

11. THE EVOLUTION OF GOVERNMENT

The frequent wars of preindustrial Europe created a highly competitive environment for governments in which only the fit survived. Fitness was defined, however, not so much in military as in fiscal terms. A government's success in war, and so its survival, depended primarily on its ability to mobilize resources.¹

The potential resources available to a government depended on the size and strength of the economy on which it could draw. However, extracting resources from an economy can do serious damage, reducing the potential yield in the future. Over time, therefore, those governments that found ways to tap their economies without destroying them survived. Those that did not, ultimately disappeared.

In this way, fiscal pressure shaped the evolution of government in a direction that made it more hospitable to economic progress. It was through this process that in preindustrial Europe a regime of government eventually emerged that enabled economic progress to continue more or less uninterrupted.

PATTERNS IN THE EVOLUTION OF GOVERNMENT

Within this process of political evolution, there were two distinct dynamics—a dynamics of scale and a political-economic cycle.

The dynamics of scale

We saw in Chapter 10 that there are advantages of scale in the waging of war. The military advantage is obvious: a larger force, other things equal, can be expected to prevail against a smaller one. But there is also a more fundamental fiscal advantage: a government able to draw on a larger economy for resources can field a larger force and keep it in the field longer.²

Because of these advantages of scale, there was a tendency for territory to be consolidated into larger and larger units. Rulers sometimes acquired territory through

¹Of course, as we will see, war also created strong incentives for technological progress in military techniques and weaponry. However, military innovations were soon available to all governments that could afford them, and they at best provided their originators with a short-lived competitive advantage.

²(Spruyt 1994).

conquest; but they often did so through marriage or inheritance.³ Cities too acquired additional territory both by war and by voluntary merger. In whatever way it happened, however, once a larger territory came into being, its government had a better chance of survival and of acquiring yet more territory.

However, as we saw in Chapter 10, greater size also brought increasing problems in the organization of government. In particular, as the scale of an associational government grew larger, it became increasingly difficult for its people to control their leaders. Leaders, freed of effective control, frequently made themselves rulers, and associational government degenerated into predatory government.

The logical conclusion of this process of consolidation would therefore seem to have been a single predatory government controlling the whole of Europe. Independent associational governments would disappear, either through absorption or degeneration, and the whole of the territory would ultimately be consolidated in the hands of a single predatory government. This had indeed happened earlier with the Roman empire, and it happened often in other parts of the world.

That this was not the outcome in preindustrial Europe was the result of the fortuitous emergence of an entirely new regime of government—the associational state. We will see that this ‘mutation’ remained associational at a scale large enough to allow it to hold its own against predatory governments. And it was the continued existence of the associational state that blocked the natural process of consolidation.

The political-economic cycle

The process of consolidation was not a continuous one: it proceeded in fits and starts. The advantages of scale motivated rulers to acquire more territory—or risk being swallowed by a larger rival. However, the acquisition of territory by war was costly and the lack of sufficient resources could be a serious impediment.

As a result, preindustrial Europe experienced periods of comparative peace and economic progress alternating with periods of widespread war and economic regress. Peace would permit trade to expand and the economy to develop and grow. Economic

³This sort of peaceful consolidation was a phenomenon unique to Europe. No state or empire outside Europe was ever built in this way: all were created by conquest ((Finer 1997) v3 Ch. 5).

growth would increase revenue from exaction, placing greater resources at the disposal of governments. The greater resources increased their capacity to wage war, and at some point they would feel able to act.

The resulting wars would drag on, and their cost would grow, eventually exceeding the resources available to finance them—however adequate these had seemed initially. The resulting fiscal pressure would force governments to resort to new and harsher means of exaction, causing ever greater damage to their economies and pushing their populations into revolt.

Eventually, government exaction, together with the interruption of trade and the direct destruction of war and civil unrest, would undermine the economic base that sustained the military effort. As a result, the belligerents would run out of resources and so be unable to continue to wage war. The hostilities would peter out and peace would return. Economies would recover, and this would set the scene for a new period of comparative peace and economic progress.

In this way, economic progress and war were mutually self-limiting. Economic progress provided the means for war, which brought an end to economic progress. War went on to destroy the economic base that supported it, which brought an end to war.⁴

THE CRISIS OF THE LONG FOURTEENTH CENTURY

As we saw in Chapter 1a, preindustrial Europe experienced two iterations of this political-economic cycle between the eleventh and seventeenth centuries.⁵ In Chapter 10, we traced the evolution of government during phase one of the first cycle—the economic expansion of the Commercial Revolution. We take up the story here with the phase two—the crisis of the Long Fourteenth Century.

The impact of war on government finance

Rulers funded their wars initially from their war chests and by borrowing. However, the wars went on longer than they had anticipated. We saw in Chapter 10 that the construction of stone fortifications during the Commercial Revolution had given the advantage to the defender: castles and cities with stone walls could only be taken through

⁴(De Long 2000) describes this cycle and attributes its discovery to Ernest Gellner.

⁵See Chapter 1a for more details.

protracted siege. As a result, the wars of the Long Fourteenth Century tended to drag on indecisively. As expenses mounted, the sources of financing that had enabled governments to launch their wars proved inadequate to sustain them.⁶

The limitations of borrowing

The borrowing of rulers from merchant banks proved unsustainable: first France and then England defaulted.⁷ It was not until the late fifteenth century that merchant banks found the courage to lend again to sovereign borrowers. As we saw in Chapter 9, cities enjoyed better credit and were therefore able to continue to rely on borrowing for their financing. It was indeed the fiscal pressure of the wars of the long fourteenth century that led to the development of the new forms of municipal debt—annuities in the north and *monti* in the south.

With borrowing from merchant banks cut off, rulers had to find alternatives. To some extent, they could borrow elsewhere. The kings of France borrowed from the pope and from wealthy individual merchants.⁸ The counts and dukes of the Low Countries were able to borrow directly in the financial markets of Champagne and Bruges—with the help of guarantees from merchants, nobles, and cities.⁹

Rulers also expanded the farming of revenues and the sale of offices. These arrangements had developed as solutions to problems of administration. However, as we saw in Chapter 10, they were also a source of financing. Now, increasingly, rulers saw them primarily in this light. In England, the king continued to farm the custom on wool, replacing the now bankrupt Italians with a consortium of English merchants—the Company of the Staple.¹⁰ The rulers of France were able to expand significantly the sale of offices, since they needed more officials to collect their new taxes (about which more

⁶(Miller 1971); (Nicholas 1999).

⁷See Chapter 10 on England's borrowing and (Kaeuper 1988) on France's. The much larger English default contributed to the collapse of the Florentine merchant banks in the 1340s—the first great international financial crisis.

⁸(Kaeuper 1988).

⁹See Chapter 9.

¹⁰See Chapter 6.

presently). As we saw in Chapter 10, governments also tapped their officials for loans—a practice known as the ‘fiscal sponge’.

These expedients helped, but they were not enough by themselves to meet rulers’ needs. And they raised cash only as an advance against revenue from existing sources. To raise more, rulers needed to find additional sources of revenue. They found two—expropriation and debasement. Both had the added advantage of providing rulers with immediate cash.

Expropriation

We have seen that by this time the rule of law was reasonably well established, so rulers could not expropriate at will. However, the protection of the rule of law extended less clearly to marginal groups, such as foreigners and Jews. This made their expropriation less damaging to the ruler’s reputation and so more attractive.

In deciding whether or not to expropriate, rulers had to weigh the immediate gain against the loss of potential future taxes, loans, or services the victims would have provided. Expropriation became more attractive, therefore, when for some reason the expected future benefits diminished.

Edward I of England expropriated the Jews, who had until then been his main source of credit, only after Italian merchant bankers arrived in the country offering him an alternative and more generous source of lending.¹¹ Similarly, the rulers of France repeatedly expropriated Italian merchants and bankers, because, unlike the rulers of England, they did not expect to obtain much from them in the way of loans.

Debasement

We saw in Chapter 10 that, during the Commercial Revolution, rulers had derived a modest revenue from seigniorage on the coins produced by their mints. Now under intense fiscal pressure, they increased this revenue dramatically by raising both the rate of seigniorage and the number of coins produced per pound of silver. For example, if previously a mint had produced 100 groats from a pound of silver and kept 10 as seigniorage, it now produced 200 and kept 100.

¹¹(Veitch 1986).

This, of course, reduced the silver content of the coins: in our example, the groat was reduced from $1/100^{\text{th}}$ of a pound of silver to $1/200^{\text{th}}$. Debasement, of course, caused inflation: the price of commodities in groats, freely determined in the marketplace, rose roughly in inverse proportion to the decline in their silver content. What had cost one groat, now cost two.¹²

But prices that were set contractually—such as rents and wages—had to be renegotiated and so could not adjust so easily. Consequently, debasement eroded the value of such payments in terms of purchasing power: in our example, if the prices in question did not change, inflation halved their value.

Similarly, paying off a debt in debased groats represented a loss to the creditor—and a gain to the debtor—in comparison to payment in good, undebased coin. In these circumstances, debtors were happy to bring silver to the mint despite the increase in seigniorage. In our example, a pound of silver now yielded 100 groats instead of 90 and so paid off a larger debt.

