obviously, however, countries depending only on one or a small number of industries suffer to an exceptional degree if their industry or industries happen to be severely depressed. Such has been the case of a great number of countries in Latin America and Africa. On the other hand, conditions have been favourable in certain countries with specialised industries which have been relatively little affected. The majority of European States have a varied economic life. Such countries have reached a degree of self-sufficiency as a result of which disturbances in the outside world, acting on their foreign trade, affect them relatively little. During the present depression, the prices of commodities entering into international trade have in general fallen considerably more than those of goods produced for the home market only. Hence countries for which foreign trade is of great importance, such as Great Britain and most extra-European countries with a specialised type of industry, felt the effects of the slump more quickly and more acutely than most others (Ohlin 1931a: 234).

In addition, the variety of international experiences was also brought into sharp focus when considering the internal mobility of factors when market imperfections supervened. In short, monopolistic phenomena blurred the terms of trade argument for protection. Factor mobility in particular was not always perfect within nation states such that it did not respond quickly to market price signals or tariff-influenced price signals. The internal adjustability of prices and factors figured as a major consideration in Ohlin's report. He referred to the widespread 'inelasticity of wages' (p. 231). Moreover, he argued that greater 'flexibility in the price system' (p. 269) may encourage greater mobility of factors between industrial sectors, occupations and regions. However, an overwhelming body of evidence submitted through the League suggested extensive

wage and price inflexibility in member countries.<sup>8</sup> Imperfect competition was also a feature of labour markets; non-competing groups were the norm.<sup>9</sup> Consequently, if a nation's trade pattern alters unfavourably it is not able quickly to respond by changing that pattern appropriately. Increasing labour mobility by subsidising the use of labour in specific activities was considered a better response from an *international* standpoint, compared with various forms of external trade protection. Always preferred in Geneva research (eg. at the ILO) were *direct* domestic policy responses to market failure over trade interventions.

The Ohlin report set in motion League research on the international transmission of the business cycle in the context of rising protectionism in the 1930s. Folke Hilgerdt, who joined the League Secretariat in 1933, cast doubt on the benefits of trade restrictions of any kind for countries specialising in the production of manufactures for domestic consumption and/or for export. Hilgerdt (1933: 289) granted that 'the policy of economic isolation' pursued in some countries and by the U.S.A. from the late 1920s, had the objective of stabilising domestic production and prices. Nevertheless, despite tradeable goods forming a low proportion of national output in the U.S.A., that country was not completely closed from the influence of the international business cycle since it was highly dependent on foreign raw materials. Under these circumstances, it was a patent error to maintain that the observed rise in tariffs could prevent changes in price relations originating from an external source. According to Hilgerdt, tariffs could not immunise a country from being drawn into the international business cycle. If the purpose, as is generally the case, is the protection of manufacturing industries, then raw materials are generally duty-free or only liable to very low rates, while manufacturing goods have to pay rates which increase with the degree of manufacture. The United States tariff is probably one of the most refined in this direction (p. 289).

<sup>8</sup> Thus, the 'present economic system is based on adjustment through changes in the prices mechanism. Into this mechanism elements of rigidity have been introduced, which effect and to some extent impede its working' (p. 273).

<sup>9</sup> The problem of factor market distortions is taken up in a more formal analysis in Ohlin (1931b).

Here tariffs can stabilise the prices of manufactures, but they were not regarded as useful at the time (say in variable form) to stabilize marked fluctuations in the prices of raw materials. Drawing on data from the U.S.A., Hilgerdt demonstrates that capacity constraints tended to raise the price-margin between manufactures and primary products creating a temporary industrial boom.<sup>10</sup> Even without retaliating tariffs, the demand for manufactures in raw materials producing countries will decline. Now a 'liberal trade policy' mitigates against an ensuing, significant economic depression. The foreign demand for manufactures 'has a stabilising effect upon industrial activity' (p. 290).

Two case studies are adduced to support Hilgerdt's contentions. First, in Germany, 'no economic isolation of the same kind as in the United States prevailed before the depression and where, accordingly, a large part of the manufacturing industry was working for export, the export industry was an important stabilising factor.' Second, in the United Kingdom, high raw materials prices are accompanied by increased foreign demand for industrial products and vice versa. That foreign raw materials producing countries are the main consumers of British exports compounded the problem of economic depression in the 1930s. So up to 1933, while some 'modern economists seem to have deprived this doctrine [of free trade] of the bulk of its theoretical significance' (p. 289), Hilgerdt's evaluation of data collected by the League concluded that at least *freer* trade had much practical significance. The increasing trade policy interventions from the late 1920s created only very short-term benefits, and then only to the relatively closed economies such as the United States and France. National measures taken in isolation were fraught with dangers; one of which Hilgerdt identified as domestic inflationary pressures which contributed to the amplitude of the business cycle in the early 1930s.

