From Mercantilism to 'The Wealth of Nations'

The Age of Discovery gave rise to an era of international trade and to arguments over economic strategies that still influence the policies of commerce.

By Michael Marshall

We live in an era when continual economic growth is almost considered a birthright, at least in the developed world. It has become the benchmark of the health of a society, guaranteeing an ever-expanding prosperity. The current president of the United States even finds that his extensive misbehavior is overlooked by a majority of Americans because he happens to be presiding over an extended period of economic growth and optimism.

If annual growth drops below about 2 percent, planners and politicians start to get nervous, while a recession (negative growth) is considered a serious crisis. Where will it all end? Can such growth continue—with periodic setbacks, of course—indefinitely? We do not know and usually do not care to ask.

One thing is clear, however. It was not always so. For most of human history it has not been so. In western Europe in the period 1500–1750, output increased by a mere 65 percent, by one estimate, or an average of 0.26 percent a year, even though the population grew about 60 percent. For most of this period, 80 percent or more of the population worked the land. Studies of wage rates in England and France suggest that the working poor had to spend a full four-fifths of their income on food alone.

So this was not an economically dynamic society. There was relatively little disposable income, that being enjoyed by the prosperous elite of landed aristocracy and, increasingly in this period, merchants. Consequently, there was no prospect of creating a mass domestic market for new products. Most wealth was still tied up in the relatively static commodity of land, and agriculture was the major measure of a country's wealth.

Yet in the period from the voyages of discovery in the late fifteenth and early sixteenth centuries [see "Columbus and the Age of Exploration," THE WORLD & I, November 1998, p. 16] up till the Industrial Revolution there occurred what has been called a "commercial revolution."

The story of that revolution, which I will tell here, weaves together a number of significant themes. The upshot of the Age of Discovery was the emergence of a network of global trade. The consequences of that trade, and the measures taken by increasingly centralized European governments [see "The Ascent of the Nation-State," THE WORLD & I, March 1999, p. 18] to control and direct it, produced the system later labeled, most notably by Adam Smith, mercantilism. This was the practice of imperial rivalry between European powers over global trade, and it gave impetus to the disagreements between Britain and its American colonists that led to the American Revolution. Critical consideration of these issues gave birth to Smith's theoretical study of economics, which culminated in the publication of his masterwork *The Wealth of Nations*.

PROTECTING BULLION RESERVES

Smith wrote: "The discovery of America and that of a passage to the East Indies are the two greatest and most important events recorded in the history of mankind." No doubt he exaggerated,

The Commercial Revolution

Voyages of discovery in the fifteenth and sixteenth centuries resulted in a growing network of international trade.

Silver from the New World became the lubricant for the machinery of an emerging global economy.

Fearing the success of their rivals, European governments imposed trade restrictions to protect their national interests.

Viewing commerce as an arena of conflicting national interests at times thrust competing European powers into war.

Advocates of free trade criticized mercantilist policies, suggesting peace could arise from mutually beneficial terms of trade.

Clashes over trade were significant factors in the antagonisms that led to the American Declaration of Independence.

The growth of economic relations between America and Britain after the Revolutionary War suggests that the free traders were right.

but nothing was more important in the unfolding of this story. The Spanish conquistadores went to the New World in search of El Dorado. They found little gold but plenty of silver at Potosi in Peru and in northern Mexico. This silver became the lubricant of the machinery of an emerging global economy.

It flowed into Spain, from where much of it went to the rest of Europe, especially Holland, to pay the debts the Hapsburg rulers had incurred through the religious and dynastic struggles in their German possessions and in the Spanish Netherlands. Some of it then flowed to the Baltic to pay for the timber, rope, and other shipbuilding materials that the region supplied, especially to Holland and Britain. The bulk of it, though, went to Asia to satisfy the growing European demand for spices, silk, Indian calico, and later, Chinese tea.

