

12. GOVERNMENT AND ECONOMIC PROGRESS

Government evolved in preindustrial Europe under the fiscal pressure of war to become more hospitable to economic progress. But what made it so? The considerable variation in preindustrial Europe both in regimes of government and in the pace of economic progress suggests some answers.

Our period begins under feudal government and ends with the emergence of two quite different regimes—the associational state and the predatory state. Under feudal government, economic progress was quite rapid during the Commercial Revolution. However, it was interrupted by the wars of the Long Fourteenth Century. Economic progress resumed with renewed vigor once peace returned.¹ Under the associational state, economic progress accelerated. Under the predatory state, it stalled and even reversed.²

What was it that distinguished the economically successful regimes—peacetime feudal government and the associational state—from the unsuccessful ones—wartime feudal government and the predatory state? Differences in exaction were certainly important: we have seen that the evolution of government selected for systems of exaction that were less harmful to the economy. However, governments also did other things that might be expected to have an impact on economic progress: they protected their populations from predation by others; they provided a framework for the enforcement of contracts; and they engaged in various kinds of economic intervention, including the provision of infrastructure. We will look in turn at each of these different areas of government activity.

EXACTION

How did the burden of exaction differ under the different regimes? The only numbers we have are a few estimates of government net revenue as a fraction of total income.

¹We called the post-war regime the conglomerate state—a transitional regime between feudal government and the predatory state.

²This economic divergence within Europe has been called the ‘little divergence’ (see, for example, (van Zanden 2009)) in contrast with the ‘great divergence’ that took place between Europe and the rest of the world (see, for example, (Pomeranz 2000)).

In Castile, considered to be one of the most heavily taxed territories in Europe, the net revenue of its rulers has been estimated at some 5% of total income at the start of the sixteenth century and perhaps 10% by its end.³ In England, considered to be one of the most lightly taxed, the ruler's revenue was perhaps no more than 2% of national income at the end of the sixteenth century.⁴ The net revenue of most predatory governments was probably somewhere in this range—feudal territorial governments at the lower end, predatory states at the higher.

The net revenue of associational governments could be significantly higher—especially in times of war. Florence, during its war with Milan in the early fifteenth century, was collecting some 13% to 16% of income in direct taxes, plus an additional 18% in forced loans.⁵ One estimate for the Dutch Republic during its war of independence has net revenue at around 22%.⁶

These numbers are puzzling. They suggest that the level of exaction was lower under predatory governments than it was under associational governments—the reverse of what one might expect. The numbers also suggest that levels of exaction in most cases were relatively modest by modern standards. How, then, could exaction have had such a significant impact on the economy?

The answer to the puzzle is that government net revenue is a poor measure of the level of exaction and that the level of exaction, even if measured more accurately, is a poor measure of the harm it does. Moreover, how poor an indicator it is differs systematically across regimes.

Systems of exaction

To understand why this is so, we need to recall the different systems of exaction under the different regimes.

³(Thompson 1998)

⁴(Rodger 1998)

⁵(Veseth 1990)

⁶This is an estimate of per capita tax revenue for Holland as a percentage of the income of an unskilled laborer. (de Vries and van der Woude 1997) Table 4.3 p 97.

Peacetime feudal government

We have seen that under feudal government, the ruler was weak and controlled directly only a small part of his territory; local lords and cities enjoyed considerable power and independence.⁷ The ruler's weakness meant that he was unable simply to take what he wanted by force: exaction required the acquiescence of his subjects. Moreover, since he had no independent system of administration beyond his own domains, exaction also required his subjects' active cooperation.

As a result of the ruler's weakness, both the level of exaction and its form were subject to negotiation. The level, therefore, was generally modest—at least in peacetime. And feedback from those who bore the burden tended to eliminate or modify the most damaging forms of exaction.

The Commercial Revolution improved matters even further. With the gradual commercialization of government organization and with the growing availability of credit, rulers found it increasingly in their own interest to establish a reputation for keeping their word and for respecting the law. The resulting rule of law served to constrain further both the level and the form of exaction.

Feudal government in times of war

All this changed, however, in times of war. The power of rulers increased, and their need for resources rose sharply and became more urgent. With access to credit limited, this necessitated a steep increase in the level of exaction.

Since constitutional constraints limited the ability of rulers to increase taxes, they found alternative ways to mobilize resources, such as expropriation and debasement. These forms of exaction were particularly harmful.

The urgency of defending against foreign enemies enabled rulers to obtain the consent of their subjects to general taxes; these were collected throughout a ruler's territory by the ruler's own officials. The cost of obtaining consent, however, was a further strengthening of constitutional constraints on taxation through the establishment of representative assemblies.

⁷As we saw in Chapter 10, the Church too was relatively powerful and largely independent.

The predatory state

Under the predatory state, government became more powerful. However, much of the power came to reside, not in the hands of the ruler, but in the hands of a new predatory class—the predatory bureaucracy. This new predatory class steadily eroded the power of local lords and cities.

Exaction under the predatory state resembled that under wartime feudal government. Indeed, it was precisely the fiscal pressure of war that transformed feudal government into the predatory state. Early over-borrowing led inevitably to default, so that the rulers of predatory states, like their feudal predecessors, had only limited access to credit. They too, therefore, had to rely largely on increased current exaction to finance their wars.

Despite their greater power, the rulers of predatory states still required the acquiescence and cooperation of their subjects. They continued, therefore, to respect the constitutional constraints on taxation. However, to meet their growing fiscal needs, they had to find a way around those constraints.

Their solution was to sell or grant exaction rights to others rather than engaging in exaction directly themselves. They sold offices, tax farms, and monopolies, and they financed their armies by granting enterprisers the right to collect ‘contributions’.⁸ The holders of these rights of exaction made up a significant part of the predatory bureaucracy.

While members of the predatory bureaucracy collected taxes for the ruler or served him in other ways, they engaged at the same time in predation on their own account. We will call such predation—employing the government’s command of force for private benefit—private exaction.⁹ Private exaction typically took the form of corruption, extortion, and embezzlement.

⁸The sale of exaction rights had the additional advantage of providing rulers with much-needed liquidity, since it capitalized the present value of the flow of exaction the purchaser or recipient expected to receive.

⁹Private exaction is a form of private predation. What is different about it is that it employs the government’s command of force rather than a private command of force and that it is often sanctioned by the government—at least implicitly.

Private exaction was informal—it did not officially exist—so constitutional constraints did not apply. That was, of course, the whole idea. Subjects complained, but rulers were far too dependent on the sale of exaction rights and on the support of the predatory bureaucracy to pay much attention. There was consequently no effective constraint either on the level or on the form of private exaction.¹⁰

The associational state

The central government of the associational state, in contrast to that of the predatory state, was weak. The central government of the Dutch Republic had no independent power of its own: it answered to the provinces, and these in turn answered to the cities.¹¹ Power rested ultimately, therefore, almost entirely with local associational governments.¹²

The system of exaction reflected the structure of power. The total sum to be raised was decided at the level of central government through negotiation among the provinces. Each province was then free to raise its quota as it saw fit. Taxes were collected by officials appointed by local associational governments. Such officials were relatively easy to monitor and were immediately accountable to the local population.

Under this system, it was essentially the cities that decided how much to tax and in what form. Because they were imposing taxes on themselves, there were no constraints on their ability to do so. The Dutch Republic had no need, therefore, to engage in such harmful expedients as the sale of offices, tax farming, or the sale of monopolies.¹³ (This was similarly true of independent associational governments under the feudal regime.) As a result, the associational state did not develop a predatory bureaucracy.

¹⁰There are parallels between this method of government finance and that of the late Roman empire, which assigned territorial exaction rights to barbarian mercenaries in lieu of pay (see Chapter 10). In both cases, exaction rights tended to become private property passed on through inheritance. In both cases, the recipients or purchasers became a predatory class.

¹¹See Chapter 11. See also (de Vries and van der Woude 1997) Ch. 5.

¹²The local nobility had some representation at the provincial level.

¹³Some of these practices did exist, but only for administrative convenience. In no case did they make a significant contribution to state revenue. (Hart 1993) Ch. 7; (Hart 1997); (de Vries and van der Woude 1997).

