The Rise of Mercantilism

Exchange, Production, and the Question
That Built Political Economy

ECO 4343 / 5343 · Fall 2026

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Before we start: introduce yourself

hot-intake.netlify.app

Scan this, pick your name, and take a selfie.

It takes two minutes and I only ask for it once. I use it to learn your names and faces early, which matters in a class that runs on discussion.

Pick your own name carefully, and only I can see what you submit.

What is economics about?

Before there there was a discipline called economics, people were already trying to answer a question:

Where does wealth come from?

Two competing intuitions run through this entire course:

A. Exchange

Wealth comes from buying low and selling high. Trade, commerce, and access to markets make a nation rich.

B. Production

Wealth comes from making things. Labor, technology, and the organization of work make a nation rich.

Chapter 2 traces how thinkers moved from A to B—and why that shift matters for everything that comes after.

Part I

The mercantilist world

It is 1620. A ship leaves London carrying silver and comes back carrying Indian pepper and cotton. Did England become richer or poorer?

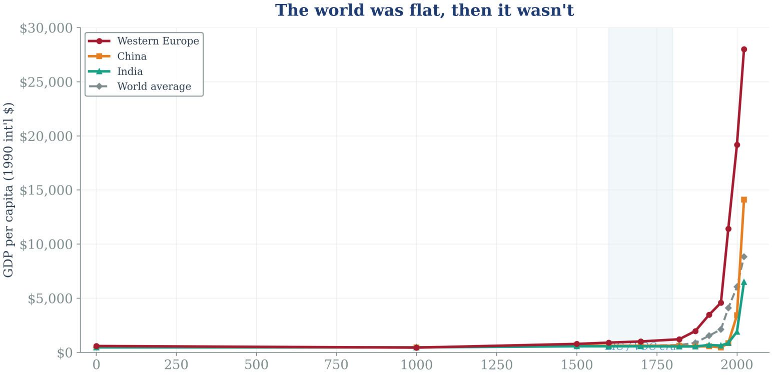
What “wealth” looked like in 1600

An intelligent person in London around 1600 did not see GDP. He saw:

- Ships arriving with pepper, cotton, porcelain, tea, and silver.
- Customs receipts at the port.
- Gold and silver entering or leaving the country.
- Wars over ports and islands.
- Governments awarding monopoly privileges to particular merchants.

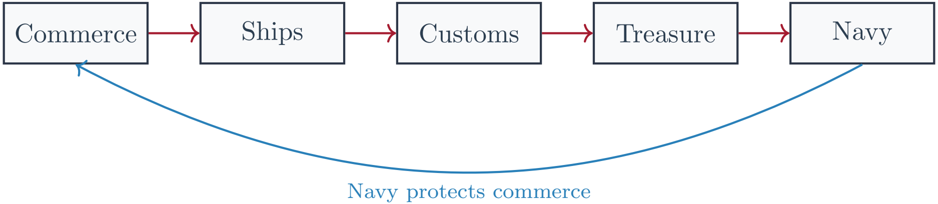
> The categories that were observable—money, ships, customs, trade balances—explain why mercantilism looked the way it did.

Nothing was growing yet



A writer in London could see ships, silver, and customs receipts. He could not see growth, because there was almost none.

The mercantilist feedback loop



Mercantilism is better described as a theory of the **fiscal-commercial-military state** than merely a mistaken theory about gold.

Two systems were running at once

- In the countryside the lord still took his share of the harvest by custom, as he had for centuries.
- In the ports the merchant took his by buying low and selling high, under contracts enforced by law.
- Neither man had displaced the other. They were extracting a surplus from the same country at the same time.

The old system did not end. It sat alongside the new one for centuries.

HL, ch. 1, pp. 8–9. “In place of laws as we know them today, the custom of the manor governed.”

Nobody owned a factory yet

Who	Owns the tools	Takes the surplus
Lord and serf	the serf's plough	the lord, by custom
Master and journeyman	the master's shop	the master, by guild rule
Merchant and craftsman	**the craftsman**	the merchant, by reselling

A merchant could not squeeze production, because he did not own any part of it.

