Angeles

Source: *Louis XIV*, by Justus van Egmont

The Colbert Show

Queen Anne had been married to Louis XIII for 23 years. She had experienced four stillbirths and there was no heir to the French throne. Miraculously, in 1638 a son was born and survived. But only four years later, Louis XIII was on his deathbed. He appointed a regency council to rule until his son came of age, but upon his death, Queen Anne had the council annulled and had herself appointed sole regent. She then named Cardinal Mazarin as chief minister to run the affairs of France while she tended to her young son.

Europe was gripped in the Thirty Years War, a conflict that would claim 20% of its population and bankrupt its economy. When the war ended in 1648, France was immediately engulfed in a civil war, known as the Fronde, led by the feudal aristocracy protesting high taxation and seeking to regain its privileges lost to the crown during the war. Over the next five

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years, the rebels were first repulsed, then rallied, placing Queen Anne and her son under house arrest, and back and forth until Louis came of age and was crowned king. At that point, the rebellion faded away.

Louis XIV had grand plans for his monarchy, but his treasury was barren after decades of war. He exiled the powerful Superintendent of Finances, Nicolas Fouquet, on charges of embezzlement, and turned to an aide of Cardinal Mazarin, Jean-Baptiste Colbert, to restore solvency.

Louis XIV famously said, *l'etat c'est moi*, I am the state. More accurate would be, *l'etat c'est de l'argent*: money is the state. All the *gloire* we associate with Louis XIV, from military victories to the grandeur of Versailles, would not have been possible without funding. Louis XIV may have been the Sun King, as the earth revolved around him, but without the financial genius of Colbert, the Sun King would have gone dark.

Jean-Baptiste Colbert instituted important reforms that made the government more efficient. But by the time of his death, Colbert was widely reviled, and his economic policies, that at first had helped create a wealthier France, would inhibit further progress, and the power of France would fade over time. Colbert's policies and his legacy, both good and bad, are directly relevant to our world today, as we shall see.

For only the fourth time in the past 150 years, US equities posted consecutive 20%+ annual gains. Subsequent returns are mixed (Table 1), dependent, as always, on the underlying funda-

Table 1 Returns Following Consecutive 20%+ Equity Returns, US, 1874-2024

S&P 500 up >20% for 2 years in a row			S&P 500 returns in following 2 years		Treasury returns in following 2 years	
1927	1928	→	1929	1930	1929	1930
31%	38%		-12%	-28%	4%	5%
1935	1936	→	1937	1938	1937	1938
42%	28%		-39%	25%	1%	4%
1954	1955	→	1956	1957	1956	1957
45%	26%		3%	-14%	-3%	6%
1995	1996	→	1997	1998	1997	1998
34%	20%		31%	27%	12%	14%
2023	2024	→	2025	2026	2025	2026
24%	24%					

Source: BofA

mental macroeconomic drivers. But the past ten-year return in US equities has been among the best ever (Chart 1).

In contrast, the bear market in bonds continues. At no time in the past century has rolling 10-year returns on long-term government bonds been negative. Until now (Chart 2).

