# Lecture Notes for Economic History

## Timeline for Early Modern Period

(Cameron and Neal, chpts 5,6)

Medeival Economy:
- Growth of cities
- Guilds
- Primitive capital accumulation
- Proto-institutions of capitalism
- 10% of land fenced-in
- Property rights

1400 — Age of Exploration begins

1494 "Line of Demarcation" dividing world discoveries between Spain and Portugal (C+N, p. 102)

"Price Revolution" 1540 - 1590

First "Government Sponsored Enterprises" (GSEs) created for trade

1580 — Dutch rebel against Holy Roman Empire

1602 Dutch East India Company founded, which "legally monopolized trade" between Indies and Netherlands (C+N, p. 120)

First corporations, publically-traded equities

Colonization of North America begins

1609 Bank of Amsterdam established, Grotius' "Mare Liberum" published

1637 Tulip "Bubble"

"Colbertism" under Louis XIV 1661-1683

1689 "Glorious Revolution" in England establishing constitutional monarchy

1690 John Locke's "2nd Treatise on Government"

1701 Calico Act in England, trade barriers against imported clothe from India, imported by the English East India Company.

1720 South Sea "Bubble" and John Law's "system"

ca. 1750 "Dawn of Modern Industry"

First "economists", French Physiocrats (Quesnay, Turgot, Cantillon), argue for Laissez-faire and a simplified tax code were precursor to Adam Smith

On mercantilism and the "Price Revolution"

- mercantilism, or "Economic Nationalism" (ca. 1500-1750), was a system of nation-state building where it was seen that a country gained wealth by collecting gold (and silver) into the state (Kingdom) treasuries. This meant the state controlling external trade, most often by granting monopoly trade rights to certain Government Sponsored Enterprises (GSEs), such as the English Muscovy Co. (1555), East India Trading Co. (1600) and South Sea Co. (1712), as well as the Dutch East India Company (1602), which is oftentimes seen as the first "corporation" form of business entity. These trading companies were given monopolies for trade with the new colonies in America, with Africa, & with the Russian and Ottoman empires.
- mercantilism prioritized subsidized (cheaper costs) exports over domestic consumption by putting into place import quotas and other trade barries to import. In general, the exportation of precious metals was punishable by death. In addition the states (kingdoms) sought to control the shipping industries, which in turn created an informal sector of "privateers" (pirates) who were oftentime supported by competing states.

On mercantilism and the "Price Revolution" (cont.)

We can evaluate mercantilism by using the Keynesian identity for the macroeconomy:

$$Y = C + I + G + (X - M)$$

National Income = consumption + Investment + government expenditures (or taxes if a balanced budget) + (exports − imports).

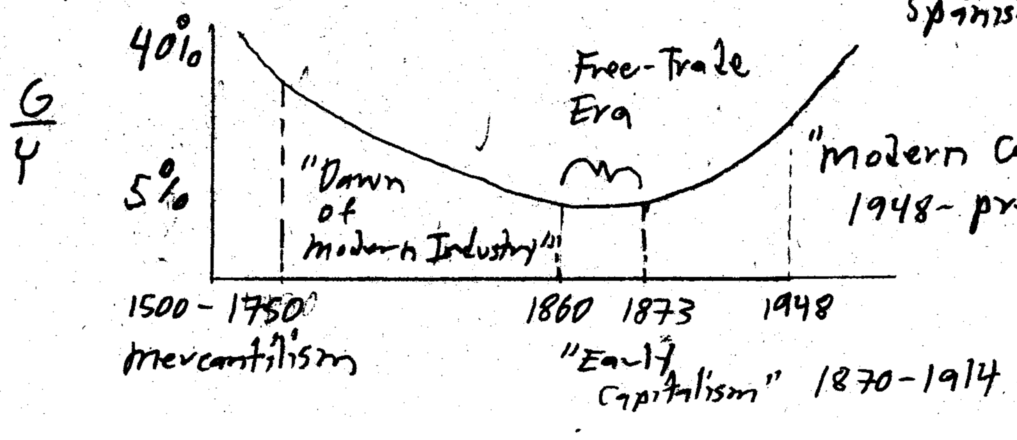
Mercantilism prioritized $X > M$, this meant subsidizing exporters over the overall consumption of the populace. Because international trade was funded through exchange of gold for imports, it was seen that only exports, and thus the gathering of gold in the government treasuries, created wealth. C, I, G and M were minimized while X was prioritized by the mercantilist governments.