Moreover, once the Dutch Republic re-established its credit, the fiscal burden of war could be spread over time. This made it unnecessary to impose sharp increases in exaction or to rely on emergency sources of liquidity.

A more accurate assessment of the level of exaction

Government net revenue underestimates the true level of exaction for two reasons. First, it does not include all of the government's take from exaction. Second, it does not include what the population loses to exaction beyond what the government takes. Because of their different systems of exaction, the importance of these omissions differs systematically across regimes.

Non-monetary exaction

Government net revenue understates the government's take, because it misses forms of exaction that do not generate cash revenue. In preindustrial Europe, these included the arbitrary seizure of goods and services (through purveyance, billeting, requisition, and conscription) and the gains to the government from debasement and from default on its debt.¹⁴

These non-cash forms of exaction made up a large part of the total for wartime feudal rulers and for predatory states. However, they were negligible for independent cities and for the associational state, which financed themselves almost exclusively through explicit money taxes.

Collection costs

The loss to the population from exaction was not the government's net take, whether cash or non-cash, but its gross take. The two differed by the cost of collection—primarily the compensation of the collectors. This could take the form of explicit payment or of implicit payment through authorized private exaction.¹⁵

Collection costs were far greater for predatory governments. This was especially true for predatory states, which relied so heavily on the sale of exaction rights. For example,

¹⁴In some forms of arbitrary seizure, victims received partial compensations. In these cases, the amount of exaction was the value of goods or services seized less the compensation paid.

¹⁵“Any attempt to produce a quantitative estimate of the size of governmental demands on population is bound to be wrecked on this unknowable but formidable structure of wrongdoing.” (Fryde 1979) p 830

reformers in sixteenth century Spain claimed that no more than a third of the total collected by officials actually reached the treasury.¹⁶

In contrast, under feudal government, many of those responsible for exaction were appointed locally, and under the associational state all were. In these cases, there was much less ‘leakage’ and the government received most of what was collected.¹⁷

Beyond these collection costs, which came out of the gross taken by government, there were additional costs borne directly by the population. These too were higher under predatory governments. As one example, when officials in Spain requisitioned supplies for the military, representatives of towns and villages had to travel two or three times to the regional capital to negotiate compensation and then again to receive payment. The expense of these trips often exceeded the value of the requisition itself.¹⁸

Costs of non-collection

The population also incurred ‘costs of non-collection’—costs of avoiding exaction. For example, tolls on some inland waterways were so high that merchants found it cheaper to ship by road, even though this was twelve times more costly.¹⁹ The consequently higher costs of transportation did not accrue to the government as revenue, but they were nonetheless a loss to the population attributable to the government’s exaction.

The costs of non-collection also included the cost of resistance. In the worst case, resistance could escalate into armed rebellion or even civil war, with enormous losses to all involved. Peasant uprisings in particular were a frequent occurrence under predatory governments, and these were almost exclusively motivated by resistance to exaction.

The costs of non-collection were generally far lower under associational governments.

¹⁶(Thompson 1994). In France, contemporaries estimated that as little as a half of gross tax revenue actually reached the treasury ((Levi 1988) Ch. V).

¹⁷(de Vries and van der Woude 1997) Ch. 2; (Fritschy 2009)

¹⁸(Thompson 1976) Ch. 8

¹⁹(Parry 1967); (Heckscher 1935) Ch. 2

The problem of over-exaction

Sometimes rights of exaction overlapped, with the result that the overall level of exaction tended to be too high—even from the point of view of those engaged in it. That is, a lower overall level would have provided them with greater total revenue.

Someone who has exclusive rights of exaction has reason to limit his current take, because doing so will increase his potential take in the future. However, if exaction rights over the same source are shared by many, none has reason to hold back, because the increase in the future take will accrue mainly to others.²⁰

Under feudal government, this problem occurred when multiple authorities—for example, the ruler, the local lord, and the Church—had the right to exact resources from the same agricultural producers. Under the predatory state, it manifested itself when multiple purchasers of exaction rights preyed on the same population.

The problem of over-exaction was only exacerbated when some of the exaction rights were temporary, as was the case with military enterprisers and tax farmers. It made sense for these to take as much as they could in the present, since future potential was of no value to them.²¹

Under associational government, and particularly under the associational state, all of the exaction from a given territory was in the hands of the same entity. Even when a city collected taxes for its local lord or ruler or for the central government in addition to those it collected for itself, it was aware of the whole picture. It could therefore take into account the effect of its actions on total exaction—adjusting its own taxes when necessary and negotiating adjustments in the taxes it collected for others.

In all, therefore, the true loss to exaction was generally far higher than estimates of net revenue might suggest. And the underestimation was far greater for wartime feudal governments and for predatory states. For the latter, a total loss of 30-50% of income or

²⁰Economists know this problem as the ‘tragedy of the commons’. The usual illustrative example is a fishery in the open seas.

²¹(Smith 1976 [1776]) p 434-5

more seems quite plausible.²² In contrast, for associational states, and for associational governments generally, the total loss was probably much closer to the estimated net revenue.

The impact of exaction on economic progress

A more accurate assessment of differences in the losses due to exaction still fails to capture adequately the differences across regimes in the impact of exaction on economic progress. Doing so requires an understanding of how economic progress works and of how different types of exaction can stand in its way. To see how important this is, let us begin with an analysis based on the conventional theory and then see how much more is revealed by an analysis informed by the new theory.

A conventional analysis of the impact of exaction

According to the conventional theory, the impact of exaction on the economy comes primarily from its incentive effects on production. Producers, expecting that a part of their product will be lost to exaction, devote less effort to production. They also find it less attractive to invest in production. Furthermore, exaction diminishes their ability to invest by reducing the resources they have available.²³

Such incentive effects depend, of course, not only on the level of exaction but also on its form. For example, exaction that is capricious and unpredictable does far more harm than taxes that are predictable and raise the same revenue. The forms that were most unpredictable in preindustrial Europe included the arbitrary seizure of goods and services, expropriation, debasement, default on government debt, and private exaction.

All of these were far more common under wartime feudal government and especially under the predatory state. Precisely because these forms of exaction were so harmful to

²² (Anes 1994) estimates that by the end of the sixteenth century, a Castilian peasant gave up half his harvest to dues, taxes, and rents. This represented, of course, a much higher percentage of his actual income (his value added).

²³Beyond this, exaction may reduce production through the loss or destruction of existing capital. In preindustrial Europe, agricultural producers often had to sell their seed corn, livestock, tools, and even their land to pay their taxes. ((Hilton 1978); (Kaeuper 1988) Ch. 1). And since livestock was difficult to hide, it was the first thing taken by government purveyors ((Ardant 1975)).

the economy, associational governments generally avoided them completely and relied instead entirely on explicit taxes. As we have seen, under feudal government, negotiation between subject and ruler often resulted in the replacement of arbitrary seizure or debasement with the payment of a regular tax.

The incentive effects of exaction on production are undoubtedly important. However, the conventional theory misses the impact of exaction on the *process* of economic progress. The core of that process is market expansion and the resulting reorganization of production. So forms of exaction that slow, or even reverse, market expansion are especially harmful, as are those that hinder reorganization.

The impact on market expansion and the reorganization of production

Exaction affected market expansion mainly through its impact on trading costs. It raised them directly through its effect on the cost of transporting goods—through arbitrary seizure and through the imposition of tolls and tariffs. And exaction raised trading costs indirectly through its impact on commerce. Exaction inhibited commerce in much the same way as it inhibited production. The prospect of loss reduced the expected reward from trading and so the effort devoted to it; it similarly reduced the incentive to invest in commerce. And actual losses to exaction depleted merchant capital which impaired the financing of commerce. The resulting inhibition of commerce meant that it performed less effectively its function of mediating and so reducing the cost of long-distance exchange.

