GOVERNMENT FINANCE IN PRE-INDUSTRIAL EUROPE*

Meir Kohn

Department of Economics
Dartmouth College
Hanover, NH 03755
email: mkohn@dartmouth.edu

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ABSTRACT: Government finance in pre-industrial Europe was shaped by two forces—continuing economic development and incessant warfare. Continuing economic development increased potential revenue and altered the ways in which it could be mobilized. Incessant warfare exerted constant, often intense, pressure to provide the funds needed for the waging of war. By the end of the sixteenth century, two very different systems of finance were emerging associated with two very different forms of government. In France and Spain, unsustainable borrowing led to default and to the ruin of government credit. With access to financial markets denied, these governments had to resort to expedients that were highly destructive of their economies. In the Netherlands, in contrast, the government slowly reestablished its credit, thereby avoided having to resort to the same harmful expedients. Differences in the systems of finance did much to explain the relative military success of the two types of government and ultimately their survival.

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Government finance in pre-industrial Europe was shaped by two forces—continuing economic development and incessant warfare. Continuing economic development increased potential revenue and altered the ways in which it could be mobilized. Incessant warfare exerted constant, often intense, pressure to provide the funds needed for the waging of war.

These two forces interacted in a kind of 'political-economic cycle'. Each iteration of the cycle began with an interlude of economic development and growth. This increased the resources available to governments. At some point, governments felt they had sufficient resources to embark on military adventures. The result was a period of widespread warfare. War—and the financing of war—depressed the economies of the territories involved. Ultimately this reduced the resources available to governments and so their ability to continue fighting. With the return of peace, economies recovered and prosperity returned. This set the scene for another iteration of the cycle. Between the eleventh and seventeenth centuries, Europe went through two iterations of this cycle. The first begin in the eleventh century and ended in the middle of the fifteenth century; the second began then and ended in the middle of the seventeenth century.

Before we trace the development of government finance over these two iterations of the political-economic cycle, we need to establish some basic principles of government finance during this period.

THE FUNDAMENTALS OF GOVERNMENT FINANCE

In pre-industrial Europe, there were two different types of government that differed in important ways in the way that they financed themselves. The first type, predatory government, was imposed from above by a warrior class of kings, princes, and lords. Territorial government was usually of this type. The second type, associational government, was in contrast created from below, and it served as a vehicle for joint action. The governments of cities were generally associational.

Predatory governments exacted what they could from the territories they controlled. Exaction was for the benefit of the ruler: there was hardly even any pretense that it was for the good of their subjects.[1] It is useful to think of the behavior of rulers as maximizing

[1] "A favorite Renaissance metaphor was that the fisc was a parasite…". ((Wolfe 1966) p 467)

exaction subject to constraints. Differences in rulers' behavior can then largely be understood in terms of the differences in the constraints they faced.[2] For example, a predominantly rural territory offered its ruler different possibilities from one that was heavily urbanized. The urbanized territory was richer, but commercial capital was more mobile than landed property and therefore more difficult to tax. Another constraint that might differ from one territory to another was the degree of resistance to exaction. For example, in a territory threatened by invasion or by domestic disorder subjects might be more willing to endure exaction in exchange for protection. Another factor that might differ was the ruler's security of tenure. One who was more secure might take a long run view, while one with only a tenuous hold on power might grab what he could without regard for the effects on future revenues.[3]

Associational government, at least in principle, exacted revenue to finance the joint action for which it was formed. However, associational governments often came under the control of particular groups or individuals who used the apparatus of government at least partly for their own ends—that is, for predation. The fiscal behavior of a city government depended on the degree to which this happened. It depended, too, on the degree of independence the city enjoyed and so on the extent of the city government's responsibilities. Some cities, mostly in northern Italy, achieved formal independence. They were therefore entirely responsible for all government functions—including defense—and in complete control of their own finances. Most cities elsewhere were formally subject to some territorial ruler or lord, but in practice many enjoyed some degree of independence, including financial independence.

By far the largest component of government spending was military. For example, less than 8% of the government spending of Castile was not related to war.[4] Governments of both types were constantly engaged in war. Predatory governments fought to add to their territory and to defend it against challengers internal and external. Cities fought to defend their rights against encroachment by the ruler. Independent cities also went to war for much the same reasons as territorial rulers—to extend their territories and to defend them

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[2](Levi 1988) Ch. II
[3](Olson 2000)
[4](Thompson 1995)

against rivals. Cities, and later rulers too, went to war as well for economic reasons—to secure access to markets or to sources of raw materials.

To wage war successfully, governments had to be able to mobilize their resources quickly. While revenues came in gradually over time, the cost of a war was concentrated in a relatively short period. For example, at the start of the Hundred Years, Edward III of England was spending some £100,000 a year on his campaign in the Low Countries War—over three times his regular income of £30,000 a year.[5]

Consequently, to finance their wars governments required not only resources but *liquidity*—the ability to raise large sums of money quickly. In principle, there were two possible ways they could do this: they could borrow what they needed (liability management) or they could sell off their existing assets for cash (asset management). As we shall see, governments at different times relied on both of these methods.

FEUDAL GOVERNMENT FINANCE

To make sense of government finance in pre-industrial Europe we need to go back to its origins.

The origins of the feudal system

Both Europe's system of government and its system of government finance had their origins in the Roman empire.[6] In the third century, invasions and civil wars led to a major fiscal crisis. To finance rapidly rising military expenditures, the imperial government resorted to repeated debasements. The consequent inflation devastated the economy and severely eroding regular tax revenues. Demonetization of the economy and the collapse of its tax revenues forced the government to resort to a system of *ad hoc* requisitions in kind in order to maintain its army.[7] This non-monetary system of finance was regularized and systematized under Diocletian.[8] Assessors graded land according to its productivity and tax rates were set accordingly. A new hierarchy of officials was created to collect the resulting revenue. These officials were essentially tax-farmers: they paid a fixed sum in advance for the right to collect taxes for a specified period of time.

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[5](Kaeuper 1988)
[6](Grantham 2003)
[7](Bartlett 1994)
[8](Finer 1997) V1 Ch. 8; (Webber 1986) Ch. 3

Major tax farmers purchased the farm of whole provinces. They then sold districts within the provinces to smaller tax-farmers, and so on down.

With taxes paid in kind—in produce or in labor—most revenues had to be utilized directly where they were collected, mainly to support troops stationed in the area.[9], The Roman army had by this time come to consist largely of barbarian tribes hired as mercenaries. The empire paid the chiefs of these tribes by assigning them tax districts from which they were to receive the revenue. The chiefs paid their followers in turn by assigning them subdivisions of these districts.[10]

The feudal system of government and of government finance grew out of the disintegration and 'privatization' of this late Roman system of taxation and military financing. The descendents of the tribal chiefs became territorial rulers who 'owned' the tax districts that had once been assigned to their ancestors. Similarly, the descendents of the chiefs' followers, who had received subdivisions of tax districts, became the feudal vassals of the territorial rulers. These vassals 'owned' their subdivisions and owed their lords in return military service.[11]

Territorial rulers and their vassals were the government in the territories they controlled—with all the associated rights and responsibilities. They had the right to tax the population of their territories, and they had the responsibility to protect them and to provide justice. With government privatized in this way, there was no distinction between the governmental and the personal. There was no separation between the property of the government and the private property of the ruler or lord. There was no separation in budgeting: the household expenses of the ruler or lord were as much a part of the government budget as were his military expenditures. There was no separation of credit: government debt was personal debt.

The right of the territorial ruler or lord to tax was, however, strictly circumscribed. He had the right to impose taxes only on his own domain—on the territory he controlled directly. Outside that territory he had no right to tax. Specifically, he had no right to tax

[9](Grantham 2003)

[10](Grantham 2003)

[11](Grantham 2003) Different parts of Europe differed in how 'feudal' they were: see (Kohn forthcoming) Ch 21.

his vassals and he had no right to impose taxes on their domains.[12] All he could demand of his vassals was military service.

Consequently, the territorial ruler was expected to support himself entirely from his domain income—'to live of his own' (*vivre du sien*).[13] That is, he was expected not only to pay his household expenses out of his private income but also to finance the functions of government. His vassals were in a similar position: they had to finance their obligations out of their domain income, and they could demand of their own vassals only that they serve them in battle.

Of course, a territorial ruler could—and often did—ignore the rules and impose taxes beyond those permitted him. However, to impose 'unjust' taxes was to invite armed revolt by outraged subjects.[14] In a period in which great vassals were military powers to be reckoned with, this was something to be avoided.

Domain income

Most sources of domain income (*domaines* or *ordinaires*) originated in the major sources of revenue for the Roman empire—income from land owned by the state and by the imperial family (the *fisc*); a property and head tax; and taxes on trade collected at ports and toll stations.[15]

With the privatization of government, the distinction between the different kinds of income from land became a purely semantic one: whether the payment was called a rent or a tax did not make a great deal of difference either to the payer or to the collector. Feudal lords collected a variety of land-connected revenues. Louis IX of France (1225-1270), for example, collected from parts of his domain a *champart*—a rent in the form of a share of the crop.[16] From free peasants on manorial tenures and from the citizens of towns he collected a fixed money rent, the *cens*. He also collected fees when land passed to an heir or was sold (the fees were substantial—as much as a year's income in the first case and 12% of the value in the second). Serfs paid a small poll tax (*chevage*) and both serf and free had regular obligations of labor at harvest times and on other specific

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[12]"In practice, *no medieval monarch was ever fiscally absolute*." (Finer 1997) p887, italics in original.
[13](Wolfe 1972)
[14](Finer 1997) V 2 Ch 5
[15](Miller 1971); (Ekelund 1997) Ch. 5; (Grantham 2003)
[16](Wolfe 1972) Ch. 1

occasions. Louis could also impose a more or less arbitrary tax on towns and villages. These then divided the amount among their constituent households, assigning each a 'portion' (*taille*) roughly related to its wealth.

Governments taxed trade wherever could, stationing collectors at choke points that traders found hard to avoid—markets, ports, bridges, passes, and waterways.[17] Tolls had been an important source of revenue for Charlemagne in the eighth century—especially the 10% duty on goods moving through Quentovic, the main port for the lucrative trade with England.[18] However, over time many tolls had been appropriated by local lords. By the time of Louis IX, the king collected tolls (*péage*) and fees from fairs and markets(*stallage*) only within his domain.[19]

Domain income included a variety of non-tax revenues. Among these were several forms of expropriation that had become legitimized by custom.[20] These included the right of the ruler to first pick of goods brought to market (*droit de prise*)—purchased at a price set by the ruler's officials rather than by the seller.[21] Then there was the right to hospitality (*droit de gîte*): the ruler, together with his extensive entourage, would descend upon some unfortunate vassal and expect to be fed and housed, in a suitable manner, for an indefinite period. The ruler could expropriate foreigners at any time and frequently did so. Foreigners—Jews especially—were outside the feudal system and were therefore not protected by its rules. Even when not expropriated, foreigners were routinely made to pay for the ruler's 'protection'. And, finally, there was the ancient right to plunder in wartime.

There was additional revenue from a variety of 'feudal incidentals'.[22] Basically, if there was any doubt as to whom something belonged, it belonged to the ruler. If a vassal died without an heir, his territory reverted to the ruler (*escheat*). If a foreign merchant died, his goods reverted to the ruler (*aubaine*). If a ship ran aground, or if a treasure trove was discovered, it belonged to the ruler. If a bishopric or abbacy fell vacant, the ruler enjoyed its income until the position was filled.

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[17] See (Kohn forthcoming) Chs 5 and 17 respectively on tolls and market taxes.
[18] (Ormrod and Barta 1995)
[19] (Wolfe 1972) Ch. 1
[20] (Wolfe 1972) Ch. 1; (Ormrod and Barta 1995)
[21] See (Kohn forthcoming) Ch 17.
[22] (Wolfe 1972) Ch. 1

Another right that rulers inherited from the Roman empire was the right to mint coin (*jus moneta*).[23] Control of the mints provided the ruler with regular income in the form of seigniorage—a percentage of the amount of coin minted. It also created the opportunity for debasement as an important source of revenue and liquidity.[24] However, by the eleventh century, many mints had fallen under the control of local lords: for example, of the sixty to eighty mints in France, no more than twenty were under the control of the king. Associated with rights over the coinage were rights over the mining of minerals—originally monetary minerals such as gold, silver, and salt, but later extended to include other minerals.[25] The nature of these rights varied from ruler to ruler: some had a right of preemption (purchasing the entire output at a price set by the ruler); some had a right to receive a fraction of the output (typically a fifth).

The final component of domain income was revenue from the sale of violence services. These services fell into two main categories—the provision of justice and the enforcement of monopolies. The ruler used his command of violence to provide protection and to maintain order through his courts. This yielded him revenue in the form of fines and fees. The ruler also used his command of violence to enforce monopolies. For example, Louis IX, required the inhabitants of his domains to use only his mills, his wine presses, his bakeries, and his forges: for this they paid him fees (*banalités*).[26]

Lords lower down the feudal hierarchy derived their domain incomes from much the same sources. Like the ruler, much of their income came from taxes, rents, and fees on land. Like the ruler, they taxed trade whenever it passed through their territory, collecting transit tolls and market taxes. They enjoyed the same rights to non-tax revenues and feudal incidentals from their own vassals. Many enjoyed the right to mint coin. Local lords, like the ruler, earned income from the provision of justice on their domains and they too enforced monopolies of various kinds.

The income of the Church followed a similar pattern. Bishops and monasteries were much like local lords, in that they too had largely privatized the land under their control.

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[23](Bisson 1979) The Romans had justified this on the grounds that regulation of the currency was in the public interest.