Adam Smith (1776) explicitly wrote against mercantilism because it suppressed the well-being of the populace, limited the extent of the market competition and stated that it was free trade, which encouraged specialization of labor and competitive investment in productivity-improving technologies, and, thusly not the state accumulation of gold which increases the wealth of nations.

mercantilism and the "Price Revolution" (cont.).

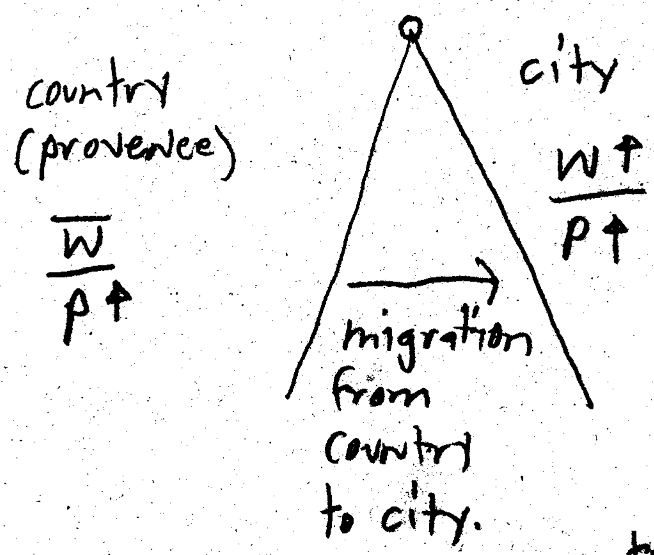
Under Charles V (1517 - 1556) and Philip II (1556 - 1598) the kingdom of Spain controlled much of the Gold flow into Europe*, taking approx. 40% of all gold imports for state treasury. This means that the "burden of government" (per American economist Murray Rothbard), $\frac{G}{Y}$, could be said to be approx. 40%. One of the defining characteristics of "modern capitalism" (per Edward Nell 2008) is that $\frac{G}{Y}$ is also approx. 40%. However as noted under the welfare state government expenditures, G, are not suppressed as they were under mercantilism. Under "early capitalism", which also coincided with the Free Trade Era, $\frac{G}{Y}$ was approx. 5%. (Nell 2008).

* Spanish imports of gold came through Spanish colonies in the Americas.



mercantilism and "Price Revolution" (cont.)

Cameron and Neal (p. 134) state the gold flow (annualized) through Spain into Europe increased from one million ducats ca. 1530 to eight million ca. 1590s. Because the international monetary standard for trade was gold, this vast increase in gold importation lead to a rapid increase in prices and decreasing relative wages ( $\frac{W}{P}\downarrow$ ). This in turn lead to social unrest and more movement of people from the relatively low wage country-side to the relatively high wage city.

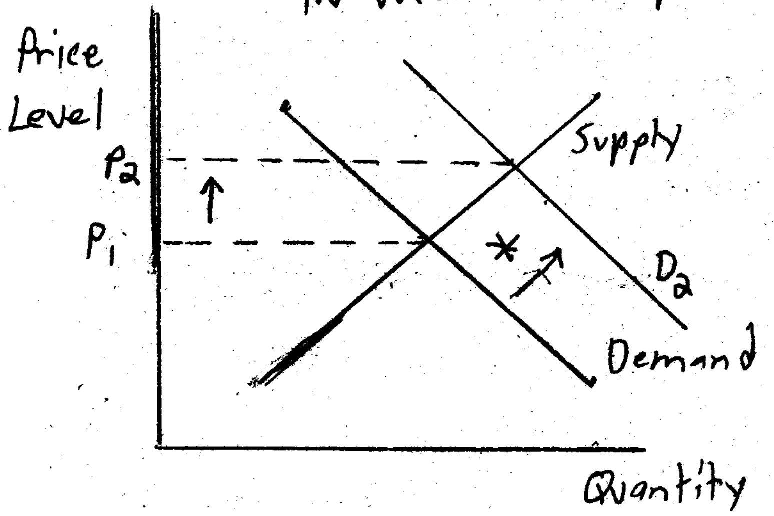



Wages were kept higher in the cities relatively because of the power of the Guild system. However, as more unskilled labor moved to city the guilds began to lose political and economic power. This lead to technological innovation in the forms of "labor-saving" production methods, and, eventually, factory wage-labor.