Chart 1 **S&P 500 10-year Rolling Annualized Returns, 1936-2024**

Source: BofA

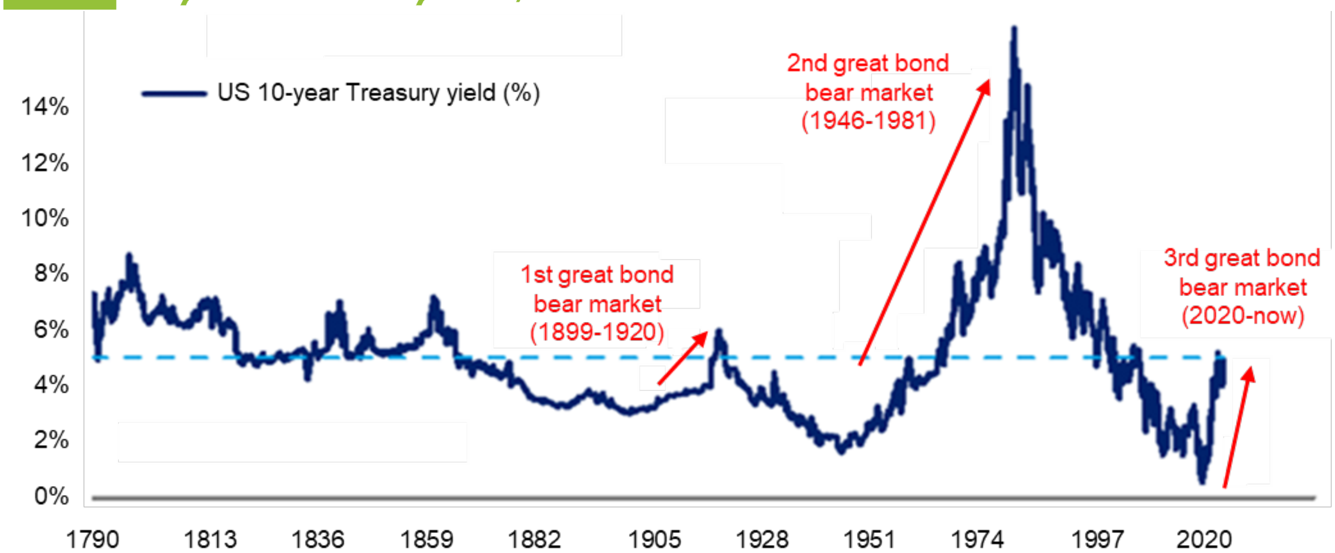
Chart 2 **10-year Rolling Returns on Long-term US Treasury Bonds, 1936-2024**

Source: BofA

The bear market in bonds is just beginning (Chart 3). Bond investors will likely face years, if not decades, of minimal returns. Demographics, debt and deglobalization all serve to push inflation, and interest rates, higher.

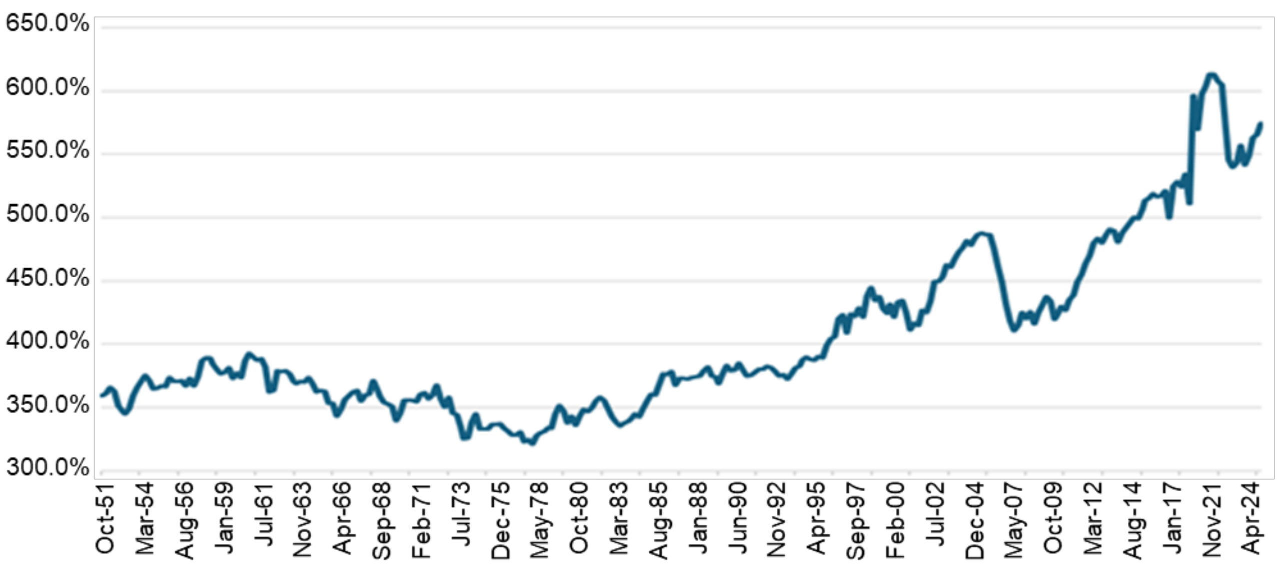
Supporting the bull market in equities is a strong economy, led by growing household wealth and rising corporate profits. At a record $160 trillion, household net worth is more than five times US GDP (Chart 4), spurring and supporting economic growth.