Profit as arbitrage

Arbitrage means buying in one place and selling in another at a higher price, without changing the good.

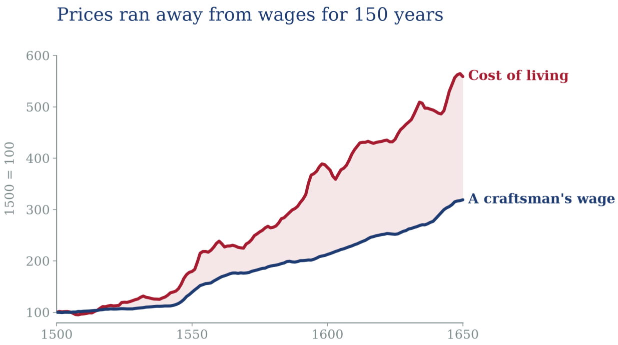
In the early mercantilist period, workers still owned their tools and workshops. Capitalists were primarily **merchants**—their capital was money and inventories, not factories.

So where did profit come from? Two sources:

- **Over time:** buy, hold, sell later into higher prices.
- **Over space:** buy cheap in India, sell dear in London, because nothing moved between them easily.

Profit came from *exchange*, not from making anything new.
And that is exactly what mercantilist writers theorized.

Prices ran away from wages



England. Cost of living index and building craftsmen's daily wage, both Clark (2009, 2014).
Bank of England, A Millennium of Macroeconomic Data v3.1, sheet A47. Nine-year averages.

This is why holding goods paid. It is also why the poor laws were written.

Barbon on value

Nicholas Barbon, *A Discourse on Trade* (1690), summed up the mercantilist view:

> *"The Market is the best Judge of value; for by the Concourse of Buyers and Sellers, the Quantity of Wares, and the Occasion for them are Best Known: Things are just worth so much, as they can be sold for."*
>
> *"The Value of all Wares arise from their Use; Things of no Use, have no Value, as the English Phrase is, They are good for nothing."*

— Barbon, quoted in HL, p. 24

Value is about *demand* and *market price*—not about labor or cost of production. That distinction will matter for the rest of the course.

Europe ran out of money

- Gold and silver production stagnated between 1300 and 1500, while trade kept expanding.
- Money was gold and silver coin, so this was a shortage of money itself, not of wealth.
- Portuguese mining on the African Gold Coast eased it a little after 1450, and American silver ended it after 1550.

Wanting more bullion was not a superstition.
It was a response to a shortage people could feel.

HL, ch. 1, p. 18. Sixteenth-century prices then rose “between 150 and 400 percent.”

The Mun experiment

Thomas Mun, merchant and EIC director, defended exporting silver to India.

Transaction	England's bullion	Merchandise
EIC leaves London with silver	−100	—
Buys Indian goods	—	+100 equiv.
Half sold in England	—	domestic consumption
Half re-exported to Europe for 90	+90	−50
Shipping services earned abroad	+25	—
Net	+15	

Do not judge the bullion balance one transaction at a time. Judge the country's **overall** foreign trade.

Illustrative figures, source unknown — a worked example of Mun's argument, not his own numbers.

Better than the textbook caricature

> "Mercantilists thought exporting money was always bad."

One of the canonical "mercantilists" wrote a book explaining **why exporting money could be good**.

Mun is thinking in something close to a multilateral balance-of-payments framework:

$$CA_{\text{India}} < 0 \quad \text{does not imply} \quad CA_{\text{England, world}} < 0.$$

Reflect on what you just read

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Answer this before you leave

Barbon says “Things are just worth so much, as they can be sold for.” A modern economist might agree—but might also object.

Prompt: Is Barbon right that market price *is* value? Or is there something about a good’s worth that the market can miss? One or two sentences.

Participation entry, not a quiz.

Part II

Companies as merchant capital

What the East India companies actually were

Not "big companies." They were **hybrid public-private institutions**: privately financed merchant corporations with state-created monopolies and sovereign-like powers overseas.

