Absolutism and financial revolution: The case of the Crown of Aragon, 1340-1750

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One of the tenets of the New Institutional Economics is that pre-modern rulers were predator: the absolutist kings overtaxed their subjects and offered no legal security, thus precluding economic growth. According to North and Weingast, the English Glorious Revolution gave birth to a regime in which, for the first time in history, property was protected, as a Parliament constrained the ruler and prevented predation. Moreover, the English government could borrow at lower interest rates than before, as the lenders knew that the Parliament would ensure that debt was honoured.[1] That idea of credible commitment engaged with a long tradition of English exceptionalism. It was inspired by the notion of financial revolution, coined by Dickson to describe the political and institutional innovations developed in England since 1688. According to him, these changes had allowed the government to issue long-term debt at low interest rates, since it was secured by taxes raised and monitored by the Parliament. That had been the main cause of the extraordinary expansion of the English empire and the precocious industrial revolution.[2] The ideas of credible commitment and financial revolution have been applied to other European countries like the late medieval and early modern Dutch provinces and towns, and also the Italian city-states in the High Middle Ages. Some authors perceived that similar innovations had also happened in Iberian territories of the Crown of Aragon, but only regional and local historiography has defined them as a financial revolution.[3]

This paper argues that the ingenious financial and institutional arrangements developed in Valencia, Catalonia, and Aragon since the mid-fourteenth century constituted a true financial revolution which resulted in a highly decentralised political model. This system lasted for more than three centuries thanks to sophisticated formulae like the debt rescheduling agreements called *concordias*. The Aragonese model did not decay because of the intervention of an absolutist ruler, who actually protected the traditional mechanisms fearing that the credit system collapsed. Its decline was produced by a change in the profile of the creditors, mainly ecclesiastical institutions which behaved as rent seekers, and by the impossibility of refinancing the debt provoked by the royal ban on raising new taxes and issuing more debt. The obstacles to economic growth were not legal insecurity and predation by absolutist rulers, but decentralised rent seeking and coordination failures. Only the modern state, which started emerging in the 1750s, made economic growth possible.[4]

The Aragonese model and the *concordias*

The Crown of Aragon was a polity born from the union between the Kings of Aragon and the Counts of Barcelona in the twelfth century. The kingdoms of Valencia, Majorca, Sicily, Sardinia, Naples, and the distant duchies of Athens and Neopatras were incorporated into the Crown of Aragon until the fifteenth century. In 1469, the marriage between Fernando of Aragon and Isabel of Castile meant the union of the two Crowns, which would be inherited, together with other Iberian and European

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[1] Douglass C. North & Barry R. Weingast, 'Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England', *The Journal of Economic History*, 49, n.º 4 (1989): 803-32.

[2] P. G. M. Dickson, *The financial revolution in England: a study in the development of public credit, 1688-1756* (Macmillan, 1967).

[3] Juan Vicente García Marsilla, *Vivir a crédito en la Valencia medieval: de los orígenes del sistema censal al endeudamiento del municipio*, (València: Univ. de València, 2002).

[4] Stephan R. Epstein, *Freedom and growth: the rise of states and markets in Europe, 1300-1750*, (London; New York: Routledge, 2000). For the Spanish case, Regina Grafe, *Distant tyranny: markets, power, and backwardness in Spain, 1650-1800*, (Princeton University Press, 2012).

territories, by their grandson Carlos. The Crown of Aragon became a constituent of the Hispanic monarchy, but every territory preserved its institutional and legal peculiarities at least until the early eighteenth century.

The Aragonese kingdoms had developed those particular institutions since the 1340s. In the context of the wars in Sardinia and against Castile in the Iberian Peninsula, the municipal councils started issuing redeemable annuities to pay the subsidies granted to the monarch by the parliament of every kingdom. Instead of borrowing directly, the Aragonese rulers financed their Mediterranean campaigns by using the municipalities as intermediaries. As a consequence, a highly decentralised fiscal, financial, and political system emerged.[5] There were several factors which allowed the town councils to borrow at low costs, like the so-called *censos* –the redeemable annuities issued by the municipalities which included collective- and private-responsibility clauses– or the creation of municipal deposit banks, the *taules de canvi*. Moreover, the Aragonese town councils had institutional arrangements which fitted perfectly the model of oligarchical city proposed by Stasavage: they were small, autonomous political entities, similar to city-states, with permanent assemblies that monitored local taxation; that facilitated access to credit. Besides, the lenders of the municipalities were the town councillors themselves. Most of them were merchants who owned liquid assets and who saw municipal debt as a safe and profitable investment, as they could ensure debt service through the town assemblies. Even though the costs of borrowing were low, in the long term these towns suffered economic stagnation derived from regressive fiscal systems whose main aim was servicing the debt.[6]

There was another fundamental element in the Aragonese financial revolution which has been misinterpreted. By the late fourteenth century, many municipalities started experiencing solvency problems: they were over-indebted, and the creditors wanted their money back. The municipal authorities resorted then to a contract called *concordia*, an agreement generally used by private individuals and communities to settle their disputes. The *concordias* were adapted to the municipalities to reschedule their debts. They allowed the municipal authorities to reduce the cost of debt service, and the debtholders to avoid bankruptcy and the judicial costs of trials to share out the collateralised assets which secured the debts. Furthermore, since the contract was standardised, the costs of transaction decreased.[7] The *concordias* have been interpreted as a symptom of insolvency and bankruptcy, but here it is argued that they were another crucial element of the Aragonese financial revolution, the cause of the system surviving and working more or less effectively for more than three centuries. Through the *concordias*, both the municipal authorities and the creditors could overcome collective action problems, ensure debt service after generalised haircuts, and continue borrowing.

