



Classical Theories of International Trade

Lecture 2



Lecture 2

Evolution of Trade Theories

- **Mercantilism**
- Absolute Advantage
- Comparative Advantage
- Factor proportion Trade
- International Product Cycle
- New Trade Theory
- National Competitive Advantage



Lecture 2

Outline

- Introduction to Mercantilism
- Historical Background of Mercantilism
- Main Points
- Mercantilist Thinkers
- Conclusion

Lecture 2

- What is Mercantilism?
 - the theory that a country's power depended mainly on its **wealth** to build **strong navies** and purchase **vital trade goods**.





Lecture 2

- Mercantilism had no systematic, comprehensive, consistent treatise, no leader, common method, or theory.
- Each "mercantilist" sought advantage for a specific, trade, merchant, joint-stock company or social group.
- "Protectionism" is often seen as a primary characteristic of Mercantilism.



Lecture 2

- The primary objective of Mercantilism **was to increase the power of the nation state.**
- One of the important aspects of national power or strength was wealth that was equated with specie.
- The states that followed a policy of mercantilism tended to see trade, colonialism and conquest as the primary ways of increasing wealth.



Lecture 2

- When?
 - 16th – 18th C
- Where?
 - Western Europe, particularly England and France



Lecture 2

- **Historical Background of Mercantilism**
 - Generally, Mercantilism is associated with the rise of the “Nation state.”
 - Feudal institutions were weakened by the increasing use of money and a greater reliance on exchange within the economy.
 - The Protestant Reformation weakened the role of the church and consequently the civil role of the state was expanded
 - There was a rise of Humanism (the concern for well-being of humans in the short term).



Lecture 2

- The decline of feudalism was influenced by changes in technology
- “enclosure movement” and the commercialization of agriculture
- Increasing use of money in the economy reduced the role of barter and reciprocity, people wanted to sell or work for money
- nailed horse shoe, harness, stirrup, horse collar, heavy plough
- rise of mechanical power [water, wind] used in textile and mining
- urbanization



Lecture 2

- rise of markets and fairs
- gunpowder
- improvements in navigation, shipping, transport
moveable type, (standardization, mass production and marketing of books in a variety of languages),
mechanical clocks, mechanisms, instruments,
- Increased skills of craftsmen who made machines



Lecture 2

- The Decline of Feudalism and the Plague
 - The "Black Death" of 1346-61
 - restricted trade
 - reduction in population
 - Increased production of wool; need industry and commerce to process and sell wool and textiles.
 - strengthening of guilds leads to an emphasis on trade



Lecture 2

■ Reduction in Population

- Population of England fell by about 1.5 million (out of a population of 3.5 to 5 million in 1346).
- Result was more money per person but also more animals, land and goods per person, prices fell.
- Labour shortage pushed wages and earnings up.



Lecture 2

- Less people with increased agricultural production (some problems with harvests and animals dying, but on average diets improved.)
- Labour became more mobile, masters on feudal estates had to "hire" labour. This led to the rise of "free" labour.
- If you couldn't hire workers, then you rent the land to others. Small farms with limited labour shifted to pasture and sheep rather than tilling the soil.



Lecture 2

■ Medieval Breakdown

- Feudal system imposed many imposts upon merchants/tradesmen/moneylenders; but social change went against feudalism:
- Growth of specialist manufactures in towns: the guilds
- Growth of specialist traders between nations: the Mercantilists
- Revolt against religious strictures against merchants/lending, church hypocrisy
- Religious revolts: beginnings of Protestantism bound up with growth of merchants/financiers
- A new ideology/analysis struggled for dominance:
Mercantilism



Lecture 2

- **1500s and 1600s**
 - Invention of printing with movable type gave rise to economic literature written by lay people
 - Thomas Wilson (1525-81) wrote *Discourse on Usury* (1572)
 - Charles Dumoulin (Latinized as Molinaeus) wrote *Treatise on Contracts and Usury* (1546)
 - Denied that interest was forbidden by divine law
 - Suggested public regulation of lending and interest
- Inflow of gold and silver from the New World



Lecture 2

- **Main Points of Mercantilism:**
 - Economics as applied statecraft
 - Promotion of National wealth and power
 - Importance of trade surpluses
 - Trade surplus leads to a net gold inflow, and thereby to greater national wealth and power
 - Encourage domestic production and exports, discourage imports



