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Credible commitment in early modern Europe : north and Weingast revisited

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Credible Commitment in Early Modern Europe:
North and Weingast Revisited

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This paper proposes a revision to existing arguments that institutions of limited government (characterized by multiple veto points) improve the ability of governments to credibly commit. Focusing on the issue of sovereign indebtedness, I present a simple framework for analyzing credibility problems in an economy divided between owners of land and owners of capital. I then argue that establishing multiple veto points can improve credibility, but whether this takes place depends upon the structure of partisan interests in a society, on the existence of cross-issue coalitions, and on the extent to which management of government debt is delegated. I develop several propositions to take account of these factors and evaluate them with historical evidence from 18th century England and France. The results show that incorporating these additional factors can help to explain a broader range of phenomena than is accounted for in existing studies.

1. Introduction

In recent years it has become widely accepted that establishing institutions of limited government increases the credibility of government economic policies. In political systems where multiple veto players must agree to any policy change, private agents will have less reason to fear opportunistic policy changes by government, such as repudiation of debt or *ex post* changes to investment regulations. One of the seminal contributions to this literature has been North and Weingast's (1989) article which argues that the establishment of institutions of limited monarchy in England after 1688 allowed the sovereign to credibly commit to repayment of debts and to the security of property rights in a way which was not previously possible.[1] I suggest in this paper that their argument is compelling but incomplete. While creating multiple veto points should, on average, increase credibility, this institutional step is neither a necessary nor a sufficient condition for commitment. In some circumstances, credibility can be insured even with only one veto point. In other instances, credible commitment cannot be obtained even with multiple veto points. Ultimately, establishing propositions in this area necessitates considering not only the number of veto points, but also partisan control of different veto points, the possibility for cross-issue coalitions, and whether policy is delegated. I use historical evidence from 18th century France and England to evaluate several propositions, focusing on the credibility of sovereign debt repayment.

My argument has three key implications for our understanding of credibility and limited government. Most directly, it highlights the need for a reinterpretation of credible commitment in 18th century England and France. By tracking changes in interest rates on government debt over time, I present evidence to show that credibility was not irrevocably established in England after 1688. Instead, credibility varied depending on the partisan control of the House of Commons, the House of Lords, and ministerial positions. Likewise, while 18th century France is often portrayed as suffering from low credibility due to the absence of institutions of limited government, a joint examination of political institutions and partisan politics leads to a different conclusion. Even if institutions of limited government had been established, there is good reason to believe that credible commitment would not have been obtained, due to the poor representation of government creditors in national representative assemblies. In fact, one proposal to establish limited government in France in 1715 was made precisely to facilitate a repudiation of government debt, not in order to establish credibility.

A second implication of this work is that in order to explain credible commitment, one has to consider how bargaining between politicians over multiple dimensions of policy can lead to different outcomes than if issues were considered in isolation. Following on this idea, it is also important to consider the role played by political parties, to the extent that they provide a means for heterogeneous interests to cement cross-issue bargains. Analysts often note that most members of the English Parliament after 1688 were landowners and that very few directly represented the London-based financial interests who were the government's main creditors. What is less often considered is that landowners could actually have had a short-term interest in defaulting on government debt so as to allow a reduction in taxes on land. This means that when we restrict our attention to this one policy dimension (taxes on land vs. taxes on capital) it is difficult to explain why the increased power of Parliament after 1688 improved credibility of debt repayment.

I argue that government creditors were often well represented in the English Parliament after 1688, because they were part of a larger Whig coalition which took a common stand on multiple issues of religion, foreign policy, and finance. Of key importance, the Whig coalition was also characterized by a form of party organization which gave party leaders important means to enforce voting cohesion. A large volume of work by historians over the past four decades has demonstrated both the importance of partisan politics for policy choices in Great Britain during the period 1688-1715 in particular, and that leaders of the Whig party were able to use a number of devices to increase voting cohesion among their rank and file. In France, in contrast, those political coalitions which did develop in the National Assembly after 1789 were unstable, and they were generally not characterized by forms of organization which would have allowed leaders to enforce voting cohesion among the rank and file.

Cross-issue bargaining may be particularly important in the aftermath of a period where governments have been unable to establish credibility. Following any period where government opportunism has been prevalent, if institutions of limited government are subsequently established, groups with the most to lose from abrupt changes in taxes or regulations (due to the nature of the assets they own) are likely to be politically weak. The reason is that over time, in response to an environment of low credibility, private agents will have moved assets into activities which will be less subject to opportunism. To the extent that it is costly to transfer assets back into activities which were once subject to opportunism (like finance), any lobby opposed to opportunism may initially lack influence. The experience of England after 1688 suggests that even if groups who stand to lose from actions such as default on debts only have minority representation in a legislature, credible commitment may still be established if these groups belong to a broader political coalition which votes cohesively on multiple issues.

A third and final implication of this paper involves the use of bureaucratic delegation to increase credibility. For England after 1688, it has been argued that giving a privately owned central bank the privilege of managing government finances increased credibility of debt repayment. The reason was that if the government defaulted, the bank might withhold revenues or even enforce a credit boycott. Institutional arrangements with a similar rationale were proposed in France. Existing literature on bureaucratic delegation often assumes that legal privileges such as managing government finances, once granted, would be "costly" to change, but the literature fails to further specify how these costs are likely to vary across different political contexts. More recent work has argued that this form of bureaucratic delegation will only improve credibility when groups which oppose a decision to reverse delegation control at least one veto point in a political system. Historical evidence from England and France provides support for this hypothesis.

The remainder of this paper is organized as follows. Section 2 reviews theories of debt repudiation, limited government and credible commitment. It develops several propositions about the link between partisan politics, political institutions, and credibility. Section 3 evaluates these propositions based on evidence from sovereign borrowing by the English government during the period 1688-1720. Section 4 evaluates the same propositions using evidence from three episodes of failed institutional reform in France between 1715 and 1789. Section 5 concludes

2. The political economy of default

In this section I present the basic credibility problem with regard to debt repayment, and the potential solutions to this problem, focusing on reputation, political institutions, cross-issue coalitions, and bureaucratic delegation. The section concludes by detailing two alternative hypotheses to be evaluated and the criteria that will be used to evaluate them.

The literature on time-inconsistency problems in taxation and borrowing has shown that even social welfare maximizing rulers have incentives to default on debt in order to allow a reduction in distortionary taxes(Prescott, 1977). Default here can be considered as the analytical equivalent of a one-time levy on accumulated capital. Governments can have an incentive to raise taxes on capital *ex post*, in order to allow a reduction in distortionary taxes on factors such as labor. Such tax increases will reduce distortions to the extent that accumulated capital cannot be put to alternative uses in the event of a tax increase, whereas an individual's labor can be reduced to allow more time for leisure. Tax increases of this sort will, however, be distortionary to the extent they are anticipated, and thus governments would benefit if they could credibly commit not to making *ex post* changes in taxation.

Reputation

One potential reason for continuing to service debt is to preserve one's reputation. Unfortunately, as North and Weingast note in their 1989 article, the conditions under which reputational considerations will prompt a government not to default are quite restrictive. Bulow and Rogoff (1989) have shown that a government which has borrowed abroad may have an incentive to default on its debt and live in autarky as long as, after defaulting, it can still negotiate "cash in advance" insurance contracts with private creditors.[2] Second, even if a government cannot write such contracts, it must not discount the future heavily, otherwise the promise of future payoffs will be insufficient to make repayment an equilibrium strategy. Heavy discounting will occur when there is a significant probability that a ruler's tenure will be brought to an end through war, domestic revolt, or the like. As North and Weingast argue, these were common conditions for monarchs in early modern Europe, and so one should not expect reputation to have posed much of a constraint on sovereigns in 18th century England and France.

Political institutions

An alternative explanation for debt repayment is that it may be assured if government creditors are better represented within a legislature than within the voting population as a whole. Persson and Tabellini (1994) construct a simple two-period model to consider the time-inconsistency problem in capital taxation. Since this problem is closely related to that of debt repayment, their model can also be adapted to consider this latter issue. I will assume for simplicity that the only type of capital investment available is in government bonds. In the Persson and Tabellini model, in the first period owners of capital must decide whether to save or consume their capital. In the second period taxes on labor and capital income are set subject to an exogenously determined budget constraint. Owners of labor decide in each period how much of their labor they will supply, but owners of capital cannot make such changes in period 2. Under these conditions, the median voter in society would have an incentive to increase taxes on capital and lower taxes on labor, as described above.[3] In their model, however, Persson and Tabellini allow for the possibility that the median voter in a unicameral legislature might have a different endowment from the median voter in society. The greater the extent to which the median voter in a legislature represents owners of capital, the greater the credibility of the commitment not to alter rates of capital taxation *ex post*.

Persson and Tabellini's model would need to be modified to fit an 18th century context where labor was not represented within legislative institutions. Instead, the primary division might be between owners of land and owners of capital. Relative endowments of land and capital income for each individual would then determine preferences with regard to the taxes levied to finance the government budget constraint.[4] In Figure 1 the policy dimension is the portion of the government budget constraint financed by land taxation vs. capital taxation. At one extreme only capital income is taxed while at the other extreme, only land income is taxed. In the example portrayed here, commitment is sustained by the fact that the median legislator favors taxing primarily land (and thus taxing capital less heavily).