In many cases, the *concordias* established the creation of deputies and assemblies of creditors, which monitored or directly managed the municipal treasuries. These institutions can be compared to the Genoese Banco di San Giorgio and the early-eighteenth-century companies and Bank of England. The Aragonese assemblies of creditors were neither banks nor companies, and there was no debt-for-equity swap, but, like San Giorgio or the English companies, they centralised the action of the creditors and established tight supervision over their respective governments. The assemblies of debtholders reduced the possibilities of free riding and defection of individual creditors from the group. Furthermore, they provided the municipalities with a crucial public good, namely greater credibility. While the debtholders could distinguish between excusable and non-excusable defaults, the town councillors were more trustworthy, as potential lenders knew that they were monitored, hence the lower cost of borrowing. The rent seeking behaviour of the creditors could be exploited for

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[5] Manuel Sánchez Martínez, Antoni Furió, & Ángel Sesma Muñoz, 'Old and New Forms of Taxation in the Crown of Aragon (13th-14th Centuries)', in *La fiscalità nell'economia Europea secc. XII-XVIII*, ed. Simonetta Cavaciocchi, (Firenze: Firenze University Press, 2008), 99-130.

[6] David Stasavage, *States of credit: size, power, and the development of European polities*, (Princeton University Press, 2011).

[7] For two examples of these dismissed *concordias*, see Arxiu General del Consell de Mallorca, XI-405/2, and Archivo Histórico Provincial de Zaragoza, Real Audiencia, pleitos civiles, J/1325.

the sake of the municipality.[8] Nevertheless, not all the Aragonese town councils borrowed regularly while being supervised by assemblies of creditors.

Even though the elements of the Aragonese financial revolution did not appear all at the same time nor in the same place, they constituted a series of dramatic innovations which allowed the municipalities to keep borrowing credibly for more than three centuries without going bankrupt. Yet the *concordias* and the assemblies of creditors had a negative side too. By transferring the control of the municipal treasuries to the debtholders, the latter could decide when the debt was redeemed. By the mid-seventeenth, most of the municipal annuities passed to ecclesiastical institutions via donations and testaments. The religious people were not interested in cancelling a regular source of income, so the debt became perpetual and the assemblies of creditors –read the Church– managed freely the municipal treasuries. The debtholders became, in conclusion, rent seekers.

Absolutism, municipal debt, and state formation

By the early eighteenth century, the municipalities were in the hands of their creditors, mostly ecclesiastical, and suffered severe over-indebtedness. Yet the traditional mechanisms –the redeemable annuities, the *concordias*, the municipal deposit banks– remained intact. The War of the Spanish Succession (1701-1715) has traditionally been interpreted as a moment of change. The Bourbon dynasty came to the Spanish throne, the Hispanic monarchy was dismembered, and the legal and institutional regimes of the Aragonese territories were partially abolished and replaced by a model based on Castile. Felipe V, the first Bourbon to reign over Spain, has usually been described either as the moderniser of Spain or as a tyrant who showed no respect for the traditions of the constituents of the monarchy. Therefore, regardless their position, many historiographical accounts depict Felipe V as a unifying, centralising, and absolutist king, just like his grandfather Louis XIV.[9]

Actually, the attitude of the monarch towards the Aragonese municipalities had nothing to do with that picture. Initially, the Bourbon ministers knew little about the *concordias* and the particularities of the Aragonese financial system, so they ordered the provincial courts of the Crown of Aragon to report to the Consejo de Castilla (by then the supreme council of the monarchy) on the municipal annuities, their clauses, the taxes which financed them, and, above all, on the *concordias*. The reports informed that the Aragonese town councils had a long tradition of debt restructuring agreements. In some cases, if the creditors were reluctant to accept the *concordia*, the royal officials intervened. They aimed to avoid the misery of the towns and the annihilation of the realm. Although the king was initially pleased with the mediation, many municipal debtholders in the Kingdom of Aragon protested about the intervention of royal officials in the signing of *concordias*. They accused the officers of forcing the creditors to accept the terms of the town councils and begged the king to order the officers not to intervene anymore in the renegotiation of the debt. Felipe V accepted the complaints of the creditors and deauthorised the royal servants. From then on, the *concordias* would be negotiated and signed without the intervention of any officials, as a purely private affair.[10] That does not fit very well with the idea of an absolutist ruler. In fact, Felipe V maintained and protected the main elements of the Aragonese financial revolution and the highly decentralised political model related to it. Why?

