SUMMARIES OF LECTURES in ECO 303Y1:

the Economic History of Modern Europe, to 1914

for the Academic Year: 2012 - 2013

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IV. Week no. 4: Lecture No. 5: on 3 October 2012

The Market and Trade: Domestic and Foreign Trade

Prologue and Précis: England (then Great Britain) enjoyed two major market advantages over its continental arrivals, that also help to explain whey Great Britain was the Homeland of the modern Industrial Revolution:

(1) **A domestic market:** that was (from 1707 Act of Union) the largest single unified market in Europe, and also the fastest growing market (doubling from 6 to 12 million), with high living standards, and one that became fully integrated, physically, with the transport revolution in canals (1760-1800

(2) **Foreign markets:** which became the more decisive markets for growth, after 1815, based upon the creation of Europe's most viable and profitable Overseas Commercial Empire – one that proved to be far more conductive to modern industrialization than any other such Empire; and one that profitably practised the economics of New Colonialism (as opposed to the previous, self-defeating Old Colonialism) and the protectionist micro- and macro-economics of Mercantilism, so closely related.

A. The Domestic Market: the more important to 1815

(1) **Importance of the domestic market:** played a more powerful role than the foreign market in the first crucial phase of the Industrial Revolution, from ca. 1760 to ca. 1810

I) in 1770, the domestic market consumed 77% of total English manufacturing output, and still 69% as late as 1810

ii) Table on foreign trade: shows that exports, having expanded 2.5 fold from 1700, reached a plateau in the 1760s, and did not increase at all until the early 1790s

iii) After the Napoleonic Wars (ending in 1815), however, foreign trade became the more decisive market variable affecting British economic growth

iv) Britain's population could not have tripled from 1810 to 1910 – from 12 to 36 million – without the agency of foreign trade: i.e. to supply the requisite foodstuffs and industrial raw materials

(2) **Factors promoting aggregate growth of the domestic market, 1760 - 1810:**

I) **population growth:** doubling from 6 to 12 million. Note that no European country experienced such a dramatic growth in population during this period

ii) **Market Unification and Market Size:** with the Act of Union of 1707, by which Scotland joined England and Wales (form Grear Britain), and then with the union of Ireland, to form the United Kingdom in 1805, Britain or the United Kingdom became the largest single, unified market in

Europe. All other nation states (Netherlands, France, Germany, Italy, Spain, etc.) were not unified – divided by internal barriers – until much later.

iii) **Urbanization:** especially in the growth of London, from 50,000 in 1500 to 550,000 in 1750 – to become Europe's largest city, growing to 2.491million by 1851, when England had become 49% urbanized, whereas France was only19% urbanized.

iv) **Say's Law:** the supply creates in own demand. The Industrial Revolution did so, principally, through:

- technological change: reducing costs and thereby (by market competition) and prices to create mass-consumption goods with both broad and deep markets.
- It did so also by expanding the number and size of urban markets: concentrated markets with low transaction costs.

(3) **The question of real wages and income distribution:**

I) note that an increase in population will not proportionally increase aggregate demand, until that increased population is gainfully employed, without reductions in real incomes (i.e., from the Malthusian Trap)

ii) **general agreement that real wages, and nationally real incomes in general, were steadily rising from the 1690s to the 1770s:** RWI = NWI/CPI (with a specified base period = 100). The Real Wage Index is the Nominal Wage Index divided by the Consumer Price Index.

iii) **The Standard of Living Debate:** the course of real wages for artisans and labourers from the 1780s to the 1820s: a much disputed question, disputed in particular between Pessimists (Marxists) and Optimists (Conservative), though a majority view today favours the Pessimist case.

iv) **Argument for the Pessimists' Case:** on the decline of real wages from the 1780s to the 1820s:

- **Marxist views:** increased exploitation of labour to finance the Industrial Revolution: reduce consumption to increase capital investment
- **Kuznets U-Shaped Curve:** that the initial phases of economic development and modern industrialization requires a shift of wealth, resources, income from the lower to upper economic strata of society, again to shift national income shares from consumption to increased investment, whose subsequent fruits lead to rising real incomes throughout society
- **The Malthusian Trap:** that increased population pressures led to diminishing returns and fall labour productivity and thus to declining real wages: OK in agriculture, but why in urban industry. Note the previous assertion: that the Industrial Revolution, through productivity-enhancing technological changes, broke forever the Malthusian constraints, to permit the simultaneous growth of population, the economy, and real incomes – but not until the 1850s
- **The Negative Effects of Warfare, 1792 - 1815:** the French Revolutionary and Napoleonic Wars: from the disruptions to international trade and the wasteful diversion of resources and manpower into warfare.
- **The Financial Costs of Warfare:** in particular, hurting the lower classes
    - ♦ Increased taxation, especially in the form of highly regressive excise taxes on consumption, afflicting the lower classes far more than the upper classes
    - ♦ Inflation: financing warfare by excessive increases in the money supply, to purchase increased public debt issues. In Banking and Finance, see the lecture on the 'Paper Pound'.

