MID-18TH CENTURY ECONOMIC CHANGES: THE RISE OF ADAM SMITH AND THE DECLINE OF THE MERCANTILISTS AND PHYSIOCRATS

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ABSTRACT

The mid-18th century was a time that saw the birth of new economic systems. The mercantile system of the past 250 years was being attacked by new movements in economic thought. One of the chief critics of mercantilism was Adam Smith, and with the publication of his greatest work, Smith drastically changed modern economic theory and created a science out of what was once a philosophy of merchants. Smith was not the first critic of mercantilism. He was preceded by a group of French economic philosophers whose theories had much influence on Smith's work. This paper will explore the rise of mercantilism and its principles, detail the criticisms of Adam Smith toward mercantile doctrine, and discuss the physiocratic doctrine that laid the groundwork for economic change.

INTRODUCTION

This paper will discuss the origins of mercantilism. Through an exploration of the times leading up to mercantilism, a more detailed understanding of mercantile principles will be ascertained. The onset of international commerce laid the groundwork for the mercantile system by creating a new class of merchants who explored the philosophy of economics in an attempt to ensure their own well being. Mercantilists derived much of their doctrine from their strong sense of nationalism. The desire to create a strong state led to the development of the mercantile principle of wealth as existing in the form of specie--gold and silver. The desire to accumulate large amounts of specie led to the development of the balance of trade principle, which would be essential to mercantilistic economic policies. The mercantile system thus developed from a strong sense of nationalism, which led to a desire for the accumulation of gold and silver, further leading to the balance of trade doctrine, enabling said accumulation.

The paper will also address Smith's comments on mercantile doctrine. In *An Inquiry into the Nature and Causes of the Wealth of Nations*, Smith explores the importance of gold and silver accumulation that is embedded in the tenets of mercantilism. Smith, through his analysis of mercantile arguments in favor of specie accumulation, will ultimately find such arguments in error. By his analysis of mercantile principles, Smith proves to be one of mercantilism's greatest critics. He advocates against specie accumulation and the necessity of a favorable balance of trade to aid in this accumulation, two doctrines that are at the heart of mercantile thought.

The paper will end in a discussion of the physiocratic doctrine that developed in France during the last half of the 18th century. The physiocratic doctrine was vastly different from the principles of mercantilism. The physiocrats placed much emphasis on land as the true creator of wealth. The mercantile principle of wealth existing in the forms of gold and silver was dismissed and more concrete forms of wealth were adopted. The circulation of wealth within a nation was also demonstrated by Quesnay, the undisputed leader of the physiocrats, in his book *Tableau Economique*. This book also explored the productivity of labor and ruled that agriculture was the only productive industry. The physiocrats exhibited strong criticism toward the mercantilistic economic system of the time, especially the system of taxation. The physiocrats further opposed governmental regulation in favor of a *laissez-faire* system of no interference. The physiocratic system is clearly the antithesis of the mercantile system and lays the groundwork for the publication of Smith's book.

THE RISE OF MERCANTILISM

"Mercantilism is the name given to some 250 years of economic literature and practice between 1500 and 1750" (Landreth, 1976). Mercantilism was the result of the developing commercial class, the merchants, and the name "mercantilism" is "derive[d] from the Italian word for merchant" (Canterbery, 2001). As they gained wealth and power, merchants' writings began to develop into the economic system known as mercantilism. "The substantial development of economic thought was due to the leaders of economic activity, the merchants. The theories that evolved were never contained in a body of doctrine such as that of the Canon law. What has made it possible to speak of mercantilism is the appearance in a number of countries of a set of theories which explained or underlay the practices of statesmen for a considerable time" (Roll, 1974). Niehans (1990) states, however, that "mercantilism was not a system, but rather an unsystematic assortment of arguments, measures, and ideas with wide differences from one country to another." It is true that mercantilism lacks the established doctrine that many other systems have built upon, but there is a set of beliefs and tendencies common to most mercantile writers, such as a strong sense of nationalism and, above all else, the belief in a strong balance of trade. Before addressing the generally accepted principles of the mercantile system, it is necessary to comment on the time in which this system took root.