(Figure 1 about here)

Persson and Tabellini's model is highly stylized, and so their result is subject to a number of assumptions. First, there is no possibility for side payments between individuals. Second, government spending must be devoted to a pure public good. Otherwise, differential benefits from government spending might also change voting patterns. Relaxing either of these assumptions might allow for the formation of coalitions in favor of default if owners of land paid off a segment of capital owners. However, it is also plausible that relaxing the assumptions might allow for the formation of a broader coalition in favor of repayment. The more basic point remains. Credible commitment with respect to taxation of a certain asset may be achieved even when there is only one veto point as long as owners of that asset form a majority in a representative assembly with veto power.

In order to apply Persson and Tabellini's model to the question of debt repudiation, one further modification is necessary, with regard to the reversion point. This is the outcome that would apply in a situation where there are multiple veto points (such as multiple legislative chambers or a legislative chamber and a monarchy) and those who control each veto point fail to agree to a change in policy. In the case of taxation, the reversion point in the event that veto players cannot agree is the status quo; current rates of taxation remain in force. The case of default can be different. If there is an exogenous shock, such as a revenue shortfall, which requires adjustment policies to continue to service debt, then a default will occur as long as any one veto player opposes either raising taxes or cutting spending. In Figure 2 if the status quo lay in between the policies preferred by the two median legislators, the reversion point for default would lie somewhere to the left of this point, because default involves a one-time increase in taxes on owners of capital. Where exactly the reversion point lies would depend upon the size and scope of the default that results from the failure to raise taxes or to cut spending.

(Figure 2 about here)

What do the above arguments suggest about the link between multiple veto points and credible commitment? If preferences and status quo policies were independently distributed and there were no exogenous shocks to government revenues, then it is true that the greater the number of veto points in a political system the greater the likelihood that a status quo policy that gives capital owners an incentive to purchase government debt will be preserved.[5] So, on average, multiple veto points should increase credibility. However, when considering individual country cases, it is important to recognize that multiple veto points are not a necessary condition for credible commitment, which can be obtained even if there is a single veto point. It should also be clear from the above presentation that multiple veto points are not a sufficient condition for credible commitment to the extent that all veto points may be controlled by landowners or, for risk-averse investors, due to the possible effect of revenue shocks. This possibility would seem particularly relevant to the case of early modern France or Great Britain where landed interests made up the vast majority of members of representative assemblies.

Cross-issue bargains, political parties, and policy credibility

The above sub-section considered the single issue of taxation and suggested that credibility will depend on the endowment held by the median voter(s) in one or more houses of a legislature. When one introduces the possibility of cross-issue bargains and of political parties, this result can change significantly. Even if government creditors do not form a majority in a legislature, they may be part of a political coalition which does form a majority and which votes cohesively across different issues. For example, landowning interests might form a majority in a legislature, but credibility of debt repayment might still be assured if some fraction of landowners votes in favor of debt repayment in order to secure the support of owners of government bonds on other issues like religion or foreign policy. This could lead to a result of the sort observed in Figure 3 where the majority party position differs significantly from the legislative median. For reasons of simplicity, I do not explicitly portray preferences in the second issue dimension here, given the primary interest in tax policy.[6]

Cross-issue bargains might be more durable if they were made by members of a common political party.[7] In order for this outcome to be secure however, there needs to be some enforcement mechanism to see that individual legislators do actually vote cohesively even when they might prefer to renege on deals with coalition partners. The literature on political parties has identified a number of different mechanisms which can fulfill this purpose. For example, when party leaders have substantial privileges to select individual candidates for elections, they can use this privilege to support party discipline.[8] Section 3's discussion of party politics in early eighteenth century England considers the extent to which leaders of the Whig and Tory parties used similar mechanisms.

(Figure 3 about here)

Bureaucratic delegation

In addition to emphasizing the importance of political institutions characterized by multiple veto points, North and Weingast (1989) and others have also stressed the role played by bureaucratic delegation in restraining government opportunism. Jones (1994), Root (1994) and North and Weingast argue that with the creation of the Bank of England in 1694, credibility of debt repayment was enhanced. Sargent and Velde (1995) suggest that the absence of a national bank prevented the French crown in the 18th century from making credible commitments. Delegation of this sort could increase credibility of debt repayment if it gives government creditors (for example in the form of a privately owned central bank) the right to withhold revenue from the government in the event of a default.

The potentially problematic aspect of the above arguments is that any legal privileges which an independent authority is granted might be easily revoked. If an authority's statute can be easily modified, say in an absolute monarchy where there is in effect only one veto player, then this can actually weaken credibility by providing an easy way to default that cannot be challenged by the courts. Interestingly, this interpretation fits well with an idea commonly held by many 18th century thinkers, that national banks were only feasible in republics or limited monarchies (Kaiser, 1991).

In contrast, bureaucratic delegation can have a more profound effect in systems with multiple veto points, by altering the reversion point in the event that no adjustment measures are taken subsequent to an external shock. As argued above, in the absence of delegation, if a temporary negative shock to revenues resulted in a default, the effective outcome would be *ex post* taxation of a group of creditors to make up this financing gap. In the presence of delegation, the outcome is different. Government creditors would be able to seize revenues to recover their losses, or they might be able to enforce a credit boycott. The net effect might be to move the reversion point rightwards, as in Figure 4 below. Reversing these legal privileges for debtors would typically require the assent of all veto players.[9] This implies that when there has been a prior decision to delegate, government creditors need control only one veto point in order to ensure credible commitment.

(Figure 4 here)

Evaluating the hypotheses

The previous discussion can be distilled into two hypotheses regarding political institutions, partisan politics, and the credibility of debt repayment.

1. *Following North and Weingast (1989), increasing the number of veto points in a political system will, on average, increase credibility of debt repayment*
2. *Alternatively, debt repayment is more credible when one of the three following conditions is satisfied*

   (i) owners of government bonds control all veto points

   (ii) owners of government bonds control at least one veto point and there is delegation of debt management

   (iii) owners of government bonds are part of a cross-issue coalition which votes cohesively and which controls (one) all veto points in the (presence) absence of delegation.

In order to evaluate these two hypotheses one needs to first establish a way of measuring government credibility. In the extreme case, instances of partial or complete default are obvious examples of low credibility, and sections 3 and 4 detail examples of default in both England and France. Other indicators are also available. When private agents believe that a government may fail to respect its debt contracts they will charge higher risk premia on loans. Data is available on rates for government borrowing in England and France during the periods considered here, and comparisons can also be made to rates of government borrowing in the Netherlands, where investors during the 18th century are known to have charged very low risk premia. As a final measure of credibility, one can refer to changes over time in share prices for financial companies which are subject to government opportunism.

After providing a brief synopsis of the evolution of political institutions and of institutions for policy making, a subsequent section for each country assesses the extent of government credibility over time. The final sub-sections complete the empirical evaluation by considering whether each of the above two hypotheses is consistent with observed patterns of credibility, political institutions, and partisan politics.

3. Credibility in England after the Glorious Revolution

Evolution of political institutions and policy making institutions

English institutions underwent two important transformations after 1688. First, Parliament gained new influence over decisions concerning taxation and spending. From the restoration of the monarchy under Charles II in 1660 to the overthrow of James II in 1688, the English Crown had enjoyed far reaching powers in matters of borrowing and spending and little need to consult parliament.[10] After the Glorious Revolution of 1688 Parliament reasserted its right to veto legislation and it gained substantial new authority with regard to monitoring spending by the monarchy.[11]

The second key institutional change after 1688 with a major impact on finance was the creation of the Bank of England. In 1694, by act of Parliament, the government launched a £1.2 million loan for which subscribers would receive 8% interest. The subscribers were given the right to issue banknotes equal to the sum advanced to the government and to incorporate themselves as the Bank of England, a valuable privilege which made shareholders willing to lend to government at lower rates of interest than would otherwise have been the case. In subsequent years the Bank of England's privileges were extended to include the following (1) no other note-issuing bank was to be established by Act of Parliament (2) the Bank of England was exempted from taxation (3) its charter was extended till 1710, and (4) increasingly payments to the government were to go through the Bank (Andreades, 1909). This last provision increased the credibility of repayment, since in the event of a suspension in debt servicing by the government, the Bank could halt the flow of funds to the government. In other words, in the event of an exogenous shock, followed by failure to implement adjustment measures (spending cuts or revenue increases) the reversion outcome might now be paralysis of government rather than selective default.

Measuring Credibility

English governments after 1688 did, on average, improve their credibility with regard to debt repayment when compared with their predecessors. This overall trend, however, belies the fact that there was very significant variation in levels of government credibility between 1688 and 1715.

