ECON 2175: Economic History of North America to 1913

Mercantilism

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Outline

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   - What form did mercantilism take?
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What is Mercantilism?

- Mercantilism is not a clearly defined set of ideas. It is not an ideology.
- However, the common thread to mercantilism is a set of formal governmental institutions that restrict imports and encourage exports.
- The goal is to achieve a "favorable" balance of trade (more exports than imports) which meant that gold and silver would flow into a country.
- Colonies of a mother country, within a mercantilism system were meant to buy only from the mother country and also what they could produce.
- In a strange way, it was "economic nationalism" and was "anti-free-trade"

What form did it take?

- Example: Navigation Act of 1651 for Britain which 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 its colonies had to be carried in either English or colonial vessels (Ransom, 1968; Reid, 1970; Walton, 1971; McClelland, 1973; Sawers, 1992; Zahedieh, 2010). This also eventually applied to Quebec and Canada.
- Other example: 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 re-exported to Europe.
- Other Example: Manufacturing of beaver pelts into hats was prohibited in New France (Quebec) (Sainte-Marie, 1948). While Canadian "raw products" were preferred in France to foreign products, colonial "finished goods" were discouraged (Reid, 1953).

What form did it take?

- Remember, colonies are only instruments in mercantilist policy. Colonies must be subservient to the interest of the mother country (Clément, 2006).

Does Mercantilism Make a Society Richer?

- In introductory macroeconomics, you saw that GDP was equal to

$$Y = C + I + G + X_n \tag{1}$$

- Where Y is total GDP, C is consumption, I is investment, G is government spending and X_n is net exports (exports minus imports).
- The mercantilist idea is that you have to X_n as large as possible by exporting more or importing less (or both) which is what will make you richer.
- But this is a fallacy because of I which is all capital investments and another concept called "Net Capital Outflow" (domestic residents' purchases of foreign assets minus foreigners' purchases of domestic assets)
- When a Canadian resident buys stock in Telmex, the Mexican phone company, the purchase raises Canadian net capital outflow. When a Japanese resident buys a bond issued by a Canadian firm, the purchase reduces Canadian net capital outflow.

Does Mercantilism Make a Society Richer?

- For pure accounting reasons:

$$NCO = X_n \tag{2}$$

- Arises because every transaction that affects X_n also affects NCO by the same amount (and vice versa)
- When a foreigner purchases a good from Canada, Canadian exports and X_n increase the foreigner pays with currency or assets, so the Canadian acquires some foreign assets, causing NCO to rise.
- When a Canadian citizen buys foreign goods, Canadian imports rise, X_n falls the Canadian buyer pays with Canadian dollars or assets, so the other country acquires Canadian assets, causing Canadian NCO to fall

Does Mercantilism Make a Society Richer?

- We can add two identities that you learned in intro macro. First savings (S) which is income minus consumption minus government spending (which captures by definition the savings of governemnts). The second is that under autarky, $I = S$ whereby under free trade:

$$Y = C + I + G + X_n \tag{3}$$

$$Y - C - G = I + X_n \tag{4}$$

$$S = I + X_n \tag{5}$$

$$S = I + NCO \tag{6}$$

- This is useful because it tells us that imports do not make us poorer (they are not subtracted from GDP) (see Lemieux (2015) for an explanation accessible to laymen).

Does Mercantilism Make a Society Richer?

- Why? Because if $S > I$, then $NCO > 0$ which means that Canadians buy more foreign assets than foreigners buy Canadian assets – this is a net capital outflow
- If $S < I$, then $NCO < 0$ which means that Canadians buy less foreign assets than foreigners buy Canadian assets – this is a net capital inflow
- Wealth of Canadians is the sum of real national assets and net foreign assets.
- If $S < I$, we are borrowing from foreigners – foreigners would not lend to us if they did not think that there would be greater returns from doing so than elsewhere. They are financing our capital investments (K-stock) which make workers more productive (and K-stock also grows faster than foreign debt). But to buy our assets, foreigners have to sell us goods.
- If I ¡ S, its the reverse – we are buying assets from foreigners and we grow richer too. However, to do so, we must be the ones selling the goods to buy the assets.

Does Mercantilism Make a Society Richer?