Exaction also affected market expansion through its impact on the supply of goods and on the demand for them. The effect of exaction on supply is captured by the conventional analysis of its impact on production. The effect on demand came primarily from its impact on the disposable income of potential purchasers. In preindustrial Europe, this effect was particularly significant with respect to ‘luxuries’ such as non-grain foods and cheap manufactures. As we saw in Chapters 3 and 4, expansion in the production of these mass-market goods played a particularly important role in economic progress. Of course, exaction also raised the income of the predatory class, and this increased their demand for military supplies and luxury goods. We saw in Chapter 2 that this was an important factor in initiating economic progress in the early Middle Ages.

The effect of exaction in slowing or even reversing market expansion, forestalled the reorganization of production that would have taken place. But some forms of exaction actually inhibited reorganization directly. One notorious example was the Spanish *alcabala*, a 10% *ad valorem* tax levied on every sale of goods or property.²⁴ This tax effectively precluded development of the new manufacturing, which involved extensive buying and selling of intermediate products across specialized enterprises.²⁵

Another form of exaction that inhibited productive reorganization, this time of agriculture, was debasement. The reorganization of agriculture required, as we have seen, the leasing of land to family farms, generally for a fixed money rent. However, the inflation caused by debasement eroded the real value of rents, making this arrangement a risky one for landowners. The result in some cases was regress to older and less efficient forms of organization.²⁶

Exaction also hindered the reorganization of production through its effect in depleting merchant capital. As we saw in Chapter 3, merchants played an essential role in financing the reorganization of production and in financing the new forms of organization that resulted.

Once again, associational governments, attuned as they were to the economic consequences of exaction, avoided forms of exaction that inhibited market expansion or the reorganization of production. Under feudal government, they negotiated with their rulers to substitute less harmful forms of exaction. For example, in the fifteenth century, the rulers of Spain agreed to accept a fixed annual sum from the cities in place of the *alcabala*.²⁷

Under feudal government, local lords too were able to negotiate the substitution of less harmful forms of exaction. For example, in various territories during the crisis of the

²⁴(Ruiz 2001)

²⁵(Miskimin 1977) Ch. 4. Note that the tax was on the total value of the intermediate product, not on the value added alone. The destructiveness of the *alcabala* was noted by Adam Smith ((Smith 1976 [1776]) p 431)

²⁶On the effects of inflation (in this case, not caused by debasement) on the organization of agriculture, see (Harvey 1973).

²⁷(Tracy 2002)

Long Fourteenth Century, the nobility agreed to pay the ruler subsidies in return for his refraining from further debasements.²⁸

Under the predatory state, however, associational government and local lords were much weaker, and there was therefore less feedback and mitigating negotiation. As a result, the predatory state was much less sensitive to the harm it caused. The increasingly desperate rulers of seventeenth-century Spain, for example, reimposed the *alcabala* and debased the currency.

In addition to these various effects of exaction itself, there were other effects—no less important—of the different *systems* of exaction. In particular, these had an impact on entrepreneurship, on cities, and on association—all of which, as we have seen, played an essential role in the process of economic progress.

The impact on entrepreneurship

As we saw in Chapter 5, the various changes that generated economic progress did not just happen by themselves: they were the result of the efforts of the many entrepreneurs who sought out and exploited opportunities for gain—in expanding the market, in reorganizing production, and in innovation.

At any time, however, the supply of entrepreneurship is limited: not everyone possesses the wit, the resources, and the tolerance for risk required of an entrepreneur. Those who do possess these qualities, seek out opportunities for gain wherever they can find them. Such opportunities may exist, at least in principle, in all three economic activities—in predation no less than in commerce and production. The allocation of scarce entrepreneurial talent across the three activities will depend, therefore, on the relative rewards.²⁹

The different regimes differed in the opportunities they offered entrepreneurs. Under feudal government, there were abundant opportunities for entrepreneurship in all three

²⁸(Bisson 1979). The promise was not always kept.

²⁹The seminal work in this area is due to (Baumol 1990). For a survey of subsequent developments, see (Desai and Acs 2007).

activities. Nobles found opportunities in predation, merchants found opportunities in commerce, and both found them in production.³⁰

Under the predatory state, entrepreneurship in commerce and production was considerably more difficult. At the same time, there were abundant entrepreneurial opportunities in predation—particularly within the predatory bureaucracy. So the allocation of entrepreneurial talent shifted accordingly.³¹ The nobility focused its efforts on securing senior positions in the bureaucracy; the growing size, importance, and opulence of the court was testimony to the intensity of competition for the ruler's favor. And the sons of the commercial elite purchased positions lower down the ranks of the bureaucracy.

Under the predatory state, therefore, entrepreneurial talent became concentrated in the machinery of predation.³² There, rather than finding new ways to create wealth, entrepreneurs found new ways to appropriate the wealth created by others. As a result, rather than being agents of economic progress, they placed obstacles in its way.

Under the associational state, the situation was just the reverse. Obstacles to entrepreneurship in commerce and production were minimal and opportunities abounded. Increasingly, not only merchants but producers themselves acted as entrepreneurs—assisted by the ease with which they could obtain financing.³³ While there was probably no less readiness to exploit entrepreneurial opportunities in predation, such opportunities were much harder to find. The very limited power of the central government made it an unpromising instrument of predation. And at the level of the city, where most of the

³⁰Merchants did not pass up opportunities in predation—particularly in privateering in times of war (more on this below). Nobles, for status reasons, were more reluctant to engage in commerce, although the degree of reluctance varied considerably from territory to territory.

³¹(Ekelund 1997). On France, see, e.g., (Wolfe 1972) p 249; on Spain, (Thompson 1998) and (Drelichman 2005); and on England, (Root 1994).

³²(Drelichman 2005)

³³See Chapter 9.

power resided, political competition was intense.³⁴ It was far easier to make a fortune in commerce or production.

The impact on cities

As we have seen, most of the new entrepreneurial opportunities in production and commerce were to be found in or near commercial cities. That was also where it was easiest to exploit such opportunities: the concentration of demand and the low trading costs facilitated the reorganization of production; the presence of commerce facilitated innovation and its diffusion. Cities played a similarly central role in the development of commerce itself: they were the nodes in the network of long-distance exchange and their organized markets, both for goods and for finance, were a vital component in the organization of commerce.

Commercial cities thrived under peacetime feudal government. The comparative weakness of rulers gave them considerable freedom to order their own affairs.³⁵ This allowed them to adjust to new challenges and to take advantage of new opportunities. Exaction by the ruler was usually modest, as was the exaction of the cities themselves. In wartime, of course, the situation deteriorated, with exaction becoming more onerous and with the flow of trade reduced.

Commercial cities suffered even more under the predatory state. The Hapsburg wars—both their physical destruction and the unrelentingly heavy burden of exaction needed to finance them—devastated the commercial centers of northern Italy, the southern Low Countries, and southern Germany; and the commercial cities of Spain began their long decline. In all these territories, high taxes made it impossible for local manufacturers to compete abroad, or even at home, with a flood of cheaper English and Dutch goods. By the seventeenth century, northern Italy—long a center of commerce and manufacturing—was making its living primarily from agriculture.

³⁴Within each city the elite was divided into factions which vied with one another for control of the most lucrative municipal offices. (van Nierop 1997); (Israel 1995) Ch. 6

³⁵Sicily was an exception in this respect. Its rulers saw the independence of its cities as a threat and were powerful enough to suppress it. (Mack Smith 1968) Ch. 5; (Pryor 1979)

The predatory state also weakened commercial cities by eroding their self-government. This was particularly true in Spain, where election to city office was replaced by royal appointment and the resulting positions were sold off by the ruler.³⁶ The purchasers of municipal office joined the ranks of the predatory bureaucracy, with very different interests from those of the local commercial elites that had previously governed the cities.³⁷

Not all cities, however, suffered under the predatory state. Just as individuals can make their living from any of the three basic economic activities, so too can cities. The cities that suffered and declined were those that made their living from commerce and production. Cities that made their living from predation grew and prospered.

