

# Jacob Viner, the Cost of Protection, and Customs Unions: New Light from a Manitoba Consulting Assignment

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**Abstract:** This paper considers an extraordinary and almost unknown document which came out of a consulting assignment Jacob Viner undertook for the Canadian Province of Manitoba in the late 1930s as part of the Canadian Royal Commission on Dominion-Provincial Relations. Viner analysed the Canadian Federation as a customs union and the evidence points to this having an important influence on his development of his thinking on the theory of customs unions, in particular providing a concrete example of trade diversion, and developing his understanding of the circumstances which affect the magnitude of trade diversion losses when assessing the overall impact of customs unions. Despite its sophisticated understanding of the role of tariffs on inputs, and links to economists who developed the concept of effective protection, it does not have a place in the history of the concept of effective protection.

## 1. Introduction

This paper considers an extraordinary and almost unknown document which came out of a consulting assignment Jacob Viner undertook for the Canadian Province of Manitoba in the late 1930s as part of the Canadian Royal Commission on Dominion-Provincial Relations.<sup>1</sup> Viner saw the calculation of the burden on Manitoba of being part of the Canadian Federation as equivalent to estimating the net benefits of a country joining a customs union, and carried out detailed dollar calculations of what he would later call trade diversion losses in the report he prepared for the government of Manitoba. It is extraordinary given the state of development of tariff theory and the available data in the 1930s.

Viner's work in connection with the Royal Commission has escaped the attention of historians of international economics, writers on the economics of customs union, and even writers on Canadian tariff policy (for instance it is not cited in Barber 1955). Max Corden was one international economist aware of its significance, as Viner mentioned his report in reply to a letter from Corden sending Viner offprints of his work on the calculation of the cost of protection (Corden to Viner, 22 October 1957, in Viner papers). Following Viner's reply, Corden was able to track down Manitoba's 1937 *Submission Presented to the Royal Commission on Dominion-Provincial Relations* in his university library, and made detailed notes on it, comparing it with the method used in the famous Australian Brigden Report (Corden to Viner, 30 April 1958, in Viner papers). Corden could not locate Viner's 1938

*Supplementary Statement* to the Commission so Viner later sent him a copy (Viner to Corden, 9 May 1958).<sup>2</sup>

As well as alerting international economists and historians of economics to the existence of this document, the paper considers its significance for two questions.

The first is the question of the influence of the Manitoba assignment on Jacob Viner's work on customs unions, which culminated in his classic *The Customs Union Issue* (Viner 1950). Viner had been thinking about this issue since his employment by the US Tariff Commission as a special expert in 1917-18, an appointment sandwiched between his Harvard PhD under Frank Taussig, on the international adjustment mechanism in Canadian trade (published as Viner 1924a), and his appointment as an assistant professor at the University of Chicago. He published two early articles (Viner 1924b; 1931) on the economics of preferential trading arrangements but nothing else of substance on the topic until the 1950 book.

The secondly question concerns the place of Viner's Manitoba work in the story of the concepts of the cost of protection and effective protection in international economics. Some of the circumstances of the work, such as the geographical and temporal connections with the Manitoba economist Clarence Barber's discussion of the concept of effective protection (Barber 1955, which Max Corden cites in his own account of the story of effective protection, Corden 2005), and the early correspondence between Corden and Viner, might suggest that Viner's work contributed to the development of the idea of effective protection. After all Viner has a reputation for not pressing claims in relation to ideas associated with others which he is now recognised as pioneering, for instance the theory of monopolistic competition and the theory of second-best (Samuelson 1972).

## **2. The Manitoba Assignment**

Jacob Viner was engaged by the Province of Manitoba to assist with its case for budgetary assistance in the Canadian Royal Commission on Dominion-Provincial Relations. He was well qualified as a Canadian who had taken US citizenship following PhD studies at Harvard, and who had risen rapidly to full Professor at University of Chicago. A number of pathbreaking articles had established his reputation as an economic theorist, his *Studies in the Theory of International Trade* had just been published, and he had experience as a policy advisor to the League of Nations and US Treasury among other organisations.

The Royal Commission on Dominion-Provincial Relations was established in 1937 by the Canadian Government to examine ‘the economic and financial basis of Confederation and the distribution of legislative powers in the light of the economic and social developments of the last 70 years’. Essentially the problem was that the Provinces believed the taxation powers granted to them were inadequate and that some adjustment by the Federal Government was required.<sup>3</sup> Tariffs and duties were particular issues. Viner assisted with Manitoba's submission to the Commission, entitled *Manitoba's Case – A Submission Presented to the Royal Commission on Dominion-Provincial Relations, Winnipeg, November 1937*, and had most input into *Part IV: The Effects of Federal Tariff Policy on the Western Canadian Economy* (Viner 1937), although he noted in correspondence that because of severe limitations on his time, and logistical problems, his contribution was less than he would have liked. Viner was based in Chicago and the relevant Commission hearings were in Winnipeg and Ottawa. Professor Kenneth Taylor on behalf of the Province of Ontario presented a critique of the initial Manitoba submission, to which Viner responded in *Manitoba's Argument with Respect to the Burden on the Prairie Provinces as a Result of Dominion Tariff Policy – a Supplementary Statement* (Viner 1938).

