

**“Richer and Weaker”: From Realist Means to Liberal Ends**

**Britain’s Relative Decline in the late nineteenth century**

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“Pride goeth before destruction, and an haughty spirit before a fall”, Proverbs 16:18.

There is a widespread misunderstanding in the International Relations literature that tends to exclusively associate Realism with mercantilism and Liberalism with free trade. According to this view, the emergence of a (supposedly) liberal free trade era led by Great-Britain in the 19<sup>th</sup> century was a reaction to the previous realist mercantile era. I argue, however, that such a view is only partially correct. There is a relationship between mercantilism and Realism, but also between free trade and Realism. If economic nationalism – originally called mercantilism – assumes and advocates the primacy of politics over economics (Gilpin 1987, p. 26), this is no less true after the advent of free trade. I claim that Britain’s interest in promoting that free trade system was in accordance with realist-oriented rational calculations in adapting to changing economic circumstances (England’s industrial revolution and the relative advantage from scale production). Only when England achieved a condition under which it could profit more than her trading partners in a free trade system, that it choose to support the creation of such an economic system. This condition, however, involved industrialization as a prerequisite. In this case, the demise of mercantilism does not contradict realist assumptions but rather it confirms them.

Within England, the increase in production generated by industrialization, along with the accompanying lower costs of production provided by greater economies of scale, created the necessity to increase demand. As a result, England found it more efficient to engage in free trade as compared to monopolistic commerce with colonies. This means that material conditions that favored greater production were necessary before free trade could be practiced. These material conditions were provided by the accumulation of

capital and stimulus to industry provided by the mercantile system, especially due to slavery and the triangular trade. Slavery was as an efficient means to build the capital base needed to later move to free trade.

By 1870 Britain had been successful in disseminating free-trade doctrines in Europe as well as to less developed countries. As Geoffrey Pigman (1997: p. 189) notes, at that time enough countries had liberalized trade so that international economic relations looked genuinely different from the preceding mercantile era. At mid-century Britain enjoyed of both absolute and relative power, standing in a hegemonic position. However, in the last quarter of that century Britain ceased to use her resources effectively, leading to her decline in terms of power. This paper aims to examine the rationale of Britain's behavior in the late nineteenth century by delving into the causes of her relative decline. The late Victorian period seems to be a supporting case for proponents of Liberalism, since Britain showed a strong commitment to liberal principles in the conduction of her foreign affairs and, more specifically, in her foreign trade policy. During the Great Depression,<sup>1</sup> Britain kept her free trade policy when other powers such as Germany, France, and the United States were raising tariff barriers in order to protect their industry and agriculture. These events seem to undermine Realism because Britain did not act as expected by realist predictions of prudent behavior. A realist response to the general raise of tariffs would have been to follow Arthur Balfour's proposition of selective imposition of retaliatory tariffs sufficient to force concessions from trading

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<sup>1</sup> The term "Great Depression" is usually understood to refer to the inter-war period in the twentieth century. However, during the nineteenth century there was also a Great Depression, from 1872 until 1896. In that period, an expanded worldwide production of industrial and agricultural goods led prices and profits down in Europe, resulting in slower overall growth and periodic high unemployment (Friedberg 1988, p. 35). This time also coincided with the peaking of railroad-building in England and in the Continent (Kurth 1979, p. 15).

partners. In the worse case, if Britain's trading partners would not make any concession or reestablish a free trade relationship with Britain, her domestic industry and agriculture would at least be protected.

During the second half of the nineteenth century, Britain de-emphasized her industry and focused instead on the absolute "invisible" earnings of the City of London. By 1870 there was a considerable trade imbalance between Britain and her partners (especially Germany), in which Britain ran a visible deficit in its manufacturing sector. However, this potentially troublesome economic state of affairs was overshadowed by the highly profitable earnings from England's banking, insurance, and shipping sectors. These events also support Liberalism and challenge Realism, since Britain aggressively sought after absolute "invisible" gains from trade, but showed herself careless in regards to her relative position of power in the international system by neglecting her industry. Ultimately this preoccupation with absolute gain over relative power concerns led to the loss of England's status as the leading commercial and military nation of the world.

Despite the relative ease under which England's behavior appears to confirm Liberalism's predictions of proper conduct, in this paper I will make a defense of Realism by showing the deleterious effects of Liberalism to Britain's national interest in terms of power. I argue that although material factors led to Britain's decline, these factors resulted from policy choices that reflected Britain's distortion of free trade from (a) an utilitarian means to power to (b) an end in itself, a blind and increasingly dogmatic doctrinal force committed to Liberalism without a rational outcome other than more wealth creation. Economic success became a self-fulfilling prophecies, as the creation of wealth led to drives for even more wealth creation. This obsession for wealth

maximization had the unfortunate consequence of causing England to neglect other important areas which its security depended on. In this sense, Britain's preference for finances and services over industry is not irrational from a Liberal point of view, in which states are assumed to be atomistic actors concerned about maximizing utility only, but was certainly imprudent from a Realist point of view, in which the disregard of her domestic industry would have detrimental effects to security over time, as can be seen in the First World War. I begin the remainder of this paper by making a brief discussion on the role of slavery and the triangular trade on the financing of the British Industrial Revolution. Then, I examine Britain's behavior rationale in the context of her foreign trade policy options in the realms of tariffs, industry, and finances in the last quart of the 19<sup>th</sup> century. After exposing Britain's choices I will present a critique of the liberal principles that grounded such choices.

*Building a good foundation* – Realism postulates that the international system is anarchical in its organizing principle, meaning the absence of a central agency to enforce states' promises or to provide other states with protection (Waltz 1979 and Grieco 1993, p. 132). In such an environment there is a pervasive uncertainty about the future intentions of other states, which causes a pattern of self-help behavior and constrains them to be concerned not only with absolute gains, but more importantly relative gains, since today's friend can be tomorrow's empowered enemy. The best means to guarantee survival and security is power. Wealth is an absolutely essential means of power, whether for security or for aggression and power is essential as a means to the acquisition and retention of wealth. Power seeking and wealth creation should be seen as two halves of

the same coin. However, the relationship between politics and economics is one of subordination in which economic activities are a means to state building and the interests of the state (Gilpin 1987, p. 31).