Figure 5 (below) shows initial interest rates on English government long-term loans between 1665 and 1740.[12] While this series does show a secular decrease in lending rates, it is not immediately obvious that the Glorious Revolution of 1688 was an important watershed, because interest rates on English Crown loans took more than thirty years to converge with those paid by the Estates of Holland at the time.[13] North and Weingast (1989) suggest that high interest rates during the first decade following the Glorious Revolution might be explained by uncertainty whether the new constitutional system would prove durable. It would be more difficult to make the same claims for the subsequent increase in English Crown borrowing rates beginning in 1710. As noted in figure 5, and as will be discussed in detail below, these loans coincided with a period where the Tory party won a landslide majority in the House of Commons. This increase in interest rates did occur during a period of renewed warfare (1702-1713), but since England had been at war since 1702, another explanation for the abrupt increase in rates after 1710 seems necessary.[14] Following the succession of

Queen Anne by George I and the arrival of a Whig majority in both Houses of Parliament in 1715, interest rates dropped substantially.[15]

(Figure 5 about here)

It is also important to recognize that the English government after 1688 did not completely refrain from unilateral renegotiation of debt contracts. In particular, the creation of the South Sea Company in 1711 represented a unilateral renegotiation by the government on short-term debts, and it remains to be explained why Parliament would agree to an Act which infringed upon the property rights of government creditors. Like the Bank of England (created in 1694) and the New East India Company (1698), the idea behind the South Sea Company was for the government of the day to obtain finance from private investors at a low rate of interest in exchange for equity holdings in a privately owned company with monopoly privileges. The South Sea Company was, however, different from the two other companies in one fundamental way. While subscriptions to the Bank of England and the New East India Company were purely voluntary, the South Sea Company was created by conversion into equity of short-term navy debts which the government was having great difficulty servicing.[16]

So far I have argued that increased interest rates on government borrowing after 1710 and the creation of the South Sea Company in 1711 point to a weakening in the English government's credibility at this time. Further evidence in this regard comes from the fact that prices for Bank of England stock dropped by 20% between July 1710, when a Tory ministry was established and the beginning of November 1710, one month after the Tories won a landslide majority in the House of Commons.[17]

Contemporary observers drew a direct link between this price drop and the assumption of power by the Tories, because of fears that the Tory party would undermine the privileges of the Bank.[18]

(Figure 6 about here)

The structure of partisan politics in 18th century England

The previous section showed that the establishment of institutions of limited government after 1688 in England did not irrevocably establish credibility with respect to debt repayment. As a result, the North and Weingast argument regarding credibility is incomplete, and we need to examine what might account for this post-1688 variation. Section 2 suggested that one sufficient condition for credibility is if those representing owners of government bonds control all veto points (in the absence of delegation) or at least one veto point (in the presence of delegation). But after 1688 the vast majority of members in both houses of parliament of this time represented landowners.[19] This section argues that credibility after 1688 in England was nonetheless achieved via participation of owners of government bonds in a cross-issue coalition: the Whig party. While the majority of Whigs were landowners, when it came to issues of taxation and finance, the Whig party consistently pursued policies supporting "the monied interests" as part of a broader platform of policies.

While recent interest in 18th century England by political scientists has focused on the reform of political institutions in the wake of the Glorious Revolution of 1688, a large volume of historical scholarship over the past thirty-five years has emphasized that the period between 1689 and 1715 was also marked by another very significant trend: the emergence of partisan politics. Two political parties developed which took different stances on a variety of issues, and members of parliament very frequently voted along strictly partisan lines.[20] While the majority of historians emphasize that divisions between Whig and Tory were the most salient feature of politics in Great Britain between 1689 and 1715, they also emphasize that the pattern of British politics changed significantly after 1715. In 1715 the Tory party collapsed, and the result was a long period of Whig dominance. However, the Whig party itself split into factions at this point, as has occurred in other one-party systems.[21] As a result, one should draw much different conclusions about the nature of party politics for the period before 1715 when compared with post-1715. In the discussion that follows I will concentrate on the period between 1689 and 1715 both because of space limitations, and because the most pressing questions about credible commitment in Great Britain (or in other contexts) involve how it was initially established.

The Whig and Tory parties after 1688 were each associated with a specific opinion on four major issues of the day. First, while the Whig party was associated with support for religious toleration, the Tory party was more closely associated with those opposed.[22] Second, while the Whigs favored legislation prohibiting a Catholic from ascending the throne, the Tories did not favor such legislation.[23] Third, while the Whig party favored English participation in European wars as a counterweight to France, the Tory party was much more isolationist in this regard.[24] Finally, the two parties had divergent positions on taxation and government finance. The Tories opposed both the development of a sizable government debt and the creation of a land tax to service this debt (both of which helped finance England's continental engagements), and as a result identified themselves with support for the "landed interest". In contrast, despite the fact that a majority of its members were also landowners, the Whig party was consistently identified with support for the new "monied interests" of the City of London, support for the recently founded Bank of England, and support for servicing debt through land taxes.[25]

While the Whig and Tory parties held divergent positions on the issue of taxation and government finance, this divergence cannot be explained by the assertion that the majority of Whigs (or those who voted for them) were capital owners, because this was clearly not the case. Whig support for the “monied interests” can be better understood when one considers that Whig landowners might have been prepared to vote in favor of monied interests on issues of taxation and finance in order to ensure support of the monied interests on other issues like foreign policy, religious toleration and the succession. While “monied men” made up a minority of members of the House of Commons (as noted above), the fact that they did make up 10-15% of the MPs (and a larger fraction of those regularly attending) made them potentially valuable as coalition partners.[26] At the same time, authors such as Harris (1993), Speck(1969) and Holmes (1967) have emphasized how members of the monied interest recognized that they needed to form a coalition with landed interests in order to gain parliamentary majorities in support of debt repayment. These accounts suggest that most of the landowners with Whig leanings were drawn from the upper gentry.[27] As further evidence of their mixed composition, one of the premier 18th century critics of the Whigs, Jonathan Swift, referred to their party as being "patched up of heterogeneous, inconsistent parts".[28]

In terms of parliamentary voting between 1689 and 1715, a number of studies have demonstrated that members of the House of Commons and even the House of Lords voted consistently with one party across different issues. So for example, Speck

(1981) and Horwitz (1977 p.319) have both conducted studies using available records on parliamentary voting during the period, concluding for the Commons that more than 85% of MPs never voted across party lines.[29] If cohesion was slightly weaker in the Lords, evidence collected on seven separate votes shows nonetheless that 71% of members voted for one party on all votes, and the great majority of those who crossed party lines did so no more than once.[30] What is also interesting here is that cohesion among the Whigs seems difficult to explain strictly in terms of preference similarities, suggesting that party institutions may have had a significant impact on voting behavior.[31] So, for example, when a Whig majority held the Commons between 1708 and 1710, it voted to increase the rate of taxation of land income, even though a majority of the coalition's members were landowners.

The next step in examining whether voting cohesion among the Whigs in particular was due to political party institutions is to provide evidence of the disciplinary devices at the disposal of party leaders. While party organizations in England at this time lacked many of the disciplining devices used by 20th Century British political parties, Geoffrey Holmes (1967) and Trevelyan (1933) show that the Tory and especially the Whig parties were able to obtain cohesiveness through several mechanisms. First, evidence shows that Whig leaders met frequently to coordinate their activities, and they developed a sophisticated network for passing orders to MPs.[32] Second, party members who failed to vote the party line could suffer sanctions.[33] It also seems clear that Whig leaders in London had substantial influence in designating local candidates, and thus those who failed to vote the party line could find themselves de-selected.[34] A further means to ensure cohesion was that both the Whigs and Tories also used a system of regional whips designed to ensure that MPs actually attended Commons sessions.

As an alternative explanation to my emphasis on a cross-issue bargain between Whig landowners and monied men, it has been suggested that the monied interests gained influence over government policy after 1688 in part by financial lobbying and patronage.[35] As a result, landowning whigs may have been willing to vote in favor of debt repayment and increased land taxation because they were paid off, not because they then expected the monied men to support them on constitutional or religious issues. Undoubtedly, payoffs and patronage played a role in allowing the monied interests to influence policy, but it would be an exaggeration to emphasize these factors to the exclusion of others. First of all, the majority of monied men declared themselves quite openly for the Whigs, whereas if patronage was all that mattered, one might have expected them to remain neutral and make payments to both Whigs and Tories. So, for example, De Krey (1985) demonstrates that while 30 directors of the Bank of England between 1694 and 1715 were Whigs, only 3 were Tories, and Carruthers (1996) gives similar figures. Likewise, Whigs outnumbered Tories among Bank of England shareholders by more than 2 to 1.[36] Second, and as will be discussed more extensively during the next section, trends in the perceived credibility of government debt were clearly correlated with trends in the partisan composition of government.[37]

Partisan politics and credible commitment

Now that evidence has been presented to show that owners of government debt gained political influence through their membership in the Whig party, the next task is to ask whether the credibility of the English government as a borrower covaried with trends in partisan control of the House of Commons, the House of Lords, and ministerial positions. I focus on the period between 1701 and 1720 here, drawing heavily on information from Holmes (1967), Speck (1970), and Morgan (1922, 1921).[38] Partisan control in England between 1700 and 1720 can be divided into four distinct periods: (1) divided government 1701-1708 (2) unitary Whig government 1708-1709 (3) unitary Tory government 1710-1714, and unitary Whig government after 1715.

From 1701 to 1708 the Whig party did not control the House of Commons, but it did control a majority in the House of Lords, thanks in large part to the allegiance of members appointed by William III, and the Whigs also controlled several ministries within a ministry that was predominantly Tory.[39] Queen Anne chose to have a mixed ministry during this period, but she is widely regarded as having had Tory sympathies. While the Whigs did not have the ability to pass new laws without obtaining agreement from the Tories, because of their relative dominance in the Lords, they probably did have sufficient veto power to block any decision such as one to revise the Bank of England's statute. Given that payments to government were increasingly channeled through the Bank of England, control of one veto point was sufficient to ensure credibility of debt repayment. These conditions may explain why interest rates on government borrowing were quite low during this period.