The era of mercantilism began with the ending of the Dark Ages and the beginning of the Age of Exploration. With the ending of the Dark Ages, society underwent massive changes. The small, self-sufficient manors of the feudal system gave way to the growth of great nations in which large areas of land and a great populace were governed by a centralized state. The end of the Middle Ages also saw the development of international trading. The isolated manor, in which what was consumed was produced within, gave way to the rise of international trade and exploration. A society no longer had to rely on merely what it could make, but it could now draw on other sources of production spanning the globe. The shift from isolated manors to interdependent trading nations was the catalyst for the development of mercantilism and the displacement of the old economic system known as feudalism.

The obsolete system of the Middle Ages "became inadequate in its regulation of production. The revolution in the methods of farming destroyed the basis of feudal economy. It led to rural overpopulation, growing commutation of feudal dues, increased indebtedness of feudal lords and their resort to trade or new methods of farming for the market" (Roll, 1974). As trade began to flourish, the localized manor began to disappear and the market system took root. "Production of goods for the market became more important, and land, labor, and capital began to be bought and sold in markets" (Landreth, 1976). As society began to look outside the manor for resources, the development of foreign commerce put the last nail in the coffin of feudalism. Roll (1974) states, "Another powerful factor is to be found in the maritime discoveries which led to a very great expansion of foreign commerce." With the development of commerce and markets, farmers and producers could go beyond the markets of their own land and into foreign lands that further destroyed the self-reliant system. "In England, for example, where the development of capitalism can be most clearly observed, the growth of commerce destroyed subsistence farming and caused agriculture to rely increasingly on the market" (Roll, 1974). The onset of foreign commerce brought with it a new sense of foreign competition. The development of nation-states changed the perspectives of rulers from internal concerns to external concerns. Nations began to fight for the resources of far off lands, such as the East Indies and the Americas. It was now a matter of country against country instead of feudal lord against feudal lord. This sense of national competition gave rise to the first defining principle of mercantilism, a strong sense of nationalism.

Nationalism was an essential part of mercantile thought. The mercantilist writers believed heavily in the strengthening of the nation-state. Lionel Robbins (1998) states that mercantilism is "that body of thought which was concerned with nation-building--the transformation of the system of the Middle Ages into the system of national states." The reason for the mercantilists' concern over the strength of their nation was, simply put, self-interest. Merchants needed strong national governments capable of protecting their territories and their goods as they traveled over seas and to far off lands. "National defense was the dominant organizing force of mercantilism, much as local defense had been for feudalism" (Canterbery, 2001). Merchants also wanted the national government to take steps to protect the domestic industries in the world market, and thus protect the interest of the merchants. The merchants strengthened the government and reaped the benefits of such strength. "The building-up of nation-states [was] put in the forefront, and monetary, protectionist, and other economic devices [were] regarded merely as instruments to this end" (Roll, 1974). Trade and production were devices to use to strengthen the nation. "The material resources of the society (the means) were, in general, to be used to promote the enrichment and well-being of the nation-state (the end). The single most important concern of mercantile writers was that the nation's resources be used in such a manner as to make the state as powerful as possible both politically and economically" (Ekelund & Hebert, 1975). As the merchants gained wealth, they also gained power and prestige. Coupled with their proclamation of national interest, this prestige enabled the mercantilists to influence the actions of government. "Those responsible for government accepted mercantilist notions and fashioned their policy accordingly, because they saw in them means of strengthening absolutist states against both rivals abroad and the remnants of medieval particularism at home" (Roll, 1974). The mercantilists, through their desire to ensure a strong state, made economic policy just one more tool in the nation's arsenal. "The ultimate objective of economic policy is the political power of the state, both internal and external. The Austrian Philipp Wilhelm von Hornigk epitomized this clearly in the title of his tract of 1684: 'Austria above all if she only will.' It is consistent with the down-to-earth objective that the typical mercantilist author was not a speculative philosopher but a cabinet minister, administrator, government advisor, merchant, lobbyist, or adventurer" (Niehans, 1990). In exchange for their loyalty, the wealthy merchants were well rewarded by their political allies. The mercantile governments enacted bills protecting domestic goods from competition abroad, giving domestic monopolists complete control over certain government approved markets. The governments also attempted to strengthen their domestic industries in the foreign markets. "The efforts of the merchants and companies to achieve control over the distant areas with which they traded were seldom sufficient. They had to be supplemented by the exercise of the power of the states, towards the strengthening of which the merchants were contributing in such large measure. The links between the trading interest and the state were thus still further tightened; and the concern of state policy became increasingly concentrated of problems on trade" (Roll, 1974).

