

Exploring the aims of the mercantile system



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Mercantilism is the main economic system, which is used within the 16th to 18th centuries. Its main goal is to increase the wealth of the country through imposing governmental regulation concerning all of the commercial interests in the nation. It was argued that national strength can be maximized through limiting the amount of imports via tariffs and raising the amount of exports. It discusses that the economic strength of every country is related mainly to the repair of positive trade balance. It aims at the idea of making every country use export techniques more than import techniques as a way to remain in an economic and political viable position. So, positive trade balance upon the mercantilist thought concludes in a way of using gold in the practice of country's treasury (Mark Blaug).

The Scottish economist Adam Smith (1723-1790) was the man who was responsible for the term "mercantile system." So, mercantilism was in a contrary side of Smith's ideas of free enterprise, free trade, and the free move of people and goods. One of the main assertions of mercantilism is the national wealth that will appear through the accumulation and import of gold or any other precious metals, like silver (Paul Johnson).

Being an economic system, mercantilism leads to make foreign competition and discouragement of direct foreign investment. This term supposes that the wealth of any nation will primarily depend on the ownership of precious metals as silver and gold, but this system cannot be achieved forever, because the universal economy would be stagnant when all countries wanted to make exports without imports. After a very short time, a lot of people started to act against the mercantilism idea and stressed the very bad need of free trade. The continuous pressure result was found in the

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implementation of “ laissez faire economics” in the 19th century (Lars Magnusson).

Mercantilism, being a historical period, had been associated with the increase of a particular structure of capitalism in Europe which referred to it to be merchant capitalism. It was a doctrine developed by different economic writers in this period that call for the powerful alliance among the monarchial system and merchants. Nowadays, the mercantilism term is used to view the protectionist trade policies when combined with other governmental policies, directly or indirectly in particular industries to acquire the regional or national trade advantage. Mercantilism has associated with the nationalistic economic policies shunned by free trade and advocates that argue for minimum state interference in the international and domestic marketplace (Henry William Spiegel).

The mercantile system stated different policies of nationalistic trade thought to acquire the wealth of the nation. It can be achieved via five basic elements of mercantilism, as indicated by David L. Sills: The first one is nationalism and policy start together with all possible policy directed towards the nationalism. The second element is foreign trade that should always be thought of in light of its effects on the state’s stock of owning precious metals. The third one is lacking domestic mines of gold or silver; the precious metals should be collected by excess the exports over the imports. The fourth element is governmental trade authorities that should strive to limit imports and give encouragement to exports. The last element is the economic and political foreign policy that should be coordinated in order for the achievement of these goals (Mark Blaug).

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While most of them closely associated with 18th century in Europe, the mercantilism term has been used in order to refer to the aggrandizement's general principle of state authority for the economic benefit of the capitalist class through controlling and manipulating trade. For example, during the colonial times it took the shape of military control on trade routes and large tariffs imposed on imported goods in general and manufactured products in particular (Lars Magnusson).

The mercantilist practices' rationale, upon the imperatives of colonial conquest and empire, had been reflected in the eighteenth century concepts of the profit's origin and the exchange nature. While being the goal of for-profit entity, the mercantilists managed to apply this opinion to the whole nation. This is in contrary to the belief of the ideology of marketplace done by classical economists. This exchange should be done on the aspect of equivalents. Moreover, mercantilists believed that the seller can gain via the loss of the buyer. Therefore, the nation will become richer when it sells or exports more than it buys or imports. Gold or any other money sources will be amassed to benefit the state. The opinion related to the surplus or profit happened in the unequal exchange in commodities was perfectly cope with the mercantilist policy in controlling the trade terms (Paul Johnson).

Mercantilism had played an important role but not a dominant role in the transition period from feudalism to the industrial capitalism. However, mercantilism did benefit greatly large merchant companies to ship home goods through trade routes maintained and protected by the country. Foreign trade was the necessary thought to be done for gold accumulation because the domestic trade cannot generate a net profit or surplus.

