

ENGLISH SEVENTEENTH CENTURY COLONIAL EXPANSION  
AS A FORM OF RENT-SEEKING

Except where reference is made to the work of others, the work described in this dissertation is my own or was done in collaboration with my advisory committee.  
This dissertation does not include proprietary or classified information.

---

William Macy Finck

Certificate of Approval:

---

T. R. Beard  
Professor  
Economics

---

Robert B. Ekelund, Jr., Chair  
Eminent Scholar Emeritus  
Economics

---

Richard W. Ault  
Associate Professor  
Economics

---

Joe F. Pittman  
Interim Dean  
Graduate School

ENGLISH SEVENTEENTH CENTURY COLONIAL EXPANSION  
AS A FORM OF RENT SEEKING

William Macy Finck

A Dissertation  
Submitted to  
the Graduate Faculty of  
Auburn University  
in Partial Fulfillment of the  
Requirements for the  
Degree of  
Doctor of Philosophy

Auburn, Alabama  
December 17, 2007

ENGLISH SEVENTEENTH CENTURY COLONIAL EXPANSION  
AS A FORM OF RENT SEEKING

William Macy Finck

Permission is granted to Auburn University to make copies of this dissertation at its discretion upon request of individuals or institutions at their expense. The author reserves all publication rights.

---

Signature of Author

---

Date of Graduation

ENGLISH SEVENTEENTH CENTURY COLONIAL EXPANSION  
AS A FORM OF RENT SEEKING

William Macy Finck

Doctor of Philosophy, December 17, 2007  
(M.S., Auburn University, 2002)  
(B.A., Bellarmine University, 1999)

168 Typed Pages

Directed by Robert B. Ekelund, Jr.

The central purpose of this dissertation is to apply a rent-seeking analysis to seventeenth century colonial policies in England. The dissertation is an extension of the rent-seeking model which Robert Ekelund and Robert Tollison developed and applied to English domestic trade policy in *Mercantilism as a Rent-Seeking Society* (1981). I contrast this new perspective with historians' traditional view of mercantilism, which emphasizes self-sufficiency and wealth accumulation. England's colonial policy in the seventeenth century, while frequently paralleling such actions as would be inspired by traditional mercantilist ideas, were actually intended to maximize revenues through the regulation of markets, regardless of whether colonial production freed Britain from dependency on imports from other European nations. Developments in the tobacco industry show that when the paths of mercantilism and revenue maximization diverged,

the crown selected a course that contradicted the tenets of mercantilism in favor of policies designed to maximize revenues.

I also show that while the colonial policies were designed to capture rents from regulated markets, opportunistic behavior on the part of groups of agents within the regulated markets (as well as within the government) caused the dissipation of contrived rents. This opportunistic behavior was made possible by the crown's inability to properly enforce market regulations. Throughout the seventeenth century, England's colonial policies evolved to correct the enforcement problems and allow the crown to capture a greater share of the available rents. I follow the development of England's colonial policies and analyze the effect of policy changes on the behavior economic agents attempting to capture the contrived rents for themselves. In modern society we still see many of the unintended consequences of economic regulation which troubled the English government in the seventeenth century.

## ACKNOWLEDGEMENTS

The author would like to thank Dr. Robert Ekelund for his support, patience and advice throughout the process of writing this dissertation. Thanks are also due to my wife, Emily, and our parents, Bill, Mary Beth, Anthony, and Frieda, for their love and support during this process.

Style manual or journal used: Southern Economic Journal style

Computer software used: Microsoft Word

## TABLE OF CONTENTS

LIST OF TABLES .....	x
LIST OF FIGURES .....	xi
CHAPTER 1. INTRODUCTION.....	1
CHAPTER 2. LITERATURE REVIEW.....	7
Monopoly Profit and the Rent-Seeking Model .....	9
Opportunistic Behavior and the Regulation of Domestic Markets.....	17
Political Landscape: Competition for the Right to Supply Regulation.....	25
Regulation of Imports and Exports.....	27
Chartered Companies and Regulation of Colonial Markets.....	30
Conclusion.....	38
CHAPTER 3. THE COLONIZATION OF VIRGINIA AND EARLY REGULATION OF THE COLONIAL TOBACCO TRADE AS A FORM OF RENT-SEEKING.....	40
Traditional Explanation of Colonial Regulation.....	41
Colonization as Rent-Seeking: Charter of the Virginia Company .....	44
Regulation of the Tobacco Industry: Overview.....	52
Pre-Colonial Regulation of Tobacco.....	57
Introduction of Colonial Tobacco.....	63
The Royal Tobacco Monopoly .....	67
Regulation of Retailers and Improved Enforcement in the Colonies .....	73



Conclusion.....	76
CHAPTER 4. OPPORTUNISTIC BEHAVIOR AND THE EVOLUTION OF THE NAVIGATION ACTS.....	79
Traditional Explanation of the Navigation Acts.....	80
The Economic Theory of Regulation.....	83
Historical Perspective.....	84
The Navigation Act of 1660.....	87
An Economic Interpretation of the Navigation Acts.....	90
The Staple Act of 1663.....	111
Additional Attempts to Increase Revenue.....	120
The Navigation Act of 1685.....	131
Conclusion.....	138
CHAPTER 5. CONCLUSION.....	143
BIBLIOGRAPHY.....	148
APPENDIX.....	154

## LIST OF TABLES

Table 1. Estimated Rents .....	54
Table 2. Market Structure .....	56

## LIST OF FIGURES

Figure 2-1. Market with Constant Costs: Competition vs. Monopoly .....	11
Figure 2-2. Market with Constant Costs: Identifying the Welfare Loss.....	13
Figure 2-3. Opportunistic Behavior Within a Cartel .....	18
Figure 2-4. Equilibrium Price and Quantity in a Monopsony Market Structure .....	37
Figure 3-1. Tax Revenue Maximization .....	62
Figure 4-1. Long Run Firm Profits: Unregulated vs. Regulated Markets .....	92
Figure 4-2. Market with Constant Costs: Identifying the Welfare Loss.....	95
Figure 4-3: Effect of Customs Duties on Prices of Foreign Goods .....	105
Figure 4-4. Effect of an Increase in Duties on Total Revenue when Demand is Elastic	124

## **CHAPTER 1:**

### **INTRODUCTION**

The central purpose of this dissertation is to apply a rent-seeking analysis to seventeenth century colonial policies in England. The dissertation will be an extension of the rent-seeking model which Robert Ekelund and Robert Tollison developed and applied to English domestic trade policy in *Mercantilism as a Rent-Seeking Society* (1981). This approach to mercantilist colonial policy is unique, and I intend to contrast this new perspective with historians' traditional view of mercantilism, which emphasizes self-sufficiency and wealth accumulation. England's colonial policy in the seventeenth century, while frequently paralleling such actions as would be inspired by traditional mercantilist ideas, were actually intended to maximize revenues through the regulation of markets, regardless of whether colonial production freed Britain from dependency on imports from other European nations. Developments in the tobacco industry show that when the paths of mercantilism and revenue maximization diverged, the crown selected a course that contradicted the tenets of mercantilism in favor of policies designed to maximize revenues.

I also intend to show that while the colonial policies were designed to capture rents from regulated markets, opportunistic behavior on the part of groups of agents within the regulated markets (as well as within the government) caused the dissipation of

contrived rents. This opportunistic behavior was made possible by the crown's inability to properly enforce market regulations. Throughout the seventeenth century, England's colonial policies evolved to correct the enforcement problems and allow the crown to capture a greater share of the available rents. This dissertation will follow the development of England's colonial policies and analyze the effect of policy changes on the behavior of economic agents attempting to capture the contrived rents for themselves.

Over the years, scores of scholars have written on the subject of England's colonial economic policy. A large proportion of these writings have been concerned with establishing a link between England's colonial policies in the eighteenth century and the Revolutionary War. These authors<sup>1</sup> argue that England's colonial trade policies sacrificed the welfare of the colonists to supplement the king's interests. They cite high levels of direct taxation and binding constraints on trade behavior as direct causes of the Revolution. The other most common objective of English colonial historians is to determine the cause of the remarkably high rates of growth in the English colonies compared to those of the colonies of other empires, such as Spain and France. Generally, these authors<sup>2</sup> claim that early English colonial policy was designed to protect colonial industries and foster growth, whereas the colonial policies of the other nations of Europe were designed to exploit the colonies and enrich the treasury. I contend that the intentions of the English crown paralleled those of the other monarchs of Europe. I will prove, through an analysis of the evolution of English colonial policy from the very beginning until the late seventeenth century, that the crown developed colonial policy in a

---

<sup>1</sup> The list of authors who take such a stance on England's colonial policy includes Oliver Dickerson (1951), Alan Kulikoff (1979), Patrick O'Brien (1988), and Arthur Schelsinger (1966) among many others.

<sup>2</sup> Among the most prominent authors adopting this position are Charles Andrews (1938), G. L. Beer (1908, 1913), Lawrence Harper (1939), and John McCusker and Russell Menard (1985).

way that was intended to maximize treasury revenues. The fact that English colonies experienced more economic growth than the colonies of other European nations was the result of two primary factors: the unique system of government in England which restricted the crown's ability to maximize revenues through direct taxation and a flawed system of enforcement of economic regulations – not the relative benevolence of the English monarchy, as the traditional view seems to imply.

The period of colonial expansion during the 16<sup>th</sup> and 17<sup>th</sup> centuries in Europe is often referred to as the “mercantile” era. Many historians consider the mercantile era a period in which governments focused on the building of strong, self-sufficient nation-states, and suggest that most political and economic decisions were motivated by such objectives. Ekelund and Tollison summarize the traditional view:

All the major students of mercantilism appear to organize their interpretations of the period and its writers around a paradigm that emphasizes certain regulatory implications flowing from a balance-of-trade and specie-accumulation objective. The utility of the specie argument is then further linked to the process of creating and developing the nation-state. (1981, p. 5)

The period was characterized not only by the expansion of empires, but by frequent military conflicts over new borders and trade routes. In such an environment, it was critical to a nation's survival to maintain as much independence from the production of foreign goods and services as possible, because, in the event of a war with that nation, the empire could lose access to vital staple products. Thus, according to the traditional view, one of the primary purposes of colonial expansion was the creation of domestic sources of supply of goods for which the empire was dependent on foreign production.

Self-sufficiency was desirable for the safety of the nation-state; hence colonial policy was designed in a manner that encouraged the colonists to engage in the development of industries that could furnish the metropolis with goods that otherwise had to be imported from foreigners.

There was, of course, another key element to the survival of a mercantilist empire: currency. Fighting in successive wars was expensive; and for monarchs to remain in power required constant searches for new sources of revenue. A close inspection of the charters of the companies granted the right to settle the New World clearly demonstrates that revenue-maximization, rather than self-sufficiency, was the primary focus of colonization. In my dissertation, I will show through a close examination of the charter of the Virginia Company that the primary purposes of English colonial expansion were the accumulation of precious metals and the capture of economic rents through the regulation of trade.<sup>3</sup>

The presence of a strong Parliament in England during the mercantile era prevented the English crown from increasing revenues in the traditional method of direct taxation utilized by the other European monarchs. The English crown attempted to substitute a policy of indirect taxation through regulation for direct taxation to accumulate revenues. The crown supplied monopoly rights to individual producers or organized groups of producers in exchange for rental fees and access to loans at low rates of interest. The groups to whom the king granted the exclusive rights to supply particular

---

<sup>3</sup> As noted in the above passage by Ekelund and Tollison, the traditional view of mercantilism includes specie-accumulation among the objectives. The rent-seeking elements of colonial policies, however, have been ignored.

goods and services actively sought such regulations and willingly agreed to the crown's terms due to the advantages afforded them by the elimination of competition.

To defend any theory about seventeenth century English colonial policy using empirical evidence is extremely difficult due to the lack of records from that era. What little data exists seems, on the surface, to support the traditional contention that the English government's economic policies were designed to stimulate growth in the colonies rather than to exploit them for the sake of increasing treasury revenues. The colonies enjoyed high rates of growth in terms of population and per-capita production, and the crown failed to capture a large percentage of the rents available in the regulated colonial markets. I will argue, however, that these results occurred by accident rather than design. A close evaluation of the evolution of England's regulatory policies reveals the true intentions of the English government: the policies were clearly designed to restrict competition in order to control output levels and capture artificial rents, and often contradicted policies which would maximize total social welfare and encourage growth.

A successful system of indirect taxation through regulation, however, requires strict enforcement of the regulatory policies. For the crown to capture rents in the form of rental payments from the beneficiaries of regulation, the parties must ensure that competition is prohibited and the law is upheld. The recipients of the monopoly privileges will only be capable of paying the rental fee if they earn positive economic profits. Positive profits are only possible if artificial barriers to entry by outsiders are properly enforced, and the actions of members of the cartels are properly monitored and constrained. Competition, from without or within the cartel, increases outputs, reduces prices, and eliminates potential economic rents. I contend that the government's



difficulty with successfully exploiting colonial markets was the result of a poorly designed system of enforcement which allowed for frequent instances of opportunistic behavior on the part of market participants such as the colonists, foreign merchants, domestic producers, and the customs officials at the ports. I will defend my position with an economic analysis of market conditions (when data is available,) as well as anecdotal evidence such as first-hand reports of illegal behavior, frequent royal proclamations condemning the opportunistic behavior of market agents, and the nature of the changes in regulation over time. I contend that those policy changes which call for improvements in the system of enforcement and/or a reduction in duties on imported goods provide evidence of opportunistic behavior and unsuccessful regulation. Those policy changes that call for an increase in the duties on imports or result in an increase in the crown's share of available economic rents (which infrequently occur) provide evidence of an improved enforcement system.

This dissertation contains original calculations of the value of artificial rents in the colonial tobacco market. It is also among the first to apply the rent-seeking model to English colonial policy throughout the seventeenth century. My contribution to the extensive literature that exists concerning the American colonies will hopefully provide a more complete understanding of how markets evolved in this country from the very beginning of their existence. A more complete understanding of our history can help us more accurately predict how individuals will respond to incentives (both intentional and accidental) in current and future market structures.

## **CHAPTER 2:**

### **LITERATURE REVIEW**

#### **I. Traditional View of Mercantilism**

Ekelund and Tollison's 1981 book *Mercantilism as a Rent-Seeking Society* challenged the traditional methodology of the study of mercantilism. Rather than accepting the interpretation of mercantilist ideas presented by historians and then evaluating these ideas from an economic theory standpoint, Ekelund and Tollison provided an altogether new explanation of mercantile political economy using positive-economic theory.

The traditional view of mercantilism includes a strategy of increasing the power and influence of the state. Such economic policies as controlling the international trade through the taxing of imports and subsidization of exports of finished goods were seen as exogenously determined methods of state-building and promotion of domestic industry with an ultimate goal of the attainment of self-sufficiency.<sup>4</sup> For instance, Charles Andrews describes the mercantile motivations for colonization as such:

England was seeking new opportunities, by means of exploration, discovery, and trade, for the benefit of the state and the good of her people. She was stirred by the first impulses of a pride in national achievement; by a determination to share

---

<sup>4</sup> For economic evaluations of the mercantilist ideas presented by historians, see Viner (1930) and Heckscher (1934).

in those products of the soil which . . . could be obtained only from distant and tropical countries; and by a deep-seating enmity for [continental] power. (1938, p. 2)

G. L. Beer agrees that “the chief economic benefit that England expected to derive from colonial expansion was freedom from dependence on other European rivals,” (1908, p. 59). He then elaborates on the specific ends to be attained through the means of colonization. The first of these goals is the attainment and control of an exclusive, shorter route to the Pacific, thus wresting from the Dutch control of the Asian markets that supplied England with precious commodities such as wine, spices, and silk. Beer also suggests that the English government sought to develop the domestic fishing industry, for at the time the colonization of North America began, an estimated two-thirds of the fish consumed in England came from imports. Hence, strengthening the domestic fishing industry would keep in line with the general concept of self sufficiency. Finally, according to Beer, England hoped to establish a domestic market for naval stores (goods also imported from the Baltic provinces) to lower the cost of defending the colonies.<sup>5</sup>

In their writings, Andrews and Beer provide excellent descriptions of England’s colonial economic policy during the seventeenth century. However, they offer little explanation of the forces behind the development of these policies. The idea that government officials developed all colonial policy with an overall goal of self-sufficiency fails to explain why tobacco was the first staple exported from the colonies. Although England was dependent on Spain for its supply of tobacco at the time that the colonies sent the first shipments, the high import duties on Spanish tobacco was encouraging rapid

---

<sup>5</sup> Beer (1908, p. 60)

growth of tobacco production in England.<sup>6</sup> Thus, colonial tobacco production was not necessary to free England from a dependence on imports, nor was tobacco among list of markets in which England desired freedom from imports. In fact, Gately points out that of the goods England hoped to import from the colonies, “tobacco was not on this wish list, although it was comprised of articles England presently had to import” (2001, p. 70). In addition, James I despised the consumption of tobacco and seemed to have no interest in strengthening its supply from any source, foreign or domestic.<sup>7</sup> In spite of these facts, tobacco remained the primary commodity imported from the colonies throughout the entire seventeenth century. James I began a system of regulation that encouraged the importation of the colonial product at the expense of Spanish tobacco and the homegrown product. It should be understood that, regardless of other “mercantile” motivations James may have possessed, the primary objective of the regulation of the colonial tobacco industry was to establish control of prices and quantities and to maximize the revenues earned by the treasury.

## **II. Monopoly Profit and the Rent-Seeking Model**

The seventeenth century was a time of expansion and empire for the nations of Europe. The development and protection of new lands created a perpetual incentive for revenue-seeking on the part of the governments of these new empires. The crown earned revenues through two methods: direct taxation of production and transactions and indirect taxation via collection of a rental fee in exchange for the granting of exclusive production and/or retail privileges to a monopolist or cartel of producers.

---

<sup>6</sup> MacInnes (1926, p. 77)

<sup>7</sup> Beer (1908, p. 81)

In mercantile England, limitations on the crown's ability to collect revenues through direct taxation created an incentive to participate in nationwide regulation of markets. The existence of a well-established Parliament constrained the ability of the monarch in England to tax as early as the 13th century. By 1297, Parliament declared that all direct taxation other than ancient customs required the consent of the public. In addition to constraints by Parliament, Ekelund and Tollison describe other problems with direct taxation as a means of revenue collection:

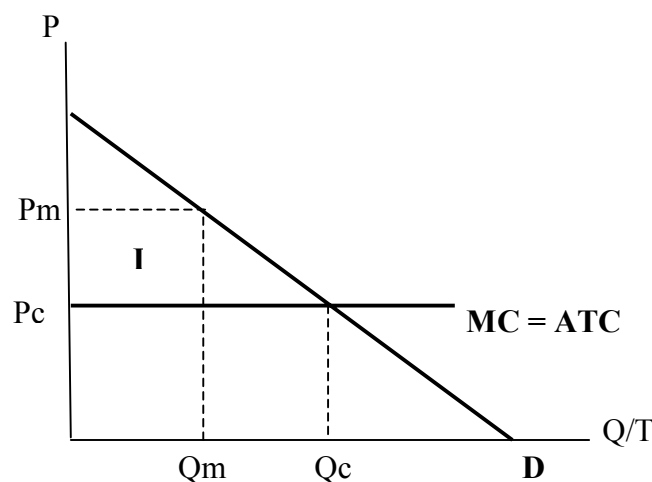
But beyond the consensual constraints, tax collection was a relatively inefficient means to raise revenue for the mercantile central state, because the costs of monitoring and controlling tax evasion were high. Barter and non-market production were undoubtedly widespread in the agricultural economy of these times, and commercial record keeping was not highly developed for market production. Moreover, tax collectors were susceptible to bribery and not very vigorous because they did not receive the full marginal value of their efforts to collect taxes. These sorts of factors made tax collection an unattractive revenue alternative (at the margin) for the mercantile authorities. (1981, p. 33)

The alternative to creating revenues through direct taxation was the capture of artificial rents through the regulation of production, specifically the granting monopoly rights to an individual or group of producers. Such a method of revenue-seeking will be superior to direct taxation in a system where a strong central authority (monarchy) possesses the sole right to grant monopoly or cartel privileges, and enforcement of the regulation is performed directly by the monarch or the economic agent receiving the

privilege of exclusive production. Before discussing the specific details of the process of indirect taxation in mercantile England, it is necessary to illustrate how a monopoly market structure creates a greater opportunity for the collection of revenue by the crown than competition.

## MONOPOLY PROFIT

Consider the theoretical market with constant marginal cost represented in Figure 2-1. In the absence of barriers to entry, competition between producers will result in an equilibrium market price equal to marginal (average) cost. At that price, market output will be  $Q_c$ . In this scenario, there will be no economic profit, which Ekelund and



**Figure 2-1.** Market with Constant Costs: Competition vs. Monopoly

Tollison define as “a payment to a resource owner over and above the amount his resources could command in their next-best alternative use,” (1981, p. 18). An increase in demand or downward shift of the cost curve will temporarily create economic profit, but the profit will create an incentive to increase production, which will eliminate profits and lead to an allocation of resources to their most valued uses. The response by

producers to a temporary increase in economic profit can be considered a form of rent-seeking. However, rent-seeking of this nature, which I prefer to term “profit-seeking,” inflicts no social cost on the economy. These activities create value in the form of additional supply, and drive the price-rationing, self-correcting market system of resource allocation.

Now consider a situation in which a single producer obtains the exclusive right to the production of this good or service. In the absence of competition, the single producer, or monopolist, has an incentive to reduce output to  $Q_m$ .<sup>8</sup> The reduction of output creates a contrived scarcity in the market and the diminished availability of the product creates an incentive for producers to pay a higher price to obtain it. A non-price discriminating monopolist selling  $Q_m$  units can charge a maximum price of  $P_m$ . This price is well above the average cost of production and leads to significant economic profits, identified in Figure 2-1 as **II**. As the English monarchs of the mercantile era understood, the right to become the sole supplier of a good or service was quite valuable to a producer in a competitive market. A potential monopolist would be willing to pay a high price for such an opportunity. A payment of this nature is a form of rent-seeking as it shall be defined in this dissertation.

## RENT-SEEKING

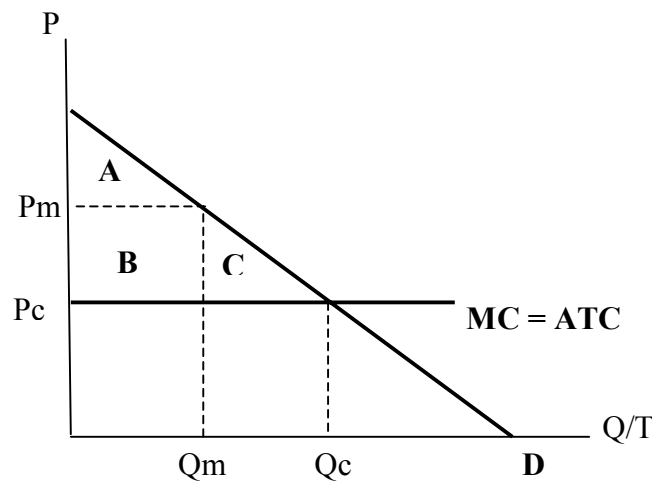
Ekelund and Tollison distinguish profit-seeking from rent-seeking by defining rent-seeking as “the expenditure of scarce resources to capture a pure transfer,” (1981, p. 19). In the above scenario, the payment to the crown for monopoly rights is the

---

<sup>8</sup> The profit-maximizing behavior of a monopolist was first identified by Cournot in 1838.

expenditure of scarce resources. This expenditure does not create additional goods and services; it simply secures a transfer of welfare from consumers, who enjoy low prices in a competitive market, to the monopolist in the form of economic profit. While historians frequently claim that the government designed mercantile policies with the intention of increasing the good of the empire of the whole,<sup>9</sup> the creation of a system rife with rent-seeking results in wasted resources and reductions in welfare from a number of causes.

The reduction of output and the increase in price that results when a monopolist is granted control of a competitive market causes a net welfare loss in the economy.



**Figure 2-2.** Market with Constant Costs: Identifying the Welfare Loss

Consider, again, the hypothetical constant-cost market from the previous example, this time represented in Figure 2-2. The demand curve on this graph represents the maximum that consumers would be willing to pay for various quantities of the good or service. Total consumer welfare is represented by the area under the demand curve from the origin to the quantity purchased. For any quantity, the difference between total consumer

<sup>9</sup> For an example of the traditional view, see McCusker and Menard (1985, p. 45).



welfare and total expenditure (price \* quantity) is known as consumer surplus.<sup>10</sup> When the market is competitive, and the market price is  $P_c$ , the consumer surplus is the sum of areas **A**, **B**, and **C** in Figure 2-2. When the market becomes a monopoly, the price increase reduces consumer surplus to area **A**. Area **B** is transferred to the monopolist in the form of economic profit; however, area **C** becomes the net welfare loss. The consumers willing to pay a maximum price between  $P_m$  and  $P_c$  no longer receive the good. Since the monopolist chooses not to produce the goods previously purchased by those consumers, the welfare they once received is not transferred to the producer – it simply no longer exists.<sup>11</sup> The extent of the total welfare loss to society will be limited to this area only if the monopoly profit is considered a pure transfer from consumers to producers, so that transactions costs are zero. Tullock (1967) argued that the overall reduction in welfare would be much greater due to the process through which monopolies are granted.

The elimination of competition in production can create competition of another kind in the market. If multiple firms have the potential to supply the output of the entire market, then competition for monopoly rights will occur. The competition for contrived monopoly profits spends society's resources on non-productive activities, such as lobbying. These resources have an opportunity cost that can be measured in terms of lost production. Tullock (1967) estimated that at best, these wasted resources will have a value equivalent to the value of the monopoly profit, perfectly dissipating the available rent. In Figure 2-2, area **B** represents the welfare loss that results from rent-seeking.

---

<sup>10</sup> The concept of consumer surplus was first introduced by Jules Dupuit in 1849.

<sup>11</sup> The net welfare loss caused by monopolies was also first identified by Dupuit.

Tollison identifies the various levels on which rent-seeking wastes resources, depending on the method the government uses to grant the monopoly. He uses the example of a monarch granting exclusive production rights in the market for playing cards:

At one level the king can allow individuals to compete for the playing card monopoly and waste resources through such activities as bribery. Such outright venality is perhaps the simplest and most readily understood level of rent-seeking. At a second level the state could sell the monopoly right to the highest bidder and put the proceeds at the disposal of government officials. In this case the monopoly rents will most likely show up in the wages of state officials, and to capture rents at this level individuals will compete to become civil servants. . . At still another level should the monopoly right be sold to the highest bidder and the resources dispersed through the state budget in terms of expenditure increases and/or tax reductions, rent-seeking costs will be incurred as individuals seek to become members of the groups favored by the tax-expenditure program (1982, p. 578-579).

Posner (1975) offers a simple numerical example of how rents are perfectly dissipated in competitive rent-seeking. Posner considers 10 bidders competing for a monopoly right worth \$100,000. He assumes the bidders are risk-neutral and do not collude. In that case, each will submit a bid for the monopoly equal to the expected value of obtaining it. The expected value of a future event in the presence of uncertainty where there are two possible future states of the world can be calculated using the following formula:

$$(1) EV = S1*P1 + S2*P2$$

where S is a possible future state of the world and P is the probability of that state occurring. In the absence of collusion or side payments, each bidder has a ten percent chance of winning the monopoly right and a ninety percent chance of losing and receiving no benefit. Thus the expected value of the monopoly is \$10,000. When each potential monopolist bids this amount, the social cost of the resources used in the competition is exactly equal to the value of the wealth transfer.

Any attempt by producers to capture monopoly rents obviously comes at the expense of consumers. The consumer surplus enjoyed by consumers in a competitive market structure is reduced when a monopolist increases the price of the good, and the artificially contrived rent is a transfer of wealth from the consumer to the producer. Adam Smith identified this burden upon consumers in *Wealth of Nations* when he notes “the interest of the home-consumer is evidently sacrificed to that of the producer. It is altogether for the benefit of the latter, that the former is obliged to pay that enhancement of price which this monopoly almost always occasions” (1937, p. 625). Even without rent-seeking costs, the granting of monopoly rights harms the consumer by more than the producer benefits. Thus, consumers have an incentive to engage in rent-seeking behavior to prevent the transfer of welfare to the producer. In the absence of transactions and information costs, legislation that creates a net reduction in social welfare will not pass. The model created by Stigler (1971) and extended by Peltzman (1976) shows the regulation of markets as a function of the costs and benefits to various groups in society. Given zero transaction and information costs, consumers would spend more resources to keep the price in Figure 2 close to  $P_c$  than the producers would spend to increase the

price to  $P_m$ , because consumers would collectively gain more from blocking any trade-restricting regulation. However, given that producer interests were well-represented in Parliament in seventeenth century England and those of the consumer were not, the costs to consumers of determining their losses as a result of the regulation of trade and taking the necessary actions to prevent such regulation were sufficiently high to prevent the demand for counter-legislation. Hence the observance of the resulting market conditions identified by Smith above.