Without the silver that demand could not have been satisfied: Europe had nothing that Asia wanted to import in exchange. That situation would not change until after the Industrial Revolution, when clothing from the Lancashire cotton industry in the north of England found a market in Asia. Even then problems remained. The economic reason for the shameful opium trade in the early and mid-nineteenth century, when opium grown in India was exported illegally to China, was to earn exchange to pay for tea without having to export silver.

Silver was not without problems. So much of it flowed into Europe in the sixteenth century that it caused serious price inflation. The Spanish economy, in particular, was considerably disrupted, a significant factor in Spain's gradual decline. During the seventeenth century, from a peak around 1600, the supply of silver began to decrease. The demand for goods from Asia, however, did not. The result was a net outflow of silver bullion from Europe, a shrinkage of the money supply, and as a result, economic recession.

No economic theory existed at the time, and no contemporary thought argued that governments should not regulate such matters affecting national wealth in the national interest. So they did. The ad hoc system of tariffs and other measures influencing trade and manufactures that came to be known as mercantilism began to emerge.

The context in which this happened was one of increasingly centralized emerging nation-states that were spending a greater portion of the total national income than in the past, especially in the frequent times of war. They exercised closer control over more aspects of life in pursuit of national policy than in the past, especially through the taxation needed to fund wars. Trade with the New World nurtured the idea that commerce could be a source of national wealth and strength just as much as agriculture and should be developed to that end.

Spain, Britain, and France all banned the export of gold or silver bullion, but this proved to be like trying to stop water from running downhill. The belief was that bullion represented the national wealth or treasure, and that trade should be conducted so as to amass a surplus of it. A country would then have a reserve to cushion itself from the economic effects of adverse fluctuations in the supply of gold and, especially, silver.

Underlying this thinking was the assumption that markets and the amount of trade were relatively fixed, and that gaining a larger share of the pie necessarily meant depriving another country of part of its share. Trade was thus conceived as an arena of national competition and even conflict, a form of war by other means.

COLBERT AND FRENCH MERCANTILISM

Advocates of free trade in the late eighteenth and the nineteenth centuries strongly criticized this aspect of mercantilist policy. They proposed that peace was one of the benefits of free trade, since it tied trading partners in mutually beneficial exchanges that could only be lost through war. Neither side was totally right. Circumstances always affect cases, and the mercantilist policymakers were pragmatists who reacted to the situation before them.

The most systematic practitioner of mercantilist policies was undoubtedly Jean-Baptiste Colbert, finance minister for France's Louis XIV in the later seventeenth century. Colbert used the considerable power of the Sun King's state to increase its wealth through the promotion of French trade and manufactures. He certainly banned the export of bullion, but his policy was aimed at replacing bullion as the means of payment for necessary imports with the earnings from the export of French manufactures.

To that end he developed selected industries by state subsidies and bringing in skilled foreign artisans. He particularly encouraged high-value products such as quality furniture, glass, and tapestries, and the quality of French workmanship in these areas became legendary throughout Europe. He used tariff bar-

riers to protect industries that faced serious foreign competition. Wanting to develop the French cloth industry in the face of the well-established British cloth trade, he doubled the duty on imports.

Thus emerged the classic mercantilist pattern that, because it came about in a piecemeal, pragmatic manner, has only existed in its complete form in the writings of historians. The export of domestic raw materials was largely discouraged, so that domestic manufacturers could enjoy their use. The export of sheep and raw wool from Britain, for example, was heavily regulated for the benefit of the domestic textile industry. The export of manufactures was encouraged as the means to a favorable balance of trade and the bullion inflows that came with it.

The import of foreign manufactures was restricted since this adversely affected the balance of trade. Raw material imports were looked on favorably to the degree that they could be used in or support domestic manufactures, although a large agricultural country like France, under Colbert, aimed at as much self-sufficiency as possible.