In some territories, debasement became a major source of revenue—even the principal source.¹³ The rulers of fourteenth century France, for example, obtained half their annual revenue and more from their repeated debasements.¹⁴ An additional bonus: if the ruler owed debts denominated in his own coin, he too could benefit by paying them off in debased currency.

Representative assemblies

Even these expedients, however, did not raise enough revenue to cover the continuing and growing cost of war. Rulers had no choice but to impose new taxes.

The need for consent

This was, however, a problem. Feudal custom expected rulers to finance themselves out of their own ‘ordinary’ income—the income from their domains and from certain

¹²In terms of silver, the price was unchanged— $1/100^{\text{th}}$ of a pound

¹³Some of the Italian cities, such as Genoa and Florence, were also driven to debasement by the needs of war ((Spufford 1988)).

¹⁴(Fryde 1979).

other sources to which they had a right, like seigniorage. But rulers were already exploiting their ordinary income to the hilt.

To find additional revenue, rulers had to be able to impose new *general* taxes—taxes imposed not only on the ruler’s own domain but on the whole of his territory. We have seen that in times of emergency rulers could expect, additional, voluntary subsidies from their subjects. The general taxes rulers now required could be represented as a form of such a voluntary subsidy. However, voluntary subsidies were voluntary: they required consent. The need for consent to new taxes had been established more or less universally by the fourteenth century as a pillar of the rule of law.

The origin of representative assemblies

Consent necessitated an institutional framework within which it could be given. Institutions, however, are rarely created from scratch: when some new function needs to be performed, an existing institution is usually adapted to the task.¹⁵ In this case, there existed a suitable institution that could be adapted with relative ease.

Rulers had already established assemblies to hear grievances against their officials and to provide redress; these assemblies were usually extensions of the great council.¹⁶ Since the imposition of additional taxes could be seen as creating a ‘grievance’, it was only natural that rulers should turn to these same assemblies to obtain consent.¹⁷

Assemblies began to perform this function with the outbreak of war in the late thirteenth century, and by the fifteenth century almost every territory in Europe boasted some form of representative assembly.¹⁸

These assemblies included representatives from the groups most capable of providing financial and military support—nobles, bishops, and cities.¹⁹ In many cases, the representatives of each group met separately, creating a multicameral structure.

¹⁵(Blockmans 1978).

¹⁶(Reynolds 1997) Ch. 8.

¹⁷(Koenigberger 1995), (Tilly 1990).

¹⁸(Koenigberger 1995).

¹⁹The representative assembly established in Sweden in the sixteenth century also included representatives of the villages. These were a major source of support for the new Vasa dynasty and their militias made up much of its army ((Glete 2002) Ch. 5).

The functions of the assemblies

Representative assemblies did more than just give consent. Some, like the Castilian Cortes and the provincial States of the Low Countries, were also responsible for collecting the taxes they authorized. Some played an important role in shaping, and sometimes in initiating, legislation. In England, for example, the representatives of the wool merchants in Parliament were instrumental in designing the export tax on wool and in implementing it.²⁰ So, like the feudal great councils out of which they grew, representative assemblies also played an administrative and legislative role.

In addition, the new functions of consenting to taxes and administering them served to strengthen the hand of representative assemblies in performing their original function of seeking redress for grievances. While assemblies rarely conditioned their consent explicitly on the fulfillment of particular demands, the ruler did now have a much stronger incentive to take their demands seriously.²¹

In this way, assemblies that had originally performed purely top-down functions—both administrative and judicial—began to take on a role in governance—a bottom-up function. That is, they were able, to some extent, to constrain a ruler's actions to take into account the interests of his subjects.

The impact of the assemblies

Representative assemblies affected the nature of exaction. While it was highly unusual for assemblies to deny their consent outright, they did ask questions, voice objections, and suggest modifications. Assemblies had a say in the total amount of new taxes, in the form they took, and in how long they were to be levied.²² Indeed, rulers frequently received less than they requested and for a shorter period. Taxes that were

²⁰(Power 1942). Indeed, the first appearance of the Commons was almost contemporaneous with the first imposition of the wool tax.

²¹(Strayer 1970) Ch. 2.

²²(Henshall 1992).

particularly onerous or economically damaging tended to be replaced with ones that were less harmful.²³

Both rulers and subjects benefited from this process of bargaining. Rulers, by gaining their subjects' consent and cooperation, were able to obtain the general taxes they needed to finance their wars. Subjects, by gaining a measure of control over their rulers, were able to create and to protect a fiscal and legal environment more conducive to commerce and production.

Even so, rulers found bargaining with their subjects distasteful and even humiliating. They therefore did their best to tap sources of revenue that did not require consent—a major attraction, for example, of expropriation and debasement.

Moreover, debasement turned out to be a major bargaining chip in obtaining consent to new taxes. By eroding rents, debasement had had a devastating effect on the incomes of the land-owning classes. The nobles and bishops were therefore more than happy to grant subsidies in exchange for the ruler's promise to refrain from further debasements.²⁴

When rulers did obtain general taxes, they did their best to make them permanent, so that they would not have to go back to their representative assemblies to have them renewed. Their success in this depended on the strength of their bargaining position. The bargaining positions of the rulers of France and Castile, victors of prolonged wars on their own soil, was strong, and they succeeded in making their general taxes permanent. In contrast, the bargaining position of the rulers of England, defeated after a long and expensive foreign war, was weak, and they did not succeed in doing so. Indeed, so weak was their position that they lost to Parliament control of the custom on wool, which initially had been a royal prerogative.²⁵

²³This process of negotiation reduced the deadweight loss of the new taxes—the harm done to taxpayers that was of no benefit to the ruler.

²⁴(Miskimin 1985).

²⁵(Nicholas 1999).

Consolidation and centralization

The wars of the Long Fourteenth Century led to the territorial consolidation of both predatory and associational governments. And in those territories controlled by predatory governments, they led to a significant centralization of power.

Consolidation

The many independent and semi-independent kingdoms, duchies, and counties were consolidated into a few, larger ‘conglomerate states’. By the late fifteenth century, the kingdoms of England, France, and Spain were such conglomerate states, as were the Burgundian, Hapsburg and, later, Ottoman empires.

The individual territories that made up a conglomerate state were often geographically distinct, and they differed widely in their economic and social makeup. Although subjects of a single ruler, they retained their identities and their own, individual structures of government—for example, their own separate representative assemblies.

Independent associational governments also underwent a process of consolidation. The many independent city states of northern Italy were absorbed into a few, larger, territorial states, each controlled by a single dominant city.²⁶ Within the dominant city, government remained associational, at least in principle. However, the dominant city’s rule over the broader territory was predatory—essentially for its own benefit.²⁷ In addition, in Milan and Florence, the internal governance of the dominant city broke down, and its leaders became dynastic rulers.

Consolidation was not, however, the only way to capture the advantages of scale in warfare. Associational governments also did so by banding together for mutual defense, while each otherwise retained its autonomy. By the late fifteenth century, the Hansa had expanded to include some two hundred semi-independent cities in northern Germany and the Rhineland.²⁸ By 1500, the Swiss Confederation—initially a coalition of three rural

²⁶(Epstein 2000).

²⁷(Epstein 2000) Ch. 2.

²⁸(Spruyt 1994) Ch. 6. Most of the cities were formally subjects of the Holy Roman Emperor, but *de facto* they were largely independent.

valley communities—had expanded to include the important cities of Zurich, Berne, and Basel.²⁹

Centralization

Among predatory governments, consolidation was generally accompanied by a centralization of power.³⁰ This was a result both of fiscal changes and of changes in military technology, both of which were themselves consequences of the wars of the Long Fourteenth Century.

Earlier, feudal rulers had had little direct control over resources or military force. To assemble an army, they had had to rely on their vassals and cities to provide the necessary troops. The rulers of conglomerate states, however, were often able to collect general taxes and to use the proceeds to hire mercenaries.

We saw in Chapter 4 that technological progress in armaments led to the development of siege artillery capable of reducing stone fortifications. The new technology had a major impact on the nature of war: with stone walls no longer invulnerable, the defense lost its advantage.³¹

This change in military technology strengthened the hand of rulers relative to that of their vassals and cities, now no longer able to rely on their castles and walls for protection.³² Taking advantage of this opportunity, the rulers of Spain, France, and England devoted much of their attention from the late fifteenth century to crushing domestic rivals and consolidating their hold on power.³³

In these new circumstances, nobles increasingly found it preferable to give up their private armies and to become courtiers instead. A share in the predation of the state promised greater rewards than independent predation on their own account.³⁴ Cities too came to rely less on military power in their relations with rulers and more on negotiation

²⁹(Coddington 1961); (Rappard 1936).

³⁰(Glete 2005).

³¹(Rogers 1995). For example, after having held out for centuries, both Constantinople and Granada fell to siege artillery in 1453 and 1492 respectively ((Bean 1973); (Parker 1995)).

³²(Bean 1973).

³³(Tilly 1990) Ch. 3.

