

Lives



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essay: Mercantilism Livesessay, 17? 21 Many Americans may not realize that some of today's political leaders and mainstream media espouse ideas that were discredited and left for dead over two hundred years ago. As in any number of horror flicks, sometimes the dead don't stay that way. When I studied economics in college, I learned that mercantilism supplanted feudalism to become the predominant economic doctrine through the late Middle Ages. Mercantilism, "economic nationalism for the purpose of building a wealthy and powerful state,"¹ is based on this logic: "The richer the nation, the stronger the nation; the stronger the nation, the better for every member of that kingdom."² It wasn't until the 17th century that mercantilism was seriously challenged, and Adam Smith finally drove a stake through its heart when he published *The Wealth of Nations* 235 years ago. Perhaps most economists hold this clean view of history, but it seems that the rest of the world never got the memo. Unfortunately, the archaic and counterproductive ideas of mercantilism are alive and kicking in 21st-century America. Mercantilism is a somewhat amorphous constellation of ideas specifying how the components of society should be organized. Mercantilist writers didn't always agree with each other and were, ironically, often critical of the mercantilist system.

Still, a few central themes emerged: Protectionist measures should be implemented to protect domestic producers; exports should be increased and imports reduced; employment should be fostered in the domestic market; and monetary policy should increase the quantity of money and precious metals. With regard to this last point, while consumable goods increase our quality of life, mercantilists believed that money was better

than goods because money could always buy more goods, while goods might go unsold or even spoil. Plus, they reasoned, goods are consumed and, therefore, “lost,” while precious metals have lasting value. Mercantilism is an economic theory from the perspective of exporters, protectionists, politicians, and money hoarders, and its primary beneficiaries are big business and big government.

Basically, the more goods you sell outside your country and the more gold and silver you bring in and store safely in your vaults, the better. The corollaries are that exports are good, imports are bad, a weak currency is wonderful, and trade surpluses are the bees knees. Whether they realize it or not, many modern politicians of various stripes are mercantilists. Just watch the news and you'll see those in our government and in the media expressing predominantly mercantilist views: “Our trading partners currencies are too cheap and the trade deficit is too high” together, these two factors reduce domestic employment. One mercantilist action available to a country like the United States is to devalue its currency, which simultaneously makes its exports cheaper and its imports more expensive. This may sound logical, but this tenet of mercantilism is counterproductive. If you have dollars in your wallet and I have yen, wouldn't you be upset if your dollars became less valuable and you grew poorer relative to me? Can you imagine anyone celebrating a decline in the value of his or her assets? Do you have more dollars in your portfolio than yen or renminbi or euros? I do.

Don't you want your portfolio to increase in value? I do. Then why wish for the American dollar to decline in value? While I have nothing against gold and silver (I own some of each), they are a store of value” a means to an

end” not an end in themselves. I hope to use my gold and silver (and dollars, yen, renminbi, and euros) to someday buy another house, another car, more education, and more vacations. It is these goods and services” not the intermediate stores of value that I use to purchase them” that improve and enrich my life. By focusing on stockpiling money and structurally impeding the market in the process, mercantilist actions ensure that I will get fewer of the goods and services I want. Other mercantilist actions available to the U.

S. government include import restrictions and tariffs, which various politicians and pundits discuss and advocate regularly. By taking these actions, with the alleged goal of helping ordinary Americans, the U. S. government would make it harder and more expensive for us to buy what we want. For more about trade deficits, see International Capital Flows, by Mack Ott, in the Concise Encyclopedia of Economics (CEE) See also Balance of Payments, by Herbert Stein, in the CEE. Lets directly address the much-maligned trade deficit.

If I buy a made-in-Japan car from Toyota, what happens? Simple. I get a nice car and a Japanese company gets some dollars that it then pays to its suppliers, employees, and shareholders (the last of whom include me). What can these people do with the dollars that they dont spend on American goods? Only five things: buy U.

S. assets, including stocks, bonds, and land; engage in direct investment in the United States by building plants, etc.; buy U.

S. services; exchange the dollars on the currency market; or keep them. By purchasing U. S. assets or services, the purchasers make individual Americans and American companies richer.

