How did states further the rise of the Great Divergence?

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The debate on the Great Divergence is bound to continue; not even the publication of Escaping Poverty by Peer Vries, an inspiring interpretation of the dominant strands in the debate, will change this.¹ The metaphor for the growing global contrasts that emerged in per capita economic growth and prosperity in the nineteenth century is simply too appealing. Yet the content of the debate will surely change. Escaping Poverty shows how the debate on the Great Divergence has undergone a gradual shift from being about ‘coal and colonies’ to being about ‘institutions and the state’; something that is especially visible in Chapters 20 and 25, which are entitled Ultimate causes: institutions and The institution of institutions: The role of the state, in particular that of Britain, respectively. So far, however, clear answers are lacking on the crucial questions of how the British state might have stimulated the Industrial Revolution, and how state institutions might further modern economic growth in general, above all before the development of powerful state establishments in the nineteenth century. This article analyzes the difficulties encountered in the search for more convincing answers, and addresses the question of how and to what degree central states might have influenced the rise of the Great Divergence.

1 The problem of obscure definitions

The historical overview of the debate given in Escaping Poverty by Peer Vries employs a number of concepts in relation to the Great Divergence –

¹ Peer Vries, Escaping poverty. The origins of modern economic growth (Vienna and Göttingen 2003).
Britain, which according to Acemoglu and Robinson were under the rule of the most advanced 'inclusive institutions' of the time, suffered from a lack of cadastral surveys and from poor (customary) property rights on their lands. Enclosure (a typical rent-seeking phenomenon) and the high costs of lawsuits furthered the accumulation of land and wealth by the proprietor classes at the expense of those with a limited amount of property. Some property rights were enforced, whilst others seem to have been disregarded; some people gained inclusive rights whereas others were deliberately excluded. Without taking such class-related aspects into account, the terms used by Acemoglu and Robinson obscure more than they reveal.

A similar problem affects the 'fiscal-military state', a concept that is also seriously under-defined. John Brewer, who coined this concept in his groundbreaking *Sinews of Power*, did not provide a clear definition, but referred to the English version of the fiscal-military state. The provenance of his term 'fiscal' is quite obvious, being derived from the Schumpeterian notion of the 'tax state' that is characterized by the extraction of resources for the state through taxes, in contrast to revenues from the 'crown domains', which had been the dominant mode of extraction for the medieval 'domain states'. The term 'military' refers to the debate on the Military Revolution, with the concomitant rise of larger and more permanent armies and navies.

After the publication of *The sinews of power*, other historians applied the concept of the fiscal-military state to Spain, the Dutch Republic, Russia, Austria, Ethiopia and Savoy, among others, all obviously less efficient than Britain. Savoy could only survive thanks to subsidies from other states, for example, and several of these 'fiscal-military states' did not even develop a

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4 See a similar criticism by Vines, *Scraping Poverty*, 126.
proper system of public debt. In *Escaping Poverty*, Peer Vries typically uses the ‘English model’ of the fiscal-military state as the standard. China is thus excluded from the concept by definition; yet it should be included, being the world’s first tax state, with its roots in the successful Qin state of the fourth century BCE and with capacities that were further improved during the eight-century Song dynasty. Recent research shows that East Asia was involved in a military revolution, too, which resulted in the use of innovative arms and tactics with linkages to taxation and state-formation. Furthermore, China’s taxes applied to almost every inhabitant of the country, with virtually no exemptions or privileges for specific classes or groups (in contrast to England and almost all European states), within a large territory that was kept firmly under control by a meritocratic bureaucracy (and not through patronage, as in England and most European states). When wars affected part of the territory, the revenues of the remainder of China continued to support the state thanks to economies of scale, which recurrently reinforced Chinese hegemonic claims in Eastern Eurasia. The British fiscal state, by contrast, was only firmly established during the 1750s. The imposition of novel, highly regressive taxes (above all, excises) was accompanied by widespread unrest, since these taxes laid a particular burden on the lower classes. The state budget ran almost continuously at a deficit, whereas Chinese state budgets operated at that
time with massive, regular surpluses, at least up to the late 1790s. The imposition of taxes was by no means as uniform throughout Britain as has been assumed, since Scotland and Ireland paid far below their capacity as compared to England, due to the threat of secessionist movements. Like numerous other European states, Britain was still a ‘composite state’, not a unified whole. With regard to the British Empire as a whole, the state obviously exerted little control over the more peripheral territories overseas. The attempt to tax the American colonies had even resulted in a glaring defeat for Britain in the 1770s, leading to the independence of the United States and the loss of a massive potential economy-of-scale revenue machine. In addition, British power was entrenched in the European state system and always needed allies to defeat its arch-enemy, France, whereas China could maintain a centuries-long hegemony in East Asia on its own.