Chart 3 **10-year US Treasury Yield, 1790-2024**



Source: BofA

Chart 4 **US Household Net Worth as Percentage of GDP, 1951-2024**



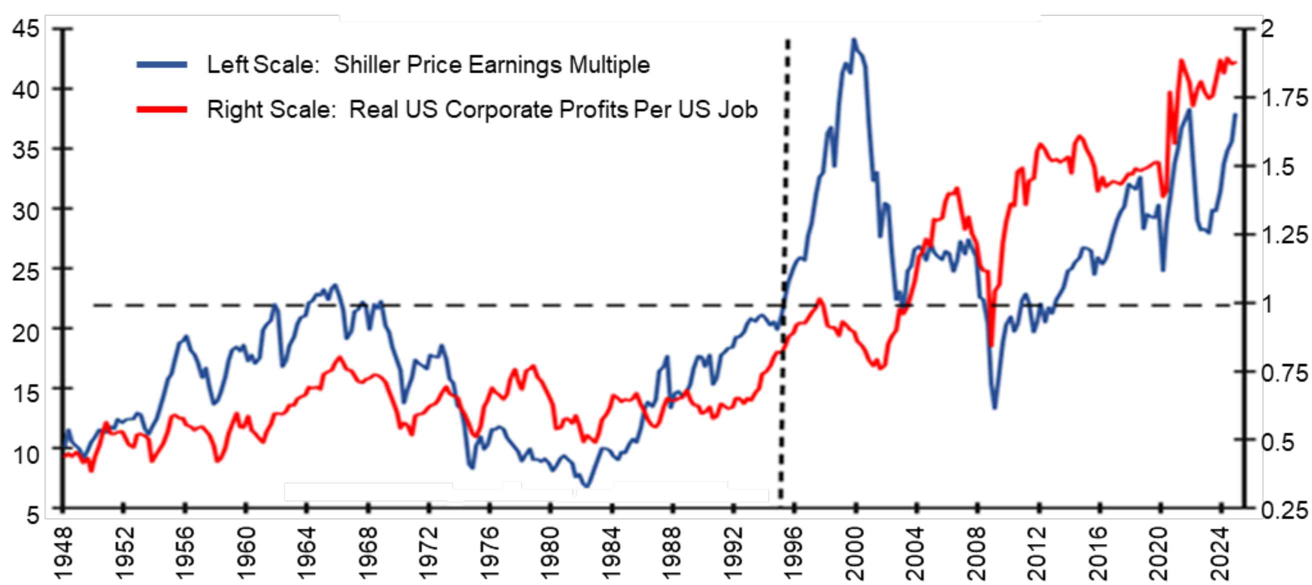
Source: Federal Reserve System and Bureau of Economic Analysis

Corporate profits are also at record highs, more than \$4 trillion, and accelerating higher (Chart 5). But it's not just overall profits that are rising. Importantly, profits per worker, a measure of productivity, have been growing strongly for the past three decades. The increase in the equity market P/E multiple reflects this higher productivity trend (Chart 6).