[24]See (Kohn forthcoming) Ch 7.

[25](Ormrod and Barta 1995)

[26]The monopolies were usually farmed to private operators.

Their income made up of the same elements as that of secular lords. Although the Church, through bequests and donations, had accumulated a significant proportion of the cultivable land in western Europe, little of the income from this land went to the Church itself (that is, to the papacy). In some parts of Europe, the Church collected tithes and a part of this went to Rome. There were also various special taxes that were imposed initially to finance the Crusades, but which continued afterwards and went to supplement the general revenue of the papacy.[27]

Aids and subsidies

Although vassals were not obliged to provide financial support to the ruler, in exceptional circumstances they could choose to do so voluntarily. It was customary to grant the ruler 'aids' or 'subsidies' on the birth of a son or the marriage of a daughter, to ransom a ruler captured in battle, and—most important—to help to finance a war.[28] Indeed, if a war was 'just', the ruler's subjects were expected to contribute.[29]

Since this sort of support was voluntary and conditional, it required negotiation.[30] Was the war indeed just? Had the ruler exhausted all other options? He was expected to make full use of his own resources—mortgaging his land if necessary or even pawning his crown jewels—before coming to his vassals and subjects for assistance. Before consenting to 'extraordinary' payments, subjects wanted to be assured that their future rights and freedoms would not thereby be compromised. Indeed, given the typically desperate plight of the ruler on such occasions, this was a good opportunity to demand an expansion of those rights and freedoms.

Given the difficulty of obtaining aids and subsidies from their subjects, rulers had the strongest incentives to maximize their 'ordinary' incomes.[31] They did what they could to

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[27](Ekelund, Tollison et al. 1996); (Strieder 1931)

[28](Bonney and Ormrod 1999)

[29]Voluntary contributions, too, had their origins in the ancient world. In the Roman empire, and even before that in Greece, direct taxation had been regarded as inconsistent with a citizen's liberty. So rather than suffer the indignity of taxation, wealthy citizens had contributed voluntarily to the funding of public works. ((Webber 1986) Ch. 3)

[30](Wolfe 1972) Ch. 1

[31](Miller 1971). As did those lower down the feudal hierarchy: "… in the feudal system a fief holder was expected to manage his fief with an eye to profit. The successful baron might disdain bourgeois haggling over merchandise, but he was an expert in using military and governmental means of making money." ((Lane 1958) p418)

increase the revenue from the land they had, and they did what they could to acquire more land. They confiscated the land of rebellious vassals or of those who fell from favor, and they seized land from the Church, which owned a great deal of it. Rulers tried too to recapture some of the imperial rights they had lost to local lords—especially the control of the mints, the taxation of markets, and the provision of justice.

Rulers sometimes obtained voluntary subsidies from outside their territories. An ally might provide help: for example, England provided financial help to Flanders during their common war with France in the early fourteenth century. The pope sometimes provided financial assistance, often in exchange for help in the repeated struggles for papal succession or to forestall confiscation of Church property.

Liquidity

As we have seen, the financing of war required liquidity. Ordinary revenues came in steadily but slowly, and extraordinary aids and subsidies, even when granted, took a long time to collect.[32] Although some wars could ultimately be self-financing—through plunder and increased exaction from expanded territories—the cost had to be paid before these additional resources became available.[33] So rulers had to find some way to meet their immediate needs for funds.

To some extent rulers could rely on credit. Over time, rulers had managed to extend the *droit de gîte* beyond its traditional meaning of hospitality and transportation for the royal household to include supplies and transportation for the king's armies. This prerogative of 'purveyance' enabled rulers to billet their troops and to requisition goods and means of transportation against the promise of later payment by the treasury.[34] Armies in foreign territory also requisitioned what they could against future payment; however, the distinction between this practice and plunder was somewhat fuzzy.[35]

But credit only went so far. Many expenditures required payment in cash, especially expenditures abroad—payments to foreign suppliers, for example, and subsidies to

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[32](Ertman 1997) Ch. 2

[33](Thompson 1995)

[34](Kaeuper 1988); (Fryde 1979)

[35]One was not supposed to plunder the territory of an ally, so requisitioning would have been more acceptable. However, if payment was never made (as was not unusual) this was just plunder under another name.

allies.[36] To address their need for cash, rulers relied on the simplest form of asset management—cash reserves. They accumulated a war chest in anticipation of future wars—a reserve of coin and treasure often literally stored in a chest.[37]

Rulers were also able to borrow some money. Mostly they borrowed from the Church, in whose hands much of Europe's treasure had accumulated over the years. To raise the funds demanded of them, bishops and abbots were sometimes forced to melt down the ornaments of their churches and chapels. They sometimes also acted as financial intermediaries, borrowing from others in order to raise the amounts they needed to satisfy their rulers' demands for loans.

GOVERNMENT FINANCE IN THE FIRST POLITICAL-ECONOMIC CYCLE

From the eleventh century to the end of the thirteenth century, Europe experienced a 'Commercial Revolution'—a period of rapid economic development, with steadily growing population and increasing urbanization. Economic expansion greatly increased the revenue from traditional sources of government finance. Rising demand for agricultural output raised the income from land, the main source of domain income. The expansion of trade increased the revenue from taxes on trade. This was especially true in the urbanized central regions of the two zones of Europe trade—northern Italy and the Low Countries. But there was a significant increase too in the revenues from tolls along the trade routes that linked these regions and that passed through Switzerland and France.

The Commercial Revolution also monetized government revenues. The expansion of markets brought large parts of the countryside within the money economy. As a result, rulers and lords began to collect rents and taxes in cash rather than in kind or labor. This made their revenues more mobile and fungible, making it easier, for example, to hire mercenaries and to supply expeditionary forces abroad. However, monetization had its drawbacks too. Unlike payments in kind, fixed money payments were affected by changes in the value of money. In late twelfth century England, for example, rising prices significantly eroded the king's domaine income.[38] Desperate to finance his war with

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[36](Thompson 1995)

[37]There were not yet any other liquid assets available: liquid financial assets did not yet exist. See (Kohn forthcoming) Ch 6.

[38](Harvey 1973). The inflation, in this case, was not caused by debasement but seems rather to have been caused by the inflow of bullion that accompanied the rapid expansion of English exports of wool.

France, King John imposed arbitrary taxes on his vassals. They rebelled and in 1215 forced him to accede to a bill of rights—the Magna Carta.

By the end of the thirteenth century, rising government revenues across Europe made it possible for both territorial rulers and independent cities to embark on a series of military adventures. The result was a period of extensive warfare that engulfed much of Europe for over a century. Governments soon found, however, that the revenues that had emboldened them to launch their wars were inadequate to sustain them.[39] The military technology of the time was such that wars tended to be long and indecisive.[40] The growing reliance on mercenaries also made them increasingly expensive. As a result, victory often depended less on military prowess than on fiscal staying power.

The transformation of territorial government revenue

The intense pressure of financing war transformed government finance throughout Europe.[41] Rulers came to depend increasingly on general taxes collected from their territories as a whole rather than from their domains alone. Such taxes were, at least in principle, voluntary, so they required some regular arrangement for obtaining consent. This need led to the emergence and development of representative assemblies during this period.[42] Consent, however, required negotiation, concessions and compromise—something rulers found distasteful and even humiliating. They therefore did their best to find ways of imposing taxes without the need of asking consent.

Most economies, except in the highly urbanized central regions, were predominantly agrarian. Consequently, most of the new general taxes fell directly or indirectly on the income from land. In France, the principal tax was an extension of the property tax, the *taille*, from the royal domain to the whole of the territory under royal control. The total sum to be raised was agreed, and this total was then apportioned among provinces, towns, and villages, where local officials apportioned it among households.[43] The nobility resisted the extension of the *taille*, realizing that it would encroach on their own ability to

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[39](Miller 1971); (Nicholas 1999)

[40]See (Kohn forthcoming) Ch 19.

[41]"Above all, fiscal systems owed their development to the financial pressures arising from a policy of dynastic and territorial aggrandizement." (Ormrod 1995) p124

[42]See (Kohn forthcoming) Ch 21.

[43]{Ames, 1977 #3232

exact revenue from their territories. A compromise was reached that exempted the nobles themselves from paying the tax but imposed it on all commoners within their territories. England had a similar general tax on property that parliament granted periodically. It was known as the 'tenth and fifteenth' because it was originally assessed at a rate of one tenth of the value of movable property of burgesses and one fifteenth of that of free residents of shires.[44] However, after the initial assessment of 1334, the tax was levied as an unchanging fixed amount from every village and city ward: the total sum raised was about £30,000.[45] The tax could be imposed repeatedly as necessity demanded and as parliament allowed.

Some rulers were able to tax the income from land indirectly by imposing taxes on its produce, so avoid the unpleasant necessity of negotiating with their assemblies or of confronting their nobles. In England, Edward I converted an existing general customs tax on all imports and exports into a specific export tax on wool and hides. Since taxes on trade were a traditional royal prerogative, Edward felt under no obligation to seek consent. However, to gain the cooperation he needed from the wool merchants in collecting the tax, he granted them the right to form a cartel.[46] Although the government and the wool merchants maintained that the tax would be born exclusively by foreign purchasers, it fell to a significant extent on English producers of wool. Since wool was a major output of English agriculture, the 'new custom' provided the king with an indirect way of taxing land outside his domains without having to obtain consent.[47] The rulers of Sicily and southern Italy had earlier imposed a tax on their main agricultural export—grain: this may have provided a model for the English tax.[48] The rulers of Castile

[44]{Nicholas, 1999 #2591} An unsuccessful attempt to replace this tax on property with a poll tax was the principal cause of the Peasants' Rebellion of 1381.

[45](Schofield 2004) Ch. 1

[46]The customs tax (the 'new aid'), originally imposed by John in 1202-6, had not been a success. The tax of 1/15 on the value of all imports and exports had proven difficult to collect. Moreover, it had immediately ran into the opposition of the cities, which saw it as a violation of their liberties. Several cities, including London, negotiated or purchased exemptions from the tax for their merchants. Edward's 'new custom' was much easier to collect, since it fell on bulk exports and he gained merchant acquiescence with the sweetener of a cartel. ((Kaeuper 1973) Ch. 5; (Koenigberger 1995))

[47]The custom on wool ultimately more than compensated for the domain income that the English crown had lost earlier in the thirteenth century. (Ormrod 1995)

[48](Ertman 1997)

achieved much the same effect by imposing a transit tax on transhumant sheep—the *servicio y montazgo*.[49] In Castile too, wool was a major agricultural export.

General taxes on trade played a role in some territories. The most important example was the Castilian *alcabala*. This was first imposed in the late thirteenth century by Alfonso IX to finance the continuing expense of the *reconquista*. The *alcabala* was a new sales tax on the towns—clearly an imitation of existing municipal sales taxes.[50] The rulers of France imposed a similar general sales tax, the *aides*.[51]

Rulers tried where they could to make these general taxes permanent. That is, they tried to convert them into 'regalian rights' to which they were entitled, like their domain income, without any need for further consent on the part of their subjects. Whether they succeeded or not depended largely on whether war was intermittent or continuous. Subjects rarely refused to grant aids and subsidies to finance a war. However, the taxes they granted were either fixed levies, like the *taille*, or granted for a limited period like the *alcabala* or the English customs. Consequently, once the war ended, the tax ended too. If a ruler wanted to finance a new war, he had to come back to his representative assembly and ask for new taxes to pay for it. However, where wars continued for decade after decade, the granting of new taxes became routine. Rulers either obtained formal recognition from their representative assemblies of the taxes' permanence or simply stopped asking for consent and rested on custom.

The rulers of England had been the first to obtain a permanent general tax in this way during their long struggle with Viking invaders. They obtained a general tax on land which, through repeated imposition, became established as a customary right and survived long after the Vikings were no longer a threat.[52] Later wars were more intermittent—wars with the Welsh and the Scots and even the Hundred Years War with France. As a result, by the end of the thirteenth century a strengthened parliament regained control over the general land tax, making it once again subject to consent. Parliament also gained control over the new custom on wool, which had initially been

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[49](Vicens Vives 1969) Ch. 22

[50]Alfonso initially imposed the tax without asking for consent; later rulers asked the representative assembly, the Cortes, to confirm their right to collect the tax ((Ormrod 1995)).

[51](Ames and Rapp 1977)

[52](Kaeuper 1988); (Miller 1971)

regalian. Once producers realized that it was they rather than foreigners who were bearing the burden of the tax, they used their power in parliament to force the king to acknowledge the need for consent, which he did in 1362.[53]

In France and Castile, the trajectory was the reverse—not from permanent to voluntary but from voluntary to permanent. At the time of the Viking invasions, France was threatened too, but the threat there was more intermittent. As a result its rulers had failed to obtain a permanent general tax, and they were therefore far more dependent on domain income than the rulers of England.[54] The situation changed with the onset of the Hundred Years War. The war was largely fought on the soil of France, and the conflict there was more or less continuous. As a result, the *aides* and the *taille*, granted repeatedly during this period, became established as permanent taxes by the end of the war in the 1450s.[55] Similarly, in Castile, as the *reconquista* went on for decade after decade, the *alcabala* and the *servicio y montazgo* became entrenched by the late fifteenth century as permanent regalian rights.[56]

The pattern of government finance established during the wars of the long fourteenth century was to remain largely unchanged until the eighteenth.[57] The general taxes introduced at this time became the mainstays of government finance—in England, the custom on wool and the land tax; in France, the *taille* and the *aides*; in Castile, the *servicio y montazgo* and the *alcabala*. In France and Castile the fiscal independence of the rulers had been strengthened when these taxes had become regalian rights. In England, rulers had become less fiscally independent as they had increasingly had to ask the consent of parliament to new taxes.

