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The Anglo-French Rivalry and the Rise of British Finance, 1688-1720

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박　유　미

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이 논문을 외교학석사학위논문으로 제출함

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The Anglo-French Rivalry
and the Rise of British Finance, 1688-1720

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Why did Great Britain rise as a hegemon in the 18th century Europe? What was the role of sovereign borrowing in the process? Great Britain had access to unprecedented levels of war finances via the expansion of the debt market in the early eighteenth century, and its eventual success was reflected in Britain's prodigal expenditure on military and naval equipment. Effective government borrowing has hitherto become one of the predominant factors in explaining the rise of Great Britain as a global hegemon in the eighteenth century.

This dissertation focused on the eighteenth century Anglo-French rivalry underpinning British financial growth to argue that the pressure to financially outperform France provided Britain the incentives to implement schemes that restructured the debt market, from public ownership of debt to modern forms of private holdings. The two grand schemes were to convert the unfunded debt to the funded debt by inducing interest rate flexibility of loans and reducing the cost of debt via the sinking fund and the South Sea Bubble. The implementation of each scheme was triggered by financial developments in France. As a result, the two schemes committed Britain to lower the cost of its national debt and

institutionalize private sector control over the national debt.

The thesis, in particular, focuses on the financial developments from 1700 to 1720 because when distinguishing the different types of debt, the twenty years starting from 1700 to 1720 is the transitional period where old forms of debt are restructured to modern forms of funded debt. In other words, the ownership of the national debt restructures from the public sector to the private sector, typically in forms of the bond market. This dissertation has divided the twenty years into 1700-1710 and 1710-1720 to analyze major financial developments that enabled the restructuring of the national debt.

From 1700 to 1710, two political events affected Britain to compete for its fiscal-military reputation over France, in order to secure finance in the debt market. Britain's military outperformance over France and internationalization of the British debt market, made Britain increasingly reluctant to forgo its future finances by reneging its commitment. To sustain the inflow of investment from foreign creditors, reputation fiscal-military mattered and especially Britain had the pressure to consistently manifest her devotion to consistent implementation of debt servicing policies despite domestic complexities.

From 1710 to 1720, Britain implemented two grand schemes that restructured British national debt from unfunded debt to modern forms of funded debt. Each of the schemes was achieved in response to the financial developments in France. The first scheme to lower the interest rate of the national debt was implemented by the Tories in 1711 via the founding of the South Sea Company. This scheme was triggered by developments in 1702 France where their saving banks were re-established and their Treasury notes were circulating faster via the lowered interest rate on the Treaty notes. The second scheme to repay the debt was implemented by the Whigs in 1716 in response to the seemingly rapid fiscal recovery of France via the development of the Mississippi Company in 1716. In response, Britain actively sought to repay their public debt via the sinking fund and lower the cost of debt

further by generating the South Sea Bubble that encouraged the private sector to provide speculative incentives to absorb the old forms of debt to modern forms of government bonds.

The thesis, thus, provides two significant implications for international political economy. First, this thesis shows how inter-state relations influence the trajectories of financial growth for a state. I argued that the international dimension or the Anglo-French rivalry provides a better explanation in explaining the restructuring of old forms of national debt to modern forms of national debt. Recasting the international dimension to the discussion suggests that international factors can equally, and more powerfully explain government finance.

More importantly, however, this thesis provides implications for hegemonic rivalry and its effect on financial growth. Anglo-French rivalry played an important role in setting the foundation for the rise of British finance, and not necessarily the endogenous factors of the British hegemon. Anglo-French rivalry and the continental war in Europe provided Britain the pressure to go beyond domestic political complexities and consistently implement policies favorable to debt servicing.

Key Words: Financial Development, Sovereign Debt, Public Borrowing, Anglo-French Rivalry, Hegemonic Rivalry, Great Britain

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I. Introduction

1. Inter-state Politics and the Development of Credit

'War made the state, and the state made war,' is a dictum remarked by Charles Tilly that helps capture the essence behind the rise of powerful fiscal-military states in the eighteenth century Europe.[1] Major powers involved in the European struggle for power saw that credit was the backbone of their economic system at war. Military success was determined largely by the ability to find money at the decisive moment, and not a moment later. The correlation between power and credit provided greater implications for major powers in Europe when the eighteenth century Europe witnessed the rise of a new hegemon: Great Britain.[2]

Great Britain had access to unprecedented levels of war finances via the expansion of the debt market in the early eighteenth century, and its eventual success was reflected in Britain's prodigal expenditure on military and naval equipment.[3] The importance of credit was already well understood within the British political circles towards the end of the seventeenth century as Charles Davenant, states in his essay, *An Essay upon Ways and Means of Supplying the War* (1695), "the whole Art of War is in a manner reduced to Money, …, who can

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[1] Charles Tilly, "Reflections on the History of European State Making," in Charles Tilly (ed) The Formation of National States in Western Europe (Princeton: Princeton University Press, 1975), p.42. This view was first revisited by Brewer to explain the British rise as a powerful fiscal-military state between 1688 and 1714. See John, Brewer, The sinews of power: War, money, and the English state, 1688-1783 (London: Harvard University Press, 1990).

[2] The Acts of Union of 1707 united England and Scotland into the political union of Great Britain.

[3] British Military spending was on average 16% of British total revenue during the War of the Grand Alliance, 13% during the War of the Spanish Succession and 15 % during the Seven Years War. The highest military spending was in 1711which recorded an extraordinary amount of 34% of total revenue, which accounts for £12,663,000 alone in this year. See, Brian R. Mitchell, *British Historical Statistics* (Cambridge University Press, 2011), Public Finance 2

best find Money to feed, clothe and pay his army, not he that has the most valiant Troops, is surest of Success and Conquest."[4] Effective government borrowing has hitherto become one of the predominant factors in explaining the rise of Great Britain as a global hegemon in the eighteenth century.[5]

This paper thus argues that there are three advantages to narrowing the analytical focus to the role of finance in explaining the rise of a hegemon.[6] First, the role of finance is essential in state-building and improving state capabilities against other states in the modern international system. The ability to tax and raise public funds has been considered as the most important source of state power, referred to as the "sinews of power" by Brewer (1990). Moreover, Great Britain is a critical case because it is the first country to have accumulated unprecedented levels of sovereign debt in the modern sense after the financial reform of 1688.

Second, the transition of power in the modern international system almost always involves the transition of financial powers.[7] For example, the financial center relocated from Venice to Antwerp in 1500, Antwerp to Amsterdam in 1590,

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[4] Charles Davenant, *An Essay upon Ways and Means of Supplying the War* (London, 1695), pp. 26-7, re-quoted from Anne L. Murphy, *The Origins of English Financial Markets* (Cambridge University Press, 2009), p.39.

[5] Sovereign debt or government borrowing refers to the sale of bills and bonds issued by the Bank of England (1694) or the South Sea Company (1711). Origins of British national debt is found during the reign of William III (1689-1694), who organized City traders and merchants to offer for sale of an issue of government debt. This syndicate soon evolved into the Bank of England. Later, the South Sea Company, another trading company, was in charge of the national debt to finance the wars. Before the 17th century, it was customary for the state to fund its war debt by levying new taxes.

[6] Finance is a type of property that "consists of notes, public funds, actions, royal securities bearing interests, the fruits or interest of which are not destroyed by consumption, like those of the earth, but are permanent and unperishable, and multiply in every hand they pass through, yet, under the auspices of credit and circulation, preserve their fertility"; Isaac de Pinto, *Traité de la Circulation et du Crédit [An Essay on Circulation and Credit]* (Amsterdam, 1771), p.130-131.

[7] A financial center is capable of financing international trade and investment to foreign states; Youssef Cassis, *Capitals of Capital*: *The Rise and Fall of International Financial Centers 1780-2009* (Cambridge University Press, 2010), p.19.

and Amsterdam to London in 1790.[8] The relocation of financial centers was closely related to the transition of power from Spain who controlled the city of Antwerp, to the Dutch Republic and to England.[9] Thus, it is highly illustrative to focus on the competition or interaction of new powers from the perspective of finance in understanding the dynamics of power transition.[10]

Last, this paper revisits the role of hegemonic rivalry or the inter-state rivalry underpinning the financial growth of the rising power. In the case of the eighteenth century Europe, Anglo-French rivalry played an important role in setting the foundation for the rise of British finance, and not necessarily the endogenous factors of the British hegemon. Anglo-French rivalry and the continental war in Europe provided Britain the pressure to go beyond domestic political complexities and consistently implement policies favorable to debt servicing.

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[8] Hopkins argues that the Dutch financial hegemony reached its peak during 1620-78. On the other hand, Wallerstein argues that the economic hegemony of the Dutch can be assumed to have lasted until the early 1700s, when focusing on the commercial aspect rather than the financial aspect. For further discussion refer to David Wilkinson, "Authenticating seventeenth century 'hegemonies': Dutch, Spanish, French or None?," in Salvatore Babones and Christopher Chase-Dunn (eds.), *Routledge Handbook of World-Systems Analysis* (Routledge, 2012), p.181.

[9] The city of Antwerp was a city in Belgium (Low Countries) that was under the Spanish control during the 16th century. Local monied interests were forbidden to engage in trade and therefore foreigners controlled the finances of the city of Antwerp. Foreign monied interests predominantly included traders from Spain, Portugal and Venice.

