

International Trade: Lecture 2

Trade History and Economic Thought

Biwei Chen

Bichen@barnard.edu

Department of Economics
Barnard College · Columbia University

January 28, 2019

Outline

1 World Trade History

2 Mercantilism

3 Classical Thought

Ancient trade: to the 1st century BC (web)

Trade originated with human communication in prehistoric times. Trading was the main facility of prehistoric people, who bartered goods and services from each other before the innovation of modern-day currency.

- ① Development of local markets
- ② Waterborne traffic 3000-1000 BC
- ③ The caravan from 1000 BC
- ④ New routes to the west from 300 BC
- ⑤ Doura-Europus, a frontier town from the 3rd century BC
- ⑥ Palmyra from 300 BC (east-west axis from Persia to the coast)
- ⑦ A trade route from China 2nd century BC

Trade history: to the 15th century AD

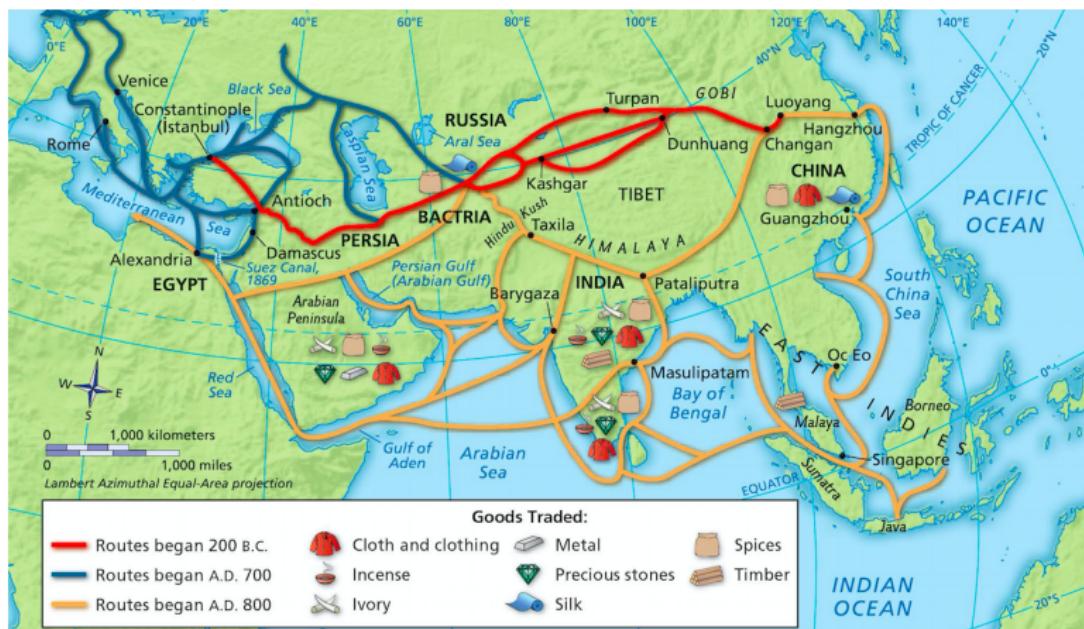
- ① The trading kingdoms of West Africa 5th-15th century
- ② Vikings in Russia from the 9th century
- ③ The Pax Mongolica and the Silk Road 13th-14th century
- ④ Hanseatic League 12th-17th century
- ⑤ Portuguese slave trade 15th-17th century
- ⑥ Chinese sea trade 15th century (Zheng He)
- ⑦ Europe's inland waterways 15th -17th century

Trade history: 16th-18th century AD

Nautical trade was dominated by Europeans in the so-called Age of Exploration. Subsequent eras, in particular the period of colonialism, would not have come about without the existence of the nautical trade routes that led to European domination during this critical and difficult moment in human history.