As Heckscher (1935) properly puts it, the most vital aspect of the problem is whether power is conceived as an end in itself, or only as a means for gaining something else, such as the well being of the nation. I argue that in the case of Britain's relative decline this crucial point ultimately determined her fate. From the mercantile era until mid-nineteenth century Britain had a rational behavior of power maximization. Early in the 17th century, Britain accumulated wealth that was then used to finance her industrial revolution and her shipping industry. These efforts rapidly translated into immense commercial and maritime power which ultimately cumulated in England achieving hegemonic status within Europe. By the middle of the 19th century Britain was the "workshop of the world". No other nation was as technologically advanced as England was. The sophisticated tactics and techniques of British manufacturers and entrepreneurs allowed England to overproduce and underbid any of her possible overseas rival competitors. By drawing from the rest of the world raw materials need for her industries, England was able to focus on producing and exporting high quality machinery and consumer goods at low cost. Laissez-faire was regarded as the reason for British success and prosperity. It was argued that free trade, by the elimination of tariffs and other trade barriers, reduced production costs and increased the efficiency of industry, allowing British industries and manufacturers to capitalize off of its comparative advantages vis-à-vis the rest of Europe and maintain its economic supremacy throughout Europe.

Britain's technological advantage enabled her not only to profit, but also and more importantly to profit more than her partners, giving her not only absolute gains but also relative gains from trade. In this scenario, free trade was the rational foreign economic policy that enhanced Britain's power. In this sense, I disassociate free trade from Liberalism and argue that under certain conditions – the possession of technological advantage that allows for efficient means of production – free trade is be a rational realist policy of wealth accumulation and power furtherance. Actually, this argument is in consonance with the free trade theorists of the first half of the 19<sup>th</sup> century, who “believed that consideration for the interest of their own country demanded free exchange with other countries” (Heckscher 1935, p. 13). However, even though laissez-faire allowed Britain to become the most powerful nation in the mid-nineteenth century, free trade could never guarantee that Britain's gap in technological advancement would last forever. Free trade wouldn't be enough to maintain British industrial advantage because, as Marxism asserts, technology dispersion over time is virtually inevitable. “However powerful the means of production which a capitalist brings into the field, competition will make these means of production universal” (Marx, ME Reader, p. 213). Therefore, in 1870, only Britain and maybe Belgium could be said to be highly industrialized nations, whereas by 1900 Germany, the United States, France, Russia, and Japan had emerged as such. Britain's place among the nations would depend on the extent to which she would be able to retain industrial leadership.

*Slavery, Triangular Trade, and Accumulation: Financing the Industrial Revolution* – The means by which England began her ascendancy the position of hegemony in the mid-19<sup>th</sup> century go back to her strategy of capital accumulation during the mercantile era. The profits provided by Slavery in the British West Indies and by the triangular trade were fundamental for the growth of British industrial capitalism (Manning 1990: 13-14 and Eric Williams 1994). Certainly the expansion to the New World was paramount to the strengthening of great powers' economies and maximization of power during the colonial era. However, free land itself did not create colonial prosperity as Adam Smith expected<sup>2</sup>, but rather prevented it (Wakefield apud Solow 1991, p. 33). The explanation for this outcome lies in the relationship between land and labor as factors of production. “The cheaper and more plentiful the land, the harder it is to get the labor; in the limit, it is impossible” (Solow 1991, p. 33). If one were to hire laborers and pay them wages, eventually these laborers will leave and acquire their own land (using the wages earned by their labor). In the context of cheap and plentiful land, there is no incentive for a man to willingly share the fruits of his labor with another if he can capture them all himself (Solow 1991, p. 34). Mere immigration does not ensure economic growth. The immigrants will just replicate their family-sized farms across the vast landscape. Division of labor will be retarded. The surplus of such farms will be small, and there will be difficulties in marketing it. Potential returns of capital cannot be realized without the supply of labor to capitalist landlords. Therefore, countries with abundant cheap land stagnate instead of grow. “Where land is free, there will never be a

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<sup>2</sup> “The colony of a civilized nation which takes possession either of a waste country, or of one so thinly inhabited, that the natives easily give place to the new settlers, advances more rapidly to wealth and greatness than any other society” (Adam Smith apud Solow 1991, p. 21).

supply of hired labor. If anyone works for someone else, it is by coercion” (Solow 1991, p. 36).

Thus, in the colonial system, slavery was the sole source of permanent supply of labor to landlords and was responsible for a sizable accumulation of capital (Solow 1991, p. 35). Capital accumulation depends on the private ownership of the means of production. In the transition from feudalism to capitalism this privatization occurs when landlords acquire property rights to their estates and the power to exclude laborers from them. In the context of cheap and plentiful land, property rights exist legally but because of the abundance of land they are valueless. The lack of (valuable) property rights in land means that there is no source of surplus for investment (Solow 1991, p. 35). Moreover, slavery has obvious advantages – compared to the small farmer or peasant proprietor – when it comes to crops whose cost of production is reduced on larger units (such as sugar, cotton, and tobacco). The vast profits of economies of scale production make the use of inefficient slave labor economically efficient. Only when the population density is high (making property rights valuable) the expenses of slavery (cost and maintenance) exceed the cost of hired laborers. In this environment then, slavery becomes less economically sound. Therefore, “when slavery is adopted, it is not adopted as a choice over free labor; there is no choice at all” (Williams 1994, p. 6).

