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Outline, including examples as appropriate, the main commercial policies adopted in the 17th and 18th centuries that could be described as 'mercantilist'

Mercantilist policy dominated economic thought in Europe throughout the 17th to 18th century; this essay shall focus on mercantilist commercial policy including examples from the English Empire followed by the British Empire, France and the Dutch Republic. The first section will introduce the core ideas behind mercantilism and its policies; the second section will examine the commercial policies adopted by mercantilist policy makers; finally, the third will examine if mercantilism was an important factor in the development of these countries, concluding that despite the mixed results of commercial policy, mercantilism was a crucial element in the development of these nations.

Section 1

Mercantilist principles

This section will illustrate the main mercantilist objectives to introduce how commercial policy was used to achieve these objectives. These ideas will also be examined to see how they are viewed by different schools of thought as this gives us an insight to why the mercantilist legacy is interpreted as it is: as a doctrine that damaged economic prosperity.

The Nation's prosperity

Mercantilist principles to some extent within these countries during the 17th to 18th centuries. However mercantilism was driven mainly by pragmatic forces rather than being a unified system of economic thought. These forces are the result of the mercantilist's main objective of protecting and advancing their nation, so they were willing to contradict principles if it was for the national interest. International trade and diplomacy was viewed as a zero-sum game; this is opposed by the classical Ricardian trade theory which suggests all parties gain from trade, therefore free trade is desirable for all nations. Classical economists also questioned whether these merchants were acting in their own interest or the nation's interest. Adam Smith viewed mercantilists as rent seekers (Brezis, P484, 2003), whereas economists such as Heckscher interpret, as claimed by (McCusker), that the policies were created "to support the rising nation states of Atlantic Europe by subordinating private economic behavior to national purposes". Despite mercantilism having some modern favourable interpretations, such as Heckscher and Keynes, the anti-mercantilist views of classical economists have been dominant and this is consequently the conventional interpretation of the mercantilist approach.

Favourable balance of trade

Mercantilists viewed a favourable balance of trade as exports being greater than imports; higher exports leads to the inflow of gold and silver. Some Mercantilists viewed these precious metals as the nation's wealth, this view would be rejected by Classical economists who recognised as suggested by (Blaug, P10-11, 1985) who quotes Adam Smith, "The Strain of their argument frequently supposed that all wealth consists in gold and silver".

Mercantilists reached an interesting conclusion about the effects of money supply on output, (Blaug, P18, 1985) explains this using the Quantity theory of money (MV=PY): they assumed that when M (money supply) increases, Y (output) increase), whereas classical economists saw an increase in M increasing P (prices). Ideas similar to this would later be used in Keynes' General theory and as (Blaug, P13-15, 1985) claims Keynes argued against the classical interpretation of mercantilism for multiple reasons, such as the favourable balance of trade leading to the inflow of precious metals lowering the interest rate and therefore increasing investment.

Section 2

Commercial policies

This section will evaluate mercantilist commercial policies including economic analysis and examples.

Prohibition

Prohibition was used by mercantilism to prevent specific imports or exports, either to protect domestic industries or to maintain a favourable balance of trade.

England

The Cockayne project prohibited the export of undyed cloth, although this is also an example of granting monopoly privileges. James I granted monopoly exporting privileges to Cockayne for dyed cloth and banned the sale of unfinished cloth. This commercial policy was an attempt to end Dutch control of this industry and to generate greater revenues from finished cloth. The English failed to achieve their aims with this policy because the Dutch prohibited British finished cloth importing and England lacked the technology used by the Dutch to create dyed cloth efficiently (Irwin, P138, 1992). The policy was eventually abandoned. The consensus among economic historians including (Findlay, O'Rourke, 240, 2007) is that this policy "ended in failure".

This attempt to increase dyed cloth exports decreased the overall welfare of the economy because the Dutch had a comparative advantage for dying cloths whilst the English had a comparative advantage in the production of unfinished cloth. If both countries had followed the doctrine of free trade they would have increased the welfare of their countries, but instead they suffered a decrease in welfare due to deadweight loss. The reduction in trade was not compensated with a growth in English cloth manufacturing despite the policy's ability to change incentives, so the policy was completely ineffective.

The Calico acts in the 18th century had interesting unintended consequences. The first of these acts banned the importation of printed cotton and the second prohibited the consumption of these goods, although there were exemptions. Both policies stimulated the cotton industry in England and this industry became "the cradle" of the Industrial Revolution (Cameron, 160, 1997). This is an interesting case where prohibition worked as an effective policy outcome for the country that adopted it, but this was an unintended consequence which indicates that it is hard to predict the outcomes of prohibition as a policy.