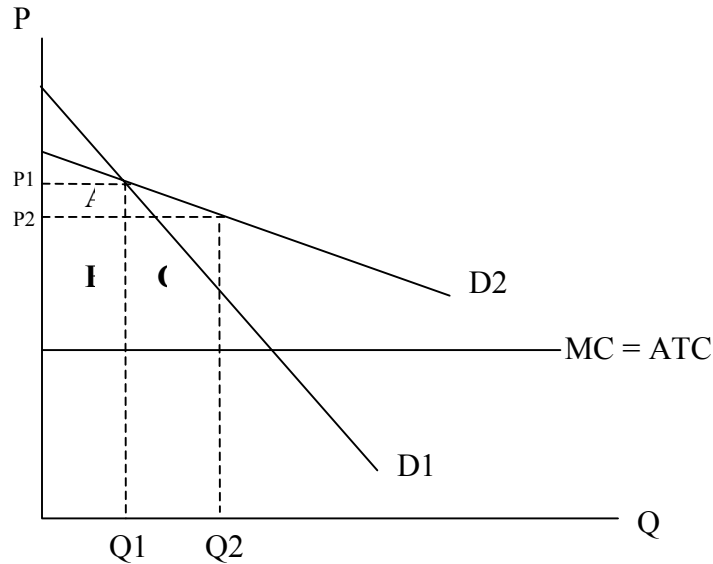
### **III. Opportunistic Behavior and the Regulation of Domestic Markets**

Ekelund and Tollison describe the national economic regulation of domestic markets in England as an extension of the local guild system established in medieval times. The medieval guild system allowed established town merchants to form a cartel and collude to prevent entry by farm laborers. A cartel is an agreement among a group of producers to behave as a monopoly by restricting output and raising the price. By restricting competition, the guild could charge higher prices and earn greater profits, all the while insisting that the system facilitated the maintenance of product quality and thus was in the interest of the public.<sup>12</sup> In this way, the rent created by the artificially high price (roughly equal to area **B** in Figure 2-2) could be divided among the members of the cartel. The administrators of the guild were responsible for maintaining and enforcing entry restrictions through agreements with local law enforcement officials. Guild officials found that the restriction of cheating on local cartel agreements (from without as well as from within) proved to be a difficult and expensive task.

---

<sup>12</sup> Ekelund and Tollison (1981, p. 31)

To explain how competition from within the cartel was problematic during the guild period of England, it is necessary to closely examine cartel theory. As stated above, a cartel is an agreement among firms to set prices and quantities at monopoly levels. Figure 2-3 represents one cartel member. The members each agree to restrict output to  $Q_1$  and charge a price of  $P_1$ . With perfect enforcement, each firm earns a share of the monopoly profit equal to  $A + B$ . Without proper enforcement, there is a high probability that the agreement will break down as a result of opportunistic behavior by the members of the guild.  $D_1$  represents the demand curve faced by the representative firm when all firms charge the same price. If cartel members choose to decrease the agreed price to  $P_2$  then, according to the Law of Demand, a larger number of consumers will be willing to purchase the good. However, if the cartel price remains at  $P_1$  and a single member of



**Figure 2-3.** Opportunistic Behavior Within a Cartel

the guild lowers the price of his product without the knowledge or consent of the other members, then the increase in quantity demanded associated with the price change will be

greater than the increase in quantity demanded represented by a movement along D1. The opportunistic guild member is selling a product which is a close substitute for the product of other guild members at a lower price. Thus, in addition to the increase in quantity demanded caused by a movement along D1, the firm in violation of the agreement will also benefit from selling to consumers who were previously buying the good from other cartel members at the cartel price. Hence, the demand curve faced by the cheating firm is relatively more price elastic than the demand curve faced by a firm charging the same price as other members of the guild. The increase in quantity demanded that results from cheating on the cartel agreement is represented by a movement along D2 from Q1 to Q2. The potential increase in profit from cheating on the cartel is represented by C – A. A portion of the revenue that could have been earned from selling Q1 units at a price of P1 is lost, but the additional profit from the sale of Q2 – Q1 units of the good at a price of P2 far exceeds the loss from the price reduction. The profits to the guild as a whole, however, decrease when one of the members cheats by lowering their price. Cheating by more than one member of the cartel, or a price war resulting from retaliation against the cheater, further dissipates the potential profits and moves the market closer to competitive equilibrium. Because all firms in the cartel face the same incentive to cheat, cartel agreements tend to breakdown in the long run. The incentive to cheat also plagued the cartel agreements of England's colonial policy, such as the chartered companies and the organization of tax collectors at the ports. This will be discussed in detail in the following chapters.

Town guilds also faced the unpleasant prospect of competition from non-member producers, such as foreign merchants, reducing market prices and dissipating profits. To

prevent competition from outsiders, town guilds attempted to purchase a national system of regulation from the monarch. Guilds offered the crown a fee in exchange for protection against entry by foreigners. In this way, artificial rents were created through the restriction of supply in local markets, and the sovereign captured a share of rents in the form of the fixed rental.<sup>13</sup>

#### STATUTE OF ARTIFICERS

The Elizabethan Statute of Artificers was enacted in 1563 as an effort to unify the various local attempts at economic regulation and to provide enforcement of guild policy on a nationwide level. The new system was to be enforced by the justices of the peace. The justices were responsible for banishing illegal producers to the countryside, and for preventing the smuggling of illegal outputs into the towns from the countryside producers.<sup>14</sup> The justices were not paid, however, and the failure to provide the justices with compensation equivalent to the marginal value of their efforts created an incentive for the justices to engage in opportunistic behavior which resulted in a system of selective enforcement. Heckscher explains:

Justices of the Peace were unpaid. It is not easy to say how far they recouped themselves by accepting bribes. Allegations to that effect were not absent. Thus, in the year 1601 a speaker in the House of Commons stated: 'A justice of peace is a living Creature that for half a Dozen of Chickens will Dispense with a whole Dozen of Penal Statutes'; and there is divers other proof of their corruption. (1934, 1: 246)

---

<sup>13</sup> Ekelund and Tollison (1981, p. 36)

<sup>14</sup> *Ibid* (1981, p. 36)

Becker and Stigler (1974) note that such behavior is predictable and should be expected in situations where compensation is low and actions of the agent remain mostly unsupervised by those parties interested in maintaining the regulation. Unpaid, unsupervised justices of the peace face a low probability of getting apprehended and a low opportunity cost of getting fired.<sup>15</sup> It should be noted here that when the English government would later attempt to grant the colonies a monopoly of the market for tobacco in England, successful regulation would require a prohibition of tobacco growing in England. The responsibility of enforcing the ban on domestic tobacco planting would fall on the same unpaid justices of the peace, which resulted in many of the same issues that applied to the regulation of domestic markets. This will be a topic of the following chapters.

The failure to compensate justices of the peace for enforcement activities probably stemmed from a desire to keep enforcement costs low in order to maximize the level of rent available for capture and thus maximize revenue from indirect taxation. Through accepting bribes, justices were transferring a portion of the contrived rents from the guild members and the crown<sup>16</sup> to themselves and the illegal producers. However, by allowing illegal production, either by guild members who expanded production beyond cartel levels or by non-guild members entering the regulated industries, justices also dissipated the rents available for capture as the market moved closer to competitive equilibrium.

---

<sup>15</sup> Edwin Chadwick observed the same relationship between the compensation of police officers and the quality of law enforcement in England in 1829.

<sup>16</sup> The crown's share of the rents (the rental fee) was predetermined in advance and re-evaluated annually. Thus, malfeasance on the part of justices would not have an immediate effect on crown revenue; however, the dissipation of available rents reduced the value of regulation to the guilds, and decreased future rental fees.



The benefits of malfeasance and non-uniform enforcement to both non-guild producers and justices of the peace created an incentive for some individuals to take on both roles. A non-guild producer could avoid paying bribes by becoming a justice<sup>17</sup>, and a justice could increase his returns from disregarding the statute by becoming a guild-competing producer in his jurisdiction. Nef provides an example of the latter scenario from a case involving a grain-mill patent granted by Elizabeth in 1585 in the port of Bridgewater. In the original letters patent:

. . . A clause was inserted binding the mayor, recorder, and alderman not to allow anyone to brew or sell any beer and ale in the town unless the malt and other grain had been ground at certain water-driven mills called Little Mills. These mills were owned partly by the crown and partly by the Earl of Hertford. Some 25 years later, in 1609 or 1610, a prominent citizen of the town named Robert Chute built a horse mill for grinding malt, for his “owne private gain.” Chute was mayor of the town and a justice of the peace, so his duty to uphold the brewing clause of the municipal charter was clear. Yet he not only permitted brewers and others to desert Little Mills for his horse mill, he brought pressure to bear on them to do so. He used the power of his office against some who did not. He had a part of the water supply diverted from Little Mills, and this prevented the two wheels there from turning during steadily dry summers. . . . When charges were brought in the Court of Exchequer against Chute for defying the brewing clause of the town charter,

---

<sup>17</sup> Heckscher provides evidence of this occurrence: “as regards the control of industry itself, there were a large number of people among the controllers who were themselves interested in the particular industries, and of course not in the application of the legal regulations; and to appoint them controllers was to set a thief to catch a thief” (1934, 1 : 248).

his witness defended him on the ground that Little Mills had not a sufficient supply of water to grind all the malt consumed in Bridgewater. (1968, p. 52 – 53)

This incident clearly shows that it was possible for justices of the peace to use their regulatory authority to engage in a pattern regulation that benefited the firms in which they held interests. This self-interested, opportunistic behavior on the part of the justices was only one of several factors that resulted in the breakdown of mercantile regulatory policy in England.

On the occasion that the justice of the peace of a particular town did (to protect in interests of a firm with which he was affiliated) banish a non-guild member to the countryside, it became the responsibility of the countryside justice to prevent that producer from smuggling his goods back into town to sell. Unless the rural justice was a non-guild producer/smuggler himself, then a self-interested, opportunistic justice could maximize personal welfare by collecting bribes from the smugglers. Ekelund and Tollison explain that rural justices were interested in “simply expanding the size of the local economy . . . thus, it may have been in the interest of rural justices of the peace to encourage the migration of labor from the cities,” (1981, p. 43). Non-guild producers could avoid the regulation of Statute of Artificers by choosing to migrate to the countryside, although a migration of that distance may not have been necessary.

By simply moving to the suburbs of the towns, guild-competing producers could remain within the jurisdiction of the town justices, but raise the cost of enforcement of the statute above the potential gains to the town justice. With producers scattered about town in this fashion rather than remaining in a central location, they were able to avoid

prosecution by town justices and avoid paying a bribe to the rural justice.<sup>18</sup> Suburban, guild-competing producers, just like the justices that allowed infringement upon the cartel, captured a portion of the rents available in the regulated market, and also dissipated the total rent by engaging in self-interested, opportunistic behavior. Regulation of colonial and international trade would later face similar difficulties with evasion. Competition between ports and merchants' usage of unregulated waterways such as rivers and creeks led to an increase in the illegal supply of regulated goods and the dissipation of rents available for capture. These parallels will be further illustrated in the following chapters.

The Statute of Artificers offered self-interested merchants and town officials an opportunity to secure protection from “foreigners” from rural areas and suburbs in exchange for a fee to the monarch. As discovery and exploration of new lands encouraged shipping and international trade, mercantile economic regulation was expanded to exclude merchants of other nations, rather than just those from other parts of the country. This dissertation will demonstrate that mercantile policy of the seventeenth century was simply an extension of the nationwide protection that self-interested merchants attempted to secure in 1563. I will also show that regulation of colonial and international trade failed as a result of many of the same problems that surfaced during regulation that occurred at that time, such as difficulties with enforcement and the breakdown of cartel agreements.

---

<sup>18</sup> Ekelund and Tollison (1981, p. 43 – 44)

#### **IV. Political Landscape: Competition for the Right to Supply Regulation**

Another significant factor in the collapse of national monopolies in England was the development and evolution of the constraints placed on rent-seeking economic agents by government institutions. Ekelund and Tollison specifically address the role played by the mercantile courts and the struggle between the crown and Parliament for the right to supply economic regulation (1981, p. 47).

Prior to the mercantile era, three common law courts evolved. While the common law courts were originally under the direct control of the king, as the mercantile era approached, the courts became increasingly independent of the king and fell into competition with one another over jurisdiction. Holdsworth attributes this competition to the fact that jurisdictional boundaries were ill-defined and the compensation of judges depended partly on fees collected in court on a per-trial basis (1966, p. 253 – 255). Holdsworth also notes that as a functional separation of the judiciary from the other branches of government continued to develop, there also evolved an alignment of the interests of the common law courts and Parliament:

Common lawyers were an important element in the House of Commons; and the judges of the King's Bench and the Common Pleas [both common law courts] were common lawyers similarly educated, similarly employed, often changing from one bench to the other. They were tending to fall apart from that large body of royal clerks who acted in the various departments of government controlled by king and council. It is not surprising, therefore, that

the common lawyers came to think that errors in the King's Bench ought to be corrected in Parliament, and not by the Council. (1966, p. 210 – 211)

Ekelund and Tollison provide further details on this alliance between Parliament and the common law courts through a discussion of how each depended on the other to establish their authority on legal matters:

Beyond being peopled by individuals of similar training and interests, the common law courts were also attracted to the interests of Parliament because they regarded Parliament as simply another common law court (The House of Commons could overturn any decision made by a court of common law.) Parliament, moreover, could legislate jurisdictional boundaries and other aspects of the courts but was nevertheless dependent upon the courts for the permanence and security of its laws. (1981, p. 50 – 51)

Just prior to the reign of Elizabeth I, the king attempted to regain his administrative right to establish and enforce grants of national monopoly rights by avoiding the common law courts altogether and creating a new royal judicial system centered in the Privy Council. A battle ensued over the right to supply and enforce economic regulation, with the crown and the royal court system and the now stronger alliance between the common law courts and Parliament. Rent-seeking, of course, lied at the heart of the struggle as each potential team of suppliers and enforcers attempted to share in the rents created by sustaining economic regulation. In this competitive environment, a monopoly right established by the crown may be ruled legal by the royal courts but invalid by the common law courts. The reverse would be true for regulation granted by Parliament. Ekelund and Tollison note that competition reduces the durability

of monopoly rights, and uncertainty over durability reduces the value of the monopoly right to the special interest. As the benefit of regulation falls below the cost to the special interest of establishing the regulation, the ultimate result will be the elimination of regulation altogether (1981, p. 51 – 54). The competition between the crown and Parliament for the right to collect revenues from the regulation of the colonial markets would eventually contribute to outbreak of Civil War in England in 1641.

## **V. Regulation of Imports and Exports**

Duties at the ports provided the crown one source of revenue from direct taxation which did not suffer from the same inefficiencies and interference from Parliament as those described above which resulted from other attempts at direct taxation. Quantities of goods imported and exported could be more readily measured, and Parliament traditionally did not interfere with the crown's right to collect such taxes. Beginning in the time of the Norman kings, centuries before the "mercantile" era, merchants willingly paid a toll to the king in exchange for protection from pirates and thieves<sup>19</sup>. Dowell explains the origin and early evolution of these duties:

The merchant . . . willingly paid, on entering the kingdom and on taking his merchandise out of it, toll to the king, for the necessary safeguard for himself and his merchandise . . . in port, on land, and on the seas. The toll was, in short, in the nature of a premium paid to the king for insurance. But in whatever manner these tolls may have commenced in England, they became subsequently definite in amount, acquired by continuance the validity allowed

---

<sup>19</sup> Nearly all merchants in England at this time were foreigners, and thus were probably offered little protection by English law prior to this arrangement.

to that which has long existed, as so came to be termed ‘consuetudines’ or customs. (1965, p. 75)

By this account, Parliament continued until mercantile times to grant the king the right to collect these duties primarily because they had existed since prior to the passage of the Magna Carta. The passage of Magna Carta in 1215 eliminated additional, arbitrary fees which the king’s collection officials attempted to exact beyond the traditional rates, but it “recognized and therefore confirmed the ancient and just customs,” (1965, p. 76).

Over the next 60 years, as overseas trade increased so did the need for insurance. The merchants offered to pay higher tolls in exchange for additional insurance, and the first Parliament of Edward I in 1275 established the first official rates for the “ancient customs” on specific goods<sup>20</sup>. In spite of the official rates, Edward would exercise his royal prerogative to include additional taxes on merchants without a grant from Parliament in order to finance ongoing military campaigns in Scotland and France. These additional taxes included a substantial in-kind tax on wine which the merchants found objectionable. In exchange for the reduction of the wine tax, merchants agreed to pay other additional duties, including a tax of three pence per pound value of all goods not explicitly listed in the ancient customs. This tax, established in 1302, came to be known as “poundage.” Dowell explains how the crown initially collected this duty in the following passage:

In collection of the poundage, credence was to be given to the merchants as to the value of merchandise imported, on the production of letters from their principals or partners – ‘by letters which they might show of the same goods of their lords or

---

<sup>20</sup> The term “ancient customs” was coined in 1297 when Parliament again recognized the duties as a regalian right (Dowell, 1965, p. 78).

companions;’ but should they not have any such letters, they were to be believed by their oath of the value. (1965, p. 80)

Opportunistic behavior on the part of the merchants was likely a large problem with this early system given the degree of trust inherent in the collection process.<sup>21</sup>

Parliament continued to grant the right to collect duties on imports and exports throughout the 14<sup>th</sup> century. In 1347, the merchants agreed to the imposition of six pence per pound value (double the original amount) for poundage, and in 1371 Parliament again took up the issue and granted the same amount ‘for the safe and sure conduct of the ships and merchandize coming inwards to this country by sea and passing outwards,’ (Dowell, 1965, p. 169). Richard II and Richard III were granted these subsidies for life, as were all of the Tudors and the Stuarts. During the reign of Henry VIII, however, the discovery of mines in the New World created a large, positive shock in the supply of precious metals. Rapid inflation followed, and those duties at the ports which were fixed by weight or volume rather than pound value diminished in real terms. Also, higher nominal prices created a greater incentive for merchants to lie about the value of cargoes on which poundage was required. In 1556, Queen Mary imposed additional imposts on certain items and later issued the official Book of Rates which listed specific values for various items, making duties more consistent than they had been under the old system of determining value according to the sworn statement of the merchant.<sup>22</sup> During the reign of Elizabeth, further measures were taken to prevent fraud by collection officials in the

---

<sup>21</sup> The crown eventually established an official book of rates so that the level of duties collected at the ports did not depend so heavily on the merchants’ assessments of their cargoes.

<sup>22</sup> Dowell (1965, p. 179)



custom department. I will cover malfeasance on the part of customs officials and the attempts by the crown to improve enforcement in detail in the next chapter.

## **VI. Chartered Companies and Regulation of Colonial Markets**

The structure of colonial and international trade in mercantile England mirrored that of domestic trade, only on a larger scale. As Beer notes, “England’s foreign commerce was to a great extent controlled by companies whose monopolistic privileges barred other subjects of the Crown from trading in a considerable portion of Europe,” (1908, p. 178). The companies that controlled international trade were essentially large cartels made up of smaller, local cartels that controlled trade in the towns of England and were enforced by the Statute of Artificers. Ekelund and Tollison characterize these trading companies as “an extension of monopoly power from the local to the national level,” (1981, p. 113). Rather than being formed and controlled by the crown, as was the case in other European nations at the time, the English companies were formed by private initiative. The crown granted monopoly rights in exchange for a share in the profits, and occasionally made investments in capital as well, such as the provision of ships and other supplies.<sup>23</sup> The crown regulated colonial commerce in much the same fashion. Companies designed to capitalize on profitable opportunities in America followed the design of the other trading companies: a collection of private investors whom the king granted a monopoly of trade in newly discovered lands in exchange for a share of the profits.

---

<sup>23</sup> Ekelund and Tollison (1981, p. 113 – 114)

The first attempt to establish an English trading company in America occurred in 1496, when Henry VII issued letters patent to John Cabot and his sons. While the company disbanded prior to engaging in any trade whatsoever between England and America, the structure of the arrangement between the company and the crown set a precedent for future charters. Beer describes the nature of the patent:

The patentees were granted a monopoly of the trade to such countries as might be discovered, and merchandise imported thence was exempted from the payment of customs duties. In return for these privileges, the King reserved to himself one-fifth of the profits of each voyage, and in order to secure this share, the vessels were obliged to return to the port of Bristol. (1908, p. 179)

The crown sought rents from the regulation of trade in other manners as well. Ekelund and Tollison note that the crown used the company as a source of low-interest loans<sup>24</sup> and Beer makes reference to arrangement with the Levant Company that required the company to import enough merchandise to increase the customs revenues by £500 per year in exchange for monopolization of trade.

When a firm (or collection of firms) acquires the right to monopolize an industry, the absence of a threat of competition can lead to inefficiencies in production. Without the threat of entry, the monopoly can cover cost increases resulting from inefficiencies in the production process by further increases in the price (to the extent allowed by market demand.) However, the method by which the crown created trade monopolies in England ensured efficient production. Rather than establishing state-controlled monopolies, the

---

<sup>24</sup> Ekelund and Tollison cite an example given by Heckscher of one such “loan”, “Elizabeth (1560 and also later) on Gresham’s advice, distrained on the outgoing fleets of the Merchant Adventurers and seized their cargoes of cloth, so as to force a loan from them which would cover the crown’s debts on the continent,” (1981, p. 114).

crown in England essentially franchised the monopoly to private initiatives. Heckscher explains the process of monopoly franchising:

The formal relationship between the companies and the state consisted in this, that the state paid for the advantages it received from the companies by issuing charters. But the actual profit derived from the company charters was twofold, and there was an important difference between the two.

One part of the benefit was made up of a monopoly, in the usual sense of the word – exclusive rights granted to the companies in their various fields of activity. The monopoly, of course, was employed by its owner to demand higher prices than he would otherwise be able to get, which meant, in effect, that the customers paid for the credit which the state secured through the companies. . . . It was indirect taxation of consumption by means of a monopoly, not in the hands of the state but wielded by private individuals. . . . The second aspect was of a totally different kind, consisting as it did in the right to corporative status. It might appear as though the state in this case granted a favor costing nothing at all, and as though the companies received something for which no one had to pay; but that is a mistake. Where the actual advantage lay was in the fact that the arrangement was not extended to everybody. The state could demand payment in return for its permission to form corporative associations, simply because it withheld the same privilege from all the other concerns which could have made use of it. . . . For this reason [the privileged enterprises] were prepared to pay the Crown for these advantages by allowing it favorable terms for loans. (1934, 1: p. 441 – 442)

Essentially, the various groups of merchants bought monopoly privileges from the state by making these loans at favorable terms. The collection of merchants that could operate the most efficiently could make the crown the best offer, and the threat of the crown receiving a more favorable offer from another group insured that the group granted the charter would continue to operate efficiently after winning the bidding process. Ekelund and Tollison note “this system of ‘competition for the field’ thus maximized the franchise fees received by the state and enhanced the efficiency of the English trading companies,” (1981, p. 132).

In each of the arrangements between the crown and private initiatives, the right to monopolize trade was granted to a collection of merchants rather than a single individual. The trading companies in mercantile England took measures to restrict and monitor the behavior of cartel members to prevent a breakdown. Trading companies generally ordered all ships to return to England although, as Beer notes, “this was not explicitly stated in the charters,” (1908, p. 181). Beer attributes this condition of the cartel agreement to an understanding that the purpose of the trading company was to supply England with foreign imports at prices more favorable than would be received from foreign merchants, suggesting that the purpose of trading companies was the unification of the nation-state – a common theme of the historians’ interpretation of mercantilism. If the crown intended to obtain foreign goods at lower prices, then it would have encouraged entry into foreign trade markets by as many merchants as possible rather than restricting entry to a select group. Competition in foreign trade markets would have ruined the crown’s ability to collect duties at the ports and significantly reduced revenue, which was certainly not in the crown’s interest. Beer is correct in his assertion that the

crown desired to transfer control of foreign trade from foreigners to domestic merchants, however, by establishing cartels to control foreign trade the crown could earn additional revenue in the form of franchise fees without risking a decrease in revenue at the ports. The trading companies ordered ships to return to England in order to monitor the behavior of cartel members, rather than to increase supply and establish lower prices<sup>25</sup>. The return of the merchant ships to England was also in the interest of the crown, for no duties could be collected on goods shipped to foreign ports. Later charters contained explicit instructions for all ships engaged in foreign trade to return directly to England.

Chartered companies used various other methods to ensure members honored the cartel agreement. One was the placement of representative agents in the major markets where the trade of the cartel occurred. Thus, cartel enforcement followed the course of trade, and the costs of violating the cartel agreement increased for all members. Chartered companies also tended to conduct trade exclusively through the port of London, and forbade merchants with ties to retail trade to become members of the cartel. The use of London as a single port lowered the cost of monitoring the activities of cartel members, and the exclusion of merchant/retailers made it more difficult for members to engage in illicit exchanges.<sup>26</sup>

In spite of the efforts of the company members to prevent fraud, prevention was not always successful. If representative agents stationed in foreign markets were not paid a wage equal to the marginal value of their efforts, then one should expect the same malfeasance that occurred in England with respect to the unpaid justices of the peace.

---

<sup>25</sup> Beer later recognizes the desire to enforce the cartel agreement as a secondary reason for requiring ships to return to England: "Apart from the policy of the government, the trading companies were wont to instruct their ships to return to England in order to prevent speculation and fraud," (1908, p. 183).

<sup>26</sup> Ekelund and Tollison (1981, p. 115 – 119)

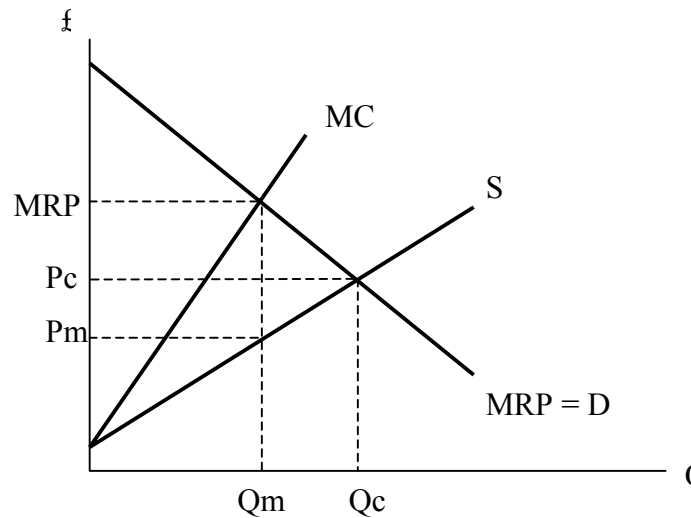
Scott provides evidence that in at least one of the trading companies “factors were badly paid and that some of them embezzled the company’s funds, others engaged in private trade, and a few even intrigued with the Dutch and interloping English merchants against the body that employed them,” (1951, 2: p. 42).

In 1606, James I issued a charter to a collection of merchant adventurers that allowed the settlement of, and monopolization of the trade within, what would become Virginia. Less than 20 years after the original charter the Company was dissolved due to a lack of cartel enforcement and opportunistic behavior on the part of market participants. The representative agent in the Virginia Company was the governor, and I will show that the manner in which the governor received compensation created incentives to act in a fashion that clashed with the goals of both the company and the crown. The exclusive use of London as a central port created unforeseen enforcement problems as well. Restricting trade to London was intended to reduce the cost of cartel enforcement; however the lost revenue at other ports gave officials in those areas an incentive to encourage merchants to use their ports illegally by offering discounted duties. The removal of company agents from these ports in an effort to cut costs only facilitated malfeasance on the part of port officials and self-interested merchants. In addition, while the chartered companies were granted monopolies on the sale of goods from their colony, there was no legislation requiring the companies to produce different products. Thus, when the Virginia Company and the Bermuda Company both began exporting tobacco in 1616, competition between the colonies reduced the companies’ abilities to earn economic profits.

Although the duties at the ports were direct taxes collected from the merchants, the method of collection created a similar situation to the granting of monopoly or cartel rights in other industries. The crown collected the duties on imports through a method known as “farming.” Farming is the practice of granting syndicates of wealthy business people the sole right to import goods and collect the duties from merchants at various ports in exchange for an annual rental. The farmers of the customs agreed in advance to the fixed rental to be paid to the Exchequer. Once the farmers paid the rent, they could pocket any additional customs duties collected. The advantage of the farming method for over the collection of customs revenues by royal officers was that the advance payments from the farmers established a fixed level of income that would not be affected by fluctuations in the price or the size of the crop. In addition, by granting the farmer a monopoly on the importation of the good, the farmer could theoretically maximize the available rents by buying imports from the competing merchants at a price near the cost of production plus transportation and charging the competing retailers monopoly wholesale prices. The discussion of the effect of monopoly on prices and quantities was discussed above; however, it is necessary to analyze the effect of monopsony, or a single buyer, on a market.