We also need to remind that at that time it was in the interest of the powers to keep their population at home. Large home populations were seen as a necessary prerequisite for major power status. By the end of the XVII century, the accumulation of bullion became secondary when compared to the development of industry and incentives to export as aims of national economic policy. The economic logic behind this shift is

that full employment leads to a decrease in wages and, thus, to a higher surplus, which could then be employed in national defense and offence (Honorks 1925, p. 61). Similarly, Williams says that “The mercantilists argued that the best way to reduce costs, and thereby compete with other countries, was to pay low wages, which a large population tended to ensure” (1994, p. 16). Thus, for a colonial power that wanted to simultaneously build its domestic industry and extract the maximum surplus possible out of its colonies, the rational choice in terms of economic efficiency was to opt for black slavery<sup>3</sup>. For its turn, “Negro slavery demanded the Negro slave trade” (Williams 1994, p. 30). The slave trade was not only a means to an end, but also an end in itself. The British slave traders provided the necessary laborers not only for British plantations, but also for those of their rivals.<sup>4</sup> By trading slaves – legally or illegally – with the Spaniards, British mercantilists increased the supply of bullion in England.<sup>5</sup>

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<sup>3</sup> Although white servants were also a possibility, they proved not to be as efficient as black slavery, since after a given number years of work these servants would stop working for a landowner and would begin working for themselves in their own land. That was a real option for a white servant due to the abundance of land in the colonies. I must disagree, however, with Williams’s account of white servant labor in the colonies. According to Williams, the emigration of white servants to the colonies was favored by the mercantile theories of the time, “which strongly advocated putting the poor to industrious and useful labor and favored emigration, voluntary or involuntary, as relieving the poor rates and finding more profitable occupations abroad for idlers and vagrants at home” (Williams 1994, p. 9-10). I believe that it was not in the best interest of colonial powers to send their population to the colonies, since population would be better employed as available work force at home, pushing the wages down, which diminished costs of production and made domestic goods more competitive abroad. Moreover, it was prudent to avoid rivalry in manufacturing between the white laborers in the colonies and the mother country. “Better black slaves on plantations than white servants in industry, which would encourage aspirations to independence” (Williams 1994, p. 18). “Finally, and this was decisive factor, the Negro slave was cheaper” (Williams 1994, p. 19). Manning (1990, p. 21) explains that Europeans focused this demand on Africans because of their relative immunity to disease, the low transport cost resulting from their relative proximity to the New World, and their low purchase price.

<sup>4</sup> “The Privy Council Committee of 1788 paid special attention to the fact that of the annual British export of slaves from Africa two-thirds were disposed of to foreigners” (Williams 1994, p. 34). The supply of slaves to the French colonies engendered a clash of interests between the British slave trader and the British sugar planter (Williams 1994, p. 33). This clash of interests, nonetheless, does not in any way challenge the realist assumption on the unity of the state as an international actor, since, overall, the slave trade, even with France, worked as a mean of accumulation of power and wealth for the British state.

<sup>5</sup> Williams (1994, p. 37) explains that even if the profits from the slave trade were smaller than those made by the British East India Company, the India trade was seen as a bad trade and, therefore, of less importance than the slave trade. The India trade drained Britain of bullion, while the slave trade was based

While slavery generated slave trade, slave trade gave rise to the profitable triangular trade, which can be summarized as follows: England (and also France and Colonial America) supplied manufactured goods for export. These goods were traded at a profit for slaves with African slave merchants. The slaves were then sent to colonial plantations, which paid for them with raw material. These raw materials were then sent to the home country (Williams 1994, p. 51-52). The monopolistic trade with the colonies stipulated that they were obliged to send their products to England using only English ships. They could not have any imports that were not British unless they were first taken to England. England's concession was to give the colonial products a monopoly of the home market. The bedrock of this policy was the Navigation Laws<sup>6</sup> aimed at the Dutch, who "supplied credit, delivered goods, purchased colonial produce and transported it to Europe, all at more attractive rates than the British could offer in open market" (Williams 1994, p. 56).

Hence, the triangular trade was a great stimulus to British industry. It stimulated British capitalism<sup>7</sup> by fostering her production of manufactured goods (slaves were purchased with British manufactured goods), providing employment at home, granting her a favorable balance of trade<sup>8</sup>, and encouraging navigation and shipbuilding (the slaves were transported to the plantations in British ships). The processing of the tropical

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on British manufactured goods, besides of being connected with the plantation trade, making Britain independent of foreigners for the supply of tropical products.

<sup>6</sup> The Navigation Acts boosted British shipping, which fostered both trade and defense (Cain and Hopkins 1993: 87).

<sup>7</sup> "Finery for Africans, household utensils, cloths of all kinds, iron ad other metals, together with guns, handcuffs and fetters: the productions of these stimulated capitalism, provided employment for British labor, and brought great profits to England" (Williams 1994, p. 65).

<sup>8</sup> By that I mean exports larger than imports, due to the exchange of manufactures for raw materials and bullion.

products (sugar, cotton, indigo, molasses) fostered new industries in England.<sup>9</sup> Thus, the profits generated by the triangular trade provided one of the main sources of accumulation of capital that financed the Industrial Revolution in England (Williams 1994, p. 52). In one sense, Industrial Revolution means the introduction of new machinery into the existing production process. For its turn, the increasing usage and improvements of machinery, along with a more efficient division of labor, results in the proportionate decrease of the cost of production (Marx, ME Reader, p. 212). By improving its machinery, England raised the productive power of labor<sup>10</sup> and was able to produce goods more cheaply (which allowed for greater profits). But as production expands, the need to sell also increases. In the pursuit of greater profits, England sought to secure larger markets for her commodities, by selling them more cheaply than her competitors. As a result, English incentives and visions for the creation of a global free trade system, where British goods would enjoy vast competitive advantages, began to mature.

*British policy options* – The period from the 1820's to 1879 was basically one of decreasing tariff levels in Europe (Krasner 1976: 324). This pattern reflected Great-Britain's push to free trade in the Continent, beginning in the 1820's with Britain's reductions of duties and other barriers to trade and reaching its most notorious moment

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<sup>9</sup> Obviously, the reason why the refining of the raw sugar was not done on the plantations had nothing to do with the skill of labor or the presence of natural resources. The division of labor between planting and refining was a deliberate policy of the home country and was a sound policy from the perspective of the national interest: it fomented British shipping, and guaranteed British exports of iron and textile manufactures. Refining in the plantations would diminish the number of shipping trips to those lands, undermining British shipping, and thus being a disadvantage to Britain national interest (Williams 1994, p. 75).