Chart 5 **Earnings Per Share, S&P 500, 1989-2024**

Source: S&P Global Courtesy: JP Morgan

Chart 6 **Real US Corporate Profit per Job and P/E Multiple, 1948-2024**

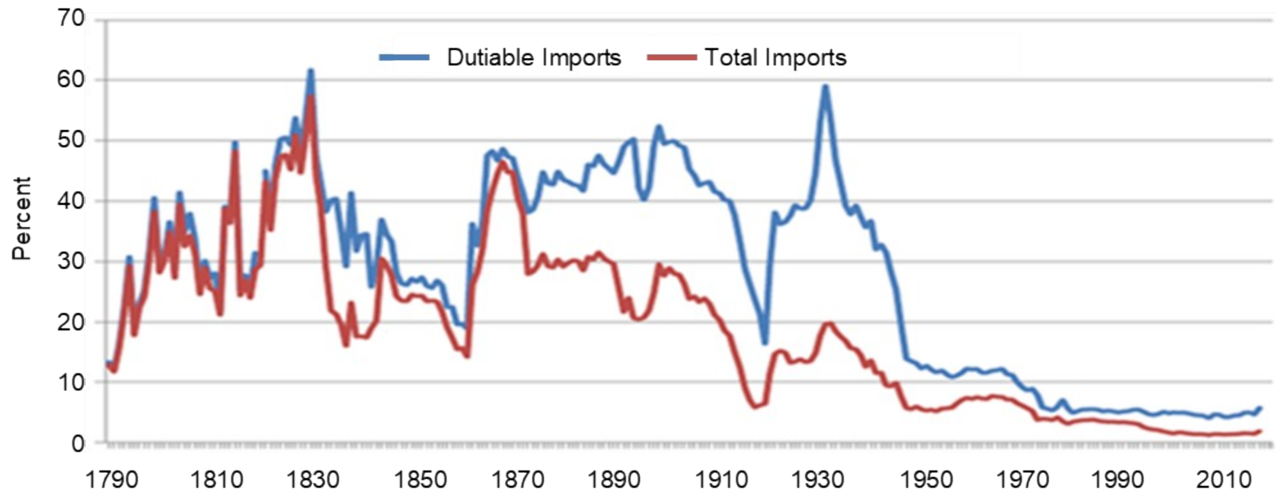


Source: Jim Paulsen

Tariffs were the principal source of government revenue in the first century of the United States as a nation. It wasn't until 1913, with the ratification of the 16th Amendment authorizing an income tax, that government financing shifted decisively. Over the past century, tariff rates fell from nearly 50% to just a few percent (Chart 7).

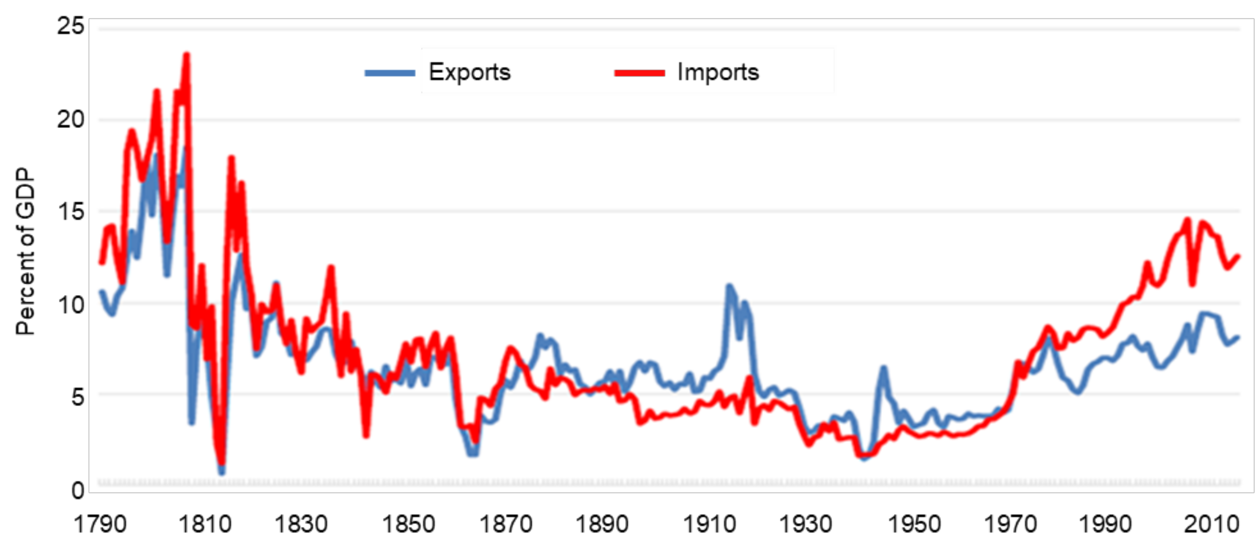
Tariffs fell consistently after the Second World War, and trade accelerated (Chart 8). It's reasonable to draw a direct link between lower tariffs and greater

Chart 7 **Average Tariff on Dutiable and Total Imports, 17901-2018**



Source: Irwin, Douglas A. 2017. Clashing over Commerce: A History of U.S. Trade Policy. Chicago: University of Chicago Press

