The Rise and Fall of Laissez Faire

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How large should government be? What roles should it fulfill? What activities should it regulate, and how? What powers should be centralized rather than allocated to local authorities? These are some of the most important questions that any organized society faces, age-old questions that have been fought over for as long as government has existed. And they remain just as relevant today, and as hotly debated, as at any time in history.

This book aims to brings us closer to answering these difficult but important questions. To do so, it harnesses the world's boldest experiment in small government: the laissez-faire experiment undertaken by Britain in the nineteenth-century. This unique experiment in limited government, which spanned nearly a century, has much to teach us about how small government works in practice, its consequences, and its trade-offs. Most important, it allows us to understand why such a system proved unable to cope with the challenges of the modern world, and why it was ultimately discarded in favor of a larger and more interventionist welfare state.

In the early 19th century, infused with the new ideas emerging from the Enlightenment, buoyed by the economic fruits of the Industrial Revolution, an expansive empire, and victory over Napoleon, Britain had attained a leading economic and political position among European states. It was at this time that a laissez-faire philosophy, characterized by small government, limited regulation, low taxes, and free trade, began to dominate the thinking of the country's leaders. The result was a movement to limit the size and activity of government relative to what had gone before. Welfare safety nets were curbed by the New Poor Law of 1834. Trade tariffs lifted with the repeal of the Corn Laws in 1846 and reduced further by Gladstone's budget of 1852. By the middle of the century, total government expenditure rarely exceeded ten percent of GDP, extremely low by modern standards. Even relative to peer countries in the 19th century, such as France and Prussia, Britain embraced a uniquely small and non-interventionist system of government. This experiment with small-government within the context of an institutionally stable country at the forefront of world technology stands as unique in human history.

What were the consequences of this great experiment in small government? More to the point, why was this philosophy ultimately abandoned? At the heart of any answer to these two important questions is a need to understand the complex interaction between the laissez-faire system and the modernizing forces unleashed by the Industrial Revolution. Using a combination of historical and statistical evidence, together with insights from modern economic theory, this book analyzes the consequences of the economic changes that took place during the 19th century—industrialization, urbanization, globalization, the rising importance of education, and conscription—for a country committed to small and unobtrusive government. This analysis highlights how Britain's laissez-faire system struggled to deal with these challenges and helps us understand why, ultimately, it was abandoned by the country that had embraced it more completely than any other in history.

The first set of challenges that faced Britain's small government system was the rise of industrialization. The Industrial Revolution, which began in the textile mills of Lancashire and spread out across the country, and the world, ushered in a new economic system. This factory system raised the productivity of human labor to new heights, but it also brought new challenges, both within and outside of the factory gates.

Within the factory gates, unregulated owners and managers exploited employees in ways that shocked the conscience of the Victorian elite. In early factories, one could find children as young as eight being employed on shifts lasting more than twelve hours, six days a week (and sometime more). These abuses led to an expansion of central government interference in the everyday lives of the working people in the form of the Factory Acts. These regulations began as an attempt to limit the exploitation of small children, but over time they expanded to encompass a wide range of employment and workplace safety regulations.

Outside the factory, industrialization presented a different, but equally important set of challenges. One example, which I consider in detail, is pollution. Facing no environmental regulation, manufacturers in the laissez-faire economy were free to release as much pollution as they desired, but these emissions came with substantial costs for those who were exposed. While the government was initially reluctant to act, faced with the magnitude of the costs it slowly and ponderously began to intervene, beginning with the first modern pollution regulation, the Alkali Acts of 1863, followed by a much less successful struggle against the larger problem of coal smoke pollution.

Thus, both within and outside of the factory, industrialization created new challenges which exposed the weaknesses of the small government system. Over time this elicited new regulation, oversight, and government control. Combining data and modern economic theory can help shed light on both why industrialization exacerbated problems like pollution and the exploitation of labor, as well as why these problems required a government response

The early expansion of government into areas such as workplace safety and pollution regulation laid the foundation for the system we see today. Perhaps surprisingly, these changes can be traced back to at least the 1830s, the heyday of *laissez-faire*. Thus, even while the small-government philosophy was reaching its peak, we can already begin to identify the forces that were eroding its foundations.