Merchant 1600–1757 → **Company-state** 1757–1813 → **Imperial administrator** 1813–1858

Their charters gave each company a *legal monopoly against merchants of their own country.* They did not prohibit Gujarati, Armenian, Portuguese, or Chinese merchants from trading throughout Asia.

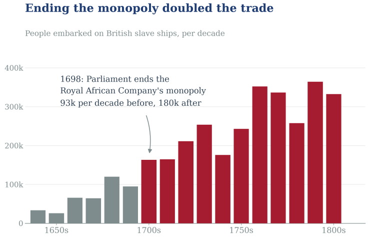
The corporation as an economic technology

A round trip to Asia immobilized capital for years. One shipwreck could wipe out a voyage partnership.

Innovation	Problem it solves
Joint-stock finance	One investor need not finance one enormous voyage.
Permanent capital	Long-lived forts and networks need not be liquidated.
Transferable shares	Investors exit by selling, not by liquidating the firm.
Limited liability	Caps exposure, enables wider participation.
State charter	Creates monopoly rents and a recognized legal identity.
Armed fleets and forts	Protect—or impose—property rights where courts cannot.

The Royal African Company

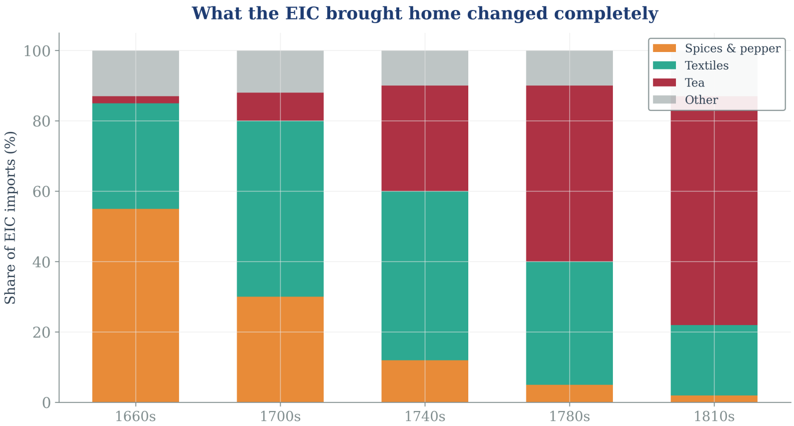
Chartered in 1672 with a monopoly on English trade to West Africa. The bars count people taken from Africa on British ships. Parliament ended the monopoly in 1698 and opened the trade to all English merchants.



Trans-Atlantic Slave Trade Database, slavevoyages.org,
2010 estimates edition, sheet Summary_volume.

Mandeville argued that private vice produces public benefit while this was happening.
Hold that against the chart.

What the EIC traded changed completely



Approximate composition from EIC commercial ledgers (Bowen collection). The shift from spices to textiles to tea tracks the evolution of consumer demand in Europe.

Mini exercise: a mercantilist cabinet

Proposal: **ban or heavily tax imported Indian cotton cloth.**

- **English cloth producers**—gain.
- **London consumers**—lose.
- **EIC shareholders**—depends.
- **The Crown**—wants customs revenue.
- **Indian textile producers**—lose access.
- **Smugglers**—new profit opportunity.

When a writer says this policy is good for "England," which of those groups does "England" mean?

The technology behind early globalization was as much the corporation, the balance sheet, and the stock exchange as it was the ship.

These were institutions of *exchange*, not production. That distinction explains why mercantilist thought focused where it did.

Part III

The moral economy of early mercantilism

The poor were made, not found

- Landlords fenced the open fields for sheep, because English wool and cloth were what Europe would pay for.
- A tenant with common rights could feed a family; a tenant without them had nothing to sell but his labor.
- Earlier we said the weaver owned his tools. This is where that stops being true, for a great many people.

Here are the two sides for the first time: those who own, and those who only work. The rest of this course is an argument about them.