If a market is controlled by a single buyer, that buyer will face the entire, upward-sloping market supply curve. In other words, if the importer of tobacco, for instance, wants merchants to offer a larger quantity of tobacco for sale, then he must offer a higher price for tobacco to the merchants from the competing companies bringing their tobacco to port. The supply of a good in a monopsony market structure is represented in Figure

2-4. Due to the upward-sloping supply curve faced by the monopsonist, every increase in the quantity of the good purchased requires an increase in the amount paid for every unit of the good imported. Thus, the marginal cost associated with purchasing another unit includes the price paid for the shipment of the additional merchant, as well as the increase in the amount paid for the shipments of all the other merchants. As a result, the marginal



**Figure 2-4.** Equilibrium Price and Quantity in a Monopsony Market Structure

cost of importing additional units rises faster than the supply, which determines the amount paid by the monopsonist. A profit-maximizing monopsonist will buy imports up to the point where the marginal cost is exactly equal to the amount of revenue earned from importing an additional shipment. The value of the revenue earned, or marginal revenue product, can be calculated using the following formula:

$$(2) \text{MRP} = \text{MP} * \text{MR}$$

where MP is the number of additional units purchased from the additional shipment and MR is the additional revenue from selling one of those units. Thus the profit-maximizing



monopsonist will import  $Q_m$  units and offer merchants a price of  $P_m$ . Both of these values are lower than the competitive market equilibrium values of  $Q_c$  and  $P_c$ .

In theory, the monopoly power (in the retail market) and monopsony power (at the ports) of the importer maximize the rents available for capture by the importer and the crown. However, there were factors present in the markets for colonial goods which reduced the market power of the importer. Until 1620, the Virginia and Bermuda Companies were entitled to send their tobacco exports directly to Europe, and the European demand for English colonial tobacco put upward pressure on the price paid by the importer. Even after 1620, the colonists continued to illegally ship large quantities of tobacco directly to Europe. The crown would not correct the flaws in the system of enforcement that allowed such evasion until nearly 1640. In addition, retailers of tobacco in England had access to additional sources of supply, from smuggled colonial tobacco to tobacco grown domestically in England. This competition put downward pressure on retail prices, and further dissipated the rents available for capture in colonial markets. The government's response to opportunistic behavior on the part of participants in colonial markets throughout the seventeenth century will be analyzed in detail in this dissertation.

## **VII. Conclusion**

Ekelund and Tollison (1981, 1997) present evidence that although revenue-maximization was the primary objective of economic regulation in seventeenth century England, the English system of government and methods of enforcement did not create an environment where contrived rents could be captured by the sovereign. Their work

demonstrated that regulation of markets in England ultimately failed because of competition between Parliament and the Crown over right to grant monopolies (as well as competition between the courts associated with each branch of government over rent-collection jurisdictions) and also because of flaws in the enforcement methods. Such inefficiencies of the British system of trade restriction initially allowed for opportunistic behavior by agents in the related industries to capture contrived monopoly rents sought by the monarch, and competition among rent-seekers eventually led to the evaporation of rents altogether, as the system ultimately gave way to one of free trade.

Indirect taxation ultimately failed on all levels (domestic, colonial, and international) in England throughout the seventeenth century. My dissertation will extend the work of Ekelund and Tollison through an analysis of the evolution of the regulation of colonial and international trade over this period. I will show that initially improvements in the system of regulation resulted in increased competition between Parliament and the crown for the right to supply such regulation, which contributed to the outbreak of Civil War in 1641. Upon the restoration of the monarchy in 1660, the system of regulation was restored and developed over the remainder of the century. As the system improved and strengthened the constraints on the behavior of the colonists, the colonists eventually revolted and sparked the Revolutionary War.

**CHAPTER 3:**  
**THE COLONIZATION OF VIRGINIA AND EARLY REGULATION OF THE**  
**COLONIAL TOBACCO TRADE AS A FORM OF RENT-SEEKING**

**I. Introduction**

The purpose of this chapter is to provide an in-depth analysis of the English government's regulation of the market for colonial tobacco during the first half of the seventeenth century. I will apply the rent-seeking model to the colonial tobacco market and reveal that the regulations passed by the government were not consistent with the commonly accepted principles of mercantilism. The regulations were, rather, the design of a self-interested ruler with a desire to increase revenue through regulation and indirect taxation. I will also provide an explanation for the crown's inability to capture a significant share of available rents for much of the first half of the seventeenth century. Finally, I will provide evidence that the king's rent-seeking efforts found more success just prior to the Civil War on account of an extension of the regulations on the market to the retail level.

The widespread popularity of tobacco in England throughout the 17<sup>th</sup> century provided the crown with an opportunity to earn revenue through both direct and indirect taxation. During the early period of tobacco consumption in England, all tobacco consumed was imported from the Spanish colonies. Parliament granted the Stuart kings

the right to collect customs duties on all imports, and beginning with James I, the Stuarts attempted to create monopolies in the tobacco industry to keep prices artificially high. If successful, this system of regulation would result revenue maximization both at the ports and through and the capture contrived rents. However, inadequate enforcement of regulatory policy and opportunistic behavior on the part of economic agents in the tobacco market kept the rents available for capture and the crown's share of available rents lower than their optimal levels (from the perspective of the monarch.) Unlicensed importation and sales of tobacco continued to limit the crown's revenues until Charles I developed a relatively effective system of enforcement in 1637. Four years after Charles improved the system of regulation of the tobacco market, Parliament revoked the king's right to supply this regulation and England found itself in Civil War.

## **II. Traditional Explanation of Colonial Regulation**

The colonial period of American history was an era characterized by rapid economic growth and development. Economic historians have attempted for decades to provide an explanation for the economic success enjoyed by the colonists. With respect to the government's colonial policies, historians generally accept that, at least during the seventeenth century, they were designed with the good of the entire empire in mind and aided the colonists in their rapid economic development. The traditional view of mercantile colonial policy states that colonies were to be used as a source of raw materials and of finished goods on which England was previously dependent upon foreign nations for production. As historian George Louis Beer states in *The Origins of the British Colonial System 1578 – 1660*, “emphasis was laid on colonization as a means

of quickening English commerce and freeing England from what, according to the prevailing economic theories, was a dangerous dependence on rival nations,” (1908, p. 53). More recently, economic historians John McCusker and Russell Menard have confirmed Beer’s take on how colonization fits the purpose of mercantilism:

As consumers of the goods produced in the metropolis, successful colonists would stimulate British domestic manufacturing and increase that nation’s exports, thereby earning it credits in the balance of payments. As producers of goods the colonists would supply the metropolis with commodities that previously had to be purchased abroad, thus diminishing debits Great Britain owed to competitors. (1985, p. 38)

Historians accept that colonial policies, including the act of colonization itself, were designed to help create a strong, self-sufficient empire which could provide all necessities for itself during wartime. Only after the colonists established a strong presence in international markets, according to the traditional view, did the English government attempt to exploit the colonies by changing from a set of colonial policies designed to foster growth to those which allowed for the capture of significant revenues. The link between the exploitative economic policies of the eighteenth century and the American Revolution has been discussed and analyzed at length by historians.<sup>27</sup>

The course of history seems to support the traditional view of the development of the English colonies in America. The fact that the colonies were exceptionally prosperous and that the government earned little revenue from the colonies initially could certainly lead one to conclude that the king did not desire to exploit the colonies for his

---

<sup>27</sup> For a full discussion, see Dickerson (1951), Sawers (1992), and Schlesinger (1966).

own benefit during the seventeenth century. The development of the colonies over the course of the century seems consistent with what one should expect to find when policies are designed with the purported mercantile objective of establishing a strong nation-state, free from dependence on other nations. Upon closer inspection, however, the presence of tobacco as the primary colonial export over the entire period seems to conflict with the mercantilist objectives.

For the period between the introduction of tobacco to the English market and the first shipment of tobacco from Virginia, English consumers depended on Spain for their supply. As tobacco grew in popularity in England, English farmers began to plant tobacco on English soil in large quantities, even prior to the reception of the first colonial exports of the good. The traditional view of mercantile colonial policy fails to adequately explain why the English government would allow colonial production of a good which could be produced domestically in large enough quantities to satisfy demand. If one argues that the government designed the policies toward the market for colonial tobacco to help foster growth to strengthen the colonies as a whole, then an explanation is necessary for the heavy duties placed on the importation of colonial tobacco very early after its introduction. It is my position that the objective of the colonial policies of the English government was consistent from the beginning through the Revolution: to regulate colonial markets in a way that maximized revenue to the crown through direct and indirect taxation. The evolution of England's colonial policies over the seventeenth century suggests that there was not an abrupt change in policy from fostering to exploitative. Rather, the policies were designed with revenue-maximization as the

primary objective from the very granting of the charters to the colonizing companies.<sup>28</sup> The fact that customs revenues from colonial imports were initially quite low is the result of the failure of the early regulations to achieve their purpose. Flaws in the enforcement of regulations and opportunistic behavior on the part of agents in colonial markets with a desire to capture available market rents for themselves created a need for constant revision of colonial policy. As the system improved, the crown managed to capture a larger share of the available rents.

### **III. Colonization as Rent-Seeking: Charter of the Virginia Company**

#### MOTIVATION FOR COLONIZATION

The work of colonizing North America was primarily carried out by groups of private individuals with the permission of the king. The permission was granted through letters patent, or charters, which explicitly stated the rights and requirements of the colonizing companies. The companies sought to colonize the New World primarily for the opportunity to make a profit. They sought a charter from the king for a number of reasons, which have been summarized by Beer:

Those interested in [colonization] sought a charter for various reasons. It was the only method by which they could obtain a legal title to the soil as well as the authority to govern the settlers thereon. In addition, there were in existence a number of English laws, such as those prohibiting Englishmen

---

<sup>28</sup> One notable exception would be the policy of excluding the Virginia Company from the payment of all customs duties for the first seven years after the granting of the charter. However, one can argue (and I later will) that the intention to collect duties on shipments from the colonies after that time is a clear indication that the king intended his colonial policy to increase revenue rather than increase the common good. Thus, the seven-year exemption can be viewed as a means of ensuring that the colonists would eventually produce greater volumes of taxable exports, maximizing revenue to the crown in the long run.

from leaving the country, and others forbidding the exportation of a number of commodities, which made it impossible to colonize America. Immunity from these laws was desired, and also special privileges in other respects. As a rule the charters for a specified time exempted trade of the proposed colonies from the payment of the English customs duties; and furthermore, in a number of instances, the patentees were allowed to exclude all others, whether Englishmen or aliens, from commercial intercourse with the new settlement. Finally, the consent of the government was necessary because it was assumed that the proposed colonies were to be under English jurisdiction. (1908, p. 16 – 17)

Essentially, the colonizing companies wanted to enter the agreement with the king stated in the charter for three reasons: to make the existence of the colony possible, economic advantages, and the protection provided by the English military.

Beer also states the king's motivation for entering into agreements with colonizing companies under no uncertain terms. He is so certain that the English crown's incentive to colonize America followed the commonly accepted tenants of mercantile policy that he clearly states his view three times in the first seven pages of his *Economic Theory of Colonization*.<sup>29</sup> In the first paragraph he states, "emphasis was laid on colonization as a means of . . . freeing England from what, according to the prevailing economic theories, was a dangerous dependence on rival nations," (1908, p. 53). He later states that the "desire to free England from the necessity of purchasing from foreigners

---

<sup>29</sup> Beer's *Economic Theory of Colonization* is the third chapter of his 1908 book entitled *The Origins of the British Colonial System 1578 – 1660*. The pages listed, though numbered in the fifties, are within the first seven pages of the chapter.



formed the underlying basis of English commercial and colonial expansion,” (1908, p. 57). Finally, two paragraphs later, he states his theory for a third time, “Thus the chief economic benefit that England expected to derive from colonial expansion was freedom from dependence on other European rivals,” (1908, p. 59 – 60). Beer’s assessment of the situation is very similar to that of other historians and contains a great deal of truth. The period of colonization was certainly an era of friction between frequently warring empires. War with a rival on whom England was dependent for vital commodities could cripple the welfare of her citizens, and at the time England was dependent on a number of foreign imports.

According to Beer, England’s foreign trade during the mercantile period consisted of four major divisions, which he describes as follows:

In the first place, there was the Baltic trade with Sweden, Russia, Poland, and Germany, whence came the naval stores necessary for her shipping and the potash used in England’s basic industry, the woolen manufacture. . . . A second important branch of the English import trade was that with Southern Europe, whence came in large quantities, wine, silk, salt, sugar, and dried fruits. . . . [The third branch was] that to the Far East which supplied England with dyes, saltpeter, and spices. . . These Eastern products had been controlled by Portugal and subsequently by the Dutch, who sold them to England at enhanced prices. Finally, although the English fishery was not an insignificant industry, a considerable proportion of the fish consumed was caught by foreigners and bought from them. (1908, p. 56)

Historians such as Beer generally agree that the king extended the Virginia Company (and other colonizing companies) its charter based on the prediction that the colonization of America would create a domestic supply of many of these goods, thereby freeing England from her dependence on foreigners. In fact, when making their case for a charter before the king, members of the Virginia Company emphasized that the natural resources of Virginia made it an ideal replacement source of supply for many of the goods from the Baltic and Southern European regions, such as shipbuilding supplies, copper, iron, steel, furs, wines, oranges, sugar and rice.<sup>30</sup> Freedom from dependence on foreigners was certainly a matter of importance to the early Stuart kings when they issued the charters of the colonizing companies. However, a close examination of the contents of the charter of the Virginia Company suggests that an increase in treasury revenues was of even greater importance.

#### CHARTERS OF THE VIRGINIA COMPANY

The first charter of Virginia, issued on April 10, 1606, attempted to establish a royal province ruled by a council. The Council of Virginia, composed of thirteen men, was to be nominated by the king and was assigned the duty of enforcement of British law within the colonies in accordance with the king's instructions.<sup>31</sup> The Council of Virginia resided in London and had authority over the colonial councils in matters concerning the governing of the colony.<sup>32</sup>

---

<sup>30</sup> Beer (1908, p. 67 – 68)

<sup>31</sup> Andrews (1934, p. 107)

<sup>32</sup> Beer (1908, p. 297 – 298)

The charter granted the members of the Virginia Company the exclusive right to production and control of all trade involving the province. The colony was granted exclusive use of all lands and natural resources within 50 miles of the first settlement to the north or south along the coast, and settlement of any lands inland of the territory granted each colony was forbidden without license from the council of the colony. The following passage from the charter pertains specifically to the regulation of colonial trade:

[The king grants the company the] power and authority to take and surprise by all ways and means whatsoever all and every person with their ship, vessel, goods and other furniture, which shall be found trafficking into any harbor, creek or place within the limits or precincts of [Virginia] not being of the same colony, until such time as they, being of any realms or dominions under our obedience, shall pay or agree to pay to the hands of the Treasurer of the colony two and a half upon any hundred of anything so by them being trafficked, bought or sold; and being strangers and not subjects under our obedience, shall pay five upon any hundred . . . which for and during the space of one and twenty years . . . shall be wholly employed to the use and benefit of [Virginia] and after the said one and twenty years ended the same shall be taken to the use of [the king.] (1606, articles xi – xiii)

Nothing in the charter suggests that colonists in Virginia should use their resources to produce goods which would free England from dependence on foreign producers. It simply stated that exchanges taking place within the colony would be regulated and

subjected to direct taxation, regardless of the type of products being produced and traded.<sup>33</sup>

The attempt to establish Virginia as a royal province<sup>34</sup> failed within the first two years of its existence for a variety of reasons. The initial experiment was designed to exploit Virginia's resources rather than establish new markets. The colonists did not have the skill or the mindset to sustain themselves without shipments of supplies from England. However, the biggest problem facing the colony as a royal province was the difficulty with coordinating activities in America with instructions from London. The inefficiencies associated with attempts by the Council of Virginia at remote control from across the Atlantic foreshadowed the problems that would continue to plague the Virginia Company, the customs officials, and the king for the remainder of the century.

In 1609, the king issued the Virginia Company a new charter. The new charter abolished the royal council and changed the structure of the company from a royal endeavor to a joint-stock corporation consisting of fifty-six companies of London and 659 individuals.<sup>35</sup> The new charter granted the powers of government to the governor of the colony and a colonial council. The company intended for the governor of Virginia to be the company's agent in the colonies. The governor of the colony was responsible for

---

<sup>33</sup> The only goods that the charter specifically encouraged the company to produce were gold, silver, and copper. The charter established that one-fifth of all gold and silver, and one-fifteenth of all copper must be paid to the crown in exchange for the exclusive rights of production within the colonies. The stockpiling of precious metals is frequently cited by historians as a major tenet of mercantilism, and it appears that such stockpiling was among the primary objectives of colonization. However, the requirement that a significant share of all precious metals discovered go directly to the treasury supports my contention that the king placed the maximization of revenues above all other objectives.

<sup>34</sup> A royal province was a colony where all administrative activities were conducted by the English government rather than by groups of private individuals. In a royal province, the crown had the authority to directly tax every transaction that occurred within the borders of the colony. The restructuring of the Virginia Company as a privately-owned, joint-stock corporation reduced the king's authority to practice direct taxation and increased productivity incentives.

<sup>35</sup> Andrews (1934, p. 103)

enforcement of trade laws and collection of duties. The governor's compensation, however, depended on the revenue of the treasury of the colony.<sup>36</sup> This eventually created a conflict of interest between the company and the agent. Once the colony began producing and exporting goods, the Virginia Company intended to limit production and maintain high prices, whereas the governor frequently complained about a low volume of exchanges. To increase the volume of exchanges and improve his personal welfare, the governor needed only to refrain from enforcing the restrictions on colonial trade, thus violators frequently went unpunished.<sup>37</sup> This conflict will be examined in much greater detail later in the chapter.

The new charter of the Virginia Company also eliminated the requirement that the company collect a percentage of all exchanges for the royal treasury, thus the king's motive for granting the charter still needs to be established. The new charter maintained that the crown receive a significant share of all precious metals discovered in the colony.<sup>38</sup> Certainly the crown predicted (erroneously) that this provision of the charter would provide a great boost to revenue. The charter once again failed to specify the types of goods which the colonists in Virginia should endeavor to produce, thus, it is difficult to establish that the king intended the Virginia Company to free England from a dependence on foreign producers. On this point, however, I am in agreement with the historians that the king intended the colonies to supply England with goods currently imported from foreign countries. I base this conclusion on two pieces of evidence. The first is a curious feature of charter. In spite of the declaration contained within the charter

---

<sup>36</sup> Beer (1908, p. 320)

<sup>37</sup> Schlesinger (1966, p. 46)

<sup>38</sup> Second Charter of Virginia (1609, article v)

that the colonists are entitled to the same rights and privileges as residents of England,<sup>39</sup> the colonists were required after a period of seven years to pay customs duties on all goods imported into or exported out of England.<sup>40</sup> The second item supporting my conclusion is the structure of domestic markets in England at the time. Production in English markets was restricted to small organizations of producers known as ‘guilds.’ The guilds paid the government a fee in exchange for protection from competition from unlicensed producers. Through the regulation of production and the collection of fees, the crown could earn more revenues from capturing rents which would not be available in a competitive market structure.<sup>41</sup> Through the collection of import and export duties on commodities shipped to and from the colonies, the king hoped to establish a new source of revenue. However, if the colonies exported goods which were presently supplied by domestic producers, the competition would drive down prices and reduce revenue by decreasing the rents available for capture in the regulated domestic markets. Therefore, it was in the interest of the king for the colonies to specialize in the production of goods which were otherwise supplied by foreigners.

An additional benefit of having the colonies produce goods which could be substituted for foreign imports is the potential for the crown to regulate all levels of trade, allowing the producers even more control over prices and creating additional rents for the king to capture. I conclude that the king did, as the historians suggest, intend for the colonies to produce substitutes for foreign imports, not only in the interest of establishing a self-sufficient empire, but primarily for the potential increase in the customs revenue.

---

<sup>39</sup> *Ibid*, article xxi

<sup>40</sup> *Ibid*, article xvii

<sup>41</sup> For a complete discussion of the guild system, see the previous chapter or Ekelund and Tollison’s *Mercantilism as a Rent-Seeking Society* (1981).

My conclusion is supported by the evolution of the regulation of market for tobacco, Virginia's primary export. As the following sections of the chapter will illustrate, although a dependence on foreign tobacco would not endanger the welfare of English society and King James I personally despised England's consumption of tobacco, his desire to maximize revenues trumped any mercantile objectives he hoped to achieve. James allowed Virginia to produce tobacco because it created the greatest opportunity for increasing the customs revenue. He would even attempt to eliminate the production of tobacco in England to protect the customs revenue he earned from Virginia.

#### **IV. Regulation of the Tobacco Industry: Overview**

Adventurers such as Hawkins, Drake, and Raleigh first introduced England to tobacco during the middle of the 16<sup>th</sup> century upon their return from various voyages to the New World. At this time, tobacco could only be obtained from colonies in the New World under Spanish rule, and the Spanish crown tightly controlled production. Early in its history in England, tobacco usage was not only considered fashionable among the upper-class, but tobacco was also hailed as a panacea and the apothecaries sold it alongside their other medicines and remedies.<sup>42</sup> As news of the alleged medicinal value of tobacco spread, its usage also spread rapidly. The mercurial rise in demand combined with Spain's strict control of supply caused the price of tobacco to soar in the late 16<sup>th</sup> century, reaching a peak of £4 10s per pound in 1598.<sup>43</sup> Since the highest estimate of the

---

<sup>42</sup> Gately (2001)

<sup>43</sup> MacInnes (1926, p. 35)

cost of producing tobacco in the New World ever is only 27 pence,<sup>44</sup> there was great potential for rent-seeking in the early tobacco market.

While Elizabeth never exploited the opportunity to capture rents in the tobacco market, James I wasted little time, imposing substantial new duties at the ports on imported tobacco in 1604. By this time, however, opportunistic behavior on the part of English citizens was already resulting in the redistribution of the available rents. The high retail price of tobacco attracted additional retailers at such a rate that by 1614 there were 7000 taverns, alehouses, and tobacco specialty shops selling tobacco in London alone.<sup>45</sup> The opportunity to turn a profit also attracted English farmers to the market. MacInnes finds evidence that English farmers began growing domestic tobacco as early as 1571 (1926, p. 75). Domestic tobacco production would continue to hinder the crown's ability to capture rents in the tobacco market for the entirety of the seventeenth century. When James I increased the duties on tobacco in 1604, not only did the new legislation stimulate domestic production, but it also greatly increased the incentive to smuggle the Spanish tobacco into England without paying the customs. Gately states that after James enacted the new duties on tobacco "the weed flooded into England over every unguarded inch of coastline," (2001, p. 79). Gray estimates that the quantity of tobacco smuggled into England equaled the total imported legally from 1615 until 1622 (1927, p. 231). During this period, available rents in the tobacco market, while often redistributed, were never eliminated altogether for two reasons. First, upon the passage of the new duties, James I restricted the importation of tobacco to a single individual. The importer of tobacco could keep farm prices suppressed and retail prices inflated as long as

---

<sup>44</sup> In the seventeenth century, there were twenty shillings to a pound sterling and twelve pence to a shilling.

<sup>45</sup> Andrews (1938, p. 13)



competition from smugglers and domestic producers did not become too strong. In addition, the demand for tobacco in England continued to rise at incredible rates, thus decreases in retail prices caused by increases in supply were offset to a degree as the number of consumers in the market increased. Thus, as can be observed in Table 1, total rents available in the tobacco market actually followed an upward trend throughout the first half of the century.<sup>46</sup>

**Table 1:** Estimated Rents

Year	Imports	Retail Price	Cost	Total Rent	Crown's Share
1602	16,128	£1 7s	2s 3d	£19,958	£134 (0.7%)
1621	125,000	5s	1s 8d	£20,833	£8,000 (38.4%)
1624	404,000	2s 10d	1s	£37,034	£6,390 (17%)
1631	1,500,000	11d	6d	£31,250	£6,792 (22%)
1640	1,593,000	11d	2.5d	£56,419	£20,902 (37%)

When the colonies began exporting tobacco to England in 1616, James capitalized on an opportunity to free England from its dependence on Spanish tobacco, as well as an opportunity to regain the customs revenue lost to increases in the domestic production of tobacco. By 1620 the colonies began exporting tobacco in quantities great enough to satisfy England's consumption.<sup>47</sup> In that year, the Virginia and Bermuda Companies agreed to ship all of their tobacco exports directly to England where, upon importation, it would be charged a duty of one shilling – twice the amount stated in the companies' charters. In exchange, James I agreed to prohibit the production of tobacco in England,<sup>48</sup> however, the king failed to uphold his end of the bargain.<sup>49</sup> Tobacco production increased rapidly in the colonies and the metropolis, and retail tobacco prices began to

<sup>46</sup> See Appendix for the sources of the data contained in Table 1. Values for total rent are calculated by the author.

<sup>47</sup> In 1620 the colonies shipped 110,000 pounds of tobacco to England (Beer, 1908).

<sup>48</sup> Beer (1908, p. 119).

<sup>49</sup> MacInnes (1926, p. 79).

fall sharply in spite of ever-increasing demand.<sup>50</sup> Thus, while the king managed to secure a relatively large portion of the available rents in 1621, opportunistic behavior by smugglers and domestic producers cut the king's percentage of rents in half by 1624.<sup>51</sup>

Opportunistic behavior was not limited to smugglers and domestic producers during this time. Farm prices were falling due to the fact that the king appointed the sole importer of tobacco, and that individual had the ability and incentive to keep farm prices low. Thus, colonial tobacco producers had an incentive to find other buyers for their product. The colonists willing evaded the law by selling tobacco directly to smugglers and European merchants, from whom the colonists obtained higher prices for tobacco.<sup>52</sup> In addition, legal battles occurred over the right to the importation monopoly between the customs officials and the Virginia Company.<sup>53</sup> The Virginia Company obtained a short lived victory which ended in 1624 with the dissolution of the Virginia Company and the king himself taking over the importation of tobacco.

Charles I continued the royal monopoly of tobacco importation throughout the remainder of the decade, but could do little to increase the customs revenue. In spite of repeated proclamations restricting shipments of colonial tobacco to England and prohibiting the planting of tobacco in England, opportunistic behavior continued due to a poor system of enforcement.<sup>54</sup> At this time, colonial trade was not monitored by anyone but the governor of the colony. The governor had an incentive to protect the self-interest

---

<sup>50</sup> Beer (1908, p. 120).

<sup>51</sup> See Table 1 above.

<sup>52</sup> Kepler (1999, p. 119).

<sup>53</sup> Beer (1908, p. 123 – 134).

<sup>54</sup> Those primarily responsible for enforcing the ban on domestic tobacco production were the justices of the peace, who were not compensated for their services. The effect of this lack of compensation is covered in detail later in this chapter. (See p. 69 – 71)

of the colonies, and frequently ignored violation of the regulations on the market.<sup>55</sup> In England, those responsible for the enforcement of the prohibition of domestic tobacco farming were the unpaid justices of the peace, who not only disregarded their duties, but frequently maintained a personal stake in the industry.<sup>56</sup>

**Table 2: Market Structure**

Era	Producers	Importers	Retailers
Pre-1604	Spain	Competing Merchants	Apothecaries
1604 – 1615	Spain	Farmer of the Customs	Competitive
1616 – 1621	Spain/Colonies <sup>57</sup>	Farmer of the Customs	Competitive
1622 – 1623	Colonies	Colonies	Competitive
1624	Colonies	Customs Officials	Competitive
1625 – 1636	Colonies	Crown Agents	Competitive
1637 – Civil War	Colonies	Farmer of Customs (Goring)	Licensed

By the 1630's the regulation of the tobacco industry was such a failure that only the ever-increasing demand and falling costs of production prevented the complete elimination of rents from competition at all levels: the colonies' attempts at crop controls failed due to competition between individual farmers and between colonies;<sup>58</sup> smugglers and foreign merchants continued to compete with the crown's agents for colonial tobacco;<sup>59</sup> competition at the retail level was very strong, and many retailers were continuing to sell smuggled and homegrown tobacco;<sup>60</sup> there was even competition between ports over the right to service the merchant ships carrying tobacco.<sup>61</sup> Towards the end of the decade, Charles I passed a series of improvements in the system of

<sup>55</sup> Beer (1908, p. 231 – 235)

<sup>56</sup> MacInnes (1926, p. 79 – 87)

<sup>57</sup> Bermuda and Virginia, English colonies under the control of separate chartered companies, both began importing significant quantities of tobacco at this time.