- ① Portugal's eastern trade 1508-1595
- ② Rivals in the overseas trade 1555-1595
- ③ Spanish silver trade 16th century
- ④ The Atlantic cod trade 1497-1583
- ⑤ Dutch trade in the east 1595-1651
- ⑥ English trade in the east 17th century
- ⑦ Triangular trade 18th century

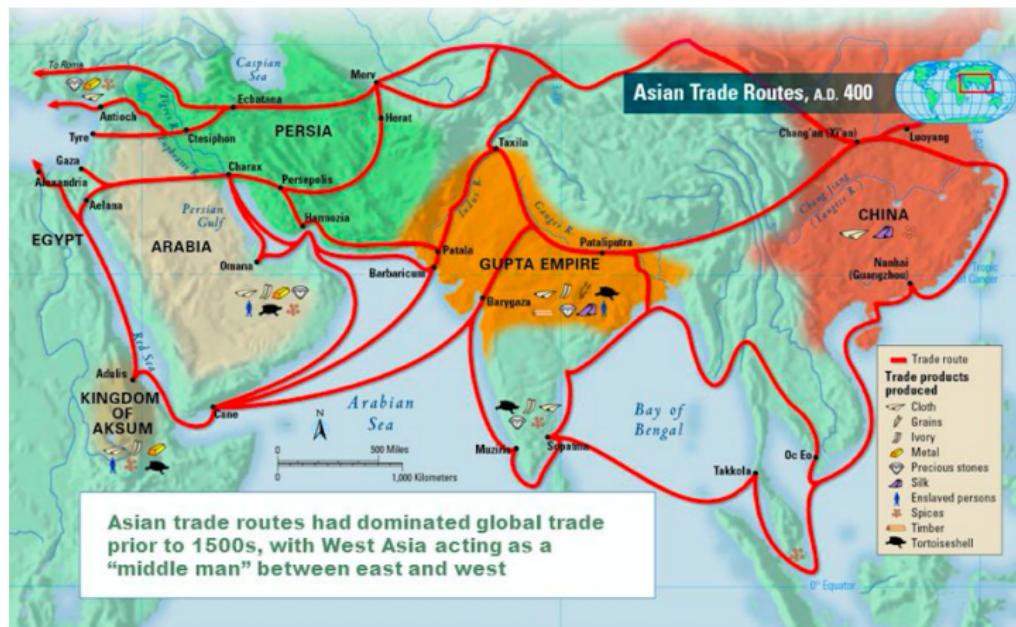