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Struggling by this view of the profits' origin, merchants used exports as a necessary means of acquiring surplus profits. The merchants, such as all better policy makers, argued that using this policy would benefit in turn the whole state (Henry William Spiegel).

These policies in order to achieve these goals involving state subsidies of the export industries, high tariff was used to encourage home production in the prohibition on the gold sale to foreigners, the subsidization of basic industries when necessary, the control over certain kinds of capital, and the relentless gold import and the raw materials from different colonies. The most of these policies contained strict control in trade routes and the prices stabilization in state currency (Steele G. R.).

Throughout the mercantilist period, the merchants had controlled the trading system, but not the production of services and goods. Before the start of industrial capitalism, the production was on the line of crafts system that embodied remnants of the very old feudal arrangement. In addition, the industrial capitalism emerged the merchant's power. They would come to see them taking over or being involved in the production means that would enhance their profits through giving them the control over the labor productivity. However, the merchants cannot control the production means, as the primary concern lies on selling and buying. The policies of mercantilists encouraged the imports of raw materials that in turn can be manufactured to make different products. The finished goods can be sold and exported subsequently in high price in comparison with the original cost. So, it found its way to the treasury of the nation (Mark Blaug).

The foundation of the mercantile system started with the beginnings of the capitalism in sixteenth and seventeenth century in Europe. At this time France, Spain, and some of the Low Countries as Holland and Belgium were transformed into economies in merchant-dominated. So, the modern states were emerging of being as a political complement in the merchant economy. This system indicated that it was regulated by the competitive labor market. It led to the formation of a new class of people that found them being free from feudal system to the land to be only forced to sell the labor to ensure subsistence. The emerging was also a class of manufacturing and industrial entrepreneurs recruited from the declining merchant class (Lars Magnusson).

The merchant class paved the way of losing control over the new economic system to the forces of the capitalist competition when profits and price were regulated through the accumulation and production of capital. When trading was essential for the emerging of industrial capitalist system, the transactions were viewed as a sharing out in the total of selling price among the purchasers and buyers, including the merchant. The concept of mercantile idea, which trade led to the profits in the whole system, paved the way to the opinion of the classical economist that the production and reinvestment of profit was the actual source of the wealth of countries (Paul Johnson).

When the general perception of the term of mercantilism being one of a very long era in the history of economic thought, the mercantilist authors were business and professional people that wrote and made known of their thoughts in a long time before economics came to be a separate academic discipline. Many representative of the mercantilist writings were English and <https://assignbuster.com/exploring-the-aims-of-the-mercantile-system/>

French writers of the 17th century. These practical thinkers sought the protection, order, and stability essential for the expansion of their activities. This in turn will benefit the state. In exchange for the military protection of the trading routes, they succeeded in acquiring the monopolistic subsidization from crown when the country extends its material means for the colonization. Wealth found to both the merchant elite and the state in form of gold and different raw materials to add its value, and then exported in form of the finished goods. Mercantilists saw production to be very important because it only led to the surplus of exports (Mark Blaug).

When the merchant class had been far from cohesive, the disagreements about policy in the merchant class were different to the aims of a common goal of expanding the extent of trade surplus. The mercantilists encouraged exports, except the machinery, plant and equipment, which might help foreign competitors. They discouraged imports, except in raw materials and precious metals. The colonies, including the Americas, had served as a primary export market and the tax revenue source, military bases, and a source of silver, gold, and raw materials. The strong navy and the military war machine were vital to the maintenance and implementation of these policies (Lars Magnusson).

As production became more important, the capitalists realized that in controlling production, this would be possible to decrease costs, increase productivity, and undercut the competitors by lowering prices. The line of thinking led economists like Adam Smith to oppose the idea that gold constituted wealth. In the powerful critique of mercantilists, Adam Smith had pointed out that money reflected the wealth produced while expressing the

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value of goods and services that offered in the marketplace. Moreover, struggles among merchants in trade monopolies and prices made conflict to all the detriment concerned. Many criticisms of mercantilism had culminated in a devastating critique that is known as the specie flow mechanism. The Scottish philosopher and political economist called David Hume (1711-1776) had pointed out that the very success of a nation's mercantilist policies will set in motion forces, which would tend to reverse trade surplus, through the normal operation in markets. Allowing in the money free flow, at this time especially gold, it was discussed that would tend to result in balance of trade equilibrium (Lars Magnusson).

