Economic Policy and the Rise and Fall of Empires

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▶ Confronted with a fragmented world—countless governments, currencies, legal systems, religions, armies, languages and customs—Alexander of Macedonia understood the enormous benefits of unification. In the years before his death in 323 B.C., he conquered his world, breaking down the barriers to communication and commerce.

Caesar Augustus' Empire-wide tax census made it possible to lower the rates of those who had previously borne all the tax burden, ended the confiscation of the incomes and properties of the most visible citizens and generally encouraged the accumulation and spread of wealth that continued until the accession of Commodus in 180 A.D. The following 100 years of spending, taxes and monetary manipulation yielded chronic inflation, however, and led finally to Diocletian's decree of universal wage and price controls.

After the Pax Romana ended the quest for a world government and a world economy did not resume until the American and French revolutions in the late 18th century. The latter was a blind, angry rebellion against the political leaders who had strangled the French economy with excessive taxation and government regulation.

Unlike Alexander and Augustus, who had begun with conquest and brought reforms afterward, Napoleon began with internal reforms made possible by the revolution. He lowered domestic tax rates, stabilized the currency and reformed French (and eventually European) law with the Napoleonic Code. ▶

I

Imagine the United States did not exist in its present form. Instead, imagine 50 sovereign nation states, each with its own national government. The people of each state speak different languages or variations of the same tongue. The predominant religions differ, and perhaps in some all but the state religion are banned. Each state has its own system of customs and tariffs. Each, its own tax structure. Each, its own currency and monetary authority, and its own system of laws, criminal and civil.

Given this condition, the standard of living of the citizens of these 50 nations would inevitably be much lower than at present. The people of the 50 nations would still transact business with each other, but with much greater difficulty. A significant portion of each nation's population would have to be pulled away from production of goods and services and channeled into the mere effort of exchange. Specialists in language variations would have to be developed so that business entities in Kansas and New York could understand one another in order to transact. Currency specialists, "money-changers," would be required to assay the value of each nation's money so that businessmen could have confidence in their transactions. As well as each nation having its own domestic tax wedge, each nation would have an international wedge against commerce, with added paperwork and financial costs for every transaction across borders.[1]

Even worse, the mobility of each citizen of the 50 nations would be limited. If a citizen of New York was unhappy with the government of New York, he could go only to those other nations that permitted immigration. And even then, he and his family would have to

1. Footnotes appear at end of article.

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adjust to a new language. Perhaps their religion would be treated inhospitably or prohibited outright.

Each nation state would have its own national defense system, with all states having standing armies, and the coastal states having navies as well, to protect against other maritime powers across the oceans as well as against the other coastal states.

Clearly, the costs of having 50 nations instead of a federation of states in one nation would be enormous, so much so that we would not recognize the continent if we saw it in such condition, such would be its relative poverty. Indeed, it could hardly survive in a world of other nations as they exist at present.

Such is the condition that Alexander of Macedonia encountered in 336 B.C., upon the assassination of his father Philip. The world he saw was a world of fragments, countless governments, currencies, legal systems, religions, armies, languages, customs. It was as if the 21-year-old heir, who had been schooled in government and philosophy in his formative years by Aristotle, understood the enormous costs to the world of fragmentation and the enormous benefits that would accrue through unification. In the next dozen years, before his death in 323, he conquered "the world," not by enslaving it, but by snapping—one small piece at a time—the barriers to communication and commerce that had lain over Europe, the Mediterranean and Asia Minor like a spiderweb.

Imagine, in our hypothetical America, that a political and military genius sets out from New York to conquer New Jersey. As he does so, both New Jerseyans and New Yorkers discover the efficiencies of unity. The New Jersey army merges into the New York army, but a segment of both is freed for production, and the cost of maintaining armies through taxation falls in both regions. Not only does spending fall, but tax rates can be lowered too, a double surge down the path of the Laffer Curve.[2] The same occurs with the elimination of border costs of commerce between New York and New Jersey as tariff walls fall, as two monetary authorities merge into one and a common currency replaces dual systems. Mobility of citizens increases and languages and customs merge, as long as the New York political genius does not attempt to *impose* language, religion, or customs on the conquered terrain. If in this first campaign the New York genius has a sense of what he must and must not do to cut through the spiderweb, the citizens of adjoining states—Pennsylvania, Connecticut, etc.—may still resist conquest, but not as vigorously as New Jersey did when it was still unknown what kind of political leader the New Yorker would be.