In an effort to create a strong national state, the mercantilists developed the principle that the wealth of a nation was contained in the vaults of the king or prince in the form of gold and silver. The mercantilists lived in a world plagued by foreign wars and believed that these wars were funded by the gold and silver of a nation, its specie. Thus in order to develop a strong world power, the accumulation of large amounts of gold and silver was a necessary component. With this specie the nation would be able to fund future wars and maintain its place in the world hierarchy. The mercantilists' obsession with gold and silver became their "basic belief...that it was necessary to accumulate gold and silver through foreign trade in order to foster national wealth and power and therefore a variety of restrictions on imports and subsidies to exports was needed" (Staley, 1989). "For the mercantilist, power consisted of men and money. Men were needed as workers and soldiers; money (in the treasury) was needed to pay for armies and navies, to finance the government, and to pay for extravagant courts" (Niehans, 1990). The mercantilists paid little attention to the goods produced by the nation, except to the extent to which they could be traded for gold or silver. The governments of this era were largely influenced by the mercantilists and developed policies designed to keep large amounts of specie in the country. "An Act of 1339 attempted to compel wool merchants to bring in a certain amount of plate for each sack of wool exported. Richard II, in a reply to a complaint about the shortage of money, included in the Navigation Act of 1381 a prohibition of the export of gold and silver," and "the method generally in use to preserve treasure was still the medieval one of direct control. Prohibitions of the export of bullion and of the import of luxuries were supplemented by the establishment of the office of the Royal Exchanger" (Roll, 1974). The governmental restriction on the export of specie is congruent with the belief of "the early mercantilists [who] recommended that the export of bullion be strictly prohibited. Later writers suggested that exporting bullion might lead to an improvement in overall trade balances if the bullion was used to purchase raw material for export goods" (Landreth, 1976). This statement establishes a cornerstone of mercantile thought, the belief in a balance of trade. It further ends the belief in the necessity of a complete prohibition on specie exportation; however, the supply of gold and silver within a nation is still essential to mercantile thought.

Mercantilist doctrine, in an attempt to understand the flow of wealth between two trading nations, created the principle that there exists a balance of trade between commercial nations. The balance of trade doctrine has at its root the "assumption that the total wealth of the world was fixed" (Landreth, 1976). If this assumption is true, as the mercantilists believed it to be, then in any transaction where a person gains wealth, it is at the expense of the opposing party. "The mercantilists carried this reasoning over to trade between nations, concluding that any increase in the wealth and economic power of one nation was necessarily at the expense of other nations. Thus the mercantilist emphasized international trade as a means of increasing the wealth and power of a nation and, in particular, focusing on the balance of trade between nations" (Landreth, 1976). The wealth that a nation hoped to gain through a favorable balance of trade was in the form of gold and silver, the payment demanded by the mercantile nations for any trade deficit. Furthermore, nations lacking natural mines from which to gain gold and silver could only obtain these precious substances through trade with other nations (Niehans, 1990).