<sup>10</sup> In a contemporaneous article Keynes (1933) reflected on the drive for 'national self-sufficiency'. He recognised that self-sufficiency and hence internal stability through trade interventions (and possibly currency devaluations), would enable a country to break away from external price level fluctuations. Temporary trade benefits would ensue although, and this is the point of Hilgerdt's contribution, inflationary pressures can weaken the case for self-sufficiency.

In these early studies, the overriding conception of the world economy and international trade policy was one which emphasised interdependence. Exchange rate stability is usually assumed, perhaps reflecting misplaced confidence in eventual return to a gold standard. The world economy was not held together by one predominant trading nation, but many countries diverse in their degrees of dependence on tradeable goods. These countries were bound by long run equilibrating tendencies in their economic interconnections, that is, by tendencies effected through compensatory internal price adjustments. Trade restrictions of any kind masked, but did not ultimately thwart, such adjustments. A debatable normative conclusion, at least from the stance of any *individual* country, was also drawn: every nation is at a maximum in the long run with freer trade.<sup>11</sup>

### 3. Disturbances to 'International Equilibrium': League Assessments in the 1930s

Against the background of the Hawley-Smoot tariff of 1930 and the new British tariff regime of 1931-32, the League's *World Economic Survey (WES)* presented a simple, 'contracting spiral of world trade' in diagrammatic form (*WES* 1932-33: 8). Owing to a considerable fall in prices over the period, the value of trade figures used are somewhat misleading, although the Economic Intelligence Service of the League also collected data on trade volumes (which declined by 25%, 1929-34; Condliffe 1935b: 23). John B. Condliffe, the author of *WES*, quickly attributed the contracting spiral primarily and directly to 'a veritable rise of economic armaments' due to a breakdown in the fragile spirit of international trade policy cooperation originally created at the 1927 WEC (*ibid.*: 25, 29). Quotas, prohibitions, higher tariff and non-tariff barriers and competitive devaluations compounded the problem.

<sup>11</sup> This normative proposition was formally explored by Samuelson (1938). The welfare economics of free trade in the late 1930s demonstrated that trade restrictions can improve the terms of trade and welfare of the country imposing them. It is not a foregone conclusion that world welfare declines since the gain of one country has to be set against the losses of others. This issue was *not* recognised explicitly in early Geneva research.

League research produced data showing relatively price-inelastic demand for agricultural commodities in importing countries. Now, if the elasticity of foreign demand is not great, this provides a rationale for any *one* country autonomously to introduce restrictions on trade and increase domestic employment. The latter would be bolstered if actual or potential retaliatory measures did not have much potency for the country in question (Condliffe 1933b: 654-55; Ohlin 1936: 103). Here immediate domestic employment effects may be the *singular* trade policy desideratum rather than the value or volume of trade. Notwithstanding this well-understood rationale in Geneva (and even the 'optimum tariff' argument was vaguely recognised in relevant research reports from the early 1930s), it did not seem to League researchers that these arguments were applicable to a world which had embraced a generalised acceleration of trade restrictions. That these restrictions were accompanied by an ongoing reduction in the volume and value of trade reinforced their scepticism. The other argument which could have been made but was not, would have likened tariffs to monopoly restrictions in which case the loss imposed in some countries may be represented, under certain conditions, as being greater than the gain to the tariff implementing country. The maintenance of all the resource allocative inefficiencies implied thereby would have strengthened the League's preference for freer trade. However, not until the mid-1940s was this argument formally expressed in the literature on trade theory.<sup>12</sup>

Condliffe (1933b: 655) concluded gloomily that 'a reduction of tariffs' from 1933 'will not alone suffice to restore world trade'. The wholly provisional, bilateral character of international trade policy negotiations post-1932 were not a cause for celebration. The 'new protectionism' or 'new mercantilism' as it was later dubbed, made

<sup>12</sup> Samuelson, Scitovsky and Lerner were the leading theorists on this matter. See Metzler (1949: 74-75). Broader efficiency considerations bearing on this argument are canvassed in Ohlin (1936: 63) and we find Ohlin's (1938: 506) review of Haberler (1936) anticipates results of the relevant positive trade analysis in the 1940s: 'Surely if a free-trade country alone raises tariffs during a depression, it can bring about a large increase in employment, and part of it may be retained even if other countries retaliate'.

extensive use of discriminatory bilateral tariff treaties, monetary and quantitative restrictions (*WES* 1935-6: 192; Condliffe 1941: 307). The *WES* surveyed the content of these developments, concluding that they were invariably 'short-term compromises...designed to make possible the continuance of at least a minimum of foreign trade', especially in raw materials (1932-3: 206). The noticeable trend toward bilateralism had the policy objective of trade balance equalisation; narrow arrangements were the norm so that combining certain import-export arrangements with 'most favoured' third parties was usually ruled out. Presumptively, trade-diverting effects were thought to dominate trade-creating effects. Therefore, while the trend toward bilateralism led to some downward tariff adjustments, it could not quell the 'present riot of nationalism'. However 'defensible such policies may have been in particular cases, they are in aggregate a flight from reality. The reality is that the peoples of the world are, and must be, interdependent' (*WES* 1934-5: 192).