Changes in borrowing

The Commercial Revolution paved the way for the wars of the long fourteenth century not only by increasing rulers' revenues but also by making it easier for them to

53(Nicholas 1999)

54(Ormrod and Barta 1995)

55(Ames and Rapp 1977). Charles VII struggled with the Estates to grant additional *tailles*, but after 1429 he began to tax first and ask later, relying on military force where necessary to collect the tax ((Finer 1997) V3 Ch. 5). In 1439 the estates agreed to a permanent tax, the *taille des gens de guerre* to finance a standing army to prevent the continuing depredations of bands of unemployed mercenaries (*écorcheurs*) ((Howard 1976)).

56(Thompson 1994)

57(Ames and Rapp 1977), (Finer 1997) V3 Ch. 5

borrow large sums of money.[58] Indeed, it may have been access to a new and substantial source of borrowing that emboldened the rulers of England to pursue their dynastic claims in France, so kicking off the Hundred Years War.

By the twelfth century, the Commercial Revolution had concentrated substantial liquid wealth in the hands of merchants, providing rulers with a new potential source of lending to supplement their traditional source, the Church. To begin with, rulers borrowed from individual merchants: the wealthy cloth merchants of Arras, for example, were early sovereign lenders.[59] By the late thirteenth century, however, continuing economic expansion had brought about considerable financial development. Financial markets were emerging, as was a new type of financial intermediary—the merchant banker—who financed his own lending by borrowing in the new financial markets. Such merchant bankers—mostly Italians—were able to offer territorial rulers much larger loans.[60] Because these merchant bankers also operated a system of international remittance, they were also able to make the funds available wherever a ruler wished, making it easier to fight wars overseas.[61]

However, lending to territorial rulers was always risky. The debt of a ruler was personal: as we have seen there was no distinction between ruler and state. If a ruler died—a common enough event—his successor was not obliged to assume his predecessor's debts.[62] In case of default, recourse was limited. There was, of course, no point in turning to the ruler's own courts. Creditors could seize the goods of the ruler's subjects overseas or ransom their persons. Or they could try to convince the pope to threaten a defaulting ruler with excommunication.

Given the risks of lending to rulers, good security was essential. The early loans from the Church had usually been secured by land.[63] Loans from individual merchants had often been secured by pawns of jewels or other valuables. Loans from merchant bankers, however, generally relied on securitization. That is, merchant bankers generally received

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[58](Körner 1995)

[59](Pirenne 1937)

[60]See (Kohn forthcoming) Chs 9 and 10.

[61]John of England had used Italian bankers to remit funds to allies in Germany at the beginning of the thirteenth century ((Lunt 1939))

[62](Fryde and Fryde 1971)

[63]See (Kohn forthcoming) Ch 11 on mortgage lending.

the right to collect payment *directly* from a dedicated source of revenue. For example, when Edward I obtained his custom on wool, he used it to secure a loan from the Ricciardi of Lucca. The Ricciardi were repaid directly by the officials charged with collecting the tax, against which the Ricciardi had first claim.[64] Securitization made sense because the cash flow on which it was based was more reliable than the general credit of the ruler.[65]

A ruler's ability to borrow from merchant bankers depended therefore on his possessing reliable cash flows that he could securitize. That is why the rulers of Sicily and southern Italy and the rulers of England were early borrowers: export taxes on grain and wool respectively provided them with the requisite cash flows.[66] Indeed, northern Italian merchant bankers played a major role in both cases in setting up and managing these taxes with the clear intention of their becoming security for subsequent loans.[67] The rulers of France, however, found it more difficult to borrow, because they lacked a single large and reliable source of revenue like the custom on wool that they could place in the hands of a lender. They did obtain some loans from the Guidi brothers ('Biche' and 'Mouche'), but on a much smaller scale.[68]

The difference in the ability of the rulers of England and France to borrow from merchant bankers had two important implications. First, although the regular income of the rulers of England was no more than a fifth that of the rulers of France, borrowing enabled them to sustain a comparable level of military expenditure.[69] Second, because of their limited ability to borrow, the rulers of France were forced much sooner to turn to alternative sources of liquidity that proved far more damaging to the French economy.[70]

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[64](Hunt 1994),(Parker 1977)

[65]See (Kohn forthcoming) Ch 10 for more on the sovereign lending of merchant bankers. See (Kohn 2003) Ch. 14 on securitization.

[66](Pryor 1979). (Kaeuper 1973) notes that the new custom of 1275 not only significantly increased the revenues of Edward I, but "Even more important were the possibilities presented by using this steady source of funds as security for loans negotiated with firms of Italian merchant-bankers." p135

[67]See (Kohn forthcoming) Ch 10.

[68](Kaeuper 1988). The Guidi brothers were the local representatives of the Francesi Company of Florence..

[69](Kaeuper 1988) Ch. 1. "Yet French kings, despite the size and wealth of France, were apparently unable to accumulate and spend more money on war than their English opponents." p63

[70](Fryde 1979). (Prestwich 1979) also argues that English access to loans from Italian bankers reduced the burden of war on the economy by spreading the burden over time and avoiding the need for heavy temporary taxes.

Borrowing from merchant bankers, while it was important initially, did not hold up well under the pressure of war. Rulers soon borrowed more than they could possibly repay. By 1339, Edward III of England, for example, had run up a debt of some £300,000—about four times his annual revenue.[71] This was all short-term debt. Merchant bankers lent short-term largely because that was the nature of their own funding, but it also enabled them to keep a tighter reign on their borrowers. The short term of the loans was, however, a huge problem for the borrowers: large sums constantly came due and could only be repaid out of new borrowing. When Edward's Italian bankers faced a liquidity crisis of their own in the early 1340s and were therefore unable to roll over his loans, he had little choice but to default.[72] The crisis of the Florentine merchant bankers, exacerbated by Edward's default, largely cut off this source of lending to territorial rulers. Significant sovereign lending by merchant bankers did not resume until the end of the fifteenth century.

With this major source of lending cut off, rulers sought alternatives. Philip VI of France received some large loans from the papacy in 1347-8: the popes, then residing in Avignon under his protection, found it difficult to refuse.[73] The counts and dukes of the Low Countries were able to borrow directly themselves in the financial markets of Bruges and Antwerp, although their deteriorating credit forced them to rely increasingly on guarantees from individual merchants, nobles, and towns[74]

Domestic merchants, although they lacked the resources of the great merchant bankers and the access to international financial markets, were also a source of lending.[75] In England, Edward replaced the Italian merchant bankers with consortia of domestic merchants. These were able, jointly, to provide substantial loans in exchange for the right to collect the custom on wool. In France, rulers leaned on rich merchants to provide them with loans: "Such levies are often called forced loans and did involve royal pressure; but the advantages of gaining the king's gratitude may have been sufficient indirect pressure

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The alternative sources of liquidity are discussed in the following section.

[71](Hunt 1994)

[72]See (Kohn forthcoming) Ch 10.

[73](Kaeuper 1988)

[74](Van der Wee 1993)

[75](Körner 1995)

to loosen bourgeois purse strings, even though repayment was uncertain and so slow that inflation and currency changes could convert loans into virtual gifts."[76]

Another alternative was to tap government officials for loans—a practice known as the 'fiscal sponge' or 'inside credit'. Tax officials were asked to advance to the crown a fixed sum, out of their own pockets, against future taxes.[77] They often had to borrow in their own names to be able to provide the sums asked of them. Since the officials were receivers of taxes, they were in a good position to ensure that the loans would be repaid. The loans seem generally to have been interest-free: presumably the benefits of office provided a sufficient *quid pro quo*.[78] This form of borrowing was pioneered by the rulers of Aragon in the thirteenth century, and then adopted and refined by the French during the Hundred Years War.[79] The new general taxes established at that time required the appointment of many additional officials, called *élus*, to administer them. The government deliberately chose wealthy merchants for these positions since they could most easily provide the desired advances. A royal ordinance of 1401 specified that *élus* should be rich: indeed, "one candidate for office in Troyes in 1407 thought it natural to stress that 'he is richer than the other existing *élus*'."[80] The crown borrowed not only from these local receivers of taxes but also from high officials. The most famous example is that of Jacques Coeur, a great merchant and royal minister. In 1449 Coeur assembled some 200,000 florins in loans, mostly raised from other French merchants and officials, to finance the campaign of Charles VII in Normandy.[81]

Recourse to asset management

With the potential for liability management (borrowing) largely exhausted, rulers turned increasingly to asset management—to selling off their assets. Their non-cash assets consisted of various sources of future revenues. The most important such source was, of course, land. While ruler's did sell their land, the importance of land both economically and in terms of status, made this a last resort. A ruler's other sources of

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[76](Kaeuper 1988) p75

[77](Wolfe 1972)

[78]Loans from merchant bankers, too, were often free of interest, the lenders being compensated in other ways. See (Kohn forthcoming) Ch 10.

[79](Ertman 1997) Ch. 2; (Fryde 1979)

[80](Fryde 1979)

[81](Körner 1995); ((Wolfe 1972))

future revenue included his right of exaction, his right to mint coin, his right to provide justice—essentially all of his rights that yielded revenue of one sort or another.

The most direct way of selling rights to future revenues was through the device of farming. The rule sold to a farmer for a fixed sum, usually paid in advance, the right to collect a specific revenue for a certain period of time. The revenues farmed in this way included domain rents, indirect taxes, and seigniorage income from the mints.[82] Farming was not, of course, new: as we have seen, it was standard practice under the Romans. However, it became more and more common in medieval Europe as a result of the financial pressures of the fourteenth century.[83]

Farming differed from securitization in that the farmer was entitled to *all* the revenue he collected rather than to repayment of a specified amount out of that revenue. With securitization, the collector of the revenue (often the creditor or his agents) was required to provide an accounting of what he collected and to hand over the excess to the ruler. With a farm, no such accounting was required, since all the revenue went to the farmer. The farmer generally assumed the risk that revenue would be less than expected.[84] However, some contracts allowed for *ex post* adjustments if revenue was adversely affected by external events—a war for example. Generally, the farm was put up for auction, so that competitive bidding would ensure the seller a fair price.

There were other ways to sell rights to future revenue that were functionally equivalent to farming. Rulers sold charters to cities that bestowed on them various prerogatives. One of these, typically, was the right to collect market taxes that otherwise would have been collected by the ruler.[85] In a variation on this, a city sometimes agreed to pay a fixed sum in advance in order to be relieved of a particular tax (the city could raise this sum however it pleased).[86] For example, in the fourteenth century the cities of Castile agreed to pay a lump sum (*encabezamiento*) in place of the *alcabala*, which they found to be unduly onerous.[87] Another such sale of future revenue was the sale of mineral

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[82]In the last case, the farmer also admisitered the mint: see (Kohn forthcoming) Ch 7.

[83](Ertman 1997) Ch. 2. On tax farming in ancient Athens, see (Webber 1986) Ch. 2

[84]For example: "When Christophe Aubry undertook the farm of the wine *octroi* (a city tax) for Paris the lease stipulated that it was *à ses perils & fortunes*." ((Wolfe 1972) p323)

[85]See (Kohn forthcoming) Ch 17.

[86](Nicholas 1997) Ch. 7; (Miller 1971)

[87](Thompson 1994)

rights—a part of the ruler's *jus moneta*. The purchaser was free to extract the mineral in question and exempted from any requirement either to sell the output to the ruler or to give the ruler a share of the output.[88]

A rulers sometimes sought to enhance the value of a stream of revenues that he was selling, and so obtain a higher price for it, by attaching to it monopoly rights. For example, in 1363, when Edward III granted the right to collect the custom on wool to the Merchants of the Staple, an association of English merchants, he increased the potential revenue of the custom by granting them a monopoly on the export of wool.[89] Rulers similarly increased the value of market franchises they sold to towns by ensuring that no competing market would be established in too close a proximity.[90]

Another somewhat different way to sell rights to future revenues was through the sale of office. The Church and the Norman kings of England had pioneered the practice, but—as with tax farming—it reached its most developed form in France.[91] In the feudal culture of medieval Europe, official positions tended to become 'privatized'. That is, office-holders established 'ownership' and passed on the office to their heirs as a part of their personal property. By the fifteenth century office-holders were commonly selling the positions they 'owned' to third parties. Given the privatization and the private trade in offices, rulers sought to capture some of the value for themselves by selling the office in the first place.[92]

The sale of offices combined borrowing with the sale of a stream of revenues. The purchaser received an official salary, usually for life. In this sense, the transaction was like a loan to the ruler—a lump sum payment by the purchaser in exchange for an annuity.[93] Indeed, the papal states sold purely titular offices (no need to show up for work) as a way of avoiding usury; the 'salary' was about 11% of the purchase price, and

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[88] Jacques Coeur, for example, purchased mineral rights from Charles VII of France.

[89] "The king wanted a company of merchants to whom he could give a monopoly in the export of wool, so as to tax monopoly profits by means of a heavy export duty and raise loans from merchants on the security of the duty." (Power 1942) p88

[90] (Masschaele 1997); (Nielsen 1998). See also (Kohn forthcoming) Ch 17.

[91] (Bonney 1995), (Fischer and Lundgreen 1975)

[92] (Fischer and Lundgreen 1975)

[93] (Swart 1949) Ch. 1. The annuity (rente) was the common form of long-term debt, since it avoided explicit payment of interest: see (Kohn forthcoming) Ch 11.

these offices were often purchased by 'societies' or groups of investors.[94] However, in most cases the office was real and the purchaser obtained in addition the right to a stream of revenues—to embezzle taxes that he collected or to accept gratuities and bribes.[95] That is, the 'venal' official purchased the right to divert a cash flow that should, in principle, have gone to the ruler. In France, it was estimated that as little as half of gross tax revenue actually reached the treasury.[96] An additional part of the deal, as we have seen, was what that officials were expected when asked to advance money to the crown against taxes they would later collect. This added an element of secured borrowing to the package.