- "*When a country runs a current account deficit, it is either borrowing from or selling assets to the rest of the world to finance expenditure on imports in excess of export revenue. However, even when this results in an increase of net foreign indebtedness, and associated future debt servicing requirements, it will promote economic wealth if the spending is for productive purposes that yield a greater return than is forgone on the assets exchanged to finance the spending. Many developing countries with high rates of return on capital have run current account deficits for extremely long periods while enjoying rapid growth and solvency. The United States was one of these for a large part of the nineteenth century, borrowing from English investors to build railroads.*" (Key passage from the Library of Economics and Liberty – Mercantilism Entry)
- As such, mercantilism does not make a society richer. Theoretically, it is hard to phatom how it could!.

If it made people poorer, how much poorer?

- Okay...so we know mercantilism did not make the New World richer (nor did it the Old World). But if it hurt, how much so?
- Some scholars claim that the costs of mercantilism were very high (DiLorenzo, 2005). For Canada, there is a claim that the policies made the economy too reliant on a moribund fur trade sector (Hamelin, 1968) (no other sectors were emerging). (DiLorenzo, 2005). The other belief is that the dependence on the fur trade (and cod in Newfoundland) rather than a larger number of export products caused Quebec and Canada to be less engaged in international trade.

If it made people poorer, how much poorer?

- But this is hard to buy...consider the case of the Navigation Acts (Thomas, 1965).

TABLE 2.2

ANNUAL NET BURDEN ON COLONIAL FOREIGN COMMERCE (million $)

	1770	1763–1772
Burden		
Exports		
tobacco	1.63	1.04
rice	.60	.70
other	.27	.18
Imports	.61	.72
total*	3.10	2.63
Benefit		
Tariff Preference	.28	.20
Bounties	.17	.18
total*	.44	.37
Net Burden	2.66	2.26

*Columns do not add up due to rounding errors in the individual entries.

Source: Robert Thomas, "A Quantitative Approach to the Study of the Effects of British Imperial Policy on Colonial Welfare," *Journal of Economic History* 25 (Dec., 1965), p. 626.

- Given the GDP estimates that we have for *circa 1774*, the net burden is (Lindert and Williamson, 2016) equal to 1.3% of GDP. Its not small, but its not gigantic.

If it made people poorer, how much poorer?

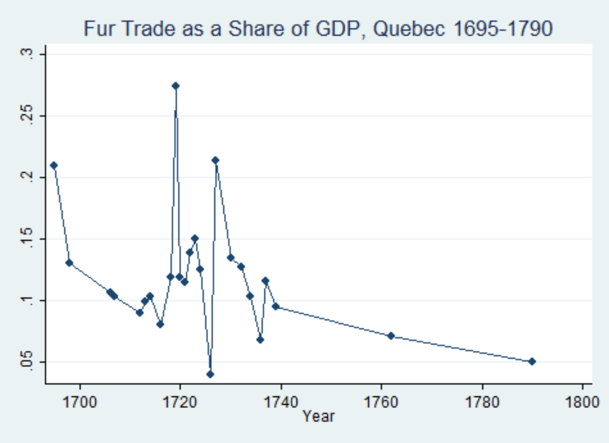
- It seems that the argument for Quebec is also overblown. For example, we know that its trade with the rest of the world was not out of sync with the rest of North America (McCann 1983).

PER CAPITA VALUES OF AVERAGE ANNUAL COMMODITY EXPORTS
OF THE BRITISH NORTH AMERICAN COLONIES
BY REGION, 1768-1772
PLUS INVISIBLE EARNINGS BY REGION IN 1770[a]

Region	Per Capita	Per White Resident	Plus Invisibles Per Capita	Plus Invisibles Per White Resident
Quebec	1.07[b]	1.40	1.34	1.61
New England	.84	.86	1.56	1.59
Middle Colonies	1.03	1.10	1.57	1.72
Southern Colonies	1.80	3.0	1.85	–

If it made people poorer, how much poorer?

- Also, the argument that the Canadian economy was poorly performing because of a dominating fur trade is weak as the fur trade as a share of GDP fell pretty sharply during the 18th century.



If it made people poorer, how much poorer?

- Its not because the King dictates something that people listen. For example, there was a massive illegal trade in furs (Lunn, 1939). Altman (1988) argues that it was 13% of the "legal" fur trade.
- The Navigation Acts were not applied on the Great Lakes between the US and Canada (which matters post-1800) (Marr and Paterson, 1980). Quebec City was also a "free port" (an exception to the Navigation Acts) which means that the costs suggested above did not apply to Canada. Halifax became a "free port" too in 1818. This means that we can't really assign a big role to these Acts (especially given that the proportion found for the US was already small).