One of the flaws of the mercantilists relate to their reasoning in regards to the accumulation of specie through a favorable balance of trade. They believed "that a favorable balance of trade--and thus specie accumulation--could continue over long and indefinite periods" (Ekelund & Hebert, 1975). History and practice would prove this assumption wrong, but at the time, the favorable trade balance was a key point of mercantilism to be obtained at all costs. "One's own balance of payments surplus and the deficit of one's rivals thus became the primary objectives of economic policy, to be achieved by all sorts of import restrictions, duties, bounties, subsidies, and regulation" (Niehans, 1990). The tools used by governments to protect their favorable balance of trade were numerous, but their goal was the same, to ensure that no more wealth left the nation than was coming in and if possible, to allow for the entry of more wealth than was exiting. Mercantilists believed that "[p]rotective duties should be placed on manufactured goods from abroad, while importation of cheap raw material, to be used in manufacturing goods for export, should be encouraged" (Landreth, 1976). Such restrictions were, however, one-sided. By putting duties on the manufactures of foreign competitors, domestic manufactures had a monopoly in the market. Furthermore, if they ensured the importation of cheap raw materials, they also ensured a higher profit margin. The importation of cheap raw materials did not support the raw material industry of the domestic nation, but manufactured goods were held at a higher level of economic importance.

Besides ensuring low costs in the area of raw materials, mercantilists also desired low cost in the form of labor. "The mercantilists advocated low wages in order to give the domestic economy competitive advantages in international trade, and because they believed that wage levels above a subsistence level would result in a reduced labor effort. Higher wages would cause laborers to work fewer hours per year; thus national output would fall. Poverty for the individual, therefore, benefits the nation when the goal of economic activity is defined in terms of national output and not in terms of national consumption" (Landreth, 1976). This passage is yet another example of how mercantilist doctrine supported the interests of the merchants who wrote it and yet contained a sense of patriotism.

SMITH'S CRITICISMS OF THE MERCANTILE SYSTEM

Smith dramatically changed the general economic views of his time with his criticisms of mercantilistic principles. "Smith devoted nearly two hundred pages in his *Wealth of Nations* to a harsh criticism of mercantilistic theory and practice, particularly their equation of the wealth of a nation with the stock of precious metals internally held" (Landreth, 1976). Smith begins his criticism by discussing the value of gold in relation to the mercantile nations. He states that "for some time after the discovery of America, the first inquiry of the Spaniards, when they arrived upon any unknown cost, used to be if there was any gold or silver to be found in the neighborhood?" (Smith, 1999). The Spanish had gold mines within their own borders, unlike England, but they desired to increase their stock of gold through the exploration of the New World. Thus, gold became their primary motivation and blinded them to the other natural resources that other lands offered. Smith further explores gold's role as a measure of value and medium of exchange by comparing the Spanish to the Tartars. Smith states that, "Among the Tartars, as among all other nations of shepherds, who are generally ignorant of the use of money, cattle are the instruments of commerce and the measures of value. Wealth, therefore, according to them, consisted in cattle, as according to the Spaniards it consisted in gold and silver. Of the two, the Tartar notion, perhaps, was the nearest to the truth" (Smith, 1999). In this statement, Smith downgrades the inflated mercantilist notion that gold is the primary source of wealth. Here Smith gives cattle higher value than gold, perhaps due to the numerous uses of cattle when compared to the primary use of gold as merely a medium of exchange.

The Wealth of Nations also expresses the views of modern mercantilists. Smith paraphrases the beliefs of Locke by writing that "Money...is a steady friend, which, though it may travel about from hand to hand, yet if it can be kept from going out of the country, is not very liable to be wasted and consumed. Gold and silver, therefore, are, according to him, the most solid and substantial part of the movable wealth of a nation, and to multiply those metals ought, he thinks, upon that account, to be the great object of its political economy" (Smith, 1999). In this statement, the national economic policy of a mercantile nation is set, the prevention of the exportation of specie allowing for the accumulation of said specie. "In consequence of these popular notions, all the different nations of Europe have studied, though to little purpose, every possible means of accumulating gold and silver in their respective countries. Spain and Portugal, the proprietors of the principal mines that supply Europe with those metals, have either prohibited their exportation under the severest penalties, or subjected it to a considerable duty. The like prohibition seems anciently to have made a part of the policy most other European nations" (Smith, 1999). The outright prohibition of the exportation of gold and silver is a short-lived method for the accumulation of precious metals.