Ancient trade routes: 200 BC to 800 AD



Roman empire trade: 200 AD



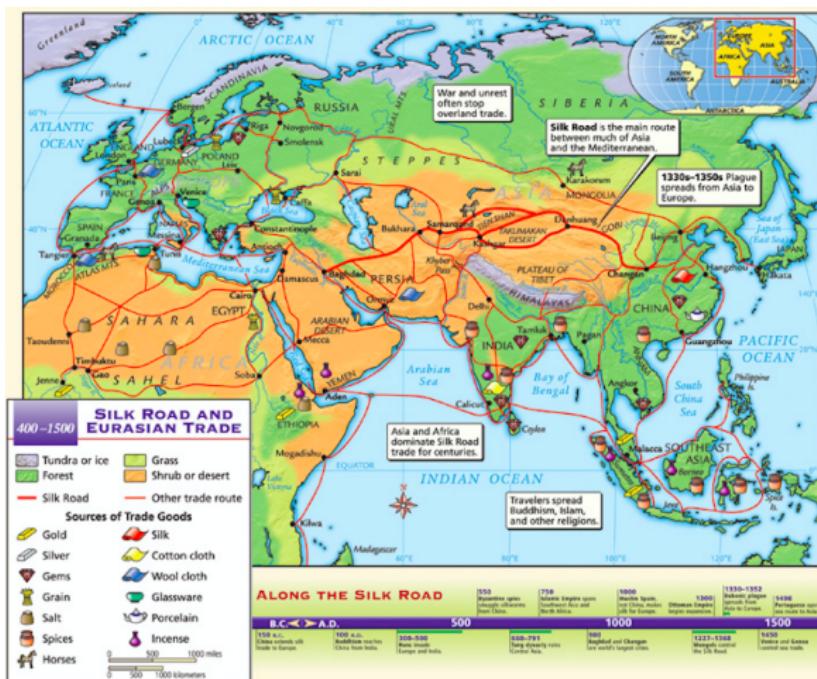
Asian trade routes: 400 AD



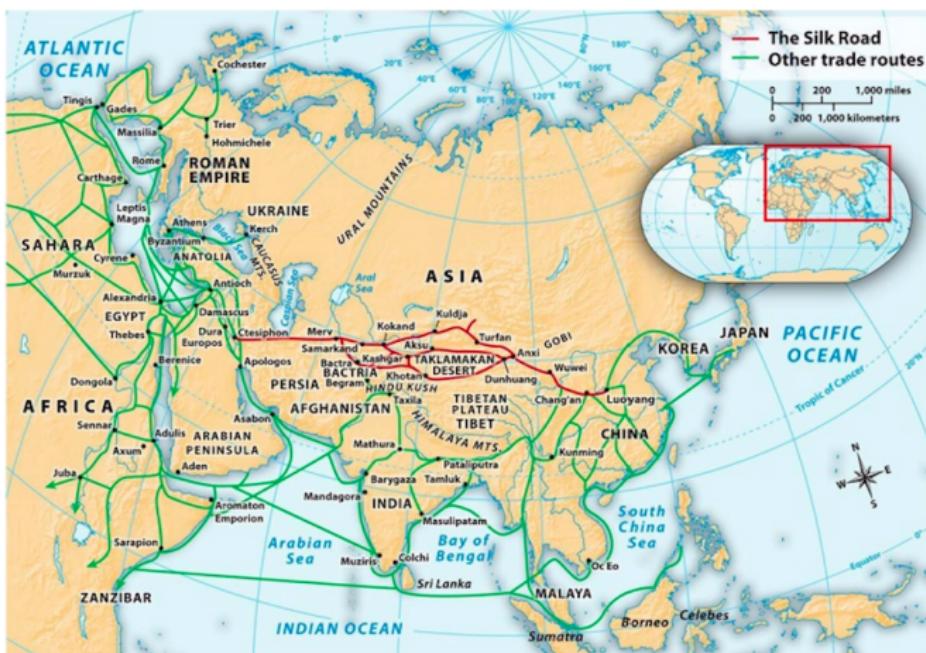
World trade routes: 11th to 12th century (web)



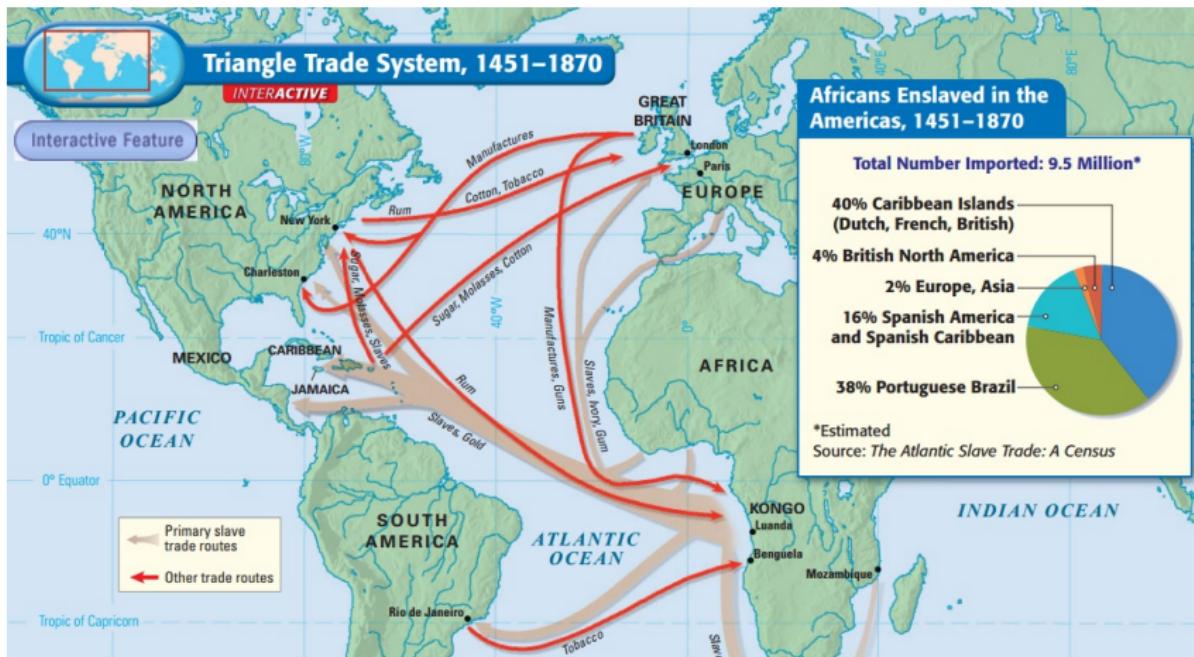
The Silk Road: 400-1500 AD (Video)