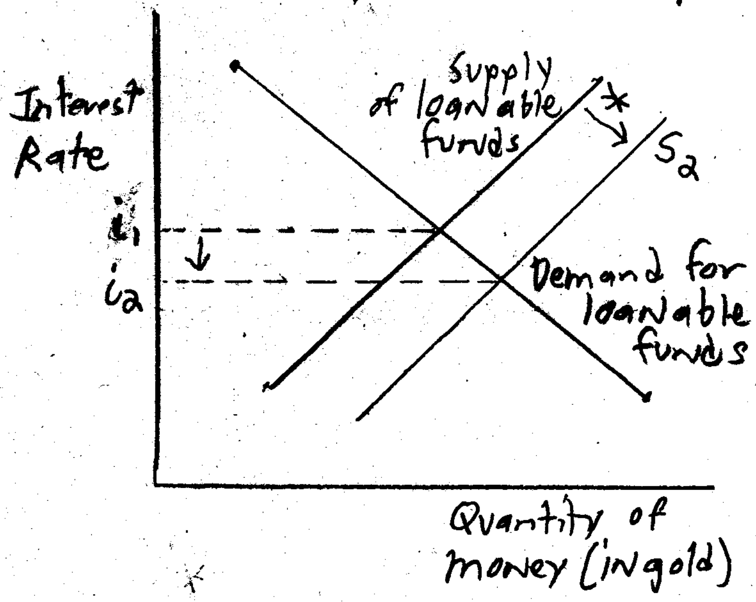
mercantilism and "Price Revolution" (cont.)

The "Price Revolution" (ca. 1540-1590) can be seen in the cartesian plane in two ways:

1) Agregate Price Level in Western Europe




2) Interest Rate in Western Europe



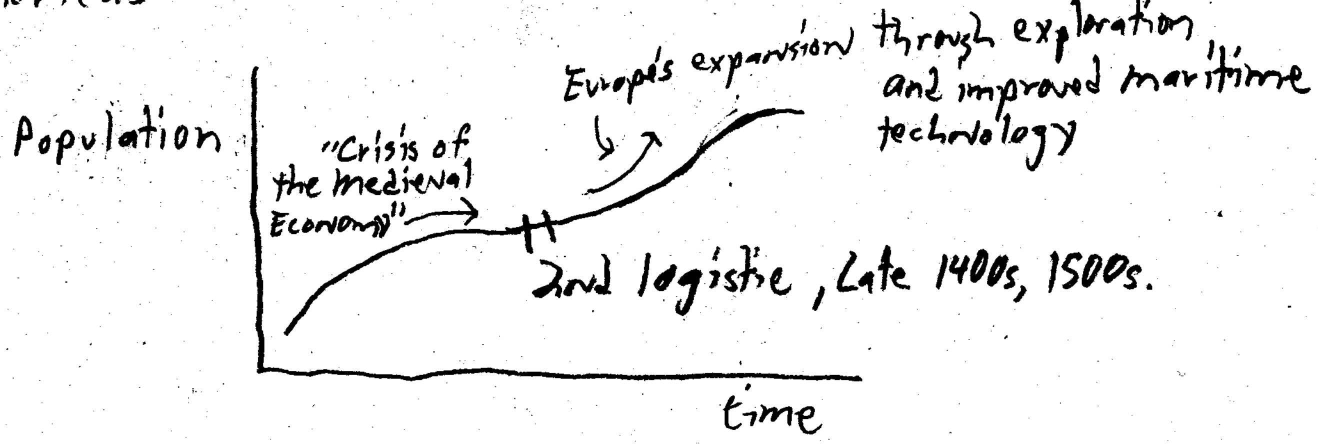

* An 800% increase in the money supply lead to a 300% increase in the price level

* An increase in the money supply lead to a decrease in the interest rate.