In 1708 the Whig party secured a sizable majority in the House of Commons, prompting Queen Anne to create a ministry dominated by Whigs despite her own reputation for having Tory sentiments. As a result, the Whigs now controlled all the levers of parliamentary power in England. Consistent with hypothesis 2 (above), the brief period of unified Whig government during 1708 and 1709 was characterized by a low rate of interest for long-term government loans.[40]

While the Whig Party gained undisputed control of both the House of Commons and the House of Lords in 1708, it soon suffered a severe reversal of political fortune, and the government's credibility suffered as a consequence.[41] Declining political support for the Whigs encouraged Queen Anne to dismiss several of the most ardent Whig ministers from her cabinet during the Spring of 1710, followed by the nomination of an entirely new cabinet exclusively composed of Tories. In October 1710 a general election was called, and the Tories won a landslide victory in the Commons. Over the course of the next year, the Whigs would also lose their majority in the Lords as Queen Anne created 12 new Tory peers in 1712.

Consistent with hypothesis 2, when the Whigs lost control of the cabinet and eventually the Commons, the English government found that it was obliged to pay significantly higher interest rates on its long-term loans. What's more, during the period the share price of Bank of England stock dropped significantly, as has already been noted (Figure 6). Numerous observers at the time saw this trend as being directly linked to the declining political fortunes of the Whig party and to the hostility of many Tories towards the Bank of England.[42] Finally, as argued above, the launching of the dubious South Sea Company project was motivated in large part by the Tory government's difficulties in finding funds through other means.

In stark contrast to the negative impact which the arrival of unified Tory government had on credibility in 1710, the transition to unified Whig government of 1714-15 was associated with very low rates for long-term government borrowing. One clear reason for this decline was that England was no longer at war. Nonetheless, the scope of the interest rate drop, and the fact that these levels were unprecedented even for previous periods of peace (both before and after 1688) suggests that political change was also instrumental in resulting in lower rates of borrowing.

In order to examine the inferences drawn above in more systematic fashion, Table I reports results of a regression of long-term interest rates for government borrowing 1690-1730 on a variable measuring partisan control of the House of Lords and the House of Commons. The variable is scaled from 0-2 with 2 representing Whig control of both houses, and 1 representing majority control of one House.[43] The regression also controls for several other likely determinants of interest rates including quantity borrowed in a given year (since greater demand will push up rates), the rate of inflation, and a dummy variable for lottery loans (since these offered additional incentives to purchasers)[44] Finally, I have also included a time trend, because the overall return on capital would have been expected to fall during this period as the overall British capital stock increased.

While the number of observations here is quite small, it is interesting to note that Whig control of Parliament is estimated to have had a negative and statistically significant effect on interest rates for government debt, even when controlling for other determinants. A shift from complete Whig control to complete Tory control is estimated to result in a 2% drop in interest rates.[45]

(Table 1 here)

In sum, events in England following the Glorious Revolution support the argument that multiple veto points are not a sufficient condition for establishing policy credibility. The extent to which the British government could commit to repaying its debts depended upon the extent of Whig party control of the House of Commons, the House of Lords, and the ministerial positions. Creation of multiple veto points after 1688 did improve possibilities for establishing credibility, to the extent it became more likely that the Whigs would hold at least one veto point, but it was by no means a guarantee of credibility.

4. Credibility in France: 1714-1789

While the English government during the 18th century increased its credibility as a borrower, the French government was much less successful in doing so. My treatment of France focuses on three unsuccessful institutional reforms. These changes in political and bureaucratic institutions had the potential to improve the French government's credibility as a borrower, but the end result in each instance was continued default and high costs of government borrowing. I argue that, given the political position of relevant groups of government creditors, each of these institutional reforms had little chance of increasing commitment.

- In the first episode, in 1715 several top ministers suggested calling the Estates General, a national representative institution which had not been convened since 1614. In the end, the Estates General was not called.

- In the second episode, a national bank was created in 1716 under the direction of John Law, but it went bankrupt within a few short years. Other existing bureaucratic institutions, such as borrowing through intermediaries, also failed to secure government credibility.

- I also consider a third episode of institutional reform, which took place during the Fall of 1789, as the deputies of the new Constituent National Assembly debated plans to create a national bank. The deputies opted not to do so, raising the question whether the decision not to create a national bank was a missed opportunity for the French government to credibly commit.

French political and bureaucratic institutions before 1714

To a greater extent than even British monarchs pre-1688, the French monarchy during the 18th century enjoyed relatively unchecked authority, a feature of French politics which has traditionally been seen as the root of its credibility problem. It is important to note here that French monarchs did not have unlimited power. Regional appeals courts (the *parlements*) had powers to block legislation and could be overridden only with a cost, and the same applied to provincial assemblies in certain regions. Nonetheless, these were quite weak checks on monarchical authority when compared with the veto power enjoyed by the British parliament after 1688.

In addition to the prerogatives of the monarch, French political and bureaucratic institutions before 1714 were also distinguished by a heavy reliance on corporate intermediaries both to collect taxes and to lend funds. These intermediaries included venal office-holders from several different administrations, or *corps*[46], in addition to borrowing from the aforementioned provincial assemblies. Faced with difficulties in borrowing directly, Hoffman (1994), Dessert (1984) and Luthy (1959) show that as early as the 16th century, French monarchs began borrowing through intermediaries so as to increase the credibility of debt repayment. In case of default, the corporate intermediaries were empowered, in theory, to impound revenues in order to satisfy creditor demands. Root(1994,1989) has suggested that these arrangements served as credibility enhancing devices. As with the case of delegation to the Bank of England, this institutional setup had the potential to alter the reversion outcome in the event that no decision was made on increasing taxes or cutting spending so as to avoid default

1715: The proposal to call the Estates General

The death of Louis XIV in 1714 (in the midst of a major fiscal crisis) prompted a number of proposals to reform French political and financial institutions. The most significant of these was a suggestion by several senior ministers that the Regent (who governed in place of Louis XV) should call the Estates General, France's national representative institution, which had not met since 1614. In the end, the Estates General was not called, and in the opinion of Sargent and Velde (1995), this decision represented a major missed opportunity for France to adopt the sort of political institutions which they see as having been successful in establishing credibility in England. The following section will argue that an alternative reason for calling the Estates was precisely to renege on existing debt contracts.

1716: The proposal to establish a national bank

While the Regent rejected reform of France's political institutions, he was swayed by the Scottish financier, John Law's proposals for the creation of a national bank in France similar to that which already existed in England. Law envisaged establishing an institution that, like the Bank of England, would have liabilities including shares and banknotes, while its assets would include government securities and other reserves. Unlike the Bank of England, for which currency issues were strictly limited by statute, issue of paper currency by Law's Bank would be subject to royal approval, and at the same time a royal guarantee would ensure the necessary confidence in the bank notes.[47] Law's bank was initially successful, but it was undermined after 1719 as Law responded to a crisis through an excessive issues of banknotes. By 1720 public confidence in the notes issued by the *Banque Royale* was badly shaken. Ultimately, Law's bank was liquidated, and he was forced to flee the country. While in the popular imagination John Law's bank has acquired a reputation as a dangerous gamble which was bound to go wrong, recent work by economists has highlighted the fact that the basic economic assumptions underlying his project were not unsound (Garber, 2001; Murphy 1997). Instead of being fundamentally flawed, his plan was wrecked by the decisions beginning in 1719 to dramatically increase issue of banknotes. This raises the question why these disastrous decisions were made.

1789: a new proposal to establish a national bank

The years between the failure of Law's project in 1720 and the beginnings of revolution in 1789 witnessed numerous attempts by different ministers of the crown to reform France's financial system, but generally with only limited success. By mid-1789 the Constituent National Assembly had become the sovereign political decision making body in France. On November 14, the king's finance minister, Jacques Necker, made a proposal to turn an existing private bank, the *Caisse d'Escompte*, into a full-fledged national bank with an increased capital and the monopoly right to issue banknotes.[48] In the end the deputies of the Constituent National Assembly decided against transforming the *Caisse d'Escompte* into a national bank. Instead, monetary policy would be set directly by the legislative authorities. As noted above, Sargent and Velde (1995) have seen this as another missed opportunity for the French government to establish credibility through institutional reform. In order to fully investigate this question, however, we need to attempt ask the difficult counterfactual question of what would have happened if a national bank had been established?

Measuring French government credibility

There is ample evidence to show that the French government lacked credibility as a borrower throughout the 18th century. Most significantly, there were three major episodes where the government defaulted on debts: after the death of Louis XIV in 1715, in 1759, and again in 1770.[49] There is also evidence that corporate intermediaries were no more immune to these defaults than other creditors. Dessert (1984, pp.165-66), Luthy (1959), and Hoffmann, Postel-Vinay, and Rosenthal (1995) have all prevented evidence to show how even very senior government office holders were adversely affected by the defaults which followed Louis XIV's death.

The creation of John Law's bank beginning in 1716 did not result in a long-run increase in credibility for the French monarchy. While Law's project was initially successful, the policies he implemented beginning in 1719 generated a dramatic increase in price levels (the index of Parisian commodity prices rose by 70% between August 1719 and September 1720, (Hamilton 1936). This had significant redistributionary effects as the real value of outstanding debts depreciated massively. These policies amounted to an indirect form of default on government debts.