- ♦ clear evidence that consumer prices soared well above any rise in money wages: as in RWI = NWI/CPI

v) **How Was Aggregate Demand Retained or Augmented under these adverse conditions?**

- ■ Remember that only a minority proportion of society was dependent solely on money wages
- ■ many wage earners who suffered a decline in daily real wages compensated by increasing the number of days worked in the course of the year (when the early
- ■ In the large agricultural sector: producers who sold grains and other agricultural commodities gained in real terms, as prices for their products rose more than did the CPI: i.e., market demand maintained as the barter-terms of trade favoured the large agricultural sector
- ■ Incomes in terms of rents, profits, and interest rose with commercial, financial, and industrial expansion, even if aggregate wages decline in real terms (but that decline is far from being proven).
- ■ **the renewed importance of the foreign-trade sector from the 1790s: see the table**

(4) **Integration of the National Domestic Market:** Canals, as the firs of three Transportation Revolutions

I) **Great Britain's disadvantages and advantages:**

- ■ road networks were very bad, in terrible disrepair, compared to much of continental western Europe
- ■ but no significant location in Britain (England especially) was more than 100 km from some form of water transport: as a compact island cris-crossed by rivers

ii) **1670s to 1770s:** large investments in making English rivers navigable, greatly expanding feasible water transport with boats and barges

iii) **origins of the canals:** population growth and urbanization:

- ■ cheaper water transport to required for supplying larger towns with foodstuffs and fuels (wood and coal), as population pressures drove up their prices
- ■ Industrial Revolution in cottons: required cheap transport of American raw cotton, in large bulk lots, from port towns (Liverpool) to industrial towns (Manchester)

iv) **The era of canal building: the creation of the Cross Scheme:** 1760s to 1790s, NE towns with SW towns, NW towns with SE towns (London), intersecting at Birmingham in the industrial Midlands

v) cut the costs of shipping grain, coal, iron ore, raw cotton, etc. by 50% to 75%:
- ■ brought all areas of England within an effective market economy
- ■ cost cutting => price cutting, to bring many more commodities (but more industrial than agricultural) within the purchasing power range of the masses

v) **Problems and solutions:**

- ■ canals were necessarily Parliament-sanctioned monopolies (with monopoly rights of way),
- ■ and as such, they were rent-seeking and prone to inefficiencies, as well as high costs
- ■ but that provided the incentive for the Second Revolution in Transportation: steam powered locomotives (the railway), from the 1820s

B. **Foreign Trade:**

(1) **Importance of Foreign Trade for British Economic Development:**

- came to the fore, as the more decisive market sector, after the Napoleonic Wars (1815): when Britain literally had to 'export or die',
- for reasons already stressed: for imports of foodstuffs and industrial raw materials as for export earnings (both completely related).
- As the Classical School Economists argued: a nation exports principally in order to import goods more cheaply than producing them at hom**e**
- The purpose of this lecture is to explain the evolution and development of England's foreign trade sector from the 1660s to the French Revolutionary & Napoleonic Wars (1792 - 1815): developments in foreign trade from 1815 will be dealt with in a subsequent lecture (the last in this term).

(2) **The 1660s as a crucial turning point leading to the Industrial Revolution era:**

a) **Two complementary theses on this turning point:**

I) **Ralph Davis: the Commercial Revolution of 1660 - 1760:** broke England's three-fold commercial dependence that had prevailed for previous four centuries

- dependence on the nearby continent of western Europe
- dependence in particular on the Low Countries'
- dependence on one export commodity: first wool, and then woollen cloth
- while attempts at overseas trade diversification, in both regions and commodities, had begun in the mid-16th century, they proved successful only from the 1660s, in establishing a viable overseas commercial Empire, i.e.. British Imperialism
- principal regions: Asia, the Caribbean region, and North American (Africa: only much later)

ii) **Hobsbawm: the 'General Crisis of the 17th Century' and the New Colonialism:**

- as part of his thesis, a Marxist model to explain the transition from a 'feudal' economy to a modern 'capitalist economy', beginning with the British Industrial Revolution, Hobsbawm portrayed a crisis of 'Old Colonialism' giving way to a 'New Colonialism'
- 'Old Colonialism' based on the key medieval profit or rent-seeking motives: the lust for overseas precious metals (gold and silver) and spices (from the East Indies, principally), both of which are luxury commodities that do not promote economic growth
- ultimately international competition drove down the rents and led to soaring costs in miliary measures that literally 'bankrupted' Old Colonialism
- forcing a switch to a 'New Colonialism:' one based on mass-produced and much cheaper mass-consumption colonial markets, but also the development of colonial markets (principally in the Western Hemisphere).
- Great Britain, of all the European powers, most successfully and most profitably achieved this transition from Old to New Colonialism.