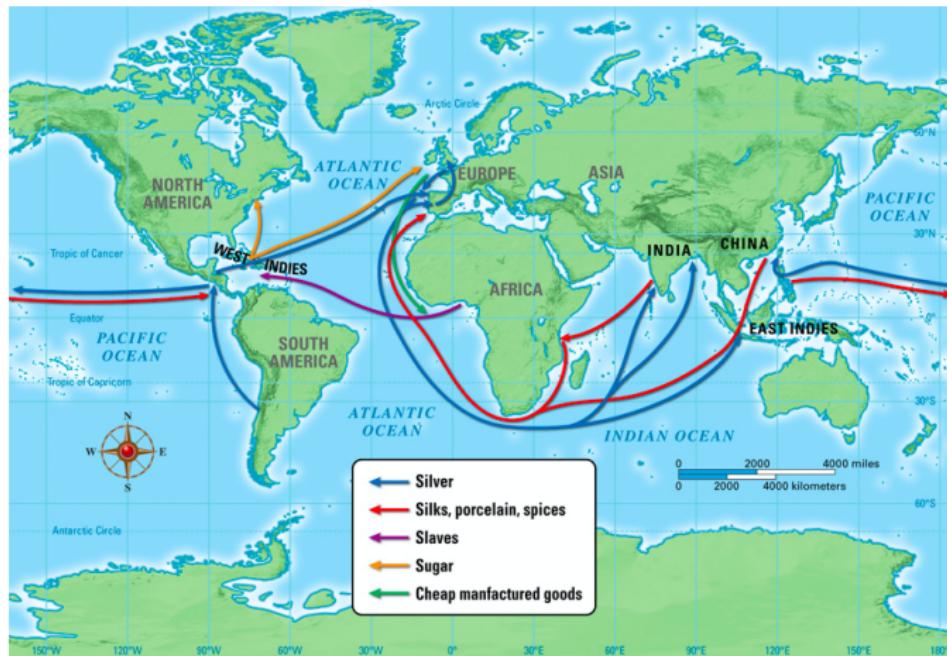
The Silk Road 17th century



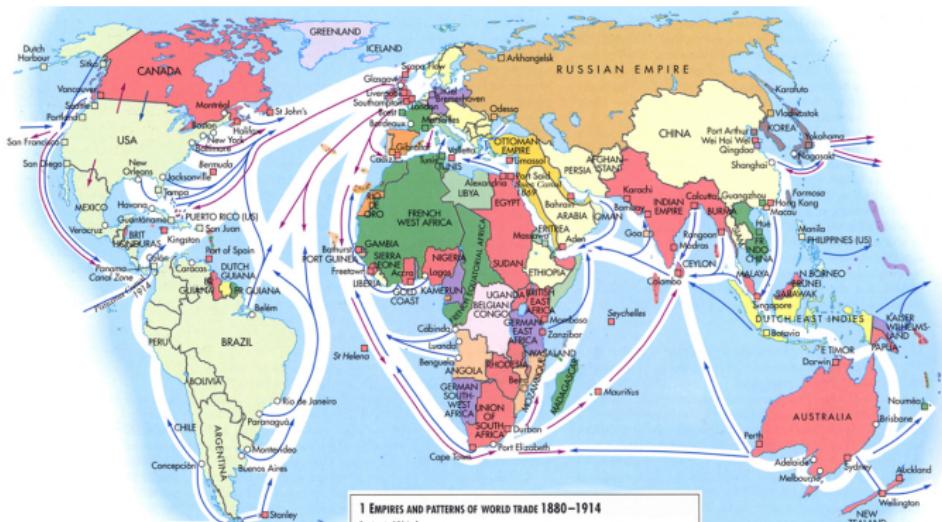
Triangle trade 1451-1870



World trade patterns 1500-1600



Empires and world trade flows 1880-1914



▲ The strengthening of colonial rule was linked to a number of economic and political factors, including the need for raw materials to supply rapidly industrialising economies and the desire to find new markets for manufactured goods.

1 EMPIRES AND PATTERNS OF WORLD TRADE 1880–1914

Belgium	Independent country
Denmark	Independent country previously under European control
Italy	Major shipping route
Turkey	Main trade in raw materials
Russia	Main trade in manufactured goods
Japan	Major base and coaling station

Map Copyright © Philip's, a division of Octopus Publishing Group Ltd
Source: Philip's Atlas of World History

Outline

1 World Trade History

2 Mercantilism

3 Classical Thought

Mercantilism 1500-1776: historical background

Mercantilism is economic nationalism for the purpose of building a wealthy and powerful state. This system dominated Western European economic thought and policies from the 16th to the late 18th centuries.

- ① The self-sufficiency of the feudal community slowly gave way to the new system of merchant capitalism.
- ② The discovery of the 'new world' of America, based in part on the development of navigation, and the establishment of colonies thereby some European States in the 15th century resulted in a large flow of gold and silver into Europe from Mexico and Peru.
- ③ International trade henceforth became more and more important merchants took on an important role, also in the domestic economy.
- ④ Colonial trade and merchant companies increasingly became part of an endless story of wars between the nation states of Europe.

Mercantilism: historical background

- ① National states were rising, and the most powerful of them were acquiring colonies and spheres of influence. Economic rivalries between nations were intensified. England ultimately emerged as the victorious, imperialist country.