Another obscure term is mercantilism, a true zombie-term in view of its repeated burials and revivals by historians. In *Escaping Poverty*, the term seems to be on the rise again. Peer Vries suggests the following definition: ‘A broader set of measures that basically had in common that they were meant to support the national economy.’ Viewed in this way, however, China obviously belongs to this category, too. Its rules furthered the colonization of less populated districts, maintained canals and rivers through impressive campaigns, preserved a nationwide granary system to prevent famines, and strictly regulated foreign trade, all with the aim of strengthening the national economy.

Even then, I wonder whether such a ‘benevolent’ interpretation of mer-

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cantism is adequate for Britain. Institutions such as the East India Company and the Bank of England were founded with truly rent-seeking and extractive motives: their primary aim was to raise war funds for the state, not to develop the national economy.21 The fact that in due course the Bank of England acted as a powerful buffer during monetary crises (see also below) was a typical unintended consequence of a typical rent-seeking action. The oft-mentioned assumption that foreign trade profited from imperialist expansion is dubious, too: trade with the United States did not drop at all after the War of Independence.22

The content of the debate must surely benefit from 'purging' the concepts of the most rabid Anglo-american. Eighteenth-century China was a reasonably well-developed fiscal-military state, with an efficient, nationwide tax system that yielded annual surpluses more often than not. It ensured proper property rights for the large masses of the peasantry and supported considerable economic development, albeit one that was Smithian in character. In many respects, China resembled European states. On the other hand, Britain was not the ideal fiscal-military state in all respects. Its fiscal system avoided taxing the wealthier groups in society and overburdened the lower classes; its budgets suffered from recurrent deficits; its mercantilist measures were strongly rent-seeking in character; the inclusive institutions of the peasantry were destroyed. Yet such insights still do not answer the crucial question: was there a connection between the policies of the central state and economic development?

2 Local dimensions of early-modern economic growth

In this respect, the debate suffers from the use of an anachronistic notion of the state.23 The Industrial Revolution is frequently analyzed in its national context, but the 'central state' did not exert much impact on society at all.

21 Bruce C. Carnethon, City of capital. Politics and markets in the English financial revolution (Princeton 1989); see Isaac de Pinto, An essay on circulation and credit in four parts and a letter on the jealousy of commerce (London 1774) 261; Robert R. Eldrige and Robert D. Tollison, Mercantilism as a rent-seeking society (College Station 1986). Marcus Olken, The rise and decline of nations (New Haven 1986).
22 Moreover, the evidence points to the gradual weakening of mercantilist policies after the middle of the eighteenth century, which renders the concept less applicable after the 1780s. At the same time, corruption also seems to have been on the decline. Mosky, The enlightened economy, 639, 393, 496, 513.
23 Vries, Escaping poverty, 328-329.

The eighteenth and the nineteenth centuries saw the emergence of the modern, territorial and eventually also the national state, but by the 1750s it was still emerging, with the waging of war and the extraction of taxes as its main tasks, with rare involvements in either agriculture of industry.24 The Industrial Revolution was a localized event, at least until the coming of the railway.25 The British government deliberately refrained from influencing local economic arrangements and left most of the power for carrying out day-to-day procedures to local governments, which were still dependent upon the willing service of the local gentry. In fact, like most of continental Europe, the country consisted of a patchwork of numerous 'politics' and autonomous corporations that exercised some form of political independence. The interaction with the central state increased only gradually, above all during the political crisis of the 1780s caused by the disaster of the War of American Independence, when leading members of small-scale communities invigorated local governance, which then developed in tandem with the growing power of the central state.26

The context of the 'local state' provided the diverse political and societal framework that was needed for the spread of 'public science'; it was responsible for education and skills, and also furthered the diffusion of knowledge on all kinds of subjects. Public lectures by instrument-makers, local schoolmasters and others were given all over the country, on topics such as mechanics, mathematics and chemistry.27 This was in fact the most important level playing field, to use Acemoglu and Robinson's term, with the difference that it had existed before the rise of Leviathan.