[10] Disagreements continue as to whether 16th and 17th century European system was unipolar, multipolar or neither. However, focus on finance allows the application of the power transition theory to 17th century Europe. For further discussions refer to David Wilkinson, "Authenticating seventeenth century 'hegemonies': Dutch, Spanish, French or None?," in Salvatore Babones and Christopher Chase-Dunn (eds.), *Routledge Handbook of World-Systems Analysis* (Routledge, 2012).

2. Question

Why did Great Britain rise as a hegemon in the 18th century Europe? What was the role of sovereign borrowing in the process? The goal of this paper is to explain the rise of Great Britain as a global hegemon in the 18th century.

Successful mobilization of war finances in Great Britain after the Glorious Revolution in 1688 intrigued many scholars to analyze the leading factors for efficient government borrowing.[11] Literature on sovereign debt stress that financial channels or sovereign borrowing cannot expand if there are no security measures that guarantee the rules of exchange in financial markets. Britain found two alternatives in securing credibility. One was to take advantage of institutions that promote revenue and the other was to strengthen institutions that veto default. Brewer (1990) focuses on the importance of revenue in which he contends that Britain was able to supply the series of war ranging from the War of the Grand Alliance (1688-97) to the War of the Spanish Succession (1701-14) by acquiring high taxes and a well-organized civil administration to secure its standing army as a major European power.

North and Weingast (1989), on the other hand, emphasize the role of institutions that veto default by illustrating how setting constitutional rules to constrain a sovereign from violating commitments provided a critical momentum for Britain to enhance its credibility. Stasavage (2012) takes a step further to stress that mere institutional development is not enough but having creditor interests involved in the majority coalition in representative assemblies is necessary.

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[11] Government borrowing or public debt refers to the sale of bills and bonds issued by the Bank of England (1694) or the South Sea Company(1711). Origins of British national debt is found during the reign of William III (1689-1694), who organized City traders and merchants to offer for sale of an issue of government debt. This syndicate soon evolved into the Bank of England. Later, a trading company, the South Sea Company was in charge of the national debt to finance the wars. Before the 17th century, it was customary for the state to fund its war debt by levying new taxes.

Preceding approaches are resourceful, however, they fail to capture the role of inter-state rivalry underpinning financial growth. This failure arises from undistinguishing the different types of public debt, which yields two specific shortcomings. One account is that focusing solely on the trend of the aggregate sum of the debt can oversee the fact that the composition of the national debt underwent significant transformations. In fact, modern forms of funded debt start to override old forms of unfunded debt only by 1720, a time lag that cannot solely be explained by the constitutional reform in 1688 and the establishment of the Bank of England in 1694. Therefore changes between 1710 and 1720 need greater attention to understand the development of the modern forms of debt.

Another insufficiency is the assumption of the multiple veto-points approach, which argues that the delegation of debt ownership to the private sector was a desired and permanent outcome of the parliament. Cox (2012) limits the parliamentary role, arguing that debt accumulation had not been a favorable option for the parliament since repayment responsibilities were attributed to the parliament. In fact, Britain as a typical emerging economy struggled with structural inflexibility and needed strategic planning to restructure the national debt from unfunded debt to funded debt. Broz and Grossman (2004) contend that the private corporations including the Bank of England was not a permanent institution, but a political actor that had to renew its charter and build strategies to deal with the uncertainty that it can be dissolved by the parliament upon one year's notice.

Understanding the international dimension of British financial development, on the other hand, complements for the missing explanations of the expansion of funded debt between 1710 and 1720. According to the partisan politics approach, policies favorable for debt servicing is possible only when the creditor interests are included in the majority coalition in representative bodies. However, when the Tory ministry came to power in 1711 to 1714, their coalition including the landed interests or non-creditor interests did not draw back from debt-servicing policies and instead actively sought to implement schemes to sustain and expand the public debt to modern forms of debt. The paper thus shows that the international dimension has great leverage in explaining the expansion of funded debt between 1710 and 1720 by showing that the Anglo-French hegemonic rivalry pressured Britain to go beyond domestic political complexities and consistently implement policies favorable to debt-servicing.

3. Research Method

1) Subject

This paper performs a single case study of Great Britain after the Glorious Revolution. Great Britain is a critical case because it is the first country to have developed national debt in the modern sense. The modern financial system of banking and financial markets enabled the creation of debt through the issue of bills and bonds after the changes followed by the Glorious Revolution.

To understand the rise of Britain from the perspective of finance, *the thesis focuses on the inter-state rivalry underpinning financial growth*. Centering on the expansion of the funded debt between 1700 and 1720, this paper argues that the Anglo-French rivalry enabled Britain to achieve modern forms of public debt. Britain's fiscal reputation was an important factor in drawing creditors to invest in the British debt market in competition to the debt market of France. The pressure to outperform France in securing future finances and attracting creditors, provided Britain the incentives to implement fiscal policies favorable to debt servicing which consequently restructured the debt market, from public ownership of debt to modern forms of private ownership of debt. This was conducted under two grand schemes: absorption of the unfunded debt by the funded debt via the sinking fund and marketization of the cost of debt by inducing interest rate flexibility of loans.

2) Reputational Rivalry and Credible Commitment

The depiction of the Glorious Revolution as the triumph of the parliament, have hitherto driven the literature of credible commitment to set institutional veto points as the condition precedent to financial development. The role of reputation in public borrowing became marginalized and it no longer was the driving force for the development of institutional devices, but institutions itself became the pronominal word for reputation. The institutional veto points approach argues that the preceding practice to rely on the Crown's reputation became insufficient to police the default of the Crown and required institutional veto players to secure credibility. According to this approach, to solely rely on the Crown's reputation would situate the monied interest into vulnerable positions. In other words, the sovereign would face stronger incentives to renege, whenever the sovereign has his survival at stake and heavily discounts the future for its present credit needs.

In this paper, I recast the role of reputation in the literature of sovereign debt. To be specific, I argue that the Anglo-French competition for a greater fiscal-military reputation triggered the restructuring of British national debt from old forms of debt to modern forms of funded debt between 1700 and 1720. The two political events between 1700 and 1710–Britain's stronger commitment as a balancer of Europe and internationalization of the British debt market - strengthened British reputation against France, the predominant factor in determining British future finances in the financial market. Reputation of the state, and not of the Crown, was important because it drew creditors to invest in British national debt and encouraged speculation or greater risk-taking behavior in the British financial market.

According to the reputational theory forwarded by Tomz (2007), reputation of a state can be defined as the *impression* creditors hold about the borrower. In other words, the flow of investment is dependent on the impression creditors hold on the host country. Also, in international debt markets with repeat play, the reputation of the borrower develops under the conditions of incomplete information in the market. The condition of incomplete information can be particularly stronger when applying the reputational theory to the eighteenth century financial markets where investors had a stronger tendency to herd their investment based on what was manifested: military prowess and favorable debt servicing policies of the host country.

The reputational theory of Tomz also argues that political changes in the borrower country can cause the reputation of the borrower to be altered. Attaining consistency in government preference over debt servicing is an uneasy task for emerging economies as debt repayment creates economic winners and losers.[12] However, Britain was able to minimize the influence of divided opinions over her commitment to debt servicing by prioritizing her fiscal-military reputation against France, which generated investor confidence for the investors.

From the perspective of creditors, Britain was still a financial pygmy compared to her counterpart France, at the outset of the Glorious Revolution and the political stability of its regime was as questionable as its credit. However, Britain's military outperformance over France in the European mainland and the prospect that Britain would soon parallel the major military powers of eighteenth-century Europe generated the impression that speculative investment in British debt would yield high net worth. From the perspective of Britain, as the borrowing state, future channels of finances were valued to sustain the protracted war in Europe. Consequently Britain became increasingly reluctant to forgo its future finances by reneging its commitment and instead faced the burden to manifest policies that were favorable to debt servicing.

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[12] Jeff Frieden, "Sectoral Conflict and Foreign Economic Policy, 1914-1940," *International Organization* 42:1(1988), pp.59-90.

4. Outline of the Dissertation

This paper argues that the development of British finance was *embedded* in the Anglo-French fiscal-military rivalry.[13] The article focuses on the expansion of the modern forms of funded debt between 1700 and 1720 to explain how Anglo-French rivalry provided the impetus to restructure British national debt from unfunded debt to modern forms of funded debt.

Chapter 2 provides an in-depth review of the preceding literatures regarding British development of finance in the eighteenth century. The chapter divides the approaches of the existing literature into two categories: institutions that promote revenue and institution that veto default. Literatures that stress the importance of institutions that promote revenue have emphasized factors including taxation, civilized civil administration and the determination to act as a major power. On the other hand, literature that stress the importance of institutions that veto default, focuses on the establishment of multiple veto points and the incorporation of monied interest in the majority coalition at representative assemblies. Tracing the development of the literature on British finance and debt will help the reader to understand the limits of the preceding literature along with the contributions of this paper in highlighting the international dimension of the development of debt.

