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NATIONAL WEALTH AND PROTECTION COSTS

Spokesmen for modern imperialism repeat the faith of the mercantilists that war is an instrument which can and should be used to increase national prosperity. In that tradition, arms are also viewed as a means to the high end, power, but wealth is said to depend on power just as power depends on wealth. Accordingly, one school of writers regards the defeat of the Spanish Armada as a fact of major importance for the increase of the wealth of Britain. Another school, more devoutly attached to the faith of Adam Smith, minimizes the economic consequences of military successes.¹ A reconciliation of the conflicting traditions is hardly to be expected, but perhaps more could be done than has been done to apply the economists' traditional style of thought to some aspects of non-peaceful behavior. Before attempting to describe in these terms specific historical situations, it is necessary to clarify the starting points of the analysis.

An essential charge on any economic enterprise is the cost of its protection, its protection from disruption by violence. Different enterprises competing in the same market often pay different costs of

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protection, perhaps as tariffs, or bribes, perhaps in some other form. The difference between the protection costs forms one element in the income of the enterprise enjoying the lower protection cost. This element in income I will call *protection rent*. Just as differences in the fertility of land produce rents for the owners of the more productive fields, so differences in the difficulties of protection produce rents for the enterprises which are more easily or efficiently protected. To the categories traditional with the economists, that is, wages, interest, and land rent, can be added for present purposes the category protection rent.²

How a change in protection costs could shift a carrying trade from one nation to another is illustrated by the trade of the West Indies at the time of Colbert. At the beginning of his ministry the trade of those islands was conducted almost entirely by Dutch enterprise, and there is every indication that under free competition without the interference of armed force the Dutch would have continued to underbid competitors. At Colbert's direction not only was the Dutch trade declared illegal, but a fleet of three naval vessels was sent to seize the Dutch ships visiting French islands. This use of armed force caused the Dutch some loss, threatened them with more losses, and increased the cost of "protection" for those Dutch who continued to trade as smugglers. At the time of Colbert's death some 200 French ships were receiving passports each year for voyages to the French West Indies. By raising the protection costs of the Dutch, Colbert had given the French the advantage of a protection rent and so made the West Indies trade profitable for French enterprises.

But profits for French enterprises trading to the French West Indies did not necessarily mean a profit for France as a whole—did not necessarily mean any increase in the total national income of France. The protection costs compared so far were those of private French trading enterprises and those of private Dutch trading enterprises. In order to discuss French national income, a way must be found of balancing against the profits made by French traders to the West Indies such items as the cost to France of maintaining naval squadrons there. In short we must consider protection costs from the point of view of the nation.

As soon as we adopt this point of view, it is necessary to stretch the

meaning of the word protection. Under national protection costs are to be included not only what is spent by a nation for the defense of the economic enterprises of its own members, but also what the nation spends in raising the protection costs of competing enterprises of other nations. Besides protection costs which are obviously defensive—such as the cost of convoys for defense against pirates—there are others which may be called offensive protection costs. Perhaps to include these the term “political costs” would be preferable, but the word “political” is too vague. The phrase “national protection costs,” whatever the verbal contradiction in applying it to aggressive actions, at least preserves the suggestion of the use of armed force. I shall use it to cover all the expenditures by which a nation seeks to create protection rents in favor of its own enterprises. In modern times many such expenditures, for example the expense of maintaining a permanent navy, may be regarded as overhead costs. Allotting the cost of a navy to various branches of trade would be as difficult to a cost accountant as the problem of allotting the cost of a dam between its various uses for power production, irrigation, and flood control, but perhaps no more puzzling. This difficulty is less in the study of medieval and early times because force was then more commonly exerted in direct connection with particular commercial activities and there is more basis for estimating how much a particular branch of trade added to national protection costs.

To discover the effect on national income, involves considering also the national opportunity cost of the new enterprises, that is, the cost of violating the law of comparative advantage. As Adam Smith argued so convincingly in similar cases, goods could have been more cheaply obtained in the West Indies, and West Indian wares could have been more cheaply obtained in France, if the transport had been left to the Dutch, and that French capital and labor which was in fact diverted to the West Indies trade had been allowed to find employment according to “the system of natural liberty.” The profits of the new French enterprises were being paid for not only in royal outlay on the naval squadron, but also in the higher freights on shipments between France and the West Indies.