After the end of the Law experiment, the French government slowly regained some credibility as a borrower, but finance ministers continued to resort to selective default on government debts on several other occasions, most notably in 1756 and in 1770. Velde and Weir (1992) show, not surprisingly, that the French government paid a premium for default risk when compared with similar bonds issued by the British government in the mid-18th century (Figure 7).[50]

While the *ancien régime* had consistently failed to establish its credibility as a borrower, the revolutionary government established in 1789 had the opportunity to change this pattern. It is true that the spread between yields on French and English government securities declined for a brief period in 1790 (as shown in Figure 7), and the Constituent Assembly did also vote to honor all debts from the *ancien régime*.[51] However, the monetary policies pursued by the Constituent Assembly involving excess note issues led to a massive price inflation which amounted to an indirect default on government debts. In August 1794 the monthly inflation rate in Paris hit 60% and continued to accelerate, provoking hyperinflation (Sargent and Velde, 1995). This inflation was generated by excess issue of France's new currency, *the assignats*, in order to fund military expenditures.[52]

(Figure 7 about here)

Partisan politics, institutions, and credibility in France

The above discussion raises two related questions about credibility in eighteenth century France. First, was low credibility in France in 1715 attributable to the absence of institutions of limited government? Evidence presented here favors a different interpretation. France would in all likelihood have lacked credibility due to the structure of its partisan politics, even if the Estates General had been called in 1715. A second question is why did bureaucratic innovations such as borrowing through intermediaries and John Law's *Banque Royale* fail to durably improve government credibility in France, and might a national bank established in 1789 have been more successful in this regard? Here as well, available evidence supports an argument that such institutions were insufficient to guarantee credible commitment given the pattern of partisan interests in 18th century France.

The effect on credibility of the failure to call the Estates General

Had France's Regent called the Estates General in 1715, as some of his ministers proposed, this could have represented a major step towards establishing limited government in France. The assembly would have been composed of three separate estates, the clergy (1st), the nobility (2nd), and the bourgeois with the professions (3rd). Given that we cannot know for certain what would have transpired if the Estates General had been called, one way to assess the likely impact of this move is to consider what motives the Regent's ministers saw in suggesting that he call the Estates. The duc de Saint-Simon was one of the principal advocates of this proposal, and fortunately he also was the court's most detailed chronicler. In his memoirs (Saint-Simon vol.5 p.336) Saint-Simon notes that calling the Estates would be "without danger" and "useful with regard to state finances". However, what Saint-Simon had in mind in terms of usefulness was not establishing credibility. He clearly stated that when faced with the necessity of raising new taxes in order to sustain the government's debt service, the Estates General would instead choose to default, absolving the Regent from the responsibility of making such a move himself. The reason it could be expected to do this was that government creditors would be poorly represented in the Estates, as the quote below suggests.

> An obvious reflection shows that the Estates General will be almost entirely composed of people from the provinces, especially for the First and the Third estates. In contrast, almost all the individuals or corporate bodies which bear the immense burden of the King's debts are financiers based in Paris. The provincial nobility, while obliged by financial ruin to marry beneath itself, has few debts

> outside of the provinces and none contracted with the King's creditors, who are all financiers based in Paris and officers such as *secrétaires du Roi*, *trésoriers de France*, and all sorts of *fermiers généraux*; people who are unlikely to be deputies for the Third estate. As a consequence, the great majority of deputies from the three orders will have a personal interest and an interest for their constituents in preferring bankruptcy to the possibility of increased taxes, and they will pay little heed to the ruin and the cries which bankruptcy will cause (1715 p.342)[53]

Saint-Simon's reasoning is powerful evidence against the claim that limited government in France would have improved credibility of debt repayment. Why would an Estates-General be expected to opt for default even if the previous Estates-General in 1614 had not? The key difference might have been the dire financial situation facing an Estates-General in 1715, making it necessary to choose either default or new taxes.[54] Nor would this scenario have depended on the monarch controlling the agenda at the Estates-General, since Saint-Simon expected a majority in favor of default to emerge spontaneously.

The basic logic underlying Saint-Simon's argument is supported by data on debt holdings. The figures in table 2 below show, based on a sample of notarial records, the portion of French government debt held by different social groups in the period leading up to 1715. Hoffman, Postel-Vinay, and Rosenthal (1995) note quite a striking regularity in that nobles and officers before 1715 did indeed hold the largest portion of royal debts.[55] These were the same individuals who lost the most during the default of 1715. As Saint-Simon suggests, if the Estates General had been called, members of the first and third estates in particular would have less interest in opposing debt repudiation than would the nobility.

(Table 2 here)

A further reason that French government creditors would have been poorly represented in the Estates General, is that they did not participate in a broader political coalition as did government creditors in England after 1688. While in England national politics had been centralized for several centuries, and political party organizations were well developed in the 18th century, in France no national political movements existed. The obvious reason for this was that the Estates General had not met for over a hundred years (1614) and those representative institutions which did exist were restricted to the provincial level.

Why the Regent ultimately chose to default unilaterally, rather than attempting to do so via the Estates General, remains unclear.[56] If carried out, however, Saint-Simon's strategy would have been but one in a list of many occasions in which the French monarchy had undermined any threat from representative institutions through a strategy of divide and rule. Hoffman (1994) shows how this tactic had been successfully adopted with regard to previous meetings of the Estates General.

The failure of bureaucratic institutions to secure credibility

If calling the Estates General would not have solved France's credibility problem in 1715, because government creditors did not control any veto points in France's political system, this same political reality also undermined the possibility that the practice of borrowing through corporate intermediaries could commit the monarchy to repaying its debt. This delegation arrangement could only increase credibility to the extent that the monarchy could not easily revise, rescind, or otherwise ignore agreements with intermediaries. In practice the monarchy was often able to just this. In the years between 1715 and 1720 the Regent was able to directly threaten creditors with prosecution for usury and other trumped up offenses. Under these conditions creditors had little incentive to withhold revenues when the government defaulted.[57] Similarly, Doyle (1996) shows how the monarchy frequently pressured venal office holders into a renegotiation of debt contracts by among other techniques, threatening to sell new offices which would reduce the value of existing offices.

Ultimately, the intermediaries which were most able to resist royal attempts to renegotiate contracts may have been the representative assemblies which existed in several provinces and had managed to retain a number of prerogatives even during the height of absolutism.[58] Potter (2000) and Potter and Rosenthal (1997) show that the Estates of Burgundy loaned frequently to the monarchy during periods of high demand such as the Seven Years War, and that the Estates themselves were able to issue bonds to cover these loans at a lower rate of interest than that which the monarchy borrowed at directly. Clearly, these loans were considered safer than direct royal loans. Recognizing that the monarchy still retained means of pressuring the Estates of Burgundy into renegotiating debt, however, Potter and Rosenthal suggest that the full political story why this was possible remains to be told. Finally, it should also be noted that loans from provincial assemblies never represented the principal source of royal borrowing during the eighteenth century.[59]

Just as borrowing through intermediaries proved an imperfect mechanism for increasing government credibility, one can make the same claim with regard to the failure of John Law's national bank. The detailed study by Faure (1977) argues that Law had a need to continually please the Regent so that the complete plans for his bank could be carried out. The implicit threat was that the Regent could unilaterally decide to liquidate Law's bank and his other financial ventures. Given that the Regent himself was in a somewhat precarious political position during this period, because he was not himself the king of France, Law may well have faced a strong incentive to over-issue banknotes. Increasing the issue of banknotes allowed the monarchy to reduce its indebtedness, as well as to distribute money to political favorites. As Saint-Simon notes with regard to Law, "He had the ability to issue bank notes at will in order to garner support".[60] Saint-Simon also directly states that the Regent hastened the demise of Law's bank.

> That which hastened the demise of the Bank and of Law's System was the incomprehensible prodigality of the duc d'Orléans (the Regent), who, without limit and, if that is possible, without choice, could not resist the temptation, even with those whom he knew, no doubt, to be hostile to him. He distributed notes to each and everyone and frequently let himself be defrauded by people who ridiculed him and who respected only their own arrogance (1720 p.605-606).

In sum, John Law had firmly believed that establishing a national bank in an absolute monarchy was a viable project, but events proved him wrong.[61]

Effect on credibility of the failure to create a national bank in 1789

We cannot know with certainty how a national bank would have performed in France in 1789, because the National Assembly decided not to create one. What we can do is analyze how it might have functioned, based on the positions taken by different deputies during the debates over whether to establish a central bank.[62] Proceedings of these debates suggest that a national bank would have lacked durable political support in the National Assembly, and so it would have been no more immune from political interference than had been John Law's bank in 1719-20.[63] One important reason for opposing a bank in the eyes of some deputies was that it could give too much authority to the monarchy by relaxing borrowing constraints. There is also evidence, however, that lack of support for the Bank is attributable to the weak political position of private bankers within the Constituent Assembly.

It is worthy of note that the Constituent National Assembly, which decided upon Minister Necker's bank proposal, had few deputies who represented the private financial interests that would have benefited most directly from such an institutional change. Those who would have benefited most directly were the shareholders of the *Caisse d'Escompte* which would be transformed into the national bank. As argued by Doyle (1988) and Taylor (1967), contrary to Marxist interpretations of the French Revolution, where the new National Assembly represented a rising bourgeoisie, many of the deputies of the Third Estate, which was now dominant within the Assembly, were actually venal office-holders.[64] There were very few private bankers in the assembly, nor were bankers an important constituency for the deputies in general.