The most striking example was Madrid, which became the capital of Hapsburg Spain in 1561.³⁸ While the populations of Spain's commercial cities were declining, the population of Madrid doubled by 1600 to 65,000, and by 1630 it almost trebled again to 175,000. All of this growth was financed, of course, with exaction.³⁹

In contrast, commercial cities in the Dutch Republic thrived under a regime that afforded them complete self-government. Indeed, as we have seen, it was the cities that controlled the central government rather than vice versa. The relative power of cities and state was reflected in the comparative insignificance of the Dutch capital. In the 1580s, to avoid bickering among the more important cities for the honor, The Hague was chosen as the seat of central government. At that time, The Hague was an 'unwalled place'—not even a city—of some 5,000 souls.⁴⁰ By 1647, its population had grown to 18,000, a little over one tenth that of Amsterdam.⁴¹ The contrast with Madrid could not have been greater!

³⁶(Elliott 2002). The rulers of France began to sell municipal offices only after 1692 (Swart 1949) Ch. 2.

³⁷See Chapter 11 for more on the absorption of city government into the predatory bureaucracy.

³⁸(Ringrose 1983)

³⁹“Madrid exported political services (government) in return for taxes and revenue.” (Ringrose 1983) p 314

⁴⁰(Hart 1993) Ch. 7

⁴¹(Israel 1995)

The impact on association

We have seen that association was an essential component in the organization of production and of commerce. However, rulers were always ambivalent about it.⁴² On the one hand, associations could serve as instruments of administration, particularly the administration of exaction. On the other hand, whatever their original purpose, associations could always be turned to new forms of joint action—including sedition.⁴³

Most feudal rulers, given their weakness and their lack of administrative capacity, found associations in general and associational governments in particular more useful than threatening and did nothing to discourage their formation. As a result, there developed in feudal Europe a culture of joint action that made it easier for people to form new associations.⁴⁴

Not even the rulers of predatory states went so far as to suppress associations: instead, they co-opted them. We have seen that the rulers of Spain took over the associational governments of their cities, effectively making them a part of the state bureaucracy. The rulers of both Spain and France did much the same with artisan guilds.⁴⁵ When the predatory state undermined associations, the culture of cooperation weakened and joint action became more difficult.⁴⁶

Under the associational state, with associational government firmly in charge, association in all its forms flourished. It is no coincidence, for example, that it was in the

⁴²(Barzel 2002)

⁴³(Reynolds 1997) Introduction to Second Edition, Ch. 3. The Church shared rulers' suspicion of associations, seeing them as potential hotbeds of heresy. Even cities sometimes feared their independent guilds and fraternities as organizers of subversion ((Nicholas 1997) Ch. 7).

⁴⁴As we have seen (fn. 35), the rulers of Sicily were an exception. Their suppression of associations and associational governments was highly detrimental to Sicily's future economic development.

⁴⁵See below, in the discussion of monopoly.

⁴⁶“The cycle is vicious; loss of group membership in one generation may make men less capable of group membership in the next.” (Homans 1950) p 457.

(Putnam 1993) attributes the difference in economic progress between Northern and Southern Italy to the thriving of association in the North versus its disappearance in the South, due to its subjection to predatory government in the thirteenth century.

Dutch Republic and in England, where the culture of association was also strong, that joint-stock companies first emerged.⁴⁷

PROTECTION AGAINST PREDATION

A governments can use its command of force to engage in predation—in exaction from its own population. But it can also use its command of force to protect its population against predation by others. For predatory governments, this is obviously in their interest, since predation by others diminishes the potential for their own predation; in addition, providing such protection bolsters their subjects’ acquiescence to their rule. For associational governments, the provision of such protection is the basic reason they are created.

Protection against other governments

The most important protection a government needs to provide is protection against predation by other governments. Under an otherwise favorable regime of government, the greatest threat to economic progress is that that regime will be replaced by an unfavorable one.

The inability to provide such protection proved to be a fatal weakness of the associational governments of cities. The independent cities of Northern Italy, previously the economic leaders of Europe, became backwaters after the region was conquered by France and by the Hapsburgs. The Hapsburgs had a similarly doleful effect on the Southern Low Countries, on Southern Germany, and indeed on Spain—all of which had previously been regions of quasi-independent cities and centers of economic progress.⁴⁸ In contrast, the Dutch Republic, the first associational state, defended itself successfully against the Hapsburgs, allowing economic progress to continue there uninterrupted.

⁴⁷(North 1991). See also Chapter 7.

⁴⁸(De Long and Shleifer 1993). The Norman conquest of Southern Italy had earlier had a similar effect as had, to some extent, the unification of Spain under Ferdinand and Isabella. De Long notes that regime change in the other direction—liberation from predatory government—is a major spur to economic progress: he cites the Dutch Revolt and the Glorious Revolution as examples. One could add Northern Italy gaining its independence from the German Emperor in the twelfth century.

Private predation on land

Governments were not, however, the only source of predation. As we saw in Chapter 2, predation was a particularly serious problem for goods and persons in transit: the cost of this was a significant part of trading costs and the one most subject to uncertainty and fluctuation. Much of this predation on transportation was private—by actors other than governments. Such private predation was quite similar to government predation (exaction), both in its form and in its effects.

Rulers and central governments did attempt to provide protection against private predation. However, at the outset of the Commercial Revolution most rulers were too weak to do so effectively. Local lords were in a better position to provide protection, but they were instead themselves the greatest source of private predation and violence. The weakness of rulers left local lords free to engage in banditry and to fight one another for territory, causing widespread death and destruction.⁴⁹

In this environment, producers and merchants were thrown back on their own resources—on ‘self help’—to protect themselves and their property. Self help was in part individual: everyone carried a weapon and was prepared to use it.⁵⁰ However, the benefits of scale in the use of force favored joint action. Indeed, joint action in protecting against predation—often by local lords—was often the original motivation for formatting associational governments in cities and villages. Some groups, merchants in particular, also formed non-government associations for the same reason.⁵¹

As feudal rulers expanded control over their territories, they began to suppress banditry and to provide protection both to their own subjects and to foreign merchants passing through.⁵² Where they succeeded in suppressing banditry—for example, along the routes to the Fairs of Champagne and Flanders—trading costs fell and trade

⁴⁹(Kaeuper 1988) Ch. 2

⁵⁰(Kaeuper 1988) Ch. 2

⁵¹For a group to exploit the advantages of joint action, it had to create a framework for decision-making and execution—that is, it had to become an association. See Chapters 3 and 6 for examples.

⁵²This was partly to promote trade and so their own revenue from taxing it, and it was partly to assert their authority and to increase acquiescence to their rule.

expanded.⁵³ In the same period, banditry by local lords tended to be replaced by less harmful tolls—to the mutual benefit of predator and prey.⁵⁴

As long-distance trade expanded, however, tolls proliferated.⁵⁵ Local lords and cities along a particular route imposed tolls without regard for their cumulative effect—another example of over-exaction. The sum total of tolls along a given route was often so great as to make its use uneconomical. Depending on the availability and cost of alternative routes, this inhibited long-distance trade.

In principle, central governments should have been able to mitigate this problem, but few managed to do so. The two most powerful feudal rulers, those of England and Sicily, did succeed in eliminating internal tolls—to the benefit of their domestic markets.⁵⁶ But most feudal rulers were too weak to do this. For example, in France and Germany, where rulers were weak, the innumerable tolls could bring internal trade to a standstill.⁵⁷

Rulers of predatory states had the necessary power, but for political reasons they generally chose not to exercise it. Any attempt to eliminate tolls would have alienated the local elites who profited from them. This would have endangered the cooperation of these elites in matters of greater concern to the ruler.⁵⁸

And this was one area in which the associational state also failed to shine. Although the constitution of the Dutch Republic prohibited internal tolls, the central government did nothing to enforce the prohibition.⁵⁹

⁵³[Postan, 1987 #842] p 185

⁵⁴This parallels the replacement of harmful forms of exaction with taxes that we saw earlier.

⁵⁵“It is not too extreme a generalization to say that there were tolls everywhere on everything.” (Leighton 1972) p 94

⁵⁶See (Postan 1987) on England. (Epstein 1999) compares the situation of medieval Sicily, with a strong central government, with that of fragmented contemporaneous Tuscany.