Chart 8 **US Merchandise Exports and Imports as Percentage of GDP, 1790-2018**



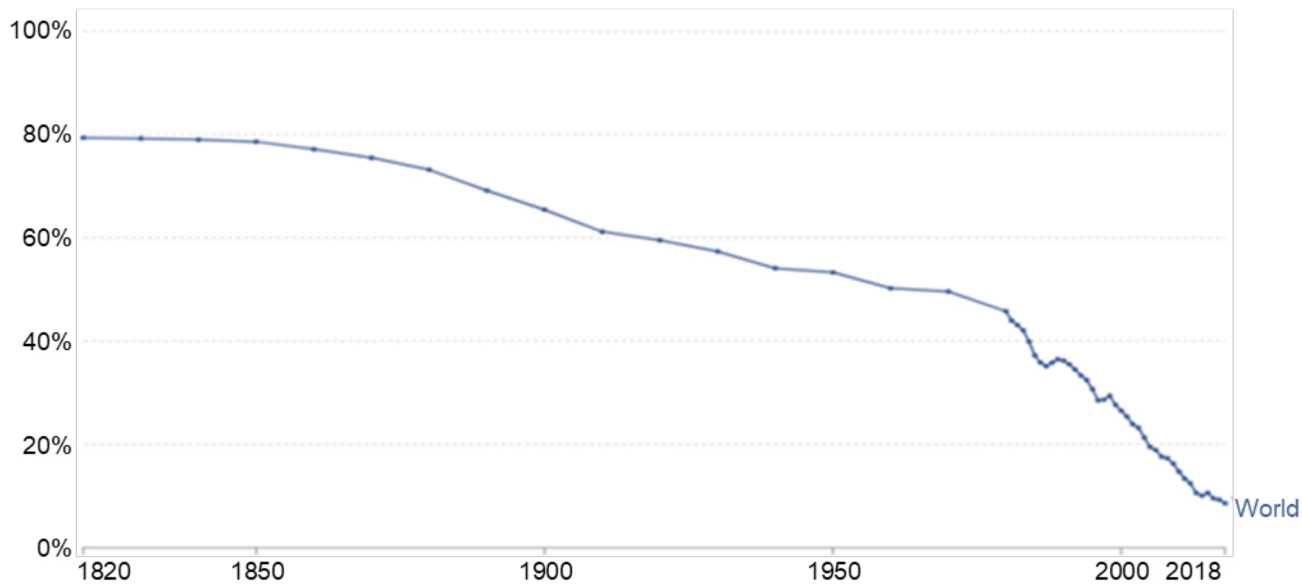
Source: *Historical Statistics of the United States, Millennial Edition,* Cambridge University Press, 2006 and Bureau of Economic Analysis.

trade. It is also one of the causal factors behind the record reduction in world poverty (Chart 9).

The policies that fostered trade for the past 70 years have reversed. The political consensus has shifted to seeing trade as a zero-sum proposition, where one country can benefit only at the expense of another, rather than viewing trade as promoting greater welfare for all participants.

The perceived loss of economic welfare through trade has been translated into geopolitical terms. National power and prestige are dependent on economic strength, which has been weakened by trade and therefore can be restored by restricting trade. This has become a national imperative embraced across the political spectrum.

Chart 9 **Share of World Population Living in Extreme Poverty, 1820-2018**



Data source: Michalis Moatsos (2021)

Note: Data after 1981 relates to household income or consumption surveys collated by the World Bank: before 1981 it is based on historical reconstruction of GDP per capita and inequality data. Data is measured in interational-$[1] at 2011 prices

Source: OurWorldinData.org

In the current consensus trade restrictions are seen as necessary but not sufficient to re-establish national supremacy, and a broader industrial policy is also required. This entails promoting targeted domestic companies and industries, and by restricting foreign, even allied, firms from the domestic market.

Thus does government policy, rather than market competition, play a greater role in determining economic winners and losers. To benefit, companies will have to align with government objectives, even at the expense of profit maximization. In exchange, favored companies and industries will be shielded from competition, but this will ultimately reduce their productivity and innovation.