³⁴(Koenigberger 1995); (Ertman 1997) Ch. 4.

and the exchange of favors. That is, cities too found it preferable to become a part of the system.

THE SECOND POLITICAL-ECONOMIC CYCLE

The period of war and economic decline came to an end in the middle of the fifteenth century. With the return of peace, trade recovered, and economic growth resumed. Population recovered too, more than making up the losses caused by the natural and man-made disasters of the Long Fourteenth Century.³⁵

By the late fifteenth century, renewed prosperity and population growth had greatly increased government revenues—doubling them in England and France and increasing them by a factor of 10 or more in Spain.³⁶ With their coffers replenished, governments were soon ready again for war. Adding to the appeal, the new siege artillery made the rapid conquest of additional territory a real possibility.³⁷

A new round of wars opened with the French invasion of northern Italy in 1494. This set off a sixty-year struggle between France and the Hapsburgs for control of the Italian peninsula.³⁸ The Hapsburgs were at the same time locked in war with the Ottomans for control of the Mediterranean as a whole. These wars would lead to others, and not until the middle of the seventeenth century would something like general peace return.

The war phase of the second political-economic cycle differed significantly from that of the first. Most notably, wars were fought on a far larger scale. Despite this, however, they were far less harmful economically. Indeed, it was not until late in the sixteenth century that war had much of an impact on economic prosperity. The reason for both these differences was the same—the far greater ability of belligerent governments to finance their wars by borrowing.

³⁵See Chapters 1 and 2 for details.

³⁶(Bean 1973) The increases are in real per capita terms.

³⁷(Tilly 1985).

³⁸The Hapsburgs could not permit the French to succeed: “A French-Italian conglomerate state might have become the most powerful empire in Europe.” ((Glete 1999) Ch. 6)

The scale and cost of war

Compared to the earlier round of wars, both the size of armies and overall military expenditure increased dramatically. Before 1500, an army of 5,000 was considered a large force to send into battle; by the early seventeenth century armies of 25,000 were not unusual.³⁹

The overall number of men under arms increased correspondingly. In France, between 1494 and the 1550s, total forces grew from 18,000 to 40,000; in Spain, in the same period, they grew from 20,000 to nearly 100,000.⁴⁰

Military expenditure increased together with the number of men under arms. For example, between 1500 and 1650, the spending of the Spanish government—almost all of it war-related—quadrupled.⁴¹

The new gunpowder technology contributed to the growth in the size of armies and in expenditure. Following the French invasion of Italy, the Italians—the masters of military technology—soon came up with a new type of fortification employing earthen ramparts that could stand up to cannon fire. As a result, by the 1530s, the advantage had shifted back to the defense, and war became once again a series of prolonged sieges.⁴² The minimum effective scale of this new type of fortification, however, was much larger, and it therefore required a much larger garrison to defend it.⁴³ This meant of course that the besieging army too had to be much larger.

Firearms not only helped to create the need for larger armies, they also helped make larger armies possible. Pikes and muskets were relatively cheap and required only modest skill in their use: both weapons were intended to be employed *en masse*.⁴⁴ By allowing the substitution of unskilled labor for skilled, the new weapons increased the pool of

³⁹(Nef 1950) Ch. 5.

⁴⁰(Tilly 1990).

⁴¹In real, inflation-adjusted terms. (Thompson 1995).

⁴²(Howard 1976) Ch. 2. The Dutch, for example, were able to hold out behind their fortifications for eighty years against the might of the Hapsburg empire.

⁴³(Bean 1973).

⁴⁴(Roberts 1995).

potential recruits and made it feasible to mobilize much larger armies.⁴⁵ Firearms also made the new infantryman much less costly to equip and train than the feudal knight he replaced.

Ultimately, though, armies could grow and expenditure increase only because governments were able to afford larger armies and greater expenditure.

War on credit

The increase in government revenue that we have already noted helped to finance the increase in military expenditure, but it was not by itself nearly enough. For example, by the 1550s, Spain's expenditure was exceeding its revenue by 50%—year in and year out.⁴⁶ Governments were able to spend more than they took in for prolonged periods only if they could borrow the difference.

So it was not that rising expenditures forced governments to borrow; rather it was their ability to borrow that allowed them to maintain such high levels of expenditure.⁴⁷ Borrowing was not a last resort: it was the first resort.⁴⁸

As a result, the waging of war became increasingly dependent on credit, and access to credit became the ultimate determinant of military success.

The sources of government borrowing

Rulers found it easier to borrow than they had in earlier conflicts because of the commercial and financial development that had taken place in the meantime. We saw in Chapter 9 that by this time both short-term and long-term financial markets had developed considerably.

The market for bills of exchange had expanded enormously by the sixteenth century, reaching new heights of sophistication in Antwerp and Lyons. At the same time, the market for private and municipal annuities had grown rapidly in the Low Countries and in northern France and had spread from there to Germany and Spain.

⁴⁵(Parker 1995).

⁴⁶(Tracy 2002).

⁴⁷(Parker 1995) p48.

⁴⁸(Thompson 1994) p 158.

Merchant banks had originally funded sovereign lending by accepting deposits. However, from the 1540s they began to raise money actively by selling bills of exchange in the money market. This greatly increased the amounts they could raise and so the amounts they could lend. It is perhaps no coincidence that the 1550s saw a significant intensification of the war between France and Spain.⁴⁹

Short-term and long-term markets played different roles in government finance. As we saw in Chapter 9, rulers relied on short-term borrowing from merchant banks as their primary source of liquidity. They sold annuities principally to pay down their short-term debt whenever this became excessive. The combination of short-term and long-term markets offered rulers unprecedented liquidity.

Default

Perhaps not surprisingly, sovereign borrowing continued to grow until it became unsustainable. When Charles V acceded to the throne of Spain in 1516, his short-term debt in Antwerp had been ten thousand florins; by 1556, it had risen to seven million.⁵⁰ Other rulers were similarly unrestrained in their borrowing.

That most of their debt was short-term only exacerbated the problem. Bills of exchange had a maturity of three or six months, at which time not only the interest was due but the whole of the principal. At these levels of debt, the only way to pay off maturing paper was by selling new paper.

However, as the amounts outstanding continued to grow, lenders became increasingly nervous, and they demanded ever higher rates of interest to compensate them for the risk of default. Borrowing rates for Spain, for example, rose from 28% in 1543 to 49% in 1556.⁵¹ The rise in the interest rate, of course, enlarged the amount outstanding even further and made ultimate repayment even less likely.

⁴⁹(Hauser 1933).

⁵⁰(Van Houtte 1977) Charles's long-term debt had also increased.

⁵¹(Thompson 1995).

The inevitable default duly arrived in 1557 for Spain and in 1558 for France.⁵² With borrowing cut off, the war between the two came to a sudden halt. The two defaults differed, however, in their consequences.

In the case of France, its credit never really recovered. France was cut off more or less permanently from international financial markets.⁵³ Its rulers continued to sell annuities at home, but they now had to force people—mostly officials—to buy them. The payment of interest became irregular in the 1570s and in 1586 it stopped altogether.⁵⁴

Spain, in contrast, was able to renegotiate its debt, persuading its creditors to accept a conversion of its short-term paper into long-term debt at much lower rates of interest.⁵⁵ As a result, the Hapsburgs were able to resume their borrowing, and they were able therefore to continue financing their war with the Ottomans. Indeed, Spain continued to borrow—and to default repeatedly—until the 1640s.⁵⁶

New sources of revenue

Initially, ready access to credit reduced the fiscal pressure on rulers, making it unnecessary for them to increase taxes to harmful levels or to turn to damaging non-tax expedients for additional revenue. Consequently, for much of the sixteenth century, war had relatively little impact on their economies, which continued to thrive.

As borrowing became increasingly difficult, however, the fiscal pressure began to mount. Rulers were forced, once again, to increase taxes. In France, for example, between 1450 and 1610, repeated increases doubled the total take in real terms and raised it by two thirds on a per capita basis.⁵⁷ There were, however, limits to how much more could be squeezed out of taxes.

⁵²Portugal defaulted in 1560 ((Cohn 1971)).

⁵³(Ertman 1997).

⁵⁴(Tracy 1985).

⁵⁵(Van der Wee 1977).

⁵⁶As we saw in Chapter 9, the Genoese were willing to replace the now bankrupt South Germans as lenders largely because royalties from surging silver production in the Americas greatly improved Philip's liquidity ((Drelichman 2005)). Indeed, (Drelichman and Voth 2010) argue that Spain's debt was in fact sustainable and that its defaults were merely liquidity crises.

⁵⁷(Wolfe 1972) Ch. 1.