Municipal debt was an obstacle for the monarch to impose his rule over the territory. Firstly, the municipalities were governed by the assemblies of creditors by virtue of the *concordias*, so the reform to control the town councils was almost irrelevant. Secondly, debt was serviced with local taxes, which were in direct competition with the royal ones. And last but not least, debt was a useless burden. Since the Bourbon ministers did not plan to borrow anymore through the town councils, i.e., they did not need credibility anymore, why not defaulting on the municipal debt? There was a twofold reason to maintain the debt. The municipal annuities were not a mere financial instrument, but also a political tie between the ruler and his subjects. Defaulting on the annuities would have

[8] J. Lawrence Broz, 'The Origins of Central Banking: Solutions to the Free-Rider Problem', *International Organization*, 52, n.º 2 (1998): 231-68.

[9] For a historiographical synthesis see Roberto Fernández Díaz, *Cataluña y el absolutismo borbónico: historia y política*, (Barcelona: Crítica; Universitat de Lleida, 2014).

[10] Archivo Histórico Nacional (AHN), Consejos, leg. 22.444, nº 10, pieza 1.

tantamounted to cutting the loyalty ties between the monarch and the debtholders, and that could have generated social unrest, especially dangerous in a postwar period. The second reason why Felipe V and his advisors did not default on the debt was their fear of a financial meltdown. Most of the municipal annuities were owned by ecclesiastical institutions, which ran one of Spain's main credit systems. From the point of view of the royal ministers, a default could trigger a financial shortage with unpredictable economic and social consequences.

Therefore, the decline of the Aragonese financial and political model during the first half of the eighteenth century was not produced by the intervention and centralisation promoted by an absolutist ruler. The causes have to be found elsewhere. Many municipalities suffered debt overhang, but that had also occurred in the past and the town councils had successfully restructured their debts to borrow again. Arguably, there were two major factors which contributed decisively to the decline of the financial revolution. The first one was the change in the profile of the creditors. Most historiographical accounts usually focus on the debtor's side, but the lenders are equally important to understand a debt relationship.[11] Since the seventeenth century, the debtholders were ecclesiastical institutions which had different business than the original merchant lenders. The religious institutions' capitals were less mobile and were allocated to different activities. More importantly, many churches, convents, and monasteries were highly dependent on municipal annuities, so they fiercely resisted any attempt to amortise debt. The second factor was the legitimacy of taxation. With the arrival of the Bourbons, the legality of the existing municipal taxes –and by extension of the debt they financed– was questioned. Although Felipe V considered them to be licit, he prohibited the town councils from issuing more annuities and raising new taxes.[12] Without the possibility of refinancing their debts, the municipalities entered into a slow decline until the 1750s, when the Aragonese financial revolution and political model would eventually collapse.

Conclusion

Rather than being an exclusively English phenomenon, financial revolutions took place all over Western Europe since the Middle Ages. The Iberian territories of the Crown of Aragon experienced a process of tremendous financial and institutional innovation in the mid-fourteenth century which gave rise to a highly decentralised political, fiscal, and financial model, based on the municipalities. The system survived for more than three centuries thanks to a debt rescheduling agreement called *concordia*, which allowed the town councillors and the debtholders to overcome collective action problems, restructure the debt, avoid bankruptcy and costly lawsuits, and ensure debt service at a lower cost. Furthermore, the municipalities could borrow again. In many cases, assemblies of creditors were created to supervise or directly manage the municipal treasuries. They centralised the action of the debtholders, reducing the risk of free riding and defection; however, they were seldom exploited to borrow at lower costs. Even worse, the creditors, which were mostly ecclesiastical institutions, became rent seekers.

The arrival of Felipe V, usually described as a centralising and absolutist ruler, did not mean an immediate, significative change. Far from prohibiting the *concordias* and defaulting on the burdensome debt of the municipalities, the Bourbon monarch protected the restructuring agreements and the municipal annuities, thus maintaining the decentralised Aragonese model. He and his advisors were afraid of a financial meltdown and social unrest if municipal debt was defaulted. Therefore, the royal intervention was not the cause of the decline of the Aragonese financial revolution. That is to say that predation and legal insecurity were not the problem in pre-modern regimes, as argued by the New Institutional Economics: the Aragonese model was extremely secure –maybe too much– and the Bourbon king only intervened to preserve the system unaltered. As Epstein proposed and Grafe proved for Spain, the problem was not predation, but lack of coordination and decentralised rent seeking. These obstacles to economic growth would be only

[11] Oscar Gelderblom & Joost Jonker, 'Public Finance and Economic Growth: The Case of Holland in the Seventeenth Century', *The Journal of Economic History*, 71, n.º 1 (2011): 1-39.
[12] AHN, Consejos, leg. 22.444, nº 11, piezas 1-3.

overcome by the modern states which started emerging in the 1750s, when the traditional mechanisms eventually collapsed. But that is another story.