 - the defeats of Spain and Portugal in the 16th century
 - the defeat of Holland in the late 17th century
 - the defeat of France in the 18th century
- ② This pluricentennial story of wars dominated the minds of the founding fathers of political economy during the Enlightenment. It is not surprising that a body of doctrine evolved that superseded feudal concepts, promoted nationalism, gave new dignity and importance to the merchant, and justified a policy of economic military expansion.

Mercantilist pioneer: Thomas Mun (1571-1641)

- The 16th century is the age of mature mercantilism. The leading writer of the period is Thomas Mun (1571-1641), who was a very successful merchant and became a Director of the East India Company in 1615.
- In 1621 Mun wrote a pamphlet, *A Discourse of Trade, from England to East Indies*, in order to defend the Company from the accusation of being detrimental to Britain's prosperity because it exported bullion in order to import goods.
- In 1622 and 1623 Mun was also a important member of a committee of merchants which had been asked by James I to examine the problem of the fall of Britain's exchange rate. His magnum opus, *England's Treasure by Foreign Trade* was published posthumously by his son in 1664.

Mercantilist pioneers

- ① Gerard Malynes (1586-1641), English
 - Lex Mercatoria: or, the Ancient Law-Merchant, 1622
- ② Charles Davenant (1656-1714), English
 - An Essay on the East-India Trade, 1696
 - An Essay on the Probable Means of Making the People Gainers in the Balance of Trade, 1699
- ③ Jean Baptiste Colbert (1619-1638), French minister of finance from 1661 to 1683 under Louis XIV, represents the heart and soul of mercantilism, which is called Colbertism in France.
- ④ Sir William Petty (1623-1687), French
 - A treatise of Taxes and Contributions, 1662
 - Verbum Sapienti, 1691; Political Arithemick, 1690

