

The principles of mercantilism essay example

[Economics](#), [Trade](#)



Countries trade with one another, especially to obtain goods that it does not produce, or even to offload any excess produce. There have been advanced several theories that support the theory of international trade. The most common ones include Mercantilism, by William Petty, Thomas Mun and Antoine de Montchrétien model, the theory of comparative advantage by (David Ricardo model) and also the theory of absolute advantage by Adam Smith. Mercantilism was the oldest theory that was fronted in relation to international trade, in the 1600's (Jones & Ronald, 1987).

This paper attempts to explain the principles of mercantilism, but major emphasis will be on the criticism of mercantilism by later date economists who included Adam Smith and David Ricardo who explained the theories of both absolute and comparative advantage, other significant critics will also be interrogated.

Mercantilism is an international trade theory that was in use about years ago. The theory was premised on a ' commercial revolution'' and the transition from local economies to nationalized economies.

Mercantilism was the main economic system that had been adopted widely in the 16th through the 18th century. It was based on a premise that the wealth of a nation would increase if the nation increased its exports and collected precious metals in return for its exports.

The theory encouraged geographical discoveries that were not only important in the stimulation of international trade but also ensured a continued flow of gold and silver which encouraged a money and prices economy(Melitz,&Marc 2003).

The state in the mercantilist period was expected to exercise a lot of control over economic life majorly through corporations and trading companies.

Production was carefully checked to ensure that only very high quality goods were produced and at low costs so as to ensure that the nation held its place in the international markets and was by extension competitive.

According to this theory, the world contained just a fixed amount of wealth and therefore to increase the wealth of a nation, such a nation had to take over the wealth of another country. This tendency to always export more and import less is what was known as mercantilism (Feenstra&Robert, 2003)

The most important activity that a nation would use its land for was agriculture, mining and or manufacturing. This is majorly because mercantilism was majorly concerned about production, with the aim of ensuring that the country exports the maximum to its neighbors' to maintain a positive balance of trade for stability.

The mercantilists also believed that all raw materials that are found in a country must be manufactured locally as finished goods have higher value than raw material. This means that export of raw materials was banned in all nations during the period. Likewise, nations had to make huge investments on processing equipment.

Mercantilism also encouraged a large working population. Mercantilists believed that the wealth of a nation is vested in its people and therefore encouraged the population to continue to increase indefinitely.

Mercantilists banned all exports of gold and encouraged all domestic money

to be kept in circulation in the country. This would ensure that the country's wealth is kept in its boundaries.

Mercantilists also discouraged the importation of foreign goods as this was thought to stifle the domestic industries and essentially reducing the countries competitiveness (Feenstra & Robert, 2003).

In case of the importation of goods that were indispensable, mercantilists encouraged the payment of such goods with local goods and not gold and/or silver. This was essentially to keep the countries moneys within its territories.

That the country constantly seeks market for its extra produce and insists as far as it's practicable to obtain payment in terms of gold and silver. This would increase the countries gold and silver reserves, which were seen as wealth of the nation.

Finally, the nation would not encourage the importation of goods is such goods could be suitably produced and supplied at home (Dixit et al, 1986)

Criticism of mercantilism

One of the main critics of mercantilism was Adam smith, who made scathing attacks on the proponents of mercantilism, in his book, wealth of nations. He saw mercantilism as a conspiracy by the manufactures and the government against consumers.

Robert E. Ekelund and Robert D. Tollison also criticized mercantilism and called it a rent seeking society since it made the theory of economics impossible. This is because, according to Adam smith, mercantilists viewed

the economic system as a zero sum game in which the gain by one party resulted to the loss by another, thus any system that benefited a group would definitely harm the other. And it was not possible for economics to be used for the common good of all. Smith also criticized mercantilists for working hard to justify a particular practice rather than investigate into the best practices and policies.

According to smith, mercantilists did not seem to understand the effects of setting prices in the economy. The proliferation of monopolies in the mercantilist system was seen to promote a quota system, corruption and inefficiencies in the system (Melitz & Marc, 2003). This resulted to black markets. Modern economists have also criticized the economic oppression that was promoted by mercantilists. According to them, the goal was to maximize production with little concern for consumption. Extra money, free time and education were seen to result to laziness which was harmful to the economy.

Adam smith, David Hume and David Ricardo have been known to be the fathers of the modern criticism of the infamous mercantilist school of thought. In fact, mercantilism is thought to have lost grounds in the 18th century after subsequent criticism from John Locke, Dudley North and Hume.