A variation on the sale of offices, adopted both in France and in Castile, was the sale of noble rank. Since nobles enjoyed valuable tax exemptions, this was in effect a lump-sum buyback of a tax obligation—much like that of the cities through *encabezamiento*.[97] Of course, noble rank carried additional social benefits that enhanced its value to the merchants who were the principal purchasers.

Clearly, the ability of rulers to sell offices depended on their credit.[98] Like a lender, the purchaser of office needed to believe that the future payments promised him would actually materialize. For example, a stop on official salaries was like a stop in interest payments in that it made it harder to sell new offices. This was less of a concern when the purchaser himself controlled the stream of payments due to him (peculation and corruption). However, even then the ruler could default by taking back the office—and, of course, selling it again to someone else. So purchasers had to have some faith that this would not happen. It did happen sometimes however: for example, before Richard I set off for the Crusades, he sold the office of sheriff of the various counties; when he returned, he removed the incumbents and re-sold the positions.[99]

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[94](Tracy 1994); (Laven 1966) Ch. 4

[95]Writing of the purchasers of offices in Norman England, (Tout and John Rylands Library. 1916) asserts that they "recouped themselves for their capital outlay, not only by the legitimate profits of office but still more by the unlawful but customary peculations and extortions in which the early mediaeval functionary delighted " p15

[96](Levi 1988) Ch. V

[97](Ames and Rapp 1977)

[98](Thompson 1998)

[99] ((Swart 1949) Ch. 3)

A different form of asset management that did not depend on the ruler's credit was expropriation—the 'asset' in this case being the future benefits, whether taxes or loans, that could be expected from the individual or group expropriated. The asset was liquidated by seizing the wealth of the individual or group in question, thereby gaining a capital sum immediately in exchange for the loss of the potential future benefits. The decision to expropriate was therefore essentially a matter of calculation. Expropriation presumably became more attractive when there was a fall in the expected future benefits or when the future mattered less because of an urgent need for liquidity. Expropriation was easier, of course, when wealth was concentrated, so great wealth was an invitation to expropriation. Expropriation was also more likely when the wealth in question was liquid, because such wealth was more difficult to tax, making the flow of future benefits more uncertain.

Rulers were not, of course, free to expropriate at will. They were subject to the rule of law, and even when they had the power to ignore the law there was a price to doing so in terms of undermining the ruler's legitimacy and of provoking armed revolt. As we have seen, outsiders—especially foreigners and Jews—were not covered by the law's protection and this made their expropriation less costly to the ruler and therefore more likely. The expropriation of subjects, however, required justification. If, for example, some high official was guilty of a serious offence, typically treason, the ruler took the opportunity to expropriate his wealth. Alternatively, if the ruler wished to expropriate the wealth of some individual or group, he had to manufacturer charges against them.

In general, the lack of good alternative sources of liquidity in France made expropriation a more common recourse there, but it was far from unknown in England. For example, in 1290 Edward I expropriated the Jews, who had been his main source of credit, after Italians merchant bankers arrived in the country, offering a better source of loans.[100] Edward III, as we have seen, defaulted on his debt to the Italians (a form of expropriation), when it became unlikely that they could continue to provide him with new loans. The rulers of France expropriated Italian merchants more frequently than did the rulers of England because, unlike the latter, they did not expect to obtain significant loans from them. On one occasion in 1331 Philip VI arrested the Italians in Paris on charges of

[100] (Veitch 1986)

usury. Not only did he require them to pay a large fine to secure their release, but he also ordered their debtors to make repayment to the crown rather than to the bankers themselves (to encourage compliance, he excused the debtors of interest). This ploy was so successful that it was repeated in 1337, 1340, and again in 1347.[101] Two other famous victims of expropriation in France were the Templars, in 1307, and Jacques Coeur, in 1451.[102]

A final source of liquidity was debasement.[103] Additional cash could be generated through the simple device of minting more coins from a given weight of bullion. For example, instead of minting 40 pennies from a pound of silver and keeping four as seigniorage, the ruler could mint 80 pennies and keep 30 for himself. Debasement could be a large source of revenue. In some years in fourteenth century France, for example, it accounted for as much as 70% of royal revenue.[104] However, even more important than its role as a source of revenue was its role of as a source of liquidity. Debasement could provide large amounts of ready cash more or less immediately. In this sense it was more a substitute for borrowing than it was for taxes.[105]

Debasement, by reducing the bullion content of the coinage, caused inflation, because prices in terms of coin tended to rise to reflect its lower intrinsic value. Some prices rose relatively quickly. Goods prices did so because they were adjusted continuously in the marketplace.[106] However, other prices did not adjust so easily. Both rents and taxes were set through painful negotiation between the parties, and once set they became entrenched in custom. So changing them was fraught with difficulty. As a result, the real (purchasing power) value of rents and taxes was severely eroded in times of inflation.[107]So debasement, too, can be understood as a form a asset management. It sacrificed future revenue (an asset) in exchange for immediate liquidity.

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[101](Kaeuper 1988)

[102](Fryde and Fryde 1971). On the Templars, see also (Barber 1994).

[103]For more on the debasement, see (Kohn forthcoming) Ch 7.

[104](Ormrod 1995); (Fryde 1979)

[105]"As the reign of Philip the Fair had shown, coinage manipulation was a tempting alternative to borrowing as a means of securing ready cash for war." (Kaeuper 1988) p 75-6

[106]Rulers sometimes tried to prevent prices from rising, but these attempts were generally ineffective: see (Kohn forthcoming) Ch 22.

[107]We have already seen the example of the English inflation of the late twelfth century and its effect on royal income.

The various forms of asset management were relatively expensive sources of liquidity: the current cash value realized was small compared to the loss of future revenue. The cost of tax farming and of the sale of offices was inflated by ‘agency’ problems: farmers and officials behaved in ways that benefited them but harmed the interests of the ruler. For example, farmers wished to extract the greatest possible revenue from their farms over the fixed period of the contract. It did not matter to them, although it did to the ruler, that excessive taxes might ruin the taxpayers and so reduced potential future revenues.[108] Similarly, venal officials were interested in exacting as much as they could without regard for the impact on the economy and so on the total take. This resulted in ‘over-corruption’—rather like the over-grazing of common pasture. In addition, there was a political cost to the actions of tax farmers and venal officials that they themselves did not bear. Their behavior often caused unrest and rebellion that the ruler was obliged to suppress at considerable expense to the treasury. Other forms of asset management had their costs too. Expropriation had reputational consequences: if expropriation seemed likely, potential victims might respond by keeping their wealth and their persons out of the ruler’s reach. The inflation caused by debasement damaged the economy by increasing transactions costs, and so reduced the potential for future exaction.[109]

Given the high costs of the various forms of asset management, they were generally a last resort. Rulers, who had relatively good alternative sources of liquidity and who were under less fiscal pressure, like the rulers of England, generally avoided them. Rulers who lacked alternatives and who were under great fiscal pressure, like the rulers of France, had little choice but to resort to them frequently.[110]

The transformation of municipal finance

The intense pressure of financing war transformed the financing of city government no less than it did that of territorial government.

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[108](Smith 1976 [1776]) p434-5

[109]For more on the effects of these practices on the economy see (Kohn forthcoming) Ch 23. For more on the agency problems see (Kohn forthcoming) Ch 21.

[110](Kaeuper 1988); (Wolfe 1972) Ch. 1

Municipal finance had been developing for centuries. It was cities and other forms of associational government, rather than territorial rulers, that were responsible for most of the functions we associate today with government. It was city governments that were responsible for public works (roads, bridges, churches, and marketplaces), for economic regulation, and for charity and poor relief. Most important, city governments, especially those of independent cities, were responsible for defense—for building walls and raising militias.

All of this, of course, had to be paid for. Cities relied for revenue largely on indirect taxes on trade and consumption.[111] They generally avoided direct taxes on wealth, because city government was generally controlled by wealthy elites who, not surprisingly, preferred to shift the burden of taxation to others. The reliance on indirect taxes spread the burden widely within the city, and it shifted some of it to outsiders who came to the city to trade.[112] The regressivity of indirect taxes was sometimes tempered by charging higher rates on imported luxuries. Nonetheless, indirect taxes were often viewed as unfair and inequitable, and riots and rebellions were not uncommon.[113]

Cities usually collected tolls at the city gates. Those on items of basic consumption—such as grain, salt, oil, wine, and beer—were the most lucrative.[114] In the Burgundian Low Countries, it was said that "municipal finance… floated as a cork on a great pool of beer".[115] Cities also imposed transactions taxes in the marketplace—paid at the official beam or collected by licensed brokers.[116] Since the right to such taxes belonged in principle to the territorial ruler or the local lord, subject cities had to purchase the right to collect them. Cities also had a variety of other sources of revenue. Their courts collected fines for violation of economic regulations and for other offenses. Cities also levied inheritance taxes. These could produce considerable revenue, especially during plagues: for example, in 1368-9 death duties accounted for nearly 15% of the total revenue of

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[111](Hocquet 1995)

[112]Venice deliberately shifted the burden to foreigners by charging them higher tax rates. It charged foreigners a custom of 2.5% on goods entering by road and 20% on those entering by sea, compared to the 1.25% that Venetians paid in either case. ((Hocquet 1995))

[113](Hibbert 1971)

[114]In most French cities, the wine tax alone accounted for two thirds of total revenue ((Nicholas 1997) Ch. 5)

[115](de Vries and van der Woude 1997) p 93

[116]See (Kohn forthcoming) Ch 17.

Ghent.[117] Some cities collected an 'issue tax' on property leaving the jurisdiction of the city.[118]

The total sums the cities mobilized were substantial. Indeed, the revenues of some of the larger independent cities of northern Italy equaled or exceeded those of many territorial states. For example, Milan's revenue of 700,000 florins a year in the 1330s exceeded that of Edward III of England and was only slightly lower than that of Philip IV of France.[119]

The wars of the long fourteenth century had as great an impact on the government finance of cities as it did on that of territorial rulers. The independent cities of the south were engaged in almost continuous warfare with one another. Moreover, during this period they switched from reliance on voluntary militias to the hiring of mercenaries, and this raised the cost of war enormously.[120] Florence, for example, relied on a citizen militia in 1300, but by the 1330s it was employing mercenaries at a cost of some 140,000 florins a year.[121] The subject cities of the north, although they did not possess armies of their own, faced growing demands for subsidies from their territorial rulers. This was especially true of the wealthy cities of the highly urbanized Burgundian Low Countries.[122]

To meet the demands of war—whether financing an army or paying a subsidy—cities, like rulers, had a need for liquidity: they had to be able to mobilize large sums quickly. The traditional way to do this was to turn to the city's wealthy elite for short-term interest-free loans.[123] Sometimes these loans were voluntary, sometimes they were forced (to some extent this practice made up for the regressivity of the tax system). As the wars went on and on, however, and as expenses continued to mount, this solution became increasingly problematic. The size of the outstanding debt grew enormously: for example, between 1300 and 1342 the debt of Florence ballooned from 47,000 florins to

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117(Nicholas 1997) Ch. 5
118(Nicholas 1990)
119(Pryor 1979)
120(Becker 1967); (Fryde and Fryde 1971)
121(Becker 1967)
122(Nicholas 1997) Ch. 2
123(Nicholas 1990); (Veseth 1990)

800,000 florins.[124] Repayment was frequently delayed, sometimes indefinitely. Cities had no choice, therefore, but to replace their *ad hoc* system of short-term borrowing with a more sustainable system of long-term debt.

Long-term borrowing was much easier for cities than it was for territorial rulers.[125] Cities, whether they were formally incorporated or not, were perpetual: unlike rulers, they did not die, leaving their creditors in the lurch. Moreover, a city's debt was effectively guaranteed by the assets of all of its citizens. If the city defaulted, foreign creditors could seize the property of any of its citizens (which is the reason that so much city debt was held by foreigners). Moreover, cities—governed by merchants—were more cognizant of the importance of reputation and of the damage to credit caused by default. But cities were not only more inclined than rulers to pay their debts, they were also more able to do so. Not only were they wealthy, but they were also better able than rulers to tap their wealth. Independent cities in particular had much greater fiscal authority than territorial rulers: if they needed to impose a new tax to repay a loan, they could do so far more easily.

The cities of the north and the cities of the south developed different forms of long-term borrowing.[126] Essentially, each took advantage of existing instruments and markets, and these differed between the two areas.

In the north, a market had earlier developed for annuities—claims on a stream of rents from a designated property. This instrument was readily adapted to municipal use. From the late thirteenth century, cities began to issue annuities that were claims on a stream of revenues from a designated tax. Tax receivers paid the holders of outstanding annuities directly out of revenues before they passed on the remainder to the city government.

In the south, there already existed a well-developed market for shares in share ventures—a form of business organization for the joint ownership of a fixed asset such as a ship or a mine.[127] This market too was readily exploited for municipal use. It had

[124](Becker 1967) By 1400 the debt had risen to 3 million florins, and by 1450 to 8 million, equal in value to the total private wealth of its inhabitants.

[125](Fryde and Fryde 1971)

[126]For a more thorough discussion of long-term city debt, see (Kohn forthcoming) Ch 11.

[127]See (Kohn forthcoming) Ch 14.

already, since the twelfth century, been used to mobilize investment in tax farms. In the fourteenth century, it was tapped with a new type of municipal security—the *monte*. This was essentially a mutual fund into which a city consolidated all of its outstanding short-term debt. Florence, for example, introduced its *Monte Commune* in 1345.[128] The holders of the original debt received shares in the fund, and the fund was given direct control of a dedicated source of tax revenue to cover its obligations.