Some economic historians believe that the lower interest rate afforded by the price revolution lead to prolonged time-preferences due to cheaper interest rates and thus more investment, which in turn created the initial capital accumulation for the industrial revolution. However this is debatable as Spain and Portugal, who touched this "cheap money" first, were not part of the industrial revolution, and, the Netherlands, whose laissez-faire policies meant much of gold entering Europe ended-up in the Dutch financial system, was "late" in industrializing.

A note on the Age of Exploration.

Cameron and Neal state that the "2nd Logistic" of the Western Community is the increase in population (economic growth) afforded by expansion to Asia, the Americas and Africa.



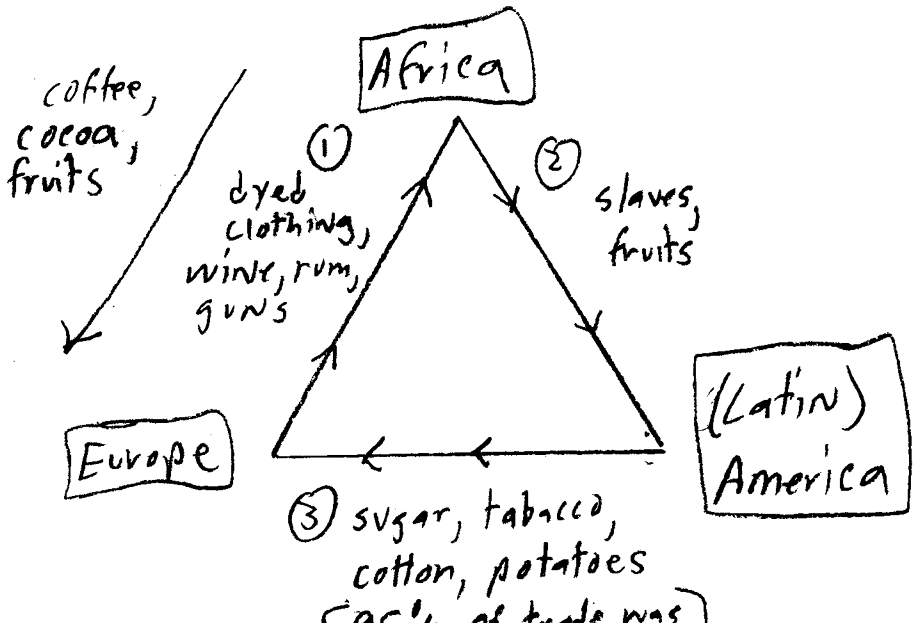

Thomas Carlyle's "Great Man" Theory of history might say this change is society was due to "Henry the Younger" of Portugal (1393-1460) who brought together "astronomers, geographers, cartographers and navigators from all nationalities" (Cameron and Neal, p. 99).

Marx might say that the technological advances that resulted from the Age of Exploration resulted in new Social Relations of production ($\Delta T \rightarrow \Delta S$), that of imperialism and the slave trade between Africa and the new European colonies in the Americas.

Addenda to Notes on Age of Exploration and Mercantilist Periods (1500-1750); e.g. "Early Modern" Period

The trade patterns set-up during the first wave of European Imperialism (the second wave being after the formation of the European Nation-States in the mid-late 1800s) was based on trilateral trade between the (mostly) Spanish Holy Roman Empire, as well as Dutch and English, slave-trade with the New European "discoveries" in the Americas. The trade flows can be visualized below.

Trade Flows ca. 1575




95% of trade was silver + gold during 1500s, leading to "Price Revolution" in Europe

→

sugar, rice, cotton, cereal grains, horses, cattle, sheep, goats, pigs

As well as firearms, alcohol, small pox + measles, reducing indegenous population in Americas from ≈ 25m to ≈ 3m and increasing demand for slave labor in the Americas.