While in England the private shareholders in the Bank of England were key elements of the Whig coalition, in France the Protestant bankers who were the main shareholders in the *Caisse d'Escompte* were political outsiders.[65] What's more, the lack of durable political coalitions within the Constituent National Assembly reduced the possibility that the shareholders of the *Caisse d'Escompte* could gain influence via participation in a broader political coalition. One of the reasons for this lack of durable political coalitions was that no effective means existed for coalition leaders to enforce a common ideological line.[66]

Records from the assembly debate over establishing a national central bank are consistent with the above interpretation. Those in favor of establishing a national bank stressed above all that giving privileges over note issue to a bank like the *Caisse d'Escompte* would allow the government access to credit at lower interest rates.[67] Not surprisingly, some of those who spoke in favor of establishing a national bank were themselves shareholders of the *Caisse d'Escompte.*[68] Those opposed to creating a national bank stressed a different set of motives. No matter what advantages it might bring the government, they opposed the idea of giving special privileges to a consortium of bankers, arguing that a national bank would be useful above all to the "bankers and capitalists of Paris".[69] In the end, the bankers and capitalists of Paris lacked the political support to push through the national bank proposal.

5. Conclusion

There is a strong case for believing that limited government can improve credibility, but it is neither a necessary nor a sufficient condition for government commitment. Empirical evidence from 18th century England and France supports this argument with regard to the sufficiency condition in particular. In England after 1688 credibility was achieved not just because there were multiple veto players, but because holders of government debt were members of a cohesive cross-issue coalition in a parliament which would otherwise have been dominated by landowning interests. Therefore, explanations of the emergence of credibility in England should place as much weight on the emergence of cross-issue coalitions, reinforced by political party institutions, as on the development of limited government. Bureaucratic delegation through the foundation of the Bank of England also contributed to credible commitment. Nonetheless, the fact that the creation of the Bank had this effect was only possible because of the veto power held by those opposed to any attempt to interfere with its operations.

In France, in contrast, there is significant, if more speculative, evidence to suggest that had institutions of limited government been established in 1715 (by calling the Estates General for example), they would not have succeeded in firmly establishing the government's credibility. They might have even had the opposite effect if Saint Simon's prediction that the Estates General would have chosen to default is accurate. After 1789 France established limited government of a sort, but the lack of durable political coalitions within the Constituent National Assembly meant that financiers were unable to gain passage of a law establishing a national bank. Once again, the structure of partisan interests and political coalitions would appear to have been as important as the number of veto points in explaining whether credible commitment was obtained.

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[1] Levy and Spiller (1994) and Spiller (1996) have made a similar claim about the link between multiple veto players and the credibility of utility regulation. Henisz (2000) has provided empirical evidence on the link between institutions of limited government and growth.

[2] More specifically, in an infinite horizon game where a borrower is subject to stochastic shocks to its revenue, repayment will not be an equilibrium strategy for all potential states of the world.

[3] assuming for the sake of simplicity that the median voter in society has an endowment which is equally divided between labor and capital.

[4] Persson and Tabellini assume that taxation is necessary in order to satisfy an exogenous government budget constraint. The government budget constraint could be characterized as a situation where politicians need to raise money to support an essential public good (such as national defense), and alternative sources of taxation (such as excise taxes) are insufficient for this purpose. As a consequence the public good needs to be financed by some mix of taxes on capital and land income. One crucial difference between land and capital, however, would be that the time-consistency problem would be present only for the latter asset. Since the supply of land is relatively fixed, a government would have no incentive to defer tax increases on land with the idea that more land might be accumulated.

[5] This may also be true in terms of expectations in a case where there are revenue shocks with mean 0.

[6] For a formalization of the two-dimensional framework using a legislative bargaining model see Stasavage (2001).

[7] Schwartz (1989) and Aldrich (1995) suggest that such cross-issue trades provide an important rationale for forming political parties. Cox and McCubbins (1993) present alternative motivations for party formation which also open up the possibility that a majority party will support a policy other than the legislative median.

[8] A second possibility, modeled recently by Diermeirer and Feddersen (1998) and Huber (1996) is that legislative prerogatives such as the ability for a prime minister to call a vote of confidence or proposal rights can also promote party discipline.

[9] This argument draws upon existing work linking agency independence to the presence of multiple political veto points, as in McCubbins, Noll, and Weingast (1989)

[10] Parliamentary consent was required for levying of taxes, limiting the powers of the monarchy in this area, but this could hardly provide a credible commitment to repayment of debts as long as monarchs were willing to default. The Crown at this time made use of royal prerogative on many occasions to pass bills without parliamentary consent. For surveys of English political institutions before and after 1688 see Stone (1980), J.R. Jones (1994), or Harris (1993).

[11] The Bill of Rights of 1689 declared illegal any attempt to pass a bill through royal prerogative. *An Act Declaring the Rights and Liberties of the Subject and Settling the Succession of the Crown, 1689*

[12] The 1693 tontine loan made by the English government is omitted from this series, because Weir (1989) has shown that the extremely high rate on this loan was due to a lack of understanding about how tontines operated.

[13] There are few individual data points for interest rates on debt issued by the Estates of Holland here. But it is well established that borrowing rates for the Dutch government fluctuated within a fairly narrow band during this entire period. Clark (1995) has presented evidence from land rents which he interprets as suggesting that 1688 was not a watershed in terms of credibility, because there was no significant drop in rents associated with the Glorious Revolution. While this may be valid evidence for the perceived effect of the Glorious Revolution on the security of private contracts in general, this data does not provide direct indications about the monarchy's credibility as a borrower.

[14] The next sub-section's regression analysis presents more rigorous evidence that the increase in interest rates on government debt in 1710 was not driven purely by factors such as increased demand for funds.

[15] Two other factors which undoubtedly contributed to the long run decline in interest rates on government debt were the development of an improved administrative apparatus for collecting revenues and the invention

of a form of consolidated debt, the "consols", which entailed a liquidity premium (Neal, 1990) However, many reforms of tax collection were implemented under Charles II (1660-1680) suggesting that these cannot explain post 1688 trends. Likewise, the "consols" were not created until the middle of the eighteenth century, when the British government's rates of borrowing had already converged with those prevailing in the Netherlands.

[16] While the parliamentary act creating the South Sea company did not oblige investors to accept this conversion, it stipulated no other provision for repayment of the short-term debts. In reference to this forced conversion, Dickson (1967), the classic reference on the British finance for this period, states that "The establishment of the South Sea Company got rid of the floating debt, with the grudging acquiescence of the financial community in the City."

[17] Wells and Willis (2000) have presented evidence from a VAR model which favor the interpretation that the Tory election victory of 1710 was a significant negative break in the trend in Bank of England share prices.

[18] See Morgan (1921) for a discussion of contemporary accounts. It was also believed at the time that if the Pretender succeeded to the throne (something which was more likely to occur under the Tories) he would renounce all public debt incurred since the Revolution of 1688 (Speck, 1969 p.151).

[19] Based on the estimates made by Holmes (1967) only about 1/7th of members of the House of Commons were “monied men”. These individuals did make up a larger percentage of active members of the house, however, because they were based in London, while transport conditions sometimes dissuaded MPs from elsewhere from attending sessions.

[20] Early proponents of this view include Morgan (1921, 1922) and Trevelyan (1933). The thesis that partisan divisions dominated British politics during the period 1689-1715 was subsequently challenged by Walcott (1956), but since the seminal study by Holmes (1967) the majority of historians of the period have presented evidence regarding the importance of partisan divisions between 1689 and 1715 and the fact that the Whig party in particular voted cohesively in parliament. See Holmes (1967), and the historiographical survey by Hill (1993), as well as Speck (1970), De Krey (1985), Horwitz (1977), Richards (1972), and Plumb (1967).

[21] See the discussions in Plumb (1967) and Speck (1977). This split was also accompanied by a significant increase in the use of corruption as a tool for forming parliamentary coalitions. Speck (1977) shows that this use of corruption was a subject of frequent popular debate, and Stone (1980) suggests that this development also helped provoke the reaction of the American writers of the late 18th century against the venality and factionalism of British parliamentary politics.

[22] This refers to religious toleration for "dissenters", or Protestants who did not belong to the Church of England, not to toleration for all faiths. For reviews of the different stances on each issue see Holmes (1967), Stone (1980), Harris (1993). Tensions over religious toleration became increasingly exacerbated after 1700 as Tories claimed that the Church of England was "in danger".

[23] And some more extreme Tories actually associated themselves with the "Jacobite" cause of restoring James II (and subsequently his son) to the throne. This was clearly not a majority view among the Tories, however.

[24] For example, one of the key issues in the election of 1710 was whether Great Britain should seek a peace treaty with France.

[25] In addition to the references cited above, a short overview of party positions on these issues can be found in Speck (1969)

[26] This also dispels the notion that the monied interests were strictly a lobby with no parliamentary representation that gained access to Commons majorities via payments (legal or illegal). Many of the "monied men" who were members of the Commons were directors in joint-stock companies of the City of London (Carruthers, 1996), and Holmes (1967 p.164) shows that in the Commons which sat between 1708 and 1710 no fewer than 11 directors of the Bank of England held seats.

[27] As Holmes classic study remarks with regard to the Whig party, "it would scarcely have been a viable political alternative to its opponents without its many adherents among the country gentlemen" Holmes (1967) p.166.