The Christian paternalist ethic

The medieval moral order—carried into early mercantilism—rested on a premise:

> *God had selected the wealthy to be the benevolent stewards of the material welfare of the masses.*
>
> — *Hunt & Lautzenheiser's summary, p. 25*

This ethic did three things:

- Justified extreme inequality as divinely ordained.
- Obligated the wealthy to care for the poor (noblesse oblige).
- Condemned greed, acquisitiveness, and the pursuit of wealth for its own sake.

The Catholic Church enforced this ethic. What happens when the Church loses that role?

Henry VIII takes over the Church's job

England's break with Roman Catholicism under Henry VIII transferred the Church's social functions to the state. HL describe it this way:

> *"The state in the form of God's monarchy assumed the role and the functions of the old universal church. What Henry had done in his own blunt way was to sanctify the processes of this world."*
>
> — *HL, p. 26*

Meanwhile, the enclosure movement and the decline of the wool trade were creating mass unemployment and poverty across England.

The Church's organized charity was gone. Someone had to deal with the poor. The state stepped in.

England builds a welfare state, 1531–1601

Year	**Statute and what it did**
1531	Poor Laws distinguish “deserving” and “undeserving” poor. Only the deserving may beg.
1536	Parishes made responsible for poor relief through voluntary contributions.
1563	Statute of Artificers: employment conditions, apprenticeship lengths, periodic wage assessments, and *maximum* wage rates.
1572	Compulsory “poor rate” (tax) enacted to fund relief.
1601	Poor Law of 1601 integrates the framework: aged/sick at home, pauper children apprenticed, able-bodied given work, vagrants imprisoned.

Notice the tension: the same state that recognizes poverty as a systemic problem also sets *maximum* wages and builds prisons for the poor who won’t comply.

Poverty as a systemic problem

Here is what HL consider the key shift in this period:

> *The various statutes passed during this period "were predicated upon the idea that poverty, instead of being a personal sin, was a function of the economic system." These statutes acknowledged that those who were the victims of the deficiencies of the economic system should be cared for by those who benefited from it.*
>
> — *HL, pp. 27–28*

A remarkable claim for the 1500s. But keep your critical distance: HL write from a Marxist-influenced perspective. Other historians might emphasize social order, religious duty, or fear of rebellion.

The merchant moved into the workshop

craft: weaver buys wool → weaver makes cloth → weaver sells cloth → **weaver keeps it**

putting-out: merchant buys wool → weaver makes it at a piece rate → merchant collects cloth → **merchant keeps it**

- The merchant began supplying the wool, then the yarn, then the loom itself.
- The weaver kept his cottage but stopped owning the cloth he made.
- Once the capitalist owned the tools and the output, profit no longer had to come from a price gap.

England stopped selling wool and started selling cloth

Exports through English ports. Wool sacks converted to cloth equivalents at the rate used in the source, 4.33 cloths per sack.
Carus-Wilson and Coleman (1963) and Stone (1949), via Bank of England, A Millennium of Macroeconomic Data v3.1, sheet A34a. Nine-year averages.

The same change as the last slide, for a whole country, three centuries early.

Two changes that ended merchant profit

By the mid-1600s, two developments were making the old system unsustainable:

1. **Competition eroded arbitrage profits.** Despite monopoly charters, more merchants entered trade. Price gaps between regions shrank. Buying low and selling high got harder.
2. **Capitalists moved into production.** Through the putting-out system and the transformation of craft guilds, a new class of producer-capitalists emerged who controlled both making and selling.

> When profit can no longer come from exchange alone, thinkers have to find a new answer. Where does the surplus come from?

Before you go

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The merchant now owns the wool, the loom, and the cloth. Where does his profit come from?

Write what you actually think. There is no right answer yet — that is the point. We start here next time.

For your library

Mun, *England's Treasure*
on archive.org

Primary source

Thomas Mun, *England's Treasure by Forraign Trade* (written c. 1630, published 1664).

The full text is freely available on the Internet Archive. Scan this on your way out and bookmark it—this is the single most important statement of mercantilist trade theory, and it is short.

No need to read the whole thing before Tuesday. But chapters 2–4 are where the Mun experiment comes from.