Both forms of long-term debt—annuities and *monte* shares—were securitizations of tax revenue. Also both forms of security were readily tradable, since they could take advantage of the organized markets that already existed for annuities and shares.[129] Their security and their liquidity made them attractive to investors.

Cities tapped other sources of borrowing too. There was some borrowing from commercial financial intermediaries—moneylenders, merchant banks, and deposit banks. For example, the Rialto banks in Venice were an important source of wartime liquidity.[130] Some cities in the Low Countries borrowed directly in the money markets of Bruges and Antwerp: not surprisingly, the city of Bruges itself was a frequent borrower.[131]

With better access to borrowing, cities had less need to rely on asset management. Cities did frequently farmed their indirect taxes. However, this was for administrative rather than liquidity reasons: the practice was well established long before the fourteenth century. Ghent, for example, farmed 80-90% of its taxes. It typically farmed a tax to a syndicate of brokers who specialized in the good on which the tax was levied, since it was easy for them to collect the tax as part of their normal work.[132]

In the fourteenth and fifteenth centuries, cities were obliged to increase taxes to service their increasing debt. This caused increasing resentment and in not a few cases rebellion—for example in Genoa in 1339 and Florence in 1378.[133] Resentment was exacerbated by the perceived injustice of an arrangement under which the poor paid ever

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128(Becker 1967)
129(Tracy 1985).
130 (Mueller 1997) Ch. 10
131(Fryde and Fryde 1971) p 540
132(Nicholas 1990). On brokers, see (Kohn forthcoming) Ch 17.
133(Mueller 1997) Ch. 11

higher indirect taxes to service interest payments on debt held by the rich.[134] By the fifteenth century, mounting popular pressure forced the Italian city states to introduce direct taxes and to develop mechanisms to assess the wealth on which such taxes could be based.[135]

GOVERNMENT FINANCE IN THE SECOND POLITICAL-ECONOMIC CYCLE

The round of wars that began in the late thirteenth century ended by the middle of the fifteenth. With peace came prosperity and renewed economic and demographic growth.[136] As a result, tax revenues increased enormously: revenue per capita doubled in the second half of the fifteenth century and total revenue more than doubled.[137] At the same time the developing financial system offered new sources of liquidity.

By the beginning of the sixteenth century, the greater availability of resources, improved liquidity, and the promise of new military technology created a temptation that rulers were unable to resist. A new round of wars of territorial expansion broke out. The principle protagonists were France, Hapsburg Spain, and the Ottoman Empire; important supporting roles were played by England, Venice, and the provinces of the northern Netherlands.[138]

Renewed fiscal pressure

Because of the greater resources available, the wars of the sixteenth century were on a far larger scale than those of the fourteenth. Expenditures rapidly escalated, and governments soon found themselves once again under intense fiscal pressure. The effect of this on the structure of taxation was much less than it had been in the previous round of wars. Basic systems of taxation remained largely unchanged. However, the relative importance of domain income continue to decline. In France, for example, it was still 10% of the total in 1523, but it fell to 4% by 1567.[139]

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[134](Lane 1979)

[135](Hocquet 1995); (Nicholas 1997)

[136](Parker 1995)

[137](Bean 1973) Real per capital revenues almost doubled in England, doubled in France, and increased ten- to twenty-fold in Spain.

[138]See (Kohn forthcoming) Ch 18.

[139](Gelabert 1995)

Rulers who had ignored their representative assemblies in the late fifteenth century when they were flush with cash, were now forced to go back to them, cap in hand, for new taxes or for increases in old ones. In Castile, for example, the Cortes had largely lost its importance once the *alcabala* had been made permanent in the fifteenth century. Now, however, the Cortes received a new lease on life as it was summoned to increase the rate of the *alcabala* and to approve a series of new 'extraordinary' subsidies.[140] Charles VII of France, despite the rising cost of his campaign in Italy from 1494, tried to avoid such a humiliation by every means possible.[141]

In the first half of the sixteenth century, the fiscal pressure was exacerbated by the erosion of revenues by inflation. Many taxes and domain revenues were defined in money terms. Their real value therefore fell as growing supplies of bullion steadily reduced the purchasing power of money. In Spain, for example, the *alcabala* had been converted, as we have seen, into fixed money payments from the cities (*encabezamiento*). As prices rose, the real value of these payments steadily declined.[142]

Attempts to raise taxes, however, met with growing resistance. For example, to compensate for the decline in the real value of the *alcabala* Philip II increased the size of the fixed money payments by 50% in 1562 and by a further 300% in 1574. But when he tried to increase the *alcabala* yet again in 1577, the cities balked and he was forced to back down.[143] Philip was cautious in his response to this refusal because of his earlier bitter experience with the Netherlands: his attempts to raise taxes there in the 1560s had prompted a general revolt which had embroiled him in an extremely costly war to re-establish control.[144]

The ability of rulers to raise taxes depended on the perceived legitimacy of their demands. One reason for the resistance to tax increases in the Netherlands was that people resented their taxes being used to finance Spanish wars in which they had no

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[140](Ertman 1997) Ch. 3

[141](Ertman 1997) Ch. 3; (Wolfe 1972) Conclusion. Charles raised the funds he needed by borrowing and by various forms of asset management. More on this below.

[142](Thompson 1976) Ch. 3

[143](Thompson 1976) Ch. 3

[144](Israel 1995) Ch. 7

direct interest—principally Philip's war with the Ottomans in the Mediterranean.[145] In contrast, Philip's Italian possessions were more ready to contribute because they had a direct stake in the outcome of the war.[146] Similarly, in the late sixteenth century, the French acquiesced to increasing levels of royal taxation because they expected the king to restore order by bringing to an end the religious civil war that was wracking the country. In contrast, the English, with the country largely at peace, were increasingly reluctant to grant their rulers additional taxes.[147]

Approaching the limits of their ability to increase tax revenue, rulers discovered or created new sources of non-tax revenue. Just when Philip II seemed to have come to the end of his tether he enjoyed a dramatic reversal of fortune: "At this moment, …the wealth of the Indies came to his rescue".[148] As a result of the introduction of new methods of extraction, shipments of silver from Peru increased dramatically towards the end of the sixteenth century. Philip's take from the 'royal fifth' amounted to some two to three million ducats a year—about the same as his total revenue from the *alcabala*.[149] American treasure was also a boon for Elizabeth of England. English privateers preyed on the Spanish treasure fleets and the crown's share of the booty was an important supplement to Elizabeth's limited tax revenues.[150]

For European rulers as whole, however, the single largest source of not-tax revenue was plundering the Church.[151] Undoubtedly, the religious reformers of the sixteenth century were driven by issues of theology and by discontent with the corruption of the Church. However, their success in actually breaking the Church's long-standing monopoly was largely a result of the support they obtained from rulers. For centuries rulers had seen it in their interest to help the Church enforce its monopoly by suppressing

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[145] In the first half of the sixteenth century, it had been Charles V's war with France which the people of the Netherlands had regarded as being none of their business ((Israel 1995) Ch. 7).

[146] (Downing 1992) Ch. 9

[147] "As the king needed money, and the nation needed the king, the French were willing to pay a heavy price for order and domestic tranquility, at the very time when English merchants and prominent English gentry, with their growing stakes in capitalistic industry, were coming to regard every tax levied by the crown as trenching on their personal liberties." ((Nef 1940) p82-3)

[148] (Elliott 2002) p 269

[149] (Elliott 2002) Ch. 7.

[150] (Armstrong 1958)

[151] (Cohn 1971)

its competitors (heretics).[152] The intense fiscal pressures of the sixteenth century—and the attraction of tapping Church wealth—did much to change their minds on the subject.

Protestant rulers simply expropriated Church property. The expropriation and sale of monastery lands saved England's Henry VIII from bankruptcy during his costly wars with France and Scotland. During the 1540s, Henry derived about £300,000 a year from the sale of monastic land and moveables—about the same as his domain income and his revenues from taxes.[153] Other rulers too—of Denmark and Sweden and of some German principalities—sided with the Protestants and took the opportunity to expropriate all Church property in their territories. In Sweden, the crown was able to increase its domain land from 5% of the total to 28% at the expense of the Church.[154]

Even the 'Catholic kings' of France and Castile were not above exploiting the situation to their own advantage. Both succeeded in obtaining considerable financial concessions from a weakened Church that had become dependent on them for protection. In both countries, the long-standing fiscal immunity of the Church came to an end. The rulers of France imposed frequent taxes on the Church, which managed to pay them only by selling off half its lands—"a transfer of property into lay hands comparable to that in England."[155] The rulers of Spain obtained the pope's assent to their appropriating about half the Church's income there.[156] In both countries, taxes on the Church and on the clergy had risen to equal about 15% of total crown revenues by the middle of the sixteenth century.[157]

The development of sovereign borrowing

Although the income of territorial rulers, from tax and non-tax sources, did increase during the sixteenth century, it did not keep up with the increase in their expenditure. In Castile, for example, expenditure exceeded income by 10% in the 1530s, 50% in the 1550s, and 70% in the 1580s. This was possible only because of an enormous increase in sovereign borrowing.

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[152] (Ekelund, Tollison et al. 1996)
[153](Nef 1940); (Sacks 1994)
[154](Cohn 1971)
[155](Cohn 1971) p17
[156](Elliott 2002) Ch. 7
[157](Gelabert 1995)

The increase in sovereign borrowing was itself possible only because of the preceding development of the financial system. The market for short-term commercial finance developed rapidly from the late fifteenth century.[158] Antwerp and Lyons replaced Venice and Bruges as centers of the continent-wide network of markets for exchange and short-term credit. At the same time, the principle instruments of short-term credit, the letter obligatory and the bill of exchange, were evolving into transferable securities. Merchant bankers, the intermediaries in the market for exchange and commercial finance, had recovered from their problems of the fourteenth century and were thriving. The traditional dominance of the Italian houses, mainly Florentine and Genoese, was being challenged by a new group of merchant bankers from South Germany. As we have seen, there had also been considerable development in the market for long-term municipal finance, where cities had adapted various existing instruments of debt to their own needs. Antwerp hosted an active market in municipal annuities in addition to its market in short-term commercial instruments.

In the sixteenth century, territorial rulers tapped these developing short-term and long-term markets to satisfy their growing need for liquidity. The two markets, however, played different roles in sovereign borrowing. The short-term market had much greater capacity, and it was largely to this market that rulers turned to raise large amounts of cash. The long-term market was less useful as a source of immediate liquidity, since it was hard to raise large sums there quickly.[159] However, while short-term debt could be rolled over for a while, it had eventually to be paid off. That was where the long-term market came in: it played an important role in providing the funds to pay off short-term debt.

Both short-term and long-term sovereign borrowing required security.[160] The debt of territorial rulers was still regarded as personal, with all the risks that this entailed. The long-term debt of rulers, like that of cities, relied therefore on the securitization of existing streams of revenue. Domain income, although a shrinking proportion of total

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[158]See (Kohn forthcoming) Chs 9 and 10.

[159](Tracy 2002) Ch. 5

[160]"The young Charles expected that a Holy Roman Emperor should be able to borrow on the strength of this personal bond. But bankers made it clear that his signature on a piece of paper was worthless, unless backed by guarantees they trusted." ((Tracy 2002) p94)

revenue, remained important because it was useful in securing long-term debt. The various general taxes that had become permanent in the fifteenth century served this function too, and the need for more collateral for new loans gave rulers a strong motive to seek additional permanent taxes.[161] The main reason the rulers of Spain allowed the *encabezamiento* of the *alcabala* to continue despite the erosion of its real value was that it made the revenue more predictable and so provided better security for loans.[162] Whenever they contemplated canceling *encabezamiento* and returning to direct collection of the sales tax, their Genoese bankers quickly vetoed the proposal.[163]

Short-term debt was often secured with aids and subsidies granted for a limited period. Another way to secure short-term debt was to structure it as a forward purchase of commodities about to be delivered. The Hapsburg rulers of Austria borrowed in this way against their regalian revenue from the silver mines of the Tyrol[164]; the rulers of Portugal borrowed against shipments of pepper from the Indies[165]; and the rulers of Spain borrowed against the *quinto real* on bullion shipments from the Americas.[166] There was a close connection, especially after 1530, between the size of bullion imports and the volume of Spain's short-term borrowing.[167]

For security, rulers also relied on third-party guarantees from individuals and bodies that possessed credit superior to their own—wealthy royal officials and merchants, merchant banks, merchant associations, cities, and representative assemblies. The Tudors, for example, relied on guarantees from the Corporation of the city of London, from London branches of Italian merchant banks (in turn indemnified by English merchants), and from merchant associations such as the Staplers and the Merchant Adventurers).[168] In some of the German principalities, the representative assembly or *Landtag* assumed direct responsibility for the ruler's debt.[169]

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[161](Ormrod 1995)

[162]The cities took over directly the payment of interest on the juros that had been secured by the alcabala. (Tracy 2002)

[163](Ruiz 2001)

[164](Ehrenberg 1928)

[165](Strieder 1931)

[166](Parker 1996)

[167](Drelichman 2003)

[168](Ashton 1960); (Outhwaite 1966)

[169](Tracy 1990) Ch. 2

Rulers began the sixteenth century by borrowing in the traditional fashion from individual merchant banking houses with which they had ongoing relationships. For example, the Hapsburgs, recently become the rulers of Spain, continued to rely on the Fuggers and Welsers who had been their financiers in Austria.[170] This was much like the borrowing by the rulers of Sicily and England in the fourteenth century from the Bardi and Peruzzi. In both cases, individual merchant bankers provided loans on favorable terms in exchange for commercial monopolies or other favors.