<sup>10</sup> According to Marx (ME Reader, p. 212), this would mean that England could “produce a whole yard of linen in the same labor time in which her competitors weave half a yard”.

in 1846 with the abolition of the Corn Laws ending England's agricultural protectionism.

“France reduced duties on some intermediate goods in the 1830's, and on coal, iron, and steel in 1852. The *Zollverein* established fairly low tariffs in 1834. Belgium, Portugal, Spain, Piedmont, Norway, Switzerland, and Sweden lowered imposts in the 1850's. The golden age of free trade began in 1860, when Britain and France signed the Cobden-Chevalier Treaty, which virtually eliminated trade barriers. This was followed by a series of bilateral trade agreements between virtually all European states” (Krasner 1976: 325).

Thus, during the first three quarters of the 19<sup>th</sup> century, five major trading powers (France, Germany, Italy, Belgium and the Netherlands) and numerous smaller economies (e.g., Sweden) liberalized trade significantly, while other major states (Austria, Russia, and even the United States, for a time) liberalized trade to a discernible degree (Pigman 1997: p. 189). There was a growth in world economy and the market value of British exports increased 282% between 1842 and 1867 (Pigman 1997: p. 189).

By the end of the nineteenth century, however, Britain's ability to preserve her economic supremacy was in question. Two major trends developed at the time: the absolute rise in global production, trade and prosperity; and the relative decline of Britain as the leading industrial and commercial nation, and the corresponding rise of Germany (and other states). The tone of the debate – “preserve economic supremacy” – reveals the awareness of the British Right of the demands of the anarchical international system for prudent behavior. British Conservatives were worried not only about England's absolute gains – which had had been increasing over time, in spite of the Great Depression – but also about Britain's relative position in the international system. This worry was justified, since states having an inherent interest in survival are acutely sensitive to any erosion in their relative capacities, which are the ultimate base of their security and independence in a self-help system. Therefore, from a Realist point of view, Britain's main objective should have been that of preventing other states from increasing their relative capacities,

even if that meant giving up increments in her absolute capacities. If power means the increase in the strength of one country as against that of others, absolute economic progress loses its value (Heckscher 1935, p. 20). In this sense, the British Right was right in noticing that “‘Power is a purely relative concept’; even if the national wealth was now much greater, and the working man better fed and clothed than under Pitt or Palmerston, it was no consolation at all” (Kennedy 1980, p. 307).

It is said that Britain’s failure to raise tariffs on industrial and agricultural products had a harmful effect to her economy during the Great Depression, especially considering the European response, which was tailored to protect domestic producers from foreign imports through the re-imposition or raising of tariffs that had been lowered during a brief continental enthusiasm for free trade. Obviously the larger effect of this policy would have been detrimental to countries that heavily relied on exports, such as Britain. British opponents of free trade highlighted that British domestic economy and foreign trade were being undermined by foreign protectionism. The closing of overseas markets were harming British exports. While, at the same time, cheap imports were destroying British agriculture and industry. In sum, the imbalance between larger imports and low exports was draining England of her precious capital (Friedberg 1988, p. 35-36). More specifically, the recession prompted German firms to export their products at what appeared to be extremely low prices, provoking a great discussion about the growing imbalance in Anglo-German trade, which culminated in the 1903-6 Tariff Reform debate.<sup>11</sup>

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<sup>11</sup> The Tariff Reform debate was “the first great debate on Britain’s economic future after the passing of her mid-Victorian supremacy” (Rempel in Friedberg 1988, p. 22). Proposed by Joseph Chamberlain, it had as scheme the abandonment of Free Trade in favor of a system of a system of preferential duties which would

Many in England began to question whether a fiscal system suited to a free trading nation in a free trading world would function properly in a world composed of protectionists' actors. In such a scenario, Britain's choice to keep the free trade system would demand cutting prices, wages, and profits in order to maintain its current exports levels. The fewer earnings from trade would imply imports reduction, diminishing the country's welfare in the long-term (Friedberg 1988, p. 66). But why, even not having adopted any of the above measures, Britain had not suffered such a fate, but was still increasing in both imports and exports by the end of the nineteenth century? The later half of that century saw an absolute rise in global production, trade and prosperity, which obfuscated – but not totally concealed – the loss of Britain's position of leading industrial and commercial nation of the world.

Arthur Balfour, British Prime Minister at this time, (in Friedberg 1988, p. 66) explained this phenomenon – Britain's absolute growth and relative decline – had three different reasons. The first was British investments overseas, by which foreigners became Britain's debtors, paying England back by providing imports to England (mostly in the form of raw materials). The second reason was the continued existence of free trade areas in South America, small states of continental Europe, Turkey, China, and in the dependencies of the empire. Third, even protected areas were not completely closed. However, Balfour recognized that while foreign investments helped to pay for needed imports, they also drew capital away from the home market. As for the remaining free trade areas mentioned above, essential to Britain's continued well-being, they were inherently fragile. Balfour claimed that those areas not protected by tariffs were unlikely

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provide funds for social spending while promoting colonial trade and transforming the Empire into a virtually self-sufficient economic bloc (Powell 1996, p. 19).

to increase in size, but they could diminish in many ways, such as the industrialization of agricultural areas, domestic political changes in developing countries, and the extension of control by protectionist powers (Friedberg 1988, p. 66-7).

Inadvertent liberals such as Gourevitch (1995, p. 101), focusing on absolute growth only, would argue that British low tariffs were not an irrational option if other ways of sustaining income existed. Despite Canadian and Australian tariff barriers, the rest of the Empire maintained a stable demand for British industrial goods. The deficit generated by Britain's increasing imports of German manufactures was reduced by the fact that Germany's booming industry was directly importing ever more raw materials both from the British Empire and certain parts of the 'informal' British economic empire. Indeed, the 'invisible' earnings of the City of London in arranging this multilateral trade probably eliminated this deficit altogether. Shipping also provided an important source of revenue. Despite the impressive growth of the German mercantile marine, the greater part of the direct Anglo-German trade and a very considerable proportion of Germany's trade with third countries were carried in British vessels. In addition, the Lloyds of London insured the greater part of the German mercantile marine, having therefore their own profits boosted by the rise of the Reich to a great commercial power (Kennedy 1980, p. 294).