A new mercantilist principle develops which replaces the prohibition method. The balance of trade principle involves the maintaining of a larger number of exports in comparison to imports, thus creating a favorable balance of trade. The favorable balance of trade results in a trade surplus to be paid in the form of specie. To maintain a favorable balance of trade was the chief economic goal of the mercantilists, but the balance of trade principle was met with the same amount of criticism from Smith as the exportation prohibition. Smith (1999) states that, "The attention of government was turned away from guarding against the exportation of gold and silver to watch over the balance of trade as the only cause which could occasion any augmentation or diminution of those metals. From one fruitless care it was turned away to another much more intricate, much more embarrassing, and just equally fruitless." Smith's criticism, however, is not derived from the ineffectiveness of the practices in the accumulation of gold and silver. The criticisms have as their source Smith's rejection of the belief that gold and silver are the sources of a nation's wealth. "Upon every account, therefore, the attention of government never was so unnecessarily employed as when directed to watch over the preservation or increase of the quantity of money in any country" (Smith, 1999).

Smith establishes the role of money as a medium of exchange and details the role that it plays in comparison with other goods. "It is not because wealth consists more essentially in money than in goods that the merchant finds it generally more easy to buy goods with money than to buy money with goods; but because money is the known and established instrument of commerce, for which everything is readily given in exchange, but which is not always with equal readiness to be got in exchange for every thing. The greater part of goods, besides, are more perishable than money, and he may frequently sustain a much greater loss by keeping them" (Smith, 1999). Smith also shows the limits of money in comparison to other valuable goods. "Goods can serve many other purposes besides purchasing money, but money can serve no other purpose besides purchasing goods. Money, therefore, necessarily runs after goods, but goods do not always or necessarily run after money. The man who buys does not always mean to sell again, but frequently to use or to consume; whereas he who sells always means to buy again" (Smith, 1999). Money, then, is just a means to an end. It is a tool society must utilize in order to perform commerce more efficiently. Money, however, is not indispensable. Society could function on a barter system, but in a commerce system, a medium of exchange is preferable. The true value of money ultimately lies in what it can be used to obtain. As Smith (1999) states, "It is not for its own sake that men desire money, but for the sake of what they can purchase with it."

Smith attacks the necessity of holding large amounts of gold and silver within a nation's borders. "It should as readily occur that the quantity of gold and silver is in every country limited by the use which there is for those metals; that their use consists in circulation commodities as coin, and in affording a species of household furniture as plate" (Smith, 1999). In this quote, Smith argues that a nation needs only the amount of gold or silver which it can use in its two primary forms, as a coin medium of exchange and as the material for the creation of housewares, and "to attempt to increase the wealth of any country, either by introducing or by detaining in it an unnecessary quantity of gold and silver, is as absurd as it would be to attempt to increase the good cheer of private families by obliging them to keep an unnecessary number of kitchen utensils" (Smith, 1999). The very notion that an abundance of gold and silver is both useless and absurd flies in the face of mercantile thought; however, mercantile thought is founded on the desire to create a strong nation. The accumulation of gold and silver was seen as a necessary step to ensure a nation's strength through the financing of foreign wars. Smith also attacks this philosophy by arguing, "Fleets and armies are maintained, not with gold and silver, but with consumable goods. The nation which, from the annual produce of its domestic industry, from the annual revenue arising out of its lands, labour, and consumable stock, has wherewithal to purchase those consumable goods in distant countries, can maintain foreign wars there" (Smith, 1999). Smith uses as his example the last war fought by England before the publication of his book to emphasize that gold and silver were not sufficient to finance the massive undertaking that is war, and the "enormous expense of the late war, therefore, must have been chiefly defrayed, not by the exportation of gold and silver, but by that of British commodities of some kind or other" (Smith, 1999). If the accumulation of gold and silver are not the tools with which nations finance war, then "commodities...the annual produce of the land and labour of the country...the ultimate resources which enable us to carry on the war" must be the true source of wealth within a nation (Smith, 1999).