The impulse exclusively to adopt bilateral policy reforms was demonstrably linked to the difficulty in procuring raw materials. The outcome was a set of complex, disparate and unstable short term relationships. Reciprocation was subject to political factors and power considerations. A new trend was discernible in trade relations: in order to avoid retaliatory measures, each country imposed new restrictions on the products of countries in relation to which its bargaining power was strongest, that is, with which it had a positive trade balance (*LON* 1933a: 30). This was a contagious policy which had little to do with a more liberal approach to commercial policy or a 'second best' option to freer trade. The League's report on raw materials trade concluded that bilateral agreements had not significantly facilitated access to markets for manufactures (*LON* 1937b: 28). The 'new protectionism' was changing the structure of world trade. The Geneva researchers occupied a sheltered observatory so to speak - spectating on an intensifying international struggle resulting in the domination of underdeveloped countries by strong industrial nations which would ultimately endanger world peace (Hilgerdt 1935). Moreover, the League observed trade policy regimes informed by the

erroneous belief that there was a constant market which each country can reserve for itself.<sup>13</sup>

The WES (1935-6: 183-84) denounced the bilateral 'canalising' of world trade because it broke the 'essential links in the chains of transactions; it cause[d] the unprecedented fluctuations in prices, the disorganisation of production, default on financial obligations and piling up of stocks...[which] are still leading to fresh disturbances of international economic relations'. Previously League research has conceived of the world economy as an organised series of closely interlocked and interdependent markets, the comparative smoothness of whose adjustment had led to an underestimation of its importance now that specialised international system had now been abandoned. The Geneva ideal of competitive, multilateral trade based on equivalence of trading opportunities was an anachronism elsewhere.<sup>14</sup> In seeking intellectually defensible economic arguments for their disdain of bilateralism the League economists conjoined, rather casually, their more applied work on trade patterns and policies with general equilibrium analysis in the Walras-Cassel tradition (and Ohlin's innovatory work in that tradition in particular).

Condliffe's articles in *Svenska Handelsbanken (Index)* illuminated the idea that international trading relationships are underpinned by an 'economic equilibrium' which 'has proved a very powerful instrument of analysis if only because it emphasises so strongly the multilateral and interdependent nature of all causation that must be reckoned with in all economic phenomena'. The foundations of equilibrium are located in

<sup>13</sup> Later Condliffe (1941: 288) used a more sweeping generalisation to describe those trade policy developments in the 1930s which relied on bilateralism: it had 'been used to complete the destruction of nineteenth-century trade and investment and with it the organisation of world production by private enterprise'. The LON (1942: 71) chimed in with the remark that each 'bilateral agreement was *sui generis*, designed to meet the special trade requirements of, and to afford effective reciprocal advantage to, the signatories. Commercial agreements, in truth, became instruments of commercial warfare'.

<sup>14</sup> That the now 'normal' function of the nation state was to *plan* foreign trade was anathema in Geneva (see Condliffe 1941 and Heilperin 1946). And the direction of policy formulation had deviated from a clear focus on tariff instability which preoccupied post-1927 WEC discussions. Tariffs *per se* were playing a 'much less important role than formerly' (WES 1935-6: 185). More insidious controls were now in place internationally.

'the theory of pricing' (Condliffe 1933a: 226). Multi-market, country and regional interdependence had taken the form of competitive 'price bargaining' over tradeable goods and services, where the prices were conferred with integrity and stability by an internationally accepted gold standard. Condliffe paid obeisance to Ohlin and Haberler for extending the theory of pricing, as he called it, to international trade. Indeed, in his 'Preface' to *Interregional and International Trade*, Ohlin (1933: vii) acknowledged that he had constructed a theory of international trade 'in harmony with the mutual-interdependence theory of pricing', citing, *inter alios*, Walras, Wicksell and Cassel as precursors.

Condliffe contributed a loose concept of 'international equilibrium' constructed at a lower level of abstraction from that found in the contemporary formal, high theory of Ohlin and Haberler. He wished to move fluidly between observation of actual trade relationships, patterns and problems, and analytical developments in contemporary trade theory. Ohlin's work became a subject for critical scrutiny. Condliffe claimed that his general perspective encompassed 'dynamic' economic forces in a real 'network of international trade' (1933a: 229; *WES* 1931-2: 273). He perceived a 'series of intersecting equilibria set in space as well as time', thus advancing beyond the static, spatial notions which were the hallmark of Ohlin's contribution. We are treated to a glimpse - only a hint of recognition - that Ohlin's theoretical apparatus was difficult to apply to the evolution of international trade in the 1930s.<sup>15</sup> Condliffe's is still a non-monetary, classical 'theory' of international trade with price changes (rather than, say, Keynesian effective demand or income changes) acting as the centrepiece of international adjustment. The increasing inflexibility of national price structures during the early 1930s had not merely shattered any semblance of international equilibrium; it also undermined the possibility of smooth, low-adjustment cost transitions from one equilibrium to another as world trade and living standards increased *pari*

<sup>15</sup> Ohlin (1938: 498 note 1) later remarked: 'a great defect of my own work...[is] that the 'dynamic' parts - which occupy a large part of the book [Ohlin 1933] - are interwoven with the 'static' parts in a confusing manner. By 'dynamic' I mean anything that is relative to *time* i.e. deals with *successive* stages - while a 'static' theory compares *alternative* positions, without considering the transition from one to the other' (his emphasis).