<sup>58</sup> Limits on the number of plants resulted in efforts by farmers to increase per-plant leaf yields. Restrictions on output in Virginia were offset by increases in Bermuda and Maryland. See Pecquet (2003, p. 477)

<sup>59</sup> Beer (1908, p. 146)

<sup>60</sup> MacInnes (1926, p. 86 – 91)

<sup>61</sup> *Ibid*, (p. 54)

enforcement which held the colonists and the retailers responsible for their actions. By 1640, Charles had restored the crown's share of available rents to the percentage captured in 1621.<sup>62</sup> It should be noted that the additional regulations placed on the tobacco industry were not designed to achieve any goal which could be considered "mercantilist." Restrictions on colonial exports and retail sales did not free England from a dependence on foreign imports, nor did they strengthen the empire as a whole. The only beneficiaries of the new policies were the king and his customs collectors. It cannot be argued, therefore, that Charles was motivated by any factor apart from his own self-interest – the behavior determining trait that governs *all* economic decisions.

The reforms of Charles I, however, were so successful at achieving their intended purpose that they encouraged an additional group of opportunists to enter the market: Parliament. The following year Parliament fought for and acquired the right to collect import and export duties for themselves. The remainder of the chapter will explore in greater detail how the evolution of policy concerning the regulation of the tobacco market affected the rents captured by the crown and other economic agents over the first half of the seventeenth century.

## **V. Pre-Colonial Regulation of Tobacco**

### REGULATION AND OPPORTUNISTIC BEHAVIOR UNDER ELIZABETH I

According to MacInnes, tobacco reached the first English consumers by at least 1565 (1926, p. 27). The first statute of Elizabeth's reign, passed in 1558, granted the queen the right to collect a tax (known as the customs or subsidy) on all imported

---

<sup>62</sup> See Table 1 above.

goods.<sup>63</sup> The customs duty amounted to five percent of the value of the imported commodities. The values were determined by the Book of Rates, which had been carried over from the reigns of the previous Tudor monarchs.<sup>64</sup> Tobacco, however, did not appear in the Book of Rates until the 1590s, and official data on tobacco imports was not collected until 1602, at which time tobacco was valued at three shilling and four pence per pound.<sup>65</sup> Even if Elizabeth collected the entire two pence customs duty for herself without paying the collectors at the ports, her share of the rents available for capture would amount to less than one percent of the total available.<sup>66</sup> Most of the available rents at that time were likely captured by the Spanish producers, whose production was tightly controlled by the Spanish government, and the retailers in England, a small, organized collection of apothecaries who sold tobacco as a medicine.

Although Elizabeth never capitalized on the rent-seeking opportunities available in the English tobacco industry, other economic agents seized their chance. MacInnes reports that Lobelius, who would later become the royal botanist for James I, claimed that “attempts were being made to plant tobacco in England in 1571,” (1926, p. 28). He later acknowledges that “during the reign of Elizabeth the amount of tobacco grown in England remained inconsiderable,” but the supply of homegrown tobacco would continue to grow in England throughout the seventeenth century as consumers sought a low-price substitute for the imported variety (1926, p. 77). The beginning of the 17<sup>th</sup> century also witnessed the emergence of competition at the retail level.<sup>67</sup> Taverns and alehouses

---

<sup>63</sup> MacInnes (1926, p. 33)

<sup>64</sup> Dietz (1930, p. 37)

<sup>65</sup> MacInnes (1926, p. 33 – 35 and 51)

<sup>66</sup> See Table 1 above.

<sup>67</sup> For a more detailed discussion of the emergence of tobacco retailers in England, see Gately (2001).

began selling tobacco alongside their alcohol, and other opportunistic entrepreneurs established brand new shops specializing in the sale of tobacco and smoking paraphernalia. Because Elizabeth failed to regulate competition from these new entrants initially, her successor would find attempts at regulation all the more difficult.

## THE IMPOST OF JAMES I

Upon the ascension of James I to the English throne, he took immediate steps to establish control of the tobacco market and increase his revenue. In 1604, Parliament granted James the right to collect the import and export duties for life.<sup>68</sup> He then took it upon himself to issue a proclamation claiming the right to collect an additional tax, called an impost, set at “the sum of six shillings and eight pence upon every pound weight thereof, over and above the custom of two pence upon the pound weight usually paid heretofore,” (MacInnes, p. 51). Later in that same year, James doubled the value of tobacco in the Book of Rates, which increased the custom to four pence, bringing the total duties on tobacco to seven shillings per pound – an increase of 4200 percent.

Many historians claim that James increased the duties so severely in order to discourage tobacco consumption due to his moral opposition to it. Beer explains:

This deeply rooted feeling of opposition to the use of tobacco, which was predominately based on the prevailing moral ideas, was voiced by James I in his “Counter-Blaste to Tobacco” published in 1604. Therein he denied the medicinal value of tobacco, and said “there cannot be a more base, and yet

---

<sup>68</sup> Beer (1908, p. 103)

hurtful corruption in a Countrey, than is the vile use (or rather abuse) of taking tobacco in this Kingdom. (1908, p. 81)

I suggest that, given the timing of his publication, even if James was morally opposed to tobacco consumption, the Counter-Blaste served more as a justification for the forthcoming increase in the duties on tobacco, which he imposed with the intention of capturing rents rather than discouraging consumption. The new restrictions on the importation of tobacco which accompanied the impost provide evidence for my theory.

James collected the duties on imports through a method known as “farming.”<sup>69</sup> Farming is the practice of granting syndicates of wealthy business people the sole right to import goods and collect the duties from merchants at various ports in exchange for an annual rental. The farmers of the customs agreed in advance to the fixed rental to be paid to the Exchequer. Once the farmers paid the rent, they could pocket any additional customs duties collected. James preferred the farming method for the collection of customs revenues to collection by royal officers, as the advance payments from the farmers established a fixed level of income that would not be affected by fluctuations in the price or the size of the crop. In addition, by granting the farmer a monopoly on the importation of tobacco, the farmer could theoretically maximize the available rents by buying tobacco from the competing merchants at a price near the cost of production plus transportation and charging the competing retailers the maximum market can bear.<sup>70</sup>

Regardless of the intended purpose of the new impost, it failed both to discourage consumption and to increase the royal revenue. According to MacInnes, “the immediate result of these high duties, though they probably did bring in more revenue to the King,

---

<sup>69</sup> For a detailed discussion of the farming of customs duties, see Gately (2001).

<sup>70</sup> For a full discussion on the effect of monopsony and monopoly on prices, see the previous chapter.

was to stimulate planting in England . . . and also to encourage illicit trade,” (1926, p. 53). The new duties on tobacco created an incentive for tobacco retailers to significantly increase their demand for domestic tobacco due to the fact that domestic tobacco was not regulated and not subject to the extremely high duties paid on Spanish tobacco.<sup>71</sup> This in turn created an incentive for domestic tobacco producers to rapidly increase production. The high duties also created an incentive for merchants to find more profitable alternatives to paying the high duties. Many took their cargoes to the continent instead of English ports; others resorted to smuggling. Many of those that brought their tobacco to port legally “preferred to abandon their goods rather than pay [the impost,]” (Beer, p. 109). Thus in 1604, although the duties were farmed for only £2000<sup>72</sup> (which I estimate is one-tenth of the rents available at that time,<sup>73</sup>) the farmer of the customs “prayed, either the impost be lowered, or that they be allowed to surrender their farm,” (Beer, p. 109).

In 1608, James submitted to the requests of the merchants and the farmer of the customs, and lowered the impost on tobacco to one shilling per pound, revalued tobacco in the Book of Rates so that the subsidy increased to six pence, and reduced the rental price of the farm from £2000 to £400 (Beer, p. 109). Even if his original intention was to completely prohibit tobacco consumption in England, when it became clear that English consumers were going to purchase tobacco from one source or another no matter the size of the impost, James made the decision to decrease the impost in the interest of revenue-maximization. Assuming the king’s intention was revenue maximization all along, the

---

<sup>71</sup> MacInnes (1926, p. 77)

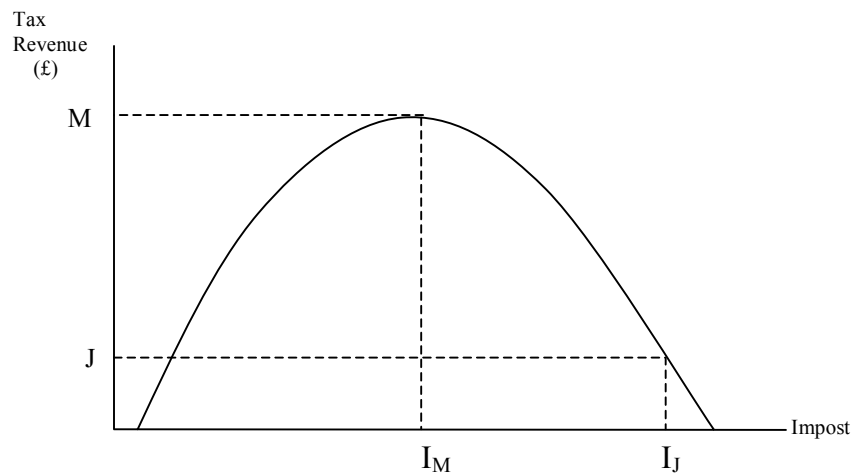
<sup>72</sup> Beer (1908, p. 109)

<sup>73</sup> See Table 1 above



1604 impost clearly exceeded the value that would maximize revenue. An increase in the cost of importing tobacco legally (the value of the impost) will reduce the quantity of tobacco that is imported legally. The effect of this decrease in quantity on the Crown's revenue depends on the price elasticity of demand for the tobacco. While the demand for tobacco is generally inelastic, the demand for legally imported tobacco in England in the early 17<sup>th</sup> century would have been fairly elastic, as a result of the availability of close substitutes: domestically produced tobacco, and smuggled Spanish tobacco. Thus, as illustrated in

Figure 3-1, when James set the 1604 impost (labeled  $I_J$ ) the large reduction in legally



**Figure 3-1.** Tax Revenue Maximization

imported tobacco reduced tax revenue to  $J$ . This value is clearly much lower than the maximum value of  $M$  which could be obtained through a reduction in the impost to  $I_M$ .

As the demand for tobacco in England increased over the next several years, so did the potential rents available for capture. By 1615, James had increased the rental

price for the farming of the tobacco customs to £3500,<sup>74</sup> and by 1618 he was charging £5000<sup>75</sup> for the right to collect the duties. It was in this year, however, that tobacco imports from the English colonies began to match those of the Spanish colonies,<sup>76</sup> and by 1619 the Virginia Company's exemption from paying import duties would expire, which permanently changed the king's regulation of the tobacco market.

## **VI. Introduction of Colonial Tobacco**

### REGULATION OF THE IMPORTATION OF COLONIAL TOBACCO

As stated above, the Virginia Company of London was granted the right to import goods into England without paying customs or additional imposts for a period of seven years from the time the charter was granted. The third and final charter of the Virginia Company was granted in 1612, which gave the company the right to import duty free until 1619. The company used this right to enter the tobacco industry and attempt to capture the significant rents available. The English colony of Bermuda also began exporting significant quantities of tobacco to England at this time. In addition to exempting the colonies from the payment of all customs for seven years, the charters also exempted the colonies from the payment of any duties in excess of the five percent customs in perpetuity.<sup>77</sup> Nonetheless, in 1619 the farmers of the import duties attempted to collect both the six pence for customs and an additional six pence for impost, in violation of the companies' charters. The Virginia Company protested and petitioned the

---

<sup>74</sup> Rive (1929, p. 5)

<sup>75</sup> Beer (1908, p. 118)

<sup>76</sup> *Ibid*, (p. 110)

<sup>77</sup> *Ibid* (p. 110)

Privy Council, which ruled in favor of the colonies.<sup>78</sup> The ruling threatened to severely damage the crown's revenue, as Spanish tobacco imports, which were taxed at a rate of two shillings per pound, now faced competition from a product that could only legally be taxed at one fourth of the rate. James, therefore, asked the colonies to agree to pay a duty of one shilling per pound in exchange for the prohibition of tobacco growing in England. The proposal was accepted by the colonizing companies on January 8, 1620.<sup>79</sup>

The fact that the prohibition of domestic tobacco growing was both offered as a bargaining chip by the king and accepted by the colonies leads to several conclusions. First, for the sixteen years prior to the agreement of 1620, the king failed to eliminate the threat to his revenue posed by the domestic producers. Second, for the colonies to accept the deal implies that tobacco planting was so widespread in England that colonists viewed the domestic product as a serious threat to their welfare. Thus, the domestic supply of tobacco may have been sufficient to free England from a dependence on the Spanish product. Thus, the policy of prohibition in favor of the colonial product was most likely motivated by revenue-seeking, rather than the achievement of a mercantile objective. Finally, the colonists' willingness to accept the deal also implies that either the companies had no idea how to negotiate, or the structure of the market for colonial tobacco was something other than monopsony. If the market for colonial tobacco was monopsonistic in 1620 (which would have been ideal for rent-maximization) then the elimination of English tobacco would have only improved the position of the importer. The importer would still be the colonists' only source of demand, and he would also become the retailers' only source of supply. That the colonists expected to benefit from

---

<sup>78</sup> *Ibid* (p. 111)

<sup>79</sup> *Ibid* (p. 112)

the prohibition of tobacco growing in England suggests that either the colonial merchants were so perfectly organized that their collusion offset the leverage of the importer, or that the smuggling of colonial tobacco into England was so widespread that the smugglers provided enough demand to drive up the equilibrium farm price of tobacco. Evidence suggests that the latter was the case. Future efforts by the colonies to collude and restrict output would fail,<sup>80</sup> but estimates of the quantities of tobacco smuggled into England at that time equal the amounts being imported legally.<sup>81</sup>

In an effort to prevent a loss of revenue due to smuggling and illegally produced homegrown tobacco, James I instituted an additional change to the system of regulation. He declared that tobacco would be subject to governmental quality inspections. Beer explains the new policy in detail:

[Tobacco] could not be sold prior to inspection, or “garbling” – to use the technical term then in use. . . James appointed a number of commissioners to enforce this system of inspection and also to prevent the sale of smuggled tobacco. Again shortly thereafter, in the proclamation of June 29, 1620, which forbade the planting of tobacco in England, the Crown forbade any but the patentees of the monopoly to import tobacco into England, and in order to prevent the evasion of the import duties and the sale of inferior grades, no tobacco could be sold unless marked by the officials appointed for these purposes. (1908, p. 119)

A portion of the proclamation simply reiterated old laws, and the system of inspection was not without its flaws, as the farmer of the customs “continued to complain about the

---

<sup>80</sup> For an example, see Pecquet (2003, p. 477). Also see p. 67 – 68 of this chapter.

<sup>81</sup> Gray (1927, p. 231)

sale of smuggled tobacco by unlicensed persons,” (MacInnes, p. 53). However, the new regulations did seem to have an effect on the quantity of colonial tobacco legally imported into England. In the first year of the new policy, due to changes in the laws and improvements in tobacco worker productivity, merchants legally imported 125,000 pounds of tobacco into England,<sup>82</sup> nearly three times the amount imported legally the year before. As a result, the farm price of tobacco plummeted by more than 50 percent.<sup>83</sup>

### OPPORTUNISTIC BEHAVIOR

The Virginia and Bermuda Companies blamed the fall in the farm price of tobacco on the importation monopoly, and petitioned to take control of the importation of tobacco themselves. In the petition against the importation monopoly, the Virginia Company threatened to send its entire crop for the year directly to Holland if the farmer of the customs continued to restrict both the quantity and the price of the tobacco purchased from the colonies. According to estimates by Jon Kepler, the company nearly did just that.<sup>84</sup> According to farm price data collected by Menard, the direct shipments to Holland resulted in a 67 percent rebound in price.<sup>85</sup> At that time there was no restriction on where the colonial tobacco could be shipped, but James I recognized that he could not afford to allow Virginia to ship its entire crop to a foreign port. After lengthy negotiations, the Virginia Company and the government finally reached an agreement in November of 1622. James granted the Virginia and Bermuda Companies the sole right to

---

<sup>82</sup> Kepler (1999, p. 119)

<sup>83</sup> Menard (1980)

<sup>84</sup> Kepler estimates that in 1621, the Virginia Company produced 55,000 pounds of tobacco and sent 47,000 of them directly to Holland (1999, p. 119).

<sup>85</sup> Menard estimates that the average farm price of tobacco in 1621 was 1s 8d, compared with only 1s in 1620.

import tobacco, and in exchange for this right, the colonies agreed to export the entire tobacco crop to England.<sup>86</sup> With the new arrangement the colonists had eliminated issues caused by a suppression of farm prices by the farmer of the customs, yet farm prices (and retail) continued to decline primarily due to the fact that the companies made no attempt to collude to keep quantities regulated, and supply began to grow at a rate faster than demand.<sup>87</sup> In addition, the domestic supply of tobacco also continued to increase in spite of James' efforts to stop it. The king sent letters to the mayor of London and the high sheriffs and justices of the peace in the counties of Kent, Essex, Middlesex, and Surrey showing his displeasure that his orders to prohibit the planting of tobacco in England had not been carried out.<sup>88</sup> While James I never found a way to eliminate or even suppress domestic tobacco production, in 1624 he would impose an institutional change on the colonial tobacco market which would continue well into the reign of his son, Charles.

## **VII. The Royal Tobacco Monopoly**

### **SYSTEM OF ENFORCEMENT**

The colonies' monopoly of the importation of tobacco was short lived. In 1624, the Virginia Company lost its charter and the importation of tobacco became a "governmental monopoly for the direct benefit of the exchequer," (Beer, p. 134.) James I farmed the customs duties to the quality inspectors, once again forbade the planting of tobacco in England, and required that all colonial tobacco be brought to London.<sup>89</sup> James died prior to carrying out his plan for a royal monopoly of the importation of tobacco, but

---

<sup>86</sup> Beer (1908, p. 193)

<sup>87</sup> McCusker and Menard (1985, p. 121)

<sup>88</sup> MacInnes (1926, p. 80 – 81)

<sup>89</sup> Beer (1908, p. 137)

his son, Charles I, took up the cause almost right away, declaring two weeks after his ascension to the throne that he intended to carry out his father's plan for a royal monopoly.<sup>90</sup> After an extended planning period, in 1627 Charles issued a proclamation which restated the pre-existing regulations on tobacco, including the prohibition of planting in England and Ireland and the requirement that all tobacco be imported only into London.<sup>91</sup> In addition, Charles commissioned a group of individuals to perform a number of duties, which Beer outlines:

These commissioners were appointed with the following objects: to seize all tobacco imported and sold contrary to the proclamation; to buy and import for account of the exchequer a small quantity of foreign tobacco; to buy and contract for the colonial crops of tobacco and to sell them for the Crown's benefit. (1908, p. 146)

In a footnote to the above passage, Beer notes what may have been the most critical aspect of the royal monopoly, that the "commissioners were to be recompensed for their services as the Lord Treasurer or the Chancellor of the Exchequer should decide." This compensation was granted on a per-unit basis, thus the commissioners had an incentive to allow as many units into port as they had the capacity to inspect. As a result, in the years following 1627 the market price of tobacco in England crashed<sup>92</sup> as competition permeated every level of the industry.

---

<sup>90</sup> *Ibid* (1908, p. 142)

<sup>91</sup> *Ibid* (1908, p. 146 – 147)

<sup>92</sup> *Ibid* (1908, p. 169)

## OPPORTUNISTIC BEHAVIOR

As a result of the falling tobacco prices due to unrestricted importation, the government of colonial Virginia attempted to regulate the production of the individual farmers by limiting the number of plants that each farmer was allowed to cultivate. Pecquet outlines the evolution of the restrictions:

In 1629, the Virginia Assembly imposed a maximum number of tobacco plants that each planter was allowed to cultivate. Initially, the limit allowed each family to cultivate 3,000 per farm worker, [however] the Inspection Act of 1629 – 1630 reduced this limit to 2,000 plants and provided for inspection. At first the tobacco planters were to select “two or three men of sound judgment” to inspect the quality and quantity of the green leaf. Sub-par tobacco was to be destroyed. If an official count revealed that a planter exceeded the statutory limit of tobacco plants, his entire crop was to be destroyed. But lax quality control could be expected when each man graded the fineness of his neighbor’s crop. (2003, p. 474 – 475)

The Assembly attempted to correct the flaws in the system by further restricting the number of plants and make inspectors more independent. The changes backfired, however, as Beer explains:

This law had unforeseen results, in that it tended to further deteriorate the quality of the Virginia crop. On account of the restriction, the colonists tried to get as much tobacco as possible from each plant, and cultivated virgin land where tobacco grew most luxuriantly, each plant containing more leaves, though of a



poorer quality, than did those raised on soil that had been tilled for a number of years. (1908, 96)

When the colonial governments failed in their efforts to restrict production, they sought out additional demand for their product in the hope of receiving a more favorable price. Estimates for the portion of colonial tobacco output sold to foreigners and smugglers average 80 percent for the period 1629 to 1631.<sup>93</sup>

Prior to Charles' proclamation restricting tobacco imports to London, a competition existed among customs officials at various ports for the right to provide services to ships importing colonial tobacco. MacInnes recognizes that "in the outports, particularly Bristol . . . the trade had been developing rapidly," (1926, p. 54). Given that a merchant could carry his cargo to whichever English port he pleased, and that collectors of the subsidy collected a small fee from each merchant serviced, this system more than likely resulted in competition between officials at various ports. It stands to reason that some port officials may have taken to lowering the price of importation (by allowing smuggling) in order to best the competition. MacInnes reports a story of a ship importing 400 hogsheads of tobacco into one of the outports, and paying duties on only 170 (1926, p. 68). It is likely that the restriction of all tobacco imports to London created an incentive for officials at these outports to engage in such behavior even more frequently, to encourage merchants to risk smuggling by using their illegal ports.

The two biggest obstacles Charles faced in his attempts to maximize revenue from the regulation of the tobacco industry were the failure of the commissioners to check importation, and the continued production of tobacco in England. In 1627, when Charles

---

<sup>93</sup> Kepler (1999, p. 119)

issued his proclamation once again banning the planting of tobacco in England and Ireland, he stated tobacco was “sown within this our realms of England and dominion of Wales, and so the mischief intended to be redressed is not yet avoided and yet our revenue in our customs is much diminished,” (Beer, p. 146). Again in 1631, Charles issued another proclamation on the issue, stating that “our foreign plantations . . . are in apparent danger to be utterly ruined,” (Beer, p. 151). Gately estimates that by this time the greater part of the counties of Gloucestershire, Wiltshire, and Worcestershire were devoted to tobacco plantations (2001, p. 78). MacInnes provides insight as to why the prohibition failed:

The Lords Council were determined to put an end to such disobedience, and the Justices [of the Peace] were commanded to summon to their aid all local officials, both in country parishes and in the boroughs, where they knew tobacco to be planted. They were further ordered to take with them personally, such necessary assistance as they might require, in order to destroy all English tobacco, and to report to the Council for punishment the names of all those who resisted them, as well as the names of those officials that were negligent in their duty. This shows not only that all previous proclamations had not been successful, but also that the interest in the industry was shared by powerful groups in Gloucestershire. Local Justices had been negligent and royal officials had actually been resisted. (1926, p. 87)

The Justices’ failure to uphold the law is a phenomenon addressed in the previous chapter. Eli Heckscher notes that the Justices of the Peace were not paid and probably made an effort to recoup themselves through bribes (1934, p. 246). Ekelund and Tollison

explain that this result is the expected outcome when agents are not properly compensated for performing their duties:

Indeed, modern economic theory leads us to *expect* malfeasance as the predictable response to low pay in situations where there is an element of trust inherent in the labor contract (Becker and Stigler 1974). This conclusion follows because the opportunity cost of being apprehended and fired is low. We contend, therefore, that the absence of pay for the justices of the peace led to malfeasance and a predictable pattern of enforcement. (1981, p. 37 – 38)

The justices' disregard for the repeated proclamations by the king went beyond a lack of incentive to enforce the law due to the absence of compensation. It was in the interest of the justices to ensure that the law was not enforced, as by the 1630s their welfare depended on a thriving domestic tobacco market. MacInnes explains:

Tobacco-growing by this time was not limited to obscure and isolated peasants, but had become a lucrative business which was participated in by people of all classes. If the Justices did not themselves as yet take part in it, they were already beginning to profit indirectly through the high rents paid for tobacco lands. This fact of the illicit interest of the Justices would seem to be borne out in . . . [the] half-hearted . . . assistance which they gave to the Government officials sent down from London to destroy this crop. (1926, p. 91)

Charles would never find a way to eliminate the supply of homegrown tobacco in England. As Gray notes, “until the outbreak of the Civil Wars the administrative machinery was wholly inadequate to suppress the British industry, and during the Civil

Wars and Commonwealth there was but little official repression,” (1927, p. 238). Charles knew that the only way to protect his revenue from the tobacco industry was to find a way to prevent the sale of the smuggled and homegrown product. After repeated failed attempts to prevent the planting and importing of illegal tobacco, in the mid-1630s he refocused his efforts on preventing its sale instead.

### **VIII. Regulation of Retailers and Improved Enforcement in the Colonies**

#### **RETAIL LICENSES**

In 1633, Charles I wisely issued a proclamation that would lead to the most effective system of regulation of tobacco that had been established to that point in time.

Beer explains:

On October 13, 1633, Charles issued a proclamation which stated that tobacco had at first been used as a medicine, but that in the course of time it was taken “for wantonness and excess provoking them to drinking and other inconveniences”; that the regulations hitherto adopted for controlling the industry had not been effective mainly because the retail selling was not controlled. It was therefore provided that in future licenses would be required from all retailers . . . forbidding the issue of licenses to such as shall keep any Tavern, Alehouse or Victualling, or otherwise sell any distilled or hot Waters, Wine, Ale, Beer, or Cider in their Houses.” (1908, p. 161 – 162).

By requiring licenses for tobacco retailers, and by including a provision making the sale of tobacco in taverns illegal, Charles accomplished several things. First, he added an additional stream of revenue from the sale of licenses and the fines imposed on those

selling tobacco without a license. Second, requiring licenses provided a barrier to those hoping to enter the market for the retail sale of tobacco. The barrier would reduce supply and slow the declining tobacco prices that had forced Charles to reduce the total duties on tobacco to four pence.<sup>94</sup> By prohibiting taverns from selling tobacco, he could further restrict supply. Finally, by monitoring the behavior of tobacco retailers Charles could prevent the sale of tobacco which had not been marked by inspectors at the ports. If successful, this new policy would significantly reduce the market for smuggled and domestic tobacco. Of course, his objectives could only be achieved if the new regulations were properly enforced.

Initially the enforcement of the licensing requirement was the responsibility of the commissioners of the customs. Under this arrangement the system was appallingly ineffective, but in 1637 Charles reinstated the practice of farming the customs duties to private individuals. On this occasion, the farm of the customs duties and the licensing was granted to Lord Goring, a man of great wealth and influence who would eventually become the Earl of Norwich.<sup>95</sup> The rights to collect the customs duties, the retail licensing fees, and the fines for violations of the licensing system were all farmed to Goring for a fixed rental. In the first year of the new system, Goring paid the crown £11,200 for the licensing farm and £7,850 for the customs farm.<sup>96</sup> The largest revenue the crown had ever received from regulation of the tobacco market was £8,000 in 1621,<sup>97</sup> thus the new system was certainly a success.

---

<sup>94</sup> Beer (1908, p. 170)

<sup>95</sup> *Ibid* (1908, p. 152 – 155)

<sup>96</sup> *Ibid* (1908, p. 163, 171)

<sup>97</sup> Rive (1929, p. 8)

## ENFORCEMENT IN THE COLONIES

In 1637, the first year of Lord Goring's patent, the market price of tobacco remained unchanged. The quantity of tobacco imported, however, spiked to over one million pounds – nearly double the amount imported three years earlier.<sup>98</sup> This increase could possibly be explained by a number of factors, including additional production from Maryland, which began exporting tobacco to England in 1634, or falling production costs in all of the tobacco-producing colonies.<sup>99</sup> I would contend that the primary factors responsible for the increase in legally-imported tobacco were the improvements in the enforcement of regulations instituted by Charles I.