iii) **Mercantilism:** as the prevailing philosophy of Political Economy in early-modern Western Europe, to the mid 19th century, in a state-influenced new structures of foreign trade and economic nationalism: can be seen as the product of both the Commercial Revolution and New Colonialism

(3) **The Commercial Depressions of the 17th century and their aftermath:**

a) **nature of the commercial depression:** – especially for England: 1620s to the 1660s

- negative effects of the Thirty Years' War (1618-48) on English trade: especially on the cloth trade: end of the era of the 'Old Draperies' (luxury quality woollen cloths)
- demographic stagnation and decline
- an agrarian depression, in part a product of the demographic decline
- monetary contraction and deflation: partly a product of changes in global commerce, as exports of precious metals to the Baltic and Asia exceeded the declining influx from the Americas
- The continued Dutch supremacy in international trade, shipping, and shipbuilding
- chief significance: to spur on overseas commercial diversification, especially for the English

b) **Successful English/British overseas commercial diversification form the 1660s:**

- **Asia:** especially the British East India Company in India, ultimately undermining Dutch supremacy in the Indian Ocean - East Indies trade (though East Indies remained a Dutch monopoly)
- **the Caribbean:** especially the sugar plantations on Barbados, Jamaica, the Windward and Leeward Islands (and later Trinidad). Here the British succeeded where the Dutch failed.
- **North America:** especially the Thirteen Colonies, which prospered economically, while the single Dutch colony of New Netherlands, based on the fur trade, failed
- In general, the British succeeded by pursuing the gains of New Colonialism, while the Dutch and French remained too wedded to Old Colonialism (especially in the fur trade)
- And thus the British succeeded in creating a viable, profitable overseas Commercial Empire that was more conducive to modern industrialization than was the Dutch or French Empires (or Spanish and Portuguese empires – not considered here).

(4) **The Era of New Colonialism and the Commercial Revolution:**

a) **the Re-Export trade in colonial products:**

I) **chief commodities:**

- sugar (Caribbean)
- tobacco (Virginia)
- Indian cotton textiles: calicoes and muslins
- tea: from India, Ceylon (Sri Lanka), China
- others: coffee, silks, pepper, dyestuffs, hemp (from Asia); and codfish, furs, lumber (North America)

ii) **the slave trade and triangular trades:** a product of New Colonialism:

- slaves purchased from West Africa, with European manufactures, and sold as labour for the sugar plantations in the Caribbean and Latin America; and for tobacco plantations in Virginia
- Caribbean sugar, rum, molasses exported to England
- New England: provided another set of triangular trades in exporting lumber, grain, fish, etc to the Caribbean and also shipping sugar, rum, molasses both to England and New England

iii) **importance:** colonial re-exports were responsible, by the later 17th century, and throughout the 18th century, for about one-third of the value of total British exports to the rest of the world

- promoted vast expansion in English/British overseas trade, shipbuilding, shipping, commercial and financial networks, insurance
- key factor in the pre-industrial growth of London and other major port towns
- major source of commercial wealth and capital accumulation

iv) **the micro-economics of the economic transformations:** mass-production (plantations) and mass distributions – mass marketing of mass consumption products – converted luxury commodities, as sugar, tea, and tobacco had once been, led to drastic cost and price reductions to reach the lower income strata of English, European, and North American societies.

b) **The Development of Colonial Export Markets:**

I) another major consequence was the development of new, non-European markets that proved vital for the British Industrial Revolution, from the 1790s

- in 1700, despite overseas diversification, Europe still accounted for 85% of total British exports, while all other markets thus accounted for only 15% of exports
- by 1798, the situation was almost reversed: continental Europe now accounted for only 30% of total exports, while other markets, chiefly those created by New Colonialism, accounted for 70%
- North America accounted for almost a third, and the Caribbean region for a quarter

ii) **The French and European markets:**

- European markets were, to be sure, much less accessible because of wars with French (the Napoleonic blockade came afer 1798, the year of the table concerned in the lecture
- but consider that the value of British exports was four times greater in 1798 than it had been in 1700, suggesting that thanks to the Industrial Revolution and related developments, especially in foreign trade, that Britain was able to finance both 'guns and butter'.

iii) **Population and economic growth in British North America:**

- the importance of American markets in particular was made possible by the spectacular growth in the population and economies of the Thirteen Colonies, which already, by 1700, had a population of almost 300,000, compared to England's population of 5.21 million
- adding 121,000, from the Caribbean, the combined western market came to 418,000
- those markets grew over 2.2 million by the eve of the Industrial Revolution (when England's population was 6.913 million
- And the population of the new Republic of the US grew to 20 million by the 1840s.