Alexander the Great was just such a military and political genius, conquering the world with such subtlety that more often than not the city-states in his path simply threw open their gates to him. He not only did not impose a religion where he conquered, but would pay homage to local religions by worshipping at the temples, even ordering reconstruction of those that had been damaged in warfare. (The modern presidential candidate in the United States dons a Stetson hat in Dallas and eats Bar-B-Q, then travels to Brooklyn where he puts on a yarmulke and eats a bagel.) Where Alexander imposed systems, they were welcomed happily, substituting for instance a faithful silver coinage standard for the elaborate bimetallism of Persia or the myriad moneys of Asia Minor.

When he died after a drinking bout in his thirty-third year, during the fever preceding death his generals asked him to whom he left his empire, and he answered, "To the strongest."

"Like most great men he had been unable to find a successor worthy of him, and his work fell unfinished from his hands. Even so his achievement was not only immense, but far more permanent than has usually been supposed. Acting as the agent of historical necessity, he put an end to the era of city-states, and, by sacrificing a substantial measure of local freedom, created a larger system of stability and order than Europe had yet known. His conception of government as absolutism using religion to impose peace upon diverse nations dominated Europe until the rise of nationalism and democracy in modern times. He broke down the barriers between Greek and "barbarian," and prepared for the cosmopolitanism of the Hellenistic age; he opened hither Asia to Greek colonization, and established Greek settlements as far east as Bactria; he united the eastern Mediterranean world into one great web of commerce, liberating and stimulating trade. He brought Greek literature, philosophy, and art to Asia, and died before he could realize that he had also made a pathway for the religious victory of the East over the West. His adoption of Oriental dress and ways was the beginning of Asia's revenge."[3]

According to the *Encyclopaedia Britannica,* "It is not untrue to say that the Roman Empire, the spread of Christianity as a world religion, and the long centuries of Byzantium were all in some degree the fruits of Alexander's achievement."

Alexander had left his indelible imprint on the world, a taste for economic unification, and although his "empire" itself dissolved with his death the memory of unification remained. The global electorate, though, had more work to do on the succession problem, for Alexander had not even left an adopted son to carry on.[4]

While the Greek experiments with democracy terminated in the fratricide of Athens and Sparta, at least the idea was imported by Rome for further trial. The Greeks had demonstrated that a democracy based on automatic rotation of political rule among the entire citizenry was impractical, as impractical as it would be to annually rotate the management committee of General Motors among all the workers. The Roman experiment divided and weighted the voting classes, but did not draft citizens for political leadership. The man at the top would have to get there by climbing the slippery slope in competition with those of his fellow citizens who were interested in trying.

It was 271 years after Alexander's death that the world found his successor in Julius Caesar. The global economy had been fragmented again, but not nearly to the degree it had been prior to Alexander, and there was a crude system of democratic succession to provide for continuity, once Caesar put the world economy together again. In 52 B.C., Caesar conquered Gaul, adding to the Empire a country twice the size of Italy and expanding the economic marketplace by five million people. Caesar treated the conquered tribes, once subdued, with such lenience that even when they could have broken loose in the civil war that followed, Rome being helpless to retaliate, they did not do so. For three centuries Gaul remained a province of Rome, learning the Latin language and transforming it, prospering in the Roman peace, channeling the culture in northern Europe.[5]

When Caesar crossed the Rubicon into Italy three years later, its cities opened their gates to him, welcoming him as a liberator and champion of Italian rights. Instead of confiscating the estates of his opponents to feed his near-empty coffers, he held back, winning at least the neutrality of the middle class. When he entered Rome, he proclaimed a general amnesty and restored order and municipal administration with free use of the state's money. "But with unscrupulous impartiality he deposited in the Treasury the booty from his later campaigns."[6]

Now Caesar was on top. In five years he laid the foundation for a system that would endure for 500 years in the West and for 1,500 years in the East.