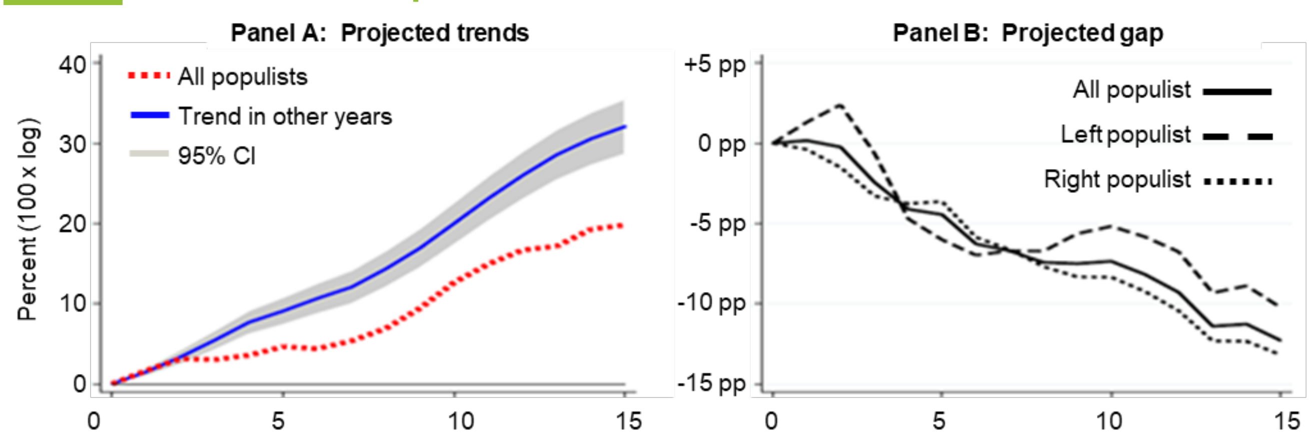
There is a real risk that other countries will not acquiesce to these restrictive policies and will choose to retaliate with constraints on US companies. Submitting to restrictive US policies may not necessarily be in the best interest of other countries. A case in point is Japan in the 1980s. Under the threat of high tariffs on Japanese exports, Japan agreed to "voluntary" limits on exports, particularly for automobiles. This was thought to help protect US car companies, but only served to stifle innovation. Both economies were harmed as US manufacturers failed to innovate and continued to lose market share while Japan's economy was thrown out of balance.

The seminal event at the time was the Plaza Accord of 1985, which saw the value of the yen double. This caused the Bank of Japan to run an accommodative monetary policy, which led to a massive financial bubble in Japanese stocks and real estate. The consequence was subsequent decades of zero or declining economic growth in Japan. There were other factors contributing to Japan's ensuing stagnation, but the Plaza Accord, which marked Japan's accommodation of US trade restrictions, was the beginning of its economic problems for decades to come. It is a lesson for those countries considering whether the path of accommodation to US demands is wise or if retaliation might be the better option.

Tariffs, geopolitical competition, industrial policies are all part of a broader populist trend that seeks to restrict the free movement of goods, ideas and people. This rise of populism will likely have material, negative economic implications.

A study[1] of populism over the past century shows that its economic impact was evidenced in substantially less economic output, with GDP lower by 1% per year over a 15-year period (Chart 10). Additionally,