Colbert realized that encouraging French industry had little point if its products could not then be exported. That meant commercial shipping and a navy to protect it. Colbert had before him the example of the Dutch. They were the dominant economic power in Europe in the early and mid-sixteenth century through their skills in trade and shipping.

The Dutch dominated North Sea fishing, annoying the British by taking huge catches of herring from Britain's east coast, developing a factory-style industry for salting the catch, then exporting it throughout Europe. They dominated the carrying trade from the Baltic to western Europe, were major carriers of imports to Europe from the Americas and from the East, and grew rich through their control of the lucrative reexport of those imports throughout Europe from their initial port of entry in Amsterdam.

To support these efforts the Dutch dredged and improved their rather shallow harbors and developed specialized forms of shipping, both for fishing and for moving bulk materials. They also developed financial instruments to ease the flow of trade and extend the use of credit. Most notably, they established the Bank of Amsterdam, a public bank that offered a source of capital very different from the government funding of chartered companies that had marked the enterprise of discovery and trade in the sixteenth century.

Colbert built up a merchant marine to rival that of the Dutch and ensure that French trade was carried in French ships. Under his direction the merchant fleet grew from a mere 60 ships of 300 tons or more to over 700 ships of that size. He provided for the protection of French maritime commerce by building up the French navy from 20 ships to 250 by the time of his death in 1683.

He always viewed commerce as an instrument of national policy, and merchants had little say in his decisions. This was unlike the situation in England, where various merchant groups formed influential lobbies on the Crown's commercial policies.

The prizes of commerce remained for him a zero-sum game: France's gain must be someone else's loss. He created a successful glass industry in Paris by inviting Venetian glass-blowers to teach their skills. He later boasted that the successful royal mirror factory that resulted was depriving Venice of one million livres a year.

COMMERCE AND CONFLICT

Colbert's attitude was much derided by the later free-trade economists, most notably Smith. The Scottish philosopher David Hume, a contemporary and good friend of Smith's, wrote on the subject: "I shall therefore venture to acknowledge that, not only as a man, but as a British subject, I pray for the flourishing commerce of Germany, Spain, Italy and even France itself."

It was an irony, too, and one that later critics did not fail to point out, that a considerable contribution was made to the growth of French transatlantic exports by industries that did not receive Colbert's nurturing support. Iron and coal, hardware, and the cheaper cloths produced by the textile industry in Normandy all developed through their own enterprise.

Nevertheless, Colbert's legacy was a foundation for rapid and successful French commercial development in the eighteenth century. Between 1715 and 1771 the total value of French foreign trade grew eightfold until it almost matched British trade. The value of French exports multiplied more than four times between 1716 and 1789. Colbert must have been doing something right.

Advocates of free trade proposed that peace was one of its benefits.

Nor were the policymakers of the time completely wrong in their view of commerce as conflict to gain the largest share of a fixed prize. It is certainly true that bilateral trade is mutually beneficial. If a country wants to export its goods, its potential trading partners must have the means to pay for those goods. So it is in the exporter's interest that partners have their own successful export markets, perhaps in the original country's own home market, to generate the revenue needed to buy its exports.

This is not true of the carrying and reexport trade, however. The Dutch had grown rich on this trade, and the British and French set out to take it away from them. Both ended up fighting trade wars with the Dutch over the issue. In the second half of the seventeenth century, Britain passed a series of Navigation Acts, which required that goods shipped in and out of British ports, and to and from British colonies, had to be carried in British ships.

This struck at the heart of the Dutch trade, hence the tensions that led to war. At issue was who would distribute the new colonial imports throughout the rest of Europe. The Dutch gradually lost out to the French and British. Between the 1660s and 1700 British exports grew by 50 percent. Half of that increase came from the reexport of colonial imports, mostly to Europe.

As a result, the eighteenth century was the Anglo-French century in terms of commerce. I have already mentioned the spectacular growth in French trade. The value of British trade

grew threefold between 1702 and 1772, and British shipping grew at a similar rate, reaching over one million tons by 1788. This phenomenal growth represented a tremendous amount of new wealth, most of it associated with colonial trade, especially that of the New World.

