

Mercantilism

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1 Introduction:

Mercantilism is a national economic policy that is designed to maximize the exports, and minimize the imports, of a nation. These policies aim to reduce a possible current account deficit or reach a current account surplus. Mercantilism includes a national economic policy aimed at accumulating monetary reserves through a positive balance of trade, especially of finished goods. Historically, such policies frequently led to war and also motivated colonial expansion. Mercantilist theory varies in sophistication from one writer to another and has evolved over time.



Figure 1: at sunrise, a French seaport painted by Claude Lorraine in 1639, at the height of mercantilism

Mercantilism was dominant in modernized parts of Europe from the 16th to the 18th centuries, a period of proto-industrialization, before falling into decline, although some commentators argue that it is still practiced in the economies of industrializing countries, in the form of economic interventionism. It promotes government regulation of a nation's economy for the purpose of augmenting state power at the expense of rival national powers. High tariffs, especially on manufactured goods, were an almost universal feature of mercantilist policy.

With the efforts of supranational organizations such as the World Trade Organization to reduce tariffs globally, non-tariff barriers to trade have assumed a greater importance in neomercantilism.

2 History:

Mercantilism became the dominant school of economic thought in Europe throughout the late Renaissance and the early-modern period (from the 15th to the 18th centuries). Evidence of mercantilistic practices appeared in early-modern Venice, Genoa, and Pisa regarding control of the Mediterranean trade in bullion.



Figure 2: Merchants in Venice

However, the empiricism of the Renaissance, which first began to quantify large-scale trade accurately, marked mercantilism's birth as a codified school of economic theories. The Italian economist and mercantilist Antonio Serra is considered to have written one of the first treatises on political economy with his 1613 work, *A Short Treatise on the Wealth and Poverty of Nations*.

Mercantilism in its simplest form is bullionism, yet mercantilist writers emphasize the circulation of money and reject hoarding. Their emphasis on monetary metals accords with current ideas regarding the money supply, such as the stimulative effect of a growing money-supply. Fiat money and floating exchange rates have since rendered specie concerns irrelevant. In time, industrial policy supplanted the heavy emphasis on money, accompanied by a shift in focus from the capacity to carry on wars to promoting general prosperity. Mature neomercantilist theory recommends selective high tariffs for "infant" industries or the promotion of the mutual growth of countries through national industrial specialization.[citation needed]

England began the first large-scale and integrative approach to mercantilism during the Elizabethan Era (1558–1603). An early statement on national balance of trade appeared in *Discourse of the Common Weal of this Realm of England*, 1549: "We must always take heed that we buy no more from strangers than we sell them, for so should we impoverish ourselves and enrich them." The period featured various but often disjointed efforts by the court of Queen Elizabeth (reigned 1558-1603) to develop a naval and merchant fleet capable of challenging the Spanish stranglehold on trade and of expanding the growth of bullion at home. Queen Elizabeth promoted the Trade and Navigation Acts in Parliament and issued orders to her navy for the protection and promotion of English shipping. A systematic and coherent explanation of balance of trade emerged in Thomas Mun's argument *England's Treasure by Forraign Trade or the Balance of our Forraign Trade is The Rule of Our Treasure* - written in the 1620s and published in 1664.

Elizabeth's efforts organized national resources sufficiently in the defense of England against the far larger and more powerful Spanish Empire, and in turn, paved the foundation for establishing a global empire in the 19th century.[citation needed] Authors noted most for establishing the English mercantilist system include Gerard de Malynes (fl. 1585–1641) and Thomas Mun (1571-1641), who first articulated the Elizabethan system (*England's Treasure by Forraign Trade or the Balance of Forraign Trade is the Rule of Our Treasure*), which Josiah Child (c. 1630/31 – 1699) then developed further. Numerous French authors helped cement French policy around mercantilism in the 17th century. Jean-Baptiste Colbert (Intendant général, 1661–1665; Contrôleur général des finances, 1661–1683) best articulated this French mercantilism. French economic policy liberalized greatly under Napoleon (in power from 1799 to 1814/1815)

Many nations applied the theory, notably France, which was the most important state economically in

Europe[clarification needed] at the time.[when?] King Louis XIV (reigned 1643-1715) followed the guidance of Jean Baptiste Colbert, his Controller-General of Finances from 1665 to 1683. It was determined[by whom?] that the state should rule in the economic realm as it did in the diplomatic, and that the interests of the state as identified by the king were superior to those of merchants and of everyone else. Mercantilist economic policies aimed to build up the state, especially in an age of incessant warfare, and theorists charged the state with looking for ways to strengthen the economy and to weaken foreign adversaries.[[need quotation to verify]

In Europe, academic belief in mercantilism began to fade in the late-18th century after the British seized control of the Mughal Bengal, a major trading nation, and the establishment of the British India through the activities of the East India Company, in light of the arguments of Adam Smith (1723-1790) and of the classical economists. The British Parliament's repeal of the Corn Laws under Robert Peel in 1846 symbolized the emergence of free trade as an alternative system.