If it made people poorer, how much poorer?

- Some argue that the weakness of enforcement of mercantilism in the United States and Canada helps explain why it never mattered much in North America:

> The royal governors were the main enforcers of British mercantile policies. They had instructions from the Board of Trade, through the Secretary of State. They appointed the officers of the Customs Boards, which were responsible for the collection of import and export duties. Critically, however, the royal governors and customs officials were paid by the colonial assemblies, which were elected by colonists. As it turned out, this was a fatal flaw in the British enforcement mechanism. As leverage to 'encourage' the governor to agree with the colonists – oftentimes in violation of direct orders from the Crown – the assemblies authorized payment of the governors' salaries just once a year. Indeed, in practice, the assemblies often delayed authorization until the governors agreed to assembly policy demands.

Figure: Passage from Zanella et al. (2003).

If it made people poorer, how much poorer?

- And yes, it does seem that enforcement was more serious in Latin America but numbers about smuggling in the area suggest that the enforcement differences were minimal (Nelson, 1945; Janzen, 1996; Skowronek, 1992).
- Pearce (2001) suggests trade of between 3 and 7 million dollars (roughly 3% of American GDP) between the Spanish and English colonies in the Caribbean alone. This is not suggestive of the possibility of strong enforcement of mercantilist policies.

What Came With Mercantilism

- Mercantilism came with heavy government involvement in military affairs. But national defense was not paid by colonists. Rather, they were paid by the taxpayers of the mother country (Desbarats, 1995; Davis and Huttenback, 1982; Rabushka, 2015; Geloso, 2018; Galiani and Torrens, 2016).
- The colonists received more in mother-country government expenditures than they paid in taxes to the mother country. This meant that they were receiving some "public goods" such as defense (Geloso, 2018) at a bargain allowing them to be one of the least taxed areas in the New and Old World (Rabushka, 2015).
- Taken together, these facts suggest that mercantilism and "mother-country-policy-towards-colonies" is hard to credit for being on net a large negative (i.e. not a big enough deal).

Why Mercantilism?

- Okay! So we have ruled out mercantilism as a big explanation of the colonial origins of divergence.
- But why adopt mercantilism?

Why Mercantilism?

Rent-seeking interests in England and by colonial governors and favored merchants explains this kind of 'mercantile' regulation. One example makes clear the motives: the Hat Act passed Parliament in 1732 under pressures from London felt makers. Already in fear of French competition, these London businesses were fearful of the establishment of a hat industry in the northern colonies. The act prohibited the exportation of hats from one colony to another, required colonists to have a seven-year apprenticeship before entering the trade, with apprentices limited to two

Figure: Passage from Zanella et al. (2003).

Why Mercantilism?

- Mercantilism is rent-seeking!
- Mercantile regulations protect privileged positions of established players. Protected from competition, they extract a rent. But that rent is drawn from using the law to establish market power (i.e. monopoly/cartel profits). Rulers would gain from this by sharing in with the rent (Ekelund, 1997).

A brief digression on staple theory

- We must, however, rescue staple theory from the association with mercantilism. Staple theory was, mostly a demand-side theory whereby foreign demand determined income in a small open (and natural-resource rich) economy like Canada. That demand was exogenous to the locals of Canada. This means that growth is driven by exports to foreign countries.
- There are two iterations of staple theory. The first is that increasing foreign demand drives economic growth and productivity gains because of "linkages" between sectors (the export sectors drive others) : "The central concept of a staple theory . . . is the spread effects of the export sector,that is, the impact of export activity on domestic economy and society. To construct a staple theory, then, it is necessary to classify these spread effects and indicate their determinants" (Watkins, 1963).

Staple Theory

- The second iteration is more sophisticated and probably more accurate: staple theory suggests that there can be such a thing as export-led growth, but the emphasis should be on productivity improvements that affect the supply-side of the economy (Altman, 2003; Henriques and Sadorsky, 1996). The gains in productivity allow the ability to export more *and* import more.
- If foreigners sold Canadians more goods than they bought from them, they were financing Canadian investments beyond what Canadian savings could allow. This stimulates capital accumulation in a manner that promotes growth more K per L means more Y per L.
- This second iteration places staple theory as an explanation for the volume of *total trade* rather than the level of exports or the balance of payment. Thus, our interest should be geared (as we will in theme 7) on what impeded supply-side factors.

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