The bulk of British trade in 1700 was still with Europe, but by 1776 two-thirds of its overseas trade was outside Europe. Between 1700 and 1763 the value of British exports to America and the West Indies multiplied fivefold, while the value of imports from those areas grew fourfold. Anglo-French rivalry resulted in a number of wars throughout the century. It is small wonder, given the importance of colonial trade, that parts of those wars were fought in North America and in India, over strategic control of its sources.

'BADGES OF SLAVERY'

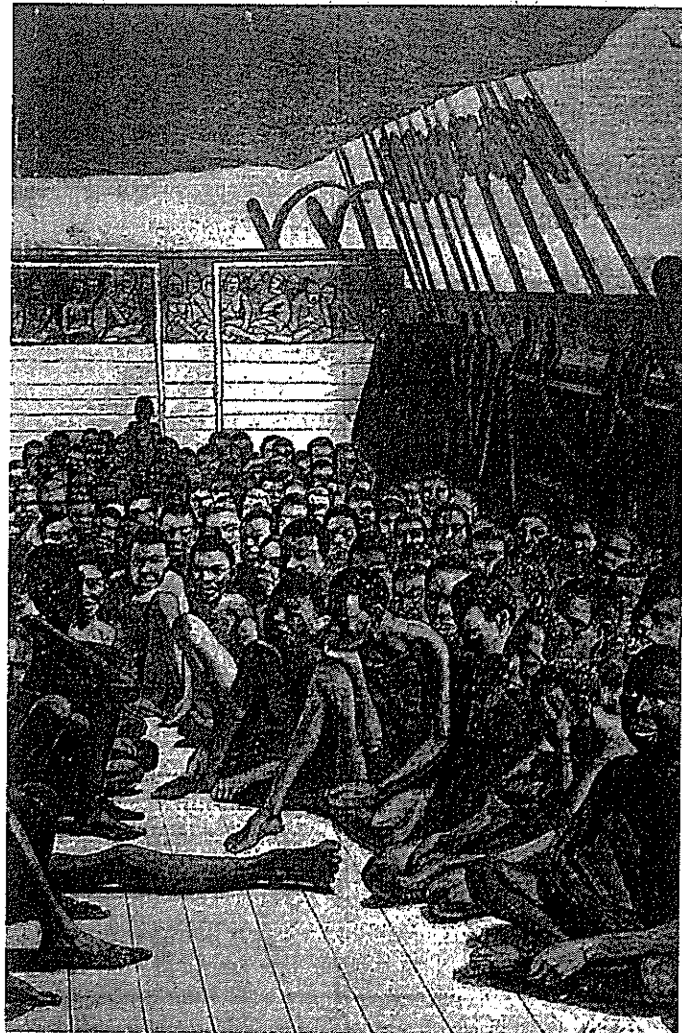
The Atlantic trade not only was the most substantial but it also formed an interlocking network. From the plantations of the southern colonies of America, the Caribbean, and the Brazilian coast, tropical staples—tobacco, cotton, sugar, coffee, cocoa, rice—flowed to Europe. European manufactures flowed back west, supplying the plantation economies with necessities they did not produce themselves. European cities, especially those on the Atlantic, grew and prospered on this trade. From Cadiz and Lisbon in the south, through Bordeaux and Nantes in France, to Bristol, Liverpool, Glasgow, and the burgeoning entrepôt of London in England, they all became part of the Atlantic economy.

A city like Liverpool benefited from importing, refining, and reexporting sugar and tobacco. It also benefited from a new and increasingly significant part of the Atlantic economy—slavery. Plantation agriculture is labor intensive, and the plantations of the Americas looked to West Africa to supply that need. Ships from Liverpool or Bristol, or Lisbon for that matter, would sail to West Africa and trade cheap manufactured items to local chiefs in return for live bodies.