3 Theory:

Most of the European economists who wrote between 1500 and 1750 are today generally considered mercantilists; this term was initially used solely by critics, such as Mirabeau and Smith, but was quickly adopted by historians. Originally the standard English term was "mercantile system". The word "mercantilism" was introduced into English from German in the early 19th century.

The bulk of what is commonly called "mercantilist literature" appeared in the 1620s in Great Britain. Smith saw the English merchant Thomas Mun (1571–1641) as a major creator of the mercantile system, especially in his posthumously published *Treasure by Foreign Trade* (1664), which Smith considered the archetype or manifesto of the movement.[19] Perhaps the last major mercantilist work was James Steuart's *Principles of Political Economy*, published in 1767.

Mercantilist literature also extended beyond England. Italy and France produced noted writers of mercantilist themes, including Italy's Giovanni Botero (1544–1617) and Antonio Serra (1580–?) and, in France, Jean Bodin and Colbert. Themes also existed in writers from the German historical school from List, as well as followers of the American system and British free-trade imperialism, thus stretching the system into the 19th century. However, many British writers, including Mun and Misselden, were merchants, while many of the writers from other countries were public officials. Beyond mercantilism as a way of understanding the wealth and power of nations, Mun and Misselden are noted for their viewpoints on a wide range of economic matters.

The Austrian lawyer and scholar Philipp Wilhelm von Hornick, one of the pioneers of Cameralism, detailed a nine-point program of what he deemed effective national economy in his *Austria Over All, If She Only Will* of 1684, which comprehensively sums up the tenets of mercantilism:

That every little bit of a country's soil be utilized for agriculture, mining or manufacturing. That all raw materials found in a country be used in domestic manufacture, since finished goods have a higher value than raw materials. That a large, working population be encouraged. That all exports of gold and silver be prohibited and all domestic money be kept in circulation. That all imports of foreign goods be discouraged as much as possible. That where certain imports are indispensable they be obtained at first hand, in exchange for other domestic goods instead of gold and silver. That as much as possible, imports be confined to raw materials that can be finished [in the home country]. That opportunities be constantly sought for selling a country's surplus manufactures to foreigners, so far as necessary, for gold and silver. That no importation be allowed if such goods are sufficiently and suitably supplied at home. Other than Von Hornick, there were no mercantilist writers presenting an overarching scheme for the ideal economy, as Adam Smith would later do for classical economics. Rather, each mercantilist

writer tended to focus on a single area of the economy. Only later did non-mercantilist scholars integrate these "diverse" ideas into what they called mercantilism. Some scholars thus reject the idea of mercantilism completely, arguing that it gives "a false unity to disparate events". Smith saw the mercantile system as an enormous conspiracy by manufacturers and merchants against consumers, a view that has led some authors, especially Robert E. Ekelund and Robert D. Tollison, to call mercantilism "a rent-seeking society". To a certain extent, mercantilist doctrine itself made a general theory of economics impossible. Mercantilists viewed the economic system as a zero-sum game, in which any gain by one party required a loss by another. Thus, any system of policies that benefited one group would by definition harm the other, and there was no possibility of economics being used to maximize the commonwealth, or common good. Mercantilists' writings were also generally created to rationalize particular practices rather than as investigations into the best policies.

Mercantilist domestic policy was more fragmented than its trade policy. While Adam Smith portrayed mercantilism as supportive of strict controls over the economy, many mercantilists disagreed. The early modern era was one of letters patent and government-imposed monopolies; some mercantilists supported these, but others acknowledged the corruption and inefficiency of such systems. Many mercantilists also realized that the inevitable results of quotas and price ceilings were black markets. One notion that mercantilists widely agreed upon was the need for economic oppression of the working population; laborers and farmers were to live at the "margins of subsistence". The goal was to maximize production, with no concern for consumption. Extra money, free time, and education for the lower classes were seen to inevitably lead to vice and laziness, and would result in harm to the economy.