First period: bullionism

- The power of the state depended on the amount of gold and silver in its coffers, because this international currency made it possible to build ships and to pay armies. National wealth can be increased by bringing more gold and silver within the borders of the state, or by preventing them from flowing out.
- The government must favor the sale of raw materials abroad because they will be purchased with precious metals. Imports must be discouraged. Tariffs and duties are among the easiest ways of increasing the revenue of the state.
- What was good for the merchant seemed to be good for state finances as well. At the beginning of 16th century, textile industry in England began with the so-called cottage industry under the supervision of the merchant-capitalist, who supplied the peasants with the raw materials and often advanced them money.

Second period: balance of trade

The extension of manufacturing activities and the need to protect newly established industry from foreign competitors led to the end of the age of bullion and to a new phase in mercantilist thinking.

- The wealth and power of a nation depend on its capacity for international trade. Increase in national wealth is a surplus trade balance (inflow of precious metals).
- The government needs to guide foreign trade in order to favor the establishment of a positive trade balance.
- The exportation of manufactured commodities have much higher value than the raw materials with which they have been produced.
- The export of raw materials needs to be discouraged, contrary to the opinions prevailing during the bullionist period.

Mercantilist: major tenets

- ① Gold and silver (precious metals) constituted the essence of wealth.
- ② Duty-free importation of raw materials that could not be produced domestically, export restriction on raw materials.
- ③ Protection for manufactured goods and raw materials that could be produced domestically (receive gold for export)
- ④ Foreign trade was the major source of wealth and prosperity.
- ⑤ Colonization and monopolization of colonial trade.
- ⑥ Nationalism, militarism, and strong central government.
- ⑦ Opposition to internal tolls, taxes, and other restrictions on the movement of goods. Monopoly and exclusive trading privileges.
- ⑧ Importance of a large, hard-working population

Mercantilist trade policies

- ① In England, Cromwell, proclaimed the first Navigation Act in 1651. The second Navigation Act 1660.
 - all trade with Great Britain and with her colonies had to take place on English Vessels, certain colonial products had to be sold only to England, and others had to land in England before being shipped to foreign countries.
 - foreign imports into the colonies were restricted or prohibited, colonial manufacturing was curbed or in some cases outlawed, so that dependent territories would remain suppliers of low-cost raw materials and importers of English manufactured goods.
- ② In 17th century France, policies designed to protect its rising domestic manufactures from foreign competitors were implemented by Colbert.

Mercantilist labor policies

Not only would a sizable, industrious population provide an abundance of soldiers and sailors ready to fight for the glory and the wealth of the nation, but also it would keep labor supply high and wages therefore low.

- ① During the reign of Henry VIII in Great Britain (1509-1547), 7200 thieves were hanged. In 1536, it was decreed that "sturdy vagabonds" should have their ears cut off, and death was the penalty for the third offense of vagabondage. In 1547 those who refused to work were condemned to be the slaves of whoever denounced them.
- ② A law passed during Queen Elizabeth's reign in 1572 decreed that unlicensed beggars of fourteen year or older were to be flogged and branded unless someone was willing to employ them; for a second offense they were to be executed unless someone would take them into service; for a third offense they were to be considered as felons and executed without mercy.

A 1806 British satire on the Napoleonic blockade (web)



Early 20th century cartoons on Britain's trade policy (web)



Outline

1 World Trade History

2 Mercantilism

3 Classical Thought

Evolution of trade theory

Mercantilism as a major system of thought lost dominance after the harsh treatment it received in Book IV of Smith's *Wealth of Nations* in 1776. However, some of the doctrines of mercantilism have not completely disappeared; a few ideas and policies present in the 20th and 21st centuries resemble the ideas of 200-300 years ago.

- ① Adam Smith (1776) – The law of absolute advantage.
- ② David Ricardo (1800s) - The law of comparative advantage.
- ③ Eli Heckscher and Bertil Ohlin (1920s) - Factor endowments.
- ④ Paul Krugman (1979) - Production variety and economics of scale.
- ⑤ Marc Meltz (2003) - Heterogenous firms and international trade.
- ⑥ Global production networks and value chain analysis.