Rulers had little choice, therefore, but to resort to the same expedients their predecessors had employed during the previous round of wars—along with some new ones. The rulers of England and France were the first, but others soon followed. Even the rulers of Spain, while they continued to borrow, faced severe pressure to increase revenues and to raise immediate cash.⁵⁸

Plundering the church

The largest single source of non-tax revenue for rulers was expropriation—which now took the form mainly of plundering the Church.⁵⁹ Undoubtedly, the religious reforms of the sixteenth century were driven by issues of theology and by discontent with the Church’s corruption. However, none of this was new: the authority of the Church had been challenged before, most notably in the twelfth and thirteenth centuries. At that time, however, rulers had found it in their interest to help the Church preserve its religious monopoly by suppressing competitors (heretics).⁶⁰

Now, however, many rulers found it in their interest to side with the reformers. The most obvious explanation for this change of heart—at least to an economist—is the intense fiscal pressure under which rulers found themselves and their consequent desire to get their hands on the Church’s wealth.⁶¹

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.⁶² Other rulers too—those of Denmark and Sweden and of some German principalities—sided with the Protestants and took the opportunity to seize Church property within their territories.

⁵⁸(Thompson 1995); (Ertman 1997) Ch. 3.

⁵⁹(Cohn 1971).

⁶⁰ (Ekelund, Tollison et al. 1996).

⁶¹(Gelabert 1995); (Miskimin 1975) Ch. 5.

⁶²During the 1540s, Henry derived about £300,000 a year from the sale of monastic land and movables—about the same as the sum of his domain income and his revenues from taxes ((Nef 1940); (Sacks 1994)).

Even rulers who sided with the Church, notably those of France and Spain, expected to be rewarded for their support.⁶³ The rulers of France imposed such heavy taxes on the Church that it was forced to sell off half its lands—“a transfer of property into lay hands comparable to that in England.”⁶⁴ And the rulers of Spain obtained the pope’s consent to appropriate about half the Church’s income there.⁶⁵

Debasement

Debasement—the other favorite expedient of the Long Fourteenth Century—was less common this time. One reason for this was the emergence, in the intervening years, of representative assemblies, which made debasement much more difficult politically.⁶⁶

Probably more important, though, was the greater dependence of rulers on taxes—not just for revenue, but also as security for loans. The inflation that would have resulted from debasement would have eroded the real value of these taxes and so impaired the ability of rulers to borrow.⁶⁷ Because of this, rulers stood to lose more from a debasement than they gained.

Some rulers, however, became so desperate that they engaged in debasement anyhow. One example was the ‘Great Debasement’ of Henry VIII of England in the 1540s and 1550s; another was the debasement of Philip IV of Spain in the seventeenth century ⁶⁸

Tax farming and the sale of offices

Tax farming became increasingly important as a source of liquidity, especially in France.⁶⁹ Before the sixteenth century, tax farms there had generally been small, the better to promote competitive bidding. Now, however, the government’s need to raise larger sums quickly led it to consolidate tax farms into larger units.

⁶³(Finer 1997) v3 Ch. 5; (Elliott 2002).

⁶⁴(Cohn 1971) p17.

⁶⁵(Elliott 2002) Ch. 7.

⁶⁶(de Roover 1949) p 77.

⁶⁷The more gradual inflation that was caused by the increasing supply of bullion also eroded tax revenues over time ((Ames and Rapp 1977)).

⁶⁸(Cohn 1971); (De Long 2000)). There were also significant debasements in France and Sweden.

⁶⁹(Wolfe 1972)

The sale of offices expanded enormously too—again especially in France.⁷⁰ Indeed, in 1522, Francis I set up a new agency dedicated entirely to the task. Supplying this agency with stock meant creating large numbers of new positions solely to have them available for sale. Henry II set up an entire new system of courts purely for this purpose. The government also imposed new regulations just so that new officials would be needed to enforce them—for example, inspectors of hogs’ tongues and controllers of perukes. The responsibilities of existing offices were divided among two, three, or four incumbents. As a final resort, offices were created with no duties at all.

In total, in the second half of the sixteenth century, France created for sale some 50,000 new offices. And, as the number of officials expanded, borrowing from them—the ‘fiscal sponge’—became an increasingly important source of liquidity.

The sale of monopolies

A new and important source of both revenue and liquidity was the sale of monopolies. Previously, monopolization had largely been used to enhance the revenue from tax farms, as in the case of the Company of the Staple.⁷¹ However, in the late fifteenth century, rulers came to realize that it was possible to create and sell monopolies, just as they created and sold offices.

Like the sale of offices, the sale of monopolies had the advantage that it did not require the approval of representative assemblies. Mining monopolies and trading monopolies were particularly popular. As usual, the French led the way, but England and Spain did not lag far behind.⁷²

How fiscal pressure transformed government

The response of the rulers of conglomerate states to the sharp increase in fiscal pressure that followed the sovereign defaults of the 1550s had more than purely fiscal consequences: it also changed the nature of government. As we have seen, rulers responded in two ways: they increased taxes and they resorted to non-tax expedients such as tax farming, the sale of offices, and the sale of monopolies. By the seventeenth

⁷⁰The following is based on (Ertman 1997) Ch. 3; (Swart 1949) Ch. 1; and (Wolfe 1972).

⁷¹See Chapter 6.

⁷²More on monopolies in Chapter 12.

century, each of these responses had, in its own way, helped to bring into being a new and different regime of government.

The conglomerate state, in its initial form, could be seen as no more than a variation on feudal government. However, its growing reliance on non-tax expedients transformed it into something quite different—the predatory state.⁷³ Simultaneously, its often brutal attempts to increase its tax revenue precipitated a multitude of revolts and rebellions.⁷⁴ One of these, the revolt that began in the Low Countries in 1572, led ultimately to the creation of second new regime of government—the associational state.

To avoid any confusion, the predatory *state* was a new regime of predatory government; other regimes of predatory government include feudal territorial government and the conglomerate state. The associational *state* was a new regime of associational government; other regimes of associational government include the governments of independent cities and of villages.

We will examine each of these new regimes in detail.

THE PREDATORY STATE

The defining condition of the predatory state was its acute shortage of liquidity—a result of its difficulty in borrowing in international financial markets. This lack of liquidity, and the fiscal adaptations to which it gave rise, transformed the organization of government and indeed its nature.

The predatory bureaucracy

Because conglomerate states were more centralized than the feudal regimes they replaced, they needed many more officials. They needed to have local officials throughout their territories to collect the new general taxes; and they needed to have large central administrations to monitor and control the mass of local officials.⁷⁵

⁷³The predatory states that emerged in the sixteenth century were arguably not the first in preindustrial Europe. Norman Sicily, in the thirteenth century, was an early precursor: see (Putnam 1993) for a description.

⁷⁴(Steensgaard 1997).

⁷⁵The central administration was also responsible for hiring and supplying the mercenaries who had taken the place of feudal levies.

The predatory state added to this already large number of officials by creating and selling new offices.⁷⁶ The totals were substantial: in seventeenth century France, for example, officials and their dependents made up as much as a third of the urban population.⁷⁷

Bureaucracy and the problem of reliance

We saw in Chapter 10 that the organization of predatory government was built from the same components as the organization of production and commerce—the enterprise, the association, and the market. In the transition from feudal government to conglomerate state, and then to predatory state, government came to be organized increasingly as a single large enterprise. And the growing scale of the enterprise required changes in its internal organization.

The head of a small enterprise can supervise all of his employees more or less directly. However, as the enterprise grows in size, this ceases to be possible. Instead, organization takes on a hierarchical structure: that is, it becomes a bureaucracy.⁷⁸ Employees at the lowest level report to superiors who are themselves employees, and so on up the hierarchy. The head of the enterprise no longer deals directly with each employee but rather with the bureaucracy as a whole through its upper levels.

Bureaucracy makes possible a larger scale of enterprise, but it also compounds the problem of reliance. As in a simple enterprise, individual employees tend to pursue their own interests at the expense of those of their employer. But, in addition, the bureaucracy as a whole now has interests that differ from those of the employer, and it pursues them at his expense.

For the predatory state, the problem of reliance was compounded by the difficulty of disciplining officials who had purchased their offices. Removing them would have been seen as a breach of contract, and this would have reduced the price the ruler could have

⁷⁶There was also a significant number of quasi-officials—the purchasers of tax farms and monopolies.

⁷⁷(Swart 1949) Ch. 1.

⁷⁸(Downs 1965)

expected from future sales.⁷⁹ And the dependence of rulers on their officials for loans (the fiscal sponge) added further to the difficulty of disciplining them.⁸⁰

A new predatory class

The bureaucracy of the predatory state constituted a new predatory class. Like the nobility, the traditional predatory class, it made its living from predation. It was, of course, the instrument of the ruler's predation—and a beneficiary of it—but it also engaged in predation on its own account.

The old predatory class had relied on its own command of force to engage in predation; the new predatory class relied instead on that of the state. The old predatory class, in return for their rights of predation, had owed the ruler their military support; the bureaucracy, in return for its rights of predation, owed the ruler its financial support.

The bureaucracy became indeed a class—a distinct, self-conscious, and organized group. Increasingly, new appointments to the bureaucracy came from among the relatives and protégés of existing officials. As a result, agencies within the bureaucracy tended to become closed, self-perpetuating bodies not unlike merchant associations or artisan guilds.⁸¹ Advancement within the bureaucracy depended heavily on patronage—typically that of some high official—and this created clan-like networks of patrons and clients, often related by blood and marriage.⁸²

The new predatory class worked tirelessly to advance its own interests—which were, above all, to enhance the value of office.⁸³ Officials, of course, were greatly in favor of new taxes they could collect and new regulations they could enforce: these offered new opportunities for embezzlement and corruption. More generally, however, the bureaucracy worked to increase the power of the state—power it could appropriate for its

⁷⁹(Major 1971); (Fischer and Lundgreen 1975).