*passu* (Condliffe 1933a: 233). The world economy was no longer an organised, 'developing organic whole' precisely because price signals were not able to operate in a manner which automatically supported world trade.

Following Ohlin and Haberler (the latter joined League researchers in 1934 through 1936), the imposition of higher trade barriers is interpreted as being equivalent to creating more space barriers, pushing national markets apart and thereby adding more noise in the transmission of market prices. International competition working through price changes in fact brought spatially dispersed markets into a closely bound network which could adjust quickly to exogenous shocks (Condliffe 1933a: 236-37; *WES* 1934-5: 184). In a subsequent article Condliffe (1935a: 3) did not explicitly recognize the Heckscher-Ohlin result on factor price equalisation, but he broadened the idea in asserting that the international gold standard operating in an environment of 'relatively free trade' produced 'harmonisation, by international competition, of the different national price and cost structures'. Trade restrictions disrupt these stable 'natural' structures. However, to the extent that trade restrictions, especially tariffs, are not altered too frequently the price system could work within and through such barriers. By contrast, quotas and quantitative prohibitions place 'insuperable obstacles' to the operation of market prices since they cut-off price signals altogether.

In view of the foregoing considerations, by early 1935, Condliffe communicated what was a carefully reformulated Geneva position. Tariff changes and price changes effected by currency adjustments were adjudged to be more acceptable responses to balance of payments problems for any country. These instruments were tolerable, second best, short run adjuncts to a long run policy agenda emphasising freer trade.<sup>16</sup> In the long run scenario constructed in Geneva during the mid-1930s, all countries were exhorted to adopt a general principle turning on 'gradual removal...of trade restrictions' - especially of quotas and exchange controls - a principle little

<sup>16</sup> The distinction between tolerable short-run trade interventions and long-run liberalisation through, for instance, negotiable, reciprocal tariff reductions was also drawn in an official LON memorandum (see LON 1936b).

changed from that adopted at the 1927 WEC.<sup>17</sup> It was fully endorsed by ILO economists (Martin 1936: 640-41; 1937: 196). There is a crucial shift in perspective here; it contains an insight predating Samuelson's (1939) positive, analytical contribution on the gains from international trade. Condliffe's argument, deriving for the most part from analysis of data flowing into the League's Economic and Financial Section, was similar to Samuelson's, for it reduces to the proposition that some degree of trade, however restricted by tariffs in particular, is necessarily better for all countries than no trade.<sup>18</sup> We turn in the next section to the Geneva proposition that multilateral trade is economically superior to other trading relationships in the long run.

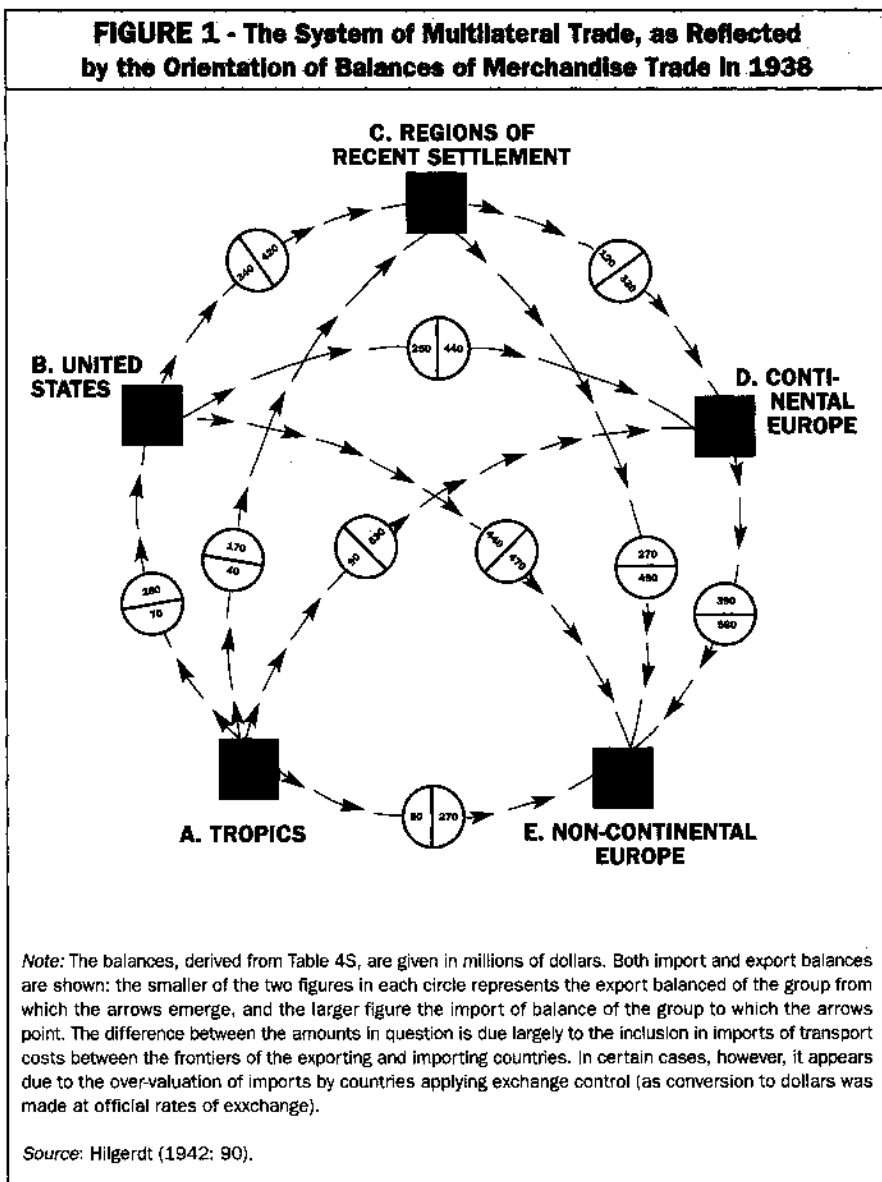
#### **4. Hilgerdt's Pioneering Calculations and Revisions in Geneva Trade Policy Doctrine**