France

Under Colbert the French also introduced prohibitions including the prohibition of grain exports. This policy had similarly disastrous consequences to the Cockayne project, (Ekelund and Hébert, P76, 1997) suggest that the policy had damaging effects when there was a surplus of grain, "lower prices drove down the income of farmers", and this resulted in an overall decline in consumption in the economy.

The effectiveness of prohibition

Prohibition is mostly an ineffective policy. The policy prevents trade which would benefit both countries and can have wider implications damaging industries, such as agriculture in the case of the grain prohibition in France and cloth in the case of the Cockayne project. Both policies attempted to damage other rival countries, but both had the opposite effect. Prohibition prevents any gains from comparative advantage and although it is possible to incentivise growth in industry by preventing imports and exports of certain goods, the policy must be realistic to lead to growth in those industries. The Cockayne project failed as it was unrealistic to expect the English to compete with the Dutch and their superior technology. The Calico Acts are rare examples of prohibition as an effective policy, but they are also examples of the unpredictable nature and potential unintended consequences of prohibition

Tariffs

Mercantilists used tariffs to protect and develop domestic industry, Colbert was the main advocate and developer of this as a mercantilist policy. Downing was an early English exponent of tariffs, favouring them over prohibition. Tariffs used by mercantilists were predominantly taxes on imports to create artificially higher import prices which would incentivise and protect domestic industry.

France

Colbert's important economic reforms began with the tariffs of 1664 which were later extended in 1667. It can be argued that Colbert achieved one of his mains aims with this policy, “His protective tariffs brought a considerable improvement in France’s balance of trade” (Asakura, P196, 2003). This can be regarded as an argument in favour of the tariffs, but only if a favourable balance of trade is the goal, which was for mercantilists; however classical economists such as Smith argue that tariffs have damaging effects “The French and English began mutually to oppress each other’s industry” (Smith, 364, 1999). The French were able to gain power towards the end of the 17th century; Colbert’s tariff reforms were important in the process of modernising and unifying France, Heckscher claims that the tariff reform was an “unquestionable triumph of mercantilism in the sphere of economic unification” (Heckscher, P103, 1955). The importance of these tariffs for economic unification and domestic industry show that mercantilist policy was effective in assisting the transition from feudalism to capitalism. Smith was right about the potential damage to growth in these countries, but the reforms were overall beneficial to France’s imperial aims.

England

Downing is considered the first English policy maker to fully utilise tariffs. Downing used tariffs against Dutch fish imports to develop the English fishing industry (Findlay and O’Rourke, 202, 2007); using tariffs rather than prohibition of Dutch fish imports was more effective because English fishing was not capable of providing the quantity of fish needed, therefore Downing altered incentives to stimulate the fishing industry by altering prices.

The effectiveness of tariffs

Tariffs are a more effective method of growing industry compared to prohibition. Tariffs can alter incentives in the economy and protect growing industries; Colbert used these the most effectively to stimulate French manufacturing. There are losses to the overall welfare due to a reduction in free trade, reducing the gains from comparative advantage, so the classical economics notion of economic efficiency is again violated, but the trade-off between efficiency and growing domestic industry had different consequences in this era. This is because mercantilists perceived trade as a zero-sum game, so by implementing tariffs they thought they were negatively effecting rivals and improving their industry simultaneously. This policy can be effective in achieving the mercantilist aims as well as supporting growing domestic industries.

Chartered companies

The most famous example of chartered companies are the East India companies of Britain and the Dutch. These companies re-exported the goods they imported from Asia at higher prices and given privileges so that the state would also gain a proportion of the monopoly profits.

Dutch East India Company (VOC)

The Dutch East India Company were established first and was dominant early on in the 16th century. The early success of the Dutch is however not seen as a consequence of "government subsidies, but to a managerial incentive scheme" (Irwin, P136, 1992). The monopolistic nature of chartered company led to corruption and rent seeking from all involved in the company - inspectors, managers and the workforce- tried to make private gains through illicit trade; the VOC would gain the logo "Perished by corruption" after its decline (Landes, P146, 1999). The monopoly on spices also led the VOC to try to limit supply using the "practice of destroying surplus spice" (Hamilton, P44, 1948). This ensured that they maintained a higher price and supernormal profits, but created further deadweight loss for European consumers, the Dutch state and merchants gained from this policy. The VOC restrictions on Eastern trade would damage the Dutch as argued by (Hamilton, P44-45, 1948) the English Navigation Acts decreased the flow of goods into Holland, the VOC prevented Eastern trade which may have aided the Dutch

British East India Company

The success of the British East India company may have been a result of it being "Formed and administered by merchants, not the government" (Hamilton, P48, 1948). Interloping on this monopoly was also frequent in comparison to the Dutch

The English East India Company also had the privileges to export precious metals for trade which violated the mercantilist principle of maintain an inflow of precious metals. The East India Company could influence government policy and therefore were able to continue trade and by 1662 the restrictions on precious metal exports had been lifted (Davis, P309, 1966). Here we see a privilege maintained so that the state could maintain its gains from monopoly profits. From 1689, chartered companies were attacked by Parliament, the East India Company was able to withstand this, but "not without major restructuring and a much greater degree of public accountability" (Ormrod, P343, 2003). The political change from the Glorious Revolution had resulted in a reduction of support for corporate monopolies. The East India Company maintained success throughout this era, partially as a result of luck as textiles import demand grew, but the unique approach of being an entirely private firm and the reforms caused by political change, unlike Dutch and French attempts, proved to be important for its long-term success.