While the specie-flow mechanism of Hume is the most known critique of the mercantilist thought, his opposition to mercantilist thinking started as early as the late 17th century. The main idea was that the success of mercantilist policies will trigger unintended consequences. So, the positive trade balance refers to money positive net flow, because a lot of money is coming in rather than going out. This situation would evolve where too much amounts of money is chasing few goods, where the system is operating in full capacity, money is not hoarded but kept in circulation. The only logical effect is to raise prices. As opposed to the countries mercantilist surplus, money is flowing out that result in the fall of prices. The deficit countries will become more competitive in time. Trade will shift their thinking resulting in trade equilibrium. That doctrine will later become known as the quantity theory of money (Mark Blaug).

In light of historical influence, mercantilist policy expanded the decrease of the feudal economy and the system of guild crafts of production. The state

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policy and merchant system complemented each other. The main objective was to indicate growth of foreign trade while encouraging the inflow of the precious metals and the raw materials to which the value could be added for exports. So, mercantilism served to rapid the transition of Europe from the land-based economy to the monetary economy. Though pure mercantilism is considered a dead economic issue, but vestiges of it remain (Henry William Spiegel).

Mercantilism, in the seventeenth and eighteenth centuries, many European countries believed that the world wealth was finite and limited. Whatever one of the countries gained, the another one lost. In order to ensure their own share, those countries issued an economic policy calling it mercantilism. Because England had followed mercantilism, this policy affected profoundly the American colonies in the years that precede independence. The cornerstone of mercantilism is that the country supply of silver and gold reflected its wealth and its economic strength. In addition, the gold enabled countries to acquire military arms. The Countries worked in many ways to raise their silver and gold stores, but the foreign trade became the basic avenue. When exporting more goods than imported, the mercantile countries could demand the difference in gold which is the principal international currency of those times (Lars Magnusson).

The trading countries such as England saw their colonies to be useful players in the mercantile game. It looked to its colonies for getting raw materials that could be obtained at low cost. So, colonies became markets for the English exports. By mercantilism, England had forged the early weaknesses and strengths of the young American economy. Starting from the first of the <https://assignbuster.com/exploring-the-aims-of-the-mercantile-system/>

Navigation Acts in 1660, the laws passed during the 17th and 18th centuries tightened England control of the American trade and economy. For example, when requiring the colonies to trade through the British Empire, England had limited any trade competition might be presented by its colonies. The laws against manufacturing also forced the colonies to import manufactured goods from the mother country. The products manufactured were routed within England, and shipping was only limited to English or colonial carriers (Steele, G. R.).

Mercantilism is economic nationalism for the purpose of building a wealthy and powerful state. Being an economic system, mercantilism leads to make foreign competition and discouragement of direct foreign investment. This term supposes that the wealth of any nation will primarily depend on the ownership of precious metals as silver and gold, but this system cannot be achieved forever, because the universal economy would be stagnant when all countries wanted to make exports without imports. After a very short time, a lot of people started to act against the mercantilism idea and stressed the very bad need of free trade. The continuous pressure result was found in the implementation of “laissez faire economics” in the 19th century (Lars Magnusson).

The most important economic rationale for mercantilism in the 16th century was the consolidation of the centers of regional power of the feudal era through large competitive nation-states. Other contributing factors were in the establishment of colonies out of Europe, the growth of commerce and industry in Europe relative to agriculture, and the increase in the breadth and volume of trade, and the increase in using metallic monetary systems, <https://assignbuster.com/exploring-the-aims-of-the-mercantile-system/>

particularly silver and gold, relative to barter transactions. Within the mercantilist period, the military conflict among states was both more extensive and more frequent than at any time in history. The navies and armies of the main protagonists were not temporary forces raised to specify a specific threat or objective, but they were professional forces. The primary economic objective of the government was to command sufficient quantity of the hard currency to support the military that would deter attacks by other countries and help its own territorial expansion.