## Addenda to Early Modern Period (1500-1750)

### Political Economy of Europe during Mercantilism and Transition to Modern Europe

In this section of the Lecture Notes we summarize main historical figures, dates, events and government policies which define what Gustav Schmoller called "state-making" (see Cameron and Neal, p. 129). This transition period from the medieval period to the modern state helps us to understand the political economy of today, assuming, of course, that history is cumulative.

### Holy Roman Empire (map, p 134, C+N)

The House of Hapsburg provided kings and Rulers throughout much of the early modern period, including the kingdom of Spain which, of course, controlled the gold flows from Latin America during the 1500's under Charles V (1517-1556) and Philip II (1556-1598). The Hapsburgs declared bankruptcy in 1557, 1575, 1596, 1607, 1627, 1647, 1653 and 1680. The House of Hapsburg created soveriegnty in:

- Germany 1200s - 1800s (The German Republic being created in 1871)
- Austria, Hungary, Czeckoslavakia until after WWI (1918)
- Portugal and Spain 1516-1700
- Mexico 1864-1887

# Lecture Notes for Economic History

## Addenda to Political Economy of Early Modern Period (cont.)

**Spain** (Also see pp 40-42 on Gold importation from Americas and 'Price Revolution')

King Charles I (1516-56) granted trade monopolies
to Spanish ships ~~for~~ trade with the Americas.
As part of Inquisition all Jews expelled from Spain in 1492,
thus Spain lost its mechant class prior to the modern period.

**Prussia and Germany**

Compared to Spain and Portugal, Habsburgs controlled less,
taxes were transparent and low, half of state
budget went to military, though mostly non interventionalist.
Nascent state required civil service accountability.
Immigration encouraged relative to Spain.

**Kingdom of Poland** 966 - ca 1795

"Liberum veto", unanimous constent liberal society until
majority rule constitution 1791 → no special interests,
no tyranny of majority

Liberal society accepted
immigrants: Protestants, Catholics, Jews,
Russian Orthodox, French Heuginots.

Flemish Germans → Poland ← Russians

(1) Russians bribed Polish politicians to get special treatment

(2) Prussia counter-acted by counterfeiting + inflating currency

by 1772 Poland partioned by Prussia + Austria | Russia

# Lecture Notes for Economic History

Political Economy of Early Modern Period (cont.)

## Poland (cont.)

Despite liberal society, Poland did not have agriculture productivity gains of "Western" Europe and by 1600 1/3 of population had migrated, while 3/4 of population remained as "serfs" [shows political liberalism does not necessarily translate to economic liberalism].

## Russia

Peter the Great (1682-1696), Piotr Romanov.
Russia was land-locked and agrarian without primitive accumulation. Peter the Great wanted to "modernize" and "westernize" Russia through adopting western technologies, granted subsidies + monopolies to foreign technicians and created Government-Sponsored Enterprises (GSEs) for weapons manufacturing, ship-building, foundaries, mines and textiles. Used "Western" technology but labor was by serfs (and thusly unsustainable investment).
Built Petrograd in 1703 on Baltic Sea to give Russia a naval power, 30,000 serfs died building city, was capital until 1917 Russian Revolution.
Alexander 1861 emancipated serfs.

Lecture Notes for Economic History (43e)

Political Economy of Early Modern Period (cont.)

France

- J-B Colbert 1668-81, minister under Louis XIV, the "Sun King". "Colbertisme" → mercantilism → "l'etatisme"
Tried to rationalize tax system but failed, taxes ↑ 700% in 1600s.
Wars with Habsburgs, Italians, English.
Couldn't raise enough revenues so sold offices in government, which meant more special interests and therefore even less revenues. Used "tax farmers" to increase revenues.
Guilds were highly taxed and highly regulated (protected).
[Import substitution and infant industry protection].
→ created "manufacture royale" luxury goods industries to support consumption by ruling class, including furniture, portraiture, silks, glassware, porcelain. *
"Trade war" lead to actual war with Dutch 1672.
- Turgot 1727-1781, member of "les economistes", promoted free-trade ("laissez-faire") + argued for simple tax code based on property + trade (unlike Ricardo 1817 et al. tax on Land), as thought that value created through agriculture.