Chapter 3 provides the background of the advent of public borrowing in Britain. The first section of the chapter provides the historical background of the financial revolution after the Glorious Revolution of 1688 by tracing the political

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[13] Among other literatures that focus on bilateral relations to explain international systemic change, the paper particularly expands on Park (2000), which applies the bilateral framework in explaining the emergence of the gold standard in the 19th century Europe. Park states that "international regimes are embedded in concrete inter-state relations" whereby the "timing and terms of emergence of the first international monetary regime was determined neither by a hegemonic state nor a natural evolutionary process of money economy, but hostile inter-state relations between France and Germany."; Jong Hee Park, *The Rise of the Classical Gold Standard: Inter-State Relations and the Mergence of International Regime*, M.A. Dissertation, Seoul National University, 2000.

history behind the implementation of the modern forms of debt. The second section of the chapter explains the technicalities of the different types of debt: terminable annuities, unfunded debt and funded debt. Understanding the difference between the different forms of debt illustrated in this section is crucial not only because it contours the restructuring of the national debt that took place in the 1700s and the 1720s, but more importantly because it helps the reader understand why shifting the focus from 1688 to the 1710s and 1720s is important in explaining the development of finance in Britain.

Chapter 4 focuses on the developments between 1700 and 1710 to emphasize two important political changes after the Glorious Revolution that reconstructed Britain's reputation in the debt market. This section argues that the two political events- Britain's military outperformance over France and internationalization of the British debt market – elevated British reputation as a competent fiscal-military power parallel to France. This chapter shows that as Britain took on a greater proportional role in the conflict with Louis XIV among the Grand Alliance, the state became increasingly reluctant to forgo its future finances by reneging its commitment. To sustain the inflow of investment in Britain under the prospect of protracted wars in Europe, British fiscal-military outperformance against France became important for Britain.

Chapter 5 focuses on the developments between 1710 and 1720 to explain how Anglo-French rivalry triggered consistent government preference for debt servicing policies despite the shifting powers in the House of Commons between the monied interest Whigs and the landed interest Tories. The section outlines two grand schemes in Britain that significantly contributed to the expansion of the British debt: absorption of the unfunded debt by the funded debt via the sinking fund and marketization of the cost of debt by inducing interest rate flexibility of loans. This section tackles the two developments separately to analyze how each scheme was triggered by the financial developments in France that pressured

Britain to adopt better debt servicing policies to its creditors compared to what was provided in France.

In the conclusion, the paper summarizes the arguments forwarded in this paper with implications the British experience has on hegemonic rivalry and its effect on financial growth.

II. Literature Review

Successful mobilization of war finances in Great Britain after the Glorious Revolution in 1688 intrigued many scholars to analyze the leading factors for efficient government borrowing. Literature on sovereign debt stress that financial channels or sovereign borrowing cannot expand if there are no security measures that guarantee the rules of exchange in financial markets. Britain found two alternatives in securing credibility. One was to take advantage of institutions that promote revenue and the other was to strengthen institutions that veto default.

1. Institutions that Promote Revenue

1) Taxation

The importance of government revenue in relation to the development of modern forms of long-term public debt is most extensively studied by John Brewer in his book *The Sinews of Power* (1989). Brewer argues that Great Britain was able to develop the system of long-term debt because it had the securities of loans rooted in the strong inflow of government revenue via taxation. In other words, public creditors invested in Britain's government securities precisely because they were backed up by a solid tax system. Because Britain had a strong tax system, creditors believed that Britain had the capacity and determination to meet its payments. Brewer further argues modern forms of public debt such as the funded debt that started to appear after 1688 was possible only because specific taxes were earmarked to back up the delivery of debts.

Brewer focuses on how military funding and tax collection was obtained in Great Britain from the War of the Grand Alliance (1688-97) to the War of the Spanish Succession (1701-14). In particular, Brewer emphasizes the change in the means of tax collection, from direct tax to indirect tax, as a major fiscal development in Britain that provided the British government with the advantage of increased state revenue and surplus of credit to channel war finances. Throughout 1688 to 1714, direct taxation, such as land tax implemented by William and Mary dominated until the indirect taxation became prominent towards the end of the eighteenth century. Indirect taxation, including custom and excise duties, eventually enabled the development of national debt in Britain.

2) Centralized Civil Administration

Literature that stress the importance of a centralized civil administration in developing a strong credit mechanism for the state, branches out from the literature of taxation. Epstein (1994) builds on the arguments of Brewer to argue that Britain was able to attain an advanced fiscal system over the major power of Europe in the eighteenth century because it developed an efficient administrative system. Put differently, the constitutional reform in 1688 that strengthened the British parliament was not sufficient to secure government's greater access to national revenue, but implementation of an efficient administration was a necessary condition for the British government to gain supply for a substantial regular income.

Both literatures discuss the distinctive traits of the British administration that generated greater tolerance within the British population to accept taxation. One distinction was that Britain managed tax farming via the development of a large centralized bureaucracy. Centrally appointed government officials conducted tax collection and this contrasted with the practices of other financial states including France and Prussia where tax farming was largely under the supervision of private financiers which gave room for corruption. Another distinction was the bureaucratic practice with a strong fiscal uniformity. Britain imposed tax to its subjects equally with no special fiscal privileges to any county, region or subjects with high social ranks. France and Prussia on the other hand had different levels of compliance for the payment of taxes and tolerated legal exemption for the privileged class. Britain's bureaucracy was also transparent that presentation of accounts and reports were required by the parliament. Centrality, transparently and the strong legality of the British bureaucracy facilitated channeling of tax monies without much public resentment.

3) Determination to Act as a Major Power

Hintze (1906), Brewer (1989), Tilly (1990) and Downing (1992) have hinted that war is a powerful force prompting rulers to alter the structure of their polity's political and bureaucratic institutions. Their perspective taps into the argument that the determination to act as a major power is essential for a state to seek for the expansion of one's credit. In eighteenth century Europe, where armies were paid and not conscripted, efforts to raise large armies also required the rapid mobilization of large sums of money. This was especially the case for Britain after 1688 as it joined the Grand Alliance to balance against the expanding French forces under Louis XIV. Already between 1688 and 1714, 75 percent of British public expenditure was used for military operations and other war finances.[14] Explanations for the role of the state's determination to act as a major power underpinning the development of state credit has left many hypotheses based on international factors untested, in which this paper partly expands.

2. Institutions that Veto Default

1) Multiple Veto Points

North and Weingast (1989) emphasize the role of institutions that veto default by

[14] John Brewer, *The Sinews of Power: War, Money and the English State, 1688-1783* (Harvard University Press, 1990), p.110.

illustrating how setting constitutional rules to constrain a sovereign from violating commitments provided a critical momentum for Britain to enhance its credibility. The Glorious Revolution was the constitutional reform that controlled the arbitrary and confiscatory power of the Crown. After the Glorious Revolution, the Crown had to obtain the assent from the Parliament to gain access to war funds. This constitutional check and balance system between the Crown and the Parliament enhanced the credibility of the British government and enabled the British government to have access to unprecedented levels of funds. Access to these funds played a critical role in the emergence of Britain as a global hegemon.

2) Partisan Politics

Stasavage (2012) argues that mere institutional development is not enough but having creditor interests involved in the majority coalition in representative assemblies is necessary. In other words, constitutional division of power is not sufficient to make the government more publicly accountable. The veto power of the Parliament only became enforceable when the coalition of the ruling party consisted of creditors.

Stasavage provides an in-depth analysis on the political issues of 17th and 18th century England to show that the monied interests formed the Whig coalition with religious interest groups who supported Protestantism and the transformation of the hereditary succession. The descriptive analysis by Stasavage can be analyzed as in Table II-1. Stasavage argues that during the Whig ministry the presence of creditors in the ruling party provided incentives for the parliament to practice its veto power against any default of repayment.

Table II-1. Political Division over Issues

ISSUES	WHIG	TORY
Party membership	-Large landowners -Heterogeneous composition -Government creditors -Shareholders of Bank of England and East India Company	-Small and medium land owners -Support from Peripheral regions -closely associated with South Sea Company (often regarded as rival of East India Company)
Religious toleration	Dissenters: non-adherents of Church of England	
	Toleration of Dissenters Act of Toleration, 1689[15]	Non-toleration of Dissenters
Divine right and Hereditary monarchy	Supported transfer of succession Act of settlement, 1701[16]	Supporter of King's prerogative and hereditary succession. Unconditional support to the monarch
Constitutional Restrains on the executive	Court vs. Country (Strong executive vs. restriction of the power of executive)	
	Not consistent	Not consistent
Foreign Policy	Hostile to France	Allied with France
Questions of taxation and government finance	- Monied interest -Financing war expenditures	Landed interest - unsatisfied with ex post facto distributional conflict to taxing land owners for repayment

Source: David Stasavage, *Public Debt and the Birth of the Democratic State: France and Great Britain, 1688 – 1789* (Cambridge University Press, 2003), p.101-114.

[15] The Act of Toleration 1689 permitted "Dissenters" who worshipped in churches other than the Church of Engalnd, to establish their own places of worship.

[16] Act of Settlement 1701 approved the succession of the Crown to the House of Hanover.