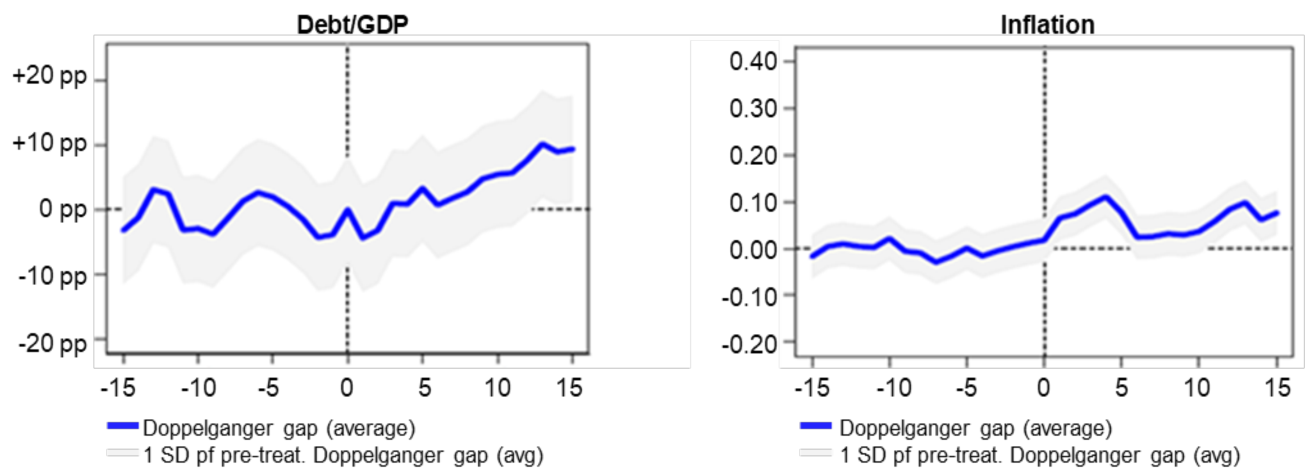
Chart 10 **Real GDP After Populist Governments Enter Office**



Source: *Populist Leaders and the Economy*, Funke, Schularick and Trebesch, Kiel Working Paper 2169, June 2022

[1] *Populist Leaders and the Economy*, Funke, Schularick and Trebesch, Kiel Working Paper 2169, June 2022

Chart 11 **Debt and Inflation After Populist Government Enter Office**



Source: *Populist Leaders and the Economy,* Funke, Schularick and Trebesch, Kiel Working Paper 2169, June 2022

countries with populist governments experienced higher levels of debt and inflation (Chart 11).

Populist leaders claim to represent the "people," but fail to deliver economic advancement as virtually all countries governed by populists in the past century experienced subpar economic outcomes. The authors of this study, from Columbia University and the New York Fed, also highlight a significant decline in judiciary independence and media freedoms under populist regimes. Populist leaders may be "popular" at first, but they inflict material economic harm on those they claim to represent.

This new economic philosophy that sees wealth as static, trade as zero-sum and seeks to protect favored domestic industries is actually not new. It dates to 400 years ago, most prominently in the court of the Sun King.

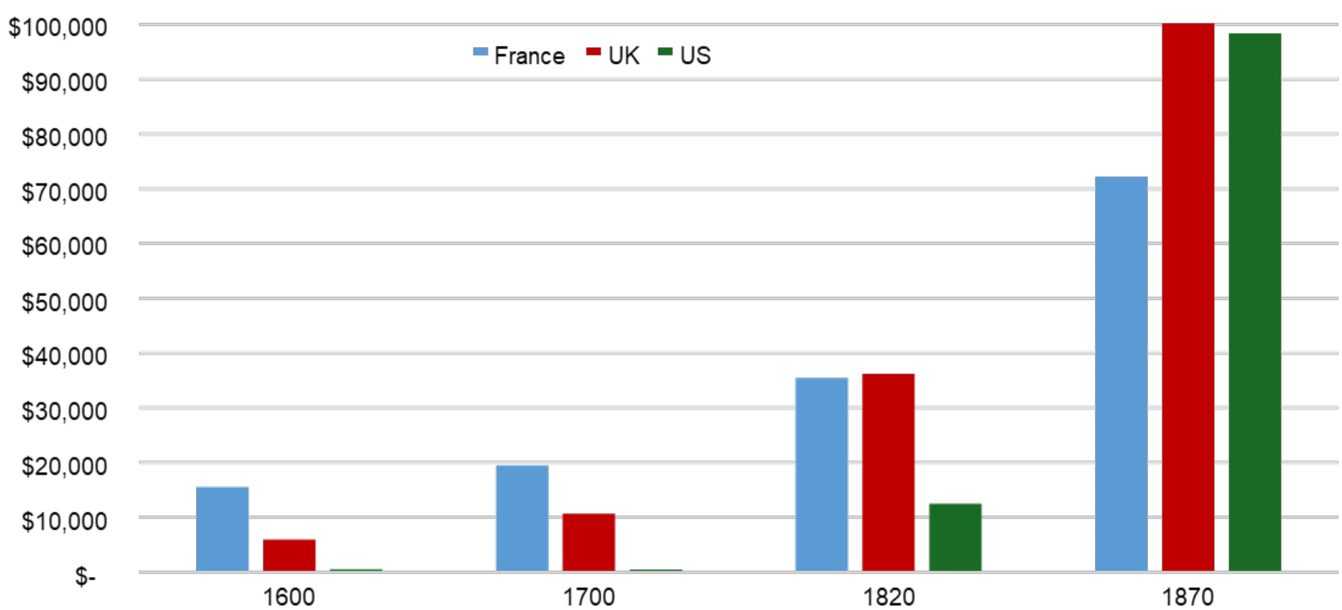
Jean-Baptiste Colbert was born in Reims in 1619. Through family connections, he became an aide to Cardinal Mazarin, chief minister of France, ingratiating himself with Louis XIV during his regency. Upon the Cardinal's death in 1661, Louis appointed Colbert to a series of high-ranking posts, from Superintendent of Buildings and Controller-General of Finances to head of the Navy and Minister of Colonies. Colbert soon held every important position in Louis' government.