* All failed, like the Russian GSEs failed, why? Lack of entrepreneurship profit-seeking risk-return economic calculation based on private gain to private risk.

Political Economy of Early Modern Period (cont.)

England

Henry VIII 1509-1547

England evolved from absolute monarchy to constitutional monarchy with "Glorious Revolution" of 1688-1689 which separated finances of Crown from that of the State. 1693 Parliament put check on spending of monarchy through requiring transparent budgeting + state expenditures which included public borrowing and creation of public debt instruments, see London Interbank (LIBOR) pricing of debt markets through today, depth of government borrowing meant development of market + lower private borrowing costs.

"Parlimentary Colbertism" in England meant support of guild system, barriers to entry + price-setting, which in turn created less social + economic mobility in English society until later 1800's political reforms.

Navigational Acts (1381-1840s) granted monopoly rights for trade within British empire due to national defense arguments. ('Privateers' developed nonetheless, or, therefore).

"South Sea bubble" created by members of government trying to raise money outside of newly-established reforms through manipulating, again, newly formed stock markets (Stock markets formed to finance GSEs created for mercantilist purposes, not least slave-trading and for 'economic development' in India colony.

South Sea "Bubble" of 1720

The South Sea Corporation was created by members of the English government to monopolize trade, under the standard operating procedures of mercantillism, with the British colonies in the Americas. In addition, however, the company was also used as a way to gain revenues for the British government (excplicitly against the newly formed policies of transparent budgeting of government sources and uses of funds through fiscal policy). As such the company was used as an off-budget way to raise resources for British imperialism without having to be accountable to the populace. Operationally, the South Sea company was a publically-held limited liability corporation whose revenues were guaranteed by the monopoly-rights granted by the government officials who founded the company (who needed money to cover war debt incurred extra-budgetarily.)

The South Sea Company was granted the rights to trade as England's representative to Spain, and thus to Spain's slave and gold trade in the Americas. The right was specifically granted to "Lord Treasurer" Robert Harley, who was a share-holder in the South Sea Corporation.

# Lecture Notes for Economic History

## South Sea "Bubble" of 1720 (cont.)

The company raised initially approximately £10 million ($100 billion in today's dollars), and gave this money to the British government in return for 6% annual payment on the debt (a debt-equity swap). The government was expected to be able to pay this interest cost from collecting tariffs (£600,000 annually) on goods brought in to England from the Americas. Several more equity offers* on the stock market were made, with both the government and the company providing positive advertizement about money to be made with the (slave) trade in the Americas. Furthermore as the stock of South Sea Corporation was rising, the company let it be known that prestigious individuals within the government were buying the stock (who actually didn't have to pay for their shares until the stock rose), which further increased the price of the stock.

* and more debt-equity swaps for State financing off-budget.

Because the stock market was rising due to the South Sea Company "bubble" other companies wanted to be listed on the stock exchange. But, because this was seen as competition to the S.S.Co. insiders, the "Bubble Act of 1720" was passed to "regulate" (prevent) other companies from listing on the London exchange at the time.