The return to an importation monopoly would lead the colonist to seek out alternative sources of demand for their product to avoid the low prices offered by the monopolist. In the past, alternative sources of demand had been provided by smugglers and European merchants. The effective regulation of tobacco retailers by Lord Goring reduced the demand for smuggled colonial tobacco. If retailers faced a credible threat of punishment for selling tobacco without a license or selling tobacco without the seal of the government inspectors (such as smuggled tobacco,) then retailers would substitute legally imported, sealed tobacco for the smuggled product. European merchants were excluded from the colonial tobacco trade through a system of monitoring shipments departing from colonial ports. Beer explains the details:

Shortly thereafter, with the specific object of preventing the direct shipment of tobacco to foreign countries, there was instituted in Virginia the system of requiring bonds that the tobacco be landed at London. . . . Moreover, in

---

<sup>98</sup> McCusker and Menard (1985, p. 121)

<sup>99</sup> Some authors claim that a movement to slave labor during this period

Virginia, a special official was appointed to enforce this policy. In 1636, Charles I instructed the Governor and Council to appoint a competent person with adequate fees to keep a register of all exports from the colony, and to send copies thereof yearly to the Lord Treasurer in England. On receipt of this instruction, the Virginia Assembly created an office for this purpose, and granted to its incumbent a fee of twopence for every cask of tobacco exported, and proportionate fees for other products. (1908, p. 205 – 207)

An effective system of regulation would result in lower farm prices, due to the monopsonistic nature of the tobacco market in the colonies, and the shipment of nearly all colonial tobacco to the sole legal importer in London. This is precisely what is observed. In 1637, the farm price of tobacco was reduced by nearly half,<sup>100</sup> and by 1640 only eight percent of the tobacco produced in the colonies was unaccounted for at London's port.<sup>101</sup>

## **IX. Conclusion**

Historians frequently contend that England's seventeenth century colonial policy was motivated by the traditionally accepted mercantilist objective of a strong, self-sufficient empire. The establishment and development of the colonies seems to indicate that crown revenue-maximization was at least as important a motivator. The charters of the colonizing companies contain no language suggesting that a freedom from dependence on foreign imports was the purpose of colonization. As the colonies developed an export trade in tobacco, the evolution of the regulation of the market

---

<sup>100</sup> McCusker and Menard (1985, p. 121)

<sup>101</sup> Kepler (1999, p. 119)

appears to follow a course consistent with a rent-seeking agenda. When it became clear that the demand for tobacco in England could be satisfied through domestic production, the king elected to suppress domestic supply in favor of the more readily taxable colonial output. That the crown failed to capture a significant share of the available rents in the tobacco market for much of the first half of the 17<sup>th</sup> century can be attributed to the redistribution of rents due to opportunistic behavior on the part of market agents. Economic agents successfully prevented the capture of maximum rents by the crown because of an ineffective system of enforcement that allowed frequent violations of regulations.

Charles I significantly improved the system of enforcement in the late 1630s and secured the highest level of revenue ever achieved from the regulation of the tobacco market. Shortly thereafter, Charles faced an additional threat to his ability to collect rents in the form of opportunistic behavior by Parliament. As Ekelund and Tollison originally demonstrated, competition for the right to supply regulation in all markets was a constant cause of tension between the crown and Parliament. Once Charles established that the government could earn significant revenue from the regulation of colonial markets, Parliament challenged him for the right to collect that revenue.

There are many factors that contributed to the outbreak of Civil War in England in 1641 that vary in nature from religious to political to economic. I contend that competition over the right to supply regulation in the colonial markets is among the contributing factors. It is likely that among the many motivations of Parliament for the overthrow and execution of Charles I, one could have been a desire to collect for itself the revenue that Charles discovered how to secure from the tobacco market four years



prior. However, during the war, enforcement of regulations of colonial markets was ignored, and direct trade routes with the nations of Europe were re-established. Upon the Restoration of the monarchy in 1660, Charles II attempted to restore a system of regulation of colonial markets with the passage of the Navigation Acts. The evolution of regulation of colonial trade after the Restoration will be the subject of the next chapter.

**CHAPTER 4:**  
**OPPORTUNISTIC BEHAVIOR AND THE EVOLUTION OF THE**  
**NAVIGATION ACTS**

**I. Introduction**

The purpose of this chapter is to present a unique and more complete explanation of the motivations behind the creation and evolution of England's Navigation Acts throughout the second half of the seventeenth century. The explanation presented here is the first to apply the economic models of market regulation and rent-seeking to England's system of colonial trade. The following discussion will reveal England's seventeenth century colonial trade policies as the result of a series of attempts by government officials (especially the king) and interest groups to maximize personal utility (in the form of tax revenue or profits) through favorable legislation regarding the regulation of colonial markets. This approach is unique in that it identifies the motivation for regulation as it appealed to the self-interest of select individuals. This chapter, as did the previous chapter, focuses on the importance of incentives in determining all economic behavior, including the enactment of government policies. It provides a more complete explanation for mercantile trade policy than the traditional view. In the past, historians have cited "state-building" and "increasing the common good" as the motivations for enacting mercantile economic policy. My approach expands on the historians' approach by more

thoroughly explaining the causes of the evolution of the Navigation Acts over time. My approach focuses on the self-interested choices of seventeenth century government officials and their constituents rather than assuming that all policies are designed to increase the common good.

This chapter will review the traditional explanations of mercantile trade policies and illustrate the errors and omissions made by historians in their assessments, and will also briefly revisit the framework of the economic model of regulation. In addition, I will provide the historical context in which the Navigation Acts were developed, summarize the legislation contained in the original Navigation Act of 1660, and provide an economic interpretation of the motivations behind the passage of the act, as well as an illustration of the difficulties with enforcement and the opportunities for economic agents to dissipate available rents. I will then describe and explain the evolution of the acts over the following 25 years, and give evidence that James II, with the passage of the Navigation Act of 1685, improved the system of regulation to prevent the dissipation of rents, increased his own personal utility at the expense of the economic agents in the colonies, and sparked the colonists' movement toward an eventual revolution.

## **II. Traditional Explanation of the Navigation Acts**

Historians generally view the Navigation Acts as England's attempt to incorporate her colonies into her grand mercantile scheme. Prominent scholars to write on the subject include Charles Andrews, G. L. Beer, and Lawrence Harper, who consistently view the acts as one piece in the overall picture of benevolent government officials' efforts to create a strong, self-sufficient empire. The restrictions on international and

colonial trade contained within the Acts are seen as exogenously determined methods of state-building and of promoting domestic industry, with an ultimate goal of the attainment of self-sufficiency. England's motivations for colonization as interpreted by Beer and Andrews were stated in Chapter 2. They contend that the primary objective of colonization was the development of a strong, self-sufficient nation.<sup>102</sup> Lawrence Harper, widely considered to be among the most prominent experts on the subject of the Navigation Acts, declares that the goal of England's 17<sup>th</sup> century colonial policy was "a self-sufficient empire, with the interests of the different sections nicely balanced," (1939, p. 217).

Andrews, Beer and Harper provide excellent descriptions of England's colonial economic policy during the 17<sup>th</sup> century. They all clearly and accurately detail the specifics of every change in the trade policy during the mercantile period. In their descriptions, it is clear that the English government tended to favor colonial production of goods which were not already produced in England. Many of England's 17<sup>th</sup> century colonial policies could accommodate a policy with the objectives listed by the historians in the passages above. However, the regulation of colonial markets did not apply strictly to those for which England was dependent on foreigners, and the numerous restrictions placed on the production and exportation of these goods went well beyond those required to free England from such dependence. Chapter 3 demonstrated that the regulation of colonial tobacco was enacted, above all other motivations, from a desire to capture rents in the most profitable of all the colonial markets. Tobacco could be produced in England at a rate of supply sufficient to meet the needs of the English consumer, thus the

---

<sup>102</sup> See Chapter 2 of this work, p. 7 – 8.

protection of a colonial tobacco trade did not fit within the tenets of mercantile trade policy outlined by the historians. With the passage of the Navigation Acts in the middle of the century, tobacco remained a focus of the English government's regulation of colonial trade, which suggests the presence of a motivation other than those traditionally given for mercantile trade policies.<sup>103</sup> It is clear that a more complete explanation is required.

The majority of the writings concerning the Navigation Acts were written during the first half of the 20<sup>th</sup> century, decades before Stigler and Peltzman developed the theory of economic regulation with which we are familiar today. Prior to the development of the Stigler-Peltzman model, writers operated under the assumption that the role of economic regulation was to correct market failure and maximize social welfare. The historians listed above make the same assumption when providing their analyses of the Navigation Acts. We now understand that the primary motive for regulation is the self-interest of the regulator and his most influential constituents. This model was first applied to mercantile policy by Ekelund and Tollison (1981) but their application was never extended to England's colonial policy. The previous chapter of this work contained an analysis of early regulation of the colonial tobacco industry, and the current chapter continues to address England's 17<sup>th</sup> century colonial policy from a modern economic perspective with a new take on the Navigation Acts, beginning with the Act of 1660 at the start of the Restoration period just after England's Civil War. The chapter will illustrate that the evolution of the Navigation Acts over the second half of the

---

<sup>103</sup> Andrews acknowledges that tobacco could be produced in England and "had been enumerated largely for revenue purposes," but maintains that the enumeration of tobacco was consistent with traditional interpretations of mercantile policy because it could be classified as a "valuable raw material" (1938b, p. 86, 88 and 118).

17<sup>th</sup> century clearly reveals the true motivations for the regulation. Opportunistic, welfare-maximizing behavior by economic agents with interests in colonial industries required a constant modification of English colonial trade law. This chapter will describe the struggle between the various groups to increase their own welfare at the expense of that of the others. I will use changes in policy as evidence of successful or failed attempts by the government and others to capture rents in colonial markets.

### **III. The Economic Theory of Regulation**

George Stigler (1971) provided the first economic theory of regulation, as well as the first look at how interest groups attempt to affect regulatory legislation in their favor. Several authors and scholars over the years have contributed improvements and expansions to the theory including, among others, Posner (1974), Peltzman (1976), and Becker (1983). Stigler's idea (which was developed into a more complete model by Peltzman five years later) was that government officials are motivated to regulate markets through consideration of their own self-interest. It is in the self-interest of the regulator to remain in power. For the king in post-Civil War England in the seventeenth-century, staying in power required sufficient revenue to fight wars and protect the empire. Acquiring sufficient revenue required a system of regulation and taxation which was favorable to the more powerful interest groups represented in Parliament: the merchants, trading companies, and customs officials. Without the approval of these groups, any attempt to increase revenue to the royal treasury through changes in trade policy would have no chance of becoming law.

According to Peltzman, securing the favor of the most influential interest groups requires the imposition of a system of regulation which transfers wealth to members of these groups and away from other members of society. By establishing a set of trade laws which granted the merchants, trading companies, and customs officials favorable market conditions at the expense of colonists and Europeans, the English government could pass taxes on colonial and European goods imported by the benefactors and secure a higher level of revenue. This is the essential theme of the Navigation Acts. In order for the mutually beneficial agreement to work, both the government and the beneficiaries need to deliver on their promises. The regulator has to be able to properly enforce the regulations if the benefiting interest groups are to receive their wealth transfers, otherwise opportunistic behavior on the part of those against whom the regulations discriminate could eliminate the potential gains to the interest groups. Also, the groups receiving the benefit have to provide the regulator with the resources required to keep the regulator in power. Both of these issues were a source of difficulty when the Navigation Acts were implemented.

#### **IV. Historical Perspective**

The Civil War in 17<sup>th</sup> century England resulted in a complete breakdown of regulation in the colonial markets. The crown could not afford to devote resources to monitoring colonial trade and, as a result, the nations of Europe, especially the Dutch, engaged in a great deal of direct trade with the colonies – as noted by Beer: “During the anarchy of the Civil War, the Stuart regulations of colonial commerce had inevitably

fallen into disregard, and as a result the Dutch merchants had secured an alarmingly large share of the trade with the English tobacco and sugar colonies,” (1913, p. 61).

Upon his ascent to the throne of England at the start of the Restoration in 1660, Charles II concerned himself primarily with the reestablishment of control over the colonial markets, both as a means of strengthening England’s naval presence and as supplement to government revenues. One of the earliest acts of Parliament during the reign of Charles II was the reinstatement in 1660 of the “Old Subsidy,” which was a customs duty granting Charles the subsidies of ‘tonnage’ and ‘poundage’ for life. ‘Tonnage’ referred to the specific duties on Spanish wines, and ‘poundage’ was the five percent duty on all imports and exports according to their values as designated in the Book of Rates.<sup>104</sup> Differences between market prices for goods and the values listed in the book of rates caused the duties in percentage terms to vary significantly between goods listed. Beer explains:

As the goods were at the time rather arbitrarily appraised, and as, in addition, it was not attempted subsequently to make these values correspond with the ensuing radical market fluctuations, these duties were by no means even approximately equivalent to 5 per cent. Thus while the rating of colonial raw sugar was at the time somewhat under its duty-paid market value in England, in the next decade it was considerably in excess thereof. Moreover, as far as colonial tobacco was concerned, there was apparently no attempt whatsoever at a correct appraisal. Colonial tobacco was valued at twenty pence a pound, when it could be freely bought in Virginia and Maryland for from one penny

---

<sup>104</sup> Beer (1913, p. 129)



to twopence, and sold in England, after paying duties, freight, and other charges, for from four to five pence. (1913, p. 129 – 130)

Colonial tobacco was rated at such a high value to keep the duty from falling below one penny per pound. The market price of tobacco was low due to widespread competition at all levels of the market: colonial farmers produced millions of pounds of tobacco each year, thousands of shops were selling tobacco at the retail level in England, and European merchants were trading with both groups, in direct competition with English merchants.<sup>105</sup> By successfully regulating trade with the colonies, Charles could restrict the access of European merchants to colonial products, creating a monopoly of colonial trade for English merchants. If successful, this regulation could strengthen the British fleet and ensure that all colonial exports pass through England's ports, where they could be subject to the import duties. Charles attempted to achieve these goals through the passage of the Navigation Acts, the first of which was enacted in 1660. The Navigation Acts were so poorly executed during Charles' reign that they would require major modifications on at least six different occasions over the next 25 years. I argue that changing market conditions calling for revisions of the Navigation Acts are evidence of opportunistic behavior. In short, this behavior on the part of merchants, enforcers, planters, and retailers all limited the crown's ability to maximize revenue from the regulation of colonial trade. Upon his succession to the throne in 1685, James II would be the first to collect a significant increase in customs revenue from modifications to the Navigation Acts. I argue that Parliament's willingness to pass legislation that increased

---

<sup>105</sup> See Beer (1913) and Menard (1980).

the customs duties is evidence of improvements in the system of enforcement which limited the ability of economic agents to engage in opportunistic behavior.

This chapter will detail all of the methods used by various agents affiliated with colonial markets to take advantage of opportunities to increase their own welfare at the expense of customs revenue to the crown. It will illustrate how changing incentives in the form of modifications to the Acts changed the behavior of these agents. Finally, the chapter will identify the improvements in the system that allowed James II to increase revenue at the expense of the welfare of the colonists, which provided the spark that eventually produced the eruption of revolution in the following century.

## **V. The Navigation Act of 1660**

The Navigation Act of 1660 had at its foundation a failed set of navigation laws passed in 1651 by the Interregnum government. The 1651 laws required that all European goods imported into England be imported directly from the country of origin in shipping owned by that nation or by the English. The Act of 1651 also banned European merchants from trading directly with the colonies, with a penalty of forfeiture of ship and cargo for all violations. However, as Harper describes, the Interregnum government did not establish a proper system of enforcement, and most of the articles contained in the Act of 1651 were blatantly ignored by Europeans:

Favorable administrative conditions in England had facilitated the enforcement of the rule that goods be imported directly. The officials who collected customs duties were available to seize merchandise imported illegally, and if they failed, special agents of the chartered companies might

act instead. The offense was easily established. A ship's papers showed where it had laden its cargo; their accuracy might be confirmed by passengers or reports from abroad. Commercial knowledge established where imports had been, grown, produced, or manufactured.

On the other hand, there was no practical method of enforcing the rule that European goods must be imported only in English ships or in ships of the country producing them. . . . No provision had been made for a system of registering ships, nor had the lawmakers required English ships in the European trades to have English masters or crews. If a master falsely swore that his vessel was English-owned, the authorities were helpless.

As far as the colonial clauses were concerned, experience showed the need for enforcement provisions. . . . The navy seized about sixty foreign vessels for trading with the colonies, but its activities were sporadic, and the number of vessels taken in its occasional raids indicates the extent of disobedience rather than the success of the laws. (1939, p. 50 – 51)

For these reasons, historians generally consider the Act of 1651 a failed attempt to regulate the shipping industry.<sup>106</sup> For Charles II to have more success with his Navigation Acts, additional enforcement measures would be necessary. Otherwise he would find it impossible to deter European merchants and colonists from engaging in opportunistic behavior so frequently.

The Act of 1660 allowed the importation into England of all European goods in any shipping from any port unless specifically enumerated. It was required that the

---

<sup>106</sup> See Beer (1913, p. 71)

importation of enumerated commodities occur in either an English ship or a ship of the country where the good originated. If imported in a ship of the country of origin, then the payment of alien duties was required. If enumerated European goods were imported in a ship of any other origin, the penalty was forfeiture of ship and cargo. Harper points out that certain clauses in the Act of 1660 allowed for improved enforcement of the regulations:

The enforcement problems previously experienced were decreased by requiring that foreign-built ships be registered and that all English ships subject to the law's regulations have a master and three-quarters of the crew who were English or Irish. Foreign vessels importing the enumerated goods were required not only to be owned by the people of the country producing them, but also to have been built there and to have masters and three-quarters of their crews people of that country. (1939, p. 55)

Similar measures were taken with respect to the colonial trade, as Beer notes: "The Navigation Act provided that no goods could be imported into or exported from any of the English possessions in America, Africa, or Asia but in vessels belonging to the people of England or Ireland, or in such as had been built in and belonged to 'any said plantations.' The master and at least three-quarters of the crew of these ships had to be English," (1913, p. 65). Ships trading in the colonies that did not meet the qualifications faced a penalty of forfeiture of the vessel and its cargo. One-third of the forfeiture was apportioned to the crown; one-third to the Governor of the colony (if the ships were seized in the colonies -- otherwise this share also went to the Crown,) and one-third went to the seizer or informer. Ships seized by the royal navy were divided in half between the

Crown and the naval officers.<sup>107</sup> In addition to requiring that all goods entering or leaving the colonies be shipped in English bottoms, the Act of 1660 also required that certain colonial goods be shipped only to England, Ireland, or some other English colony. The articles enumerated under the Act of 1660 included tobacco, as well as sugar, cotton-wool, indigo, ginger, and fustic or other dyeing-woods. In the following section, I will explain the motivation for the enactment of the Navigation Act of 1660 through an application of the economic theory of regulation. I will also explain how this interpretation of the Act differs from that of the historians.

## **VI. An Economic Interpretation of the Navigation Acts**

Andrews neatly summarizes the motivations for the passage of the Act of 1660:

The act of 1660 covered two of the main objects sought to be attained by the navigation acts – the increase of shipping and the enumeration of colonial commodities, the first in the interest of England’s mercantile marine, and the second looking to the enlargement of the revenue, the multiplying of raw materials, the advancement of England’s domestic industry, and the comfort of her people. (1938b, p. 108)

Andrews acknowledges that greater customs revenues were among the reasons for initiating the Act. I agree with Andrews that the king also intended the Act to strengthen the navy. Before continuing discussion of how the consideration of England’s domestic industries played a role in the framing of the Act, I must refer back to Beer.

---

<sup>107</sup> Beer (1913, p. 69)

Beer points out that the enumerated articles were primarily the products of the southern colonies and the West Indies. He claims that the crown did not enumerate the produce of New England because the purpose of the Navigation Acts was England's economic independence from competing rivals in Europe. By enumerating only the items which England did not already produce, "the nation's balance of trade [would] be fortified and its economic welfare advanced. The policy of enumeration was the clearest possible expression of the current economic creed," (1913, p. 73). The view that mercantile trade policies were designed with the objectives of strengthening the nation and improving overall welfare is common among historians, but this view ignores the economic factors that bring regulatory policies into existence.

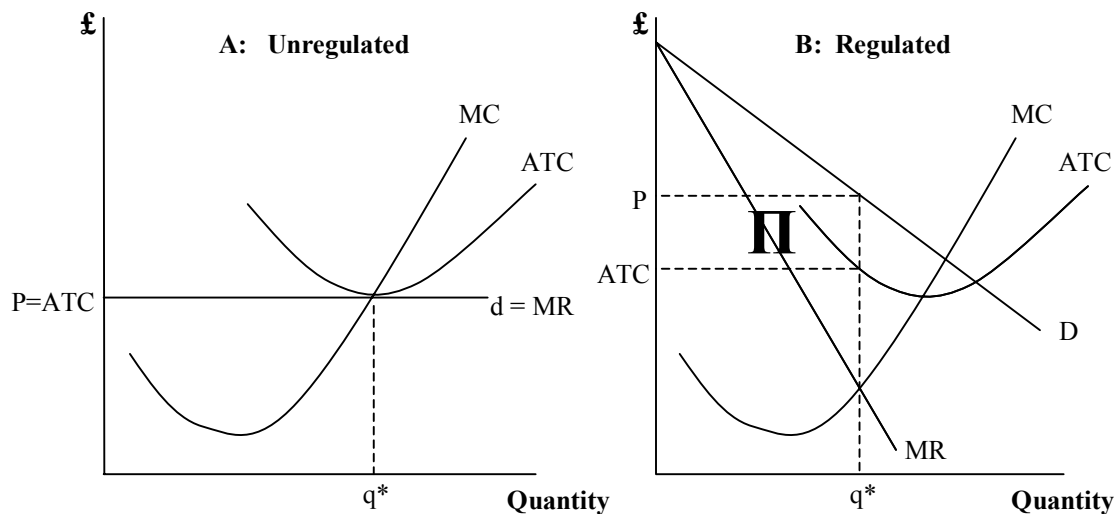
I concur that the Act of 1660 excluded domestic-competing colonial industries because "their importation would have injured the English industries," (1913, p. 72) however, Beer's explanation of the structure of the Act is incomplete. It is true that the monarchy desired to free England from dependence on foreign goods, but revenue maximization was more of a governing factor than overall economic welfare. I argue that the crown maintained an interest in maximizing economic welfare only to the extent that greater overall welfare allowed for the collection of greater levels of revenue. The crown wished to support domestic industries at the expense of foreign imports because domestic production facilitated the creation and capture of artificial rents.<sup>108</sup> If Beer is correct in his claim that the importation of domestic-competing products from the colonies would impair the English industries, then one of two things must have been true: either the colonial companies could produce at a lower cost than the domestic producers, or

---

<sup>108</sup> See Figure 4-1B

domestic producers were demanding and receiving artificially high returns due to regulation.

In a free market (one without barriers to entry) the only reason for new producers to enter is the opportunity to make an above-normal rate of return. There are only two reasons that New England producers could possibly make an above-normal rate of return in markets controlled by domestic producers in England. The first is the ability of colonial sellers to produce domestic-competing goods at a lower cost than the incumbent producers. This scenario is unlikely, given the high transportation costs associated with shipping goods across the Atlantic Ocean.



**Figure 4-1.** Long Run Firm Profits: Unregulated vs. Regulated Markets

In a competitive market where producers face identical costs, long run equilibrium occurs at a price and output level where economic profits are equal to zero. Long run competitive equilibrium is illustrated in Figure 4-1A. At the profit-maximizing level of output,  $q^*$ , the firm earns zero economic profit, thus  $P = ATC$ . Clearly this was not the case in the English markets for goods and services produced in New England, for

entry by the colonists would not be a reasonable concern under such conditions. Thus, if New England colonists faced an incentive to produce and export domestic-competing products, this scenario can only be explained by the presence of artificial rents due to regulation. Figure 4-1B illustrates an example of a regulated market where supply is controlled by a monopoly or a cartel. If entry is effectively restricted by the government, then producers can maintain a lower output and charge a higher price than producers with identical costs in an unregulated market. The area labeled **II** in Figure 4-1B represents the artificial rents created through regulation. The crown's failure to restrict New England exports to English ports suggests that revenue maximization at least served as additional motivation for the passage of the Act of 1660, if not the primary rationale.<sup>109</sup>

Although the focus of Beer's book is the colonial policies of 17<sup>th</sup> century England, one can be certain that Beer and like-minded historians would offer the same "freedom from dependency on foreigners" and "welfare-maximization" defenses of the enumeration of European imports as well. The Act of 1660 enumerated the following European goods: masts, timber, boards, pitch, tar, rosin, hemp or flax, all Russian goods, all Turkish goods, wines, brandies, vinegars, sugars, corn and grains, potashes, currants, raisins, figs, prunes, and olive oils.<sup>110</sup> Harper goes on to list various reasons for the enumeration of the specific goods on the list, and includes among the reasons influence from groups of English merchants:

---

<sup>109</sup> This argument could be strengthened if the Act of 1660 contained a clause which completely prohibited the importation of the products of New England. While the Act contained no such clause, this is probably due to the fact that the importation of many domestically-produced goods was already "strictly forbidden" by other trade laws. See Beer, p. 77 – 78.

<sup>110</sup> Harper (1939, p. 53)

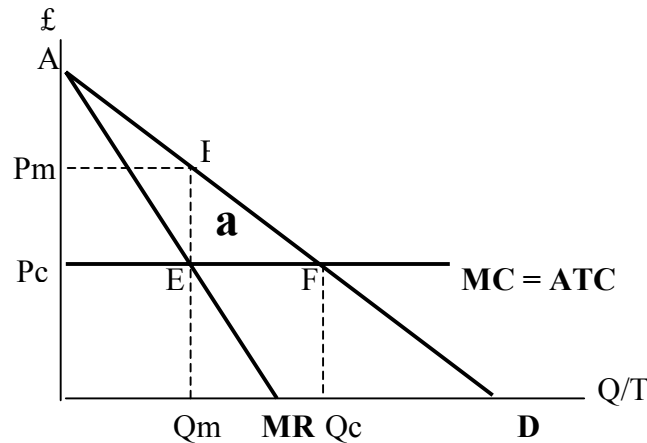


Traditional policy may have been the reason for enumerating wine; the desire not to be dependent upon others for national necessities explains the inclusion of naval stores. The wishes of the various groups who desired protection, the Turkey, Muscovy, Eastland, Spanish, and Portuguese merchants, are clearly reflected. The enumerated list included nearly all their importations. But the merchants in the cross-Channel trades had no such interest, and only fractional amounts, ranging in value from a fifth to a twenty-fifth of the trade with Holland, Flanders, Germany, and France were affected by the Act. (1939, p. 54)

Goods from Holland, Germany, and France were not enumerated because British merchants could compete with Dutch merchants in trades over short distances. Over greater distances, however, the lighter, faster, lower-cost ships produced by the Dutch gave them a comparative advantage in shipping. Thus the trading companies involved in these more distant markets sought government protection, which the king granted in the hopes that granting English merchants a shipping monopoly in those markets would create an opportunity to increase revenue through the capture of a portion of the artificial rents.

In their “Graphical Exposition of the Economic Theory of Regulation,” Beard, Kaserman, and Mayo (2003) prove that a regulator with an objective of maximizing social welfare will fail to regulate a market with a naturally competitive structure. The authors identify welfare as the sum of consumer and producer surplus (2003, p. 603). In a competitive market, consumer surplus is maximized. Figure 4-2 shows the effects of regulation on a market with constant costs. If unregulated, the producers in this industry

will sell  $Q_c$  units at a price of  $P_c$ , where price is equal to the cost of production. At this price, consumer surplus is equal to area  $AP_cF$  on the graph. Any attempt to set a regulated market price below  $P_c$  would cause losses to producers, offsetting any gain in consumer



**Figure 4-2.** Market with Constant Costs: Identifying the Welfare Loss

surplus, and ultimately (without subsidizing production) cause the collapse of the market. Thus, any sort of regulation would involve an increase in price and a reduction in the quantity produced and sold.

A regulator with an objective to maximize rents will restrict supply until the remaining producer or producers are able to set a monopoly price of  $P_m$  for a reduced output of  $Q_m$ . The increase in price reduces consumer surplus to area  $AP_mB$  in Figure 4-2. A portion of the reduction in consumer surplus, area  $P_mBEP_c$ , will transfer to the producers (and the regulator) in the form of rents. The remaining portion of lost consumer surplus (area **a** in Figure 4-2) represents the net welfare loss which results from the decrease in output. A regulator with an objective to maximize welfare will choose to set a price in the market which minimizes the welfare loss. “Therefore, a social welfare-

maximizing regulator . . . will not regulate a competitive market,” (Beard, et. al, p. 604). Thus, welfare-maximization could not have been the intention of the regulations contained in the Navigation Act of 1660.

#### OPPORTUNITIES FOR INCREASING CROWN REVENUE

According to Harper, the requirement that all goods shipped to and from the colonies in English bottoms could be effectively enforced due to the additional requirements that foreign-built ships be registered, and that English ships maintain a crew that was three-fourths English or Irish (1939, p. 55). Also Schlesinger gives evidence of strong growth in the colonial shipbuilding market after the passage of the Act, (1966, p. 16) which suggests that the requirement that all merchants carry on colonial trade exclusively in English bottoms could be effectively enforced. Proper enforcement would create an increase the demand for English and colonial ships. Assuming the shipbuilding market was unregulated, the increase in demand would create an above average return on the production of ships, which would stimulate supply and lead to an increase in output, just as Schlesinger observes.