Only by dealing with all these factors can one estimate, even roughly, the effects of Colbert’s West Indian policy on French wealth.

Against the addition to the national income embodied in the profits of the French West Indian traders and shippers must be balanced a formidable array of losses. First, obviously, there is the big deficit of the French West India Company, which pioneered the voyage; then the cost of employing a French naval squadron. Since the exclusion of the Dutch from the West Indies was one of the reasons for the outbreak of the war between France and Holland in 1672, some part of the expense of that war would have to be considered also. To allow for the national opportunity costs, the price of sugar to French consumers would have to be investigated, and if the islanders are counted part of the French nation, we must add the loss they suffered in paying prices for supplies two or three times as high as those previously charged by the Dutch. Even in authors sympathetic to Colbert the evidence presented fails, when all these factors are considered, to indicate that any gain in national income resulted during Colbert's lifetime from the capture of the trade.³

A more complicated case of seeking to increase national wealth by the use of military power is the temporary capture of the spice trade by the Portuguese. Protection costs were always especially prominent in determining who should handle the spices which moved from the Indian Ocean to Europe. In the second half of the fifteenth century most of them were carried by Arab merchants from India to Jeddah in the Red Sea. There they came under the protection of the Soldan of Egypt and passed through his lands, paying dearly on the way for his protection, until at Alexandria they were sold to the Venetians and other Europeans. When the Portuguese reached India by circumnavigating Africa, it was feared that they would ruin the Venetians by selling for less than the prices the Venetians were accustomed to charge. The often-quoted Venetian merchant banker, Gerolamo Priuli, prophesied in his diary that the Portuguese would be able to undersell the Venetians because the spices brought around Africa would not have to pay the high taxes levied on the spices which passed through Egypt.⁴ Priuli expected the Cape route to prove cheaper because of lower protection costs.

This is *not* what happened. The Portuguese did *not* set their prices below those common at Venice in the fifteenth century. True, the Portuguese did, for a short time, capture most of the spice trade, but by

methods which raised prices rather than lowered them. The Portuguese king attempted to prevent by armed force the passage of any spices from India to the Red Sea or Persian Gulf. He staked his hopes of profit on securing a monopoly. Although his success was not complete, Portuguese seizure of sources of supply, the destruction of Arab ships, and the risk of capture for others was sufficient for some decades to raise greatly the protection costs of the Red Sea route. Consequently, the Portuguese king was able to sell for prices higher than those the Venetians had received in the fifteenth century before Vasco da Gama rounded the Cape.

Since Priuli's prophecy has often been mistaken for a true statement of what happened, it may be worthwhile to give a few details on the price of pepper, that "king of the spices" which the Portuguese king tried hardest and most successfully to monopolize. Prior to the war between Turkey and Venice in 1499, pepper was selling at Venice for 42 to 57 ducats a *cargo*. War and speculation then drove the price up momentarily to 131, but that was a most exceptional figure.⁵ For more than a half century before the interference of the Portuguese, the typical Venetian wholesale price had been about 50 ducats.⁶

When news reached Venice in November 1501 that the Portuguese had sunk Arab spice ships, pepper again rose at Venice and for a few years remained between 80 and 100. From this high level the price fell, first at Lisbon and then at Venice after the return of Vasco da Gama's second fleet. The king of Portugal fixed his price in 1506 at the equivalent of 52 ducats a *cargo*, and in 1509 Venetian prices were only slightly above that figure.⁷ In short, the first shock of Portuguese interference raised prices at Venice. As soon as the Portuguese voyages were in full operation prices dipped to, but not below, the fifteenth-century level. This conclusion is based primarily on quotations of the Venetian wholesale market but agrees with what little evidence is available concerning the prices paid by English and German consumers.⁸