These arrangements reinforced the separation of British local industrial enterprise from national financial institutions based in the City of London, a trend originated in the textiles industry era when capital accumulation for industrialization was accomplished

largely without state intervention<sup>12</sup>. British financial system was characterized, thus, by a predominance of agencies engaged in short-term credits to merchants instead of long-term credits to industry. As the steel industry was largely financed by the capital generated by the textile industry, the same pattern of financial institution prevailed (Kurth 1979, p. 5-6). Thus, British financial institutions provided only short-term working capital to British industry (mainly through overdraft accounts) while they exported most of their capital, usually in exchange for fixed-interest bonds, to finance large-scale (typically government-backed) foreign projects such as railroads.

Contrastingly, the nature and figures of Germany's industrial expansion<sup>13</sup> indicate that that country relied on advanced technology, high rates of investment in new plant, ready utilization of scientific advances, high level of managerial training, aggressive entrepreneurship, and amalgamations of smaller firms. In the same line, Elbaum and Lazonick (1984) say that corporate capitalism was emerging to become the dominant mode of economic organization, notably in Japan, Germany, and the United States<sup>14</sup>.

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<sup>12</sup> Except for the elimination of barriers to a free market within the national boundaries (e.g. internal tariffs) and for the erection of external tariffs on occasion for the protection of the 'infant industry' (Kurth 1979, p. 6).

<sup>13</sup> Germany grew in the more advanced and qualitatively superior sectors of the economy. While in the early 1890 beet sugar was its most valuable export, by 1913 its exports had been transformed: chemicals (UK\$52 million), machinery (UK\$34 million), ironware (UK\$32.5 million), coal (UK\$25.8 million), cotton clothes (UK\$22.3 million), woolen clothes (UK\$13.5 million) and only then beet sugar (UK\$13.2 million). Germany's coal production, virtually only half of Britain's in 1890, had almost caught up 279,000 tons mined in 1913 compared to British total of 292,000 tons (Kennedy 1980, p. 292-3).

<sup>14</sup> Elbaum and Lazonick (1984, p. 571) characterize corporate capitalism by industrial oligopoly, hierarchical managerial bureaucracy, vertical integration of production and distribution, managerial control over the labor process, the integration of financial and industrial capital, and systematic research and development.

"Oligopoly, by helping to stabilize prices and market shares, facilitated long-run planning, particularly where large-scale capital investments were involved. Managerial coordination of product flows within the vertically integrated enterprise permitted the achievement of high-speed throughputs that reduced unit costs. Vertical integration of production and distribution provided the direct access to market outlets that was a precondition for the effective utilization of mass production methods. Managerial control over the labor process in turn facilitated the introduction of new, high-throughput technologies. Integration of financial and industrial capital, along with managerial bureaucracy, made possible the geographic mobility of capital and the rapid expansion of capacity to produce for new or growing markets. Systematic research

Britain's major 19<sup>th</sup> century staple industries<sup>15</sup>, on the other hand, were composed of numerous firms with small market shares, run by owner-proprietors or close family associates (Elbaum and Lazonick 1984, p. 569-70). British development of industrial techniques typically relied upon trial and error rather than systematic research. These findings reveal a correlation between the degree of state intervention in economy and the presence of large financial institutions, and high rates of economic growth – that is, they support the argument for a mercantilist policy for foreign trade. Mercantilism places a great focus on industrialization because industry's externalities lead to the overall development of economy (Lake 1987, p. 229-30 and Gilpin 1987, p. 33), enables economic self-sufficiency and political autonomy, and is the basis of military power, being a central component of national security.

British focus on services and financial capital vis-à-vis her supposed negligence toward industry could be explained by the *perception* that British industry was *not* showing decline at that time. In absolute terms, Britain exported as much iron and steel in the turn of the century as she did in the mid-nineteenth century; pig iron, tin plate, and rails together accounted for 49 percent of British exports in 1910-13<sup>16</sup>. Yet these figures conceal the fact that Britain's sales had declined dramatically in non-Empire markets in the early twentieth century. Her products were sold mainly in the Empire and home

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and development, particularly in such science-based industries as electrical and chemical manufacturing, provided the mainspring of technological innovation" (Elbaum and Lazonick, p. 571).

<sup>15</sup> These were textiles, iron and steel, coal, mining, shipbuilding, and engineering.

<sup>16</sup> The international development of iron and steel industry had three stages. The first begins in the 1830s; the second extends from late 1870s until 1895; and the third goes from 1895 to 1913. Before late 1870s, exports from Germany and the United States were always negligible, and those countries imported large quantities of British iron. In the second stage, Germany emerged as a major exporter of iron and steel. The proximate cause of Germany's emergency as an exporter was a decline in its iron and steel prices, which were only marginally higher than Britain's in the 1880s. The United States continued to be a substantial importer due to its high prices, far above European prices. After 1895, American prices dropped to British levels and German prices dropped below British prices. Not only Britain lost her share of world iron and steel exports, but she also became, for the first time, a major importer of steel (Allen 1979, p. 911-3).

markets, which were still willing to pay a higher price for British steel, cushioning the deterioration of British trade. For Robert C. Allen, in order to understand British iron and steel industry relative decline we must look at the relationship between product prices, costs, efficiency, input prices, and markups between 1850 and 1913. “Britain’s superior efficiency was relatively unimportant as a cause of its extraordinary export performance” (Allen 1979, p. 915).

Allen attributes German and American emergence in the iron and steel industry to lower input prices. In the 1850s, German prices exceeded those of Britain due to the high excess profits earned by the German industry, while American prices did so because American costs were greater (Allen 1979, p. 920). The high fuel consumption rate of American blast furnaces accounted for the country’s greater mineral costs<sup>17</sup>. Moreover, US nominal wage rates were also higher than in Britain, while labor productivity was lower. British labor productivity was 60% greater than American (p. 923) and exceeded Germany’s as well, although the lower nominal wage rates in Germany balanced the unit labor costs (p. 922). Also, after 1860, technical change enhanced Britain’s competitive position. The development of the eighty-foot tall furnace and the superheated blast, by reducing fuel requirements, meant that the Cleveland blast furnace industry had substantially lower costs than any other district in the world (p. 920-1).