⁵⁷“The total weight of the internal tolls was thus heavy and growing, and may in part account for the gradual clogging of internal trade in the closing centuries of the Middle Ages.” (Postan 1987) p 184

⁵⁸See (Heckscher 1935) Ch. 2 on France and (Thompson 1998) p 282 on Spain.

⁵⁹Many tolls were in fact user fees—levied to pay for roads, canals and harbors—and therefore economically justifiable (Jan de Vries, private communication). But cities also imposed tolls on transit trade purely to raise revenue ((de Vries and van der Woude 1997) Ch. 2).

Predation at sea

Hard as it was for governments to provide protection on land, it was harder still for them to do so at sea. Venice did succeed in suppressing piracy in the Adriatic, at least some of the time, and Denmark and Sweden later did the same in the Baltic. However, the control of larger bodies of water such as the Mediterranean or the Atlantic was out of the question given the naval technology then available.⁶⁰

Consequently, merchants and shipowners had no choice but to rely on themselves for protection. Merchant ships always sailed armed. Before the advent of the cannon, this meant that they carried a large complement of fighting men: doing so could double the size of the crew and so the cost of the voyage.⁶¹

On longer voyages, ships often sailed in convoy for mutual protection. Governments helped organize such convoys. Beginning in the fourteenth century, Venice organized a system of regularly scheduled galley fleets.⁶² In the sixteenth century, the rulers of Spain organized convoys for ships sailing to and from their possessions in the Americas and provided royal warships to protect them.⁶³

Even so, self-help remained important. And it became considerably more effective when relatively inexpensive iron cannon became available in the late sixteenth century. From then on, merchant ships increasingly chose to avoid the costs and delays of convoying and to rely instead on the protection of their own guns.⁶⁴

In addition, as commerce and finance developed, it became easier for merchants and shipowners to manage the risk of loss rather than to incur the expense and delay of preventing it. Insurance became widespread in the Mediterranean and in Spain. In the Netherlands, merchants preferred to use the share partnership as a way of spreading and

⁶⁰(Lane 1973) Ch. 7. Piracy remained a chronic problem in the Mediterranean throughout the period.

⁶¹[Lane, 1973 #2002] Ch. 5.

⁶²(Lane 1973) Ch. 10

⁶³(Glete 1999) Ch. 9. They similarly organized convoys and protection for the herring fleets of the Spanish Netherlands.

⁶⁴Of course, pirates too benefited from the availability of iron cannon. (Unger 1980)

diversifying risk; the existence there of charter houses also made it easy for them to split cargoes across multiple vessels.⁶⁵

While governments did make some attempt at providing protection against piracy, they were also its principal source. Indeed, relatively few pirates acted purely on their own account. The great majority were licensed by governments as privateers. In wartime, governments promoted such ‘legal’ piracy for strategic reasons—to interrupt the trade of their enemies and to reduce their revenues. And governments also shared in the profits, which could be considerable. For example, when the sixteenth-century English privateer Sir Francis Drake captured Spanish treasure ships carrying over £600,000 in bullion, some £250,000 went to Queen Elizabeth—an amount several times her normal annual income.⁶⁶

Privateering also offered the nobility a welcome opportunity for entrepreneurship in predation. English nobles, in particular, built private fleets, sometimes of as many as a dozen ships, to engage in privateering and piracy.⁶⁷ But merchants, too, found the profits attractive. When war interrupted normal trade, they were more than willing to employ their idle ships in privateering.⁶⁸

CONTRACT ENFORCEMENT

Another force-based service that governments could provide was the enforcement of contracts. As we have seen, contracts are an indispensable instrument of economic organization—especially in commerce and finance. Their use, however, involves problems of reliance. One way to address such problems is through third-party enforcement. And, because of governments’ command of force, they were in a position to act as such a third party.⁶⁹

⁶⁵With these alternatives available, insurance was relatively slow to catch on in the Netherlands ((Christiensen 1941)). See Chapter 7 for more on charter houses.

⁶⁶(Unwin 1927) Part 2 Ch. 5

⁶⁷(Scammell 1972) p 401

⁶⁸“... in the late sixteenth century the privateering war against Spain was a different matter once London mercantile wealth, energies and talent were involved.” (Scammell 1972) p 396

⁶⁹See Chapter 6 for an extensive discussion of contract, reliance, and enforcement.

Ruler courts and others

Under feudal government, rulers initially lacked court systems that would have been able to provide enforcement throughout their territories. There were, however, local courts—those of local lords (seigniorial courts) and of associational governments.⁷⁰ The Church too had its own courts, and it offered these as a venue for cases of debt and contract.⁷¹

Local courts were adequate for the resolution of contractual disputes between locals. However, they satisfied only partially and imperfectly the need to resolve contractual disputes between merchants from different places—a need that grew with the expansion of long-distance trade. As a result, as we saw in Chapter 6, merchants developed alternative ways to support transactions between strangers.

By the twelfth and thirteenth centuries, feudal rulers were developing systems of courts throughout their territories that provided an alternative to local courts and to the non-court arrangements developed by merchants.⁷² However, these other mechanisms of dispute resolution continued to exist and to function, and the different types of court competed with one another vigorously for business.⁷³

Ruler courts grew in importance under the predatory state, because of their role in enforcing the many new laws and regulations. Nonetheless, other types of court continued to thrive. Indeed, in France, most of the courts were civic or seigniorial.⁷⁴ And in Spain, seigniorial courts actually grew in importance, and much of the commercial litigation was decided in the courts of the *consulados* (merchant associations).⁷⁵ In

⁷⁰The provision of formal order was indeed one of the basic functions of associational government. The right to their own legal system with jurisdiction over their own citizens was an essential right of cities, detailed in their charters ((Reynolds 1997) Ch. 6).

⁷¹The Church argued that its interest in promoting good faith and the sanctity of promises gave it jurisdiction over cases involving usury or failure to perform oaths and vows ((Finer 1997) V. 2 Ch. 5).

⁷²The new courts were generally popular with subjects and helped to extend the rulers' authority into the territories of their vassals ((Strayer 1970) Ch. 1).

⁷³(Britnell 1996) Ch. 6

⁷⁴(Henshall 1992) However, there was a right of appeal to the royal courts.

⁷⁵(Swart 1949) Ch. 2; (Grafe 2001)

England, the common law courts more than held their own, and most commercial and debt litigation was decided in the courts of the two hundred chartered cities or in other local courts.⁷⁶

Under the associational state, the central government possessed no general system of courts of its own. In the Dutch Republic, the courts of first instance for debt and for commercial contracts were the municipal courts, and the highest courts of appeal were those of the provinces.⁷⁷ Foreign merchants found the municipal courts of Amsterdam sufficiently efficient and impartial that they relied on them entirely for settling their disputes. They saw no need, therefore, to establish their own merchant colony courts as they had earlier in Antwerp and Bruges.⁷⁸

A comparison of the different courts

Ruler courts were, therefore, only one of the many types of court available for the enforcement of contracts. Compared to the others, they had both advantages and disadvantages. One of their advantages was their broad geographic jurisdiction, which made it easier for them to enforce judgments in disputes between parties from different places.⁷⁹ They also enjoyed benefits of scale: because ruler courts handled a large number of cases, individual courts could specialize in particular types of litigation. Of course, the courts of the great commercial centers handled a large volume of cases too, so that they too were able to specialize.

The principal disadvantage of ruler courts was in the nature of the service they provided. Courts generally serve the interests of those who create them. The courts of associational governments, associations, and organized markets were created by merchants and producers to facilitate commerce and production; ruler courts were created by rulers to facilitate predation. Consequently, ruler courts existed primarily to enforce

⁷⁶(Nef 1940) Ch. 2

⁷⁷Holland and Zeeland operated two courts of appeal that served both provinces. (Price 1995). The Hapsburgs had tried to establish a central court in Mechelen, but these attempts ended with the end of Hapsburg rule.

⁷⁸(Gelderblom 2010)

⁷⁹See (Berman 1983) on the establishment in England of a national system for the enforcement of debts during the Commercial Revolution.

exaction and to punish sedition and rebellion.⁸⁰ When they added the work of enforcing private contracts, this remained subsidiary to their primary purpose.