"[He] distributed lands to his veterans and the poor; this policy, continued by Augustus, for many years pacified the agrarian agitation . . . . [He] spent 160 million sesterces in Rome on building programs . . . . Having eased the pressure of poverty, he required a means test for eligibility to the state dole of grain. At once the number of applicants fell from 320,000 to 150,000 . . . . [He] continued the Gracchan policy of inviting businessmen to support the agrarian and fiscal revolution . . . . Many of the great capitalists, from Crassus to Balbus, helped to finance him, as similar men helped finance the American and French revolutions. Nevertheless, Caesar ended one of the richest sources of financial profiteering—the collection of provincial taxes through corporations and publicans. He scaled down debts, enacted severe laws against excessive interest rates, and relieved extreme cases of insolvency by establishing the law of bankruptcy essentially as it stands today. He restored the stability of the currency by basing it on gold and issuing a golden aureus, equivalent in purchasing power to the British pound sterling in the nineteenth century. The coins of his government were stamped with his own features and were designed with an artistry new to Rome. A novel order and competence entered the administration of the Empire's finances, with the result that when Caesar died the Treasury contained 700 million sesterces, and his private treasury 100 million . . . . As a scientific basis for taxation and administration, he had a census taken of Italy, and planned a like census of the Empire."[7]

Had Caesar not adopted Caius Octavius as his son, the planned census of the Empire would likely never have been taken. After Caesar's assassination in 44 B.C., the Empire plunged into civil war, and it was 16 years before Octavius returned victorious to Rome to become the new Caesar, Augustus, not only the son Alexander never had, but an extremely competent one at that. At his return:

"Rome was full of men who had lost their economic footing and their moral stability: soldiers who had tasted adventure and had learned to kill; citizens who had seen their savings consumed in the taxes and inflation of war and waited vacuously for some returning tide to lift them back to affluence; women dizzy with freedom, multiplying divorces, abortions, and adulteries."[8]

For 44 years, Augustus consolidated the Empire, finally getting to his adoptive father's plans for an Empire-wide tax census in the year of Christ's birth. (In the Gospel of Luke: "In those days there went out a decree of Caesar Augustus that all the world should be taxed.") In fact, it was because of this decree that Joseph and Mary were en route to Bethlehem, Joseph's town, in order that he might be enumerated. Because of this coincidence and the baldness of Luke's wording, Augustus is usually treated harshly in modern depictions of the birth of Christ. But the census was the most important act of Augustus' reign, for in spreading the tax burden over all the Empire, it enabled rates to be lowered on those who had been bearing all the burden, ended the need by the government to confiscate incomes and property of those most visible, and thus encouraged wealth generally to resume its accumulation and spread.

The *Pax Romana* was under way, its golden age lasting until 180 A.D. and the death of Aurelius, when his son, Commodus, traveled up the Laffer Curve through profligate incompetence. The Empire splintered slowly but steadily as successive emperors fought contraction by tax and spending policies that moved it further up the Curve. By 301, after 100 years of spending, tax and monetary manipulation had yielded chronic stagflation, Diocletian decreed universal wage and price controls under penalty of death. Attempts to employ bond illusion or money illusion to expand inevitably seem to lead to wage and price controls, as the electorate counters illusion by raising wages and prices. It was not until the American and French revolutions of 1776 and 1789, both rebellions against the upper reaches of the Laffer Curve, that the global electorate could seriously reestablish the quest for world government that ended with the Pax Romana.

ii

Conventional perspectives view the French revolution as a mighty blow struck for equality and redistribution. But it was exactly the opposite. With the coincidence of the American revolution, it ended the long contraction in the West that had begun with the accession of Commodus in 180 A.D. On the eve of the revolution in France, the economy was strangled by taxation and government regulation that had evolved under the redistributive pressures of contraction.

At the moment of revolution in France, it is almost impossible to see how the system of income redistribution could have been worse. According to Hippolyte Taine, a French historian of the nineteenth century:

"Before 1789, the peasant proprietor paid, on 100 francs income, 14 to the seignior, 14 to the clergy, 53 to the state, and kept only 18 or 19 to himself; after 1800 he pays nothing of his 100 francs of income to the seignior or the clergy; he pays little to the state, only 25 francs to the commune and *departement,* and keeps 70 for his pocket."[9]

Even replacement by a system that would leave the electorate with 30 percent of its production instead of a mere 18 or 19 per cent would have permitted the populace to sink back into sullen depair. The revolution itself was a blind, angry rebellion against the strangulation caused by this system—voting by guillotine only after the imperious class of French political leaders steadfastly refused to hear the electorate's other attempts at communicating malaise, corruption, and despair. A revolution reaches critical mass when the electorate knows what will follow cannot be worse. The French electorate could have no idea what would emerge in place of their oppressors, only that it had to be better. This is why a violent revolution is so rare; it is the least efficient means by which the electorate votes—even the assassin, in "voting," has a rough sense of who will follow as successor. The electorate could not have foreseen the emergence of Napoleon Bonaparte, whose political and financial wizardry reproduced the prescriptions of the Caesars in putting the global political economy back on the rails it had jumped under Commodus.

