

Classical Economics (Mercantilism)

Mercantilism was a trade method used in the 16th-18th century, and it highly encouraged strict governmental regulations on the expansion of state power in a nation's economy. It was highly practiced in Europe in the Early Modern period and the late Renaissance period and also was responsible for the intra-European wars which happened during that period. The early mercantilism form of mercantilism was bullionism and was thought to have owed its military might and propensity to silver and gold. Mercantilism played a very important role in the 16th to 18th century international trade and the wealth accumulation of nations.

Jean-Baptiste Colbert, who was a philosopher, idealized the Colbertism as he was one of the mercantilism practitioners. He encouraged industry growth through the protection of tariffs and provision of subsidies, quality and price regulation in regard to the agricultural and manufactured goods. Colbert helped significantly in the breaking of trade barriers which were evident in France, initiated road building programs, and ensured that there were restrictions put in place to control natural resources use.

Mercantilism was highly adopted by statesmen and merchants. The mercantilism economic rationale in the 16th century was the regional power centers consolidation. The major contribution factor of mercantilism was the establishment of colonies. The majority of the mercantilism policies were due to the interaction which existed between different national governments and the mercantile classes of the countries. The mercantile classes paid taxes and levies to the government, and the governments were supposed to offer them protection for their businesses against any upcoming competitors in return.

Mercantilism was founded on the principle that the wealth of a nation can be judged by silver and gold that the country possesses instead of the people's living standards. The second

principle was that the supply of wealth was limited in the world, and a country could only become rich by taking away the riches of other countries. In line with these founding principles, the mercantilists further argued that the country lacking silver and gold mines was supposed to rely on other countries in foreign trade in order to become rich: this was because gold was the only means that was accepted to finance the balance of trade.

Causes of Mercantilism

One of the main causes of mercantilism was the rejection of the Medieval Europe's religious doctrines. This gave an explanation of materialism as being a medium that was responsible for making humans happy. Everybody dreamt of being happy, which gave birth to mercantilism. The fall of the feudal system is another cause for the rise of mercantilism. This happened because the feudal system collapsed, which led to the collapse of agriculture and the encouragement of the small-scale industries. The main focus of growth was placed on these industries by the guilds and towns. They had the intention to export the surplus obtained from the productions which aided in the rising of mercantilism.

The Guilds and the Banking Systems were believed to be one of the causes to mercantilism. The Guilds acted as the main distributors by exporting all the surplus while promoting international trade. The banking systems on the other hand, acted as the controllers of the international trade. Geographical discoveries and reformation movements were also responsible for the evolution of mercantilism. The sea voyages by famous individuals like Vasco da Gama, Columbus, and Magellan among many others also encouraged the growth of mercantilism.

Political patronage is another reason for mercantilism. The kings sought power from the barons and the feudal lords; so, they highly encouraged the merchants to join trade. The Queen

of England Elizabeth and the King of Portugal Henry patronized the mariners, which stimulated mercantilism. Scientific innovations also helped in the mercantilism growth. Galileo's invention of a telescope helped the sailors and merchants in their journeys. The Mariner's invention of a compass aided the merchants in determining their directions while on the voyages in deep seas. These inventions gave the merchants confidence in their shipping trips for trade.

Characteristics of Mercantilism

There are a number of characteristics which were associated with mercantilist and were seen in many countries. These include:

i). Foreign Trade

The main aim of the merchants was foreign trade. This was because they had the knowledge that not all countries possessed silver and gold and they had the intention of procuring the silver and gold from sailing to other countries with their products. According to the mercantilists, trade was considered to be a "zero-sum" game. In order for a nation to be able to gain any benefits from international and foreign trade, the nation had to initiate trade at the expense of another country. The British mercantilist had the strong believe that the propensity of the economy could only be realized through the limiting and minimization of imports and encouraging the total number of exports so as to be able to maximize the total gold amount in the country. The raw materials were produced and supplied by the colonies while America processed and resold the finished products back to the colonies.

Mercantilism was composed of different national economic policies that aided in the accumulation of direct monetary reserves through a positive balance of trade which were realized on the finished goods. These policies in such an era were responsible for many political factors

which led to war outbreaks and colonial expansion incentives. The underlying theories of mercantilism varied in the complexity levels, depending on the individual writer of the theories.

Shipping was a very important aspect of trade in the mercantile period. Countries fought over the control of the oceans as it symbolized national power which gave the nations the power to gain more colonies. Raw materials from the colonies were shipped into countries like Portugal, India, England, France, and other countries. The Dutch at this period mainly dominated and controlled all the commercial marine activities in the 16th and 17th centuries.

ii). Money Importance (Bullionism)

Money is a vital feature in mercantilism: the merchants understood that in order for trade to take part, money was needed. This gave the explanation as to why barter trade was discarded: they strongly believed in money. Baring the barter trade era, people traded on goods, and they preferred to keep silver and gold instead of keeping the commodities. Money was considered to be a significant factor in the commercial advancement.