⁸⁰(Fryde 1979).

⁸¹(Strayer 1970) Ch. 2.

⁸²(Major 1994) Ch. 8.

⁸³(Henshall 1992)p16.

own benefit.⁸⁴ This brought it into conflict with the other centers of power in society—specifically, with the nobility and with the associational governments of cities.

Relations with the nobility

As we have seen, the nobility had increasingly given up the independent exercise of force, choosing instead to seek favor at court. One of the greatest expressions of such favor was appointment to high office. Consequently, the higher reaches of the bureaucracy tended to be filled with members of the nobility. Most offices, however, went to members of the urban merchant class—mainly because they were able to bid more for them. The nobility, naturally, resented this.⁸⁵

There was also considerable friction between the nobility and the bureaucracy at the local level. Officials, in their drive to expand state power, steadily eroded the prerogatives of local lords.

Nonetheless, despite the rivalry and even conflict between the old predatory class and the new, there was a significant merging of the two groups. Indeed, rulers often granted officials noble rank.⁸⁶

Impact on associational governments

Associational government fared less well in its encounter with the bureaucracy. Associational government—especially of the cities—and association in general were greatly weakened.⁸⁷

Much of the growth of the bureaucracy came directly at the expense of associational government. Many of the offices rulers sold were municipal offices. In Castile, for example, Charles V sold some 6,000-8,000 city councillorships in the 1540s and 1550s.⁸⁸

⁸⁴“Characteristically, royal officials everywhere showed a far deeper commitment to the authority of the state even than their princes.” ((Thompson 1976) p263)

⁸⁵(Swart 1949) Ch. 1 and 2.

⁸⁶The rulers of France created a whole new category of nobility this purpose—the *noblesse de robe*—to distinguish it from the traditional nobility—the *noblesse d'épée*.

⁸⁷The associational governments of villages, however, were an exception and remained strong. The bureaucracy did not reach that deep, and the state needed the help of the villages in administration—particularly in the collection of taxes.

⁸⁸(Thompson 1998); (Cohn 1971).

Moreover, as we have seen, the bureaucracy was largely recruited from the ranks of the urban merchant elite, which had been the mainstay of the associational government of cities.

In addition, the bureaucracy, in its drive to increase the power of the state, worked to erode the rights and liberties of the cities—even when this was against the wish of the ruler.⁸⁹ As a result, city government was largely absorbed into the bureaucracy and self-government of the cities gave way to direct administration by royal officials.

Non-government associations were affected too. Merchant associations and craft guilds became government-enforced monopolies, beholden to the state for their profits.⁹⁰

The new balance of power

Despite the increasing concentration of power in the hands of the predatory state, the power of its ruler—sometimes described as an ‘absolute monarch’—was far from dictatorial.⁹¹ In particular, he still respected, on the whole, the constraints of medieval constitutional government. For example, when the ruler needed additional taxes, he still sought the consent of his representative assemblies. It was only within the bounds of his legitimate prerogatives that he claimed absolute authority—in the collection of revenues to which he had a right, in the conduct of foreign policy, and in the waging of war.

Even in these areas, however, he could not simply issue commands and expect to have them obeyed. The state still lacked the means to force unwilling subjects into obedience, and, as we have seen, the bureaucracy was far from being a faithful instrument of the ruler’s will. The relationship between ruler and subjects remained, therefore, one of negotiation and bargaining.⁹² Since a ruler’s bargaining power generally varied across his different territories, so did his success in exacting resources.

⁸⁹(Major 1971); (Wolfe 1972) Ch. 1; (Zeller 1971).

⁹⁰There had been a similar erosion of associational government and association in thirteenth century Sicily: “The civic life of artisans and merchants was regulated from the center and from above, not (as in the North) from within.” ((Putnam 1993) p123)

⁹¹(Henshall 1992) Ch. 4.

⁹²(Henshall 1992) Ch. 1.

While the mechanisms of medieval constitutional government continued to constrain the ruler's power, they did so less effectively than they had in the past. As we have seen, the countervailing centers of power on which these mechanisms depended—the nobility, the cities, and the Church—had all been weakened.

Moreover, the shift from borrowing in international financial markets to reliance on the fiscal sponge had undermined an important pillar of the rule of law. While this shift increased the ruler's need to maintain the trust of his officials, it reduced the cost of his breaking his word to others.

In any event, much of the growing power of the predatory state was in the hands, not of the ruler, but of the predatory bureaucracy. And the predatory bureaucracy was much less effectively constrained by the traditional mechanisms of medieval constitutional government. Subjects did complain about the abuses of officials—particularly when rulers summoned their representative assemblies. However, rulers were far too dependent on their bureaucracies to be able to pay much attention to such complaints.

The principle governance problem of the predatory state, therefore, was not despotism but corruption. The problem was not a single powerful predator but rather an uncontrolled mass of small predators, each exploiting the power of the state to his own benefit.

Military organization of the predatory state

The acute shortage of liquidity of the predatory state had an impact too on its military organization. In particular, the difficulty rulers experienced in financing their armies created an opportunity for a new type of military entrepreneur—the 'military enterpriser'. From the late sixteenth century, military enterprisers contracted with rulers to provide them with complete regiments and even entire armies—essentially on credit.⁹³

Sources of financing

Military enterprisers recruited, equipped, and trained the troops they supplied and often commanded them themselves in battle.⁹⁴ Most important, however, was that they

⁹³(Redlich 1964).

⁹⁴There were also naval enterprisers, such as the great Genoese admiral Andrea Doria, who could supply entire fleets ((Thompson 1976) Ch. 6).

provided the financing. Indeed, the ability to provide financing was no less important to a military enterpriser than military skill.

Enterprisers, many of them German princes, were themselves wealthy, but they generally needed additional, external financing to meet their need for working capital. They obtained this by borrowing—mostly from fellow nobles and from church officials and monasteries.⁹⁵ Frequently, they depended too on credit from their own officers and men in the form of their willingness to wait to be paid.⁹⁶

Paying off the debt

By engaging military enterprisers, a ruler could raise an army first and pay for it later. Later, however, did eventually arrive, and when it did, rulers were often unable to come up with the cash. If the enterpriser himself was out of money, the result could be mutiny, with the men plundering the civilian population in lieu of pay.

The most famous such incident occurred in 1576, when Philip II failed to deliver to the Low Countries the funds needed to pay his troops there. The men finally lost patience and took what was due to them by sacking the city of Antwerp, thereby handing the rebels a major propaganda victory.

By the early seventeenth century, this *ad hoc* solution for non-payment was being regularized and written into contracts. A ruler-employer would authorize his enterpriser to pay the troops out of ‘contributions’ levied on the population of the territory they occupied—enemy, neutral, or sometimes even friendly.

In this way, armies became self-financing. Contributions were collected in a more orderly fashion than during the sack of Antwerp, but the impact on the territory in question could nonetheless be devastating.⁹⁷

A failed public sector alternative

Earlier, Philip II had tried to free himself from his dependence on military contractors and foreign arms suppliers. He had done so by setting up in their place bureaucratic

⁹⁵Usually in the form of an annuity secured by the enterpriser’s lands ((Redlich 1964) Ch. 2).

⁹⁶(Redlich 1964) Ch. 2.

⁹⁷(Mortimer 2004).

agencies to recruit men and procure supplies and by expanding government production of arms and ammunition.⁹⁸

Not surprisingly, corruption was rife and his officials lacked any incentive to reduce costs. Moreover, because the government was in perpetual financial crisis, there were never enough men, arms, or supplies. As a result, Philip's military forces "were costing twice as much and were half as effective."⁹⁹ By the 1590s, Philip had given up the attempt and gone back to depending on contractors.

THE ASSOCIATIONAL STATE

As the rulers of predatory states demanded ever more taxes from their populations, they encountered increasing resistance. Not infrequently, this ended in armed revolt. One such revolt was of particular historical significance, because it gave birth to a new regime of government.

During the sixteenth century, the Hapsburgs faced growing fiscal pressure as a consequence of their wars with France and with the Ottomans. They therefore increased the level of taxes repeatedly in all their territories. In the Low Countries, the tax burden grew fourfold between the 1520s and the 1540s and doubled again by the 1550s.¹⁰⁰ However, despite these increases, revenue from the Low Countries continued to lag behind revenue from other, often less wealthy, Habsburg possessions.

Consequently, in 1569, the new Hapsburg governor of the Low Countries, the Duke of Alva, proposed a number of additional taxes.¹⁰¹ The most important of these was a permanent general transactions tax of 10%—much like the Castilian *alcabala*. In 1571, with the representative assemblies of the provinces still unwilling to grant the new taxes, Alva took advantage of ongoing religious unrest to assume dictatorial powers and to impose the new taxes by force.¹⁰² The provinces rose up in rebellion.