Hard on the heels of industrialization, the small government system faced a second crucial challenge in the form of rising urbanization. As factories grew, large numbers of workers were drawn into growing urban centers, places like Manchester, Birmingham, Newcastle, Sheffield and Leeds. Accelerating throughout the 19th century, these forces transformed Britain from a predominantly rural to a predominantly urban society. While urban growth brought economic gains, it also presented new challenges. The small-government system struggled to ensure clean water supplies, provide adequate sewage and refuse removal, and control the spread of disease. As cities grew, the small-government system was progressively undermined, as the need to confront these challenges led to a slow, methodical, expansion of regulation as well as enormous new expenditures. As local governments struggled, and often failed, to effectively manage rapid urbanization, the central government at first tried to facilitate progress, later to compel action, and in many cases ultimately chose to step in and implement needed improvements directly. Tracing out this evolution--with a focus on water provision, sewage removal, and housing supply--we can see variations on the same pattern of increasing intervention, centralization and public investment. In each case, the analysis reveals the inability of the small-government system to cope and the consequences that this had for health and welfare. Viewing these patterns through the lens of economics helps us understand why it was so hard for private actors and local authorities to tackle these challenges, leading eventually to central government interventions. This intervention, taken to deal with 19^{th}-century challenges, laid the foundation for the infrastructure investments, housing policies and building codes that are still with us, in some cases controversially, today.

While Britain's economy was becoming more industrialized and urbanized, it was also becoming more globalized. Globalization was both a cause of the industrial take-off—the cotton textile mills where the Industrial Revolution began were fed on imported cotton—as well as a consequence of the technological progress (railroads, steamships) that industrialization produced. Global trade, which grew rapidly during the 19th century, allowed the expansion of industrial activity as well as its concentration in locations that were most productive. This brought enormous gains, but also new risks.

One consequence of globalization was a rising demand for the government to play a role in coordinating and investing in infrastructure: both physical infrastructure, such as the railroad and telegraph, as well the financial infrastructure that enabled trade. This infrastructure worked efficiently only as part of an integrated and coordinated network. The magnitude of this coordination problem posed a challenge for the private and local actors, such as the turnpike trusts that had long played a central role in the British transportation. Moreover, were these private actors to become large enough to confront the inherent coordination problems, they would emerge as monopolies that able to exploit consumers. As a result, government was progressively drawn to intervene.

Globalization also had consequences for how the government related to workers and firms. The concentration of large numbers of workers and firms employed in the same task together in one place meant that locations could benefit from producing goods where they had a comparative advantage. Yet it also meant that a downturn in one industry could have catastrophic effects. Links between economies meant that workers in one location could be hard-hit by events occurring far away. At the same time, the need for workers to move in search of industrial jobs broke down social ties and local networks that had previously helped insured them against economic shocks.

A striking example of the consequences of the combination of these forces is provided by the severe depression that occurred in the British cotton textile industry from 1861-1865 as a result of the U.S. Civil War, often called the "Lancashire Cotton Famine". When the Civil War cut off cotton supplies from the U.S. South, hundreds of thousands of British textile workers were thrown out of work. With limited government support, many of these workers, and their families, found themselves destitute. A number migrated, and some died prematurely. Many firms went bankrupt, with lasting consequences for local development. Applying the tools of economic history to analyze this event reveals the risks of globalization in an economy with limited social safety nets and government shock absorbers.

The result of events like the Lancashire Cotton Famine was a slow but steady shift in the government's stance toward dealing with mass unemployment. The central feature of this response was a shift away from a system in which unemployment relief was a local and relatively personal affair to one where relief was provided through a more distant, institutional, and impersonal system. This evolution, which occurred slowly in the 19th century under heavy resistance, eventually led, in the decade before the First World War, to the adoption of a national system of unemployment insurance. Thus, the challenges of globalization provide another example of the slow erosion of the laissez-faire system leading ultimately towards classic welfare-state policies.