Two developments caused the drop in German prices by 1880. First, the high excess profits earned by the German industry in mid-century were eliminated in the depression of 1870s, which coincided with a brief free trade period<sup>18</sup>. Second, after 1895

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<sup>17</sup> The low productivity of American fuel reflected the chemistry of American ores and not an incorrect choice of technique (Allen 1979, p. 924).

<sup>18</sup> German iron and steel producers blamed their losses on an influx of cheap British iron. However, German production fell because domestic consumption collapsed (Allen 1979, p. 928).

German and American unit costs fell below British costs, mainly due to changes in iron ore prices (not in fuel) and the rapid productivity growth on German and American industries. According to Allen (1979, p. 929), after 1985 the cost of Spanish hematite rose in Britain, whose commitment to acid steelmaking meant that she was becoming progressively dependent on this ore<sup>19</sup>. In contrast, the German steel industry diversified its ore supplies by importing Swedish ore on a large scale. The difference in British hematite and German basic ore costs put the British steel industry at a serious disadvantage<sup>20</sup>.

Thus, British loss of world iron and steel export shares between 1895 and 1913 was not due to her industry's inefficiency alone, but rather to a decrease in German and American costs of production, which lowered their final prices and made their products more competitive in the world market. In this sense, British industry in the late nineteenth century was *comparatively* less efficient than German and American industries. The logic of relative gains appears clearly here. All three countries grew in the last quarter of the nineteenth century, but the growth rates of Germany and the United States were larger than British growth rate, which not only diminished the gap that once existed between these three nations in favor of Britain, but inverted it. The result was that Britain, by disregarding considerations of power and security, nurtured her "tomorrow's enemy".

The Liberal discourse was that there was no reason for Britain to adopt a mercantilist foreign trade policy. Rich neighbors should mean more trade and hence more wealth (Friedberg, p. 48-50, 60). In that sense, it was stressed that the rising of Germany

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<sup>19</sup> Lancashire and Cumberland, Britain's hematite mining districts, began importing it in the 1890s.

<sup>20</sup> American ore prices fell due to the discovery of new, low-cost ore fields, the development of highly capital-intensive, open pit mining methods, and a highly efficient lake shipping system (Allen 1979, p. 929).

and the United States, far from threatening Britain's economic security, led to a mutually beneficial triangular trade relationship. Britain ran a visible trade deficit (mainly due to imports of advanced industrial products), with Germany and the United States. The states, on the other hand, were increasingly dependent on raw materials from the less developed world, including the British Empire, itself a prime importer of British manufactures. Britain provided the finance and shipping, as well as the international currency for this trade pattern, benefiting from these "invisible" earnings. In addition, her investments in underdeveloped countries and colonies generated an added source of income and tied those markets to her exports (Warwick 1985, p. 102). Moreover, as the liberal argument ran, retaliatory tariffs could lead to a commercial war and, given British reliance on trade there was little hope to expect that she could succeed in such a competition.

From a short-term and a strictly numerical point of view, it made sense to persist in so doing, for it provided a cheaper and more convenient alternative to modernization. Therefore, Britain escaped from the Great Depression not by modernizing her economy, but by exploiting the remaining possibilities of her traditional position: that is, by exporting more of her staple goods to her relatively secure imperial markets and by benefiting from her role as the world's leading banker, commodity-dealer, shipper, insurer, and investor (Kennedy 1980, p. 294). But if we see Britain's industrial policy choice in the light of James R. Kurth (1979, p. 4-5) theory of product cycle, we will find out that Britain's industrial decline was inevitable. Kurth sustains that each industry has a four phases cycle. The first phase is that of the innovation of a product and the growth of its sale in the domestic market. In the second phase there is saturation of the domestic

market responded by exportation of the product to foreign markets. Thirdly, the home country engages in direct foreign investment by manufacturing the product in foreign markets. Finally, the product manufactured in foreign countries is exported into the original home market while the manufacture of the product goes into decline within the home country.

According to Kurth, whenever a product enters into its saturation phase, the home country has two choices: either export the product to foreign countries or to innovate with a new product. The first choice entails the continuity of the product cycle, in a declining curve of diminishing margins of returns; that is, profit will necessarily decrease over time. The second choice is to innovate by “the creation of new industries or new leading sectors whose rapid growth will lift up the entire economy behind them” (Kurth 1979, p. 2). This Schumpeterian strategy to stagnation gives the innovative nation a natural advantage in the world market for a decade or even for a generation. According to Lake (1987, p. 229-30) new industries, especially capital-intensive ones, fuel the rest of the economy by producing significant positive externalities that stimulate further learning, development, and technological innovation. These externalities, therefore, create a virtuous cycle of higher relative growth.

In the 1840s, British investors responded to the saturation of domestic market in the textile industry by choosing technological innovation, instead of foreign expansion; they shifted investment capital into a new industry: iron, steel, and railroads. The result was the British boom of the 1850s (Kurth 1979, p. 11). By the beginning of the 1870s, however, railroad building in Britain had reached the saturation point, and to a lesser degree that same was true of Britain’s railroad building on the Continent. Again Britain

faced a choice between foreign expansion and technological innovation, to which she chose the former. The response of British steel industry and of the bond-dealing banks of the City of London was to continue their old activity in a new place by shifting the building and financing of railroads to the United States, Canada, Australia, Argentina, Turkey, and Egypt. Britain also adopted a Keynesian solution of government-induced demand-creation through the building of steamships and naval ships (Kurth 1979, p. 16-7). The long-term consequence of Britain's strategy was the emergence of vigorous competition in Britain's colonial and even home markets from the more efficient German and American steel industries.