When Hilgerdt (1942) operationalised Condliffe's 'network of world trade' idea, Geneva researchers were no longer subjected to censure the whole host of trade interventions introduced during the 1930s. Hilgerdt's data may have engendered some confidence in the system of multilateral trade (which he depicted in a flow diagram reproduced as Figure 1 below). His calculations for 1938 in Figure 1 present a system of economic interdependence which had not been extinguished by the expansion of trade barriers in the 1930s; only a 'gradual disintegration' was observed compared to a similar model constructed for 1928, so the network was still intact (Hilgerdt 1942: 78, 91).<sup>19</sup>

<sup>17</sup> Condliffe (1935a: 16). This exhortation was entirely consistent with a 1936 tripartite agreement on commercial policy between France, the U.K. and U.S.A. which vowed to 'attach the greatest importance to action being taken without delay to relax progressively the present system of quotas and exchange controls with a view to their abolition' (Martin 1937: 189). Tariffs and non-tariff barriers were conspicuously excepted.

<sup>18</sup> Condliffe's view diverges from Samuelson's results which held for any kind of trade intervention - tariffs or quantitative controls.

<sup>19</sup> See also LON (1941: 80) which demonstrates how many European countries 'managed to maintain their trade with some degree of success during this period of hampered international transactions'. It was accepted at the League that *substantive* most favoured nation clauses granting benefits to third parties in trade agreements, preferential agreements in other spheres and regional agreements, were all conducive to the maintenance of international trade. They were legitimate second best options (WES 1937-8: 159; Condliffe 1941: 295-327; LON 1942: 58, 70, 127).



His influential pioneering model demonstrates the immense quantitative significance of multilateral trade in 1938, and was described in League publicity as a depiction of a well-functioning 'worldwide vascular system' (LON 1942: 165). Hilgerdt's (1943) paper in the *American Economic Review* represented his calculations as providing evidence for

arguments promoting multilateral trade - they were not to be regarded as mere historical artefacts. His data for 1938 show a latent degree of international integration. The full potential of multilateral trade may be actualized through postwar international organisation and coordination on an extensive scale (p. 407). Just how that outcome might be effected remained opaque.

Disturbances to the network of world trade in the late 1920s and early 1930s were not directly attributable to modifications in commercial policy, but to deeper cyclical causes. Contrariwise, the improved state of international trade identified in the *WES* for 1937-8, 'was the result rather of general economic recovery than of any great change in commercial policy' (p. 137). That each country's trade interventions reduced the volume and value of trade in the aggregate in the 1930s was viewed as an unwanted consequence of rational actions taken to meet the exigencies of international balance in the face of an exogenous disturbance. Trade policy responses were often destabilising of the international 'vascular' flow; the supervening impact of war made the matter worse. Condliffe and Stevenson (1944: 64), reporting for the ILO, reviewed Hilgerdt's model, concluding that 'economic systems are no longer meshed into a stable international equilibrium'. War, not trade interventions, was the culprit.