⁹⁸(Thompson 1976).

⁹⁹(Thompson 1976) p 167.

¹⁰⁰(Tracy 1990) Ch. 5.

¹⁰¹(Hart 1997).

¹⁰²Alva's mission included not only raising tax revenues but also stamping out heresy. He proceeded to do this in the most brutal manner.

The Hapsburgs regained control of the southern provinces in 1585, when Antwerp fell to Spanish troops. However, the seven northern provinces fought on and declared themselves an independent republic. The fighting continued, on and off, until 1648, when the independence of the Dutch Republic was finally recognized in the Treaty of Westphalia.

The organization of the associational state

The government of the new Dutch Republic was associational, but it was a new kind of associational government—an associational *state*. This new regime of government emerged—without deliberate design—out of the particular history and circumstances of the Low Countries.

The history of associational government in the Low Countries

The cities and villages of the Low Countries had a strong tradition of associational government.¹⁰³ The region was the most highly urbanized in Europe. Its cities were wealthy and powerful, and they had always enjoyed considerable freedom in managing their own affairs. In rural areas, the need for joint action in building and maintaining dykes and drainage canals had promoted strong associational institutions.

In each of the provinces, the cities and the nobles had long since established a representative assembly or States. These assemblies had not been created from above by the ruler, as was generally the case elsewhere.¹⁰⁴ Rather, they had been created by the local governments within each province to coordinate joint action among them.

Only later did the provincial States take on the additional function of governance—of negotiating with the ruler to protect the rights and interests of the provinces.¹⁰⁵ Even then, however, they continued their role in coordinating joint action within each province. In

¹⁰³(Downing 1992) Ch. 9; (Israel 1995) Ch. 2; (Thompson 1994).

¹⁰⁴The States resembled urban leagues such as the German Hansa ((Tracy 1990)). In Holland, for example, the States consisted of representatives of Amsterdam and of five other cities, each with one vote, plus representatives of the nobility who as a group had one vote ((Graves 2001) Ch. 6).

¹⁰⁵Their strong associational roots enabled them to stand up to their rulers more successfully than representative assemblies that were created top down by the ruler ((Ertman 1997)).

the fifteenth century, for example, the States of Holland financed and prosecuted a war against the Hansa, acting, essentially, as an independent government.¹⁰⁶

The seventeen provinces of the Low Countries were combined into a conglomerate territory by the Burgundians and their Hapsburg successors.¹⁰⁷ The Burgundians established a States-General for the territory as a whole, to which each of the provincial States sent representatives. The States-General took over from the individual States the role of governance—negotiating on their collective behalf with the ruler.

The Burgundians, and later the Hapsburgs, made several attempts at political centralization. However, these were largely unsuccessful, and the individual provinces retained much of their independence.

The creation of the associational state and its nature

The rebellion did not change the organization of government in the Low Countries, but it did change its function and thereby its nature. Previously, the States-General had been a vehicle for negotiations between provinces and ruler; now it became a vehicle for coordinating joint action by the provinces in their common defense. Its function changed, therefore, from one of governance to one of government.¹⁰⁸

The provinces established a central government to which they delegated limited powers—defense, taxation to finance that defense, and foreign policy. All other powers, including economic regulation and the administration of justice, the provinces retained for themselves. The Dutch Republic was created, therefore, as a federation of sovereign provinces, united for common defense.

In principle and in practice, power rested not with the central government but firmly with the provinces and cities. Under feudal government, rulers were sovereign, but they granted certain rights and freedoms to their subject associational governments. In the new associational state, it was the associational governments of the provinces that were sovereign, and it was they that granted certain limited powers to the state they created.

¹⁰⁶(Israel 1995) Ch. 2.

¹⁰⁷This territory was in turn part of a larger conglomerate state—first that of Burgundy and then that of the Hapsburgs.

¹⁰⁸(Israel 1995) Ch. 13; (Hart 1997); (Price 1995).

The provinces, in their turn, answered to the cities. And government of the cities was controlled by an urban oligarchy—the ‘regents’.¹⁰⁹ The regents did not, however, constitute a monolithic group: rather, they were divided into factions that competed with one another for power. The regents’ control of city government gave them indirect control of government at the provincial and central levels.

Below the regent class were the ordinary property-owning citizens or burghers. These had no formal say in city government, but they could influence it through petition. Since the cooperation of the burghers was essential for the functioning of the city, they possessed considerable power, and city councils tended to respect their wishes.

The Republic was, therefore, an association of associations, and each constituent association was itself an association of associations.¹¹⁰ The new associational state, then, had three levels of associational government—city, provincial, and federal. Each function of government was performed at the lowest feasible level. In particular, there was no direct local administration by the state in the provinces or by the provinces in the cities.

The responsibilities of the central government were limited almost exclusively to defense. And even in this area, as we will see, financing and administration were largely undertaken directly by the provinces and the cities: the role of the central government was essentially one of coordination. There was a great deal of government in the associational state, but it was almost all at the provincial and, especially, at the city level.¹¹¹ The size of the central government was correspondingly small, and there was no danger of anything like a predatory bureaucracy developing.

It was its structure as an association of associations that enabled the associational state to overcome the fundamental dilemma of associational government—how to achieve the military benefits of greater scale while maintaining effective governance over its leaders.¹¹²

¹⁰⁹(van Nierop 1997); (Israel 1995) Ch. 6.

¹¹⁰We saw the same principle at work within cities in Chapter 10.

¹¹¹(Price 1995), (Price 1994) p 149.

¹¹²(Olson 1971) Ch. 2; (Weingast 1995).

Associational government in Europe

The emergence of this new and vital form of associational government in the Netherlands came at a time when associational government in general was in retreat. Within predatory states, as we have seen, it was being absorbed into the bureaucracy. We have seen, too, that associational government in the independent city-centered territorial states of northern Italy had largely degenerated into predatory government.

Moreover, consolidation had proven a failure in terms of protecting against the military power of large predatory states: the city-centered territorial states were still not strong enough to defend themselves successfully. By the middle of the sixteenth century, most of Italy had come under Habsburg control or influence.¹¹³

The other way in which associational governments could achieve greater military scale—the league or confederation—had had only limited success. The Hanseatic League had faded away.¹¹⁴ The Swiss confederation had held its own militarily, but it was more a loose alliance than a state, with no real organs of central government.¹¹⁵

The Dutch Republic differed in that it was not created by bringing together previously unconnected associational governments. Rather it was formed through the ‘decapitation’ of an already existing conglomerate state. It did not therefore need to build a structure of central government from scratch. Rather, it inherited an effective structure that needed only to be adapted to the altered circumstances. This new structure solved the problem of scale of associational government while retaining its advantages in terms of less harmful exaction and a superior ability to borrow.

¹¹³Only Venice remained an independent republic. Its continuing independence was mainly due to its great wealth: in 1500 its government had an annual revenue of 1.3 million ducats—double that of the king of France ((Lane 1973)).

¹¹⁴It succumbed to the reassertion of control by the Emperor and to the rising power in the Baltic of a revitalized Swedish state ((Hocquet 1995); (Glete 1999) Ch. 5).

¹¹⁵(Coddington 1961); (Rappard 1936).

Government finance

After some initial difficulties during the Revolt, the new republic developed a robust system of government finance that gave it an enormous advantage over potential adversaries.

Early financing of the Revolt

In the early years of the revolt, the cities and provinces of the Low Countries had to scramble to finance their enormous military expenditures. Fortunately, they inherited the system of taxation they had set up for the benefit of the Hapsburgs. This they continued to operate, but now keeping the proceeds for themselves.¹¹⁶

Liquidity, however, was a serious problem. Since investors generally expected the revolt to fail, the credit of the cities and provinces had evaporated with the outbreak of war.¹¹⁷ This loss of confidence was only reinforced by delays in the payment of interest on outstanding debt. Yields on outstanding debt, 8% or less before the revolt, jumped to 20%, and so no new long-term debt was issued.

Despite the difficulty of their situation, the rebels did not resort to damaging non-tax expedients in the way that rulers generally did. Instead, they chose to finance most of the cost of the war directly out of current taxes.¹¹⁸ Doing this required a very sharp increase in the tax burden. In Holland, it rose from one florin per capita in the 1550s to seven florins per capita in the 1580s.¹¹⁹ This was ironic given that the principal cause of the revolt had been the Hapsburgs' attempt to increase taxes!

Such a 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 revolt. Second, taxation was under control of the cities, which were sensitive to the

¹¹⁶(de Vries and van der Woude 1997) Ch. 2, (Fritschy 2003). See, also, Chapter 9.

¹¹⁷(de Vries and van der Woude 1997) Ch. 2.

¹¹⁸They also received significant subsidies from England and France (England sent an army too). There was also some forced lending in the form of occasional levies on wealth.