These were then shipped across the Atlantic—the Middle Passage—to the Caribbean or the American South, where those still alive after the horrors of the voyage were sold. The ships then returned home laden with cotton, tobacco, or sugar. In the case of Portuguese ships, they would sail to Brazil and return with Brazilian produce.

European manufactures were also exported to the settler societies of the Americas. The half million Spanish settlers in Mexico and Peru paid for these with silver. As the supply of silver slackened and Latin American society became increasingly self-sufficient, this trade became less important.

The North American trade continued to burgeon. European manufactures were paid for by the products of the region. The question arose as to what those products were to be, and who should determine that: the colonists or the government in London? At this point, questions of mercantilist policy become questions about the future of the American colonies, in other words questions about independence. Adam Smith addressed both sets of questions in *The Wealth of Nations*.



LIBRARY OF CONGRESS

Slaves on the deck of the bark *Wildfire*, brought into Key West, Florida, on April 30, 1860. Carrying 510 slaves, the ship violated the 1809 slave trade law that prohibited slave importation. This engraving was made from a daguerreotype for *Harper's Weekly*, June 2, 1860. Blacks were rarely allowed on deck except for occasional "exercise."

He described the regulations by which London sought to control the American economy as "impertinent badges of slavery." They were intended to ensure that the American economy would complement the British economy, but that, of course, also meant subordinating the one to the other. The American colonies were viewed as a supplier of those staples mentioned above and a protected market for British manufactures.

The colonies were by no means expected to develop industries that might compete with those in Britain. In 1699, Britain sought to ban the woolen industry in America and prevent any intercolony trade in woolen goods. In 1750 a similar ban was applied to steelmaking and the manufacture of finished products from iron.

The role of the New England colonies was to reduce British reliance on the Baltic region for naval materials and certain types of shipbuilding timber. Thus, these strategically sensitive materials—essential for building the ships of the Royal Navy

that protected British commerce—would be under British political control. These products were allowed into Britain duty-free, as was pig iron, in that case to reduce British reliance on [illegible]ish and Russian sources. But the pig iron was not to be any [illegible]er refined in the colonies, lest it compete with the British iron industry.

Being true Englishmen jealous of their liberties, the colonists chafed under these restrictions. Political conflict inevitably resulted, and many commentators in Britain considered that the costs of that conflict outweighed any economic benefit from trying to restrict the natural economic development of the colonies. Matters came to a head in 1776, the year in which both the Declaration of Independence and *The Wealth of Nations* were published.

NEW ECONOMIC DIRECTIONS

Smith had definite views on the American economy and on the system of tariffs and trade regulations that had helped produce the conflict. Unlike the views advocated by other contributors to the debate, however, his arose from the context of an extensive theoretical consideration of how wealth is created. It is only a slight exaggeration to say that he invented economic theory.

He can certainly be considered the originator of classical economics. It was his ideas that were first developed and interpreted by David Ricardo and then by John Stuart Mill in *Principles of Political Economy*. At the end of the nineteenth century they were revived and revised as "neoclassical" eco[illegible]s by Alfred Marshall. Even the economic ideas of Karl [illegible] and, in this century, John Maynard Keynes, started from the principles first enunciated by Smith, although they then moved in very different directions.

His book discusses systematically the basic economic questions: a theory of price or value; wages, profits, and rents; the role of labor; how wealth is distributed among owners of the different factors of production; the role of capital, money, and the banking system; and taxation and the national debt. He famously introduced the concept of the division of labor, explaining how it increases productivity and also is limited by the extent of the market.

He held a dynamic view of the economy. National wealth resulted from the flow of income over time rather than from the size of the stock of capital held. His theory anticipated the actuality of burgeoning economic growth produced by the Industrial Revolution. It differed significantly from the assumptions that lay behind mercantilist policies.