Differences in purpose were reflected in differences in law.⁸¹ Ruler law was top-down—based on the will of the ruler. Moreover, since it was to be administered by geographically dispersed officials, it had to be codified. Ruler law tended, therefore, to be rigid, and its ability to adapt to local conditions, limited.⁸²

In contrast, the law of associations and of organized markets was based on custom. It was generally not codified, and it evolved organically to meet the needs of those it served. Not surprisingly, the law of contracts developed first in the commercial courts, where it was distilled from commercial practice. When ruler courts started to enforce contracts, they generally adopted the law that had already been developed by the commercial courts.

Central government courts could, therefore, contribute to the enforcement of contracts. However, because there were alternative contract enforcers, their contribution was not essential. Moreover, central government courts were not necessarily the ones best suited to the task. Most notably, the Dutch Republic managed perfectly well with no central government courts at all.⁸³

Alternatives to court enforcement

In addition, as we saw in Chapter 6, enforcement is not necessarily the best mechanism—or even a particularly good one—for resolving contractual disputes. Default can happen for one of two reasons—an unwillingness to keep a commitment or an inability to do so. Enforcement addresses only the first. However, in the high-risk business environment of preindustrial Europe, the second was far more common. Consequently, negotiation was a more appropriate response in most cases of default than

⁸⁰(Nef 1940) Ch. 2

⁸¹(Benson 1989); (Benson 1990); (Benson 1998)

⁸²This uniformity did have the offsetting advantage, however, of providing a more predictable legal environment for strangers

⁸³(Price 1995) p195

litigation. And negotiation was generally what the parties preferred.⁸⁴ Associations and organized markets catered to this preference by providing convenient frameworks of arbitration.⁸⁵

Moreover, it is possible to organize exchange between strangers so as to avoid the problem altogether. As we saw in Chapter 7, the development of commerce—in particular, the emergence of bourse markets and commission agents—reduced the need for strangers to transact with one another directly. Increasingly, they could instead transact indirectly through trustworthy intermediaries.

Such intermediaries had a strong reputational interest in honoring their commitments. And their business was organized in such a way as to minimize the danger they would be unable to do so. In particular, they arranged the financing of trade through financial intermediaries and financial markets rather than providing it themselves. As a result there was far less occasion for litigation.

So in the whole scheme of facilitating long-distance trade, the enforcement of contracts by central governments played only a minor and inessential role.⁸⁶ Moreover, commerce had a much stronger incentive than did central government to find ways of facilitating long-distance exchange, and it did so increasingly well.

ECONOMIC INTERVENTION

While much of the impact of government activity on the economy was unintended, governments, in a number of ways, did intervene in their economies deliberately. They tried to ensure supplies of essential commodities—particularly of grain. They acted to ensure an adequate supply of bullion. They created monopolies. And they invested in infrastructure.

⁸⁴(Gelderblom 2010)

⁸⁵Associations and organized markets also provided an informal order based on reputation and credit. As we saw in Chapter 6, such an informal order is better than the formal order of courts in addressing problems of reliance when performance is more difficult to verify, as it is in equity financing and representation.

⁸⁶Empirical work by (Acemoglu and Johnson 2005) on modern economies confirms this. It finds that the quality of institutions supporting private contracts has no discernable effect on economic development and growth.

Provision

Any region could suffer a shortage of grain, which would result in a rise in the cost of subsistence and sometimes in famine. A shortage of grain was a particularly serious problem for cities, with their large concentrations of population.⁸⁷

Common policies to address the problem included prohibiting the export of grain, offering inducements to importers, and regulating trading. Regulations included price controls and the requirement that producers sell directly to consumers, cutting out the ‘middleman’—who was always suspected of hoarding and speculation. When shortages were severe, governments sometimes seized and distributed private stocks of grain. They sometimes even authorized ‘grain piracy’—sending out ships to seize cargoes of grain on the open sea.⁸⁸

Under feudal government, it was mainly the cities themselves that undertook such policies. Cities generally had the necessary authority and the problem was of immediate concern to them. Rulers of urbanized regions and of large subject cities played a role too. Under the predatory state, cities enjoyed less independence and so rulers took a greater responsibility for policies of provision.⁸⁹

On the whole, these policies were counter-productive. The two best ways to mitigate shortages—which were typically the result of poor local harvests—were storage and inter-regional trade. Government intervention made both more difficult and less profitable. And, of course, interference with trade tended to prevent the kind of regional specialization that increased productivity. Fortunately, however, the ill effects of government intervention were lessened by its general ineffectiveness.

In contrast, the sole associational state had no policy of provision at all: the Dutch Republic relied entirely on the market. It imposed no restrictions on exports, even in the

⁸⁷(Miller 1971), (Overton 1996)

⁸⁸(Parry 1967) p 157

⁸⁹Rulers of predatory states were also concerned with provisioning their increasingly large armies: see Chapter 11.

face of local shortages. And there was no need to encourage imports, since Amsterdam had become the center of the European grain trade.⁹⁰

Bullionism

Governments were much concerned with the supply of bullion.⁹¹ An adequate coinage was, of course, necessary for exchange. But rulers were motivated less by this need than by their own need for revenue from seigniorage—for which a steady flow of bullion to the mints was essential. In addition, reserves of bullion provided rulers with an important source of liquidity in times of war.

Bullion shortages first became a problem during the wars of the Long Fourteenth Century. In response to developing shortages, rulers prohibited the export of bullion or coin and required importers of bullion (exporters of goods) to bring their bullion to the mints to be coined. They also restricted the activities of financial middlemen, such as money-changers, bullion dealers, and bankers, whom they suspected—not without cause—of frustrating their policies.⁹²

Bullionist policies, like policies of provision, were harmful or, at best, ineffective. Most ‘shortages’ were in fact a consequence of the mints offering too low a price for bullion compared to the price elsewhere—often because of aggressive debasement of the coinage.

Attempts to block the movement of bullion in the face of such strong incentives were doomed to failure.⁹³ Moreover, attempts to do so often caused considerable collateral damage. For example, the rulers of England tried to prevent exporters of wool from selling their product against bills of exchange, requiring them instead to demand full

⁹⁰(Tielhof 2002) Ch. 3. Amsterdam had a strong interest in free trade and that city dominated the Republic’s politics.

⁹¹(Postan 1973) Ch. 1

⁹²Rulers also took other ‘bullionist’ measures to reduce outflows of bullion—restricting imports of luxuries, for example, and promoting import substitution.

⁹³(Munro 1972)

payment in specie. This gained the crown little bullion, but it did succeed in shutting down completely the trade in English wool.⁹⁴

Rulers of predatory states generally continued the bullionist policies of their feudal predecessors. Even Spain—despite the flood of bullion imports from the Americas—continued to ban exports of gold and silver.⁹⁵ These policies caused prices to rise in Spain, making exports expensive and imports cheap, and undermining the competitiveness of Spanish producers.⁹⁶

In contrast, the Dutch Republic refrained entirely from bullionist interventions, and it imposed no restrictions whatsoever on the export of bullion. This policy helped to make Amsterdam the European center—indeed, the world center—of the bullion trade.⁹⁷

Monopoly

The creation of monopolies, of course, inhibits economic progress. Monopolies raise prices: this increases the profits of the monopolists but at the expense of market expansion. Beyond this, the absence of competitive pressure weakens the incentive to reduce trading costs and thereby short-circuits the trading cost multiplier.⁹⁸

Under feudal government, it was mainly cities rather than rulers that intervened to monopolize trade. As we saw in Chapter 6, cities used their command of force to limit exchange for the benefit of their own merchants and at the expense of those of other cities.

The rulers of Sicily and England were, however, exceptions. They created monopolies in the export of wheat and of wool, respectively, and sold the monopolies to

⁹⁴It also caused significant harm to cloth manufacturers in the Low Countries and a general shift there to a more reliable source of wool in Spain. ((Wilson 1925 [1572]) #1081}; (Munro 1979))

⁹⁵(Vives 1970). In 1551, Charles V began to grant export licenses as an inducement to international bankers to provide him with loans ((Martín 1994); also, see Chapter 9).