In 1690, David lock argued that the mercantilist assertion that the wealth of the world was fixed was not true. This is because; the wealth of the world was created by human labor. He also argued that mercantilists failed to appreciate the theories of absolute and comparative advantage, although this idea was fully driven by David Ricardo in 1817 (Jones & Ronald, 1987).

According to the theory of comparative advantage, Ricardo argued that a country should specialize in the production of the commodities that it has the biggest comparative advantage as compared to the other nations. It should therefore produce such a commodity at the best price and then trade with a country that is more efficient in the production of the commodities that the original country does not produce.

For instance, suppose France was more efficient in the production of wine than England, yet in the latter, clothes could be more efficiently produced than in France, and then if France specialized in wine and England in clothes, then both nations would be better off if they traded. This is a classic example of some of the reciprocal benefits of international trade as a result of comparative advantage and both sides benefit from the transaction.

Hume on his part noted that it was practically impossible to have a constant positive balance of trade as postulated by the mercantilists who attempted to always have a balance of trade that is positive. He alluded to the fact that as bullion flowed into a country, the supply would definitely increase and the value would reduce relative to other commodities in the country (Guesnerie, Roger, 2001). On the other hand, the state exporting bullion would eventually have its value rising. It would no longer be cost effective exporting goods from a high price country to a low price and therefore the balance of trade would eventually reverse. Mercantilists seem to have fundamentally forgotten this arguing that the increase in money simply meant that everyone became richer.

The notion that the country should not give out money was rebuffed by another economist, Petty. He argued that while money was necessary in an economy, too much of it did not serve any beneficial purpose. He argued that too much money in an economy had a negative influence on the economic position of a country since inflation always set in when there is a lot of money in operation.

Locke on his part also challenged the issue of government's full control on the economy. While he appreciated that the authorities had a role to play in ensuring order in the economy, too much trade restrictions could be counterproductive and could lead to stifling of economic growth and development. His ideas were later echoed by John Maynard Keynes who is known to be the father of modern economics after his groundbreaking work in the mid 20th century that showed that letting the economy to operate on its own with minimal government intervention is helpful in ensuring a successful economy in modern times.

Dudley north, also directed serious criticism of the mercantilist theory in his forceful work in the 17th century. In his 1691 discourse upon trade, he showed that wealth could actually exist without money. In his works, he demonstrated that agriculture and industry were the real sources of wealth. He went on to explain that money was just one of the many elements of wealth and performed in facilitating the exchange of goods and services. According to him, the quantity of money in the economy might either be more or less but the economy should be left to regulate itself without any government interference (Davis et al 2002)

North had a very strong believe in domestic trade and strongly condemned the practice of building monopolies by granting business privileges and concessions to a given group of merchants arguing that such privileges worked to public disadvantage. North is therefore believed to be an independent thinker who heralded a new economic era which was ushered in a century after, by Adam Smith Bernard (Andrew et al 2003)

Roger Coke, Nicholas Babton and Charles Davenant are also important critics to the mercantilist theory. They expressed their discontent with the mercantilist theory of foreign trade which included government control for the sake of metal alone. Coke saw the reduction and subsequent diminution of England's foreign trade as countries refused to trade with her as a result of her tight money policy. He also foresaw the stagnation of domestic industries as a result of lack of both local and foreign competition. Babton then showed how increased trade might result from removal of trade restrictions against imports. Davenant was of the opinion that trade would naturally self regulate itself and that it would do better if the government and other agencies ceded control.

The most practical opposition to Mercantilism was very strong in France where the shortcomings of mercantilism policy had almost ruined the countries financial sector. The financial administration of Jean Baptiste Colbert faced serious unrests as people protested against oppressive taxes, depressed recognition of agriculture (Anderson, et al 2004).

Lastly, the works of Pierre Boisquillebert in the criticism of mercantilism needs to be appreciated. He wrote voluminously in opposition of this school

of thought. In his many works, he argued that the national wealth did not exist in the abundance of precious metals but rather in useful things. He fought against the restriction in both domestic and foreign commerce. He noted that such arbitrary and artificial controls were harmful as there were natural laws of the economic order which once violated had dire consequences to an economy. According to him, the world operated as one unit and economic prosperity would result only if commercial relations were allowed to thrive freely among individuals and nations.

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