3) Private Institutions

The emphasis on the activities of private institution is initiated by the discussions of Cox (2012) who limits the Parliamentary role, arguing that debt accumulation had not been a favorable option for the parliament since repayment responsibilities were attributed to the parliament. Broz and Grossman (2004) expands this argument to contend that the private corporations including the Bank of England were important political actors that successfully won over greater proportions of the national debt to the private sector by renewing its charter and building political strategies that overcame the uncertainty of being dissolved by the Parliament upon one year's notice.

Neal (2000) expands this approach by focusing on the role of the informal entente more than that of the private institutions. Neal states that the chartering of the Bank of England in 1694 and its monopoly over the issue of notes in 1706 provided privileges for the goldsmith bankers acting as trustees for creditors holding claims on the British government. The goldsmith bankers expanded the scale of banking activities by facilitating trades over government annuities and shares of government chartered corporations. As De Vrie and Van der Woude (1997) would agree, this smaller and narrower pool of credit suppliers created an institutional power of its own, promoting the interests of haute-financers and monied interests in representative assemblies.

3. Limits and Implications

1) Limits to the Institutions that Promote Revenue

To solely rely on the tax system to explain the expansion of British credit in the early eighteenth century has two limits. First, France extracted greater amounts of revenue compared to Britain during the eighteenth century. In describing the superiority of the tax system in France, a historical essay of a Dutch Jew investor, Isaac de Pinto Traité de la Circulation et du Crédit [An Essay on Circulation and Credit] (1771) notes,

> "a nation [France] that would submit to pay heavy taxes without reluctance, and that, as the author supposes, would pay them from a spirit of emulation, and where the application of the revenue should be constantly directed to the public good, without any part of it being diverted, would be a nation of angels, or rather of gods, and such a one as never will exist upon this mass of earth."[17]

As Figure II-1 shows, it was not until the 1790s that the British total revenue excelled the total tax revenue in France. While Britain expanded expenditure in unprecedented levels during the 1710s and 1720s, British tax revenue only steadily increased. In fact, Britain was relatively weak in financing enough credit through taxation in comparison to France. France, on the other hand, had greater leverage over financial mobilization, financing on average 1.48 times greater amount of total revenue compared to Britain. Under the monarchic structure, the French finance minister appointed by King was given absolute authority to extract finances and fund expansionist wars.[18] Thus, to solely rely on the development of the British system for taxation may have limits in explaining the expansion of British finance in the early eighteenth century.

Second, the expansion of the British revenue in the early eighteenth century partly explains for the expansion of public debt, however, it its insufficient to explain why the transition from short-term loans to long-term funded loans occurred during the 1720s and not years later. Brewer argued that the steady increase in British tax contributed to the expansion of public borrowing as specific taxes were earmarked to back up the delivery of debts. He also explained that it

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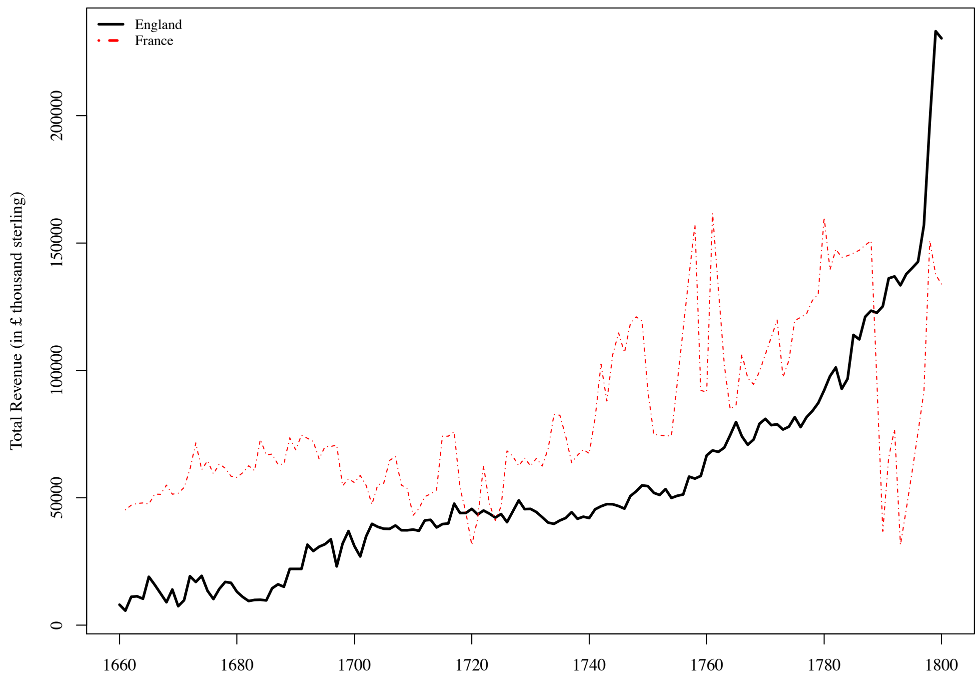
[17] Isaac de Pinto, *Traité de la Circulation et du Crédit [An Essay on Circulation and Credit]* (Amsterdam, 1771), p.133.

[18] John Brewer, *The Sinews of Power: War, Money and the English State, 1688-1783* (Harvard University Press, 1990).

took time for such sound system to evolve as the government's short-term loans led to the emergence of the long-term debt.[19] However, he fails to specify the factors that drove the transition from short-term loans to long-term loans during the 1710s and 1720s.

Figure II–1. Total Revenue of France and England, 1660-1800



Source: Mark Dincecco, *Political Transformations and Public Finances* (Cambridge University Press, 2011).

[19] John, Brewer, *The sinews of power: War, money, and the English state, 1688-1783* (London: Harvard University Press, 1990), p.74.

2) Limits to the Institutions that Veto Default

Patrick O'Brien(2002), Carl Wennerlind(2011)[20] and Stephan Epstein[21] argue that narratives that place the Glorious revolution as a central conjecture are misleading and instead, the fiscal revolution had been a continuous process. O'Brien insists that the English Civil War should continue to be the fiscal transformative point, e.g. Bill of Rights 1689, instead of the Glorious Revolution because the role of parliament had gradually strengthened since the English Civil War. Wennerlind delivers similar arguments by tracing the intellectual underpinnings that led to the Financial Revolution. Wennerlind argues that the Revolution and its "financial architecture" would not have been possible without prior revolutions[22].

More importantly, however, the failure of the preceding literature is to undistinguishing the different types of public debt, which yields three specific shortcomings. One account is that focusing solely on the trend of the aggregate sum of the debt can oversee the fact that the composition of the national debt underwent significant transformations. In fact, modern forms of funded debt start to override old forms of unfunded debt only by 1720, a time lag that cannot solely be explained by the constitutional reform in 1688 and the establishment of the Bank of England in 1694. Therefore changes between 1710 and 1720 need greater attention to understand the development of the modern forms of debt.

Another insufficiency is the assumption of the intuitionalist approach that delegation of debt ownership to the private sector was a desired and permanent outcome of the parliament. Cox (2012) limits the Parliamentary role, arguing that debt accumulation had not been a favorable option for the parliament since repayment responsibilities were attributed to the Parliament. In fact, Britain as a

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[20] Carl Wennerlind, *The Casualties of Credit,* (Harvard University Press, 2011).

[21] Stephan R. Epstein, "Freedom and Growth: The European Miracle", *Working Papers in Economic History of London School of Economics* (1994).

[22] Carl Wennerlind, *The Casualties of Credit,* (Harvard University Press, 2011), p.3.

typical emerging economy struggled with structural inflexibility and needed strategic planning to restructure the national debt from unfunded debt to funded debt. Broz and Grossman (2004) contend that the private corporations including the Bank of England was not a permanent institution, but a political actor that had to renew its charter and build strategies to deal with the uncertainty that it can be dissolved by the Parliament upon one year's notice.

Lastly, understanding the expansion of funded debt between 1710 and 1720 from an international dimension complements for the missing explanations of the partisan politics approach. According to the partisan politics approach, policies favorable for debt servicing is possible only when the creditor interests are included in the majority coalition in representative bodies. However, the Tory ministry came to power in 1711 to 1714, their coalition including the landed interests or non-creditor interests, did not draw back from, but instead, promoted debt servicing policies. The paper thus shows that the international dimension better explains the expansion of funded debt between 1710 and 1720 by showing that the hegemonic rivalry pressured Britain to go beyond domestic political complexities and consistently implement policies favorable to debt servicing

4. Chapter Summary

This chapter provided an in-depth review of the preceding literatures regarding British development of finance in the eighteenth century. The first section of this chapter divided the approaches of the existing literature into two categories: institutions that promote revenue and institution that veto default. Literature that argue for the importance of institutions that promote revenue, have stressed factors such as taxation, civilized civil administration and the determination to act as a major power to explain the rise of Britain as a financial power in the eighteenth century. On the other hand, literature that argue for the institutions that veto default has stressed the importance of multiple veto points and the incorporation of the monied interest in the majority coalition at representative assemblies.

In the second section of the chapter, I argued that the limits to the literature that emphasize institutions that promote government revenue was that when placing British revenue in comparison to France, empirical evidence show that British total revenue was not competitive to that of France during the eighteenth century. Therefore, it is more convincing to emphasize institutions that veto default, or institutions that promoted financing in forms of government debt. The limits to the literature that emphasize institutions that veto default, on the other hand, was the fact that preceding literature do not distinguish the different types of debt that composed the British national debt in the eighteenth century. Therefore, preceding literature overlooks the fact that the transition to modern forms of debt occurred from 1710 to 1720, and not immediately after the constitutional reform or institutional developments of the Glorious Revolution of 1688.