Smith methodically destroys the principles that lie at the heart of mercantile thought. He eliminates the necessity of gold in the maintaining of a strong nation state and the financing of foreign wars. Smith also establishes the commodities of a nation, the goods produced, as the true source of a nation's wealth, eliminating the need for the accumulation of gold and silver. Smith further proves that the mercantile economic practices of prohibiting the exportation of specie and the balance of trade doctrine are both absurd and unnecessary. Smith, through his analysis of mercantile principles, proves to be mercantilism's greatest critic.

PHYSIOCRACY

Physiocracy developed in France during the period of mercantilism but before Smith revolutionized economics with the publication of *The Wealth of Nations*. Landreth (1976) describes physiocracy as "a new but short-lived movement...which had analytical insights into the economy, and significant influence on subsequent economic thought." Unlike many economic schools, "the writings of the physiocratic school express remarkably consistent views on all major points" (Landreth, 1976). The source of the physiocrats' ideological consistency lies in the three unique characteristics of the physiocratic movement: "(1) Physiocracy developed exclusively in France. (2) The ideas of the physiocrats were presented over a relatively short period of time, from about 1750 to 1780...(3) Physiocracy had an acknowledged intellectual leader, Francois Quesnay" (Landreth, 1976). Quesnay was the primary focal point of the physiocrats. His writings were accepted with little debate, and the writings of others "were mainly designed to convince others of the merit of Quesnay's economics" (Landreth, 1976).

At the heart of physiocratic doctrine lies natural law, serving as the source of many principles. As Knight (1956) explains, the word physiocrat "is practically equivalent to law (or rule) of nature." The source of the physiocrats' obsession with land originates with their leader, Quesnay. At the beginning of his book, *Tableau Economique*, Quesnay (1968) establishes as his first "axiom[:] The earth is the mother of all goods." The physiocrats used their belief in natural law "in the formulation of policy. They held that natural laws governed the operation of the economy and that, while these laws were independent of the will of man, man could objectively discover them as they could the laws of the natural sciences" (Landreth, 1976). Nature serves as the origin for the physiocratic idea of wealth. Unlike the mercantilists, who believed wealth consisted in the forms of gold and silver, "The physiocrats claimed that land--a gift of nature-- was the only real source of wealth because it enabled agriculture to produce a positive net product in excess of its production costs" (Canterbery, 2001). Agriculture was seen as the essential factor of production, and the physiocrats blindly ignored all other forms of production. "The most outstanding fallacy of physiocratic doctrine...was the *exclusive productivity of agriculture*" (Ekelund & Hebert, 1975). In other words, the physiocrats believed agriculture was the only industry capable of producing more than what was put in for the production process. "In the *tableau economique*, which was Quesnay's own name for his visual representation of the circular flow, manufacturing and service industries are considered 'sterile' in the sense that they contribute nothing to the *produit net*, or net product. The net product, in turn, was looked upon as the true source of real wealth" (Ekelund & Hebert, 1975). The net product was the physiocrats' ultimate economic goal. It is simply the surplus created by land. The physiocrats held that land was the only source capable of creating more than what was initially invested in the production process. In their attempts to discover the source of surpluses, "the physiocrats tried to discover the actual form of productive labour. They had no clear idea of the distinction between use-value and exchange-value; and they thought of the surplus entirely in terms of differences between use-values that had been consumed and those that had been produced. The produit net was not a surplus of social wealth in the abstract (exchange-value), but of concrete material wealth of useful goods" (Roll, 1974). In other words, the net product was the creation of wealth from an initial investment. It was the use of material goods in the creation of more material goods of a larger quantity than what was invested, which could only be done through agriculture. "Labor, according to them, could only produce enough goods to pay the costs of labor, and the same held true for the other factors of production with the exception of land. Production from land, therefore, created surplus that the physiocrats termed net product. Manufacturing and other nonagricultural economic activities were considered to be 'sterile,' because they created no net product" (Landreth, 1976).