C. **The Economics of Mercantilism and New Colonialism:**

(1) **'Mercantilism':**

I) **a term that Adam Smith (*Wealth of Nations,*** 1776) introduced into English, from the French Physiocrats' derogatory term *mercantilisme*, directed at those (a majority of French society) who believed – wrongly, in their view – that international trade was the source of all wealth, in the form of precious metals (instead of land and natural resources)

ii) **basic principles:** in essence, of what was never a coherently organized body of economic thought:

- all those laws, administrative measures, state and private mercantile policies whose goals were to maximize both national power and national wealth, principally through state intervention
- that wealth was necessary to acquire and maintain power; and that national power was equally necessary to acquire and protect national wealth

iii) **national wealth:** according to the core monetary belief: that precious metals (gold and silver) were either the sole forms of wealth, or the best means of acquiring both wealth and power.

iv) **the acquisition of precious metals:** when most nationals lacked gold and silver mines – by ensuring a 'favourable balance of trade': to ensure (by state intervention) that the aggregate value of export earnings, from goods and services (shipping, banking, insurance, etc), always exceeded aggregate national expenditures on imports of both goods and services.

v) **The See-Saw Theorem:** that since the international supply of 'wealth' was fixed, one nation could gain wealth only at the expense of other nations, who were expected to retaliate.

vi) **Mercantilism thus meant intense international competition and continual warfare**: hence the need always to augment and maintain national power.

vii) **protectionism:** to curb manufactured imports (but encourage raw material imports), and promote exports, in order to achieve a 'favourable balance of trade' – and also to reap the 'value-added gains' from exporting fully finished goods, rather than unfinished goods or raw materials.

viii) **the importance of colonies:** as potential sources of precious metals, as sources of industrial raw materials, especially for military purposes, and as captive markets for the Home Country.

ix) **While Mercantilism has many medieval roots- both Bullionism and Protectionism – going back to the later Middle Ages (14^{th} century),** it became the pre-eminent form of political economy and economic thought with the rise of national, militarized states in the 16^{th} century and the international competition for overseas colonies in the 17^{th} century – i.e., in the era of 'New Colonialism.

(2) **Why Mercantilists pursued the acquisition of precious metals:**

I) **almost underseal belief that precious metals were the sole or primary form of wealth:** and one that ensured national power

ii) **in order to finance both defence and warfare:** though in fact they were primarily financed by state borrowing

iii) **concept that money is capital:** a view that Keynes applauded, arguing that increasing the money supply (with constant Liquidity Preference) would lower interest rates, and augment capital accumulation

iv) **inflationary stimulus of increased money supplies:** in an era of monetary contraction and deflation:

harm of deflation in increasing the real burden of factor costs of production

v) **the need for precious metals to finance trade with chronically 'deficit' areas:** especially Asia and the Baltic, to which areas Europe could never export sufficient material goods (other than silver).

(3) **The English Navigation Laws:** of 1651 (Cromwell), 1660, 1663, and 1673 (all Charles II)

I) **chief purposes:** to augment English shipbuilding and shipping, while removing the Dutch from English carrying trades

ii) **chief features:**

- all exports had to be shipped in English ships
- all imports had to be shipped by either English or English colonial ships, with one exception: that ships coming from the national origin of the goods (e.g., Spanish wines) could be imported by those ships (but with higher tariffs)
- all trade between the colonies and England had to be conducted only by English or English colonial ships: and colonists were forbidden to trade directly with other countries or their colonies
- Staple provisions: specific colonial goods (sugar, tobacco, calicoes, tea, coffee, lumber, etc) had to be shipped directly to specified English ports for English consumption or re-export

iii) **Navigation Laws:** the results:

- did have some success in promoting and expanding English shipbuilding and shipping, at the expense of the Dutch and the French
- but the chief beneficiary was not England but rather New England (Massachusetts, Maine, Vermont, New Hampshire, Connecticut, etc): based comparative advantages in natural resources
- Nevertheless: these laws restricting colonial shipping and trades, and other measures (Molasses Act, 1733; Sugar Act, 1765), and British taxation (to finance defence of North America) proved to be severe irritants that culminated in the American Revolution of 1776
- that Revolution brought an effective end to the Navigation Laws, though they remained on the British statutes books until the enactment of Free Trade in 1846-49 (last lecture this term).

iv) **Read the lecture notes:**

especially Landes and Diamond on Europe vs. China, in the context of national states and Mercantilism.

Also read the appendix: Keynes on Mercantilism