Unlike Alexander and Caesar, who began with conquest and brought reforms afterward, Napoleon began with internal reforms made possible by the revolution, especially the lowering of domestic tax rates, the stabilizing of the currency with a gold Napoleon, and reform of French law with the Napoleonic Code. Napoleon refused to talk to the economists of the day, who had been largely responsible for the economic schemes that had brought on the revolution. He brushed aside the income-redistribution ideas of Charles Fourier on the communal production of goods with an insight that one would not expect to find inside a crowned head. On Christmas day, 1799, he wrote his brother Lucien:

"Whilst an individual owner, with a personal interest in his property, is always wide awake, and brings his plans to fruition, communal interest is inherently sleepy and unproductive, because individual enterprise is a matter of instinct, and communal enterprise is a matter of public spirit, which is rare."[10]

It was because of Napoleon's insistence that the individual entrepreneur, who pre-revolution could keep only 18 or 19 per cent of his production, could post-revolution keep 70 per cent of it.

By 1805, Napoleon had cut so relentless a swath through the crowned heads of Europe allied with George III that only Britain, Sweden and Russia had not recognized the Emperor of France. Like Julius Caesar, Napoleon had extended the French Empire by a conquest that was also a liberating force to the degree his economic and political ideas knit together a larger marketplace. The ingredients of the Code took hold in the train of Napoleon's armies, spreading over much of the Continent, thereby providing legal solutions to feudal regimes and ending the virtual enslavement of the peasant to the land. [To] quote from Durant's monumental historiography:

"Even in his lifetime he [Napoleon] had a Hegel, who, unblinded by frontiers, saw in him a world force—the compulsion of events and circumstances speaking through a man—forging fragments into unity, and chaos into effective significance. Here—first in France, then in Central Europe—was the *Zeitgeist,* or Spirit of the Time: the need and command for order, ending the disruptive excess of individualistic liberty and fragmented rule. In this sense Napoleon was a progressive force, establishing political stability, restoring morality, disciplining character, modernizing, clarifying, codifying law, protecting life and property, ending or mitigating feudalism, reassuring peasants, aiding industry, maintaining a sound currency, cleansing and improving administration and the judiciary, encouraging science and art (but discouraging literature and chaining the press), building schools, beautifying cities, repairing some of the ravages of war. Helped by his prodding, Europe advanced half a century during the 15 years of his rule."[11]

[But even Napoleon] did not realize until it was too late that the only closed political economy is the world economy. [His attempt to starve Britain] into submission by blockade [failed]. As long as Britain could trade with any nation outside France, it was thus trading indirectly with France. And the more successful Napoleon was in pushing British trade away from France and the Empire, the more he weakened France.

As the war proceeded, the port cities of France decayed and merchants withered in support of the blockade. By 1810-11, Napoleon was forced to sell licenses for certain types of trade with Britain even as war continued, chipping away at his own plan in order to relieve political tensions at his back. When he could no longer finance his campaigns by exacting taxes solely from conquered lands, and added French taxes on top of the continual drain of French sons for slaughter in war, Napoleon had essentially lost the support of the electorate.