By the 1540s, rulers were coming to rely less on individual merchant bankers and more on the money market. Antwerp, in particular, developed into a general market for short-term loans to territorial rulers. These loans were organized in different ways. The Tudors, for example, requiring only relatively modest sums, relied on royal agents such as Sir Thomas Gresham to negotiate loans with consortia of individual lenders.[171] The Hapsburg Charles V, now the ruler of Spain, needing much larger sums, continued to depend on the Fuggers and Welsers. However, rather than lending directly themselves, these houses now acted as underwriters and guarantors, mediating the floatation of sovereign loans on the open market.[172] The rulers of France, excluded from Spanish-controlled Antwerp, turned instead to the money market of Lyons to meet their needs for liquidity.[173]

Territorial rulers also borrowed in the long-term market and had in fact already been borrowing there for some time. The rulers of Castile began selling annuities in the thirteenth century. These annuities—called *juros*—were secured by their domain incomes or later by permanent taxes such as the *alcabala*.[174] The Burgundian rulers of the Low Countries, early in the sixteenth century, developed a technique to convert the anticipated revenue from a new tax into ready cash. They did this by imposing new taxes on their subject cities and then having those cities sell annuities secured by the revenue from the

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170(Van der Wee 1977)

171(Richards 1929); (Hale 1985) Ch. 9

172The loan instrument was the letter obligatory, payable at the next fair or the one after that (3 months and 6 months maturity). For more on these instruments see (Kohn forthcoming) Ch 9.

173(Ertman 1997) After England's relations with Spain deteriorated later in the century, England too was excluded from Antwerp ((Van Houtte 1977)).

174(Mathers 1988)

taxes.[175] Francis I of France imitated the Burgundians, and from 1522 had the city government of Paris issue annuities—*rentes sur l'Hôtel de Ville de Paris*—in exchange for revenues that he assigned to them.[176] The Hapsburgs after they inherited the Low Countries and then Castile, exploited the methods of long-term borrowing used in each.[177]

Failures of sovereign borrowing

The developing financial markets provided a source of plentiful liquidity that rulers were unable to resist. Extensive borrowing funded an escalation of military expenditures as armies grew in size and campaigns proliferated.[178] The shift in the 1540s to direct borrowing in the money market made it even easier for rulers to raise large loans: "It was a terribly dangerous temptation for a State, which was perpetually short of money, to have this enormous and easy reservoir of capital at hand."[179] It is perhaps no coincidence that the 1550s saw a round of warfare between France and Spain of unprecedented intensity and cost.

However, continued borrowing meant a constantly growing level of debt. France, from the time of its invasion of northern Italy in 1494 ran a constant deficit, reaching 20% of ordinary revenue under Francis I (1515-47) and 25% under Henry II (1547-59). In Castile, the doubling of revenues between the 1530s and the 1550s fell far behind the tripling of expenditures over the same period.[180] Charles V's short-term debt in Antwerp was 10,000 florins at the time of his accession to the throne of Spain in 1516; by 1556 it had exploded to 7,000,000 florins.[181] Charles's long-term debt increased as well. In 1522, a third of the ordinary income of Castile was pledged to paying interest on outstanding *juros*; by 1560 debt service exceeded 100% of ordinary income.[182] To this we must add

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175 (Van der Wee 1993)

176 (Tracy 1985)

177 (Neal 1990); (Tracy 1985)

178 "The problem for the financing of the Spanish Monarchy was not to balance an annual budget, but to be able to borrow however much was needed for immediate needs by anticipating future income… Credit was, therefore, the first, not the last, response to the pull of expenditure." (Thompson 1994) p 158

179 (Hauser 1933)

180 (Thompson 1994)

181 (Van Houtte 1977)

182 (Tracy 2002) Ch 5; (Thompson 1994)

the long-term debt issued it Charles's name in the Low Countries and in Naples, secured by taxes in those two territories.

This rate of borrowing was not sustainable. When wars were short, it made sense to borrow to cover the temporarily high level of expenditure and to repay gradually over time after the war was over. However, rulers responded to the availability of credit by spending more and by continuing their wars longer. Their debts grew to a level that could not realistically be repaid and their credit collapsed. The rulers of Spain and of France were both forced to default—the former in 1557 and the latter in 1558.[183] With financing cut off, the war between the two came to a sudden halt.

As in the fourteenth century, the reliance on short-term debt exacerbated the problem. The term of most short-term loans was 'from fair to fair' (three months) or for a 'double fair'. When the loan came due, the whole amount—not just the interest—had to be repaid. If the proceeds from selling long-term debt proved insufficient, the only way to repay the debt coming due was to borrow more in the short-term market—that is, to roll it over. However, as the amount of outstanding short-term debt ballooned in the 1550s, lenders could see the writing on the wall. They became increasingly reluctant to lend, and demanded ever higher rates of interest to do so. In the case of Spain, rates rose from 28% in 1543 to 49% in 1556.[184] This, of course, had the effect of enlarging even further the amount of outstanding debt and making ultimate repayment even more unrealistic.

To get themselves out of trouble, rulers could not resort to their traditional expedient of expropriating the lenders. This had been possible when lenders were few and large and under the control of the ruler—as with the Jews in England, the Templars in France, and the Italian merchant bankers in both countries. However, in the case of the international money market the lenders were many and small and they were mostly located beyond the reach of the borrower (lenders in Antwerp generally chose not to lend to their home governments).[185] For similar reasons, rulers could not coerce an extension of the loans as they were often able to do with domestic lenders.

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[183]Portugal defaulted in 1560. (Cohn 1971)
[184](Thompson 1995)
[185](Outhwaite 1966)

The nature of the two defaults differed significantly. Henry II of France initially consolidated his debt into a kind of *monte* (called the *Grand Parti*), but he was soon unable to make the promised payments. So it remained for forty years. French credit never really recovered, and foreign lending was cut off more or less permanently.[186]Cut off from the international money market, the rulers of France borrowed what they could elsewhere. They raised loans from individual merchants, both Italian and French, securing the loans with tax farms.[187] They, like other rulers, relied increasingly on military enterprisers for short-term financing of their armies.[188] They continued to sell long-term debt domestically, but they now had to force people (mainly officials) to buy it. But by the 1570s payments of interest became irregular and in 1586 they stopped altogether.[189]

In contrast, Philip II of Spain renegotiated his debt, persuading his creditors to accept a conversion of their short-term paper into long-term debt at much lower rates of interest.[190] The loss to the lenders was substantial but not enough to prevent Spain from being able to continue borrowing—and to default again repeatedly—for another hundred years. Spanish debt resumed its rapid growth. Philip II inherited a debt of about 30 million ducats in 1556; by 1575 it had risen to 60 million; by 1607 it was reputed to be 160 million.[191]

Spanish short-term borrowing after the default, however, took on a different structure. The Antwerp money market, and the South German merchant bankers who had mediated Spanish borrowing there, never recovered fully from the default and they ceased to play a significant role in sovereign lending (the same was true of the Florentine bankers who had lent to France at Lyons).[192] The Germans were replaced as principal lenders to Spain by Genoese merchant bankers who developed what came to be known as the *asiento* (contract) system.

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[186]"It would not be an exaggeration to claim that the reputation of the French monarchy among both foreign and small domestic investors never really recovered from this episode." (Ertman 1997) p98

[187](Ertman 1997) Ch 3

[188]See (Kohn forthcoming) Ch 19 on military enterprisers.

[189](Tracy 1985)

[190](Van der Wee 1977)

[191](Thompson 1976) Ch. 3

[192](Van der Wee 1993)

The Genoese *asientistas* advanced funds to the Spanish crown in Antwerp—in gold—to pay the Spanish army of the Low Countries. These advances were repaid in Spain, partly out of the sale of new *juros* but largely from the *quinto real* on the American bullion fleets. The enormous increase in silver shipments in the late sixteenth century was a key factor in the development of this system. The Genoese financed their lending to Spain in the new 'Bisanzone' money market that replaced Antwerp and Lyons as the center of the exchange network (this market met first at Besançon and later at Piacenza).[193] The rulers of Spain depended on the *asiento* system not only for credit but also for transferring to the Low Countries the huge sums of money they needed to pay their armies there. This dependence gave the lenders additional assurance of repayment, because the strategic cost of an inability to transfer funds was substantial. For example, when renegotiation of the debt broke down after the default of 1575, mercenaries in the Low Countries received no pay for over a year. By November of 1576 they had run out of patience, and they expressed their displeasure by sacking the city of Antwerp—a huge propaganda victory for the rebels.[194]

Asset management once again

As rulers found it more and more difficult to borrow in the second half of the sixteenth century, they had to turn increasingly to various forms of asset management—sales of future revenues, expropriation, and debasement. These were the same expedients, with a few variations, that they had employed when their credit ran out during the wars of the fourteenth century. The rulers of France were the first to resort extensively to these expedients, but others soon followed.[195] Elizabeth of England as her relations with Spain deteriorated, lost access to the continental money market and was forced to find domestic sources of liquidity.[196] Even the rulers of Spain, while they

[193]See (Kohn forthcoming) Ch 9.

[194](Conklin 1998)

[195]Charles VII, after his success in obtaining considerable fiscal independence by having general taxes recognized as permanent, was loathe to give it up. So despite acute fiscal pressure after his invasion of Italy in 1494, he preferred to rely on borrowing and on various forms of asset management rather than going back to the representative assemblies to ask for more taxes. ((Ertman 1997); (Wolfe 1972) Conclusion)

[196](Outhwaite 1966)

continued to borrow, had to supplement their borrowing with various forms of asset management.[197]

Rulers continued to sell domain lands. In France, although royal land was in principle ‘inalienable’, so much of it had been sold in moments of crisis that by 1560 domain income had become negligible.[198] For the Hapsburg rulers of Spain, the sale of lands—in Milan and Naples as well as in Spain—was in the early sixteenth century a source of liquidity as important as American treasure.[199] Rulers found ways to increase the amount of land they had available for sale. One, as we shall see, was expropriation. Philip II of Spain found another. Much of the marginal land that had been captured during the *reconquista* of Castile had remained the property of the crown (the *baldíos*), but the public and the cities had been allowed to use this land without charge. However, in the late 1550s Philip, desperate for liquidity, reasserted his property rights and demanded that the users of the *baldíos* purchase it from the crown.[200]

In sixteenth-century France, tax farming underwent important changes.[201] Until then, farms had generally been small, the better to promote competition among prospective farmers to determine a fair market value for the farm. However, the need to raise larger sums more quickly led the government to consolidate small tax farms into larger units. These included *grosses fermes*, which consisted of groups of small farms, and *fermes générales*, which were multi-provincial or nationwide farms. These large farms were often sold to syndicates who in turn subcontracted pieces of the farm to *branchiers des fermes* or subfarmers. Although these larger farms raised larger amounts, there was presumably less competition and so a greater cost to the crown for the funds so raised. In Spain, the cities continued to act as quasi-farmers, paying lump-sum *encabezamiento* in lieu of various taxes. When a major new tax, the *milliones*, was instituted in the 1590s, this too was farmed to the cities.[202]

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[197](Thompson 1995); (Ertman 1997) Ch 3
[198](Cohn 1971)
[199](Cohn 1971)
[200](Vassberg 1984) Ch. 1, 6
[201](Wolfe 1972)
[202]Charles V’s replacement of *encabezamiento* with tax-farming in 1519 was one of the principal causes of the *comunero* revolt of the cities of Castile. Charles agreed to restore the system and to extend it to other taxes. ((Ertman 1997) Ch. 3)

In a variation on the tax farm, the rulers of Spain sold off parts of their domain as *señoríos*. These were not sales of land in the usual sense but rather sales of seigniorial jurisdiction over territories that included whole villages and towns. The purchaser obtained the right to administer justice and collect fines and to receive the revenue from the *alcabala* and other taxes collected there. A similar device was the sale of charters to small towns and even villages.[203] These were often oppressed by the larger cities within whose jurisdictions they fell. Purchasing a charter gave them rights of self-government and justice and freed them from this oppression. The cities that lost jurisdiction in this way over the small towns and villages were of course upset. Their own charters—purchased earlier in good faith—were thereby devalued. But no problem, the cities were offered the option of paying the crown for a promise *not* to grant charters to their subject towns and villages. These promises were often subsequently broken.

The sale of offices expanded enormously, especially in France.[204] Francis I set up a new agency, the *bureau des parties casuelles*, dedicated solely to the sale of offices. Not only were existing positions sold to the highest bidder, but huge numbers of new positions were created purely for the purpose of sale. Henry II set up an entire new system of courts, the *présidiaux*, just to create more positions that he could sell. In all, some 50,000 new offices were created for sale in France in the second half of the sixteenth century. In Castile, Charles V sold some 6,000-8,000 city councillorships in the 1540s and 1550s.[205] He also sold offices too in Naples and in the American colonies. In 1558, in the midst of an acute liquidity crisis, Philip II sent Ruy Gomez to Spain to sell and mortgage anything he could. Gomez greatly expanded the sale of offices. In both France and Spain, the desire to create and to sell more offices motivate additional regulation. This not only gave the new officials something to do but also increased the potential for bribes and so raised the selling price.[206]

There were also refinements in the terms of the sale of office. Purchased offices became tradable: the incumbent could sell the office to a third party: a fee was, of course,

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[203](Vassberg 1984) Ch. 6

[204]The following is based on (Ertman 1997) Ch 3; (Swart 1949) Ch. 1; and (Wolfe 1972)

[205](Thompson 1998); (Cohn 1971)

[206]See (Kohn forthcoming) Ch 23 for more on this.

required—typically 10-25% of the original price.[207] The purchaser of an office could also buy from the crown a *survivance*, a kind of insurance policy that protected him against the risk that he would die prematurely and not receive the full return on his investment. In 1604 offices were made heritable in exchange for the payment of an annual tax (*la Paulette*); this raised their value considerably.[208] Offices could be mortgaged or sold at auction and were a common item in marriage settlements and wills. To make offices more affordable, two, three or even four purchasers were allowed to buy an office together and to share its benefits (*offices alternatifs, triennaux, quatriennaux*). Purchasers of an office were allowed to hire a replacement—at a much lower salary—to stand in for them, so avoiding the unpleasant necessity of actually showing up for work. Even easier, they could purchase offices that involved no duties at all (*offices imaginaires*). To make offices more attractive, holders of the more important ones were granted titles of nobility. Nobility provided not only status but also exemption from taxes.