Influenced by the effect of trade policies on labour in particular, ILO economists also shared the shift in perspective in Geneva toward accepting the need for trade interventions in the short run. The ILO Director averred in 1939 that economic 'isolation is no solution to the problem presented by the unequal distribution of natural resources and the need for markets'. The gradual 'withdrawal of nations from the world system of trade' observed in the 1930s was tantamount to requiring workers to work longer, eat less and lower quality food, and tolerate poorer housing conditions (ILO 1939: 32). These consequences notwithstanding, trade restrictions in the 1930s needed to be appreciated as policy responses used to maintain high levels of employment, 'at least for a limited time' (ILO 1940: 5-6, 69-70). Another researcher in Geneva characterised this view as a legitimate socio-economic argument. Thus William Rappard's 1938 Cobden Lecture rated this position as '[m]uch more important than either the purely

economic or financial' case for trade interventions. The objective of governments is 'to avoid the sudden dislocation of the social and economic structure...[;] to combat unemployment or to protect its balance of payments' (Rappard 1938: 56).<sup>20</sup>

The ILO regarded the income accruing to labour and not just the prevention of mass unemployment and social instability as a preeminent consideration. Here, factor prices, especially labour incomes, were positively responsive to changes in domestic prices caused by trade policy adjustment. Thus, 'it is conceivable that a country which has restricted its foreign trade might nevertheless be able to maintain a higher level of real income for labour than other countries in which the volume of international commerce remain unchanged. For instance, the adverse effect of trade restrictions on the terms of trade of the latter might more than offset their advantages of specialisation arising from international commerce.' (ILO 1940: 69). Finally, the ILO report reflected on the impact on allocative efficiency of trade interventions and, when considering uses of 'the world's economic resources' rather than those of any one country, 'a loss of efficiency' is implied by a general move toward extensive restrictions. Hence the imperative to focus on long run efficiency objectives and not merely problems created by short run cyclical factors (p. 10).

Researchers at the League appreciated the ILO point of view. There was much rigidity observed in economic structures, particularly in industrialised nations with highly specialised physical capital investment, and organised labour. The resistance of both capital and labour to cuts in nominal profits and wages respectively, induced attempts 'to buttress existing industries by all appropriate means', notably by trade interventions (LON 1942: 121-22). The Economic and Financial Section of the League went so far as to sympathise with exchange controls as 'an essential prerequisite' for some countries aiming to defend their currencies against the background of a deteriorating trade balance (LON, 1938b, p. 5). Emphatically *not* countenanced was the use of exchange controls or other trade interventions to maintain large export surpluses rather than to reduce unsustainable deficits. Exchange rate realignments were preferred as a

<sup>20</sup> Rappard was Director of the Geneva Graduate Institute of International Studies.

means of preventing a cumulative decline in the volume of world trade and restoring capital movements between countries. Such realignments were an integral part of a long run agenda for a freer world trading system. However, exchange rate changes should not in principle be used in a manner analogous to other trade restrictions simply to export unemployment - a distinction which in practice was often difficult to make. By contrast, in the plethora of reports from the ILO, League and Graduate Institute of International Studies in the 1940s on trade-related issues, it is difficult to find one kind word for quantitative trade controls. The Haberler-led study for the League denounced quantitative controls regarding them as a resort to 'the line of least resistance' when less damaging forms of intervention allowing the price mechanism to function could have been employed. If quotas were still preferred then, at the very least, import licenses should be auctioned to the highest bidder (Haberler 1943: 37, 41).

## **5. Freer Trade, International Agreements and Macroeconomic Management**

In the realm of positive trade analysis, when Tibor Scitovsky (1942) reconsidered the theory of tariffs he unwittingly provided the intellectual rationale for a long-running Geneva theme insisting on the need for international cooperation in trade policymaking.<sup>21</sup> Intractable political constraints were often deliberately set aside when League researchers prescribed more cooperation (LON 1939b). They knew well that economic and political factors were intimately connected and the mere desire for cooperation was insufficient to ensure successful collaboration. Scitovsky demonstrated two outcomes that tariff retaliation would have: bilateral barter arrangements or unstable short term tariff bargaining games. Tariffs were a rational reaction by one country in order to profit (or at least to

<sup>21</sup> The best capsule summary of this theme is Condliffe (1941: 355-94). It is also a theme in James Meade's work before he joined the League in 1937 (see Meade 1933). The *WES* which Meade compiled from 1938 also reiterates the international cooperation theme in relation to trade policy (*WES* 1937-8: 165). Although Keynes championed the ideal of international cooperation he specifically nominated monetary arrangements and public investment rather than trade policy (Keynes 1981: 151-53). See also Rappard (1925: 70-85) on League efforts to effect international cooperation in the early 1920s.

obtain a more favourable trading position) *vis-à-vis* the actions of others. The effect of *all* countries following a policy of retaliation could be to reduce the welfare of each of them - but this was not foreseen by any one player. Once the game had begun, this 'rational' interest in higher tariffs not only (and unintentionally) described aspects of actual trade policy practice in the 1930s quite well; it was remarkably consistent with the Geneva researchers' interpretation of trade interventions in that period. Furthermore, Scitovsky characterised an 'ideal' free trade world as a cartel which contained forces tending toward disintegration unless some international trade conventions were established and enforced.