The global electorate had [nevertheless] come out far ahead as a result of these struggles. The French revolution had weakened monarchy and advanced democracy. Napoleon's victories had spread the modern Napoleonic Code through Europe, breaking down the remnants of the feudal system by freeing peasants from the land. In 1815, victory over Napoleon having ended 22 years of war, the British people clamored so loudly for an abrupt end to the crushing war taxes they had borne that their parliament gave in, ignoring the earnings of the economists that financial chaos would ensue. As Napoleon had demonstrated, it is prosperity that ensues when oppressive taxes are lifted. For 60 years, the British economy boomed as Britain built its own empire, lifting the entire world in one degree or another to a higher level of prosperity.

iii

Most present-day historians seem to suggest that Great Britain in 1815 had a golden age almost visibly spread before it, that with the defeat of Napoleon it was almost inevitable that the rest of the century would belong to Britain. But the future did not seem that bright to the British citizen of the day. More than 20 years of war had left Britain with a straggering public debt. Forty years earlier, on the eve of the American Revolution, the British debt was £126.8 million. In 1815, it stood at £900.4 million. At mid-century, British historian Thomas Babington Macaulay looked back on the fears of that colossal debt:

"At every stage in the growth of that debt the nation has set up the same cry of anguish and despair. [After the Peace of Utrecht] the nation owed about fifty millions; and that debt was considered, not merely by . . . fox-hunting squires . . . but by profound thinkers, as an incumbrance which would permanently cripple the body politic. Nevertheless . . . the nation became richer and richer.

"Then came the war of the Austrian Succession; and the debt rose eight millions. Pamphleteers, historians and orators pronounced that now, at all events, the case was desperate.

"Under the prodigal administration of the first William Pitt, the debt rapidly swelled to £140 million . . . Men of theory and men of business almost unanimously pronounced that the fatal day had now really arrived . . . . It was possible to prove by figures that the road to national ruin was through the national debt. It was idle, however, now to talk about the road; we had reached the goal; all was over; all the revenues of the island . . . were mortgaged. Better for us to have been conquered by Prussia . . . . And yet [one] had only to open his eyes to see improvements all around him, cities increasing, marts too small for the crowd of buyers, harbors insufficient to contain the shipping . . . houses better furnished . . . smoother roads.

"[After the Napoleonic War] the funded debt amounted to £800 million. It was in truth a . . . fabulous debt; and we can hardly wonder that the cry of despair should have been louder than ever . . . . Yet like Addison's valetudinarian, who contrived to whimper that he was dying of consumption till he became so fat that he was shamed into silence, she went on complaining that she was sunk in poverty till her wealth . . . made her complaints ridiculous. The . . . bankrupt society . . . while meeting these obligations, grew richer and richer so fast that the growth could almost be discerned by the eye.

"A sum exceeding [£240 million] was in a few years voluntarily expended by this ruined people on [the construction of railroads]. Meanwhile taxation was . . . becoming lighter; yet still the Exchequer was full . . . . The prophets of evil were under a double delusion . . . . They saw that the debt grew; and they forgot that other things grew as well as the debt."[12]

Not only was Britain's *debt* "fabulous" in 1815. In 1820, the *Edinburgh Review* observed that taxes were on the same order:

"The schoolboy whips his taxed top; the beardless youth manages his taxed horse, with a taxed bridle, on a taxed road; and the dying Englishman, pouring his medicine, which has paid 7%, into a spoon that has paid 15%, flings himself back upon his chintz bed, which has paid 22%, and expires into the arms of an apothecary, who has paid a license of £100 for the privilege of putting him to death. His whole property is then immediately taxed from 2% to 10%. Besides the probate, large fees are demanded for burying him in the chancel. His virtues are handed down to posterity on taxed marble, and he will then be gathered to his fathers to be taxed no more."[13]

What made the Industrial Revolution and the Pax Britannica possible was the audacity of the British Parliament in 1815. Spurred by middle-class agitators such as Henry Brougham, the legislature rejected the stern warnings of the fiscal experts and in one swoop eliminated Pitt's income tax, which had been producing £14.6 million, or a fifth of all revenues, and tariffs and domestic taxes that had been producing £4 million more. Had the British left their tax rates high in an attempt to quickly pay down their debts, the 60-year bull market that followed would not have been possible. As it was, the nation moved down the Laffer Curve in a "return to normalcy" on tax rates.

As the economy surged in the following decades, expanding revenues were used both to pay down the debt and reduce other tax rates. By 1855, the £900 million debt had been paid down to £808.5 million, and although the Russian War of 1855-57 added £30 million, by the end of the century the debt was chiseled down to £639 million. Over the same 85-year period, interest rates on government bonds dropped steadily, from almost six per cent in 1815 to less than 2¾ per cent.