The eventual report of the Commission (Government of Canada 1940) recommended, among other things, grants to Provinces including Manitoba out of federal tax revenues in recognition of the demonstrated burden the Federal tariff imposed on them

This was a rare excursion into paid consulting work for Viner, and his contribution was greatly appreciated by the Manitoba Treasurer, the Hon. Stuart Garson, who wrote to Viner (20 February 1939): ‘may I express the appreciation and gratitude of my colleagues and myself for the splendid way in which you handled your end of our case’, enclosing a cheque for \$2935. This was a significant sum. Viner's papers record his salary at various points, unfortunately not 1939, but extrapolating from the records it was probably about half his annual salary at the time.

### **3. Viner's Contribution**

Both in the initial submission and supplementary statement Viner framed Manitoba's argument in customs union terms – considering the impact of it being part of the Canadian Federation. Manitoba's situation according to Viner was that the Canadian tariff priced lower cost US producers out of the market, so that goods were instead imported from higher cost Canadian

producers, mostly located in Ontario. This was true both for consumer goods and inputs for Manitoba's agricultural export industries, as well as for government purchases. There was little possibility of expansion of the Manitoban industry as a result of the Canadian tariff, but a large benefit to Ontario producers. A terms of trade benefit might also be expected, as the tariff would reduce demand for imports, but since foreign demand for Manitoba's exports was almost perfectly elastic, the terms of trade benefit to Manitoba would be minimal. Any terms of trade benefit would accrue to Ontario and the other industrial Provinces. Here was a classic case of losses due to trade diversion that Viner was to famously discuss two decades later.

The terms of reference of the Royal Commission meant that only a demonstrated impact on Manitoba government finances would justify a grant. This meant that Viner had to begin his argument by broadening the discussion beyond higher prices the Provincial governments might pay for imported goods, and consider the incomes of Manitobans, since the incomes of Manitobans influence both Provincial tax revenue and government expenditure – ‘pauvre pays, pauvre roi’ (Viner 1938, p. 2).

He observed that the measurement of the tariff burden is ‘not a simple question ... economists and others have wrestled with it for over a century’ (p. 3) but went on to define the burden as ‘the reduction of real income resulting from the tariff’ (p. 3).<sup>4</sup> In the Commission's deliberations the average duty on commodities imported had often been used as a measure of the burden of the tariff. Viner observed that this was unsatisfactory because many commodities cease to be imported after imposition of the tariff (p. 6). A better procedure would be to compare prices either side of the border between the USA and Manitoba, on the assumption that differences are due to the tariff (p. 7). This meant sampling prices, and constructing price indices. The impact on a representative farm family was calculated, then transformed to give an impact on the Prairie Provinces population as a whole. Viner and his team were working with extremely limited data, and many less than satisfactory approximations had to be made in the report.

Viner then provided an extended discussion of conceptual problems with the procedure, including capital and population mobility, changes in consumption patterns and changes in technology induced by the tariff (pp. 9-15). He discussed the loss due to reallocation of expenditures induced by the change in prices associated with the tariff, but with the data available ‘a money figure cannot possibly be put on it’ (p. 40). In the end, Viner's estimate of the annual burden to the people of the Prairie Provinces was approximately \$47 million dollars

(p. 41), and considering average provincial tax rates, the impact on provincial tax revenue was approximately \$5 million. In addition the report noted there would be higher prices of equipment and supplies purchased by the government and greater need for social service expenditures (p. 42).

The underlying model Viner is working with was highly sophisticated, and the exercise impressive within the constraints he faced.

#### **4. Customs Unions**

What contribution did this consulting assignment make to the development of Viner's thinking about customs unions?