During the twenty years after 1506 the general trend of pepper prices was upward, more steeply upward than can be explained by the influx of precious metals from America to Europe. The prices charged at Antwerp by the Portuguese rose about 66 per cent between 1509 and 1527.⁹ At Venice the pepper received from Egypt was selling as high as

110 ducats a *cargo* in 1520 and, in hopes of buying more cheaply at Lisbon, Venetian galleys were ordered to call there. But when the galleys reached Lisbon in January 1522, one of the merchants wrote home that Lisbon prices were so high no one would think of buying for cash although there might be some barter. Pepper was selling at Lisbon at the equivalent of 83 ducats a *cargo*,¹⁰ well above the fifteenth-century Venetian price of 50 ducats. These prices show that the tight grip which the Portuguese had on the pepper trade in the fifteen twenties did not depend on their selling more cheaply than the Venetians had sold in the fifteenth century. The Portuguese had seized the pepper trade by increasing the protection costs of their Arab and Venetian competitors.

But at the same time the Portuguese king had created for his own spice-trading enterprise some high protection costs also, the costs of overawing Indian princes, seizing trading posts, and maintaining naval control of the Indian Ocean. These were the king's means of raising the protection costs of his competitors and were therefore what I have called an offensive protection cost comparable to the cost of the fleets which Colbert sent to patrol the West Indies. But whereas in Colbert's France the profits of the private French traders to the West Indies and the cost of naval squadron fell on enterprises entirely separate in their direction and their accounting, in Portugal the bulk of the profits from the sale of spices came into the hands of the same entrepreneur who paid the offensive protection cost, namely, the king. This cost appeared in the deficits of the *Estado da India* and in the expenses for sending out from Portugal soldiers and warships for operations in India. Hence, historians have some basis for estimating the financial results of this royal enterprise which combined spice trading with military action. Charles de Lannoy figured that by 1580 the king obtained at the most 250,000 ducats a year net from the spice fleets, a figure which allowed for wrecks but did not allow sufficiently for the many cases of spending one to three hundred thousand ducats in reinforcing the Indian army and navy.¹¹ Lucio de Azevedo, taking into account all the military expenses, asserts, "The truth is that only in the period of conquest did India pay its cost . . ." and then, as he says, only by booty, tribute, prizes and the ransom of Moors.¹² Historians of the Portuguese empire seem generally agreed that the riches

prophesied by Albuquerque proved a mirage. Long before the Spanish conquest of Portugal the inefficiency of the Portuguese system of government and trade was such that the costs of the Indian empire, added to the then considerable loss of ships, threatened to consume all the spice profits of the king. The offensive protection costs of the royal Portuguese enterprise were proving excessive.

Meanwhile the progressive inefficiency or corruption of the Portuguese government in India and the efforts of the Ottoman Turks lowered somewhat the protection costs of the Red Sea route. At times the protection costs of the Portuguese king may have been the higher, a possibility which helps explain the revival of spice exports from Alexandria to Europe in the second half of the sixteenth century.

About 1560 Venice and other Mediterranean ports regained a substantial part of the spice trade.¹³ Why, one might ask, did not the king of Portugal lower spice prices as soon as the Venetians or French threatened to take his business? Was not the all-water route around the Cape cheaper from a purely economic point of view, so that he could undersell the Venetians even if he did fail to keep the protection costs of the Red Sea route as high as in 1520? The greater economy of the Cape route, apart from protection costs, is difficult to demonstrate. Contradictory assertions on the subject are easy to find,¹⁴ but any calculation which ignored protection costs would be irrelevant to the present problem. In trying to cut off the Red Sea route the Portuguese king had assumed high protection costs for his own enterprise. He could not later lower spice prices substantially and still cover his own costs—not, at least, while his Eastern empire was so thoroughly permeated with inefficiency and corruption. That much at least is clearly implied by the statements of Azevedo and others concerning Portuguese finances.