Day Two

The Turn Toward Production

From private vices to the labor theory of value

Part IV

The individualist turn

The old ethic breaks down

Recall: the Christian paternalist ethic said greed was a sin and the state should regulate economic life for the common good.

By the late 1600s, a growing class of producer-capitalists found this ethic suffocating. They wanted freedom from:

- The mercantilist maze of regulations, guild restrictions, and monopoly privileges that had benefited the old trading companies.
- The moral condemnation of acquisitiveness inherited from the medieval Church.

> The economy created the *need* for a new licence. It did not write the argument. That took a century of people with something at stake.

Hobbes: all motives are self-interest

Thomas Hobbes, *Leviathan* (1651), offered the most extreme version:

> *"Grief for the calamity of another is pity, and ariseth from the imagination that the like calamity may befall himself; and therefore is called . . . compassion, and . . . fellow-feeling."*
>
> — *Hobbes, quoted in HL, p. 29*

Even compassion, on this view, is disguised self-interest. You feel bad for someone because you imagine the same thing happening to you.

HL read Hobbes not as a philosophical discovery but as ideology: "the majority of mercantilist writers were either capitalists or privileged employees of capitalists" (p. 29). That framing is theirs—worth thinking about, not necessarily accepting.

North says leave the merchants alone

- Sir Dudley North argued that everyone acts from self-interest and should be left to compete in a free market.
- He warned that when merchants ask for a special regulation, they are calling their own interest the common good.
- Hunt and Lautzenheiser call him the earliest clear spokesman for the ethic that becomes classical liberalism.

That is an answer to Tuesday's cabinet question,
written by someone who was there.

Sir Dudley North, 1641–1691. HL, p. 32.

The Protestant ethic

Catholic doctrine	Protestant doctrine
Wealth and acquisitiveness are suspect.	Hard work in one's calling pleases God.
Poverty can be holy.	Profit is a mark of God's favor.

- Justification moved from works to faith, so the priest lost the power to withhold absolution.
- Individual conscience became sovereign, which is the same premise the new economics would need.

Neither Calvin nor Luther intended to be spokesmen for capitalism. Capitalists found in their theology a doctrine that would serve, and they put it to work.

Mandeville's paradox

Bernard Mandeville, *The Fable of the Bees: or Private Vices, Publick Benefits* (1714):

> *"The answer to the paradox was, of course, that what had been vices in the eyes of the medieval moralists were the very motive forces that propelled the new capitalist system. And in the view of the new religious, moral, and economic philosophies of the capitalist period, these motives were no longer vices."*
>
> — *HL, p. 32*

Mandeville's claim: self-interest, greed, and acquisitiveness—despised under the old moral code—would, if practiced by all, produce the greatest public good.

Nobody claimed harmony until Mandeville

- Mercantilism was openly zero-sum: one nation gained what another lost, and monopoly gained what consumers lost.
- Your cabinet exercise had six constituencies and at least four of them lost.
- Mandeville is the first writer to claim that the conflict itself *produces* the harmony.

That claim is what this course argues about,
and Mandeville is where it starts.

Two capitalisms

	Merchant capitalism	Industrial capitalism
Capital is. . .	money, ships, inventories	factories, machines, raw materials
Profit from. . .	buying low, selling high	controlling the production process
Workers. . .	own their tools; produce independently	sell their labor for wages
Key institution	chartered monopoly company	the firm as employer
Ethic	Christian paternalism	individualism, property rights
Value theory	demand and market price	cost of production

The shift from the left column to the right column is what Chapter 2 is about. It changes the economics, the philosophy, and the politics at the same time.

Discussion

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Take two minutes on this

Mandeville said private vices produce public benefits. Hobbes said even compassion is self-interest.

Prompt: Name one mercantilist-era idea—about trade, self-interest, monopoly, or the role of the state—that you think is still alive in modern politics. One or two sentences.

We will read a few of these aloud.

Part V

Where does the surplus come from?

The intellectual shift

As exchange-based profits shrank and producer-capitalists took center stage, thinkers started asking a new question:

If profit does not come from buying low and selling high,
then **where does it come from**?