[28] Jonathan Swift in the *Examiner* no.35, cited in Trevelyan (1933)

[29] See also the historiographical review in Harris pp.150-151.

[30] Data from Holmes (1967) Appendix A. See also Horwitz (1977)

[31] Krehbiel (1993) made an influential critique by suggesting that much legislative behavior which is attributed to party organizations may be more simply due to preference similarities between legislators.

[32] In addition to Holmes (1967) see Jones (1991)

[33] In the case of the Whigs, two political clubs, the Kit-Cat and the Hanover Club were important venues for policy discussions, and members who failed to vote in parliament in accord with established Whig policy could face exclusion. Presumably, failure to adhere to the party line could also reduce an aspiring member's chances of gaining entry to one of the clubs. Holmes (1967) pp.296-97 provides several examples of expulsions from the clubs.

[34] Holmes (1967) cites as evidence of this the fact that after losing elections (such as that of 1710) the Whig party was able to find safe seats for prominent members who had recently lost their seats.

[35] It has already been argued above that the monied interests could not be portrayed *purely* as a lobby because of their direct representation in parliament.

[36] See Carruthers (1996) pp.145, 156 and De Krey (1985) pp.123-129. Patterns of ownership in other joint stock companies established after 1688, such as the New East India Company, were similar, with the exception of the South Sea Company.

[37] One might ask whether beliefs held by Tories might have led them to resist the use of patronage and payoffs, but available evidence suggests that the Tory government of 1710-1714 used similar tactics in this area as those used by the preceding Whig government of 1708-1710 (Holmes, 1967).

[38] Information on partisan control of different political institutions is somewhat less comprehensive for the 1688-1700 period

[39] Harris (1993). Party majorities in the Lords were less stable than in the Commons, due to the influence which the Crown could exert on government officials who held seats. I refer to this period as being one of a Whig majority, because based on the political chronologies provided in Holmes (1967) and Trevelyan (1933), the Whigs did not suffer a significant defeat in the Lords.

[40] In addition, the Whigs attempted to use their position to strengthen the position of the Bank of England. In 1709 the Bank's charter was renewed (several years earlier than necessary) and its monopoly over note-issuing activities was significantly extended, as described above. The charter was renewed despite vigorous opposition from the Tories (De Krey, 1985).

[41] One prime reason for this change (apart from fatigue with war against France) was that Whig leaders in Parliament badly miscalculated by prosecuting a religious minister, Henry Sacheverell, with close ties to the Tories for the sole reason that he had criticized the legitimacy of the Revolution Settlement of 1688 (Morgan, 1922, 1921). The minister had also heavily criticized the Bank of England in his sermon, calling it a usurious institution.

[42] See the discussion in de Krey (1985) as well as William Thomas Morgan's (1922, 1921) articles on the elections of 1710 in England.

[43] In addition to the sources cited in Table I, for the period 1690-1700 I used information from Harris (1993) and Trevelyan (1933) to create this variable.

[44] Data on government debt and inflation are from Mitchell (1962)

[45] While several of the variables in these regressions, including the interest rate on government borrowing, are clearly non-stationary, the small number of observations here would make it difficult to draw inferences from a more sophisticated technique, such as an error-correction model. However, it should be noted that these

results remain robust when all variables are detrended, so a spurious regression problem is not driving the results. A Lagrange multiplier test could not reject the null of no serial correlation in the residuals for this regression. The results are also robust to inclusion of a lagged dependent variable instead of a time trend.

[46] Individual members of these corporate bodies were generally venal office holders who paid a designated sum in exchange for permanent attribution of a government office which included benefits such as tax exemptions, legal privileges, and prestige. For a review of these practices see Doyle (1996)

[47] The most recent survey of Law's policies in France is Murphy (1997). See also Faure (1977) and Luthy (1959).

[48] *Archives Parlémentaires*, vo.10, p.56-65.

[49] See Norberg (1994) and Velde and Weir (1992).

[50] After showing that this differential in bond yields cannot be readily explained by differential movements in prices, Velde and Weir (1992) conclude that it reflected a risk premium.

[51] Both Louis XVI prior to 1789 and the Constituent National Assembly after 1789 refused to respond to a growing fiscal crisis by directly defaulting on debt as had happened frequently in the past, and some have attributed this to the fact that as holdings of government securities were spread more broadly across the population in the 1780s it would have been more dangerous politically to default.

[52] The *assignats* were backed by proceeds from the sale of church lands, but there turned out to be a huge disparity between the nominal value of the *assignats* issued and the proceeds from church lands.

[53] author's translation.

[54] One might also ask why the Estates-General in 1715 could have been expected to default if the Estates-General in 1789 did not choose the same option when faced with a similar fiscal crisis. This issue is considered below.

[55] This is calculated in terms of total value of debts owned by each group. Hoffmann, Postel-Vinay and Rosenthal (1995) also present data on the stock of government loans in 1711, but they judge this sample to be atypical, and so it is not included here. Dessert (1984) has also made the claim that the nobility were the primary government creditors at this time.

[56] One motivation might have been to avoid diminished royal prerogative in areas of policy making other than finance.

[57] Norberg (1994) and Dessert (1984) provide details of the prosecution of government creditors.

[58] including Burgundy, Brittany, and Languedoc,

[59] According to Potter (2000), borrowing from provincial assemblies represented 2.5% of total royal financing between 1689 and 1715. Potter and Rosenthal (1997) suggest though that for the late eighteenth century this proportion rose significantly to over 16%.

[60] The quote is from vol.7 p.577. Other evidence for this can be found in Saint-Simon vol.7, pp.428-429, 503-5.

[61] "an absolute prince who knows how to govern can extend his credit further and find needed funds at a lower interest rate than a prince who is limited in his authority." (John Law cited in Kaiser 1991, p.6).

[62] While the National Assembly did not keep records of how deputies voted on all of its bills, it did keep records of its debates, and subsequent work by historians allows us to draw a link between the positions taken by deputies and the type of interests they represented.

[63] In addition to the reasons listed below, it should be noted that the failure of Law's Bank in 1720 had helped to convince many in France that a national bank could not function effectively.

[64] In general these were lower-level office holders. Applewhite (1993) calculates that 53% of Third Estate deputies were lawyers or members of the royal judiciary. Only 11% were merchants.

[65] See Luthy (1959) on the emergence of Protestant banking groups in France.

[66] Gueniffey and Halévi (1992) note that even the leaders of the Jacobins, France's best organized political movement of the revolutionary era, were incapable of imposing a common political line on the party's rank and file. Jacobin clubs at the provincial and municipal level had complete freedom to choose their own candidates for elections without intervention by Paris.

[67] See for example the speeches by Dupont de Nemours (*Archives Parlémentaires* vol.10 p.138) and Lecouteulx de Canteleu (vol.10 pp.392-4).

[68] Lecouteulx de Canteleu is a good example of this phenomenon.

[69] deputy Bouchotte cited in *Archives Parlémentaires*.(vol.10 p.270) See also the similar speeches by Lavenue (vol.10 pp.135-6), the Comte de Custine (vol.10 p.145), and the Baron de Cernon (vo.10, p.281).

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Figure 1

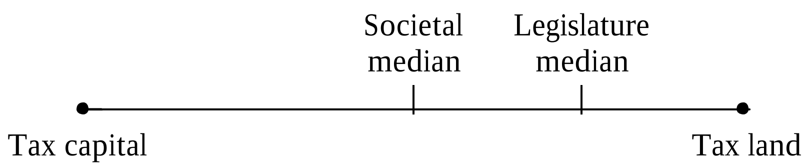

Figure 2

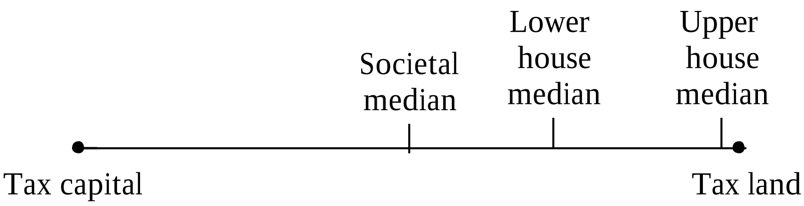
Lower house median
Upper house median
Societal median
Tax capital
Tax land

Figure 3

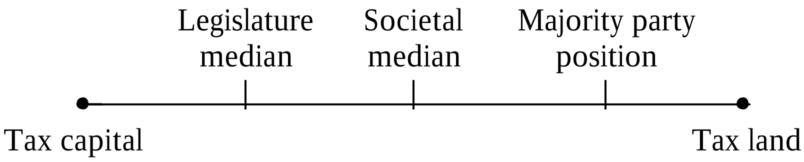
Legislature median
Societal median
Majority party position
Tax capital
Tax land

Figure 4

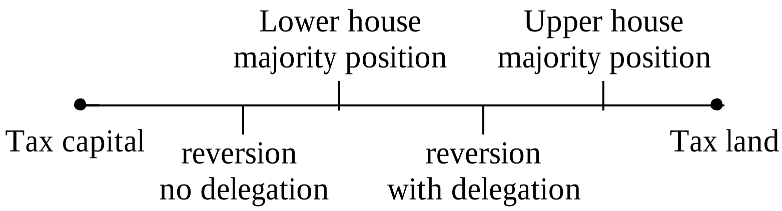
Lower house
majority position
Upper house
majority position
Tax capital
reversion
no delegation
reversion
with delegation
Tax land