On the other hand, Germany's response to the Great Depression was manifold. The German government established the tariff of 1879 and undertook the legal enforcement of cartel agreements to limit production and maintain prices. Like Britain, Germany also sought after overseas markets through Bismarck's colonial policy of 1884, although this was never vigorously sustained as it was in England. Bismarck also initiated an increase in the German naval budget in that same year (Kurth 1979, p. 20). However, besides these measures, German adopted an innovative response: the creation of two new capital-intensive industries, electricity and chemicals, facilitated by German industrial banks. The state supported the new industries through measures such as the funding of technical and science education, fostering the reform of municipal government to provide financial security for urban electric railroads and electric power systems, and military and naval procurement of explosives manufactured by the chemical industry (Kurth 1979, p. 21).

*Richer and weaker* – It has been suggested elsewhere that Britain’s inability – or resistance – to adapt to systemic demands on domestic economy (i.e., corporate capitalism and mercantilist foreign trade policy) reflected distaste for change in general, at a more fundamental or cultural level. The historical fact that the industrial revolution had not been based on new scientific breakthroughs provided a justification for the resistance of both unions and managers to the self-conscious application of scientific research and the new “scientific management” techniques to industry (Warwick 1985, p. 103, 104). Besides, it is said that British manufacturers were more concerned with the volume of trade than with innovations that could increase productivity and competitiveness (Friedberg p. 64-65), showing a greater concern for absolute rather than relative gains. How to adequately explain why a pioneering nation in the agricultural and industrial revolutions and the leading commercial world power would be, at the very culmination of its economic success, so disdainful to progress, growth, and increases in power (Warwick 1985, p. 104-6)? I argue that Britain’s relative decline in the nineteenth century demonstrates that Liberalism proved to be completely flawed in the maintenance of British power, demonstrating its inadequacy as an approach to world politics for four main reasons: its static analysis; its artificial separation between economy and politics; its assumption of atomistic actors maximizing absolute utility; and its focus on the individual.

The first great flaw in Liberalism is that its analysis tends to be static (Gilpin 1987, p. 45) that is, it does not account for change since in the short-run it holds consumer demands, institutional framework, and technological environment as constants. In this sense, Liberalism lacks a theory of the dynamics of international political economy.

Therefore, by believing that the market economy through its self-operating and self-correcting mechanisms tends toward equilibrium and inherent stability (at least over the long term) and that a long-term harmony of interests underlies market competition Liberalism ignores the security necessities generated by the economic growth of Britain's competitors. In this sense, I argue that Britain's failure to adapt to corporate capitalism and mercantilism reflects her blind commitment to Liberal principles, mistakenly justified by the previous success of the textile industry era, which results from a static analysis of the international political economy. It is this static character of Liberalism that is responsible for distorting free trade from a Realist means to Liberal end.

The early positive economic outcomes of the industrial revolution gave England an inflated sense of self-confidence (Friedberg 1988, p. 27) and created an illusion of economic excellence. Such a miscalculation stems from the fact that free trade was a necessary, but not a sufficient, condition for the success of the textile era. Without the technological innovation that allowed Britain to overproduce and underbid her commercial partners, free trade alone would not have produced the enormous gap in power favoring Britain against the rest of the world by mid-nineteenth century. As stated earlier, free trade was never a guarantee that Britain's gap in technological advancement would last forever. Therefore, Britain's distortion of free trade – from a Realist means to Liberal end – accounts for the persistence of textile economy characteristics in the iron and steel industry period, especially the separation between industry and finances.

Second, Liberalism artificially separates economy from other aspects of society and many times assumes equal individuals living in a world free from political boundaries and social constraints. Because Liberalism assumes so, it insists that

government should not intervene except in case of market failure to provide public or collective good. Unfortunately, the world does not look like that. According to Friedberg (1988, p. 35), the British Right critique of free trade in Britain observed that British dependence on foreign producers for food in a world of separate and possibly hostile nation-states would leave her vulnerable to supply disruptions and possible naval blockades. Moreover, the assumption that exchange is always free and occurs in a competitive market between equals who possess full information and are thus enabled to gain mutually is problematic. As Gilpin (1987, p. 45) argues, the terms of exchange can be affected by coercion, differences in bargaining power, and other political factors. In the late nineteenth century, the once favorable terms of trade between Britain and her European partners was turned up side down due to those countries' tariff barriers. Besides, while British industrialists operated in a private, free trade basis, in Germany, on the other hand, the mobilization of capital for iron and steel industry demanded large investment banks and the state, leading to the organization of industrial cartels to prevent competition between investment recipients (Kurth 1979, p. 12). In this sense, Liberalism neglects both the effects of non-economic factors on exchange and the effects of exchange on politics.

Also, economic decisions have important political consequences. If the "invisible" earnings of the City of London overcompensated for Britain's visible trade deficit, how exactly Britain was getting weaker if she was at the same time getting richer? How do all these relate to British international power position? The increasing trade imbalance after 1870 rendered Britain more dependent upon earnings from City of London financial services, shipping, and foreign investments than upon manufacturing,

as her export growth lagged behind that of her main competitors. This situation favored Britain's trading partners, whose commercial surpluses enable them to purchase Britain's manufactured goods and financial services. On the other hand, Britain presided over a world system of exchange (Warwick 1985, p. 101 and Kennedy 1980). According to Rosecrance (in Warwick, p. 102), an international economic empire can be maintained either through a strong surplus in merchandise trade or through a surplus in "invisibles". I argue, however, that an international economic empire is necessary, but not sufficient, to sustain and enhance a country's power position. Additionally, I also argue that choosing between building an "invisible" financial empire vs. a visible industrial economy is not a neutral or merely numerical choice. By neglecting her industry (by both leaving it tariff-unprotected and under-invested) Britain was at the same time (a) retarding her overall economic development since industry has more positive externalities than finances; (b) undermining her economic self-sufficiency and consequently her political autonomy; and (c) losing basis of military power. All these were very clear even for liberals who were afraid of a commercial war due to the increased dependence of Britain on foreign food, raw material, and on trade as the foundation of her economy.

Third, Liberalism assumes that actors are atomistic, that is, they seek to maximize their absolute individual gains and are indifferent to the gains reached by others. However, an analysis of Germany, American, or Japanese behavior during this time seems to contradict this presumption. This liberal fallacy led to a dangerous emphasis on Britain's absolute growth, while preventing her from capturing the political interests at stake; i.e., from realizing – as the British Right did – that 'power is a purely relative

concept'. Therefore, by 1913 the trade relations and power positions between Germany and Britain had been inverted.