⁹⁶(Drelichman 2004)

⁹⁷(van Dillen 1934), (Vilar 1976), (Van der Wee 1977). The Bank of Amsterdam (see Chapter 8) played a central role in this market.

⁹⁸See discussion in the conclusion to Chapter 7.

foreign merchant banks in exchange for loans.⁹⁹ Monopolization by rulers differed from that of cities in that it was generally at the expense of their own populations—being simply another form of exaction.

The creation and sale of monopolies by rulers expanded greatly under the predatory state. Already in the sixteenth century, the rulers of both France and England established monopolies in mining.¹⁰⁰ Monopolies in manufacturing was more difficult to enforce, because production was much more dispersed geographically. However, Spain and France managed to do so by turning the artisan guilds into state-enforced monopolies.¹⁰¹ England, on the other hand, was the master of trade monopolies, and by the end of the sixteenth century almost all of its foreign trade was controlled by one monopoly or another.¹⁰²

The Dutch Republic was largely free of monopoly. The main exceptions were the great Companies of the East Indies and the West Indies, which were granted monopolies of their respective trades. In both cases, however, the motive was military rather than fiscal. Each company was formed by consolidating a number of smaller existing companies to capture the advantages of scale in the use of force. This was considered necessary to challenge Spanish and Portuguese control of transoceanic trade. The state benefited from the military activity of the two companies but received no fiscal support from them. Several attempts at forming additional trading monopolies foundered on the unwillingness of merchants to cooperate and on the general unpopularity of the idea.¹⁰³

The weakness of the central government of the Dutch Republic meant, however, that the cities were free to engage in local protectionism. It was not uncommon, therefore, to find cities levying excise taxes at higher rates on ‘foreign’ goods—including those of other Dutch cities and provinces.¹⁰⁴

⁹⁹The rulers of Naples and Sicily also established monopolies in the production and sale of iron and salt.

¹⁰⁰(Wolfe 1972) Ch. 1.

¹⁰¹On France, see (Nef 1940) p 15; on Spain, (Vives 1970).

¹⁰²Being an island made it much easier, of course, to enforce such monopolies.

¹⁰³(Riemersma 1950), (Tielhof 2002), (Tielhof 2002)

¹⁰⁴(de Vries and van der Woude 1997) Ch. 2

Overall, then, the picture was quite unlike the modern idea of government as the champion of competition, preventing and, where necessary, breaking up monopolies.¹⁰⁵ In preindustrial Europe, it was governments that created and enforced monopolies.

Infrastructure

The considerable investment in infrastructure during the Commercial Revolution was predominantly the work of the cities. However, some rulers did play a role—those of Sicily, in particular.

Under the predatory state, infrastructure became a responsibility of the central government. As we have seen, the predatory state weakened institutions of joint action—particularly local associational governments. Consequently, when people wanted something done, rather than organizing it themselves, they petitioned the ruler. If there was need for a new road or canal, for example, it came more naturally to people to lobby the state for action rather than organizing it locally themselves. The state, however—in perpetual fiscal crisis—was rarely able to respond. And even when it did, projects were planned by bureaucrats in the capital and were often poorly suited to local needs.¹⁰⁶

In the Dutch Republic, investment in infrastructure was substantial and widespread. Most notable was the development of an extensive system of canals linking the major commercial cities to one another.¹⁰⁷ This system provided regularly scheduled inter-city barge services for both passengers and packages—with hourly departures between Amsterdam and Haarlem, for example. The canals also accommodated private freight barges carrying bulk cargo.

The central government played no role in the construction of this system—or of any other infrastructure. The system was built partly by the cities—motivated by competition among them for commercial business.¹⁰⁸ However, much of it was built by the peat industry to bring its product to urban markets. This was perhaps the first major example of for-profit construction of transportation infrastructure by the private sector.

¹⁰⁵Not that modern antitrust is notably successful: see (Winston 2006) Ch. 3.

¹⁰⁶(Szostak 1991)

¹⁰⁷(de Vries and van der Woude 1997) Ch. 5

¹⁰⁸(de Vries 1974); (de Vries 1981); (de Vries and van der Woude 1997)

In general, lower levels of government—and the private sector—are more effective at providing infrastructure. They are closer to the problem and so have better information. And they are more responsive to the needs of potential users.¹⁰⁹

The effects of economic intervention on economic progress

The different regimes varied widely, therefore, in the extent to which they intervened in their economies. We have seen that under feudal government, rulers intervened relatively little: what intervention there was came mainly from the cities. Sometimes, as with investment in infrastructure, intervention by the cities was beneficial. Sometimes, as with policies of provision and monopolization, it had immediate benefits for the city itself but only at the expense of hindering trade and slowing economic progress in general.

It was the predatory state that intervened most extensively in its economy. The power of the state and its large bureaucracy made intervention possible, and such intervention was in the interest both of the ruler and of the bureaucracy. New interventions required additional officials to enforce them, and this gave the ruler more offices to sell. New interventions also increased the potential for corruption, benefiting existing office-holders.¹¹⁰ For the predatory state, economic intervention was simply an adjunct to its system of exaction.

Historians have given the resulting collection of interventions the name ‘mercantilism’—implying that it was motivated by a coherent, if flawed, economic philosophy. However, whatever its rationalization, the true motive was always entirely fiscal and strategic—to generate revenue and to facilitate the waging of war. ‘Fiscalism’ would be a better name for it.¹¹¹

While the extensive intervention of the predatory state did generate revenue for both ruler and bureaucracy, this came at a high cost in terms of impeding economic progress. Trading monopolies hindered the expansion of the market; production monopolies and

¹⁰⁹(Qian and Weingast 1997); (Olson 1969).

¹¹⁰Perversely, the more harmful the intervention the better for increasing the value of office: subjects were unlikely to bribe officials to refrain from interventions that were beneficial. (Shleifer and Vishny 1993)

¹¹¹(Ekelund 1997) makes a strong case for understanding mercantilist policies in terms of rentseeking.

industrial regulation prevented the reorganization of industry and impeded technological progress.¹¹² Moreover, the government takeover of the guilds, especially in France, turned them into an obstacle to technological progress—something they had never been before.¹¹³

Of all the regimes, the associational state intervened in its economy the least. The provinces of the Dutch Republic did not give the central government the authority to do so, and having no independent source of revenue or of local administration it lacked the means. Economic intervention by the cities was limited to investment in infrastructure and some local protectionism. The benefit of the former seems to have outweighed the harm of the latter, since the internal market of the Dutch Republic was relatively well integrated.¹¹⁴ Its internal trade was substantial, and this was an important factor in its overall economic success.¹¹⁵ On the whole, markets were allowed to function unimpeded, to the benefit of economic progress.

CONCLUSION

We have seen that government can have both negative and positive effects on economic progress. We will summarize these effects and draw up a balance for the different types of government and the different regimes.¹¹⁶

What governments do

A government is an organization that enjoys a preponderance of force in a given territory. Not surprisingly, much of what it does involves the use or threat of force. It employs force to expand its territory, to defend its territory against encroachment by other governments, and to defend itself against internal threats to its control.

¹¹²(Miskimin 1977), writing on France, but his observations apply more generally.

¹¹³(Vives 1970), (Epstein 1998)

¹¹⁴For example, commodity prices throughout the country followed quite closely those in Amsterdam ((de Vries and van der Woude 1997) Ch. 5). However, (Yntema 2009) finds that increasing local protectionism in the market for beer from the mid-seventeenth century led to the decline of the brewing industry.

¹¹⁵(de Vries and van der Woude 1997) Ch. 5 p 179

¹¹⁶We defer to Chapter 17 a general discussion of what economic progress requires of government.

A government also employs force to exact resources from its territory. Such exaction may be official—for the use of the government. Or, it may be private—employing the government’s command of force to obtain resources for others. These others are often—but not always—agents of the government, employing for their own benefit the government power that has been delegated to their control.