Smith on production advantage

In a direct attack on mercantilism, Smith argued that government should not interfere in international trade. Nations, like individuals and private families, should specialize in producing goods for which they have an advantage and trade for goods for which other nations have an advantage.

"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... What is prudence in the conduct of every private family can scarce be folly in that of a great kingdom. 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."

Smith on wine production in Scotland

"The natural advantages which one country has over another in producing particular commodities are sometimes so great that it is acknowledged by all the world to be in vain to struggle with them. By means of glasses, hotbeds, and hot walls, very good grapes can be raised in Scotland, and very good wine too can be made of them at about thirty times the expense for which at least equally good can be brought from foreign countries. Would it be a reasonable law to prohibit the importation of all foreign wines merely to encourage the making of claret and burgundy in Scotland?"

-Smith, *Wealth of Nations*

Smith on trade and nations

Smith extended his belief in the harmony of interests and laissez-faire to international trade:

"The wealth of a neighbouring nation, however, though dangerous in war and politics, is certainly advantageous in trade. In a state of hostility it may enable our enemies to maintain fleets and armies superior to our own; but in a state of peace and commerce it must likewise enable them to exchange with us to a greater value, and to afford a better market, either for the immediate produce of our own industry, or for whatever is purchased with that produce. As a rich man is likely to be a better customer to the industrious people in his neighbourhood than a poor, so is likewise a rich nation."

-Smith, Moral Sentiments, 386

Ricardo on comparative advantage

- In 1817, David Ricardo published what has since become known as the theory of comparative advantage in his book *On the Principles of Political Economy and Taxation*.
- Using the example of England and Portugal, Ricardo situated the law in a practical context. In Portugal, Ricardo wrote, production of wine and cloth requires less labor than in England; however, clearly the relative cost of producing those two goods differ in each of the two nations.
- In Portugal, both are possible to produce, and produce with ease. In England, it is extremely difficult if not impossible to produce wine, but not so difficult to produce cloth.
- Thus while it is easier to produce cloth in Portugal than in England, it is more sensible for Portugal to produce excess wine, and hence trade it for a surplus of English cloth.

The classical Ricardian example

"England may be so circumstanced, that to produce the cloth may require the labour of 100 men for one year; and if she attempted to make the wine, it might require the labour of 120 men for the same time. . . . To produce the wine in Portugal, might require only the labour of 80 men for one year, and to produce the cloth in the same country, might require the labour of 90 men for the same time. It would therefore be advantageous for her to export wine in exchange for cloth. This exchange might even take place, notwithstanding that the commodity imported by Portugal could be produced there with less labour than in England."

Ricardo on the principle of free trade

"Under a system of perfectly free commerce, each country naturally devotes its capital and labour to such employments as are most beneficial to each. This pursuit of individual advantage is admirably connected with the universal good of the whole . By stimulating industry, by rewarding ingenuity, and by using most efficaciously the peculiar powers bestowed by nature, it distributes labour most effectively and most economically: while, by increasing the general mass of productions, it diffuses general benefit, and binds together by one common tie of interest and intercourse, the universal society of nations throughout the civilized world. It is this principle which determines that wine shall be made in France and Portugal, that corn shall be grown in America and Poland, and that hardware and other goods shall be manufactured in England."

– Ricardo, Works and Correspondence, 1: 133-134.

References

- [1] Bruce and Grant, 2013, The Evolution of Economic Thought. 8e. Cengage.
- [2] Vaggi and Groenewegen, 2014, A Concise History of Economic Thought: From Mercantilism to Monetarism. Palgrave Macmillan.
- [3] Laura LaHaye, Mercantilism. (w)
- [4] Charles L. Hooper, 2011, Mercantilism Lives. (w)
- [5] Adam Smith, 1776, The Wealth of Nations. (w)
- [6] John V.C. Nye, 2003, The Myth of Free-Trade Britain. (w)
- [7] Pedro Schwartz, 2017, Unilateral Commercial Disarmament. (w)