Smith and his good friend Hume refuted the argument that trade should be managed in such a way as to maintain a positive balance so as to earn bullion. Hume pointed out that if bullion flowed out of a country its prices would fall, which would render its exports more competitive, thus increasing the flow of export earnings into the country until balance was restored. In other words, Hume and Smith thought of the economy as a dy[illegible] self-regulating system. In Smith's most famous phrase, it w[illegible] as if an "invisible hand" harmonized individual economic actions pursued out of self-interest into an overall balance that served the public good. It worked best without government interference.

Economic historian Peter Mathias sums up Smith's arguments on this topic admirably, saying that

> a system of freely operating market prices, under naturally competitive conditions, would ensure the lowest effective prices to the consumer and produce the most efficient allocation of resources between the different branches of economic activity. The ultimate test of efficiency and welfare thus became a freely moving price level not distorted by legislative interference.

On the basis of this argument, Smith launched into a critique of tariffs, subsidies, and monopolies, all the tools of the commercial policy of the era that he dubbed mercantilism. "Consumption," he argued, "is the sole end and purpose of all production," yet under the mercantilist system the consumers' interest was sacrificed to that of producers, who sought special favors from the government for their particular industries.

With such views he could not help but be critical of contemporary British policy toward the American colonies. He thought that Britain could rightly impose its own taxation system on the colonies but only in the context of colonist representation at Westminster. (He was, incidentally, a friend of Benjamin Franklin's, and the two discussed these issues when Franklin was in London.) He thought, too, that Britain could extend its customs laws to America provided that *all* internal barriers to trade were abolished.

Smith thus conceived of the British Empire as a vast and free internal market for each and all of its component regions. He even envisaged that the seat of the empire should not remain fixed in London but should move "to that part of the Empire which contributed most to the general defense and support of the whole."

THE DISCUSSION CONTINUES

Economic relations between Britain and America after the Revolutionary War suggested that the free-trade arguments promoted by Smith and his fellow critics of the system of colonial regulation were right. After 1782, British exports to the United States began to grow more rapidly than those to any other region. By 1836 about a quarter of Britain's total exports went there, while the United States provided 80 percent of Lancashire's cotton.

Such evidence boosted free-trade ideas, which became increasingly influential in the nineteenth century, especially in Britain—whose manufacturers, of course, stood to gain the most by them. But the argument that Smith first articulated against mercantilist policy is still going on today. Countries still remain very sensitive about their balance of trade. In the United States, a Republican presidential candidate, Pat Buchanan, argues for greater protection for American industry, in the face of widespread free-trade thinking in both parties.

Back in the 1970s, the Carter administration bailed out Lee Iacocca's Chrysler Corporation because it was thought that the

damage to the economy as a whole and the social cost of the resulting unemployment were worse than paying the cost of a bailout. Right now the United States is entering into a tariff war with western Europe over Caribbean bananas. The Europeans want to reserve 25 percent of their banana market for producers in their former colonies. Without that guaranteed market those producers probably could not survive. The United States is arguing for unrestricted free trade in bananas, which would benefit the mighty Dole Corporation. Whoever is right in the argument, its roots lie in the system of Atlantic trade and colonies that developed in the seventeenth and eighteenth centuries.

The "commercial revolution" of the eighteenth century generated a huge increase in trade and wealth. This all happened under a system of mercantilist policy. Whether that policy nurtured the development or, as Smith argued, it took place despite the policy is a question that can probably never be resolved.

What can be said is that the commercial revolution was an important prelude to the Industrial Revolution. Some of the capital generated from trade found its way into the new manufacturing industries. Perhaps more important was the development of extensive new global markets, for it is questionable whether in the absence of those markets European domestic demand could have grown enough to sustain the rapid growth of the new industries. As it was, those industries found an already established international network of markets through which their new products could flow.

Michael Marshall is executive editor of THE WORLD & I.

This article appeared in the May 1999 issue, pp. 18-31, and is reprinted with permission from *The World & I*, a publication of The Washington Times Corporation. © 1999.