The policies took so many forms. Governments may provide capital to new industries, exempt new industries from guild rules and taxes, establish monopolies over local and colonial markets, and grant titles and pensions to successful producers. In trade policy the government assisted local industry by imposing tariffs, quotas, and prohibitions on imports of goods that competed with local manufacturers. Governments also prohibited the export of tools and capital equipment and the emigration of skilled labor that would allow foreign countries, and even the colonies of the home country, to compete in the production of manufactured goods. At the same time, diplomats encouraged foreign manufacturers to move to the diplomats' own countries (Lars Magnusson).

Shipping was particularly important during the mercantile period. With the growth of colonies and the shipment of gold from the New World into Spain and Portugal, control of the oceans was considered vitally important to national power. Because ships could be used for merchant or military purposes, the governments of the era developed strong merchant marines. In France Jean-Baptiste Colbert, the minister of finance under Louis XIV from <https://assignbuster.com/exploring-the-aims-of-the-mercantile-system/>

1661 to 1683, increased port duties on foreign vessels entering French ports and provided bounties to French shipbuilders (Steele, G. R.).

In England the Navigation Laws of 1650 and 1651 prohibited foreign vessels from engaging in coastal trade in England and required that all goods imported from the continent of Europe be carried on either an English vessel or a vessel registered in the country of origin of the goods. Finally, all trade between England and her colonies had to be carried in either English or colonial vessels. The Staple Act of 1663 extended the Navigation Act by requiring that all colonial exports to Europe be landed through an English port before being reexported to Europe. Navigation policies by France, England, and other powers were directed primarily against the Dutch, who dominated commercial marine activity in the sixteenth and seventeenth centuries (Steele, G. R.).

During the mercantilist era it was often suggested, if not actually believed, that the principal benefit of foreign trade was the importation of gold and silver. According to this view the benefits to one nation were matched by costs to the other countries that exported gold and silver, and there were no net gains from trade. For countries almost constantly on the verge of war, draining one another of valuable silver and gold was thought to be almost as desirable as the direct benefits of trade (Geoffrey Parker).

Adam Smith refuted the idea that the wealth of a nation is measured by the size of the treasury in his famous treatise, *The Wealth of Nations*, a book rightly considered to be the foundation of modern economic theory. Smith made a number of important criticisms of mercantilist made a number of

important criticisms of mercantilist doctrine. First, he demonstrated that trade, when freely initiated, benefits both parties. In modern jargon it is a positive-sum game. Second, he argued that specialization in production allows for economies of scale, which improves efficiency and growth. Finally, Smith argued that the collusive relationship between government and industry was harmful to the general population. While the mercantilist policies were designed to benefit the government and the commercial class, the doctrines of laissez-faire, or free markets, which originated with Smith, interpreted economic welfare in a far wider sense of encompassing the entire population (Lars Magnusson).

While *The Wealth of Nations* is generally considered to mark the end of the mercantilist era, the laissez-faire doctrines of free-market economics also reflect a general disenchantment with the imperialist policies of nation states. The Napoleonic Wars in Europe and the Revolutionary War in the United States heralded the end of the period of military confrontation in Europe and the mercantilist policies that supported it.

Despite these policies and the wars that they are associated with, the mercantilist period was one of generally rapid growth, particularly in England. This is partly because the governments were not very effective in enforcing the policies that they espoused. While the government could prohibit imports, for example, it lacked the resources to stop the smuggling that the prohibition would create. In addition, the variety of new products that were created during the industrial revolution made it difficult to enforce the industrial policies that were associated with mercantilist doctrine. By 1860 England had removed the last vestiges of the mercantile era. Industrial

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regulations, monopolies, and tariffs were abolished, and emigration and machinery exports were freed. In large part because of her free trade policies, England became the dominant economic power in Europe.