The mercantilists saw a large population as a form of wealth that made possible the development of bigger markets and armies. Opposite to mercantilism was the doctrine of physiocracy, which predicted that mankind would outgrow its resources. The idea of mercantilism was to protect the markets as well as maintain agriculture and those who were dependent upon it.

4 End of Mercantilism:

Adam Smith and David Hume were the founding fathers of anti-mercantilist thought. A number of scholars found important flaws with mercantilism long before Smith developed an ideology that could fully replace it. Critics like Hume, Dudley North and John Locke undermined much of mercantilism and it steadily lost favor during the 18th century.

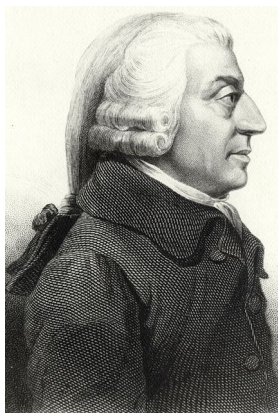


Figure 3: Adam Smith

In 1690, Locke argued that prices vary in proportion to the quantity of money. Locke's Second Treatise also points towards the heart of the anti-mercantilist critique: that the wealth of the world is not fixed,

but is created by human labor (represented embryonically by Locke's labor theory of value). Mercantilists failed to understand the notions of absolute advantage and comparative advantage (although this idea was only fully fleshed out in 1817 by David Ricardo) and the benefits of trade.

For instance, imagine that Portugal was a more efficient producer of wine than England, yet in England, cloth could be produced more efficiently than it could in Portugal. Thus if Portugal specialized in wine and England in cloth, both states would end up better off if they traded. This is an example of the reciprocal benefits of trade (whether due to comparative or absolute advantage). In modern economic theory, trade is not a zero-sum game of cutthroat competition, because both sides can benefit from it.

Much of Adam Smith's *The Wealth of Nations* is an attack on mercantilism. Hume famously noted the impossibility of the mercantilists' goal of a constant positive balance of trade.[citation needed] As bullion flowed into one country, the supply would increase, and the value of bullion in that state would steadily decline relative to other goods. Conversely, in the state exporting bullion, its value would slowly rise. Eventually, it would no longer be cost-effective to export goods from the high-price country to the low-price country, and the balance of trade would reverse. Mercantilists fundamentally misunderstood this, long arguing that an increase in the money supply simply meant that everyone gets richer.

The importance placed on bullion was also a central target, even if many mercantilists had themselves begun to de-emphasize the importance of gold and silver. Adam Smith noted that at the core of the mercantile system was the "popular folly of confusing wealth with money", that bullion was just the same as any other commodity, and that there was no reason to give it special treatment. More recently, scholars have discounted the accuracy of this critique. They believe Mun and Misselden were not making this mistake in the 1620s, and point to their followers Josiah Child and Charles Davenant, who in 1699 wrote, "Gold and Silver are indeed the Measures of Trade, but that the Spring and Original of it, in all nations is the Natural or Artificial Product of the Country; that is to say, what this Land or what this Labour and Industry Produces." The critique that mercantilism was a form of rent seeking has also seen criticism, as scholars such as Jacob Viner in the 1930s pointed out that merchant mercantilists such as Mun understood that they would not gain by higher prices for English wares abroad.

The first school to completely reject mercantilism was the physiocrats, who developed their theories in France. Their theories also had several important problems, and the replacement of mercantilism did not come until Adam Smith published *The Wealth of Nations* in 1776. This book outlines the basics of what is today known as classical economics. Smith spent a considerable portion of the book rebutting the arguments of the mercantilists, though often these are simplified or exaggerated versions of mercantilist thought.

Scholars are also divided over the cause of mercantilism's end. Those who believe the theory was simply an error hold that its replacement was inevitable as soon as Smith's more accurate ideas were unveiled. Those who feel that mercantilism amounted to rent-seeking hold that it ended only when major power shifts occurred. In Britain, mercantilism faded as the Parliament gained the monarch's power to grant monopolies. While the wealthy capitalists who controlled the House of Commons benefited from these monopolies, Parliament found it difficult to implement them because of the high cost of group decision making.

Mercantilist regulations were steadily removed over the course of the 18th century in Britain, and during the 19th century, the British government fully embraced free trade and Smith's *laissez-faire* economics. On the continent, the process was somewhat different. In France, economic control remained in the hands of the royal family, and mercantilism continued until the French Revolution. In Germany, mercantilism remained an important ideology in the 19th and early 20th centuries, when the historical school of economics was paramount.