III. Glorious Revolution and the Development of Debt

The financial revolution after the Glorious Revolution of 1688 was indeed a major transitional point for Britain to develop her government credibility. The first part of this section compares the British state of finance before and after the Glorious Revolution of 1688. More specifically, it reviews the political history behind the implementation of the modern forms of funded debt. The second part of this section explains the technicalities in the different types of debt: terminable annuities, unfunded debt and funded debt. Understanding the difference between the different forms of debt illustrated in this section is crucial not only because it contours the restructuring of the national debt that took place in the 1700s and the 1710s, but more importantly because it helps the reader understand why shifting the focus from 1688 to 1710s and 1720s is important in explaining the development of finance in Britain.

1. British State of Finance

1) State of Credit before the Glorious Revolution

In the seventeenth century, England was still a financial pygmy compared to the major powers in Europe. The Dutch largely directed the prestige as a financial power.[23] The Dutch had been a forerunner of capitalist development from banking, insurance to technological skills of capital investment during the early 17th century

[23] Hopkins argues that the Dutch financial hegemony reached its peak during the 1620-78. On the other hand, Wallerstein argues that the economic hegemony of the Dutch can be assumed to have lasted until the early 1700s, when focusing more on the commercial aspect rather than the financial aspect. For further discussion refer to David Wilkinson, “Authenticating seventeenth century ‘hegemonies’: Dutch, Spanish, French or None?,” in Salvatore Babones and Christopher Chase-Dunn (eds.), *Routledge Handbook of World-Systems Analysis* (Routledge, 2012), p.181.

to 18th century.[24] Already in the seventeenth century, Dutch capitalists were lending substantial sums to Brandenburg, Denmark, Sweden, Hamburg, Bremen, Emden, East Friesland, and the Empire. The benefits of Dutch investment to other European commercial powers were well perceived by its contemporaries. A historical essay of a Dutch Jew investor, Isaac de Pinto *Traité de la Circulation et du Crédit [An Essay on Circulation and Credit] (1771)* notes,

> "The ready money in Holland serves as a prop to an infinity of imaginary riches in vessels, commodities, paper, and public funds; and the commercial powers of Europe are so closely connected with the Dutch that the latter are, as it were, their factors, their partners, and if I may be allowed to say it, their bankers."[25]

On the other hand, the French monarchy led by Louis XIV was rapid in catching up the Dutch financial capability.[26] France extracted revenue by imposing massive tax from its population accompanied by the institutional advantage of monarchy in which the finance minister was able to extract money and transfer it to military administration. France was capable of raising 4.23 times greater amount of national revenue compared to England in the year 1688, where France had total

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[24] Dutch financial innovations included a wide range of modern investment including public bonds, acceptance of credit and commission trade, marine insurance and tradable shares in the Dutch East India Company (VOC). The Dutch government floated public debts while institutions including the Bank of Amsterdam and merchant banks intermediated the investments in the private sector. See Jan de Vries and Ad Van der Woude, *The First Modern Economy: Success, Failure, and Perseverance of the Dutch Economy, 1500-1815* (Cambridge University Press, 1997), pp. 668-74.

[25] Isaac de Pinto, *Traité de la Circulation et du Crédit [An Essay on Circulation and Credit]* (Amsterdam, 1771), p.197.

[26] The central role of taxation in France is well illustrated by Isaac de Pinto, "a nation that would submit to pay heavy taxes without reluctance, and that, as the author supposes, would pay them from a spirit of emulation, and where the application of the revenue should be constantly directed to the public good, without any part of it being diverted, would be a nation of angels, or rather of gods, and such a one as never will exist upon this mass of earth"; Isaac de Pinto, *Traité de la Circulation et du Crédit [An Essay on Circulation and Credit]* (Amsterdam, 1771), p.133.

revenue of £72,886,425 and Britain had £9,963,183.[27]

Unlike France, Britain had a smaller population and thus actively sought alternative means other than land tax to secure exigencies resorted to means of borrowing in securing exigencies. Prior to the Glorious Revolution, British borrowing in general had been based on the credibility of the Crown. Unlike the other European monarchs at the time, the British Crown had no sources of wealth that could be mortgaged. The Crown, therefore, pawned the Crown jewels to borrow money from foreign Kings and particularly from Amsterdam.[28] However, the Crown jewels were often subject to delayed redemption due to financial plight of the Crown. The obstacle to extensive lending was clearly the inadequate security offered by the Crown, and, increasingly, the Crown's financial position became the real constitutional issue within the domestic political circles in England.

Constant struggle over the Crown's inability to mobilize war finances was resolved by choosing to align with the greatest lender, the Dutch, instead of France.[29] The Glorious Revolution of 1688 to 1689 was a multi-layered event that fundamentally changed the power structure of England. It replaced the reigning king, James II, with the joint monarchy of his protestant daughter Mary and her Dutch husband, William of Orange.[30] It set the supremacy of parliament over the

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[27] See Mark Dincecco, *Political Transformations and Public Finances* (Cambridge University Press, 2011).

[28] The practice of pawning Crown Jewels dates back to 1625.

[29] The Grand Alliance was a European coalition against Louis XIV found in 1689. The Dutch Republic, Austria, Bavaria, Brandenburg, Holy Roman Empire, Ireland, Palatinate of the Rhine, Portugal, Savoy, Saxony, Scotland, Spain and Sweden and England were members of the Grand Alliance.

[30] Approval of William Orange as the new crown as a consequence of the declining popularity of James II in England involved two political interests. Religious interest groups, both Protestants and Catholics were infuriated by James II and sought means to prevent the succession of a Catholic Crown. Foreign policy interests that involved mercantile interest of Britain also found benefits in

crown, Whig over Tory, Protestant over Catholicism, transfer of succession over hereditary monarchy, and change of foreign policy from anti-Dutch to anti-French.[31] From the perspective of finance, cooperation between the Dutch and Britain created unintended effects to its financial relationship: Dutch financial innovations foreign to England were accepted without hostility.

2) State of Credit after the Glorious Revolution

When William was crowned, much obstructions and difficulties in obtaining supplies from parliament remained. Revenue to the King was granted by the Parliament on a yearly bases, in which predominantly came with conditions to be used for public purposes.[32] A historical essay by Allan Ramsay, *An Essay on the Constitution of England (1765),* notes that whenever the King requested supplies necessary for carrying on a war, "every session opened with clamor and

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approving William III as the new crown. James II and his regime provoked passionate resentment among a wide range of the English population. James regime was in this sense infuriated both by the Protestant and Catholicism, as James II being a Devout Catholic, attempted to modernize Britain's Catholicism on ideological premises taken from French Catholicism that not only directed against Protestant but also against pop Innocent XI. Protestant Mary Stuart, the oldest daughter of James and the wife of William III, therefore were not fiercely opposed against when they had invaded England to displace James II.

[31] Foreign policy concerns were at the center in accepting Mary Stuart and William Orange as the new crown. Domestic debates continued over whether Britain should adopt the blue policy or the continent policy in which became the bases for supporting Dutch or the French. In fact, Britain was given a choice between bandwagoning with the challenger, and remaining cooperative to the status quo power. Disagreements on foreign policy were extensive and politicized between the Tories and the Whigs that it had not been settled even in the early 1700s. For continued struggle over the foreign policy between Whigs and Tories in the early 1700s see Doohwan Ahn, "The Anglo-French Treaty of commerce of 1713: Tory Trade Politics and the Question of Dutch Decline", *History of European Ideas,* Vol.36, No.2 (201), pp.167-180.

[32] Allan Ramsay, *An Essay on the Constitution of England* (London: T. Becket & P.A. De Hondt, 1765), p.81.

discontent."[33] Clearly, the Parliament was careful to make no generous grants of revenues. Such difficulties of the English system obliged King William to introduce the Dutch system of loans into England with the expectation that, if properly implemented, it would facilitate exigencies and ultimately expand the purchasing power of the government.

The British system soon followed the financial innovation of Netherlands to borrow loans by mortgaging a portion of taxes to pay the interest, referred as debt charges. In its design, the new forms of debt was an innovative mean to expand government finance where its basic principal was to mortgage a portion of taxes for the payment of interest for the loaned sum. In this way the country was able to pay the minimal cost for the newly created artificial capital, which became permanently fixed and solid, and by means of credit, circulated in the public. The capital provided unprecedented financial leverage, as it was unexpendable through consumption and multipliable through circulation.[34] Britain thus developed debt instruments consisting of notes, public funds, actions and royal securities secured by taxation. The interest paid, referred as debt charges, therefore, was an institution implemented by the government to prevent the demoralization of credit and prevent government defaults by substituting debts for a perpetual annual charge. Debt charges, or interests, set at the time of initiation of a debt could not be reduced unless offering to pay the principal.

The newly adopted system in Britain thus created two benefits. In the British system of public debt, reimbursement of the principal was not a necessary requirement, in which "the reimbursement of the debt depends upon the pleasure

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[33] Allan Ramsay, *An Essay on the Constitution of England* (London: T. Becket & P.A. De Hondt, 65), p.81.