England's success as a manufacturing and financial power, coupled with the United States as an emerging agricultural powerhouse, led to the resumption of protectionist pressures in Europe and the arms race between Germany, France, and England, which ultimately resulted in World War I (Geoffrey Parker).

Protectionism remained important in the interwar period. World War I had destroyed the international monetary system based upon the gold standard. After the war manipulation of the exchange rate was added to the government's list of trade weapons. A country could simultaneously lower the international prices of its exports and increase the local currency price of its imports by devaluing its currency against the currencies of its trading partners. This "competitive devaluation" was practiced by many countries during the Great Depression of the thirties and led to a sharp reduction in world trade (Steele, G. R.).

A number of factors led to the reemergence of mercantilist policies after World War II. The Great Depression created doubts about the efficacy and stability of free-market economies, and an emerging body of economic thought ranging from Keynesian countercyclical policies to Marxist centrally planned systems created a new role for governments in the control of economic affairs. In addition, the wartime partnership between government and industry in the United States created a relationship-the military-industrial complex, in Eisenhower's words-that also encouraged activist

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government policies. In Europe the shortage of dollars after the war induced governments to restrict imports and negotiate bilateral trading agreements to economize on scarce foreign exchange resources. These policies severely restricted the volume of intra-Europe trade and impeded the recovery process in Europe in the immediate postwar period (Geoffrey Parker).

The economic strength of the United States, however, provided the stability that permitted the world to emerge out of the postwar chaos into a new era of prosperity and growth. The Marshall Plan provided American resources that overcame the most acute dollar shortages. The Bretton Woods agreement established a new system of relatively stable exchange rates that encouraged the free flow of goods and capital. Finally, the signing of GATT (General Agreement on Tariffs and Trade) in 1947 marked the official recognition of the need to establish an international order of multilateral free trade (Lars Magnusson).

The mercantilist era has passed. Modern economists accept Adam Smith's insight that free trade leads to international specialization of labor and, usually, to greater economic well-being for all countries. But some mercantilist policies continue to exist. Indeed, the surge of protectionist sentiment that began with the oil crisis in the midseventies and expanded with the global recession of the early eighties has led some economists to label the modern pro-export, anti-import attitude as "neomercantilism." (Steele, G. R.)

Although several rounds of multilateral trade negotiations have succeeded in reducing tariffs on most industrial goods to less than 5 percent, trade in

agricultural goods remains heavily protected through tariffs or subsidies in Europe, Japan, and the United States. Countries have also responded to GATT by erecting different nontariff barriers to trade. The Long Term Arrangement on Cotton Textiles (1962) was the first major departure from the key GATT rule of nondiscrimination. Discriminatory nontariff barriers are typically used by industrialized countries to protect mature industries from competition from Japan and newly industrialized countries like Brazil, Korea, and Taiwan. These nontariff barriers include voluntary export restraints, orderly marketing arrangements, health and safety codes, and licensing requirements. And the U. S. Jones Act, which prohibits shipment of goods between U. S. ports on foreign ships, is the modern counterpart of England's Navigation Laws (Lars Magnusson).

Modern mercantilist practices arise from the same source as the mercantilist policies in the sixteenth to the eighteenth century. Groups with political power use that power to secure government intervention to protect their interests, while claiming to seek benefits for the nation as a whole. Of the false tenants of mercantilism that remain today, the most pernicious is the idea that imports reduce domestic employment. This argument is most often made by American automobile manufacturers in their claim for protection against Japanese imports. But the revenue that the exporter receives must be ultimately spent on American exports, either immediately or subsequently when American investments are liquidated. Another mercantilist view that persists today is that a current account deficit is bad. When a country runs a current account deficit, it is borrowing capital from the rest of the world in order to purchase more goods and services than it sells. But this policy

promotes economic wealth if the return on the capital borrowed exceeds the cost of borrowing. Many developing countries with high internal returns on capital have run current account deficits for extremely long periods, while enjoying rapid growth and solvency (Geoffrey Parker).