¹¹⁹(de Vries and van der Woude 1997) Ch. 2. Total revenues actually rose ten-fold because of an increase in population.

economic and distributional impact of taxes; this ensured that revenue would be raised in the least harmful way possible.¹²⁰

By the 1580s, the credit of the provinces and cities began to recover. And, as they caught up on their arrears of interest, yields fell towards pre-revolt levels.¹²¹ As a result, the cities and provinces began to borrow again—quite modestly at first, and mainly in the form of short-term paper.¹²²

Government finance under the Republic

Under the Dutch Republic, the initial plans for a centrally-controlled tax system were never implemented, so that responsibility for taxation remained with the provinces. The States-General decided the total level of expenditure—almost all of it military. The raising of the necessary revenue was then allocated among the provinces according to a system of quotas.¹²³

Each province was free to raise its allocation in whatever way it pleased. Most of the resulting revenue was spent directly by the provinces themselves—mainly on the army and on fortifications. Relatively little of it passed through the hands of the central government.¹²⁴

The Republic came to rely for its liquidity on the sale of annuities.¹²⁵ With the fall of Antwerp, the international financial market had moved from there, conveniently, to Amsterdam. The issuing of long-term debt resumed in the 1590s, slowly at first, but it grew rapidly after 1620. Eventually, the Republic was able to raise huge sums quickly in

¹²⁰More on this in Chapter 12.

¹²¹(Fritschy 2003).

¹²²Mostly promissory notes issued by tax receivers on their own credit ((de Vries and van der Woude 1997) Ch. 2; (Hart 1993) Ch. 3).

¹²³The quota of Holland, by far the richest and most populous province, was 58%; that of Drenthe, at the other extreme, 1%. Not surprisingly, there was considerable and continuing contention over the sizes of the quotas.

¹²⁴(Hart 1997) Ch. 7.

¹²⁵The market for annuities, like the tax system, had been established originally to serve the needs of the Hapsburgs.

the long-term market. In one famous example, an entire issue of one million florins of 3% annuities was snapped up by the market in only two days.¹²⁶

The significance of being able to rely on the sale of long-term debt

Once the Dutch Republic was able to tap the long-term market in this way, its liquidity became a major source of strength. It was consequently able to accommodate sudden spikes in war expenditure with relative ease—raising the funds it needed immediately through borrowing. It could defer to later the small increase in taxes needed to cover the increase in its annuity payments.

Relying for liquidity on the sale of long-term debt was a major departure in government finance. Until then, those governments able to borrow at all had relied on short-term borrowing. Because the short-term market was much deeper, it had been easier to raise large sums in this way.¹²⁷

The Dutch Republic was able to tap the long-term market instead only because of its excellent credit. One important reason for this was that it was an associational state. Unlike the predatory states of its time, it had no territorial ambitions—at least within Europe. As a result, it went to war as little as it could.¹²⁸ It was therefore much less likely to get into the sort of fiscal difficulties that led predatory states to over-borrow and, ultimately, to default.

Another reason for its excellent credit—a rather circular one—was that it did rely on long-term rather than short-term borrowing. With the sale of annuities, there was no need to pay off the principal: the debt became, *de facto*, perpetual. As a result, debt service was limited, in effect, to the payment of interest.¹²⁹ As we have seen, this was very different from borrowing short-term, which required the frequent rolling over of the principal. The

¹²⁶(Parker 1995).

¹²⁷(Tracy 2002) Ch. 5. Spain had sold long-term debt too, but mostly to pay off short-term debt when the amount outstanding became too large.

¹²⁸(de Vries and van der Woude 1997) Ch. 5; (Price 1995). As one influential contemporary wrote: "in republics which live by traffick, and which have fortified themselves well, all offensive war is prejudicial and consuming." (Riemersma 1955)

¹²⁹Part of the payment represented amortization of the principal.

Republic, because it borrowed long-term, was spared the frequent liquidity crises that continued to plague the Hapsburgs.

Military organization

The Dutch Republic differed not only in the nature of its government and how it was financed, but also in the nature of its military organization. Its superior military organization contributed significantly to its ultimate military success and therefore to its survival.

The new model army

Initially, the rebels had little choice but to rely on military enterprisers to provide them with an army. However, once the Republic was established, it developed a unique system of military organization that closely matched the organization of its government and its system of taxation.¹³⁰

The central government—the States General, together with the overall military commander, the Stadholder—decided on the level of forces required. The total was then divided among the provinces, which were responsible for organizing and financing individual units. Each province was responsible both for raising the required companies of volunteers and for subsequently paying them.¹³¹ The army, once assembled, was commanded by the Stadholder.

The army created in this way was essentially permanent, and having it stationed primarily on home soil was a potential problem. Soldiers were notorious for their lawlessness and for the destruction they wreaked on civilian populations. However, the Dutch minimized this problem. First, they paid their troops regularly and well. Then, they kept them busy with constant training and drill, imposing unusually strict discipline.¹³²

The resulting skill and discipline of the troops, a positive side effect, had significant military advantages. It enabled Dutch armies to execute complex new infantry tactics,

¹³⁰The following is based mainly on (Hart 1993) Ch. 2 and (Glete 2002) Ch. 4.

¹³¹Although every Dutch city had its citizen militia (see Rembrandt), the Dutch burghers preferred to hire a professional military, so that they could devote their own energies to business ((Price 1995)).

¹³²(Israel 1995) Ch. 12.

such as the volley and ‘countermarch’, that would not otherwise have been possible.¹³³ By the seventeenth century, the Dutch army was seen throughout Europe as a model to be emulated.¹³⁴

The navy

The Dutch navy was organized along much the same lines. It was made up of several ‘admiralties’, each based in one of the major maritime cities of Holland and Zeeland. Each admiralty was responsible for building, maintaining, manning and provisioning its own ships. The governing board of each admiralty was drawn from among the local shipping magnates, who had a strong personal interest in the effectiveness of the navy, and therefore paid close attention to its management.¹³⁵ The admiralty fleets were combined into war fleets under the overall command of an admiral-general appointed by the States General.

The Dutch navy had its origins in a group of privateers known as the Sea Beggars. As we saw in Chapter 4, privateers were private owners of ships that had been authorized by a government—in this case the rebel government—to attack foreign shipping.¹³⁶ The Sea Beggars were recruited from among the ‘interlopers’ who had long traded with Spanish settlements in the Americas in defiance of the declared Spanish monopoly. Privateers remained an important supplement to the official navy, and a valuable source of battle-trained sailors and commanders.¹³⁷

Dutch sea power, both public and private, was vital in defending the Netherlands against invasion by sea.¹³⁸ It also inflicted economic damage on Spain by cutting off its important maritime trade with northern Europe.¹³⁹ And it made the war in the Low Countries much more expensive for Spain by forcing it to supply its armies by land

¹³³(Glete 2002) Ch. 4.

¹³⁴For example, Cromwell’s New Model Army during the English civil war.

¹³⁵(Glete 2002) Ch. 4.

¹³⁶(Fritschy 2003) (Glete 1999) Ch. 9. They were expected to share the spoils with the government.

¹³⁷Some of the best admirals were former privateers ((Glete 2002)Ch. 4).

¹³⁸Rivers provided good natural protection against invasion by land.

¹³⁹(Glete 2002) Ch. 4.

through Lombardy via the ‘Spanish Road’. The depredations of English and Dutch privateers also forced Spain to divert significant military resources to defending its possessions in the Americas and to protecting its communications with them.

Relying on the market

The approach to military organization of the Dutch Republic—an associational state—differed radically, therefore, from that of Spain—a predatory state. Spain favored central control and bureaucracy, and tried to free itself from dependence on the market. In contrast, the Dutch Republic favored decentralization and embraced the market to the fullest extent possible.

Rather than trying to control every detail, the central government played only a minimal, coordinating role. The provinces took on the role of military enterprisers and the maritime cities that of naval enterprisers.¹⁴⁰ While Spain relied on a poorly-functioning centralized system of provisioning, the Dutch purchased their supplies in the market: disciplined soldiers, regularly paid an adequate wage, could be relied upon to purchase for themselves whatever they needed. And the admiralties relied for their provisioning on the same market that served commercial shipping.

Where Spain tried to expand government production of arms and ammunition, the Dutch relied on the commercial arms market. In this they had an advantage, since the center of that market had moved from Antwerp to Amsterdam as the former had declined.¹⁴¹ Amsterdam had already been a center of arms manufacture, assembling weapons from parts imported from Germany and from elsewhere in the Low Countries.¹⁴² And, of course, the Dutch shipbuilding industry was the largest and most dynamic in Europe.¹⁴³

¹⁴⁰Apart from this general system of mobilization, the States General did sometimes contract directly with military enterprises for additional troops; individual cities also sometimes did this ((Hart 1993) Ch. 2).

¹⁴¹(Barbour 1950); (Hart 1993) Ch. 2.

¹⁴²(Vogel 1998).

¹⁴³The Amsterdam market provided munitions, supplies, and ships not only to the Dutch but also to their allies and even to their enemies. Spain regularly purchased supplies there for its armies in the Low Countries as well as Dutch ships for its navy ((Vogel 1998)). For the Dutch, business was business!