When Sir Robert Peel brought back the income tax in 1846, the effect was not to push the economy back up the Curve, because Peel's sole intent was to use the income tax revenues to repeal the Corn Laws, the duties on foreign grains. The reform was enormously beneficial, because the income tax fell across all lines of production, while the Corn Laws subsidized agriculture at the expense of all other producers. The economy became more efficient as a result of the reform.

But it is hardly accurate to suggest that British economic expansion did not get under way until Peel ended the Corn Laws and brought back the income tax. Modern historians who have been taught that the income tax is a "good tax" often seem troubled that it was removed in 1815, as if the economy could not do without it.[14] In fact, it was the robust expansion of the British economy in the years to 1846 that forced the issue of agriculture versus industry.

"Between 1816 and 1875 Britain was to become the world's workshop, the world's banker, and the world's trader . . . . By 1860 she was supplying half the world's output of coal and manufactured goods. In 1830 world production of coal was about 30 million tons, of which Britain produced four-fifths; in 1870 it was about 220 million tons, of which Britain produced half . . . . In 1870 the external trade of the United Kingdom was greater than that of France, Germany and Italy combined and three times that of the United States. The output of pig iron had risen from 700,000 tons a year in 1830 to about 3,800,000 in 1869-71, and to over 6,5000,000 in 1871-73. While many industries were dependent on the coal fields, the main growth had been in cotton. Cotton was the one industry into which mechanization had cut deep by 1820. Textile operatives were more than 10 per cent of the working population in 1841.

"Between 1815 and 1851 occurred the most rapid economic development of domestic resources in the whole of British economic history."[15]

Britain had become too rich relative to the rest of the world to produce the food she consumed. The Corn Laws not only kept out cheaper grains from abroad, but in subsidizing domestic agriculture as it had been arranged in the eighteenth century—sharecroppers working for the landed gentry—the Corn Laws delayed capital intensive farming that eventually did produce more food with fewer people. In a real sense it was the planet that forced repeal of the Corn Laws, for when the Irish potato crop failed in 1846, the starving Irish could not be fed from the inadequate British granaries. The Corn Laws simply had to be ended to permit entry of grains from the United States. Even so, a half million Irish died of starvation in 1846-47.

Because growth was almost continuous in this 60-year period, laissez faire worked beautifully. But as the Irish famine showed, a nation without a fallback system to meet unexpected economic contraction would suffer staggering social costs. The free-market "solution" to the famine, repeal of the Corn Laws, was really a partial solution to the next hypothetical famine; there simply was no government mechanism to prevent starvation. While economic growth resumed, bigger and better than ever, the electorate began seriously pushing Parliament toward a social-support system. It would take another 30 years, and the disastrous British harvests of 1876-79, before the coin was turned and the forces of income redistribution supplanted the forces of income growth.

Meanwhile, the problem of balancing the budget each year was a delightful one for the Chancellor of the Exchequer. For as each tax reduction invited a new wave of expansion and further increase in the tax base, tax rates had to be reduced again in order to prevent surpluses from developing. The explosion of British wealth was felt worldwide as Britain became the world's leading creditor nation, sending out surplus goods and receiving financial assets (bonds) in exchange.

"It was this vigorous, competitive, hideous and yet dazzling community which was the great exporter of the capital which made it possible to open up the vast but hitherto untapped resources lying in the hinterlands of new continents. All the underdeveloped parts of the world were calling for investments. Nearly a quarter of the £2.4 billion which was added to the capital of the United Kingdom between 1865 and 1875 was placed abroad, while a sixth went into houses and a tenth into railways at home . . . . It has been argued that the effort and the expense which went into the development of the colonial empire were at the cost of improvements which might have been made at home. This is to ignore the indirect gain which came from bringing new areas with new products into a worldwide system of multilateral trade. The small volume of direct trade with many new colonies often contained an element which played a vital part in some more complex interchange of other types."[14]

Instead of each country arranging bilateral trades with other countries, carefully keeping accounts balanced, Britain's position at the center of world trade and her willingness to accept paper financial assets in exchange for goods made possible complex three- and four-way trades. Britain sold finished goods to producers of primary materials, who paid for them both by sales to continental industrial nations and the United States, and by sending bonds to British investors. The industrial nations paid the primary producers and the United States by their sales of semi-finished products to Britain. The United States, a net importer, settled its accounts by its inflow of British investment.