[34] Isaac de Pinto, *Traité de la Circulation et du Crédit [An Essay on Circulation and Credit]* (Amsterdam, 1771), pp.130-131.

of government."[35] British government was able to borrow more money regardless of the already accumulated amount of debt, as long as interests were paid.[36] Britain, thus expended on great sums of money in which it could not earn in real revenue by mortgaging a portion of taxes. As a result, private institutions were now willing to lend funds to the government despite the expectations that principal money was not set for any reimbursement date in return for monopoly trading rights. For example, South Sea Company achieved the monopoly right in the South Americas and East India Company had attained monopoly rights in the East Indies.[37]Interestingly enough, as the government increasingly borrowed from the private institutions, the ownership of debt shifted to greater proportions of private ownership between 1700 and 1720. As a consequence, private institutions that pooled investment domestically and internationally became the dominant forms of modern debt in Britain by the early 1700s. Isaac de Pinto characterized Britain that "the whole English nation in a body, supported by their credit with foreigners, and by a few dealers in the stocks, who contribute not a little to maintain the circulation and credit o this immense volume of annuities." [38]

The second benefit was that Britain was able to enjoy military aggrandizement through the facilitated channels of finance. Perceiving financial resources as the pillar of military success was apparent as Charles Davenant, *An*

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[35] Isaac de Pinto, *Traité de la Circulation et du Crédit [An Essay on Circulation and Credit]* (Amsterdam, 1771).

[36] Interest rates, however, could not be readjusted even after the reimbursement of a part of the principal.

[37] The company was also granted with the monopoly to trade with South America. At the time it was created, Britain was involved in the War of the Spanish Succession while Spain still controlled South Americas. There was no realistic prospect that actual trade would take place and the company never realized any significant profit from its monopoly.

[38] Isaac de Pinto, *Traité de la Circulation et du Crédit [An Essay on Circulation and Credit]* (Amsterdam, 1771), p.14.

Essay upon Ways and Means of Supplying the War (1695), that "the whole Art of War is in a manner reduced to Money, …, who can best find Money to feed, clothe and pay his army, not he that has the most valiant Troops, is surest of Success and Conquest."[39] This was also well understood by the historical experience of the repeated bankruptcies of Spanish during the Dutch Revolt,[40] and financial exhaustion of the Habsburg family towards the end of the Thirty Year's war.[41] On this aspect, Wilson (1941) notes how Britain had a military advantage in securing war finances by pooling foreign investments in the forms of national debt. Wilson illustrates that,

> "[despite disagreements on the dangers of public debt] all were agreed, however, on its importance, and French, Dutch and English observers speculated about its probable effects on the Anglo-French struggle … that England could not, from her own capital resources, have maintained such an immense navy, a land army in Europe, and great numbers of troops in three other quarters of the world, and have supplied subsidies to sustain her influence, as she had done."[42]

Wilson's argument on the role of foreign investment to London as sources of English military power is reasonable when we observe the military spending of England at her times of war including the War of the Grand Alliance (1688-97), War of the Spanish Succession (1701-14) and the Seven Years War (1754-1763).

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[39] Charles Davenant, *An Essay upon Ways and Means of Supplying the War* (London, 1695), pp. 26-7, re-quoted from Anne L. Murphy, *The Origins of English Financial Markets* (Cambridge University Press, 2009), p.39.

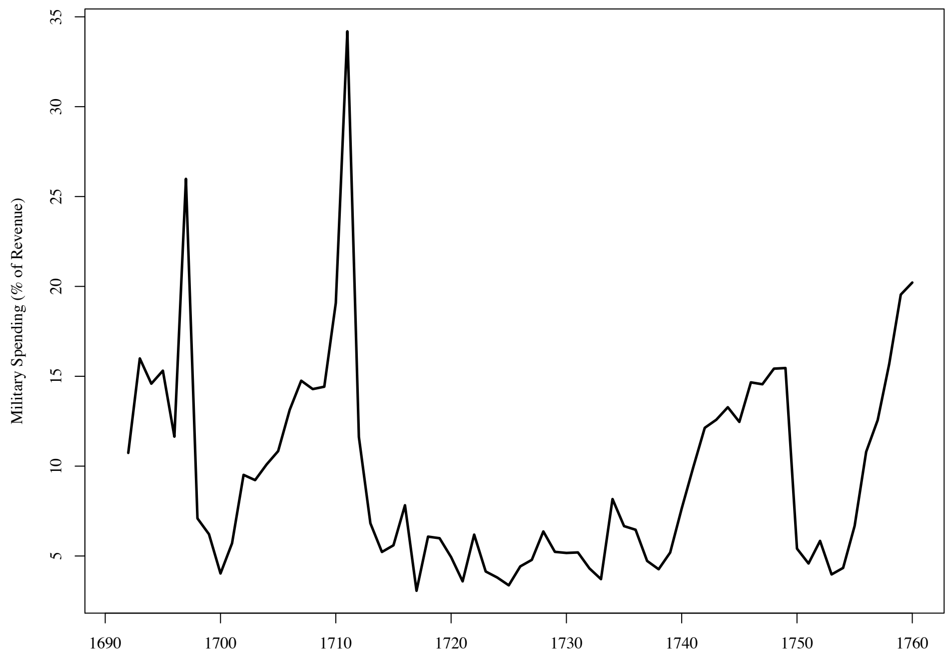
[40] In 1568, the Netherlands, led by William I of Orange revolted against Philip II of the House of Habsbourg. This was the due to the imposition of heavy taxes and constant persecution of the Protestants.

[41] Steve Pincus, *1688: The First Modern Revolution* (Yale University Press, 2009), p.311.

[42] Charles Wilson, *Anglo-Dutch Commerce and Finance in the Eighteenth Century* (Cambridge University Press, 1941), p. 88.

Figure III-1 shows that military spending of Britain was on average was 16% of British total revenue during the War of the Grand Alliance, 13% during the War of the Spanish Succession and 15 % during the Seven Years War.[43] Figure III-2 show that the highest military spending was in 1711 which recorded an extraordinary amount of 34% of total revenue, which accounts for £12,663,000 alone in this year.[44]

Figure III–1. Military Spending Ratio of England, 1691-1760



Source: Brian R. Mitchell, *British Historical Statistics* (Cambridge University Press, 2011), Public Finance 2.

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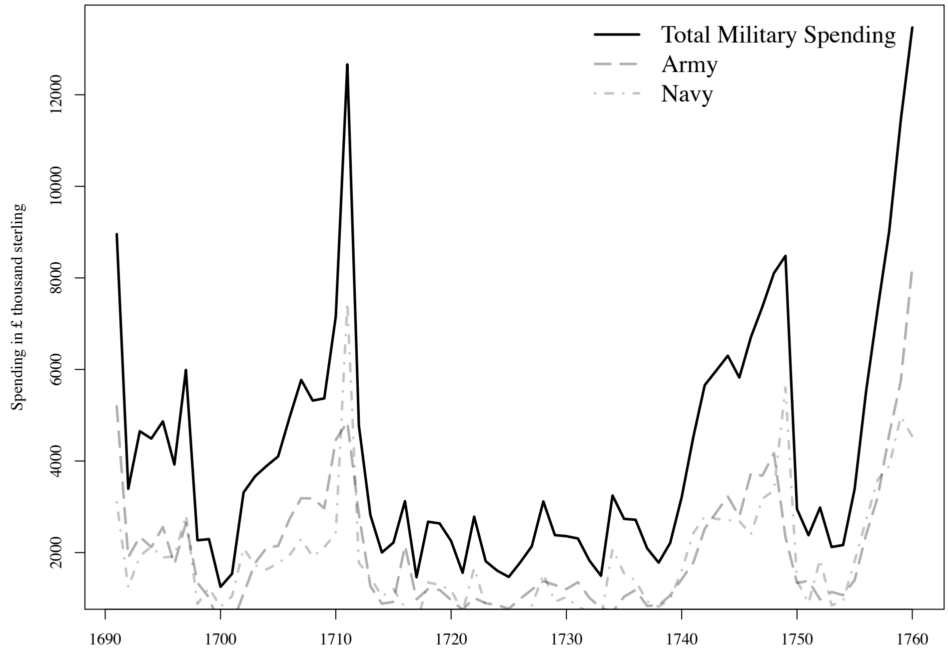
[43] Brian R. Mitchell, *British Historical Statistics* (Cambridge University Press, 2011), Public Finance 2.

[44] Brian R. Mitchell, *British Historical Statistics* (Cambridge University Press, 2011), Public Finance 2.

Figure III–2. Total Military Spending of the England, 1691-1760



Source: Brian R. Mitchell, *British Historical Statistics* (Cambridge University Press, 2011), Public Finance 2.

2. Development of the Different Types of Debt

The parliamentary archive, *Accounts and Papers of the House of Commons* (1869) keeps record of three general categories of debt from 1689 to 1800.[45] Interests were paid differently according to the three general categories of debt.[46] The different categories of debt are terminable annuities, unfunded debt and funded debt. The concept of public loan in the preceding literature have not necessarily been divided into different categories of loan. In this line of thought. However,

[45] House of Commons, *Public Income and Expenditure*, 1868-69 (366) (366-I), Part II.