Fourth, Liberalism is a theory focused on the individual and on maximizing his welfare, and defines progress as increase in wealth per capita. However, policies that fit individual preferences in a first moment can endanger a nation's survival in a second moment – just as what happened to Britain. Certainly, there were many British domestic interest groups who benefited from a continued free trade policy even when systemic conditions no longer made this type of economic practice optimal. However, I do not believe that this disqualifies or undermines Realism and its assumption of a unitary actor. Rather Realism is confirmed, with negative consequences for Britain though. Drawing on Heckscher's Weberian understanding of the state, what distinguishes the state from all other social institutions is that it is, by its very nature, a compulsory corporation; the entity that has the monopoly of the legitimate use of the force domestically. "Power must therefore be the first interest of the state, which it cannot resign without denying its own existence. (...) The state's regard for its power must precede all other considerations" (Heckscher 1935, p. 20). Whenever this principle is disregarded and a state acquiesces to particular groups or international interests in detriment of the national interest, that state will be penalized by the anarchy. As Waltz (1979, p. 118) explains, "a self-help system is one in which those who do not help themselves, or who do so less effectively than others, will fail to prosper, will lay themselves open to dangers, and will suffer". This, as it turns out, was Britain's fate.

Finally, the argument that Britain could not anticipate future outcomes for lack of comparative information is a very weak one, and an inadequate excuse for its sub-optimal

behavior. The line of argument believes that at the close of the nineteenth century, Britain's leaders understood the importance of "national economic power", but lacked agreement on what that concept meant or how it should be measured, resulting in an inability to adequately respond to changes in Britain's position in the world economy (Friedberg 1988, p. 79). Friedberg explains that at the turn of the century there were no good measures of national income or total industrial production. For Friedberg, had Joseph Chamberlain possessed at the time "an accurate aggregate measure of national income or manufacturing production", he would have been able to argue persuasively about Britain's relative decline and the need for a tariff reform. Friedberg even says that "to support his more alarming claims of relative decline and international erosion he would also have needed a universal index with which to compare Britain to other countries" (p. 80). I argue that it was possible at the time for Britain to think – and behave – in terms of relative gains, as these concerns were expressed and identified by British Conservatives who understood the precious state the English state was operating under. Ultimately it must be argued that Britain made a fateful mistake when it allowed economic considerations to prevail over security concerns.

Accurate measures would have been good, but they were not necessary. During the last decades of the century it was not only food and raw materials, but also manufactured goods that increasingly found their way into the homes and workplaces of average Britons. This fact became especially noticeable after the passage of the 1887 Merchandise Marks Act, which forced foreign exporters to label goods sold in the United Kingdom with the name of the country of manufacture. For the first time Englishmen began to realize how much they were buying from overseas. Britain was being inundated

with German machines, tools, household goods, and even children's toys (Friedberg 1988, p. 37-8, Kennedy 1980, p. 294). Therefore, it can reasonably be inferred that Britons had a very firm understanding of its precious economic situation.

*Conclusion* – This paper discussed the appropriateness of Liberalism as a guide for foreign policy. My purpose was not to contend that Liberalism shaped Britain's behavior in the late nineteenth century. Rather, this paper demonstrated Britain's firm commitment to Liberalism by evidencing the liberal assumptions that informed her commercial and foreign trade policies: i.e., *first*, that economy and politics are separate realms and, therefore, the state shall not intervene in economy; *second*, that states are atomistic actors who maximize utility defined in terms of absolute gains; *third*, that the ultimate aim of economic activities is individuals' welfare maximization; and *forth*, that there is a long-term harmony of interests underlying market competition and that the market, through its self-operating and self-correcting mechanisms, tends toward equilibrium and inherent stability. Inspired by these principles, Britain opted to maintain a free trade policy in a protectionist environment; to favor the acquisition of "invisible" gains from shipping and financial services while neglecting her industry; and to consent in the industrial and economic growth of Germany and the United States at her expenses. In sum, Britain distorted free trade from a utilitarian means to power to an end in itself.

To scrutinize the underlying assumptions that inform a country's foreign policy is much more than a mere intellectual exercise. As different assumptions produce different political outcomes, the evaluation of the implications of those assumptions in terms of its political consequences becomes a highly relevant goal for policy-makers. By informing

the trading of power for wealth as Britain's ultimate goal, Liberal principles were deleterious to Britain's national interest since their consequence was to undermine Britain's power and to make her less secure over time. I also argued that although Britain did not act as expected by realist predictions of prudent behavior this, nevertheless, did not undermine Realism but rather strengthened it. Realism *does not* say that all states behave in a security-oriented fashion all the time. Yet it *does* say that "if some do relatively well, others will emulate them" (e.g., Germany and the United States, firstly keeping up with and then surpassing England) "or fall by the wayside. Obviously, the system won't work if all states lose interest in preserving themselves. It will, however, continue to work if some states do, while others do not" (Waltz 1979, p. 118). Therefore, England's disregard of power and security did not change the nature of the world: while there is anarchy the international system shall be self-help in character.

## APPENDIX

TABLE 1  
IRON AND STEEL PRICES, 1856-1913  
(Shillings per long or metric ton)

Years	British	American	German Domestic	German Export
<i>1856-1865</i>				
Foundry pig iron	57	103	83	–
Iron bars	128	275	} 227	–
Iron rails	129	224		–
<i>1881-1890</i>				
Foundry pig iron	37	85	57 <sup>b</sup>	–
Iron bars <sup>a</sup>	105	192	119	109
Steel rails	97	152	136	109
<i>1906-1913</i>				
Foundry pig iron	52	78 <sup>c</sup>	74	–
Steel rails	121	115	–	110
Steel bars	139	127	106	106
Heavy plates	139	132	124	119
Structural steel	130	133	114	107

<sup>a</sup> Average for years 1882, 1884-89.

<sup>b</sup> Average for years 1882-1890.

<sup>c</sup> Average for years 1906-1911.

Source: Allen 1979, p. 912.

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