With the greatly expanded number of officials, the 'fiscal sponge' became an ever more important source of short-term liquidity. Not only were officials expected to advance anticipated taxes but they were also forced to suffer long delays in the payment of their salaries.

The sale of monopolies also expanded in the sixteenth century. Previously, monopolization had largely been used to enhance the revenue from tax farms. However, in the late fifteenth century rulers realized that they could create and sell monopolies, just as it they could create and sell offices. Like the sale of offices, the sale of monopolies had the added advantage of being a regalian prerogative and therefore not subject to the approval of representative assemblies. Rulers created both industrial monopolies and commercial monopolies. The sale of mining monopolies was particularly popular; so too was the sale of trading monopolies to specific foreign destinations. In this, too, the French led the way, but the rulers of England and Spain did not lag far behind.[209]

As is in the fourteenth century, expropriation was an important source of revenue and liquidity. To some extent, the French and Spanish defaults can be thought of as a form

[207] If he did so within forty days of his death, however, the office reverted.

[208] A judgeship in the parlement of Paris rose in value from 18,000 livres in 1650 to 140,000 livres in 1660—by much more than inflation. ((Swart 1949))

[209] See (Kohn forthcoming) Ch 22 for more details.

expropriation. Additional forms included privateering and the expropriation of Church property. These were, as we have seen, important sources of revenue, but they were probably even more important as a source of much needed cash. The privateering was largely directed at the Spanish treasure fleets from the Americas, and the proceeds came in the convenient form of bullion. Indeed, the rulers of Spain themselves could sometimes not resist the temptation of expropriating their own treasure fleets. When hard pressed for cash, they would expropriate the entire cargo of bullion, giving the owners *juros* in exchange.[210] While the income from expropriated Church land provided additional revenue, the land itself could also be sold off for immediate liquidity. By the end of the sixteenth century, the English crown had sold off almost all of the land it had seized from the monasteries.

In contrast with the fourteenth century, there was relatively little resort to the economically most destructive form of asset management—debasement. This was certainly not for lack of fiscal pressure: the rulers of the sixteenth century were no less desperate than those of the fourteenth. However, debasement was politically more difficult. In the intervening years, representative assemblies had developed and their cooperation was essential in raising new taxes and in securing foreign loans: the maintenance of a sound coinage was an important condition for such cooperation.[211] Perhaps even more important, levels of taxation were much higher and future tax revenues were being pledged to secure borrowing. Inflation would have had a devastating impact on the real value of tax revenues, and it would therefore have made it impossible for rulers to borrow.[212] In these circumstances, rulers themselves stood to lose more from debasement than they would gain.

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[210](Muto 1995). By the 1540s, the *quinto real* averaged some 280,000 ducats a year out of total Hapsburg revenue from Castile alone of over 2.5 million (plus much more from Milan, Naples, and the Low Countries) ((Tracy 2002) p 102). So silver was a relatively minor source of revenue until late in the sixteenth century when shipments increased dramatically. However, American treasure was always very important in terms of liquidity, playing a major role in securing and paying off short-term debt. As part of the deal, the lenders received licenses to export silver from Spain.

[211]Intellectual opinion reflected the strong aversion to manipulation of the coinage. For example, Bernardo Davanzati, a Florentine writer on money and exchange, argued that seigniorage should be abolished altogether and that the mint should be operated for the good of the public rather than as a source of revenue for the territorial ruler. ((de Roover 1949) p 77)

[212]The more gradual inflation that was caused by the increasing supply of bullion did erode tax revenues to some extent ((Ames and Rapp 1977)).

There was, in fact, only one major debasement in the sixteenth century—the 'Great Debasement' of Henry VIII of England in the 1540s and 1550s.[213] No historian has offered an explanation for this exception other than Henry's desperation for cash. Ordinary tax revenues were certainly eroded by the resulting inflation, forcing Henry's successor Elizabeth to rely much more on 'extraordinary' revenues voted by Parliament.[214] Henry himself replaced the traditional 'tenth and fifteenth'— the money amount of which had been fixed in the fourteenth century—with a new property tax based on a current assessment, presumably to adjust for the inflation.[215] However, the new tax worked poorly and generated a great deal of resentment. Perhaps, the debasement was simply a mistake: Henry was nothing if not impulsive.

A 'FISCAL REVOLUTION' IN THE NETHERLANDS

The most important fiscal consequence of the wars of the sixteenth century was the revolt of the provinces of the Low Countries against the rule of the Hapsburgs. The revolt eventually resulted in the emergence of a new type of government in Europe—the associational state. This was associational government not at the level of the city, but at the level of the territory as a whole. The problem with extending associational government to the level of the territory—as the Italian city states had amply demonstrated—had been that it did not scale up well. It tended to degenerate into predatory government. The Dutch found a solution to the problem of scale by setting up their new republic not as a single association, but as an association of associations.[216] This new form of government had enormous implications for government finance, because it made it possible to implement municipal methods of finance at the level of the state. It is no exaggeration to call this a fiscal and financial revolution.[217]

[213]Between 1544 and 1551 debasement yielded the English crown £1,270,000, compared to £972,000 from taxes and £1,050,000 from rents and sale of lands. There were also substantial debasements in France and Sweden. ((Cohn 1971))

[214](Palliser 1983) p 109

[215](Schofield 2004) Ch. 1

[216]See (Kohn forthcoming) Chs 18 and 21.

[217]It was (Tracy 1985) who first described this as a financial revolution. (Fritschy 2003) argues that, at least in its early stages, it is more accurate to describe it as a fiscal revolution.

The fiscal causes of the revolt

The revolt against the Hapsburgs was to a significant extent a tax revolt.[218] Over the centuries, the seventeen provinces of the Low Countries had been pieced together into a single political unit through the efforts first of the Burgundians and then, from 1482, of their Hapsburg successors. However, throughout this process the individual provinces had retained much of their independence and had repeatedly resisted any attempt at political centralization. They had similarly resisted all attempts at imposing a uniform system of taxation to replace the existing chaotic fiscal structure that differed widely from province to province.[219]

During the sixteenth century, with their territorial rulers under increasing fiscal pressure, the level of taxes in the Low Countries had risen sharply—increasing fourfold between the 1520s and the 1540s and doubling again by the 1550s.[220] From 1515, the Hapsburgs had relied on the major cities and on the States (the provincial representative assemblies) to sell annuities on their behalf. These annuities were paid out of new taxes created for the purpose. In 1542, Charles V modified this practice in an important way. He allowed the States themselves to impose and to collect the necessary taxes, with no specific need for his authorization.[221] These new taxes (the *niewe middelen* or 'new means') were province-wide rather than municipal or local. They included both direct taxes—on merchant assets and on the income from land and annuities—and indirect taxes—including taxes on beer and wine.[222]

Despite the new taxes, revenue from the Low Countries continued to lag behind revenue from other Hapsburg possessions—particularly frustrating given the relative wealth of the territory. In the 1540s, revenue from the Low Countries amounted to about 0.8 million ducats a year while that from Naples (about the same population but not as

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[218]There was, of course, also a religious dimension. The Low Countries were a center of Protestantism. Philip II saw himself as leading a campaign to save the Catholic Church from the evils of the Reformation. Conflict was inevitable.

[219](Blockmans 1999)

[220](Tracy 1990) Ch. 5. Close to 90% of revenue came from the three wealthiest and most urbanized provinces—Flanders, Brabant, and Holland ((Blockmans 1999))

[221](Tracy 1990) Ch. 5; (Israel 1995) Ch. 7

[222](Neal 1990)

wealthy) was 1.7 million and that from Castile (over double the population but significantly less wealthy) was 2.5 million.

In 1567, to remedy this deplorable situation, Philip II appointed a new governor for the Low Countries, the Duke of Alva.[223] Alva proposed a new uniform system of taxes in 1569.[224] This was to consist of a one-time levy of 1% on all property, a permanent 5% tax on real estate transfers, and a permanent general sales tax (like the *alcabala*) of 10%.[225] The last of these was expected to be the most lucrative—yielding a huge 13 million a year. The provinces were horrified. They were wiling to accept the property tax, but they strongly opposed the other two. They especially opposed the sales tax, which they believed would have a disastrous effect on commerce. The provinces offered to buy off the sales tax, in the manner of the *encabezamiento*, with a fixed annual payment of 0.6 million. Not surprisingly, Philip was bitterly disappointed.

In 1571, Alva took advantage of the ongoing religious unrest to assume dictatorial powers. He then forced the proposed taxes through the provincial States and appointed Spanish officials to collect them.[226] The provinces responded by rising up in revolt and a lengthy war ensued.[227] The Hapsburgs regained control of the southern provinces with the fall of Antwerp to the Spanish army in 1585. However, the seven northern provinces fought on, and they finally won formal independence in the Treaty of Westphalia of 1648.

Initial fiscal problems

Not surprisingly, in the early years of the revolt the rebels experienced severe fiscal difficulties. Faced with enormous military expenditures, the cities and provinces of the

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[223] Alva's mission included not only raising tax revenues but also suppressing heresy. He proceeded to do so in the most brutal manner, immediately seizing a number of leading noblemen suspected of heresy and having them executed.

[224] (Hart 1997)

[225] The territorial rulers had, since 1506 repeatedly tried, and failed, to impose taxes on the flourishing trade in grain that was centered in Amsterdam and that was central to its prosperity ((Blockmans 1999)). See (Kohn forthcoming) Ch 2 on the grain trade.

[226] (Downing 1992) Ch 9

[227] The revolt had been simmering since 1567, when William of Orange fled the country in advance of Alva's arrival and raised an army to expel the Spaniards. This early challenge, however, quickly fizzled. The rebels then launched a privateering campaign, based in English ports, against Spanish commerce. This culminated in a coastal raid in 1572 that succeeded in capturing the town of Brill. This success ignited the rising anger over the new taxes and set off a general uprising against the Hapsburgs. (Israel 1995)

Low Countries had to scramble to improvise a system of taxation and to find adequate sources of liquidity.

With regard to taxes, the rebels simply continued to operate the existing tax system that had been set up for the benefit of the Hapsburgs. However, they now kept the proceeds for themselves.[228] In the first two years of the revolt, the rebels relied mainly on taxes collected by the cities. However, the 'new means' of 1542 had provided them with a fiscal structure under the control of the provinces that they could readily adapt to their own needs, and in 1574 the provinces greatly expanded the taxes collected under this system. Rather than being used to service Hapsburg debt, the proceeds now went to financing the war against the Hapsburgs.

Liquidity was even more serious a problem than revenue. The credit of the cities and provinces had evaporated with the outbreak of the revolt, as lenders doubted its chances of success.[229] This loss of confidence was only exacerbated by delays in the payment of interest on outstanding debt. The province of Holland, for example, suspended interest payments completely until 1575, and even then it instructed its tax receivers to pay interest only 'if possible'.[230] Interest rates on outstanding debt, which had been 8% (1/12) or less before the revolt, jumped to 20% and no new long-term debt was issued.

In the absence of voluntary lending, there was some forced lending imposed by the cities. To bridge the gap between expenditures and revenues, cities pressured their wealthier burghers, as well as villages under their jurisdiction and charitable foundations, to provide short-term loans.[231] Military enterprisers were perhaps the most important source of credit—in one case advancing 500,000 florins in pay the troops against a personal note from William of Orange backed by guarantees from the States of Holland.[232]

Voluntary contributions from William of Orange and from other nobles were another important source of liquidity, especially at the beginning of the revolt. Foreign subsidies helped too: Elizabeth of England contributed some 300,000 florins in 1572 and another

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[228](de Vries and van der Woude 1997) Ch. 2, (Fritschy 2003)
[229](de Vries and van der Woude 1997) Ch. 2
[230](Fritschy 2003)
[231](Fritschy 2003);(de Vries and van der Woude 1997) Ch. 2
[232](Fritschy 2003). For more on military enterprisers, see (Kohn forthcoming) Ch 19.

million in 1578 and 1579; France contributed as well.[233] The rebels raised some cash too from the sale of assets expropriated from the Church and from nobles who had sided with Spain.

Despite the difficulty of finding adequate sources of liquidity, there was little resort to the more damaging forms of asset management that were a common feature of government finance in France and Spain. Most taxes were farmed, but farming was highly competitive and commercial. There was no sale of offices. The right to mint had devolved, as a result of the revolt, on the individual provinces.[234] However, the dominance of commercial interests was a brake on the use of this right to manipulate the currency.[235] Debasement yielded Holland some 250,000 florins in 1573 and one million in the late 1570s, but it was not repeated after that.[236]

Rather than resorting to harmful forms of asset management, the rebels chose instead to finance a large part of the cost of the war out of current taxes. Doing this required a very sharp increase in the tax burden. In Holland revenues from provincial taxes rose ten-fold between the 1550s and the 1580s: the per capita tax burden rose from one florin to seven.[237] The heaviness of the tax burden was ironic given the role of Philip's attempt to raise taxes in igniting the revolt in the first place. This drastic increase in taxes was possible— without resistance and without serious damage to the economy—for two reasons. First, there was strong popular support for the rebellion. Because of its religious element, it was seen as a fight for survival. As a result the high and rising level of taxes was regarded as legitimate. Second, taxation was under local control, so that there was sufficient sensitivity to the economic and distributional impact of taxes to ensure that revenue would be collected in the least harmful way.