The answer they arrived at: **labor in the production process**.

Defoe: labor is the source of wealth

Daniel Defoe, *A General History of Trade* (1713):

> *"It is the labor and industry of the people that alone brings wealth and makes . . . trade profitable to the nation."*
>
> — *quoted in HL, p. 33*

Yes, that Daniel Defoe—the novelist who wrote *Robinson Crusoe*. He also wrote about trade.

“People are the chiefest commodity”

William Petyt, *Britannia Languens* (1680):

> *“People are, therefore, the chiefest, most fundamental and precious commodity, out of which may be derived all sorts of manufacture, navigation, riches, conquests and solid dominion.”*
>
> — *quoted in HL, p. 33*

What is being claimed when a person is called a commodity? The author is arriving at the idea that labor, not gold and not trade, is the real source of national wealth.

Mandeville again: trade is the exchange of labor for labor

The same Mandeville who wrote about private vices also wrote this:

> *"Commerce, or the exchange of one commodity . . . for another, is highly convenient and beneficial to mankind. . . . To facilitate exchange, men have invented MONEY . . . Trade in general being nothing else but the exchange of labor for labor, the value of all things is . . . most justly measured by labor."*
>
> — *Mandeville, quoted in HL, pp. 33–34*

"The value of all things is most justly measured by labor."
That sentence is the seed of the labor theory of value—
the idea that will run through Smith, Ricardo, and Marx.

The surplus concept

By the mid-1700s, writers were seeing profit as a **surplus**—the gap between what workers produce and what they consume.

An anonymous pamphlet from 1751:

> *"The source of wealth is from the number of its inhabitants . . . the more populous a country is, the richer it is or may be. . . . Now whatever they [workers] have more than they consume, the surplus is the riches of the nation."*
>
> — *quoted in HL, p. 34*

Output minus consumption equals surplus. That formula—however rough—is the ancestor of every concept of profit, exploitation, and economic growth that follows in this course.

What they could not yet explain

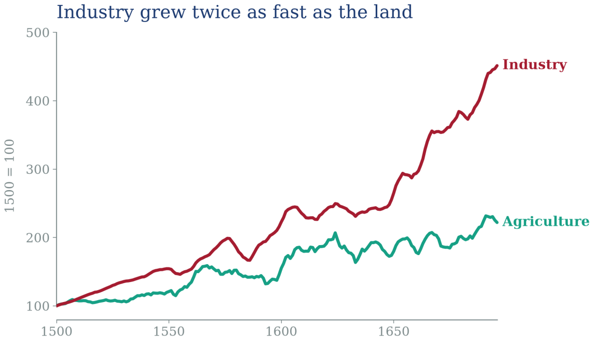
These pre-Smithian thinkers saw two things:

1. Labor determines prices.
2. Labor produces a surplus that becomes profit.

But they could not explain **how both could be true simultaneously**. They needed a clear concept of "profit on capital" as a distinct type of income, and an understanding that this income accrued to capital owners *because* ownership gave them control over labor.

> That synthesis would not arrive until Adam Smith. But first—one more school tried to answer the question from a completely different angle.

Industry grew twice as fast as the land



England, real output by sector. Broadberry, Campbell, Klein, Overton and van Leeuwen (2015), via Bank of England, A Millennium of Macroeconomic Data v3.1, sheet A6. Nine-year averages.

Keep this in mind for the next slide.