Money was deliberated very vital as the governments required it to manage the state affairs so people paid money to the state in the form of taxes. The large amounts which were required in the commercial wars against other nations in an attempt to gain and retain colonies highly contributed to the importance of money.

iii). Interest

Interests comprised a very important part in mercantilism like in the case of Thomas Mun, who was an economist and advised the charging of the interest on the principle borrowed amount of money which led to an increase in the money amount in the country. This interest also inspired the traders to work hard in order to pay the borrowed money and also gave them encouragement to become rich. The mercantilists favored low interest rates because they

believed that the higher the rates, the more scarce money became. John Locke, Thomas Manley, and Nicholas Barbon were some of the mercantilist writers who were in favor of lower interest rates.

iv). Factors of Production

Labor and land were considered by the mercantilists as the sole factors that promoted production. Labor was considered the father of all principle wealth, and the mother was the land. Most mercantilists emphasized the need for increased production in an attempt to attain self-sufficiency in foodstuffs through wasteland cultivation and export encouragement.

v). High Population Growth

High population was greatly fortified in mercantilism. There was a strong belief that the population of a state is what determined its real power. The governments practicing mercantilism highly favored high population growth. This, according to the governments, was highly beneficial as it indicated an increase in the labor supply and products.

Samuel Fortrey pleaded for the immigrant freedom and equal rights. He argued that these immigrants would bring riches into the country and also improve industry and trade conditions in it. Having large population was a symbol of availability of cheap labor which could help the country compete with other countries and increase the total domestic population. Parenthood and matrimony was highly encouraged by the state.

vi). Commercial Regulations

Mercantilism was highly characterized with the regulation of commerce, trade, and industries by the government. In mercantilism, there was the signing of treaties between countries to encourage free trade so that one country could have trading privileges in another country. A nation had the authority to control the produced goods and the mandate to encourage

trading of the produced goods to other international countries with the aim of making high profits from these sales. In order to make more profits, these countries often ensured that they sold more than they bought from the other countries. This showed that the exports were highly encouraged with the imports being discouraged. The countries with colonies on other continents used the connections that they had with the countries that they colonized to their advantage. They had to make profits as high as they could through taking away all the resources for their own benefits.

High tariffs and other trade restrictions on imports were imposed by mercantilist governments so as to enable to existence of the balance of trade. The growth of domestic industries was highly encouraged. This gave the explanation as to why some nations sought to have overseas colonies: they served as the potential markets for their products and also as the primary sources of raw materials. Colonies were barred from trading and shipping products and raw materials to other countries in an attempt to stop and kill competition between the colonizing countries. Some governments also tried to protect the depletion of national gold through the prohibition of sales of products and produce to foreigners.

Criticism of Mercantilism

Adam Smith

The 18th century moral philosophy was mainly principled according to three major issues: the selfish hypothesis, the justification and explanation of moral judgment, and the moral virtue character. Adam Smith (1776) was trying to make a political ideological and not an economic argument. A part of his argument was based on the lobbying of a new economy policy, while the other part of the argument was on the political and social engagements. Smith was against the mercantilists' zero-sum game. He argued that it was a positive-sum game because all the nations

involved also gained as a result of the trade. He believed that the wealth of a nation could only be determined by its productive capacity but not on the basis of silver and gold that the nation had.

Smith further argued on the absolute advantage where a country is only supposed to export the goods that it can be able to produce efficiently and only import the goods that the country does not have the ability to produce. If countries traded on the basis of the absolute advantage, all the participating countries could also gain as a result of the mutual trade.

	Corn	Blankets
India	1 hour	6 hours
Portugal	3 hours	3 hours

A good example of an absolute advantage is where there might be two countries like Portugal and India that can gain from trading with each other. The two countries, Portugal and India, have the ability to produce two products, corn and blankets. India can take 1 hour to produce 1 blanket and Portugal can take 3 hours to produce corn and 3 hour to produce one blanket. According to Adam Smith, the both Portugal and India could specialize in the product that they have an absolute advantage in like India has an absolute advantage in producing corn over blanket production because it only takes 1 hour while Portugal takes 3 hours to produce the same amount of corn. The production of blankets is much cheaper in Portugal as India takes more hours than Portugal to complete one blanket. India could specialize in the production of corn, while Portugal specializes in the production of blankets; India could import the blankets from Portugal, while Portugal, on the other hand, could import corn from India.