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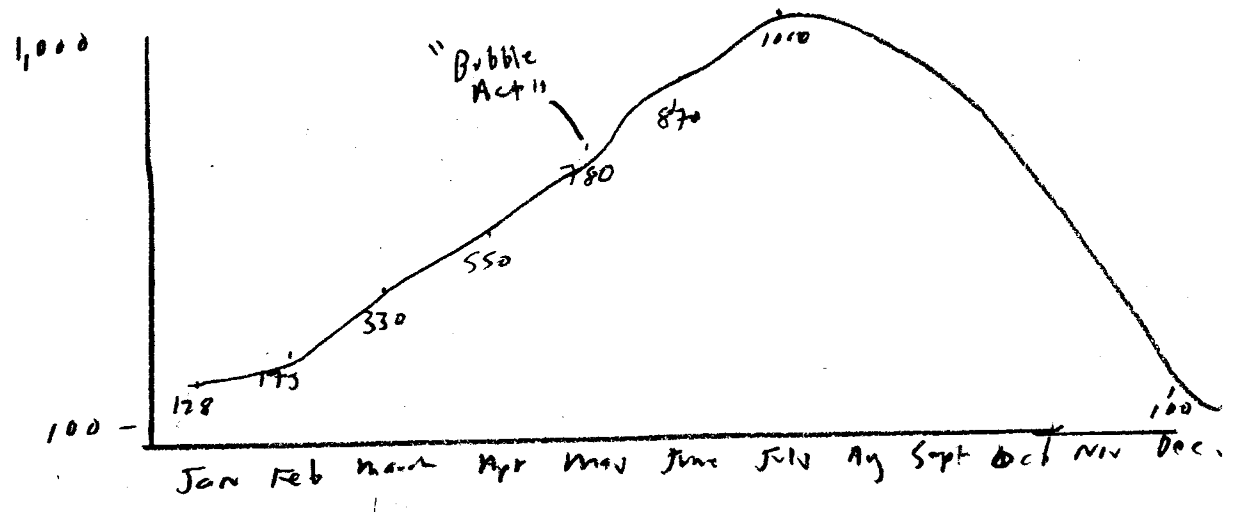
## South Sea "Bubble" of 1720 (cont.)

When the price increased of the S.S. Co. stock market price more than 10 times the initial stock market valuation within one year, original investors began to sell, popping the bubble. Those that bought shares on credit (banks, goldsmiths, aristocrats) went bancrupt. After the crisis the Chancellor of the Exchequer (Finance Minister), the Postmaster General, the "Lord Treasurer" and two ministers of government were all indicted on fraud charges. The "Bubble Act" limiting competition on the stock market was repealed in 1825 and it wasn't until 1862 that special government permission (pre-emptive regulation) was over-turned allowing the London exchange as it is today to compete with the NYSE and others.

South Sea Corporation Valuation
on the London Exchange




1720

Lecture Notes for Economic History 

Political Economy of Early modern Period (cont.)

## The Netherlands

The Dutch revolted against the Holy Roman Empire in 1580 and formed a decentralized confederation based on a "defense" treaty led by town burghers from the merchant class, one which required a unanimous vote, much like the polish "liberum veto". Like the Polish this attracted immigrants from throughout Europe including Walloons, Flemish, Jews, Huguenots (e.g., merchants, entrepreneurs, financiers, as opposed to landed-class rentiers).

Because of the Dutch "Laissez-Faire" commercial policies much of the Gold imported into Europe during the 1500s ended up in Amsterdam banks.

The Dutch attitude towards world affairs can be seen in Grotius 1609 work "Freedom of the Seas" that states the Dutch neutrality position, the rest of Europe (the world) may fight each other but we maintain our neutrality and thus our right to trade with whomever we like.

The Dutch fiscal system was free-trade on all intermediate goods, only consumption goods were taxed, and this too encouraged capital formulation. An exception to Dutch "laissez-faire" was a Mercantilitist policy towards fishery goods.

# Lecture Notes for Economic History (43 k)

## Political Economy of Early Modern Period (cont.)

The granting of monopoly rights for trade under mercantilism which includes the English Navigational laws and the rights granted to GSEs such as the Dutch East India trading company and the British South Seas Corporation, etc, meant that these companies were granted a monopoly against competition, which in turn meant that they were able to (theoritically) earn greater profits than without this anti-competitive regulation. These monopoly rights prevented a (legal) barrier to entry and thusly created "monopoly rents" or higher than average returns due to the government granted rights. This is not sustainable because competition will occur with or without policy. When you add economic nationalism to the equation, for example, only "french" ships can trade at "french" * ports that increases the profits, by limiting competition.