The Physiocrats: surplus as a gift of nature

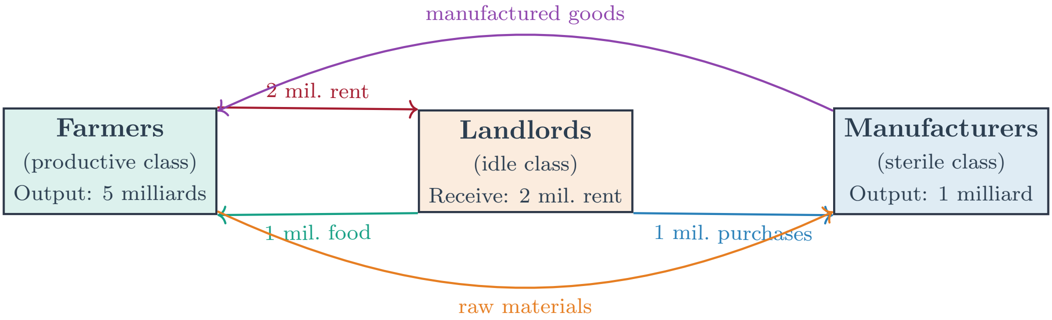
François Quesnay (1694–1774), court physician to Louis XV, led a French school called the **Physiocrats**. Their core claim:

Only agriculture produces a surplus.
Manufacturing merely reproduces its inputs.

They divided society into three classes:

Class	Who	Role
Productive	Farmers, agricultural workers	Produce the surplus ("gift of nature")
Sterile	Manufacturers, artisans	Reproduce inputs but create no surplus
Idle	Landlords	Consume the surplus as rent

Quesnay's *Tableau Économique* (1758)



The *Tableau* is the first model of an economy as a **circular flow**—production, distribution, and expenditure returning to their starting point each year.

Three lasting contributions of the Physiocrats

Nearly all later economists rejected the claim that only agriculture produces surplus. But three Physiocratic insights survived:

1. **Sectoral interdependence.** Each sector's output is a necessary input for the other (HL, p. 37).
2. **Monetary circulation matters.** Hoarding money or creating bottlenecks can cause crises—anticipating Malthus, Marx, and Keynes.
3. **Productive vs. unproductive labor.** Which workers create surplus and which do not? This "was to become an important cornerstone of nineteenth-century economic analysis" (HL, p. 37).

The Physiocrats' *answer* was wrong (surplus is not a "gift of nature"). But their *question*—where does the surplus come from?—was the right one.

Part VI

Bridge to Smith

The dependent variable itself was changing

Mun
1621–1664

Where does national treasure come from?

↓

Petyt
1680

How much national income actually exists?

↓

Quesnay
1758

Which production process generates the surplus?

↓

Smith
1776

*What makes the annual real produce per person **grow**?*

They had no production function

$$Y = f(K, L)$$

What we mean	What a mercantilist had
Y, a flow of output	a stock of treasure in the vault
f, something happening inside production	nothing — production is not theorised
K, tools and equipment	money, ships, and a warehouse
L, labor as a source of value	labor as one more cost of trading

- Defoe supplies the L when he says labor is the source of wealth.
- Quesnay supplies a rival f in which land, not labor, yields the surplus.
- Smith is the first writer in this course who has all of it at once.

Two different objects of analysis

Mercantilist observable

money + trade +
shipping + state power

$$\neq$$

Smithian object

$$\frac{\text{annual real produce}}{\text{population}}$$

What could cause the second quantity to rise?

Division of labor. Capital. Market extent. Machinery. Skill. Institutions.

What Chapter 2 taught us

> The pre-Smithian economists were not confused. They were writing during a transition in which the features of the new capitalist system were intertwined with "innumerable vestiges of the old system" (HL, p. 37).

Three things survived from this period into everything that follows:

1. The idea that labor is the source of value.
2. The concept of surplus—output minus consumption.
3. The question of whether markets harmonize interests or conceal a conflict.

Before you go

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Stop asking how much gold England has. Ask how much an English worker can make in an hour. What changes?

One or two lines. This is the question Adam Smith starts from, and we get to him next week.

Exit ticket

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Scan on your way out

Two questions, one sentence each:

1. What idea from today's class surprised you or stuck with you?

2. What is still unclear or confusing?

I read every one of these. They help me calibrate.

For next time

- Read Hunt & Lautzenheiser, **Chapter 3**: Adam Smith.
- Think about how Smith's answer to "where does wealth come from?" differs from every thinker we met this week.
- The division of labor, the invisible hand, and natural price are all coming.

Tuesday quiz covers Chapter 3. 11:02 sharp.