The effectiveness of charted companies

Chartered companies were utilised to gain monopoly profits and were effective at achieving this aim for both the British and Dutch, although French attempts failed to gain profit. The VOC succeeded in the short-run, but the spice trade, which they had gained monopoly control over, "was of declining profitability"(Irwin,136, 1992) which played a role in ending the Dutch Golden age. The policy could be effective, especially for states trying to extract high profits, but it damaged overall economic efficiency by incentivising rent-seeking for the firms and individuals involved. The policy also could be ineffective in the case of French attempts or fail in the long-run, but the English East India Company indicates that the policy could be effective in the long-run with the right approach and institutions.

Section 3

This section will examine the development of the three countries and the overall role of mercantilism within that as well as the role of other factors including institutional change.

Britain

Britain developed into the first industrialised nation, (Allen, P16, 2009) argues that the commercial development of European countries was one of the main factors that contributed to initiating the Industrial Revolution. The increase in trade caused by mercantilist foreign and commercial policy led to increasing urbanisation which incentivised developments in agricultural productivity and the division of labour.

The Glorious Revolution is also perceived to have had a direct effect on the Industrial Revolution. Both the political institutional change through this revolution and the economic institutional change through mercantilist commercial policy were necessary for further economic development. Feudalism and monarchy would have failed to create the incentives for freedom and innovation; the indirect effects of institutional change such as increasing urbanisation also would not have developed. Allen disputes this “liberal view” (Allen, P5, 2009) of the importance of the Glorious Revolution, but there is evidence of the inter-connected nature of political and economic institutions “Prior to the Glorious Revolution, the English tariff system provided little direct protection for home industry” (Ormrod, 49, 2002), therefore commercial policy was effected by the Glorious Revolution. The revolution also ended the monarch’s ability to grant monopolies and Parliament was now “acting in the collective interest of the national mercantile class as a whole” (Findlay and O’Rourke, P240, 2007), so the interactions between institutions was vital for the transition to industrialisation.

<u>Dutch</u>

The Dutch developed early into this era as “the economic wonder of the age” (Allen, P16, 2009) although towards the latter stages of this period, they were diminished by the developments of the British and French. The VOC was a vital part of Dutch commercial policy and their success of the creation of a monopoly in the spice market had the unintended consequence of contributing to their collapse as the main European power. This is an interesting example of the mixed results and unpredictability of mercantilist policy. The decline of the Dutch empire however did not reduce the living standards within the country (Bailey, P4, 2014).

The conventional explanation for the decline of the Dutch Republic is that fragmented and decentralised political institutions prevented a unified economic policy, which was present in England and France despite their different political institutions, (Ormord, P21, 2003). Historians see the weak Dutch federal government “as a major factor in the economic decline of the eighteenth century”. A unified mercantilist policy may have helped to maintain the early success of the Dutch.

<u>France</u>

The role of mercantilist policy in the development of France is mainly linked to the policy of Colbert. Colbert had success in~~ a~~ffecting domestic industry, although it can be argued that this was at the expense of France’s overall economy. France became a major European power in the 18th century along with the British although the role of mercantilist policy played a less significant role in this in comparison to the British; the mains gains from this policy was to unify the country under a central economic policy which gave them advantages over the Dutch.

Conclusion

Mercantilist commercial policy can be effective in achieving certain aims, although this does not include the classical economist aim of increasing efficiency in the economy. Tariffs were utilised successfully for protecting and growing domestic industry and Chartered companies helped generate higher revenues for Britain and the Dutch. These policies were successful in achieving the mercantilist aims of a favourable balance of trade and increasing the nations prosperity, although these polices were damaging to overall economic growth, so the nations prosperity would also have to include its position of power within Europe; some of the policies such as prohibition were ineffective in achieving any positive result. The classical economic interpretation of mercantilism is primarily negative and this has been the accepted interpretation since the 19th century, however this disregards that mercantilists had different aims to classical economists such as Smith and these aims helped Europe transition to the Industrial Revolution through encouraging commerce and unifying countries Mercantilist commercial policies could be effective for the countries that adopted them.

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