A government’s command of force also enables it to provide certain force-based services. One such service is protection against private predation—predation by parties other than governments. Another is the enforcement of private contracts. Yet another is intervention in the economy to limit transactions for various reasons—for example, to create or support a monopoly (often as a means of exaction) or to mitigate shortages.

In addition to its command of force, a government possesses a second instrument—the resources it gains through exaction. It uses these primarily to finance its deployment of force and to support the consumption of the government and its agents. But it may use some of its resources to intervene in its economy. For example, it may invest in infrastructure; it may try to influence private economic activity through incentives; and it may engage directly itself in economic activity.

The impact on economic progress

What impact did these different types of government action have on economic progress in preindustrial Europe? War—whether external or internal—was, of course, highly destructive. Foraging soldiers inflicted considerable material losses. However, loss of life—military as well as civilian—was mostly the result of epidemic diseases spread by the movement of armies. The impact of disease was magnified by the economic and social disruption caused by war and by the exaction needed to finance it.¹¹⁷

We have reviewed the impact of exaction—on production, on expansion of the market, and on the response to that reaction. The destruction of war had many of the same effects. For example, war raised transportation costs through increased banditry and piracy in much the same way as did increased exaction. Similarly, have seen that the system of exaction could be harmful to voluntary association, commercial cities, and

¹¹⁷(Landers 2005). See (Maddicott 1975) on the economic impact in England of the exaction needed to finance the Hundred Years War.

entrepreneurship—all vital to economic progress. A government's desire to prevent internal challenges to its control could have similar ill effects.

Some forms of government action could, at least in principle, be beneficial. Protection against predation by other governments was extremely important, and protection against private predation could be helpful too. Government enforcement of private contracts could sometimes be of value. Governments could also act as vehicles for joint action—for example, in the provision of market and transportation infrastructure. The value of other government actions is more questionable—for example, policies of provision, even when well-intentioned, were usually counter-productive.

The balance for the different types of government

Weighing the positive against the negative, the balance was generally positive for associational governments and negative for predatory governments. This is hardly surprising given the different purposes and origins of the two types of government. There were, however, circumstances that could worsen the balance for associational government or improve it for predatory government.

While exaction tended to be less damaging under associational governments, this could change if governance broke down and government was taken over by a tyrant or by an oligarchy, who then managed exaction to their own advantage. Conversely, exaction tended to be more damaging under predatory government, but the ill effects could be mitigated if the ruler was weak and had to negotiate with his subjects for support. Harming the economy was, of course, contrary to a ruler's own long-term interests, and more enlightened rulers could behave more as 'herdsmen' than as predators—at least in peacetime.¹¹⁸ But in times of war, consideration of the short term dominated: faced with starvation, a herdsman will slaughter his flock.

It protecting their populations against predation by other governments, predatory governments were, in principle, more effective because they generally commanded greater force. However, this advantage was offset to some extent by the greater ability of associational governments to mobilize resources and to exert economic power. Also, the

¹¹⁸(Olson 2000)

armies of predatory governments tended to do more harm to their own civilian populations.

As associations, associational governments were better suited to serving as vehicles for joint action: as we have seen, associations are readily adapted to new functions. Associational governments also had the advantage of being closer to their populations and so better tuned to their needs and wishes. As a result, they generally did a better job of protecting against private predation—most notably the maritime cities. Similarly with investment in transportation infrastructure: predatory governments were much less likely to invest in it, and when they did, the results were much less likely to be useful.

The difference is even more clear with respect to the provision of a formal order. As we have seen, effective and responsive contract enforcement was important to the development of commerce and essential to the development of financing. It was the cities that provided the necessary courts, and it was competition among them that ensured that these courts were sufficiently responsive to the needs of those who used them.¹¹⁹ Ruler courts were both less effective and less responsive.

Associational governments were more inclined to engage in economic intervention. However, the consequent harm was tempered by competition among them. Predatory governments, controlling larger territories were less troubled by competition and so more effective. For example, the English monopoly on high-quality wool lasted for centuries; it was broken only after merchants brought merino sheep to Spain and promoted production there. On balance, therefore, the economic intervention of predatory governments, when it occurred, was probably more harmful.

The different regimes

The feudal regime of government that obtained during the Commercial Revolution was conducive to economic progress, because predatory government was fragmented and weak and, as a result, associational government was strong and enjoyed considerable independence. Moreover, competition among predatory governments exerted powerful fiscal pressure on rulers that forced them to negotiate with their subjects. The regime

¹¹⁹(Gelderblom 2013)

became less friendly to economic progress as war intensified during the Long Fourteenth Century.

In the conglomerate states that emerged from those wars, predatory government was somewhat more powerful and associational government somewhat less. Nonetheless, economic progress resumed during the Long Sixteenth Century. However, the weakening of associational government in the cities of northern Italy was one of the reasons why the economic center shifted from there to the Low Countries, where associational government was becoming stronger.

The intensification of war in the Long Seventeenth Century, with its accompanying intense fiscal pressure, created both the predatory state and the associational state. In the predatory state, predatory government was greatly strengthened by the creation of a predatory bureaucracy and associational government was significantly weakened. The result was economic stagnation and decline.¹²⁰

The associational state, in contrast, represented a triumph of associational government. Predatory government was completely absent, and the tendency of associational government to degenerate into predation was effectively restrained. The consequences for economic progress were much as one would expect.

What then does economic progress require of government?

Our theory suggests a simple answer: economic progress is a self-perpetuating process, and all that is required of government is that it let it happen. That is, all that economic progress requires of government is that it not place obstacles in its way. What that means primarily is that the predation of government itself should be limited.

Is it not necessary for government to do anything else? We have seen that government can make a positive contribution to economic progress. Here, it is essential to distinguish between central or territorial government and local government. There is one positive thing that may be done better by central government—protection against harm by foreign governments or by other sources of organized force, foreign and domestic. This should be done by central government because of the advantage of scale in the deployment of force.

¹²⁰See, for example, (Alvarez-Nogal and Escosura 2007) on the decline of Spain from the sixteenth century.

There are other positive things that governments can do by serving as vehicles of joint action. These include protection against private predation, the provision of a formal order, and investment in infrastructure. However, as we have seen, if these things are done by government, it is best they be left to local associational governments; central governments do them much less well. Moreover, none of these functions needs to be performed by governments. They can be performed by other vehicles of joint action—other, non-government, associations. Or they need not be performed at all, because they are simply not essential for economic progress.¹²¹

We have seen, however, that local associational governments can also do things that inhibit economic progress—the imposition of tolls, local protectionism, and courts biased in favor of locals. Would it not be beneficial for central government to intervene to prevent these things?¹²²

Perhaps, but to do so, the central government would have to be sufficiently powerful. And the more powerful it is, the less likely it is to limit its own predation or to refrain from harmful interventions of its own. And, perhaps most important, the more power the central government possesses, the more likely it is to become an instrument for the private exaction of its officials.¹²³ A better, and safer, check on the misbehaviour by local governments is competition among them.

Indeed, the two regimes that experienced the most rapid economic progress in preindustrial Europe—peacetime feudal government and the associational state—were both characterized by the limited power of central government. Under feudal government, central government was predatory; under the associational state, it was associational. However, this difference seems to have mattered less than that in both cases the power of central government was limited.

One result of this limited power, under both regimes, was that the governed had a significant voice in determining the level and form of exaction. Another was that the

¹²¹(Tabellini 2005) reaches a similar conclusion with respect to today's developing economies.

¹²²(Epstein 2000) has argued this in the context of preindustrial Europe.

¹²³And, in any case, competition among local governments is a powerful constraint on their misbehaviour.

governed were largely free to order their own affairs—forming voluntary associations as needed and managing commercial cities to meet the needs of commerce.

It seems, therefore, that in preindustrial Europe a central government of limited power was necessary for economic progress: but it was not sufficient. Feudal government was limited, but it was also politically unstable and, therefore, susceptible to outbreaks of war. Because of its fiscal weakness, war halted and even reversed economic progress. In contrast, the associational state was politically stable and fiscally strong. Despite the limited power of its central government, it was able to mobilize sufficient force to provide effective protection against foreign governments. As a result, economic progress could continue unabated—even in times of war.

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