His first priority was to raise revenue. Tax collection contracts had been sold to a privileged few, but Colbert changed this to auctioning these contracts to the highest bidder. Tax revenues soared, and within five years the budget deficit became a surplus and the debt was cut in half.

Colbert then sought to promote French industry through subsidies and tariffs. He established monopolies, such as the French East India Company, but all these ultimately failed. He imposed heavy tariffs, first on the import of wool in order to foster a domestic wool in-

Source: Jean-Baptiste Colbert, by Claude Lefebvre, 1666, Palace of Versailles

Chart 12 **GDP of France, UK and US, 1600-1870 ($MM, 1960 USD)**



Source: Bairoch, Paul, Economics and World History: Myths and Paradoxes, 1995, University of Chicago Press.

dustry, and then more broadly. By 1667, tariffs of 100% were imposed on all imports. Seeking relief from the tariffs, Holland unilaterally eliminated tariffs on French goods, hoping France would reciprocate. To the contrary, Louis launched a war of conquest in 1672 against Holland that ended four years later and bankrupted his treasury again.

Colbert's economic policies of high tariffs and government subsidies toward favored companies and industries characterized the mercantilist system. This economic philosophy saw wealth as static, and government policies were geared toward the accumulation of this fixed pie of wealth. To attract the flow of precious metals (gold and silver) into the treasury required maximizing the trade surplus. This was achieved by promoting exports through subsidies and by blocking imports through high tariffs.

Colbert's mercantilist policies had initial success as France's wealth grew throughout the 17th century. But that marked the peak of France's relative economic power. French economic innovation was stifled by these protective policies and relative wealth began its inexorable decline. By 1820, Britain had exceeded France's economy, and by 1870, so had the United States (Chart 12).

The mercantilist system of Colbert was eventually supplanted by the classical economics of Adam Smith. In *The Wealth of Nations* (1776) Smith argued that wealth was not static at all, that it could be expanded through the "invisible hand" of competition and trade. David Ricardo expounded on Smith with the concept of comparative advantage (1802), in which countries specialized in producing goods and then traded with other countries doing the same, thus leading to a more efficient economy, both domestically and globally. It has proven to be true over the past 250 years.

We are moving back to Colbert's mercantilist world of tariffs and subsidies, and while our world is more complex than that of Colbert and Louis XIV, the economic consequences of mercantilism are the same.

George Santayana famously wrote, "Those who cannot remember the past are condemned to repeat it."[2] [The end image is René Magritte's interpretation of Santayana's quote from Magritte's series, *Great Ideas of Western Man*, 1962, Smithsonian American Art Museum]. By the time of his death in 1683, Jean-Baptiste Colbert was widely reviled, so much so that his funeral had to be held at night to avoid a large crowd of protesters. The failures of his favored companies, the hundreds of regulations he inflicted on industry, the strict penalties imposed on violators of even minor infractions of his rules, all inhibited the development of the French economy, which would soon be surpassed as the leading power in the world by Great Britain.

The United States is the leading power in the world today. It's worth considering which policies, which economic framework, enabled this ascension, and which policies, which economic framework will sustain it.

[2] George Santayana, *The Life of Reason*, 1905

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