The evolution of a new system of taxation and borrowing

A more orderly system of taxation began to emerge after 1579, when the northern provinces joined together in the Union of Utrecht, and even more so after the loss of the

[233](Fritschy 2003);(de Vries and van der Woude 1997) Ch. 2

[234](Hart 1997) One of the task of the Bank of Amsterdam, when it was established in 1609, was to fix the rates of exchange among the coinages of the different provinces.

[235](Hart 1993)

[236](Fritschy 2003); (Hart 1997)

[237](de Vries and van der Woude 1997) Ch. 2.

southern provinces in 1585. Although the Union document envisioned a uniform and centralized system of taxation, the traditional resistance of the provinces to this idea proved insuperable. Instead, the Dutch continued to rely on a system of provincial taxation.[238]

The States-General, the joint representative assembly of the provinces, decided on the total level of expenditure, which was almost all military. This total they then apportioned among the provinces according to a system of quotas. Holland, by far the richest and most populous province had a quota of 58%; Drenthe, at the other extreme, had a quota of 1%. Not surprisingly, there was considerable and continuing contention over the size of the quotas.[239]

Each province was free to raise its quota however it pleased. The different provinces relied on various combinations of direct and indirect taxes: generally the more urban provinces favored indirect taxes, while the more rural ones favored direct taxes on land. Holland, for example, raised 58% of its total revenue of four million florins in 1599 from a variety of excise taxes and 15% from stamp duties; it raised only 27% from direct taxes.[240]

Indirect taxes fell mostly on necessities, including beer, the milling of grain, salt, and cloth. [241] The system was very flexible and goods were added or dropped from the list of those taxed as need dictated. The regressivity of the system was mitigated in several ways. Higher rates were set for more up-market products: ordinary beer, for example, was taxed at 20%, while premium beer was taxed at 100%. In some cases there was also

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[238](de Vries and van der Woude 1997) Ch. 2; (Israel 1995) Ch. 13; (Hart 1993) Ch. 3. The Generality, the central government, did later have some direct income of its own—from territory captured from Spain, from the sale of monopolies, and from inheriting some regalian rights (coinage, tolls, etc.). However, this made up a relatively small proportion of total taxation, never exceeding 20%. In addition, the admiralties (the authorities that managed the fleets) independently collected customs duties and sold licenses to trade with the enemy, which they spent directly on financing the navy.

[239]The quotas were originally based on the quotas used by the pre-revolt Hapsburg government. As economic development progressed at different rates in the different provinces, the quotas became increasingly inequitable. However, it proved politically very difficult to change them: in some cases English and French mediators had to be called in. If provinces failed to pay their quota, the central government could, in principle, force payment by billeting troops of by taking provincial representatives hostage. This was rarely done in practice. ((Hart 1993) Ch. 3)

[240](Hart 1997) Ch. 3

[241](de Vries and van der Woude 1997) Ch. 2; (Hart 1993) Ch. 5. Excises were generally unit taxes of a fixed amount per unit of commodity rather than *ad valorem* taxes, and they were collected from the seller rather than the buyer. This made collection and farming considerably easier.

an ‘alternative minimum tax’ on the wealthy, according to which they paid a fixed sum and could then purchase up to a certain amount of the good without further payment of tax. Moreover, the poor, students, and hospitals were exempt.

Indirect taxes were usually farmed.[242] Farms were small and contracts short—typically six months. Farms were sold at auction by the different provinces and cities, and auctions were held simultaneously to discourage purchase of multiple farms. As a result, potential farmers of even modest means were able to compete and the process was highly competitive and transparent—in sharp contrast with the French system.

Direct taxes were adapted from the *verponding*, a tax on real property that had been used to collect revenue for the subsidies paid to the Hapsburgs.[243] The typical rate was 20% on the rental value of land and 12.5% on that of residences. Direct taxes were generally collected by provincial and local officials. Totals were set at the provincial level and allocated to local tax districts according to quota. Local magistrates periodically assessed the value of land and of moveable property, and their assessments could be appealed.

Since the overall system of taxation worked remarkably well, there was little reason to change it. Tax revenues continued to rise—from 3 million florins in 1586 to over 20 million a year in the 1620s.[244] This was partly due to population growth—population doubled between 1544 and 1648—but there was also a steady increase in taxation per capita. Provincial taxes took about 5% of the income of an urban day laborer in 1575, 9% in 1600 and 12-15% after 1610.[245] Indeed, by the end of the seventeenth century, Gregory King, a contemporary English economist, estimated that the per capita tax burden in the Netherlands was almost three times that in England or France.[246] Once again, the increasing tax burden was made possible by the devolution of responsibility to local institutions. These had greater legitimacy, and they could tailor taxes to local conditions

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[242](de Vries and van der Woude 1997); (Hart 1997)

[243](Hart 1997); (Hart 1993) Chs. 3 and 5

[244](Fritschy 2003)

[245]In addition to provincial taxes, there were also city taxes (mainly excise taxes, mostly on wine and beer); taxes imposed by drainage boards (property taxes on cultivated land) for the maintenance of dikes, windmills, and sluices; and numerous tolls on roads and canals and in harbors (many of these went directly to the central government). ((Hart 1993) Ch. 3; (de Vries and van der Woude 1997) Ch. 2).

[246]£3 1s 7d per capita in the Netherlands, versus £1 4s 0d in England, £1 5s Od in France ((Hart 1997) p12)

to minimize their adverse impact. This is not to say, of course, that the local elites who controlled the process were above biasing things in their own favor. However, immediate feedback from the general population constrained their ability to do this.

During the 1580s, as the provinces caught up on their arrears of interest, their credit improved steadily.[247] Rates on outstanding annuities fell gradually towards pre-revolt levels. Borrowing consequently increased, but it remained modest. The public debt of Holland—some 1.4 million florins in 1574—had risen to only 5 million by 1600.[248] Borrowing was mainly in the form of *obligatie*—promissory notes issued by tax receivers of provinces and cities on their own credit (for a commission). This was typically six-month paper, but it was commonly rolled over more or less indefinitely.[249]

With voluntary lending still limited, other sources of liquidity remained important. Forced lending was institutionalized after 1585 in the form of occasional capital levies or *impositie* according to assessed wealth that were imposed as the need arose.[250] Foreign assistance was even more important than in the first years of the revolt. Elizabeth provided some 15 million florins in loans from 1585 to 1603. Vlissingen and two other port cities were handed over the to the English as security.[251] Henry IV of France sent some 10 million in subsidies between 1598 and 1610.

From about 1600, borrowing began to grow more rapidly: by 1609 there was about 28 million of debt outstanding, most of it *obligatie*. The principal international money market had moved to Amsterdam with the fall of Antwerp. This provided a deep market for negotiable short-term paper that readily accommodated the *obligatie*. The *obligatie* were payable to bearer and so easily transferred.[252]

With improving credit, long-term rates continued to fall: they were down to 6% by the beginning of the seventeenth century and later fell to 3%.[253] As a result, the issuance of long-term debt slowly resumed in the 1590s and then grew rapidly after 1620. This

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[247](Fritschy 2003)

[248](de Vries and van der Woude 1997) Ch. 2

[249](Hart 1993) Ch. 6

[250](Hart 1993) Ch. 6; (de Vries and van der Woude 1997) Ch. 2

[251](Fritschy 2003) Elizabeth also provided direct military assistance on land and, especially, at sea ((Downing 1992) Ch 9; (Israel 1995) Ch. 10).

[252](de Vries and van der Woude 1997) Ch. 2

[253](Hart 1997)

long-term debt was in the form of annuities—*losrenten* and *lijfrenten*—approved by the States, secured by dedicated tax revenues, and sold by the tax receivers who were then responsible for their payment. By 1648 Holland alone had some 150 million outstanding.[254] Once, again, it was the fiscal demands of the Burgundian and Hapsburg territorial rulers, especially the 'new means' of 1542, that had laid the groundwork for this development. Once the Dutch Republic had restored its credit it was able to exploit the market for long-term public debt that the Hapsburgs had established.

The issuance of long-term debt by the Dutch Republic represented a fundamental change in the use of long-term debt in public finance. Rather than merely providing a way to pay off short-term debt, the long-term market became itself the primary source of liquidity. While previously it had been possible to raise large sums quickly only in the short-term market, it was now possible to do so in the long-term market. On one famous occasion, for example, an entire one million florin issue of 3% annuities was snapped up in only two days.[255]

This shift to the long-term market was of enormous importance. Because the debt was long-term, debt service was limited to the payment of interest. There was no need to pay off the principal, which became *de facto* a perpetual debt. Indeed, the citizens of the Dutch Republic would have been quite upset to be deprived of such an attractive financial asset. Indeed, so popular was Dutch government debt, that the cost of its borrowing actually declined over time despite the growing amount of outstanding debt. Because the debt was essentially perpetual, there were no financial crises of the sort that continued to beset the Hapsburgs.

Once the Dutch Republic was able to tap the market for long-term debt in this way, its access to liquidity was unrivalled. This meant that the Dutch government could accommodate sudden spikes in war expenditure with relative ease—raising the necessary cash through borrowing and increasing taxes later to service the relatively modest cost of the debt.

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[254](Hart 1993) Ch. 6
[255](Parker 1995)

CONCLUSION

By the end of the sixteenth century, two very different systems of government finance were emerging in Europe associated with two very different forms of government. Both systems of government finance had their origins in the escalating military costs of the sixteenth century and in the opportunities offered by a developing financial system. The two systems of finance, however, represented very different responses to these pressures and opportunities.

In France and Spain, the unsustainable borrowing of their rulers led to default and to the ruin of their credit. With access to financial markets denied or restricted, they had to satisfy their need for liquidity in other ways—tax farming, the sale of offices, the sale of monopolies, expropriation. These alternative sources of liquidity were highly destructive of their economies. In the Netherlands, in contrast, the government slowly reestablished its credit. It met its needs for liquidity in the meantime by sharply increasing taxes and through a combination of voluntary contributions, forced loans, and foreign subsidies. It thereby avoided having to resort to the expedients that were so destructive of the French and Spanish economies.

Clearly, the difference in the systems of government finance was rooted in differences in the forms of government. France and Spain were governed by predatory rulers. In both countries, under the fiscal and financial pressures of the sixteenth century, the regime was moving away from 'medieval constitutional government' and towards a more autocratic model might be called 'the imperial state'. The government of the Dutch Republic was, in contrast, associational. It was a new form of associational government—an association of associations.[256]

The system of government finance of the Dutch Republic was essentially municipal finance applied at the level of the state. Like cities—and unlike predatory territorial rulers—the Dutch Republic was able to impose taxes relatively easily. This was partly because its citizens believed that the expenditures that were being funded were to their

[256] England in the early sixteenth century, under Henry VIII, seemed to be going the way of France. However, under Elizabeth's more cautious foreign policy, England was under much less fiscal pressure and associational tendencies reasserted themselves. Which model England would ultimately follow—that of France and Spain or that of the Dutch Republic—would be settled only in the seventeenth century

See (Kohn forthcoming) Chs 18 and 21 on the evolution of these different forms of government.

benefit rather than to the benefit of a predatory ruler and his dynastic ambitions. And it was partly because a process of consultation and negotiation ensured that the burden was equitable and that taxes were designed to minimize economic damage.

Again like cities—and unlike predatory territorial rulers—the Dutch Republic came to enjoy excellent credit and more or less unlimited access to borrowing. It did so, because lenders understood that—as an associational government—it had both a greater capacity to pay its debts and a greater commitment to doing so.

One reason associational governments had a greater capacity to pay was that they went to war for more limited and calculated goals. Their wars were either wars of self-defense or wars to gain economic advantage. In either case, the war was likely to end with the borrower retaining the capacity—perhaps an enhanced capacity—to pay its debts. In contrast, predatory rulers went to war for ‘glory’: they rarely stopped before they had totally exhausted their resources, thereby destroying any ability to repay their loans. A second reason why associational government had a greater capacity to repay their loans was that they found it much easier, as we have already noted, to increase taxes whenever necessary.

Associational governments had a greater commitment to pay their debts, because they were led by merchants rather than by warriors. Merchants valued the rule of law, respected property rights, and understood the importance of credit. They therefore had a strong commitment to paying their debts. This commitment was frequently reinforced by self interest: the governing mercantile elite was usually a major holder of the debt in question. Predatory rulers, on the other hand belonged to a warrior nobility with very different values. They might grudgingly, for lack of choice, submit to the rule of law, but given half a chance they were always more than ready to trample on property rights. They disdained the mercantile values and virtues and saw no shame in default.

The difference in the systems of government finance did much to explain the relative military success of the two types of government.[257] In the case of France and Spain, their constant shortage of funds eroded military preparedness and effectiveness. Periodic financial crises led to mutinies and sometimes to military collapse. In contrast, the Dutch always had adequate funds. With a far smaller population, they were able to field one of

[257]See (Kohn forthcoming) Ch 19.

the largest armies in Europe and one that was a leader both in technology and in tactics. Because they paid their troops on time, they could maintain far better discipline and suffered far fewer mutinies. Most important, they were never forced to give up because they had run out of money.[258] The military consequences of the two different systems of government finance ultimately had profound implication for the survival of the two different types of government.

[258](Hart 1997)

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