Charles II did not attempt to capitalize on the new demand for English ships by regulating the shipbuilding market due to the adverse effect of regulation on the costs of maintaining the royal navy. If a supply restriction (due to regulation) accompanied the increase in demand, then the prices of ships and shipbuilding resources, such as timber and pitch, would have significantly increased. An increase in the cost of shipbuilding would make it more expensive to maintain a large navy. Apparently the additional revenue from regulation of the shipbuilding industry was not enough to offset the

combination of a potential cost increase and the benefits to the empire of the production of a large number of English ships, because the crown failed to eliminate competition between English and colonial shipbuilding.<sup>111</sup> The rise in demand was therefore accompanied by a rise in supply, which prevented the price of ships from rising sharply.

Thus, the requirement of the Act of 1660 that all colonial trade be conducted in English bottoms managed to increase the quantity of English ships, as foreign merchants were required to use the services of English shipping crews rather than Dutch crews, which dominated the industry to that point. However, the clause only increased the crown's revenue to the extent that European merchants chose to pay alien duties rather than employ English shipping. Harper suggests that instances of foreign merchants using their own ships and crews were rare since "some countries, like Russia, which could build their own ships, had few seamen; and others, like France, which had seamen, had few ships of their own build," (1913, p. 55). I conclude, therefore, that Charles II enacted this article of the Act of 1660 not in an effort to maximize revenues, but rather to better compete with the Dutch in the shipping industry; strengthening the navy (at the expense of the Dutch navy) in the process. The revenue-capturing features of the Act of 1660 are contained in the restrictions on the trade of the enumerated colonial exports.

In requiring that the enumerated articles be shipped only to England or its possessions, rather than directly to Europe, Charles II hoped to increase revenue through the collection of customs duties on these items, and to grant English merchants a monopoly of the European trade of colonial commodities. If successful, this trade could

---

<sup>111</sup> It is also possible that the crown failed to recognize the gains from regulation of the shipbuilding industry, and thus failure to capture rents was simply an oversight, however given the numerous other industries in which the crown did practice rent-seeking behavior, this explanation is unlikely.

then be regulated, providing the crown with another opportunity to increase revenue through rent-seeking. However, opportunistic behavior on the part of agents in colonial markets and enforcement difficulties reduced the ability of the crown to maximize revenue.

## ENFORCEMENT OF THE ACTS

### A. In England

Colonial affairs were the responsibility of three administrative departments within the English government: the Privy Council (and the Secretary of State,) the Admiralty, and the Treasury. All three were prominently concerned with the effective execution and enforcement of the Navigation Acts. The Privy Council established the various boards and committees which set all policies involving the government of the colonies, including carrying into effect the Navigation Acts.

The Admiralty was responsible for enforcement of trade restrictions and the seizure of all merchant ships in violation of the laws of navigation. Beer explains the expansion of the duties of the Admiralty upon passage of the Act of 1660:

Not only was the Admiralty entitled to specific dues, such as those arising from condemned prizes, but in addition vessels seized for violating certain clauses of the commercial code were triable in the admiralty courts. In order to carry their powers into effect, the Lord High Admiral appointed deputies in the crown colonies, and admiralty courts were erected in them. Furthermore, towards the end of the period, the ships of the navy were especially instructed

to seize illegal traders and some were stationed in the colonies for this specific purpose. (1913, p. 260)

The duties of the Admiralty focused on preventing illegal ships from trading with the colonies and trying cases involving seizures (rather than fines) in the admiralty courts.

The Treasury, which had jurisdiction over the customs officials, was primarily concerned with securing the Crown's share of all revenues associated with colonial and international trade. Beer, again, describes the duties of the Treasury in greater detail:

The enforcement of the clauses of enumeration was to a large extent under the direct control of the English customs officials. They issued the bonds to vessels sailing from England, and it was in such ships that most of the enumerated goods were exported from the colonies. These English officials were responsible that no ship departed from England without having given such bonds, and, in case any eluded their vigilance, they ordered their seizure upon arrival in the colonies. In such instances, the cooperation of the authorities in the colonies was required, but where the bond had been actually given in England, its enforcement depended solely upon the home government. (1913, p. 261)

The above passage indicates two sources of difficulty with respect to enforcement of the Act in the colonies. In cases where bond was not given, the Treasury depended on the cooperation of colonial officials, whose self-interest frequently conflicted with the interests of the British government. In cases where bond was given, the Treasury was responsible for policing the actions of buyers and sellers in a market thousands of miles away. The distance between the potential criminal and the enforcement officials greatly

increased the cost of enforcement, which in turn increased the probability of unlawful behavior.

In 1660, collection of customs duties on imports into England was still the responsibility of the farmers of the customs.<sup>112</sup> The farmers of the customs were responsible directly to the Treasury, and, since their income depended on proper enforcement of the Act, possessed interests aligned with those of the English government: maximizing the English customs revenue. At the time, however, the farmers of the customs did not retain agents in the colonies, as colonial enforcement of the Act was almost solely the responsibility of the governors of the colonies.<sup>113</sup>

#### B. In the Colonies

All three of the branches responsible for the proper functioning of the Acts of Navigation had its own representatives stationed in each colony, however, the governor was the local official primarily responsible for maintaining the colony's adherence to the Acts of trade. The governor was appointed by the crown and answered directly to the Privy Council or the king himself. The Act of 1660 required that the governors of all colonies take an oath to obey the law; any negligence in performance of his duties could result in his removal from office and the levying of a fine of £1000. The duties of the colonial governor included a number of responsibilities, as outlined by Andrews:

The governors were also ordered to keep account of all vessels trading to their particular colonies and twice a year to send to England the names of ships and masters. They were to transmit copies of all bonds, such as the act required

---

<sup>112</sup> See previous chapter for a detailed discussion of the role of the farmers of the customs.

<sup>113</sup> Beer (1913, p. 273)

all masters to give at the port of clearance, holding the latter to a faithful observance of the law requiring them to carry their cargoes to England or to some other plantation. They were to scrutinize all foreign-built ships coming to the colonies to see whether or not such ships were trading legally, had the proper certificates of “freedom,” and had given the required bond in England. (1938b, p. 115 – 116)

To perform all of the duties required to maintain colonial trade regulations under the Act of 1660, the governors were granted the right to appoint a subordinate official known as the naval officer.<sup>114</sup> Beer lists the responsibilities of the naval officer in colonial trade as follows: “He was the personal representative of the Governor and was entrusted by him with the detailed work of enforcing the commercial code: the giving of bonds, the examination of ships’ papers and cargoes, and the entrance and clearance of vessels,” (1913, p. 268).

The welfare of the colonial governor (and the naval officer as well) was generally tied to the welfare of the colonists. The colonial planters benefited from a high volume of trade and competition between merchants, which was not the intent of the Acts of Navigation. Therefore colonial planters, merchants and governors frequently participated in opportunistic behavior, usually at the expense of the customs revenue.

---

<sup>114</sup> Harper (1939, p. 170)



## OPPORTUNISTIC BEHAVIOR

### A. Customs Officials

Due to the fact that the farmers of the customs were private individuals contracted by the Treasury to collect duties rather than government agents, there were frequent conflicts of interest between customs officials and the crown. Harper explains:

Yet private administration of the laws caused complications. The farmers' interests did not extend to the higher phases of mercantilism. They had contracted to pay a certain rent, presuming that certain laws would continue. When unforeseen circumstances required various executive modifications, the farmers believed themselves entitled to "defalcations," lessening the contracted amount due the King. Even in matters of routine, their interests might run counter to those of the nation. In administering the duty of five shillings per ton on French vessels, experience had shown that more revenue would be forthcoming if it was not computed according to the extreme gauge of the ship. Otherwise vessels would attempt to stop at unguarded spots along the coast and to avoid the duty altogether. To protect their revenue, the farmers modified their demands and disregarded Parliament's intent that the duty should serve to offset a similar tax laid by France on English ships. (1939, p. 79)

The reduction in the duties charged on French ships did not reduce the Treasury's revenue, since the value of the farm was determined in advance, however the value of the farm was underestimated if such practices caused an increase in the farmers' incomes. In addition, any action on the part of the customs officials which increased the quantity of

French ships using English ports reduced the rents available to the crown through regulation of the English shipping.

#### B. Colonial Governors

The Act of 1660 instructed the governors of all colonies, regardless of classification, to provide the same oath and carry out the same duties in seeing that the laws of navigation were obeyed. However, since the governors answered directly to the residents of the colonies, rather than the English government, there were frequent conflicts of interest between the governors and the crown, and the governors frequently allowed violations of the Act to occur.

The distance between the colonial governors and the customs officials in England, in combination with the system of compensation for colonial governors and their officers, created an incentive for governors to engage in malfeasance. Colonial governors and their deputies were granted a percentage of all payments for bond violations rather than a fixed salary. Harper notes that “the amount received was never large” and seems bewildered that “applicants for office confidently expected to make their fortune,” (1939, p. 172). A system where the enforcement official’s compensation is dependent upon the zeal and effectiveness with which he performs duties would seem preferable to placing the governors on a fixed salary. However, since customs officials in England could not efficiently monitor the behavior of the governors due to the ocean separating the two, it is reasonable to assume that colonial officers supplemented their income with bribes from shipmasters illegally trading in enumerated products. Beer provides evidence of the shirking and malfeasance practiced by colonial governors:

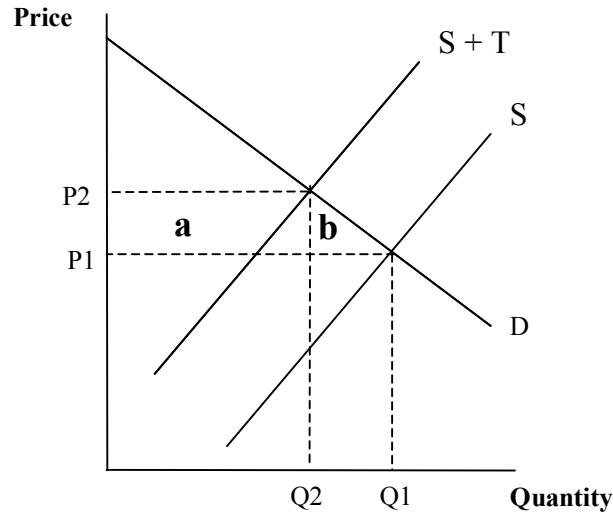
In 1663,<sup>115</sup> letters were written to the royal governors and also to the authorities in Maryland and New England, reciting the provisions of the Navigation Act and their serious obligations under them, and stating that information had been received that the law was violated, “through the daily practices and designs set on foot, by trading in foreign parts from Virginia and Maryland, and other his Majesty’s Plantations, both by Land and Sea as well unto the Monados, and other Plantations of the Hollanders, as unto Spain, Venice, and Holland.” This state of affairs was attributed to the neglect of the governors, both in not seeing that the vessels arriving had certificates that they were qualified to trade in the colonies, and also in not taking bonds before the ships with enumerated commodities on board were allowed to depart. (1913, p. 265)

The colonial governors, seeking lower prices for European imports to the colonies, had an incentive to charge little or no customs duties on goods shipped in or out of the colonies (especially since all duties claimed by the colonies were taken by the British government.) Beer notes that “when imported into England these commodities paid duties, but, when shipped to another [English] colony, either no or very slight customs were levied by the local authorities, and none of course by England, and thus the colonial consumer fared much better than his fellow in the mother country,” (1913, p. 80). Figure 4-3 shows the difference in the price charged by foreign merchants when foreign goods are subject to customs duties. When foreign merchants are not charged

---

<sup>115</sup> Malfeasance on the part of colonial governors was so persistent that the king sent an additional proclamation in 1667, which was also apparently ignored (Andrews, p. 116).

customs, the supply curve faced by colonial consumers of foreign goods is  $S$ . In equilibrium, colonial consumers are charged a price of  $P_1$  and are willing and able



**Figure 4-3:** Effect of Customs Duties on Prices of Foreign Goods

to purchase a quantity of  $Q_1$  units. When a tax (in the form of a customs duty) is collected from the foreign merchant, the supply curve shifts vertically by the amount of the tax, from  $S$  to  $S+T$ . The producer then passes on a share of the tax to the colonial consumer in the form of higher prices. The market reaches a new equilibrium when the price of foreign goods is  $P_2$  and the quantity purchased by colonist is  $Q_2$ . The resulting loss in welfare for the colonial consumer is represented by area  $a + b$ . Thus, colonial governors charged no duties upon the importation of foreign goods, nor did they punish violations of bonds given to take enumerated goods back to England. The British government would not take steps to correct this flaw in the system until 1673, with the passage of the plantation duties which required the collection of duties on enumerated goods shipped from one colony to another.

The colonists themselves also had an incentive to disregard bond violations by crews of foreign merchants. Allowing foreign merchants to take enumerated articles back to the continent, rather than first shipping them to England where they would be subject to additional duties, ensured that prices of European goods stayed low in the colonies. In addition, given that ships and cargo were not forfeited in violations of bonds given in the colonies, the informers received no share of penalties collected and thus had little incentive to do any informing. Harper identifies only three of seventy-seven cases which he examines in which the case against illegal activity was initiated by a common informer rather than an official (1939, p. 170).

### C. Foreign Merchants

Several features of the Navigation Act of 1660 provided foreign merchants with opportunities to capture rents. The original legislation only restricted the types of ships used in the colonial trade and the destination of the enumerated articles acquired in the colonies. Therefore any foreign merchant with access to English ships could participate freely in the colonial trade. As long as the ships were of English build and the crew was of English decent, foreign merchants had the right to send fleets to and from the continent without giving bond or first landing in England, provided the ships were not carrying any of the enumerated commodities. For the ships that did engage in the trade of enumerated products, the law required that all ships leaving England and Ireland for the colonies give bond of £1000 or £2000 to carry any enumerated articles loaded in the colonies back to England. However, vessels arriving in the colonies from anywhere else were obliged to give bond in the colonies to take the enumerated articles to England, Ireland, *or some*

*other English colony.* The restriction on English merchants in the inter-colonial trade was not enforced until the end of the century,<sup>116</sup> but the poor structure and enforcement of the laws still provided foreign merchants with certain advantages.

If the laws regarding the enumerated articles were perfectly structured and enforced, then foreign merchants would be completely excluded from the European trade in these goods. Foreign merchants could send their produce to the colonies and trade it for the enumerated articles, but then the ships would ultimately be required to land their cargo in England, where they would pay customs duties before either trading the colonial products with English merchants who could then bring the colonial products to the continent or selling the colonial goods directly to the English consumer. However, even if one assumes perfect enforcement, the structure of the Act created a scenario where it is conceivable that foreign merchants may have violated their bond to avoid paying English customs duties.

The penalty for landing any of the enumerated goods in a foreign port was forfeiture of the ship and its cargo if the bond were given in England. Were the bond given in the colonies, then the penalty amounted only to the amount stipulated in the bond.<sup>117</sup> Ships owned by foreign merchants could give bond to take enumerated articles to other British colonies and instead land in neighboring foreign colonies, from which the goods could then be shipped to the continent without paying English taxes. If British colonial informers, or British naval ships used in enforcement of navigation laws, caught the foreign-owned ships attempting to land in foreign colonies, the shipmasters could

---

<sup>116</sup> Beer (1913, p. 74)

<sup>117</sup> *Ibid.*, (1913, p. 72-73)

claim that inclement weather forced a change in heading.<sup>118</sup> Even if forced to pay the penalty, shipmasters were not required to forfeit the ship or the cargo when bond was given in the colonies. When the import duties in the British Empire were high, it is possible that disregarding the Navigation Acts could be more profitable for merchants than paying the duties, resulting in lower revenues for the Crown even when the law was properly enforced. Within three years, the British government passed the Staple Act in an effort to force foreigners involved in the colonial trade to pay customs duties.

#### D. Planters in England

Any duties collected on colonial tobacco at the ports created an opportunity for tobacco farmers in England to capture rents by offering retailers a low-cost alternative to buying the colonial product. In order to assure the maximization of revenues from import duties, the crown was required to eliminate the threat of domestic competition by prohibition of the planting and growing of tobacco in England – a practice which the government had unsuccessfully attempted to suppress since the days of James I.<sup>119</sup>

In 1660, on the grounds that tobacco grown in England was inferior to the colonial product as well as being detrimental to the customs, Parliament passed an act prohibiting the growing of tobacco in England and Ireland.<sup>120</sup> This current attempt at prohibition faced even more fierce and violent opposition than the previous efforts,<sup>121</sup> due to the fact that during the Civil War and Interregnum the practice of growing tobacco had

---

<sup>118</sup> Such circumstances frequently warranted an exemption from penalty.

<sup>119</sup> See the previous chapter for a full discussion of pre-Civil War efforts to eliminate domestic production.

<sup>120</sup> Beer (1913, p. 139)

<sup>121</sup> See Chapter 3 for a detailed description of attempts to prohibit tobacco planting in England prior to 1660.

spread throughout the southwest of England, and was a deep-rooted, highly profitable industry. The severe fines for violations of the prohibition had virtually no effect on the behavior of the farmers,<sup>122</sup> primarily due to the fact that enforcement was still the responsibility of the unpaid justices of the peace.<sup>123</sup> More thorough efforts at elimination of the domestic crop over the next twenty years were just as unsuccessful. Beer details the increased efforts over the next several years:

Early in 1661, on the advice of the Council of Foreign Plantations, a proclamation was issued enjoining the strict execution of the parliamentary prohibition against growing tobacco. As this was found ineffective, on April 30, 1662, the Privy Council instructed the High Sheriff of Gloucestershire – the centre of the English tobacco district – to pluck up, destroy, and burn tobacco grown and planted there. Similar letters were also sent to the high sheriffs and justices of the peace of the adjoining counties, Worcester and Hereford. The law, however, was not fully enforced. . . . Accordingly, in 1663, more energetic measures were adopted. Parliament increased the penalties imposed on those growing tobacco, and the Privy Council wrote to the sheriffs of the counties of Gloucestershire, Worcester, Hereford, Monmouth, and Oxford that great quantities of tobacco were still planted, and required them to aid the Surveyor General of the Farmers of the Customs, and such persons as he should see fit to employ, in destroying this crop. By his commission this officer was empowered to demand assistance from the

---

<sup>122</sup> Beer, (1913, p. 140)

<sup>123</sup> Becker and Stigler (1976) contend that malfeasance by enforcement officials is the expected outcome when the officials are paid less than the value of their efforts and are generally unsupervised by those most interested in maintaining the regulation. See Chapter 2, p. 20.



sheriffs, justices of the peace, mayors, bailiffs, constables “and all other his Majesty’s officers both Civil and Military.” But instead of contracting, the area of production was spreading both to the East and to the West (1913, p. 140 – 141).

It was not until the mid-1680s, during the reign of James II, that the domestic tobacco industry was finally eliminated in England. Beer gives no indication as to why the prohibition was finally enforced properly, but it may have a great deal to do with the compensation of the enforcers. Ekelund and Tollison (1981) noted that cases of incomplete enforcement of regulations were frequently the result of a lack of incentive on the part of the unpaid enforcers. They specifically refer to the justices of the peace as an example. Those same justices were being put to the task of enforcing the prohibition of tobacco planting. There is no evidence that suggests a conclusive link between James II success in upholding the prohibition and payment of the officials responsible for enforcement. However, Beer cites another example of a previously ignored law which James’ administration was able to properly enforce and from which the crown began earning revenue during the same period in the Virginia quit-rents.

Beer states that prior to the reign of James II, “Virginia had paid but slight attention to the quit-rent system. The rents had been virtually ignored and the Crown had derived no revenue from this source,” (1913, p. 194). Beer attributes the increase in quit-rent revenue to a “more systematic” system of collection, but fails to elaborate. He does, however, mention in a footnote that “the sheriffs collected the rents and deducted 10 per cent for their services. The Auditor then received them from the sheriffs and was allowed 7 ½ per cent for his work,” (1913, p. 198, footnote). Beer mentions the payments only to

downplay the size of the revenue actually received by the Exchequer, but I believe that he inadvertently discovered the key reason James II succeeded in securing revenues where others failed: the compensation of the enforcers. Even though the quit-rent revenue only averaged £850 annually during James' reign, ten percent, or £85, was a significant increase from the zero being paid by the previous rulers. In addition, the fact that the Auditor's income depended on the collection efforts by the sheriffs, the system contained a built-in check on the behavior of the sheriff. Although I can not state with certainty due to a lack of direct evidence, the similarities in the patterns of enforcement in the tobacco industry and the quit-rent system provide reason to believe that if James paid the officials responsible for enforcement in Virginia, that he did the same in England. Therefore, I conclude that the success in enforcing the tobacco-growing prohibition and the success in collecting the quit-rents can both be attributed to proper compensation for enforcement officials.

## **VII. The Staple Act of 1663**

The Navigation Act of 1660 gave England a monopoly of the carrying trade in the British colonies, however, it failed to restrict the ability of foreign merchants to freely trade within the empire, provided that they employed an English crew to handle the shipping. In an effort to tighten regulation and increase the opportunity for the crown to capture rents from colonial trade, the British government passed the first amendment to the Navigation Acts, known as the Staple Act of 1663. Andrews, in stating the motivations for establishing the Staple Act, comes incredibly close to breaking free from the traditional mercantile paradigm and locating the true rationale:

A new era was opening and the dependence of the colonies upon England has to be made clear at the outset. To allow the colonies to buy elsewhere than in England their woolens and the finished products of other countries and to carry them from the place of purchase directly to their own ports, passing by the merchants and manufacturers of England and taking advantage of lower French and Dutch prices, to their own profit but to the injury of English trade and customs revenue – such a policy was inconceivable. . . . Trade was becoming essential to the attainment of prosperity and the value of commerce and the colonies, as means whereby this result was to be attained, as recognized by all responsible men during the first years of the Restoration when the acts of navigation and trade were passed. (1938b, p. 115)

Many things can be inferred from the above passage. First, Andrews seems to recognize that it was in the interest of the government and the powerful merchants represented in Parliament that colonial trade be regulated. Andrews also seems to realize that the Navigation Acts were designed to benefit domestic merchants and manufacturers at the expense of the colonists, yet he still wants to argue that the laws were the result of the concern of “responsible men” for the prosperity of the realm as a whole. For the purposes of this dissertation, we can assess two important facts from the above passage. First, that the Staple Act and the Navigation Act of 1660 were constructed by a relatively small collection of individuals (the king and English merchants and manufacturers) with their own self-interest in mind. Second, the passage establishes a self-preservation motive for the evasion and violation of the acts by all parties affected by the legislation

whom did not belong to the benefiting groups – particularly those outside of England’s borders, such as the colonists, the Irish, and foreigners.

The Staple Act of 1663 prohibited the importation into the colonies of any European commodities that had not been laden and shipped in England.<sup>124</sup> In requiring that all goods imported into the colonies first land in an English port, the crown attempted to secure duties on all European goods exchanged with the colonies. British merchants, the group primarily responsible for the Act, hoped securing this legislation would eliminate foreign merchants from colonial trade. When forced to land their ships in England, European merchants faced an incentive to find a buyer in England rather than pay the additional costs of reloading and shipping across the Atlantic. British merchants could buy the continental imports and ship them themselves. In the absence of foreign competition, the British merchants could then ideally, through collusion, charge colonial consumers monopoly prices for European goods. If the crown could successfully regulate the British merchant cartel, then the crown could capture additional rents in the form of a share of the cartel’s profit.

## OPPORTUNISTIC BEHAVIOR

### A. Colonies

The revisions included in the Staple Act prevented foreign merchants from bringing goods into the British Empire without paying customs duties. They did not, however, prevent colonial merchants from picking up where the foreign merchants left off by trading directly with the European nations. Assuming perfect enforcement (which

---

<sup>124</sup> Beer (1913, p. 77)

it was not, as seen below) all foreign merchants were required to send their produce to England prior to sending the commodities to the colonies, creating a monopoly of the colonial market for European goods for the British merchants who purchased the goods from the foreigners. Upon re-exportation the crown repaid a portion of the customs revenue, but British merchants passed the remaining burden on to the colonial consumer in the form of higher prices. Colonial merchants who sought to eliminate the English middle-man from the trade could carry enumerated products directly to the continent provided they were not caught by enforcers in England. The colonists of the West Indies, for instance, frequently participated in violations of the laws of navigation by trading directly with European merchants. Beer cites the following case from 1668:

In 1668, Sir William Temple, the English Ambassador at the Hague, was instructed as follows: “You must make it your business to be informed very particularly of three merchant ships, fitting now at *Amsterdam*, for the *Barbadoes*, with several manufactures for their lading; and if you have an opportunity then, to advertise the Governor thereof, that he may seize them, because it is a great breach of the Act of Navigation, and yet so acceptable to the People, upon that Island, that it may contribute much to the debauching of them, at least from their dependence upon England.” (1913, p. 259, footnote)

A less blatant method of carrying out direct trade in enumerated goods with Europe involved first shipping the goods from the colony of origin to New England, and from there shipping the goods to Europe or to European colonies in North America, such as the

Dutch colony of New Netherland.<sup>125</sup> Since the products of New England were not enumerated, it was common for colonial ships to sail directly between New England and Europe. By sailing first to the southern colonies, then back to New England and on to Europe, the colonial merchants could capture a large share of the European trade from the English merchants. Beer also provides evidence that this sort of trade was a common practice:

The [direct trade with Europe] was brought to the attention of Parliament by some merchants engaged in the Virginia trade, who complained “that New England men did carry much tobacco and other commodities of the growth of the plantations to New England, and from thence did carry them to foreign nations, whereby they could undersell them and lessen his majesty’s customs.” (1913, p. 80)

In 1673, In order to discourage colonial merchants from taking advantage of the colony-to-colony-to-Europe trade, Parliament passed a law requiring the collection of export duties in the colonies on any enumerated articles unless bond was given in England to take the goods back to England and no other place.<sup>126</sup> These duties, known as the Plantation Duties, were farmed by customs officials stationed in the colonies and were nearly identical to duties paid upon importation in England.<sup>127</sup> The intention of the passage of this Act was to eliminate the incentive for merchants in the colonies to give bond to ship goods to another colony prior to giving bond to ship them to England.

---

<sup>125</sup> Andrews notes that New Amsterdam, the major port of New Netherland, was lost to England in 1664, and only briefly recovered in 1673. However, colonists continued to illegally trade enumerated goods with the Dutch either directly in Holland or in the Caribbean ports of Curacao, Surinam, and St. Eustatius. Andrews states that New England ships returning from the Caribbean with European goods “was strictly forbidden but frequently indulged in.” (1938b, p. 117)

<sup>126</sup> Harper (1939, p. 163)

<sup>127</sup> Beer (1913, p. 81 – 82)

However, New England merchants and authorities claimed that if the Plantation Duties were paid in the colonies, it was not required to give bond to ship the enumerated goods to England. Thus, they continued to carry these goods directly to foreign markets in Europe.<sup>128</sup>

## B. Ireland

The Staple Act of 1663 contained a clause that was most likely intended to prohibit the direct importation of the enumerated articles into Ireland. However, due either to obscure wording contained in the act, or to a conflict of interest between the British government and Irish customs officials, merchants were frequently allowed to ship colonial goods directly to Irish ports. In 1671, Parliament cleared the confusion with a new act that specifically forbade the direct shipment of the enumerated articles to Ireland. To ensure the enforcement of the new act, the English treasury stationed a representative in Ireland and Irish customs officials were specifically instructed not to permit the landing of enumerated commodities, and were “charged with making seizures and with keeping accounts of ships coming from the plantations ‘on any account or pretense whatsoever,’” (Harper, p. 152). These measures were not effective, as Beer describes:

The law was only very imperfectly enforced. The enumeration of tobacco was extensively evaded by vessels from the colonies sailing directly to Irish ports under pretenses of shipwreck and other fraudulent devices. In 1673, Treasurer Clifford enumerated nine ships that had sailed from the colonies

---

<sup>128</sup> Harper (1939, p. 164)

directly to Ireland with such prohibited goods. The English merchants complained that, although tobacco could not be legally imported into Ireland from the colonies, “nevertheless they of Ireland and New England and some from Virginia have and do come, by consent and without any seizure, for none can make a seizure but the Custom House officers, who in Ireland are the farmers [of the customs’] servants and dare not seize, it being their masters’ interest to have all they can brought there.” (1913, p. 95 – 96)

The farmers of the customs paid the king’s revenues at rates agreed to in advance. Any revenue collected in excess of this agreed upon level provided the income of the farmers.<sup>129</sup> Thus, their income depended directly on the quantity of imports brought to port – the more ships that landed their goods in Ireland, the higher the income of the farmers and their officials. Enforcement of the act would discourage merchants engaged in the trade of the enumerated goods from landing their cargoes in Ireland, effectively reducing the income of the farmers themselves. Thus, it was in the interest of the farmers (and the subordinate customs officials) to disregard the act.