Viner's (1943) study for the League seemed to have Scitovsky's results in mind. Viner accepted as given that some countries rigidly controlled their trade relations. To avoid complete disintegration and regression toward state controlled bilateral arrangements he suggested a multilateral conference - not merely for a rapprochement between countries - but to formulate a binding 'international convention'. That convention would set a time schedule for reducing trade restrictions postwar; define illegitimate trade practices and establish an international agency to monitor and arbitrate on changes to trade interventions. All this accorded well with the normative exhortations from Geneva throughout the 1930s in favour of freer trade through international cooperation. These were not empty, pious exhortations because they derived from extensive empirical work and case studies and turn on the consequences of trade interventions (although they sometimes lacked formal theoretical foundations). The policy desiderata were nevertheless quite transparent; microeconomic liberalisation must be assisted by an international management mechanism for meaningful trade policy reform incorporating something like an international code of conduct. Later, of course, this was ultimately realised by the machinery of the GATT.<sup>22</sup>

Microeconomic liberalisation coupled with macroeconomic management (including international management) were central to

<sup>22</sup> Haberler collaborated with League researchers to produce a report on quantitative trade restrictions which came close to anticipating postwar developments. The report recommended international supervision of trade intervention and the use of an international veto mechanism (Haberler 1943: 45).

League reports in the 1940s. Were these ideas compatible? The problem of how to engender greater efficiency and order in international trade through liberalisation had to be reconciled with 'Keynesian-type' macroeconomic policies which had delivered a vital message in the interwar years on how to increase employment in a world of persistent demand deficiency (LON 1945b: 160-68). Employment levels were no longer to be allowed to fluctuate markedly from a high level. Discriminating trade and exchange restrictions could therefore be justified to reduce the propensity to import when the high employment objective conflicts with exchange rate stability and the maintenance of favourable terms of trade. Keynes's (1936: 338-39) important caveat was that the avowedly 'treacherous instrument' of trade restrictions should not be part of an 'immoderate policy' to secure and maintain a maximum favourable trade balance.

The full employment objective could conflict with measures to preserve and extend international collaboration on trade policy, especially when the volatile forces of international competition might be allowed full dominion. Nonetheless, freer trade would be resisted without a favourable macroeconomic situation. As James Meade wrote in the League's *WES* for 1937-8, 'attempts to secure freedom of trade are intimately connected with the maintenance of buying power' (p. 165). In accepting the basic Keynesian position - advocacy of monetary and fiscal policy activism in pursuit of full employment - League economists were set free to argue vigorously that commercial policy no longer be used as an instrument of national counter-cyclical policy.<sup>23</sup> ILO reports reflected on deeper issues in this context. Full employment may well be achieved but living standards for those employed could be improved by adopting freer trade. Further, the long run *maintenance* of full employment depended on the growth of world trade (Martin 1937, p. 196; Condliffe and Stevenson 1944: 75-6, 112). A more liberal commercial

<sup>23</sup> Keynes of the *General Theory* would have concurred with the Geneva perspective in the 1940s: 'if nations can learn to provide themselves with full employment by their domestic policy...[i]nternational trade would cease to be what it is, namely, a desperate expedient to maintain employment at home by forcing sales on foreign markets and restricting purchases' (1936: 382).

policy assured more 'efficient employment' (LON 1945a, p. 30). Many small open economies in fact relied on freer trade to secure full, efficient employment. In this connection, the League's (1945b: 242) report looking toward postwar stability remarked on the need to combine domestic Keynesian-type policies with trade policy reform. It noted the dependence of many agricultural and mining countries upon foreign trade; but certain highly industrialized countries are scarcely less dependent. When capital goods constitute a large proportion of their exports, these countries are particularly susceptible to fluctuations in economic activity abroad. When in addition their imports consist largely of indispensable foodstuffs, their balance of payments becomes particularly vulnerable. Neither these countries nor certain of the smaller industrialized states with highly specialized export industries can hope to maintain a high and stable level of employment by means of domestic compensatory policies alone.

A clear sequencing preference emerged in Geneva research: liberalisation of trade policy encourages microeconomic adjustments only *after* domestic monetary and fiscal policies were used to manage aggregate demand and the exchange rate used to manage trade imbalances. *A fortiori*, exchange rate management would be more effective with freer trade.<sup>44</sup> Exchange rate adjustments could also be implemented in an orderly fashion by establishing a managed world currency system but this was dependent on international collaboration. Ragnar Nurkse (1944: 208) explained the preferred course of action at the League in respect of commercial policy: anything tending permanently to restrict and distort the international division of labor must lower the efficiency of economic effort and the standard of material welfare in all the countries concerned. While some of the social priority considerations inherent in commercial policy may have to be accepted as a datum...liberalisation [can be promoted] by lessening the need for...the general uses of commercial policy in relation to the balance of payments.