Figure 5

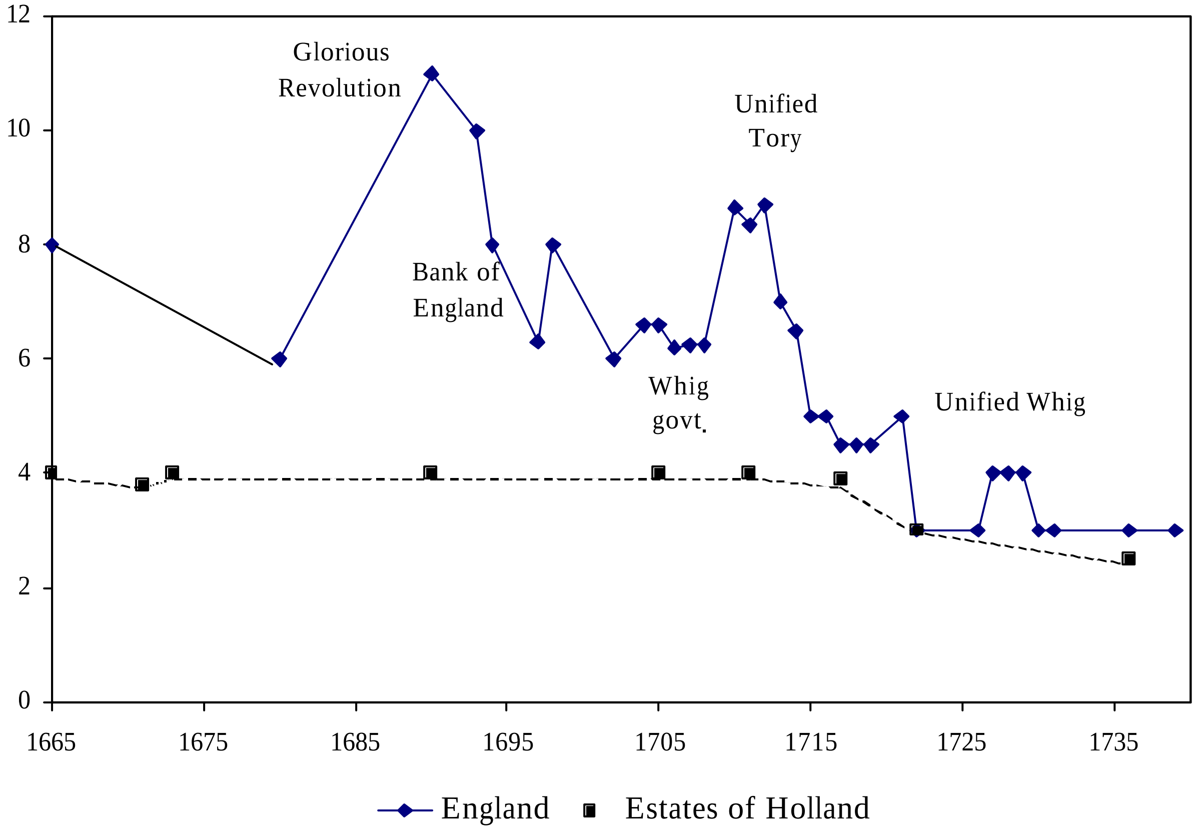
12
10
8
6
4
2
0
1665
1675
1685
1695
1705
1715
1725
1735
Glorious Revolution
Bank of England
Whig govt.
Unified Tory
Unified Whig
England
Estates of Holland

Figure 6

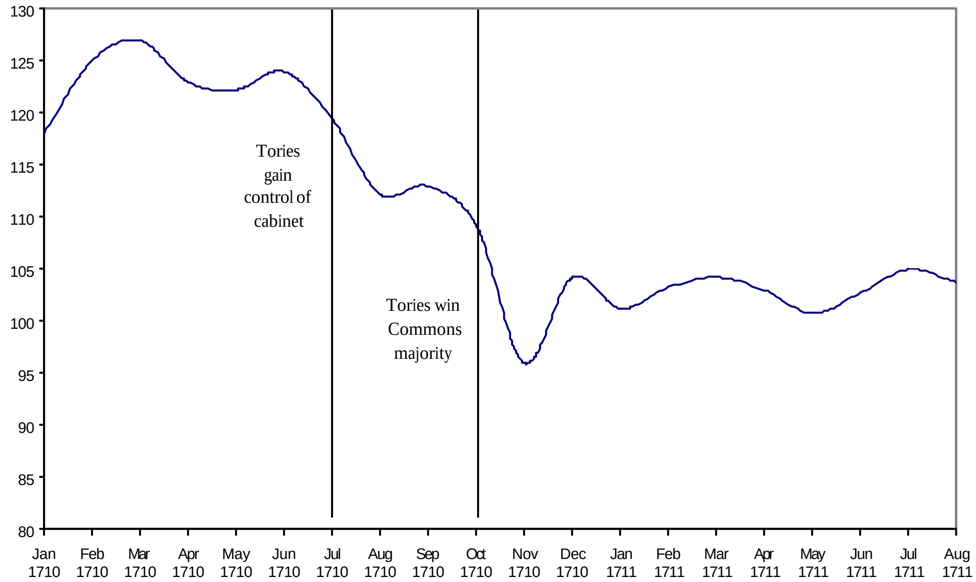
130
125
120
115
110
105
100
95
90
85
80
Tories gain control of cabinet
Tories win Commons majority
Jan 1710
Feb 1710
Mar 1710
Apr 1710
May 1710
Jun 1710
Jul 1710
Aug 1710
Sep 1710
Oct 1710
Nov 1710
Dec 1710
Jan 1711
Feb 1711
Mar 1711
Apr 1711
May 1711
Jun 1711
Jul 1711
Aug 1711

Figure 7

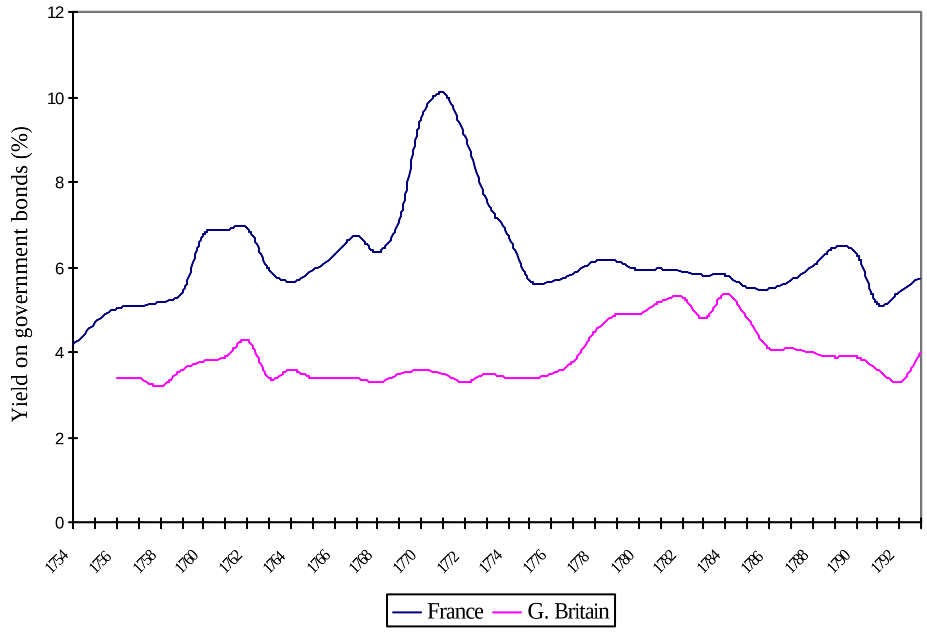
12
10
8
6
4
2
0
Yield on government bonds (%)
1754
1756
1758
1760
1762
1764
1766
1768
1770
1772
1774
1776
1778
1780
1782
1784
1786
1788
1790
1792
France
G. Britain

Figure titles and references

Figure 1: Credibility when the median legislator owns mostly capital

Figure 2: Credibility in a bicameral system

Figure 3: Credibility with a cross-issue coalition

Figure 4: When delegation increases credibility of debt

Figure 5: Interest rates on long-term government borrowing
Sources: Homer and Sylla (1991), Dickson (1967), t'Hart (1999), and Veenendaal (1994)

Figure 6: Bank of England Share Prices and the election of 1710
Source: Castaing, The Course of the Exchange

Figure 7: Yields on government bonds in France and Great Britain
Sources: Velde and Weir (1992), Mitchell (1962)

Table 1: Determinants of interest rates on UK public debt: 1690-1730

	coefficient
Whig control	-1.04
	(0.30)
Inflation	6.42
	(4.20)
Net borrowing	0.11
	(0.06)
Time trend	-0.10
	(0.02)
Lottery loan	0.32
	(0.54)
N=	31
R^2	.88

heteroskedastic consistent standard errors in parentheses

Table 2: Holdings of government debt by social category in France

Category	1682-1700	1730-1788
Nobles and officers	60%	54%
Merchants and bourgeois	17%	27%
Clergy	7%	9%
Crafts	3%	3%
Institutions	11%	--

Source: Hoffman, Postel-Vinay and Rosenthal (1995, 1992)