Turning now from the Portuguese capture of the spice trade and the nature of that “capture” to its effects on the prosperity of Portugal, we enter the field of conjecture, one in which profits from the spice trade and from pure plundering can hardly be distinguished. When Lucio de Azevedo says that the cost of the Indian empire exceeded the receipts, he seems to include under the costs the salaries and pensions with which the Portuguese king rewarded the nobles who conquered and governed the empire. In so far as these rewards came directly or indirectly from the empire, they made the income of the nobles greater than it would

otherwise have been and accordingly they represent an addition to the national income. Royal officials in India also increased their revenue illegally from booty, bribes, and private trade. The revival of the Red Sea route did not interfere with these illegal forms of revenue, since Portuguese officials could grow rich on the bribes paid them for their "protection" of Arab traders. There seems no doubt that Portuguese national income increased for a time. Even the Portuguese kings, whatever the condition of their treasury, so enhanced their credit through the possession of spices that they were able to borrow extensively from international bankers and suspend payments in the grand manner, like their fellow sovereigns, in the third quarter of the sixteenth century.

Before deciding whether the Portuguese military action in India was profitable to the nation, one must consider in this case, as in connection with Colbert's activities, the opportunity cost. Could Portuguese capital and labor, assuming the same geographic discoveries and the same skill in navigation, have been used more profitably in some other way than that to which it was directed by military action in the Indian Ocean? Admittedly it is difficult for even a lively historical imagination to conceive how Portugal could have followed in this case "nature's simple plan," but the question must be faced if the Smithian point of view is to be dealt with at all. And some contemporaries did in fact conceive policies requiring far less military action. Gerolamo Priuli was not the only Venetian observer who considered whether the Portuguese might not operate advantageously, without enforcing a monopoly, simply because their new route would enable them to avoid the high taxes formerly paid in Egypt.¹⁵ But the Portuguese soon showed that they intended to depend on force, and by basing their hopes of profit on raising the protection costs of their rivals, the kings of Portugal diverted Portuguese labor and capital from the commercial development of the voyage and focused the energies of their people on war, plunder, and the taking of bribes.

In the long run of fifty or a hundred years, a more peaceful policy, fostering a greater development of the Eastern trade, might have made the nation richer. Although the conquest of India increased Portuguese national income for a time, it was followed by a decrease later in the productivity of the nation's labor. It does not therefore supply a clear

case of success in using armed force to increase the nation's prosperity.

But can we not find an opposite case, an example of a use of armed force which, although decreasing the national income temporarily, may have increased its productive capacity in the long run? The previous discussion of Colbert's West India policy considered its effects on French national income in the short run only. Looking at the policy from the long run historical point of view, Professor Mims concluded: "In reality their development [that of the West India colonies] proved to be the most valuable colonial asset which France possessed and contributed more to her commercial prosperity than any other single branch of trade."¹⁶ By stimulating the French West Indian commerce Colbert fostered the development in France of a certain type of labor and capital which proved in the long run of a hundred years exceptionally productive.

By various measures, many of which depended on armed force, the mercantilists strove to increase the proportions of their nations' capital and labor devoted to oceanic commerce and to manufacturing for export. Thereby they diverted capital and labor from employments in which, according to nature's simple plan, they would have produced *at the time* more national income.¹⁷ But oceanic commerce and manufacturing were to prove, in the long run of a couple of centuries, those branches of economic activity capable of the greatest expansion. The distinguished continuator of the Smithian tradition, Alfred Marshall, admits that the national income of England depended much in the eighteenth century, and even more in the nineteenth, on "the action of the law of increasing return with regard to her exports."¹⁸ Colbert did not, to be sure, think in terms of "a law of increasing return" and he was more interested in power than in plenty. But in so far as Colbert diverted capital and labor from conspicuous consumption or from agricultural investments which were subject to the law of decreasing return, and directed them into commercial and industrial activities which in the future were to yield increasing return, his activity as a statesman did contribute to the future wealth of France.

Of course, armed force was not the only form of state activity used by mercantilists to canalize economic activities, and in many cases it is practically impossible to distinguish the particular effects which should be attributed to the use of force. All attempts at explaining secular

trends in national wealth must be tentative because of the number of factors involved. Explanations in terms of a single factor are properly suspect, and economists may well condemn those which are simply references to military victories. But such victories do, in some cases, change the protection costs borne by a nation's enterprises and so affect both the distribution of income within the nation and the growth or decline of the whole national income.