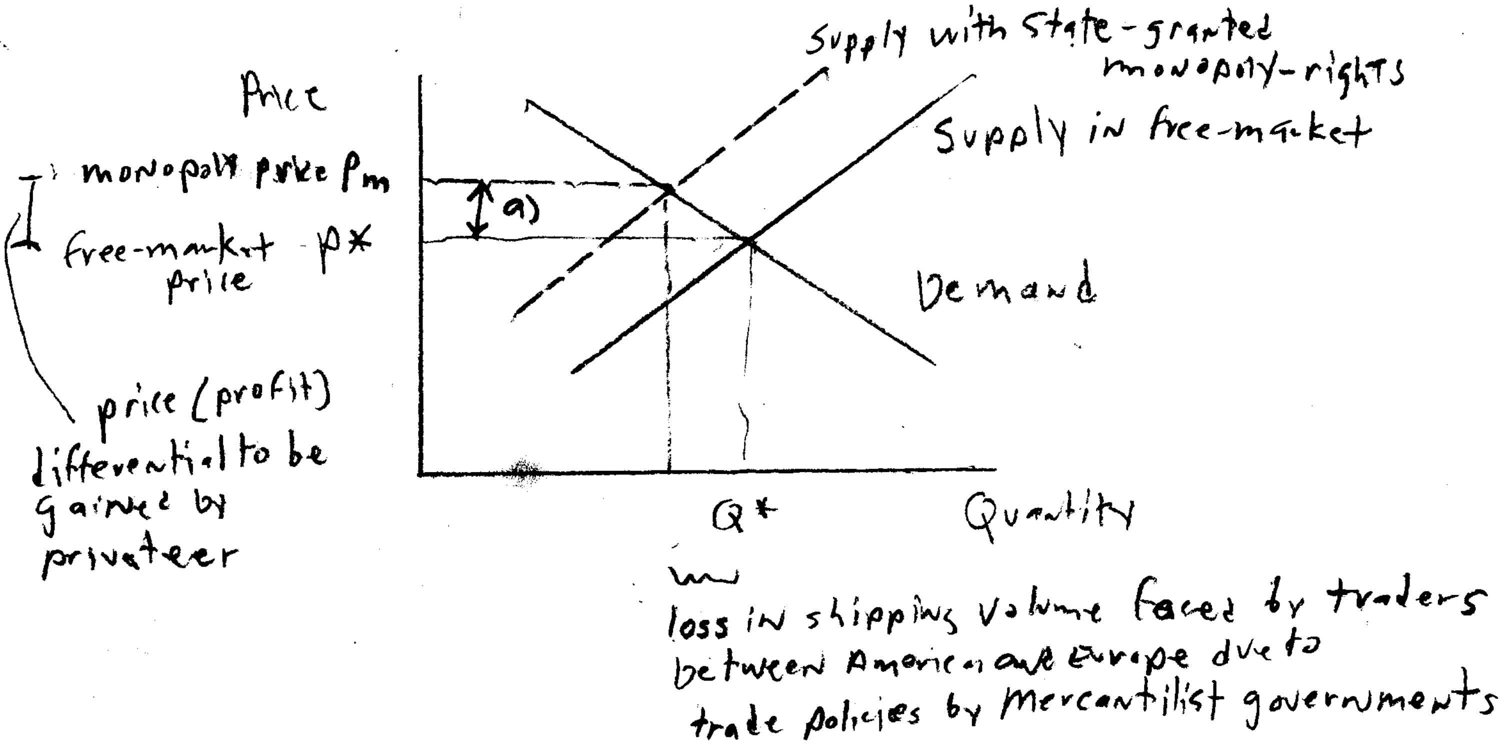
These extra-normal profits can be viewed as a "shift" back in supply due to regulation of supply. This shift back in supply in turn means that those who are granted these special rights will attract competition. If the "monopoly" rights are "legal" constraints then the competition will be illegal. privateers, or "pirates", developed in the Early modern Period due to the unsustainable monopoly rights to trade granted under policies of economic nationalism.

* In addition, say, the British government has incentives to subsidize non-French privateers against French-government created monopolies.

Political Economy of Early Modern Period (cont.)

Why "Privateers" (Pirates) develop (cont.)

Market for Shipping Services between Virginia and London in 1650 (Per ton of Cargo)




a) This is the amount of differential profit that can be captured by someone entering into the market for shipping services under trade restraints. Therefore "privateers" will offer shipping services to traders who want to lower their costs of shipping, and thereby will create additional profit to the trader as well as the "privateer" depending on how they negotiate their contracts.