As long as the world pie was expanding, prosperity fed on itself as protectionist pressures in each nation abated, permitting steady world-wide lowering of tariffs. France began peeling away its skyhigh protective rates in the 1840s. In Prussia, 17 fragmented states joined together in a tariff union (Zollverein) in 1833, providing for free trade between these German states. (The people of Germany gathered with long wagon trains at the various internal boundaries and waited for the stroke of midnight, January 1, 1834, when the tariff union came into being, and then crossed amid cheers.[17])

Italy and Russia also moderated their rates through the mid-century, and Britain, the leader of the free-trade parade, by 1875 had only 20 revenue items on its dutiable list. The constant expansion of world trade meant a diminishing of internal national complaints about an "export of jobs," and thereby a lessening of external frictions. Except for a few minor skirmishes, as in Crimea and the Civil War in the United States (which itself had deep roots in the conflict over tariff policy between the industrial North and agrarian South), the world was at peace until the end of the century. In the vital sense of the term, it was a Pax Britannica.

iv

The unwinding of the Pax Britannica occurred because of economic contraction without national or internal systems for ameliorating the pain that comes with contraction. France, for example, experienced a terrible harvest in 1875, and responded by putting up tariffs. The German Empire, unified under Bismarck, had built upon the free trade policies of the Zollverein, and through the early 1870s lowered rates until, by 1877, 95 per cent of all imports entered free. But this was the first of three horrendous British harvests and Britain, in order to import more food, pushed out more manufactured goods.

German industrialists, irritated by this "dumping" against which they had to compete, applied pressure until tariffs were raised. Russian industrialists, complaining they could not compete against cheap German manufactures, succeeded in pushing up tariffs in 1893. Germany responded by raising its tariffs against Russian goods, and Russia came back by doubling its rates against German goods. A troubled truce was finally negotiated, but commercial irritations persisted up to 1914. At the same time, France's protectionist tariff irritated Switzerland and Italy, which engaged in similar tariff wars, and with protectionists in the saddle, Italy abandoned its low tariff policy in 1887 for high rates that did not come down until the Mussolini era.

Britain meanwhile held fast to its free trade policies, but the relative contraction it felt in this period turned its electorate in search of social systems to deal with contraction:

"After 1870 the government of Britain became more and more concerned with two main tasks: (1) where there was reason to believe that the free play of individual choice and judgment would be beneficial, the government had to secure that there should be neither force nor fraud nor the obstruction of legal forms to hamper the creative power of individual self-help; (2) where the play of individual choice and judgment did not in fact produce the goods and services which common sense suggested—and experience confirmed—were desirable and possible, the government had to try to provide them. If the mechanism of the market was to produce what it could, that mechanism had to be properly serviced. Things necessary to civilized life that a market could not provide the government should provide if possible."[18]

At the same time, some of Britain's colonial investments began to haunt her, applying pressure on the budget. In 1871, unification of Germany aroused Parliament over the state of national defenses; Prime Minister Benjamin Disraeli needed more money. His chancellor, Sir Stafford Northcote, solved the problem of 1876—a prospective deficit of £774,000—by raising the income-tax rate to three pennies on the pound from two. The London *Economist* of April 8, 1876 observed: "The great advantage of our financial system—one which no other country possesses equally—is that we have at command a tax, of which the amount can be raised without affecting trade, and without pressing painfully on anyone except when its amount is very high."

The income tax was surely all of this, and certainly Britain was by now wealthy enough to provide broader public services, such as free primary education and unemployment insurance. Public spending on social services quadrupled between 1900 and 1914, and income tax rates glided upward to finance these costs. The British economy continued to grow, and while the growth rates were less dramatic than in the boom years of mid-century, the nation seemed to have hit upon a comfortable compromise of the growth and distribution models. The peaceful blending of Adam Smith and Karl Marx was largely the work of the Fabian Society, "revolutionary" socialists who formed in 1883 because of the distress in the political economy.

The political and economic irritations between the crowned heads of Europe intervened to produce the dynastic fratricide of World War I. Once and for all, the global electorate cleared the scene of Hohenzollerns, Habsburgs, Romanovs and Ottomans, making the world "safe for democracy."