Such insights are helpful in the comparison with China, where the central state also deliberately left the arrangement of almost all local matters to the local authorities. The situation was different, however, with regard to the spread of knowledge. Most knowledge was accumulated within the state educational institutions, which tended to reinforce the dominance of

existing cognitive traditions. Another problem was the serious underfunding of Chinese local governments, which worsened considerably during the monetary crisis of the early nineteenth century. The worldwide drop in the supply of silver caused strong fluctuations in the value of the Chinese money of account, causing a massive plunge in tax yields. Corruption soared as extralegal taxation by local officials increased, undermining the level playing field in communities even further and thus hampering the exchange and application of new notions and ideas.

A similar monetary crisis was averted in England thanks to the Bank of England and the ability to contract loans based upon the powerful excises. Indirect duties such as these, levied upon a large number of consumption goods, were much more flexible than direct taxes on land, as those used in China, since harvests do not increase all of a sudden and the duties cannot be raised continually. English public loans were raised even during wars, thanks to the increases on rather small excises whose proceeds ensured the payment of interest for the time being. Loans also tended to spread the burden of war over a longer period of time, resulting in a lower degree of war-induced disruption for society at large. The supposed ‘crowding out’ effects of such massive public debt were limited, since there was no increase in interest rates. The market for government securities even stimulated the rise of entrepreneurs’ bonds. The regular procurement of funds for the army and navy meant that private entrepreneurs working for the military were paid on time, which stimulated the tapping of ‘additional resources of human, financial, and commercial capital which the state was unable to mobilize’, also at the local level. The public debt-cum

29 Xu Su, China’s last empire, 541 Wukui He, Praxis toward the modern fiscal state: England (1700–1950), Japan (1850–1890), and China (1843–1911) (Cambridge, MA 2003) 48; 102; 119; Su, China’s last empire, 244, 255, 257; ‘The core, science, paper’, 226–27; 229; also Vever, Debtopping poverty, 219 and 406.

excess solution rendered the bonds between the property classes and the state even stronger.

Yet the British trump card of using public loans based on excises worked only because of ongoing urbanization. Excises thrive only in commercialized, highly urbanized societies, and the fact that at this time urbanization continued at a rapid rate in Britain (in contrast to China, and even in contrast to continental Europe) explains the country’s ability to continue to contract debts, also during the Napoleonic wars. Thus even in relation to the fruitful excises policy, the role of local circumstances weighs much heavier than assumed.

3 The complicated relationship between states and the Great Divergence

Urbanization and local networks, or the lack thereof, have been underrepresented in the debate on the Great Divergence to date. No single book can be expected to deal with all aspects of, of course, not even Escaping Poverty. I hope to have shown how future research might enrich the field by focusing more often on the role of local actors and their networks, the interaction between local and central authorities, and avoiding the use of loaded concepts such as inclusive institutions, fiscal-military states and mercantilism.

Overall, the early modern central state had a limited impact on the economy—quite the opposite is true in relation to the economy’s impact on the state35. Public debt and taxes had very little direct bearing on economic performance. Suppose China had won the Opium War; suppose the Chinese fiscal-military state had remained as powerful as it had been

during the eighteenth century; the Great Divergence would have continued 
nevertheless. The most important link is an indirect one: Britain managed 
to reduce the burden of war on the state and thus did not disrupt the 
growing bonds between local communities, local governments and the 
central state. Thanks to the flexibility of the fiscal system that became 
fully mature in the 1750s, supported by ongoing urbanization, the state 
did considerably less harm to society during wars than it had done in the 
seventeenth century.26 China’s financial problems had a nationwide im-
 pact due to its less flexible land taxes, and thus undermined potential local 
level playing fields, even destroying the famous policy to provide grain 
during famines.

The focus on the central state fails to acknowledge the true role of the 
level playing field within local communities in Britain, supported by local 
government and after 1780 also increasingly by the central state, and over-
looks the contribution made by growing urbanization to the flexibility of 
the taxes at the central level. In his final chapter, Peer Vries mentions 
emulation as a possible solution to the problem of explaining the Great 
Divergence.27 Unfortunately, he stresses only emulation between states. At 
least until the early decades of the nineteenth century, local political 
power, local emulation, and urbanization constituted crucial driving forces 
for economic development.28

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(London 2014); Marjolein ’t Hart, ‘From the Eighty Years War to the Second

26 See also Marjolein ’t Hart, ‘From the Eighty Years War to the Second World War: new 
perspectives on the economic effects of war’, Low Countries Journal of Social and Economic History 
27 Vries, Emulating powers, 414.
28 On the substantial political power of European urban communities compared to the Chinese 
ones, see Wim Blockmans and Marjolein ’t Hart, ‘Power’, in: Peter Clark (ed.), Oxford Handbook of 