Lecture 2

- Economics as statecraft not analysis
- Tendency to see gold and “treasure” as constituting national wealth
- Emphasis on balance of trade surpluses
- Emphasis on maximizing productivity and output
- Role of government in encouraging domestic manufacturing and exports while minimizing imports
- Link between money supply and prices

Lecture 2

Two Ways to Increase a Nations Wealth

- obtain as much gold and silver as possible



- establish a favorable balance of trade, in which it sold more goods than in bought





Lecture 2

■ **Mercantilism Explained**

- colonies existed for the benefit of the Mother Country
- Source of Raw materials = **cheap**
- shipped to M. C. to be turned into finished goods
- Finished good shipped to Colony = **expensive**
- profit goes to M. C.
- Pass laws forbidding colonies from producing their own goods

Mercantilism = unfair or unbalanced trade

Lecture 2

■ **Triangular Trade**

- Europeans transported manufactured goods to the west coast of Africa



Lecture 2

- Traders then exchanged these goods for captured Africans who were then sold in the Americas



Lecture 2

- Merchants then bought sugar, coffee, and tobacco in the West Indies and sailed back to Europe to sell these products.





Lecture 2

Long Term Results

- global trade routes shifted over time
- the old silk routes declined
- West Asia and the Islamic world were displaced as the centralized location of global trade
- the Atlantic and Pacific sea routes become the new focus of global trade



Lecture 2

- It measures the wealth of nation by the size of its accumulated treasures i. e. gold & silver.
- Focus is international trade, rather than internal commerce
 - Nationalism essential: promote nation by gain from trade
 - Trade imbalance the object: export more than import



Lecture 2

- Wealth (Gold) can be accumulated by encouraging exports and discouraging imports.
- This theory aims at creating trade surplus.
- Limitations:
 - Accumulation of wealth takes place at the cost of another trading partner; a win-lose game & a zero-sum game for global wealth (international trade).
 - Supported only in short run.
 - Overlooks other resources such as its natural resources, manpower & its skill levels, capital, etc.
 - Used by colonial powers as a means of exploitation and not development.



Lecture 2

Recap

- Feudal ideology significantly anti-capitalist, anti-financier. But
 - Merchants essential
 - “Exotic” commodities from other lands
 - Trade between different fiefs/kingdoms
 - Finance essential
 - Merchant activity
 - Wars
 - Merchants tolerated (but controlled, taxed)



Lecture 2

Mercantilist Thinkers

- Josiah Child
- Bernard Mandeville
- David Hume
- Von Hornick
- Thomas Mun



Lecture 2

Niccolo' Machiavelli (1469-1527)

- Author of *The Prince*, 1512
- Machiavelli's work is associated with the rise of nation state
- Morality was necessary as guide to private actions
- Politics should be free from ethical or theological influence
- general postulate about human nature, self- interest



Lecture 2

David Hume

- David Hume questioned mercantilist assumptions in his essays.
- He denied that money and gold were equivalent to wealth. Instead, they had merely instrumental value.
- He thought that accumulating precious metals would result in higher prices.
- Hume believed that imports as well as exports were beneficial.
- He suggested that trade was not equivalent to warfare, since both to the parties to the transaction benefit.



Lecture 2

- He thought that accumulating precious metals would result in higher prices.
- Hume believed that imports as well as exports were beneficial.
- He suggested that trade was not equivalent to warfare, since both to the parties to the transaction benefit.



Lecture 2

Thomas Mun

- *England's Treasure by Foreign Trade* (1664)
- Mercantilist Programs
 - Importance of trade and the social position of the merchant
 - Bring all unused land into production
 - Fully utilize natural resources including fisheries
 - Reduce consumption of imports, particularly luxuries
 - Export goods with inelastic demand—can charge higher prices



Lecture 2

- Customs duties on imports to be consumed domestically
 - Export in own ships
 - Encourage distant trade
 - make England a trans-shipment point
 - Export of bullion permitted, if for purposes of trade (non-bullionist position)
 - “Make the most we can of our own”



Lecture 2

Mercantilism: Conclusion

- Foreign trade as the source of surplus
- No analysis of production
- In practice
 - Added to feudal imposts on commerce
 - Created government-sanctioned monopolies
 - ostensibly to increase national wealth; but
 - often in practice enriched favoured individuals