In the *Tableau Economique*, Quesnay explores the flow of wealth within a nation by exploring the relationship between the three sectors of society. "The table was a crude representation of the flow of money incomes between the various sectors of the economy and of the creation and annual circulation of the net product throughout the economy. Quesnay's table represents a major methodological advance in the development of economics--a grand attempt to analyze raw reality by means of abstraction" (Landreth, 1976). Quesnay's three sectors of society are "the productive class, the sterile class, and the proprietary class or the landlords, including the government, the army, and the church. There are two industries, namely agriculture, in which the productive class is employed, and manufacturing, which gives employment to the sterile class. The landlords own the land, which they rent to the farmers as agricultural entrepreneurs. The rent income is spent partly for agricultural goods and partly for manufactures" (Niehans, 1990). The creation of the net product lies with the "productive class, consisting of farmer entrepreneurs and hired workers, [who produce] food and raw material, which are partly used inside agriculture, while the remainder is sold to the landlords and to the manufacturing sector" (Niehans, 1990). The selling of food and raw materials to the landlord and manufacturing class has a circular effect because "agriculture buys manufactures and pays rent to the landlords" (Niehans, 1990). The manufacturing sector has no productivity because the food and raw materials that it buys from agriculture are used to create the manufactures that it sells to the agricultural class and the landlords. The manufacturing class only puts out what it received in a modified form. "Land thus appears in this table as the only ultimate resource. Its income, namely rent, is correspondingly the only 'net product' in the sense that it exceeds reproduction costs (which are zero). All other factors earn just enough to reproduce themselves; their earnings represent gross income, not net income. For the economic philosophy of the physiocrats, this doctrine of produit net was of crucial importance" (Niehans, 1990). The physiocrats, however, "didn't deny that other kinds of labour were useful in various ways, but they attached tremendous importance--analytical importance--to their division between productive and unproductive, or sterile, labour" (Robbins, 1998).

The physiocrats' belief that all wealth originates from the land led them to a unique view of "taxation, the most powerful instrument of state intervention" (Roll, 1974). The physiocrats held that "industry and trade were to be freed from all contributions" (Roll, 1974). The reason for the exemption of industry and trade from taxation was that they created no value. As stated, the net product was created by land and land alone. "They objected particularly to the tax system of the mercantilists and advocated that a single tax be levied on land. Of course, according to their theory, all taxes would ultimately fall on land anyway, but only after causing much friction in the economic system" (Landreth, 1976). To prevent the economic friction caused by taxing industry and trade, "the most efficient method would simply tax the group which ultimately paid the tax. Since taxes can be *paid* only out of the net product, they should be levied against those who *receive* net product. At the same time, the tax rate set should be sufficient to meet the fiscal needs of the state;" however, a high level of taxation was needed due to "the financial demands of external wars and an extravagant court. This burden fell in an arbitrary and capricious manner on those least able to pay, namely, the poor peasant-farmers" (Ekelund & Hebert, 1975).