The British Crown survived as a showpiece, but unfortunately so did the steeply progressive tax rates Britain had imposed to help finance the war. A hundred years earlier there was a Henry Brougham to agitate for a return to normalcy on British tax rates after Waterloo. Now, in 1918, there was no similar pressure to get the economy off the upper sweep of the Laffer Curve. Until 1914, the British income tax had been very nearly proportional; except for tax-free personal and family allowances on subsistence income, all income classes paid the same rates. After 1914, the system was progressive, and the work of the Royal Commission of 1919 was not to determine whether or not wartime rates could be reduced in order to expand revenues, but to streamline the system of progressivity and make it more "equitable."[19]

This began the reversal of Britain's course in the nineteenth century. Instead of tax cut, expansion, revenue increase, tax cut, etc., the trend in Britain has been tax increase, contraction, revenue decline, tax increase. Balancing the budget became the process of increasing the "supertax" on higher incomes.

As a result, Britain dragged through the 1920s, unemployment hovering at five per cent throughout. British politicians and economists, unaware that the problem was in the tax structure, began doubting free trade principles and a monetary system tied to the planet through gold. When world depression followed the Wall Street Crash, John Maynard Keynes ended his lifelong advocacy of free trade, and in 1931 (as Britain was again increasing tax rates to balance the budget) Keynes provided intellectual support for a return to protectionism and a break with the gold standard.

The return to protective tariffs in Britain was coupled in 1932 with enactment of "Imperial Preference," by which only the British territories could enjoy preferential tariff schedules. It was an economic blessing to Britain through the 1930s that she had a colonial empire within which untrammeled trade could be maintained. And the mildness of Britain's tariff schedules relative to Smoot-Hawley is a prime reason why Britain's depression was not as severe as the United States'. But the return to protectionism in and of itself was a further blow to the world economy:

"The decision to enact Imperial Preference, made at the Ottawa Conference in 1932, had a particularly injurious effect on Japanese exports to British colonial territories. It seems permissible to say that this decision played some part in strengthening the pro-war party in Japanese politics; and it may have influenced Germany also."[20]

There would be no opportunity for Britain to repeat this process. At the end of World War II, Winston Churchill and his Conservatives—who favored continuation of colonial empire—were turned out of office by the British electorate. With India's independence in 1947, the last vestige of Pax Britannica was over. ■

Footnotes

1. The mechanics of the tax wedge are discussed in R. David Ranson and Charles E. Babin, "What's Holding Up the Capital Investment Boom?" *Financial Analysts Journal,* September/October 1978, pp. 30-41.
2. The Laffer Curve is described and discussed in Chapter 6 of *The Way The World Works.* See also Peter M. Gutmann, "Taxes and the Supply of National Output," *Financial Analysts Journal,* November/December 1979.
3. Will Durant, *The Story of Civilization,* 11 vols. (New York: Simon & Schuster, 1935-1975), Volume 2, p. 552.
4. The thesis of the global electorate is set forth in Chapter 2 of *The Way The World Works.*
5. Durant, *The Story of Civilization,* Volume 3, p. 177.
6. *Ibid.,* Volume 3, pp. 182-183.
7. *Ibid.,* Volume 3, pp. 192-193.
8. *Ibid.,* Volume 3, p. 211.
9. *Ibid.,* Volume 11, p. 263.
10. *Ibid.,* Volume 11, p. 260.
11. *Ibid.,* Volume 11, p. 776.
12. Thomas B. Macauley, *History of England,* vol. 3 (Boston: Houghton Mifflin Co., 1901), p. 432.
13. *Economist* (London), 10 April 1976, p. 74.
14. See, for example, G. M. Trevelyan, *British History in the Nineteenth Century and After (1782-1919)* (London: Longmans, Green and Co., 1937), p. 180.
15. K.B. Smellie, *Great Britian Since 1688* (Ann Arbor: University of Michigan Press, 1962), pp. 139-140.
16. *Ibid.,* p. 212.
17. Asher Isaacs, *International Trade: Tariff and Commercial Policies* (Chicago: Richard D. Irwin, 1948), p. 338.
18. Smellie, *Great Britain Since 1688,* p. 220.
19. F. Shehab, *Progressive Taxation* (Oxford: Oxford University Press, Clarendon Press, 1953), pp. 260-75.
20. Colin Clark, "A Memoir of the 'Golden' Age of the Great Economists," *Encounter,* June 1977, p. 83.