The Act of 1671 contained a clause limiting the duration of the act to nine years. Upon its expiration in 1680 it was not renewed, which allowed once again for free importation of the enumerated articles into Ireland. However, the Act of 1673 which established colonial export duties, now applied to goods shipped to Ireland as well, as Ireland was treated in the same manner as England’s possessions across the ocean. Thus, the enumerated goods could be imported into Ireland directly from the colonies, but duties were paid in the colony where the goods were loaded rather than upon their

---

<sup>129</sup> See previous chapter for a more in-depth discussion of the practice of farming the customs revenue.



importation into Ireland. Enumerated articles sent to Ireland were either consumed there or reshipped to England, where import duties were collected by English customs officials.<sup>130</sup> After 1680, enumerated articles shipped to Ireland paid no duties to Irish customs officials but Irish customs officials made an attempt to wrest control of the colonial export duties from customs officials in the colonies.

The Commissioners of the Irish Revenue submitted a formal suggestion to the English government that it would be more advantageous to revenue for enumerated commodities to pay one-half the amount of the export duties upon importation into Ireland, rather than pay the amount in full in the colonies. The Commissioners claimed the colonial customs service was inefficiently organized, and thus duties were frequently not collected, at the expense of the English Exchequer. The government agreed and accepted the new proposal, but after a brief period reverted back to a policy of prohibition of direct importation of enumerated articles into Ireland.<sup>131</sup> Beer gives no reason for the return to the old policy regarding direct shipments to Ireland, but the case clearly illustrates the problems with enforcing colonial policy due to both faulty administrative machinery and competition between collection officials at various ports.<sup>132</sup>

---

<sup>130</sup> Beer (1913, p. 97 – 98)

<sup>131</sup> *Ibid* (1913, p. 100)

<sup>132</sup> In their efforts to overturn the reinstated prohibition (which resulted in many merchants sending ships directly to England rather than Ireland, Irish customs officials made claims of corrupt practices by customs officials in Bristol and the other outports (Beer, 1913, p. 103). These claims were probably at least partially founded in truth, due to the incentive that officials at the outports would have to lure ships away from London.

### C. English Merchants

The Isle of Man, located in the Irish Sea directly in between England, Ireland and Scotland, served as an entrepôt for smugglers of enumerated commodities. Harper describes the process:

Smuggling vessels could leave the Isle's ports, carrying fictitious documents to show legal destinations which warranted the ship's proceeding in the same general direction as the contemplated illegal voyage. . . . and, when stopped by His Majesty's ships off the English coast, [shipmasters] claimed that they were blown there by unfavorable winds. (1939, p. 154)

The Isle of Man was primarily used by tobacco merchants desiring to avoid paying customs duties. When English merchants re-exported tobacco that was previously imported, the government repaid a portion of the customs duties collected upon importation. The purpose of the repayment was to allow the English merchants to remain competitive in price when selling the re-exported goods in foreign markets. Flaws in the inventory system allowed English merchants to receive the partial repayment upon giving bond to re-export legally imported tobacco to Europe, ship the goods instead to the Isle of Man, smuggle the goods back into England without payment of additional import duties, and then collect the partial repayment again upon a second re-exportation. The merchants of smuggled colonial goods could then afford to sell in Europe at a price below the law-abiding British merchants, and remain competitive with the colonial and foreign merchants who illegally brought the goods directly from the colonies. Harper notes that while estimates of the loss of English customs revenue caused by smuggling vary, "all agree that it was considerable," (1939, p. 155).

While the Staple Act contained additional clauses intended to prevent violations of the Act from going unpunished, the new laws were put into practice in a very imperfect fashion. Harper lists the new requirements and the new law's shortcomings in the following passage:

The [Staple] Act of 1663 required importers, before unlading to give a "true and perfect inventory or invoice" of the ship's cargo that would show where the goods had been shipped. In addition, the commander was to inform the governor of his vessel's arrival, her name, the name of her master or commander, her owners, where she was built, and how she was navigated. Anyone who failed to subject himself to the customs inspection was, for that reason alone, guilty of an offense. The scheme was good, but it was not carried far enough. No punishment could be inflicted unless the goods were actually landed, no matter how guilty the shipmaster's intent might have been. Thus when the "Rebecca" was seized at New York before it had actually landed its prohibited cargo of European goods, the master saved his vessel by pleading that it had been blown off its course – more than a thousand miles – from Dutch Curacao to Danish St. Thomas. Even a flimsier excuse would have sufficed, since he had not set his goods ashore. (1939, p. 165 – 166).

### **VIII. Additional Attempts to Increase Revenue**

The crown secured significant revenues from the duties on colonial imports, particularly from those on tobacco and sugar, which were imported in much larger quantities than the other enumerated articles. However, these revenues were far from

maximized due to widespread evasion and the other opportunistic behaviors described in the sections above. In 1671, Charles II attempted to increase the duties on tobacco and sugar in order to secure larger revenues. However, many of the various groups of agents with interests in the colonial markets (colonial planters, colonial and English merchants, English importers of colonial goods, English sugar refiners, and customs officials) were well represented in Parliament, and no change in colonial policy would pass both houses unless satisfactory to all of the interested parties. In addition, without improvements in the system of enforcement, additional duties would only increase the instances of violations of the laws of navigation. Thus, several years prior to 1671, Charles set the Privy Council to the task of improving the administrative machinery in the colonies.

#### IMPROVEMENTS IN ENFORCEMENT IN THE COLONIES

Conflicts of interests between the colonists, including the governors responsible for enforcement of the Acts, and the English government created a less than ideal environment for revenue maximization. In addition, the ocean separating England from the colonies impeded the crown's ability to supervise the behavior of the colonists, which further increased the colonists' incentive to violate the Acts. Beer gives the following account of conditions in the colonies at the time of the passage of the Staple Act:

At a very early date, it was seen that the royal governors and their subordinate officials were not able to secure a strict enforcement of the laws of trade. At the same time, it was also fully realized that, as there were no imperial officials of any description in the proprietary and charter colonies, the laws were apt to be ignored by the local authorities in these semi-independent

jurisdictions, whenever their local interests were to any extent adversely affected. In 1662 and 1663, the chief violation complained of was the illegal shipment of tobacco directly to New Netherland and Europe. . . . Further action was demanded by the Farmers of the Customs, who were directly interested, in so much as this illegal trade diminished the English customs revenue. They complained that the colonial and English traders did, “both by land and water carry and convey great quantities of Tobacco to the Dutch whose plantations are contiguous, the Custom whereof would amount to ten thousand pounds per year or upwards, thereby eluding the late Act of Navigation and defrauding his Majesty.” (1913, p. 272 – 273)

The solution recommended by the farmers of the customs was that they be empowered, at their own expense, to appoint “agents resident in the plantations to report violations of the Navigation Acts.<sup>133</sup> The government ratified the recommendation of the farmers in April of 1664,<sup>134</sup> and the new officials were successful in limiting violations of the Acts. However, as stated above, revenues were farmed at rates agreed to in advance, thus the improvements in enforcement served to increase the welfare of the farmers rather than government revenue.

## PARLIAMENTARY DISPUTES

Although Parliament granted Charles II lifetime rights to the collection of the five percent customs duties on all imports and exports, efforts to supplement that revenue with

---

<sup>133</sup> Harper (1939, p. 79 and p. 171)

<sup>134</sup> Shortly after ratification, England went to war with the Dutch and the modification in the enforcement system was put on hold until after the conclusion of the war, in 1669. (See Beer, p. 273 and Harper, p. 171)

additional imposts and duties required the approval of Parliament as well. The economic agents who could potentially be affected by changes in the duties at the ports were well represented in Parliament, and fierce debates over the virtues of such additional duties made passage of acts containing such clauses extremely difficult. A proposed increase in the duties on tobacco and sugar in 1671 provides an excellent example of how the political process during the Restoration period made it difficult for Charles to capture rents.

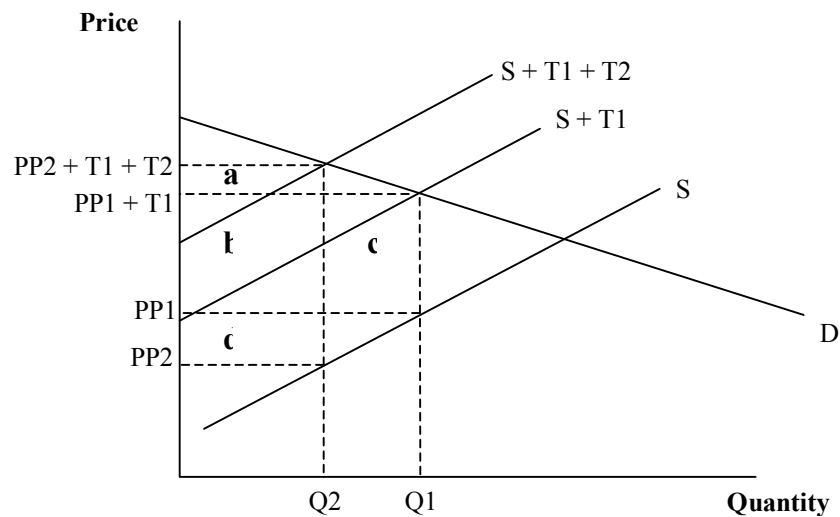
In 1671, the Staple Act of 1663 and the act prohibiting importation of enumerated goods into Ireland had passed, but the act requiring the collection of export duties on shipments from one colony to another would not pass for another two years. The colonial tobacco industry included competition between planters (including tobacco planters in England,) competition between colonial and English merchants,<sup>135</sup> a small but poorly organized group of tobacco importers, and competition at the retail level between licensed sellers.<sup>136</sup> Competition at every level in combination with poor enforcement of regulations resulted in a surprisingly elastic demand for legally-imported colonial tobacco. The presence of a number of readily available substitutes, including smuggled colonial tobacco and domestically grown tobacco would suggest that an increase in import duties would result in a large decrease in the quantity of tobacco consumed, which could reduce the level of revenue earned by the government. Figure 4-4 illustrates the effect of an increase in duties on total revenue in a market with elastic demand. Before an increase in duties, the customs duties amount to T1. This distance is represented on

---

<sup>135</sup> European merchants who successfully violated the Staple Act also participated in the colonial tobacco trade, as noted by the complaints voiced in the petition.

<sup>136</sup> See the previous chapter for a full discussion of the structure of the tobacco market.

the graph by  $PP1+T1 - PP1$ , where  $PP1$  is the amount of money earned by the producer for each unit sold, and  $PP1 + T1$  is the retail price. The total customs revenue prior to the increase in duties can be calculated by multiplying  $T1$  by  $Q1$ . In Figure 4-4, this amount is the sum of rectangle *b* and rectangle *c*. The additional duties move the supply curve from  $S+T1$  to  $S+T1+T2$  because the duties are collected from the importers who supply the goods to the consumer in England. The elastic nature of the demand curve limits the ability of the importer to pass on the burden of the additional duties to the consumer.



**Figure 4-4.** Effect of an Increase in Duties on Total Revenue when Demand is Elastic

In other words, in a market with a number of readily available substitutes, an increase in price will result in a large decrease in quantity demanded. In Figure 4-4, quantity demanded drops from  $Q1$  to  $Q2$  when the price rises from  $PP1+T1$  to  $PP2+T1+T2$ . The new tax revenue is calculated by multiplying the sum of  $T1$  and  $T2$  by  $Q2$ . The government earns more per unit sold, but loses the tax revenue on the quantity of goods that are no longer purchased. In Figure 4-4, the government gains areas *a* and *d* but loses area *c*. If the sum of *a* and *d* does not exceed *c*, then the government loses money from

increasing the revenue. In spite of this possibility, in 1671 the House of Commons passed a bill containing a proposed increase of one and one half pence per pound in the duties on tobacco.

Prior to passage, a petition against the additional duties was presented on behalf of the merchants, importers, and planters of tobacco.<sup>137</sup> The petition claimed that the new duties would be highly detrimental to the trade, suggesting that quantity demanded would decrease sharply (due to the elastic demand.) The demand for tobacco as a commodity tends to be fairly inelastic due to the addictive nature of nicotine, but the demand for legally-imported colonial tobacco could be elastic if a large number of illegal substitute goods were readily available. The probability that such alternatives existed is supported by the suppliers' desire to petition against the duties. Within the petition, the merchants argue that the additional duties would divert the colonial tobacco trade on the European continent to the Dutch, which implies that the Dutch were still regularly trading directly with the colonies in spite of the regulations in the Navigation Act of 1660 and the Staple Act. Also, the customs officials claimed that higher duties "would stimulate smuggling, with which they were already considerably troubled," (Beer, 1913, p. 148). These testimonials to the prevalent evasion of the Navigation Acts which occurred under the current customs level, in addition to previously cited cases of tobacco growing in England and colonial merchants trading directly with Europe, suggest that a proper enforcement system would be necessary before an increase in the duties would provide an increase in revenue to the crown. The House of Commons passed the bill in spite of the warnings of the petition.

---

<sup>137</sup> Beer (1913, p. 148)



Beer claims that the bill ultimately failed due to the opposition to the increases in the sugar duties contained within. In his words, “the sugar [duties] affected a number of diverse and conflicting interests and could not be arranged to the satisfaction of all,” (1913, p. 149). Among those “diverse and conflicting interests” were: the colonial sugar planters, the English sugar refiners, the English merchants trading with Portugal, and the English merchants trading with the West Indies. The concerns of the colonial sugar planters and the merchants who traded in the sugar colonies parallel those of the planters and merchants in the tobacco colonies: higher duties would lead to higher consumer prices which would lead to an increase in the demand for substitute sugar, namely that of the Portuguese colony of Brazil. At the time of the debate, Portugal’s colonial system required shipment of all colonial sugar to Portugal, where it was heavily taxed and either sold domestically or re-exported. Brazilian refined sugar sold for a price of about £3 5s per hundredweight<sup>138</sup> in England, whereas the English colonial product from the West Indies sold at a price of only £2 5s.<sup>139</sup> If the new duty on English sugar was not accompanied by a proportionate duty on Portuguese sugar, then a substitution effect could occur.

The English merchants engaged in the trade with Portugal opposed the increase in duties on Portuguese sugar for fear that it would cause the Portuguese buyers to prefer the goods of the French and Dutch.<sup>140</sup> If the English merchants trading to Portugal attempted to pass on the burden of the additional tax on Portuguese sugar to the Portuguese buyer of English goods, this could effectively raise the price of the English goods in Portugal,

---

<sup>138</sup> One hundredweight = 112 pounds

<sup>139</sup> Beer (1913, p. 150)

<sup>140</sup> *Ibid* (1913, p. 151)

which could also result in a substitution effect which decreased the demand for English goods.

The English sugar refiners also had a vested interest in the proposed new duties. The objective of the refiners was to encourage the importation of raw sugar and discourage the importation of refined sugar. Upon enumeration in the Navigation Act of 1660, raw sugar paid duties of one shilling six pence per hundredweight, and refined sugar paid five shillings per hundredweight.<sup>141</sup> The concern of the refiners in England was that an increase in only the duties on raw sugar, or even a nominally equal increase in the duties on both varieties, could induce colonists to refine the sugar themselves prior to exportation.<sup>142</sup> Interestingly, the English merchants in the West Indies supported the refiners' position. This was due to the fact that the refining process reduced the volume of sugar, thus the merchants could charge higher freight rates for the raw product.<sup>143</sup> The refiners also requested the inclusion of a drawback on the exportation of refined sugar in order to more effectively compete in European markets with Dutch refiners who, under the current system, were able to purchase raw English colonial sugar at a lower cost than the English refiners. The current system included a 50 percent drawback on colonial raw sugar that was re-exported in its raw state, but no drawback for refiners who imported raw sugar and re-exported it as refined sugar. Thus it was possible for Dutch refiners to purchase raw English sugar, refine it, and sell it in European markets at a lower price than the English refiners.<sup>144</sup>

---

<sup>141</sup> *Ibid* (1913, p. 152)

<sup>142</sup> An identical nominal increase in the duties would increase the smaller duties on raw sugar by a larger percentage, increasing the relative gains to the colonists of refining the sugar prior to exportation.

<sup>143</sup> Beer (1913, p. 153)

<sup>144</sup> *Ibid* (1913, p. 153)

The bill failed to become law due to a disagreement between the houses of Parliament on the appropriate ratio of duties between refined and raw sugar imports. The House of Commons supported the recommendation of the refiners of a ratio of four to one, while the House of Lords backed the planters request that the ratio be reduced to two and a half to one.<sup>145</sup> While new proposals on the matter continued to surface, no law raising the duties on colonial sugars would pass until the reign of James II in 1685. In the meantime, Charles II reduced violations of the Acts in the colonies through the establishment of tighter controls over colonial trade and the creation of new incentives for colonial merchants.

#### THE PLANTATION DUTIES

In 1671, Charles abandoned the farming method of revenue collection and installed a new system in an effort to capture a larger share of the rents available in the colonial trade.<sup>146</sup> Under the new system enforcement, the responsibility of monitoring adherence to the Navigation Acts in the colonies fell to the surveyors whom the Treasury assigned to each colony. The surveyors took over the duties of the agents previously appointed by the farmers of the customs. The surveyors answered directly to the newly appointed Commissioners of the Customs, and the Commissioners were directly responsible to the Treasury.

In 1673, Parliament passed the act containing the aforementioned Plantation Duties. The Act stipulated that any merchant ship from England intending to take on a cargo including enumerated goods from the colonies that had not given bond in England

---

<sup>145</sup> *Ibid* (1913, p. 153)

<sup>146</sup> *Ibid* (1913, p. 276)

to bring the cargo directly back to England was subject to additional duties at the port of departure in the colonies. The plantation duties were approximately equal to the customs duties imposed upon importation to England (one penny per pound on tobacco, and other amounts for the other commodities).<sup>147</sup> The Commissioners of the Customs created a new office, called collector, who served as deputy to the Surveyor and was responsible for collection of the plantation duties. While the revenue collected from the plantation duties was scarcely enough to cover the costs of collecting them, the duties and the additional officials stationed in the colonies had some success in achieving their primary purpose: discouraging direct shipments of enumerated commodities to Europe in violation of the Acts. Andrews acknowledges this purpose for the Plantation Duties, and also identifies the link between the prevention of violations of the Navigation Acts and the increase in revenue:

. . . the commissioners of the customs themselves defined the object of the duty as “less for revenue than to hinder the exportation of goods from colony to colony and so to foreign countries, evading the English customs.” Of course, indirectly, the law aided the revenue by stopping a leak in the system and so making more effective the working of the enumeration clause . . . but the first idea was to stop the leak and not to increase the customs revenue.  
(1938b, p. 121)

While Andrews correctly identifies the effect of the passage of the Plantation Duties (an increase in customs) the above passage leads the reader to believe that the revenue increase was an unintended consequence. The language of the passage would seem to

---

<sup>147</sup> Andrews (1938b, p. 119)

indicate that Andrews once again believes the motivation of the latest navigation law to be an improvement in overall social welfare and not an opportunistic attempt to increase crown revenue motivated by self-interest on the part of the king and the English customs officials. It is my position that the plantation duties were the first step in securing additional customs revenue at English ports. Further improvements enacted during Charles' reign would allow James II to secure the passage of an increase in the customs duties.

#### ADDITIONAL IMPROVEMENTS IN ENFORCEMENT

In 1685, James II would significantly increase revenue collected from the Navigation Acts. This change would not have been possible without the prior improvements in the system of enforcement enacted by the previous administration. Prior to 1678, in spite of all of the modification to the laws of navigation during the previous eighteen years violation of the acts were frequent. Andrews explains:

Breaches were numerous during these years. Secret trade with the Dutch and French in the West Indies went on without interference, direct connections with the European continent were maintained with Holland and Hamburg – the chief distributing centers for the Continental trade in colonial products – and “unfree” ships and foreign-built ships illegally made “free” were employed in the service of the colonies. The colonial governors . . . were not living up to the obligations imposed by their oaths and their bonds, and in the West Indies were admitting the French, Dutch and other foreigners to trade at

their respective ports. Governor Wheler of the Leeward Islands wrote in 1672 that he believed he was the only one who was doing his duty. (1938b, p. 145)

In 1678, Under Charles II, several improvements in the system were initiated. The Attorney-General was instructed to formally administer the royal governors' oaths to uphold the Navigation Acts.<sup>148</sup> Naval officers in the colonies were regularly required to send detailed accounts of all ships arriving in and departing from the colonies, as well as the content of their cargoes. Also at this time, perhaps the most significant change enacted was that of the Commissioners of the Customs adding the office of comptroller in every colony. The comptroller was subordinate to the collector, but acted as a check upon his actions and countersigned all accounts and reports sent to England. Finally, just prior to the reign of James II, it became customary for the Commissioners' collectors and the governor's naval officer to both check the bonds and cargoes of all ships upon arrival and departure. In this way the two officers served as a check on each other's actions in the same way that the comptroller served as a check on the collector.<sup>149</sup> All of these improvements in the system helped to reduce malfeasance and make the entire system more effective.

## **IX. The Navigation Act of 1685**

In 1685, Parliament finally passed an act that granted for eight years additional duties on tobacco and sugar in excess of 100 percent of the 1660 levels. Under the new act, colonial tobacco paid an additional duty of three pence per pound, bringing the total

---

<sup>148</sup> Prior to this time the requirement to swear an oath was largely ignored by the governors of the colonies. For evidence see Beer, p. 266 and Andrews p. 116 – 117, 145.

<sup>149</sup> Harper (1939, p. 175)

duties on tobacco to five pence per pound. Colonial raw sugar paid an additional duty of one farthing per pound, or two shillings four pence per hundredweight, bringing the total duties on raw colonial sugar to three shillings ten pence per hundredweight. Colonial refined sugar paid an additional duty of three farthings per pound, or seven shillings per hundredweight, bringing the total duties on refined sugar to twelve shillings per hundredweight. The following section will analyze how James II successfully secured additional revenues from colonial imports when attempts by his predecessor failed so utterly and completely. The answer involves compromises in the clauses of the Act and improvements in the system of enforcement which eliminated the availability of substitutes and allowed producers to pass on the burden of the additional duties to the consumer.

Previous attempts to increase the duties on tobacco and sugar met with strong opposition in Parliament due to a fear that consumers, both in England and in international markets, would seek out readily available substitutes for colonial goods, thus crippling the colonial industries and reducing the crown's revenue. The additional duties of the Act of 1685 met with the same strong opposition. Beer enumerates the arguments against the new duties:

This additional duty was opposed on the grounds: (1) that the trade was depressed, the existing charges being already "more than often times the commodity yielded"; (2) that these high duties would encourage smuggling and would lessen English consumption, experience showing that, the higher the tax, the less the revenue; (3) that these duties would stimulate the production of tobacco in Germany, France, and Holland and would tempt the

traders to violate the enumeration of tobacco; (4) that necessity would force the colonies to use their lands for raising provisions and would oblige them to make manufactures hitherto obtained from England. (1913, p. 161, footnote)

In order to get an increase in customs duties to pass, James first had to remove the consumers' incentive to turn to substitute goods. He accomplished this by raising the price of the substitute in some cases, and by eliminating the supply of the substitute in others.

#### CHANGES IN THE TOBACCO MARKET

Previous attempts to increase the customs duties on tobacco failed due to the threat of competition from smuggled tobacco (including tobacco imported directly to Europe,) and competition from domestically-produced tobacco, which up until this time was never suppressed in spite of repeated attempts at prohibition. At the time that James II proposed the additional duties of the Act of 1685, he was also successfully putting an end to domestic tobacco production. Proper compensation for enforcement officials resulted in complete enforcement of the laws, and the tobacco plantations in England were eliminated just a few years prior to the passage of the new duties.<sup>150</sup> The elimination of the most readily available source of substitute tobacco strengthened the ability of importers and retailers to pass the burden of the additional duties on to English tobacco consumers, which increased the likelihood that the members of Parliament who represented the interests of these groups would pass an act containing additional duties.

---

<sup>150</sup> See section VI of this chapter for a detailed discussion of the elimination of domestically produced tobacco.



Colonial importers also had to be concerned about English consumers substituting between colonial tobacco and foreign tobacco upon the event of an increase in the duties on the colonial imports. James II prevented this issue by including in the bill an increase of six pence per pound in the customs duties on foreign tobacco imported into England, bringing the total duties on foreign tobacco imports to one shilling per pound. The increases in the duties on colonial tobacco and foreign tobacco were not proportional (the ratio of duties on foreign to colonial tobacco fell from three to one to approximately two and a half to one,) but the supply of foreign tobacco was so limited, and the difference in the duties on the two products was still so great, that the demand for colonial tobacco was not affected much by the change in the ratio.<sup>151</sup>

Smuggled tobacco presented another alternative source to which consumers may turn upon the event of an increase in the price of legally imported tobacco. Smuggling, while a problem in England as well, presented an even greater challenge for merchants who desired to sell colonial tobacco on the international markets. The ease with which colonial merchants could send ships carrying tobacco and other enumerated goods directly to Europe created a threat to the crown's ability to collect additional revenues from higher duties. An increase in duties at English ports would likely create an incentive for more merchants to send enumerated goods directly to Europe in violation of the law in order to avoid paying the additional duties. An additional alternative source of tobacco for continental consumers which was growing larger at this time was tobacco which was produced domestically in Europe. For several years prior to 1685, Holland,

---

<sup>151</sup> Beer (1913, p. 161)

France, and Germany all experienced growth in the supply of homegrown tobacco.<sup>152</sup> There is no evidence to suggest that tobacco grown in these areas were equal in quality to that grown in the British colonies; however, there is still reason to believe that these goods served as a viable substitute. English homegrown tobacco was widely considered inferior to the colonial product as well,<sup>153</sup> but consumers in England purchased large enough quantities that the supply continued to expand for approximately 60 years before the prohibition was properly enforced. Therefore, the king had to assume that European consumers would respond likewise if the price of colonial tobacco increased on the international market.

Since James II could not pass a law banning the production of tobacco in Europe, the only alternative that would ensure that legally re-exported colonial tobacco remained competitive in international markets was to prevent an increase in the price. James accomplished this by refunding 100 percent of the additional duties on tobacco upon re-exportation.<sup>154</sup> By providing an exemption for re-exported tobacco, James II reduced the incentive for merchants trading in the European markets to ship colonial tobacco directly, and reduced the need for European consumers to seek a relatively lower-priced alternative to colonial tobacco. Thus, James II could keep merchants satisfied enough for their representatives of their interests in Parliament to pass the additional duties, and the king still benefited from the additional duties collected on tobacco consumed in England.<sup>155</sup>

---

<sup>152</sup> *Ibid*

<sup>153</sup> See Beer (1913, p. 139)

<sup>154</sup> *Ibid* (1913, p. 161)

<sup>155</sup> There also exists reason to believe that the crown earned revenue on re-exported tobacco even though the duties were repaid. Andrews notes that re-exporting tobacco from England to Europe was too costly to

## CHANGES IN THE SUGAR MARKET

While many of the challenges facing the economic agents in the colonial sugar market were identical to those faced by agents in the tobacco industry, a few unique problems also existed. Sugar merchants faced the same threat of buyers, both English and European, seeking alternative sources of supply for sugar. Portugal was importing large quantities of sugar from Brazil, and the French colonial sugar industry was also growing in size and strength at this time. In order to prevent consumers from facing an incentive to purchase sugar from other sources, both in England and abroad, the Act of 1685 included a full drawback of the additional duties on sugar upon re-exportation and an increase in the duties on foreign sugar imported into England. Raw sugar imported from Portugal paid an additional two farthings per pound (double the increase in the colonial duties) and refined foreign sugar paid an additional five farthings per pound (67 percent more than the increase in the colonial duties.<sup>156</sup>)

No domestic supply of sugar existed in England, which eliminated one of the challenges of passing the new duties; however, the existence of two classifications, raw and refined, of sugar presented an additional issue which the king had to overcome. Previous attempts to increase the sugar duties failed largely due to disagreements among Parliament members over the ratio of the additional duties on the new product. Representatives of the English sugar refiners desired a ratio of refined import duties to raw import duties of four to one. This ratio would make refining in the colonies

---

colonial merchants to be profitable, thus the re-exporting business “was largely, if not entirely, controlled by the English factors” (1939, p. 88). If James could successfully restrict entry into the re-exportation market, he could collect revenue through indirect taxation of the English merchants’ monopsony of surplus colonial tobacco.