After all, in any exchange, both sides gain or else they wouldn't engage in the exchange. Direct investment in plant and equipment increases the productivity and, therefore, the wages of American workers. If these foreigners keep their dollars, then we get valuable cars and they get cheap pieces of paper that our government can print for pennies on the dollar. If they exchange their dollars on international currency exchanges, then the person or entity they exchange with has the same invest/buy products/buy services/exchange/keep decision to make. In the worst case, our dollars come back to buy American goods, services, or assets. In the best case, our dollars don't come back and we get useful goods virtually for free. A trade deficit reflects the best case, while a trade surplus reflects the worst" but still good" case. Mercantilists argued for a strong nation with a strong military.

With the importation of manufactured goods, some fear an atrophy of America's manufacturing ability, and so it is the (largely mercantilist) hawks who offer the only modern argument for keeping domestic manufacturing strong at the expense of the rest of the economy. They ask, "What happens if we go to war and we have no ability to manufacture tanks and guns?"³ The simplest solution, of course, is to avoid starting any wars. (History shows that this is unlikely.) The U. S.

military is perennially muscle-bound and U. S. manufacturing is persistently strong.

While it is true that American manufacturing has shed seven million workers since the late 1970s, today's workers produce three times as much as their 1972 counterparts. 4 U. S. manufacturing hit an all-time record for output in 2007⁵ before the recession⁶ and is virtually tied with China for the world's largest.

Consider that if the U. S. manufacturing sector were a separate economy, it would fit nicely between France and the United Kingdom as the world's sixth-largest economy, enjoying an annual output of \$2.155 trillion⁶ hardly reason for hand-wringing. Modern mercantilists are saying that American consumers should suffer higher prices due to tariffs, import restrictions, and currency devaluations to support and protect American manufacturers, who can then hire workers, export goods, and bring in hard currency. Modern economists reply that this is a way to make a nation poorer, not richer.

Trade benefits both parties, whether the parties reside in Germany or Germantown, Pennsylvania. The way to make the nation wealthy is to keep the currency stable and allow domestic and international trade to flourish. In doing so, we allow individuals and individual geographical areas to specialize and discover their comparative advantage⁷ that area of production in which we are most productive and most efficiently create what others want. By finding and pursuing our comparative advantage, we get the most value for a given input, and the nation as a whole becomes richer. As Adam Smith

pointed out, It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy....

If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage.

7 Protecting domestic industries has a certain appeal. By keeping out foreign competitors, the thinking goes, we can save jobs for Americans and give struggling industries the shelter they need to become strong.

Unfortunately, the reality of protectionism is downright ugly. First, there is the effort put into lobbying Congress instead of making tough choices and creating a productive industry. Second is the direct cost of the protected jobs. For example, to save 226 American luggage manufacturing jobs, American consumers have been forced to pay an additional \$290 million annually for their luggage, which translates to an outrageous \$1.285 million for each job saved. 8 (No one, especially the American consumer, would argue that those jobs are worth that much.) Third, more workers typically are employed in industries that use the output than in industries that make the protected output. Workers in steel-using industries, for instance, outnumber those in steel-producing industries by 57 to 1.

9 Making steel more expensive hurts the 57 workers who use the steel, while only one steel-producing worker is helped, and that in addition to all the consumers who are hurt. Why, it is worth asking, should consumers be forced to support producers? Why not force producers to give a low price to consumers? One is just as arbitrary as the other. Indeed, most of us have

heard of the friend (“ the consumer”) buying a car from another friend (“ the producer”) who leans on the friendship to ask for a lower price. Mercantilist policies make our nation and us poorer, not richer. But you would never know that by listening to most politicians or by reading most newspapers.

Adam Smith saw the mercantile system as an enormous conspiracy by manufacturers and merchants against consumers, and in 1776, he wrote, “ Nothing, however, can be more absurd than this whole doctrine of the balance of trade.” 10 As economist Henry George pointed out, “ What protection teaches us, is to do to ourselves in time of peace what enemies try to do to us in time of war.” 11 That will never be good policy and will never make America strong. Isnt it time to dispel anachronistic ideas and listen to the insightful masters of modern economics? ;,?