[46] House of Commons, *Public Income and Expenditure*, 1868-69 (366) (366-I), Part II.

distinguishing the types of loan is important because it facilitates the understanding of how the form and subject of credibility transformed during the 18th century in relation to the government and market relation along with Dutch investors in the market.

1) Terminable Annuities

Terminable Annuities is a form of debt in which the government has liability to the public in respect of annuities sold for life and for terms of years. Terminable annuities were the predominant form of national debt in Britain until 1720 that mostly consisted of Exchequer annuities and lottery annuities. Debt charges on terminable annuities include interest of lottery annuities, Exchequer Annuities and life annuities.

2) Unfunded Debt

Unfunded debt consisted of loans that are redeemable at a definite date and largely resorted on the circulation Exchequer bills and loans raised in anticipation of duties. This short-term floating debt was had the smallest portion in British national debt which also became marginalized in 1720. Debt charges on unfunded debt predominantly included loans in anticipation of duties.

3) Funded Debt

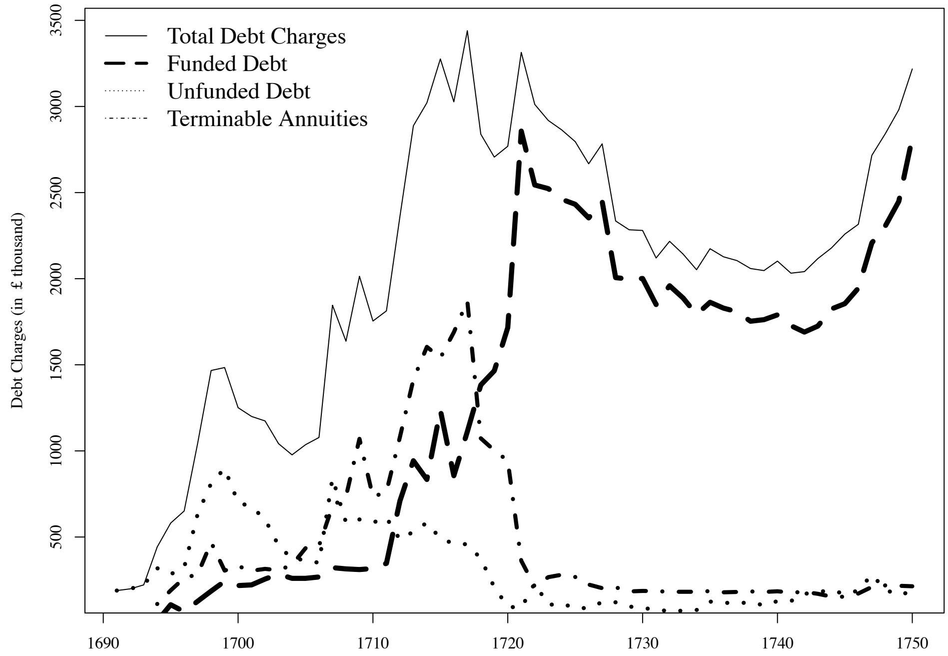
Funded debt refers to long-term debt funded by partner institutions of the government including the Bank of England (1694), South Sea Company (1711) and East India Company (1600). Each of the institutions in its founding was privately owned by stockholders in forms of joint-stock companies, as a public-private partnership to jointly reduce the cost of debt.[47] Funded debt, therefore, can be understood as funds that government owes to the private sector and pays interests to the private institutions. Because it is funded by independent institutions, the government make payments with higher interest along with the management cost of the public debt, referred as the funded debt charge. Funded debt was first issued in 1694 with the founding of the Bank of England but its active expansion occurs between 1710 and 1720. Debt charges on unfunded debt predominantly included Loans in anticipation of Duties.

3. Sovereign Debt Restructuring from 1700 to 1720

Previous literature have only observed the aggregate amount of debt to discuss credibility, however, when we divide debt under different categories of debt it is observable that the transition to modern forms of funded took place between 1700 and 1720. As illustrated in Figure 3-1, by 1720, funded debt was the dominant form of national debt in Britain and interest paid for the funded debt took up the biggest share of the total debt charge. In fact, funded loan started to significantly expand after 1710 and reached its peak in the 1720s despite the fact that institutions that provided the funded loan, the earliest one being the Bank of England, were found as early as 1694 for the specific purpose to provide loans.

[47] The Bank was privately owned by stockholders from its foundation in 1694 until it became nationalized in 1946.

Figure III–3. Debt Charges of Great Britain, 1691-1750



Source: Mitchell, B.R. 1998, *British Historical Statistics,* Public Finance 2

Funded debt started to develop after the establishment of the Bank of England in 1694. Extensive use of funded debt was accessible with subsequent findings of the South Sea Company in 1711 and the East India Company though found in 1600 started funding debt by 1699. The transfer of credibility from the government to the market, created a redistribution of power in the supply of the public funds from a large proportion of tax payers to a smaller number of bondholders. Funded debt reached its climax during the South Sea Bubble and by 1720, where the share of the British national debt held by the Bank of England, the East India Company, or the South Sea Company rose from zero in 1690 to 80 percent by 1720.[48]

[48] Stephen Quinn, "Securitization of Sovereign Debt: Corporations as a Sovereign Debt Restructuring mechanism in Britain, 1694-1750" Working Paper, p.2.

Mobilizing national debt by the initiatives of corporate entities was an important part of the funded debt in which Quinn (2004) goes so far as to label the transformation as the corporate ownership of debt.

Before the funded debt, the only method known of railing money for the exigencies was to levy taxes or impositions, which were much felt and complained of by the people in general. But the newly devised funded debt allowed and abundant supply of finance without burthening the people and the indiscriminate supply indebted Britain heavily which generated fears within domestic politics Therefore, overcoming two challenges was critical to sustain and expand the funded debt. The first challenge was to reduce the mounting debt by actively implementing means of reimbursement. The second challenge was to decrease the cost of debt by controlling the interest rate.

4. Chapter Summary

The first section of this chapter provided the background of British finance before and after the Glorious Revolution of 1688. Before the Glorious Revolution, public borrowing in England was limited and greatly resorted to the reputation of the Crown. After the Glorious Revolution, England adopted financial innovations from its political ally, the Dutch, and developed moderns forms of debt that enabled access to unprecedented levels of debt and financial leverage in conducting wars in the mainland of Europe.

The second part of this section explained the technicalities in the different types of debt: terminable annuities, unfunded debt and funded debt. To understand the difference between the different forms of debt illustrated in this section was crucial not only because it contours the restructuring of the national debt that took place in the 1700s and the 1720s, but more important because it helps the reader understand why shifting the focus from 1688 to 1710s and 1720s is important explaining the development of modern forms of debt in Britain. While public ownership of debt such as terminable annuities and unfunded debt were the dominant forms of debt before the 1710s, private ownership of debt in forms of unfunded debt expanded between 1710 and 1720. The expansion of the funded debt is important because this private ownership of national debt reflects closely resembles the modern forms of debt. Therefore, the chapter convincingly shows that the development of the modern forms of debt did not occur after the Glorious Revolution in 1688 as most literature argue, but modern forms of debt only expanded between 1700 and 1720, leaving room for further exploration on the financial developments during the 20 years.

IV. Anglo-French Rivalry and the British Credit, 1700-1710

The two political events– Britain's commitment towards a strong power and internationalization of the British debt - reconstructed Britain's reputation in the debt market between 1700 and 1710. The two events helped British reputation against France to become the predominant factor in determining British commitment to its debt.

1. Britain as the Emerging War State

1) Embarkation of the Anglo-Dutch Alliance in 1688

The Glorious Revolution of 1688 to 1689 replaced the reigning king, James II, with the joint monarchy of his protestant daughter Mary and her Dutch husband, William of Orange. It set the supremacy of parliament over the crown, Whig over Tory, Protestant over Catholicism, and transfer of succession over hereditary monarchy. Most importantly, however, the Glorious Revolution marked the embarkation of the Anglo-Dutch alliance and the change of British foreign policy from anti-Dutch to anti-French.