<sup>156</sup> Beer (1913, p. 161)

unprofitable, ensuring that all sugar was imported in a raw state, thus increasing the demand for English refining services. On the other hand, representatives of the colonial sugar planters desired a ratio of duties of two and a half to one. A relatively low duty on refined sugar would allow the colonial refiners to prosper, ensuring that the market for raw sugar remained competitive, rather than granting the English refiners a monopsony. If English refiners were allowed to establish themselves as the only buyers of raw colonial sugar, then they could set a low price, keeping their own costs down but damaging the business of the colonial planters. The Act of 1685 set the ratio of additional refined to raw duties at three to one, which maintained the ratio established by the Act of 1660. This satisfied all parties involved without giving any an unfair advantage over the other, contributing to the passage of the act in Parliament.

Once the Act of 1685 passed Parliament, its success would depend on two factors: the ability of merchants to smuggle goods into England, and the price elasticity of demand for the products, which were partly controlled by prohibitive tariffs on foreign imports and the prohibition of domestic supply. Beer provides evidence that the new duties were relatively successful, due in large part to improvements in enforcement, which was responsible for the elimination of the domestic supply of tobacco:

The only way in which these duties could adversely affect the colonies was by lessening consumption in England. To some degree this must have been the result, but its extent was apparently not important. In the case of tobacco, upon which the new duties were relatively much higher than were those on

sugar, they also led to the adulteration of the article in England<sup>157</sup> and likewise probably stimulated smuggling, both of which reacted unfavorably on the planter. The disadvantages to the colonies were, however, slight in comparison with the renewal of the preferential treatment of their produce. These new taxes produced a comparatively large revenue; from 1688 to 1692 it averaged about £122,000 yearly, of which £90,000 was derived from the tobacco impost. (1913, p. 166)

This result suggests that the elimination of domestic tobacco production, in combination with the inelastic demand from which tobacco producers benefit to this day, contributed greatly to the success of the new duties. In fact, the new duties on tobacco were so successful that on their expiration in 1693, the sugar duties were discontinued and those on tobacco were continued in perpetuity.<sup>158</sup>

## **X. Conclusion**

Prior to the work of Stigler and Peltzman in the 1970s, analyses of economic regulation assumed that regulation was always motivated in the interest of maximizing overall social welfare. Operating within this paradigm, historians have traditionally viewed trade policies of the mercantile era as having the objective of maximizing the welfare of the entire nation as a whole. Harper declares that the goal of England's 17<sup>th</sup> century colonial policy was "a self-sufficient empire, with the interests of the different sections nicely balanced," (1939, p. 217). This explanation is usually consistent with

---

<sup>157</sup> By "adulteration" Beer means the process of mixing the stalk and stem of the tobacco in with the leaf, which reduced the quality but increased the weight by 20 percent.

<sup>158</sup> Beer (1913, p. 167)

England's colonial trade policies. However, the motives for regulation listed by historians cannot account for some of the features of the Navigation Acts enacted over the second half of the century. For instance, the historians' take fails to explain the purpose for the enumeration of colonial tobacco when it was possible for England to produce tobacco domestically without relying on foreign supply. Historians also have difficulty accounting for biases against the colonies contained within the Navigation Acts. Such biases, when acknowledged, are generally written off as unintentional errors that result from miscalculations on the part of policy makers. The historians frequently use terms such as "unfortunate," "error," and "carelessness" (Harper, p. 219).

The economic theory of regulation demonstrates that chance does not play such a weighted role in the regulatory process. The regulator applies restrictions on particular markets in an attempt to protect his interests and the interests of those that can most readily assist him in accomplishing his goal. The regulator who seeks to maximize social welfare will refrain from regulating a market which naturally tends toward a competitive structure. It is clear from the continual threat of entry that the colonial markets which the English government regulated in the 17<sup>th</sup> century were competitive in their natural state. The regulations were not administered with the desired objective of attaining a strong, self-sufficient mercantilist state. They were designed and administered to maximize the utility of government officials and certain powerful interest groups, such as the merchants and trading companies. Certainly the system was not without its flaws, but the biases against the colonies were by design, not unintentional consequences of an experimental system. The flaws involved improper enforcement which resulted in various opportunistic behaviors on the part of several groups of agents operating in

European and colonial markets. In order to prevent the dissipation of rents and failure to realize potential revenues from regulation, continual modifications to the Navigation Acts were required over the second half of the seventeenth century. It is clear from the path followed over the course of the evolution of the Navigation Acts that modifications of colonial policy were enacted primarily to increase the customs revenue, not to improve self-sufficiency or maximize total social welfare.

The evolution of the Navigation Acts did not end with the passage of the Act of 1685. While the improvements in the Navigation Acts between 1660 and 1685 impaired the ability of agents in colonial markets to profit from engaging in opportunistic behavior, the system was still by no means perfect. An additional, sweeping revision was required before the end of the century, and furnished with the Navigation Act of 1696. Between 1685 and 1696, the English government was still troubled by a variety of illegal behaviors. Shipmasters frequently supplied inspectors with false bonds naming unknown merchants from uncertain residences as owners of shipments of enumerated goods. In some cases, bonds were not given at all and cooperative inspectors in smuggler-friendly ports<sup>159</sup> provided false certificates declaring that bond had been given prior to the landing of the goods.<sup>160</sup> The double-checking of ships' papers by the naval officer and the customs collector in colonial ports were not always practically feasible, and, as Harper notes, "a keen rivalry developed between the naval officers and the Commissioner's deputies, stimulated in part by competition for fees and the share of forfeitures given informers, . . . [enabling] the unfair trader to play one official against the other," (1939, p. 174). In addition, colonial officers were not granted the full administrative authority as

---

<sup>159</sup> Officials in ports in Scotland were cited most frequently as engaging in such activities.

<sup>160</sup> Harper (1939, p. 164)

officers in England until the Navigation Act of 1696 formally extended the regulations imposed by the Act of Frauds of 1662 to the entire empire.<sup>161</sup>

The system of regulation of colonial trade embodied in the Navigation Acts needed frequent modification throughout the entire 17<sup>th</sup> century in England. Opportunistic behavior by various groups of economic agents, and the high costs associated with monitoring actions across an ocean, exposed the systems' many flaws. The efficiency of the system improved over time, eventually allowing James II to increase customs duties and bring in substantially more revenue. Each tightening of the crown's grip on colonial affairs, however, put additional strain on England's relationship with the colonists. Beer nicely sums up the attitude of the colonists over this period:

Such quarrels [between colonists and crown agents,] which cropped up every now and again, hampered the efficiency of the administrative system and interfered with the enforcement of the laws. They were a direct result of the triple system of control in England and the absence of an absolutely supreme central authority in the colony, which could make its will immediately effective. If such difficulties existed in the royal provinces, it is not surprising that far greater obstacles were encountered in the charter and proprietary governments. For in these quasi-independent jurisdictions there was no royal governor, and the local authorities viewed with suspicion and dislike all agents of the imperial government. They were over-prone to look upon every act of the customs officials and of the officers of the navy as an invasion of the liberties guaranteed by the colonial charters. The resulting friction, while

---

<sup>161</sup> *Ibid* (1939, p. 176)



far more serious, was similar in its manifestations to that in the royal provinces. But it proceeded from a radically different cause. In the one case, the trouble was due to a defect in the administrative machinery, which would have been remedied by a slight readjustment. In the other, it was due to what was regarded by these self-governing communities as the intrusion of an alien authority within their limits; and for this there was no corrective other than a revolutionary change in their political status. (1913, p. 314 – 315)

As the English government's policy became more and more regulatory in nature, and as instances of direct taxation became more common, the colonists would fight for and achieve that revolutionary change in political status they desired.

## **CHAPTER 5:**

### **CONCLUSION**

The traditional view of mercantilist colonial expansion offers an incomplete explanation for the development of colonial economic policy. Historians have traditionally assumed that mercantile policies were always designed to accomplish goals such as state-building, self-sufficiency, and increasing the common good. However, this approach ignores the self-interested motivations of the influential groups and individuals responsible for getting such legislation passed. My approach follows Ekelund and Tollison's analysis of the regulation of domestic markets in mercantile England, and focuses on the importance of incentives in determining all economic behavior, including the enactment of government policies. Through an evaluation of the evolution of England's seventeenth century colonial policies, I offer a more thorough and complete explanation for the development of regulations of colonial trade. I have shown that, despite what initially appears to be evidence to the contrary, the purpose of England's colonial policy was the maximization of revenues through indirect taxation of government-granted monopolies. The policies were designed to maximize artificial rents through the restriction of competition. The traditional view of mercantilism tends to ignore the supply and demand for regulation which formed the basis for England's colonial policies; however, the two approaches are not entirely incompatible. Historians

have not failed to stress the importance of maintaining steady government revenue for the purpose of defending the empire, and from their perspective, the regulation of colonial markets helped to ensure the safety of the entire empire, and thus were designed for the good of the empire as a whole.

I have shown in my analysis that the crown often failed in its attempts to maximize revenues through the capture of artificial rents. The primary objective of the English government was to force all colonial exports to pay duties at English ports. The crown established an importation monopoly, and attempted to require all sales of colonial tobacco to go through the only legal channel. Ideally, the importer could use market power to buy colonial tobacco from merchants at cost and sell it to retailers at monopoly prices, thus maximizing the available rents. A flawed system of enforcement and incomplete record-keeping allowed for widespread evasion of the law on the part of opportunistic economic agents at every level of colonial industries.

Colonial planters traded large portions of their output directly with European merchants in violation of the law. For many years, the sole agent responsible for monitoring the behavior of the colonial planters was the colonial governor. The welfare of the governor depended on a high number of transactions and high farm prices for tobacco, thus he encouraged violations of the law. Efforts at crop controls, which restricted the number of plants each farmer could legally cultivate, resulted in efforts to increase the yield per plant and reductions in quality. English merchants who wished to avoid the payment of import duties smuggled tobacco into England in large quantities, and were often aided in their efforts by customs officials of the outports, who were prohibited from importing colonial goods but depended on high merchant traffic rates for

their welfare. English tobacco retailers benefited not only from a supply of smuggled tobacco, but also from the sale of large quantities of tobacco grown illegally in England. The English farmers received a greater return from illegal tobacco than from the planting of any other crop, and the retailers could purchase the domestic crop at a discount, as it paid no import duties. The justices of the peace, who were responsible for enforcing the ban on domestic planting, depended on land rentals for their income. Since the return to the farmers of tobacco earned a higher return, lands used for tobacco paid higher rental prices than other properties. Thus, the justices of the peace had an incentive to ignore the ban on domestic planting. All of these factors reduced the crown's share of the rents available in the market. The only factor that prevented economic rents from being altogether eliminated in the tobacco market was the ever-increasing demand for tobacco both in England and in the other nations of Europe.

The English government improved the system of enforcement over time, and gradually reduced the opportunities for market participants to redistribute rents to themselves. Toward the end of the 1630s, Charles I introduced two new components to the system of enforcement which greatly improved his ability to restrain competition and capture rents. First, he required that colonial port officials keep records of all shipments in and out of the colonies, and that they send copies of the records to England twice a year. By holding port officials accountable for all colonial exports, the king reduced the incentive for colonial officials to allow the illegal shipment of illegal goods directly to Europe. Second, Charles established a system of licensing for tobacco retailers and hired an official to both issue the licenses and collect fines from retailers who sold illegal tobacco. The pay of the official depended on an efficient execution of his duties, which

eliminated the malfeasance present when such duties were the responsibility of the justices of the peace. Once the new system was in place and proved to be effective, Charles faced competition from Parliament for the right to supply the regulation of the colonial markets. This dispute contributed to the Civil War which broke out in England shortly thereafter.

During the Civil War and the Interregnum, the enforcement of colonial trade restrictions was mostly ignored and participants in colonial markets returned to their prior opportunistic behaviors: reestablishing networks for direct trade with Europe and for smuggling, and selling smuggled and domestic tobacco without a license. Upon the restoration of the monarchy in 1660, King Charles II attempted to return to a system of regulation of colonial trade by issuing the first of the Navigation Acts. Again, imperfections in the system of enforcement would require constant modifications to the acts throughout the remainder of the century. James II passed the first increase in the duties on colonial goods in over 60 years in 1685. He was able to increase the duties thanks to a series of improvements in the system that reduced the incentives to evade the law. He successfully eliminated the domestic tobacco plantations, and discouraged a direct trade with Europe through a closer monitoring of colonial ports and a repayment of import duties on tobacco re-exported to Europe. However, the ever-present threat to the crown's power, from both rival nations and Parliament, created an incentive for the king to continue to tighten the restrictions on colonial markets. Eventually, this behavior by the crown would lead to one final form of competition: competition from the colonists themselves over the right to govern the colonies.

In modern society we still see many of the unintended consequences of economic regulation which troubled the English government in the seventeenth century. Efforts at crop controls in the agricultural markets of the United States result in attempts to increase yields. Prohibition of the sale of certain goods, such as narcotics, inevitably results in black markets. Government officials still claim, as they did in the mercantile era, that regulation is in the interest of the public, despite the fact that economists such as Stigler (1971) and Peltzman (1976) have shown that government intervention generally reduces social welfare, and regulations are passed in the interest of the regulators who require the votes of those seeking regulation to stay in power. In the future, perhaps the internet will reduce organization and information costs to the extent that those adversely affected by regulation can create an incentive for self-interested policy makers to refrain from regulation if they want to remain in office. Until then, as long as influential groups in the economy continue to use rent-seeking to demand regulations which benefit themselves at the expense of the economy as a whole, self-interested government officials will continue to supply them – just as they have for hundreds of years.

## BIBLIOGRAPHY

- Andrews, Charles M. 1938a. *The Colonial Period of American History Vol. I*. New Haven: Yale University Press.
- Andrews, Charles M. 1938b. *The Colonial Period of American History Vol. IV*. New Haven: Yale University Press.
- Baker, Charles A. 1936. "Property Rights in the Provincial System of Maryland: Proprietary Revenues." *Journal of Southern History* 2: 211-232.
- Baysinger, Barry, and Robert Tollison. 1980. "Evaluating the Social Costs of Monopoly and Regulation." *Atlantic Economic Journal* 8: 22 – 26.
- Beard, T. R., David Kaserman and John Mayo. 2003. "A Graphical Exposition of the Economic Theory of Regulation." *Economic Inquiry* 41: 592 – 606.
- Becker, G. 1976. "Comment." *Journal of Law and Economics* 19: 245 – 248.
- , and G. J. Stigler. 1974. "Law Enforcement, Malfeasance, and Compensation of Enforcers." *Journal of Legal Studies* 3: 1 – 18.
- Beer, G. L. 1913. *The Old Colonial System 1660 – 1754*. Vol. 1 - 2. New York: Macmillan.
- , 1908. *Origins of the British Colonial System 1578 – 1660*. New York: Macmillan.
- Billings, Warren M., John Selby, and Thad Tate. 1986. *Colonial Virginia: A History*. White Plains: KTO Press.
- Bruce, Philip. 1895. *Economic History of Virginia in the Seventeenth Century*. New York: Macmillan.
- Carlos, Ann, and Stephen Nicolas. 1990. "Agency Problems in Early Chartered Companies: The Case of the Hudson's Bay Company." *Journal of Economic History* 50: 853 – 875.

- Carr, Lois Green, Russell Menard, and Lorena S. Walsh. 1991. *Robert Cole's World: Agriculture and Society in Early Maryland*. Chapel Hill: University of North Carolina Press.
- Carr, Lois Green, Phillip Morgan, and Jean B. Russo. (eds.) 1988. *Colonial Chesapeake Society*. Chapel Hill: University of North Carolina Press.
- Chadwick, Edwin. 1829. "Preventive Police." *London Review* 1: 252 – 308.
- . 1859. "Results of Different Principles of Legislation and Administration in Europe; Of Competition for the Field, as Compared with Competition within the Field of Service." *Royal Statistical Society Journal* 22: 381 – 420.
- Cournot, A. A. 1960 (first published in 1838). *Researches into the Mathematical Principles of the Theory of Wealth*. New York: A. M. Kelley.
- Craven, Wesley. 1949. *The Southern Colonies in the Seventeenth Century, 1607 – 1689*. Baton Rouge: Louisiana State University Press.
- Demsetz, Harold. 1968. "Why Regulate Utilities." *Journal of Law and Economics*. 11: 55 – 65.
- Desmarais, Norman and James H. McGovern (eds.) *Essential Documents in American History*. Providence: Great Necks Publishing.
- Dickerson, Oliver. 1951. *The Navigation Acts and the American Revolution*. Philadelphia: University of Pennsylvania Press.
- Dowdell, Stephen. 1965 (first published in 1884). *History of Taxation and Taxes in England*. London: Frank Cass and Co.
- Dupuit, Jules. 1962 (first published in 1849). "On Tolls and Transport Charges." in E. Henderson (trans.) *International Economic Papers*. London: MacMillan.
- Ekelund, Robert and Robert Hébert. 1990. *A History of Economic Theory and Method*. New York: McGraw-Hill, Inc.
- and Robert Tollison. 1981. *Mercantilism as a Rent-Seeking Society*. College Station: Texas A & M University Press.
- . 1997. *Politicized Economies*. College Station: Texas A & M University Press.
- Galenson, David. 1989. *Markets in History*. Cambridge: Cambridge University Press.



- Gately, Ian. 2001. *Tobacco: A Cultural History of How an Exotic Plant Seduced Civilization*. London: Simon and Schuster UK, Ltd.
- Gray, L.C. 1927. "The Market Surplus Problem of Colonial Tobacco." *William and Mary Quarterly* 8: 231 – 245.
- Harper, Lawrence. 1973 (first published in 1939). *The English Navigation Laws: A Seventeenth-Century Experiment in Social Engineering*. New York: Octagon Books.
- Harberger, A. C. 1954. "Monopoly and Resource Allocation." *American Economic Review* 44: 77-87.
- Heckscher, E. F. 1934. *Mercantilism*. 2 vols. London: George Allen and Unwin.
- Holdsworth, W. 1966 (first published in 1903). *A History of English Law*. Vol. 1. London: Methuen and Co.
- Irwin, Douglas. 1992. "Strategic Trade Policy and Mercantilist Trade Rivalries." *AEA Papers and Proceedings* 82: 134 – 139.
- Jones, S. R. H., and Simon Ville. 1996. "Efficient Transactors or Rent-Seeking Monopolists? The Rationale for Early Chartered Trading Companies." *Journal of Economic History* 56: 898 – 915.
- Kepler, Jon. 1999. "Estimates of the Volume of Direct Shipments of Tobacco and Sugar from the Chief English Plantations to European Markets, 1620 – 1669." *Journal of European Economic History* 28: 115 – 130.
- Krueger, Anne O. 1974. "The Political Economy of the Rent-Seeking Society." *American Economic Review* 64: 291 – 303.
- Kulikoff, Allan. 1979. "The Economic Growth of the Eighteenth-Century Chesapeake Colonies." *Journal of Economic History* 39: 275 – 288.
- Kulikoff, Allan. 1986. *Tobacco and Slaves*. Chapel Hill: University of North Carolina Press.
- Luthy, Herbert. 1961. "Colonization and the Making of Mankind." *Journal of Economic History* 21: 483 – 495.
- MacInnes, C. M. 1926. *The Early English Tobacco Trade*. London: Kegan, Paul, Trench, Trubner, and Co.
- Maitland, F. W. 1908. *Constitutional History of England*. Cambridge: Cambridge University Press.

- McCusker, John, and Russell Menard. 1985. *The Economy of British America, 1607 – 1789*. Chapel Hill: University of North Carolina Press.
- Muldrew, Craig. 1993. “Credit and the Courts: Debt Litigation in a Seventeenth-Century Urban Community.” *Economic History Review* 46: 23 – 38.
- Nef, J. U. 1968 (first published in 1940). *Industry and Government in France and England, 1540 – 1640*. New York: Russell and Russell.
- Nettles, Curtis P. 1952. “British Mercantilism and the Development of the Thirteen Colonies.” *Journal of Economic History* 12: 105 – 114.
- North, Douglass. 1971. “Institutional Change and Economic Growth.” *Journal of Economic History*
- North, Douglass C. and Barry Weingast. 1989. “Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England.” *Journal of Economic History* 49: 803 – 832.
- O’Brien, Patrick K. 1988. “The Political Economy of British Taxation, 1660 – 1815.” *Economic History Review* 41: 1 – 32.
- Olson, Alison. 1983. “The Virginia Merchants of London: A Study in the Eighteenth-Century Interest-Group Politics.” *William and Mary Quarterly* 40: 363 – 388.
- Pecquet, Gary M. 2003. “British Mercantilism and Crop Controls in the Tobacco Colonies: A Study of Rent-Seeking Costs.” *Cato Journal* 22: 467-484.
- Peltzman, Sam. 1976. “Toward a More General Theory of Regulation.” *Journal of Law and Economics* 19: 211 – 240.
- Posner, Richard A. 1975. “The Social Costs of Monopoly and Regulation.” *Journal of Political Economy* 83: 807 – 827.
- Price, Jacob M. 1964. “The Economic Growth of the Chesapeake and the European Market.” *Journal of Economic History* 24: 496 – 511.
- Price, Jacob M. and Paul G. E. Clemens. 1987. “A Revolution of Scale in Overseas Trade: British Firms in the Chesapeake Trade, 1675 – 1775.” *Journal of Economic History* 47: 1 – 43.
- Rive, Alfred. 1929. “A Brief History of the Regulation and Taxation of Tobacco in England.” *William and Mary College Quarterly Historical Magazine* 9: 1 – 12.
- Robinson, Joan. 1933. *The Economics of Imperfect Competition*. London: MacMillan.

- Saloutos, Thodore. 1946. "Efforts at Crop Controls in Seventeenth Century America." *Journal of Southern History* 12: 45 – 66.
- Sawers, Larry. 1992. "The Navigation Acts Revisited." *Economic History Review* 45: 262 – 284.
- Schlesinger, Aurthur. 1966. *The Colonial Merchants and the American Revolution 1763 – 1776*. New York: Fredrick Ungar.
- Scott, W. R. 1951 (first published in 1912). *The Constitution and Finance of English, Scottish, and Irish Joint-Stock Companies to 1720*. 2 vols. New York: Peter Smith.
- Smith, Adam. 1937 (first published in 1776). *The Wealth of Nations*, ed. E. Cannan. New York: Random House.
- Sosin, Jack. 1965. *Agents and Merchants*. Lincoln: University of Nebraska Press.
- Stigler, George J. 1971. "The Theory of Economic Regulation." *Bell Journal of Economics and Management Science* 2: 3 – 21.
- Tate, Thad and David L. Ammerman. (eds.) 1979. *The Chesapeake in the Seventeenth Century: Essays on Anglo-American Society*. Chapel Hill: University of North Carolina Press.
- Tollison, Robert D. 1982. "Rent-Seeking: A Survey." *KYKLOS* 35: 575 – 602.
- Tullock, Gordon. 1967. "The Welfare Costs of Tariffs, Monopolies, and Theft." *Western Economic Journal* 5: 224 – 232.
- , 1980a. "Efficient Rent Seeking." in Buchanan, Tollison, and Tullock. (eds.) *Toward a Theory of a Rent-Seeking Society*. College Station: Texas A & M University Press.
- , 1980b. "Rent-Seeking as a Negative Sum Game." in Buchanan, Tollison, and Tullock. (eds.) *Toward a Theory of a Rent-Seeking Society*. College Station: Texas A & M University Press.
- Weiser, Friedrich. 1967 (first published in 1914). *Social Economics*. New York: A. M. Kelley.
- Wells, John and Douglas Wills. 2000. "Revolution, Restoration, and Debt Repudiation: The Jacobite Threat to England's Institutions and Economic Growth." *Journal of Economic History* 60: 418 – 441.

Winch, D. N. 1963. "Classical Economics and the Case for Colonization." *Economica* 30: 387 – 399.

Zanella, Fernando, Robert Ekelund, and David Laband. 2003. "Monarchy, Monopoly and Mercantilism: Brazil versus the United States in the 1800s." *Public Choice* 116: 381 – 398.

**APPENDIX:**  
**SOURCES FOR TOBACCO MARKET DATA**

This appendix will explain the derivation of all data contained in Table 1 in this chapter. The table uses data from seven sources as well as my original calculations of available market rent. I will cite sources for each specific value and give explanations of estimates and original calculations when appropriate. The table is reprinted below.

**Table 1:** Estimated Rents

Year	Quantity	Retail Price	Cost	Total Rent	Crown's Share
1602	16,128 lbs.	£1 7s	2s 3d	£19,958	£134 (0.7%)
1621	125,000 lbs.	5s	1s 8d	£20,833	£8,000 (38.4%)
1624	406,000 lbs.	2s 10d	1s	£37,216	£6,390 (17%)
1631	1,500,000 lbs.	11d	6d	£31,250	£6,792 (22%)
1640	1,593,000 lbs.	11d	2.5d	£56,419	£20,902 (37%)

**A. Quantity**

For 1602, see MacInnes (1926, p. 35).

For 1621, see Kepler (1999, p. 119).

For 1624, Beer (1908, p. 120) provides evidence from the Customs Rolls that 203,000 pounds of colonial tobacco were imported into England. Kepler does not provide an estimate of colonial tobacco shipped directly to European markets for the year 1624, but estimates that between 1622 and 1631, the amount of colonial tobacco shipped directly to Europe averaged 61 percent of the total quantity produced. Thus, I simply

doubled Beer's observation for English imports, and I conclude that this is a rather conservative estimate of the total colonial quantity produced.

For 1631 and 1640, see Kepler (1999, p. 119).

## **B. Retail Price**

For 1602, I estimated the market price of Spanish tobacco using observations for 1600 and 1603 which MacInnes obtains from the Report of Historical Manuscripts Commission. MacInnes lists a 1600 market price of sixteen shillings and a 1603 market price of 33 shillings. Assuming a constant growth in market price due to increases in demand and supply restrictions at the farm and retail levels, the market price of Spanish tobacco increased at a rate of 5.67 shillings per year. Thus I estimate that the price of tobacco in 1602 was 27 shillings, or £1 7s. It is possible that the market price of tobacco rose slowly initially and faster later as the popularity of consumption increased. Under such conditions my estimate would be a bit high, but the crown's revenue from tobacco imports at this time was so low that even if I overestimated the price, it would have little effect on the percentage of rents captured by the crown.

For 1621, see Beer (1908, p. 92), Gray (1927, p. 232), and Rive (1629, p. 5).

For 1624, Beer (1908, p. 136) states that the crown agreed to purchase colonial tobacco at a price of "£15 a hundredweight." A hundredweight contained 121 pounds, thus each pound sold for a price of two and a half shillings, or 2s 10p.

For 1631 and 1640, see Beer (1908, p. 169).

### **C. Cost**

Menard (1980) uses the farm price of Virginian tobacco as a proxy for the cost of production. This is a reasonable estimation due to the competitive nature of the supply of colonial tobacco. All values for cost are taken from Menard except for 1631, which was not observed by Menard and thus I used the farm price listed by Jacobstein (1907, p. 23). For 1602, the only tobacco imported into England was from the Spanish colonies, and the cost of production is unknown. I use the farm price of Virginian tobacco during the first year of its exportation as a proxy. The cost of producing tobacco in the Spanish colonies should be comparable to that of production in the English colonies. It is possible that this value is actually too high, since the Spanish producers had been in the market longer and were possibly more efficient producers. However, lowering the value in the table above would only increase the total rents available for capture, making the share captured by the crown even smaller.

### **D. Total Rent**

The values for the total rent available for capture are an original contribution of this dissertation. To estimate total rents, I used the following formula:

$$(1) \text{ Rent} = (P - C) * Q$$

where P = market price, C = farm price, and Q = quantity of colonial tobacco produced.

### **E. Crown's Share**

For 1602, I multiplied the duties on tobacco (two pence) noted by Beer (1908) and MacInnes (1926) by the quantity of tobacco imported, and assumed that the crown

received the entire sum. This is certainly overstating the revenue actually received by the treasury, as it does not take into account any payments to collectors.

For 1621, see Rive (1929, p. 8).

For 1624, see Beer (1908, p. 170).

For 1631, I estimated the crown's revenue using the values noted by Beer (1908, p. 170 – 171) for 1624 and 1632. Beer lists revenues from the customs rolls as £6,390 for 1624 and £6,850 for 1632. I assume a constant rate of growth in the revenue over that period, and estimated that the crown's revenue annually increased by £57.5. Thus, I estimate the 1631 revenue was approximately £6,792.5.

For 1640, I combined the record of the revenue from the licensing of tobacco retailers with the revenue from the customs to estimate the total amount of rents received by the crown. According to Beer's (1908, p. 163) customs rolls data, the revenue from the licensing of tobacco retailers totaled £13,052 in 1640. The closest year for which Beer lists customs revenue data is 1637 (p. 171), and the total at that time was £7,850. It is likely that the amount received from the customs revenue was larger in 1640 than in 1637, however, the 1637 figure is sufficient to conclude that the crown captured a larger share of the rents after enforcing the licensing requirements for the retail distribution of tobacco.

The percentages listed in parentheses represent the crown's share of the total rents available. All percentages were calculated using the standard formula.