Viner had the concept of trade diversion by the early 1920s, and arguably earlier from his deep knowledge of the writings of the classical economists on trade matters. For instance in an early paper on the most favoured nation principle he wrote:

reciprocity treaties, even on free-trade grounds, are ordinarily not an amelioration, but on the contrary are an intensification of the evils of customs tariffs. They not only do not counteract the tendency of protective import duties to divert international trade from the channels which it would follow under free trade, but they may cause an even wider departure of trade from its 'natural' channels than would result from a regime of uniform protective tariffs at the levels prevalent prior to the grant of partial reductions of duties through reciprocity arrangements. (Viner 1924b, p. 107)

Rather than any conceptual innovation the Manitoba assignment provided Viner with a concrete example of the losses due to trade diversion, stimulated his thinking about the relative magnitudes of the effects, and how circumstances like labour mobility and price elasticities would affect these magnitudes. Viner's classic book (contrary to the opinions of many contemporary international economists unacquainted with the text of this now relatively rare book) never argued that customs unions were always a bad thing; it depended on circumstances.<sup>5</sup> As he wrote: 'None of these questions can be answered a priori, and the correct answers will depend on just how the customs union operates in practice' (Viner 1950, p. 43). In the long list of circumstances which Viner discusses (1950, pp. 51ff), some of the issues from the Manitoba assignment feature, such as the degree of correspondence between the products produced in different parts of the customs union. Of course Viner's discussion of

the circumstances was also informed by his study of other customs unions, for the book was commissioned by the Carnegie Endowment as introduction to a proposed collection of texts of 19<sup>th</sup>- and 20<sup>th</sup>-century trade agreements, and Viner invested substantial amounts of time in studying them. The archival evidence suggests that none were studied in the detail that Viner studied the Canadian arrangements, and for none was he able to carry out the calculations of actual trade diversion losses that he carried out for Manitoba. It is significant that in his classic book the Canadian Federation was discussed several times as an example of trade diversion, and the relationship between customs union and political union (Viner 1950, pp. 64, 69, 81, 101).<sup>6</sup>

## **5. The Cost of Protection**

An initial reading of Viner's 1938 *Supplementary Statement*, plus an awareness of the temporal and geographical connections, might suggest that his work influenced the economists who later developed the concept of effective protection. Viner recognized that the tariff raised prices of inputs purchased by Manitoban farmers, that the greater the weight of protected imports in an activity the greater the impact on the activity (as did his Harvard teacher, Taussig), and also was alert to the price effects. These are the building blocks of the concept of effective protection. One senses that Viner had enough understanding of the issues to go further, but did not.

Max Corden is the key figure in the story of the concept of effective protection, but Viner is not mentioned in the accounts of its development – the classic Corden (1966) article, the account of the development of the theory in an appendix to Corden (1971), or the more personal account in Corden (2005). As noted above Corden made detailed notes on the cost protection calculations in the 1937 report, but it seems devoted less attention to the more significant 1938 supplementary statement Viner wrote himself. Both Corden's own account and the external evidence point to him developing the concept independently, and interestingly, consulting work for a textile company and policy work for the Australian Tariff Board in the 1960s played significant roles.

One might speculate about whether Viner might have developed the concept of effective protection in the 1930s if he had more time and a set of input-output tables for Manitoba in his bottom drawer. As it stands the *Supplementary Statement* didn't advance the discussion of the cost of protection beyond recognising and quantifying the impact of tariffs on imported inputs.

And so on the basis of incomplete development of the concept of effective protection and no evidence of direct influence, Viner's work is rightly omitted from Corden's surveys of the prior literature on effective protection.

## 6. Conclusions

While we might admire Viner's performance in the Manitoba assignment, the impact on subsequent theory seems to have been minimal, apart from shaping Viner's own thinking on customs unions and providing a concrete example of trade diversion.

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## Notes

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<sup>1</sup> Literature on Jacob Viner and his contributions includes Winch (1981), Douglas Irwin's introduction to Viner (1991), Bloomfield (1992) and Groenewegen (1994).

<sup>2</sup> A much appreciated letter from Max Corden to the author (13 October 2009) clarified the background of his correspondence with Viner.

<sup>3</sup> Further details may be found in the Archives Canada record, available at [www.archivescanada.ca/](http://www.archivescanada.ca/). It is commonly known as the Rowell-Sirois report after its successive Chairmen. Viner's supplementary statement is held by the Mudd Manuscript Library in Princeton. Among the voluminous commentary on the Commission is a review (Lutz 1941) in the *Journal of Political Economy*, then under Viner's editorship.

<sup>4</sup> Viner had previously discussed the burden of the tariff in an article, Viner (1936a) defining it as 'the excess of the cost at which the protected commodities are produced at home over the cost at which, under free import, they could have been obtained from the rest of the world in exchange for exports'.

<sup>5</sup> There will be more extensive treatment of Viner's classic book in the introduction to a new edition the author is currently preparing for Oxford University Press.

<sup>6</sup> This paper was initially presented at a conference in Western Australia, and it is interesting that Viner pairs the issues faced by the Prairie Provinces including Manitoba in the Canadian Federation with the issues faced by Western Australia in the Australian Federation. In each case the suggestion is that the small free trading state loses out economically from customs union, and that unless there are compensation payments (either cash or in the form public

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works such as the Canadian trans-continental railway) there will be pressures for political secession from the Federation.

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