The natural laws, which were essential to physiocratic doctrine, also influenced the physiocratic view of governmental regulation and led to the development of an essential policy that would be adopted by Smith and future generations. "They believed that the basic motivation for the economic activities of human beings was the desire to maximize gain. Prices were formed in the market by economic activity, and the formation of these prices could be studied, since it was governed by natural laws independent of the will of man...[T]hey concluded that free competition led to the best price and that, if individuals followed their self-interest, society would benefit" (Landreth, 1976). Under such a philosophy, governmental regulation was not only unnecessary but also a burden. According to the physiocrats, governmental regulation, a key mercantilistic principle, was "a major barrier to agricultural development...which restricted both internal and external trade. French mercantilism, or 'Colbertism' (named after French Minister Jean Baptiste Colbert), restricted trade between provinces and created monopoly privileges among manufacturers. The physiocrats reasoned that these restrictions were doubly perverse. They not only tended to artificially divert investment from agriculture to manufacture, but, by changing acquired tastes for manufactures, they also tended to lower the domestic demand for agricultural produce and therefore its price. The lower prices of farm products in turn prevented capital accumulation in agriculture" (Ekelund & Hebert, 1975). "But the most unfortunate of the many governmental regulations, according to the physiocrats, was the prohibition against the export of French grain. This kept down the price of grain in France, they said, and was therefore an obstacle to agricultural development" (Landreth, 1976). The two forms of governmental regulation had the ultimate result of lowering the price of agriculture, which harmed the farmer. The physiocrats opposed such regulation in favor of a system of non-governmental interference named laissez-faire. "[T]hey concluded that a laissez-faire policy would produce a tremendous growth in French agriculture as the small-scale agriculture of the feudal economy was replaced by the large-scale capitalist agriculture. Thus the wealth and power of the French economy would be increased" (Landreth, 1976). Largely due to their obsession with land and agriculture, the physiocrats gave little value to manufacturing. They believed that "industry created no values; it only transformed them. No regulation of this process of transformation could add anything to the wealth of the community. On the contrary, it was only likely to make production more cumbersome and less economical" (Roll, 1974). The physiocratic system of laissez-faire sought the elimination of "the mercantilist policies regulating domestic and foreign trade" which were seen as "the primary obstacles to economic growth" (Landreth, 1976). By destroying the governmental regulations on trade, the physiocrats believed that the "[r]emoval of these restrictions...would allow capital to flow freely into the agricultural sector and enable the size of the circular flow to grow over time, in accordance with the 'laws of nature'" (Ekelund & Hebert, 1975). The physiocratic policy of laissez-faire would go beyond the boundaries of France. "This idea in the hands of Adam Smith and subsequent economists was of tremendous importance in shaping the ideology of Western civilization" (Landreth, 1976).

CONCLUSION

This paper has illustrated the many economic changes that occurred during the 18th century. Mercantilism, the dominant economic system of the time, was slowly being replaced. It was a system obsessed with the accumulation of gold and silver, which was seen as a necessary component in the building of a strong nation. This nationalism, fueled by the believed necessity of specie stores, led to the prohibition of gold and silver exportation punishable by strict laws. The prohibition was later replaced with regulations to encourage a favorable balance of trade, the next key mercantile doctrine. Whatever the policy, the goal remained the same, the accumulation of large amounts of gold and silver to be used in times of national defense.

Mercantilism saw its end with the publication of *The Wealth of Nations*. Smith presents in his book a detailed analysis of the mercantile system. Smith examines the mercantile notion of gold and silver as the only sources of wealth and concludes that such a notion is preposterous. Smith further examines the mercantilists' attempts to accumulate large amounts of gold and silver, both by gold and silver prohibition and by the concept of a balance of trade. Smith concludes that these too are preposterous. In his criticisms, Smith irrevocably condemns the mercantile system in favor of a system in which commodities are deemed the true wealth of a nation and are allowed to flow freely within and without.

Smith, however, was not the first to condemn mercantile doctrine. The physiocrats rejected the principles of mercantilism in favor of a nature-based philosophy. The mercantile obsession with gold was revoked and governmental regulation was scorned by the physiocrats. They sought free trade and an elimination of taxes except the tax on land, the key to physiocratic economics. Land was seen as the only source of productivity, and all others were deemed sterile. Manufacturing was included in the unproductive industries because, according to physiocratic principles, it only transformed value and did not create it. The greatest physiocratic contribution to modern economics was the principle of laissez-faire, which encouraged an economic philosophy of no governmental interference. This philosophy would later be adopted by Smith and many Western economists.

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