Another advantage of the decentralized and market-oriented Dutch system was the high quality of the personnel it could recruit by offering a competitive wage. Most of its soldiers and many of its sailors were foreign volunteers.¹⁴⁴

THE SUBSEQUENT EVOLUTION OF GOVERNMENT

In subsequent centuries, the fiscal pressure of war continued to shape the evolution of government. Governments tended to gravitate to one or other of the two new models—the predatory state or the associational state. And these were tested against each other in the struggle for survival.

Predatory states and associational states

The only associational state in the early seventeenth century was the Dutch Republic. The conglomerate states that made up most of western Europe were all evolving into predatory states. The Hapsburg dominions had progressed furthest in that direction.¹⁴⁵ France was well along the way, but its commercial cities were holding their own more successfully than those under Hapsburg rule.¹⁴⁶ England under the Tudors, and even more so under the Stuarts, also seemed to be developing into a predatory state. Indeed, in some ways, England's rulers were less respectful of the rule of law than those of France.¹⁴⁷

England, however, did not become a predatory state.¹⁴⁸ It did not, because its rulers were too weak and because its representative assembly was too strong. England's rulers were weak, because they were poor.¹⁴⁹ We have seen that, unlike the rulers of France and

¹⁴⁴(Hart 1993) Ch. 2.

¹⁴⁵See (Alvarez-Nogal and Escosura 2007), (Flynn 1982) and (Vives 1970) on Spain, and (Cipolla 1970) on the Hapsburg dominions in Northern Italy.

¹⁴⁶(Fox 1971)

¹⁴⁷(Henshall 1992) Ch. 4; (Major 1971).

¹⁴⁸(Koenigberger 1995) asks the question: England seemed more like France, why did it wind up like the Netherlands?

¹⁴⁹Between 1540 and 1640 the revenue of the English crown hardly changed in real terms. Over the same period the real revenue of the French crown increased from 4 times that of England to 8 times. In 1640, the population of France was about three times that of England, and its national income perhaps double ((Nef 1940))

Spain, they had failed to establish permanent general taxes.¹⁵⁰ Moreover, unlike some other rulers of conglomerate states, they derived little revenue from royalties on mining.¹⁵¹ And their domain income had largely been wiped out by the excesses and the fiscal expedients of Henry VIII. England's rulers were, as a result, almost totally dependent for their revenue on Parliament.¹⁵²

This, of course, put Parliament in a very strong position. Moreover, Parliament was also strong institutionally. Like the States of the Low Countries, its members were chosen not by the ruler but by local jurisdictions—by the shires and boroughs of the kingdom. Parliament therefore represented local interests.¹⁵³ These could be rallied to support the financing of a defensive war, but they were not much interested in financing foreign adventures. As a result, England played only a minor role in the wars of the sixteenth century, and it thereby avoided the resulting fiscal pressure.¹⁵⁴

The lack of fiscal pressure, together with the poverty of the rulers and the power of Parliament, meant that England did not develop a predatory bureaucracy. Instead, its local officials were unpaid Justices of the Peace who worked part time. They were recruited from the country gentry and from the urban mercantile elite, just as were members of Parliament and common law judges and lawyers.¹⁵⁵ The social connections between these groups further strengthened the local, associational quality of English government.

The conflict between king and Parliament eventually erupted into civil war in the 1640s, and it was ultimately resolved by the 'Glorious Revolution' of 1688. At that time, England followed the Dutch example rather than that of France and effectively became

¹⁵⁰England's blessing was that it had lost the Hundred Years War; France's curse was that it had won it.

¹⁵¹(Henshall 1992) Ch. 8.

¹⁵²The rulers of England were also increasingly dependent for their liquidity on loans from their own merchants ((Nef 1940)).

¹⁵³(Nicholas 1999).

¹⁵⁴The protection of the sea certainly helped keep down the cost of defensive wars.

¹⁵⁵(Nef 1940).

an associational state.¹⁵⁶ Parliament, like the States General of the Netherlands, went from being an instrument of governance to one of government. English monarchs did not become the rulers of a predatory state—as some of them had wished—but rather the hereditary leaders of an associational state.

Survival of the fittest

That England ultimately fell into the associational camp was critical for the survival of the associational state as a regime of government. The Dutch Republic was too small to hold out indefinitely against its much larger predatory-state adversaries. Indeed it eventually succumbed to the armies of revolutionary France in 1795.

The wars of the subsequent centuries tested the viability of the two regimes of government. As we have seen, the two relied on very different systems of financing. These in turn created very different environments for commerce and production.

The ability of associational states to borrow, their rational approach to taxation, and their avoidance of harmful non-tax expedients allowed them to finance their wars with relatively little damage to their economies. In contrast, the heavy reliance of predatory states on non-tax expedients and their growing predatory bureaucracies led inevitably to economic stagnation and decline.

It was the fiscal efficiency and the economic strength of the associational states that enabled them to repeatedly defeat their predatory-state adversaries.¹⁵⁷ Over time, most of the latter became themselves associational states. Shaken by defeat in war, revolution, or fiscal collapse, they sought to imitate the economic and political success of their associational rivals.

CONCLUSION

In this chapter and in the last, we have traced the evolution of government in preindustrial Europe. We have seen that this evolution was driven by forces intrinsic to predation and government as economic activities as well as by their interaction with the

¹⁵⁶(Weingast 1995) argues that after 1688 England possessed, *de facto*, a federal form of government.

¹⁵⁷(Olson 1993).

process of economic progress. We have seen too that the actual path this evolution took depended a great deal on particular circumstances.¹⁵⁸

The internal forces driving the evolution of government

Government is an organization that deploys force to control territory; its purpose is to engage in predation or to protect against it—or both. Like the development of production and commerce, the development of government is a self-perpetuating process. The form of this process is determined by the nature of predation and of government as economic activities.

Because of the advantages of scale in the deployment of force, there is a tendency for government to consolidate into ever larger units. However, the larger-scale organization that this requires suffers from growing internal problems of reliance. In the case of predatory government, these can lead to fragmentation—generating cycles of fragmentation and consolidation. In the case of associational government, the problems of reliance can lead to its degeneration—wholly or partially—into predatory government.

The development of government exhibits some of the same patterns as the development of production and commerce. Increasing scale (‘the extent of the market’) induces reorganization—for example, the formation of a bureaucracy. Increasing scale and reorganization induce technological change—for example, new forms of exaction and new forms of internal predation. And these changes come about as a result of entrepreneurship—no less important in predation and government than it is in production and commerce.

Interaction with economic progress

The evolution of government interacts with the process of economic progress. Economic progress increases the potential resources available to governments; through financial development, it also improves their liquidity. At the same time, extracting resources from the economy inhibits economic progress. As we have seen this interaction can lead to the alternation of periods of peace and prosperity with periods of war and

¹⁵⁸Undoubtedly, specific circumstances mattered too in the development of production and commerce, although perhaps to a lesser extent. We will be able to say more after we consider the Chinese experience.

economic decline. This constitutes a kind of trap—a predation trap—that can hold back economic progress.

There are also other, more positive, interactions. Economic progress strengthens the associational governments of cities, so that these are better able to protect economic activity against predation. Such protection includes the making of mutually beneficial agreements with territorial predatory governments to limit the harm of the latter's actions in return for material support.¹⁵⁹

As a result of these positive interactions, government can evolve to become less harmful to economic progress, and this may make it possible to escape the predation trap. Whether this happens or not, however, depends to a great extent on the specific circumstances—on initial conditions and on chance.

The specific circumstances

Conditions in Europe after the collapse of Rome did not seem promising, but they proved nonetheless to be remarkably favorable. The fragmentation and weakness of predatory government permitted independent and semi-independent associational governments to establish themselves in the cities. The fortuitous break-up of the Carolingian territories set back the process of re-consolidation and allowed this situation to continue for some time. In addition, the long history of commercial cities in the Mediterranean left vestiges that facilitated the regeneration of associational government and of commerce.

By the time the process of consolidation resumed in earnest, cities and commerce were strong enough to exert a significant influence on how government evolved. In this particular environment, 'natural selection' produced the associational state. However, that outcome might have been different without the peculiar history and political

¹⁵⁹In Chapter 2, we talked of 'extrinsic changes' that had a positive or negative effect on market expansion: many of those came from predation and government. If we define the 'economy' as consisting of just production and commerce, then predation and government are extrinsic to it by definition. However, as we have seen, that does not mean that predation and government are exogenous to the economy in the sense of being unaffected by it.

circumstances of the Low Countries. And there would have been no associational state had the Dutch Revolt failed—which could have happened quite easily.

The consequences

Because the associational state could wage war more or less indefinitely with relatively little harm to its economy, war and economic progress were no longer mutually self-limiting. This had implications both for the nature of war and for the nature of economic progress.

Since economic collapse no longer brought wars to an end, wars tended to go on longer and to become more intense. As we have seen, this accelerated technological progress in military techniques and in weaponry. Because an enemy could no longer be relied upon to destroy his own economy, it became necessary to destroy it through military action—thus ‘total war’.

Economic progress, no longer interrupted or reversed by periods of war, escaped the predation trap. It became cumulative and accelerated. And it was the associational states—first the United Provinces and then the United Kingdom and the United States—that led the way.

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