Trade policy reform is more easily implemented against the wishes

<sup>44</sup> These ideas provided precursory foundations for the U.N.'s programmatic report *National and International Measures for Full Employment* (1949) which recommended countries maintain net capital exports or sell their currencies against other currencies if external disbursement on current account fell below normal.

of sectional interests when there is full domestic employment. While the desirable direction of reform was clear, the difficulties of the reform task were not underestimated. Bilateral arrangements and, more crucially, multilateral negotiations were required postwar (LON 1942: 163; 1945a: 27-29). That the terms of reference for these negotiations may be dominated by institutional imperatives contrived by one or two nation states did not disconcert Geneva researchers. Scitovsky's (1942) message may well have been heeded: freer trade would have to be enforced by international agreement or imposed by dominant, large nations against each country's selfish, myopic requirements. Condliffe (1941: 394) advanced further; he concluded proceedings of the 1939 Bergen conference on international trade and world peace with remarkable foresight: 'it must be an American dominated system, based on Pax Americana'.

## **6. Summary and Conclusions**

A cosmopolitan group of economists working on trade policy matters in Geneva - Condliffe, Haberler, Hilgerdt, Meade, Nurkse, Ohlin and Viner - were responsible for producing a substantial, Scandinavian-influenced research program. The sterile debate between impossible alternatives of completely free trade and autarky is avoided; instead the focus of attention is actual policy problems and changing trade patterns. It was a program informed by evolving, real case trade interventions and negotiations, and by an impressive (for the time) data base - both quantitative and institutional - collected by the League's Economic Intelligence Service.

If there was a major theme in Geneva research it was the unrelenting internationalist perspective. It was therefore always sceptical of single-country motivated optimal tariff arrangements and of the general applicability of cases for trade intervention aimed at securing balanced industrial development (with a labour intensive, import competing sector usually demanding protection). Ohlin's influence is manifest on Geneva researchers who understood the importance of factor market failure (factor price inflexibility and factor immobility) which was best dealt with

by internal microeconomic policies rather than trade intervention. It would not do, according to the Geneva program, to cite the business cycle experience of the early 1930s as a reason for resorting to permanent protection. The international business cycle was eventually transmitted with or without increased trade intervention. Hilgerdt's early empirical work suggested that freer trade in the 1930s would have reduced the depth of the 1930s depression since it would have dampened inflation pressures in the larger, relatively closed economies.

Contemporary advances in the pure theory of international trade had tangential implications for trade policy issues. Some of these implications were eventually heeded in Geneva, others disregarded. In one case it was evident that an ILO report anticipated a policy implication of the Stopler-Samuelson theorem. Whereas trade theory reasoning was ultra-formal and axiomatic, Geneva research was preoccupied with practical international economic relations and concrete trade policy problems constrained by institutions and history. While not using formal models, some important theoretical constructs were presented: for example, Condliffe forged links between Ohlin's general equilibrium approach to internal trade by contemplating a dynamic 'network of world trade' - a multilateral network integrated by market prices rather than quantitative, administrative controls. He insisted on this network's essential stability and on its resource allocative benefits provided it was not too frequently disrupted by shifts in trade interventions, or by discriminatory bilateralism. Hilgerdt operationalised the network for 1938; used it to demonstrate considerable trade integration despite the rise of protectionism in the 1930s and to indicate the potential for greater multilateral trade if only trade was liberalised.

The Geneva perspective advocated freer trade; it represented genuine multilateralism. Early on the prescription that each country was at a maximum in the long run with freer trade (an argument under certain conditions later questioned by Samuelson) gave way to a distinction between warranted, short run depression or employment policy expedients and international agreements and conventions designed to realise freer trade in the long run. Scitovsky's reassessment of the theory of tariffs ran parallel with research in Geneva. Rather than rely on homilies

about the need for more international cooperation, this research emphasised the importance of binding international agreements to expand multilateral trade and avoid aggressive bilateralism.

Keynes's ideas on trade policy in the interwar period, unlike the implicit freer trade message in Ohlin's work, did not hold sway in Geneva; at any rate they were not cited. Yet the influence of the elementary 'Keynesian' idea that aggregate demand could be actively managed by monetary and fiscal policy was acknowledged. This idea was then enlisted when promoting microeconomic liberalisation through freer trade. By the 1940s the Geneva researchers superannuated the notion of general trade interventions (for whatever nominated national objective). No longer were these interventions considered a necessary instrument for pursuing short run internal balance. However, specific interventions for economic purposes were favoured, such as exchange rate adjustments to correct persistent external imbalances.

There was nothing naive or idealistic about the Geneva freer commercial policy orientation. The view from Geneva eventually triumphed given the direction of trade policy reform post-1945; it commanded a consensus that, when national trade interventions have negative international consequences, international action is required. The profusion of trade policy research reports from Geneva in the 1930s and 1940s found many different ways of expressing this deceptively simple proposition. A study of the intellectual background to the GATT, as opposed to the much-discussed economic history setting, would be seriously incomplete without saluting the achievements of the Geneva research program. That program derived much of its fertility from contemporary developments in Scandinavian international economics. Specifically it owed much more to Ohlin than it did to Keynes and it ultimately provided the intellectual rationale for the freer trade machinery of the GATT.

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