Britain’s small government system also had to grapple with the rising importance of education, particularly in the second half of the 19th century. While formal education among the great mass of workers played a limited role in the early decades of the Industrial Revolution, by the late 19th century the rising complexity of the technologies employed in the modern factory system, as well as the transportation and communication systems that linked factories with customers and suppliers, demanded an increasingly educated workforce. This created new pressures for the British government to expand into education which, up to the 1870s, it had been happy to leave to private and parochial schools. Caught between the demands of employers and parents for expanded educational opportunities and the inability of these non-government actors to provide a quality education to the average child, the government was eventually forced to intervene. This intervention, tentative in the 1870s but increasingly muscular after 1900, meant an expansion in both the size and the roles of government.

Added to internal pressures, modernization also confronted the laissez-faire system with new external pressures. Chief among these was the rise of the mass conscript army, which presented a direct threat to the survival of the state. While in the centuries before the Industrial Revolution, states could rely on small long-service professional armies for defense, by the middle of the 19th century new technologies were making this approach untenable. This change started with the Napoleonic Wars (1803-1815), which ushered in land warfare at a scale not seen before. Changes in tactics, technology, logistics, and the support capacity of nation-states meant that far larger armies were used. These trends accelerated during the U.S. Civil War and could not be ignored after the defeat of France's professional army by Prussia's conscripts in 1870.

Britain was more insulated from these pressures than countries on the Continent, and in part this meant that it could ignore for longer the pressure that conscription created. However, the experience of the Second Boer War (1899-1902) raised concerns that a substantial fraction of the British population might not be healthy enough to contribute to the nation's defense. Suddenly, the country’s leaders began to recognize that military success (at least on land) was now closely tied to the health, education and welfare of the great mass of working people. This realization provided new imputes for efforts to improve the conditions of the working population though, unfortunately for Britain, most of these efforts came too late to have much effect before the onset of the First World War.

Together, the forces arrayed against Britain's small-government system laid bare its weaknesses. The faith in the laissez-faire philosophy, so dominant in 1850, was progressively eroded, leading ultimately to the Liberal Reforms of 1906-1914 and the even more substantial changes that followed the First World War. Yet the root of these changes can be traced back to seeds planted decades earlier, to reforms such as the Factory Acts of the 1830s, the Metropolitan Water Act of the 1850s, and the Alkali Act of the 1860s. Thus, rather than representing a change in direction, the Liberal Reforms of the early 20^{th}-century were instead a culmination of a long process of eroding faith in laissez-faire driven by the need to address market failures, ranging from pollution externalities to the need to provide public goods like sewage systems and education, generated by the forces of modernization that I have identified. Viewed in this way, the failure of Britain's great experiment in small government appears inevitable, an unavoidable consequence of the need to confront the challenges of the modern world.

These results provide a reminder of why modern developed countries have universally adopted a larger and more interventionist form of government than Britain's laissez-faire experiment. In some sense these are lessons that we have already learned, but have forgotten. The British experiment allows us to see them again, brought into sharp relief by the extreme difference between Britain's laissez-faire system and the modern welfare state. Looking back, we can gain a clearer understanding of consequences that can be expected when government fails to fulfill basic functions. This, in turn, helps us better understand why the country ultimately decided to discard the small-government system. Of course, this cannot tell us precisely how large government should be today, or what roles is should take on, but it does provide a stark warning against the sanguine visions of some small-government advocates.

This book also allows us to look forward. By providing a framework for classifying and analyzing the economic forces that drove the expansion of small government, we can begin to consider how the role of government might evolve in the future. Some of the pressures highlighted here—urbanization, globalization, the increasing importance of education—are likely to be with us for the foreseeable future. Others, such as conscription and (in some countries) industrialization may be waning. Understanding the role that these forces played in creating the modern welfare state can help us think about how these ongoing changes are likely to influence the future role of the state.