The *laissez faire* concept stated that individuals could get an aggregate wealth and social benefit if they pursued their own wealth and benefits. The ‘invisible hand’ argument by Smith

was that the governments were not supposed to interfere the free will of the individuals. The government was supposed to establish all the necessary systems which promoted free trade. An invisible hand would correct the errors and disturbances of the system for it to operate properly. A very good example to show how the invisible hand would correct the system errors is the putting of price controls by the governments: if the price controls are abandoned by the government, then the supply and demand of the market will enable the restoration of equilibrium.

David Hume

David Hume was a Scottish philosopher who was against the British mercantilism. He put an empirical argument to support his claims. He tried to give an explanation as to why net exporting in a country for the exchange of gold which was highly encouraged by the British could not enhance the wealth in the country. He believed that both imports and exports were equally beneficial to a nation and made a suggestion that trade was not supposed to be treated as being an equivalent to war since all the parties which are involved also benefit from the entire transaction.

Hume argued that the measurement of wealth was by the amount of commodities that were available in a country but not in the amount of money that was available in the country. Hume was the first philosopher to advocate the quantity theory. This quantitative theory arose in the mercantile period when the inflows of silver and gold from America into Europe resulted to inflation. This theory, according to Hume, stated that there was a direct relationship existing between the economy's quantity of money and the general prices. According Hume's theory, if there was a replication of the amount of money in the nation's economy, then the prices would also replicate causing inflation in the economy. The consumers would suffer greatly as a result as they would have to spend more on essential services or goods.

According to David Hume, the money theory directly influences the economic activity of a country. Hume refuted the equation of wealth with money which was an argument put forth by the mercantilists.. He rejected the view of the accumulation bullion as a policy for a nation and argued that changes in the money supply had a long-term influence on the output. In this case, , interest was not determined by the supply and demand for money and was in favor of the free international trade promotion.

Hume argued that trade surplus led to an inflow of specie which further led to an increase in money supply, thus causing the upsurge in the prices and wages, which contradicted the mercantilist viewpoints. This increase in the level of wages and prices led to a decline in the number of exports and an increase in the total number of imports. In this case, the balance of trade in a nation would then become negative because the country would have to develop measures to recover the deficit which could be implemented through letting of the flow of specie. This specie outflow would therefore cause the money supply to contract as there would be a relative price fall on commodities. As the prices of the country fall to the original prices after the correction of the deficit, specie will then start flowing back up to the level when there is equilibrium in the balance of trade.

According to Hume, the price level was generally the circulating money outcome ratio. Hume intended to draw attention to the events which were happening in the history of a specie inflow, after the lag and a general price increase. This inflow, according to Hume, was the result of the exports which were on an increasing margin; export competitiveness would be reduced and controlled by inflation; and the nations which were competing would also be able to gain some advantages.

Hume argued that there was no direct relationship between the price and money and the specie inflow was but just a symptom due to the increase in the total amount of exports. This increase in the economic activities which was responsible for the upsurge in the wages and the prices was not the result of an inflow of money. Hume further observed human behaviors in different societies in an attempt to explore both the custom role in the outcome and increased trade implications.

The notion of inflation was erroneously advanced by Hume with the idea that any gradual money supply decline would further lead to changes in the economic growth. The role of inflation in Hume's argument would be to increase business competitiveness. An increase in the inflation rate in a country for a longer period of time could make the exports less price-competitive in the international trade markets. This would eventually lead to reduced orders, exports, fewer jobs, and even lower prices. In a worse situation, this could lead to a dire balance of trade of a nation. A decrease in the exports could help trigger the accelerator and multiplier effects on employment and national income. This could also cause business uncertainty: high uncertainty levels could lower the capital investment spending level. This would call the intervention of the government in order to ensure that the inflation levels are controlled.

Adam Smith and David Hume, who were critics of mercantilism, showed that gold and silver acquisition could only be self-defeating because the expansion of the domestic supply of money could lead to an increase in the domestic inflation, which is an upsurge in the prices of commodities. The viewpoints of Smith and Hume were very different, although the two philosophers were the critics of mercantilism. Smith did not agree with the concept of mercantilism on the wealth being regulated by the state, and the thinking of mercantilists just

assisted in turning the social priorities upside down. Hume, on the other hand, explained that the approach by mercantilists was not a guarantee for wealth enhancement of a country.

Conclusion

The ideology of mercantilism was that the power of a nation was highly depended on its accumulated wealth which helped the nation build very strong navies and purchase goods. Each individual merchant sought an advantage and profit benefit for a joint-stock companies, social groups, or trade. Protectionism was the primary feature of mercantilism with the objective of increasing a country's power. Wealth was termed to be equal to specie. The mercantile system encouraged exportation of specie but highly discouraged importation.

The classical economists like Adam Smith and David Hume refuted the mercantilist's way of thinking where Smith argued on the absolute advantage theory where he suggested that countries could benefit from trade. Hume also brought up the quantitative money theory where he suggested that any increase in the quantity of money supply would lead to an increase in the price levels leading to inflation.