The decision of the Dutch to intervene in England was one of the unusual choices made by the Dutch. As Jonathan Israel argues, the intervention was "the boldest and riskiest strategic venture attempted by the Dutch Republic since its birth".[49] The invasion of William of Orange was essentially motivated with Dutch political interests. Despite the risks involved, the Dutch found an urgent need to strategically retrench and augment forces against expansionist France, pre-empt Anglo-French coalition and appoint a foreign general to command the Dutch army, a figure militarily competent but incapable of challenging the Holland regents in

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[49] Jonathan Israel, *The Anglo-Dutch Moment* (Cambridge University Press, 1991), p.105.

domestic politics.[50]

On the other hand, approval of William Orange in England also served two political purposes in England. Religious interest groups, both Protestants and Catholics were infuriated by James II and sought means to prevent the succession of a Catholic Crown. Furthermore, foreign policy interests were also the center in accepting Mary Stuart and William Orange as the new crown. With growing discontent towards James who had been trained in a French army, married Louis XIV's choice of bride and was an outspoken admirer of the modern absolutist state created by Louis XIV, Whig coalition strengthened by the support of mercantile interests that grew discontent with French rivalry over markets in colonies. Additionally, Pincus notes that the Dutch ceased to be an ideological threat to Britain after the Dutch political revolution in which the Dutch abandoned aggressive expansionist policies. In this sense French absolutism was a greater threat to Britain.[51]

However, disagreements on foreign policy were extensive and continued even

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[50] From the Dutch perspective, the nightmare of 1672 Franco-Dutch War, or the Third Anglo-Dutch war, was still a fresh memory in which the English backed Louis XIV in attempting to overrun the Low Countries. The Dutch found that another Anglo-French alliance would overwhelm the Republic. Political threat to its international position, impelled the Dutch to practice strategic retrenchment in bringing Britain to form the Grand Alliance against France while Anglo-Dutch hostility via the series of Anglo-Dutch war (1652-54, 1665-67, and 1672-74) had still been a fresh memory. Furthermore, the Dutch needed military support to fight land wars against France in the Southern Netherlands. The Dutch had considered themselves a maritime power during the period 1650 to 1672, in which the aggression of France forced the Republic to fight a land war in the Southern Netherlands. Dutch invasion of the Glorious Revolution enabled the Dutch to “off-shore” its land security to Britain. As originally envisaged in 1706, Holland wanted British support for a Dutch right to garrison whichever and as many towns and fortresses in the south Netherlands in exchange for guaranteeing the Protestant Succession in Britain. Dutch concern over their military power became a great political concern as its military debilitated by the end of the War of the Spanish Succession (1701-1714), impelling the need to practice a neutral policy after the Treat of Utrecht that ended the War of the Spanish Succession.

[51] Steve Pincus, *1688: The First Modern Revolution* (Yale University Press, 2009), 314.

in the early 1700s.[52] Domestic debates continued over whether England should pursue the blue policy or the continent policy which was politicized between the Tories and the Whigs.

2) Britain as a Balancer of Europe, 1700-1710

The radical shift in British foreign policy from anti-Dutch to anti-French drew Britain into a defensive alliance with the Dutch Republic, against the increasingly alarming expansionist forces of Louis XIV in the European mainland. Despite the political complexities at home, Britain increasingly took a greater proportional role in the conflict with Louis XIV among the Grand Alliance throughout the eighteenth century, and this became evident between 1700 and 1710. British demonstrated military prowess via Malborough's successive victory over the French military in driving the French forces back the Rhine by capturing Venlo, Roermond and Liege in 1702, Rijinberk, Bonn and Huy in 1703, and Bedburg in 1704, that attracted speculative foreign investors. Malborough subsequently advanced toward the French center in 1705 and 1706. The prospect of a protracted warfare necessitated Britain to have stable channels of war finances to fuel the unprecedented levels of military spending.[53]

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[52] Ahn examines extensive political journalism by Bolingbroke via the journal *The Mercator* that sought to win public support in normalizing Anglo-French trade. Ahn notes that discussions within the journal were politically and socially impactful that the Whig opposition found *The British Merchant* to refute and defend their stance. For further discussions see Doohwan Ahn, "The Anglo-French Treaty of commerce of 1713: Tory Trade Politics and the Question of Dutch Decline", *History of European Ideas,* Vol.36, No.2 (201), pp.167-180.

[53] The Grand Alliance was a European coalition against Louis XIV found in 1689, after joining of England. The Dutch Republic, Austria, Bavaria, Brandenburg, Holy Roman Empire, Ireland, Palatinate of the Rhine, Portugal, Savoy, Saxony, Scotland, Spain and Sweden and England were members of the Grand Alliance.

3) Military Reputation and the Flow of Credit, 1710-1710

The depiction of the Glorious Revolution as the triumph of the parliament have hitherto driven the literature of credible commitment to set institutional veto points as the condition precedent to financial development. The role of reputation in public borrowing became marginalized and it no longer was the driving force for the development of institutional devices, but institutions itself became the pronominal word for reputation. The intuitional veto points approach argues that the preceding practice to rely on the Crown's reputation became insufficient to police the default of the Crown and required institutional veto players to secure credibility. To solely rely on the Crown's reputation would situate the monied interest into vulnerable positions whenever the sovereign had his survival at stake to heavily discounted the future and have stronger incentive to renege.

However, as Britain entered into a binding alliance with the Grand Alliance to wage war against France, reputational commitment no longer became limited to the Crown but referred instead to the reputation of war-states and fiscal-military states. As Tomz (2007) argues, reputation of a state can be defined as the *impression* creditors hold about the borrower, in international debt markets with repeat play. Reputation of the borrower develops under the conditions of incomplete information in the market. In other words, the flow of investment is dependent on the impression creditors hold on the host country. In particular, the condition of incomplete information was stronger during the eighteenth century where investors had a stronger tendency to herd their investment based on what was manifested and especially the state's military prowess.

From the perspective of creditors, Britain was still a financial pygmy compared to her counterpart France, at the outset of the Glorious Revolution and the political stability of its regime was as questionable as its credit. However, Britain's military outperformance over France in the European mainland and the prospect that Britain would soon parallel the major military powers of eighteenth-century Europe generated the impression that speculative investment in British debt would yield high net worth. From the perspective of Britain, as the borrowing state, future channels of finances were valued to sustain the protracted war in Europe. Consequently Britain became increasingly reluctant to forgo its future finances by reneging its commitment and instead faced the burden to manifest policies that were favorable to debt servicing.

2. Internationalization of the British Debt Market

1) Foreign Investments in Britain, 1700-1710

Another political change in Britain at the outset of the eighteenth century was the expansion of the debt market to foreign investors. The establishment of the Bank of England in 1694 enabled tranches or tradable securities for foreign creditors. Foreign investment did not expand, however, by the mere establishment of the Bank of England but it was the British demonstration of state military prowess over the French military in the early 1700s that attracted speculative foreign investors. Malborough's subsequent advances towards the French center in 1705 and 1706 generated greater investor confidence over Britain and by then the sovereign debt had already accounted of three seventh of foreign investment, most notably the Dutch.[54]

It is undeniable that when financial markets are internationalized, the debt or the bond market play a crucial role in influencing, either directly or indirectly, the economic policies of the borrowing government. Sometimes the behavior of international body investors, known also as 'bond vigilantes' in financial jargon, is seen as beneficial because of the restraining influence they exert on the ability of

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[54] Charles Wilson, *Anglo-Dutch Commerce and Finance in the Eighteenth Century* (Cambridge University Press, 1941), p.78.

governments to engage in reckless borrowing and spending.

2) Fiscal Reputation and the Flow of Credit, 1700-1710

Internationalization of the British debt market made reputation of Britain, and particularly her fiscal reputation an important factor to secure channels for finances. Internationalization of the debt market had the benefit that greater amount of finances could be pooled from outside. However, it also meant that in order to direct investors to Britain, Britain had to stop investment flowing out to other destinations such as France. In other words, Britain had the burden to show its fiscal outperformance over France to provide greater investor confidence and instigate herding of investors to Britain. As herding behavior is triggered by information spread amongst the investors, one way for Britain to instigate investor herding was to publicize government policies of debt servicing which provided better security conditions to that of the financial institutions in France.

Attaining the consistency in government preference over debt servicing is an uneasy task for emerging economies as debt repayment creates economic winners and losers.[55] However, Britain sought to find means to minimize the influence of divided opinions over her commitment to debt servicing by prioritizing her fiscal-military reputation against France, which generated investor confidence for the investors.

3. Chapter Summary

This chapter showed that recasting the role of reputation is possible when we reconstruct reputation as the reputational commitment of war-states and fiscal-

[55] Jeff Frieden, "Sectoral Conflict and Foreign Economic Policy, 1914-1940," *International Organization* 42:1(1988), pp.59-90.

military states. The first section of the chapter discussed the first major political change in Britain between 1700 and 1710 that made reputation of Britain against France an important factor in securing credit in-flow to Britain. Britain's military outperformance over France in the European main land and the prospect that Britain would soon parallel the major military powers of eighteenth-century Europe generated the impression that speculative investment in British debt would yield high net worth.

In second section of the chapter, I illustrated another political change in Britain between 1700 and 1710 that made reputation of Britain against France an important factor in securing credit in-flow to Britain. The debt market of Britain became internationalized during this period where increasing amounts of foreign investments poured into Britain. With the prospect that the war in Europe was likely to be protracted, Britain found the need to secure the inflow of foreign investment by implementing policies that would elevate fiscal reputation of Britain over that of the French.

The two political events between 1700 and 1710–Britain's stronger commitment towards a strong power and internationalization of British debt market – was important because it shows why the Anglo-French rivalry over the fiscal-military reputation became important between 1710 and 1720 in explaining the restructuring of debt from unfunded debt to modern forms of the funded debt.

V. Anglo-French Rivalry and the British Credit, 1710-1720

Public debt became a frequent subject of debate in the eighteenth century British parliament as public borrowing became deeply embedded in the British society and politics. The need for public loans seemed clear. As Dickson (1993) illustrates, they were the “Breath of Man's Nostrils,” and the dominant means to sustain the wars in Europe. On the other hand, the mounting loans simultaneously became the subject of fear especially in comparison to the debt that was being rapidly reimbursed in France. Two important events that helped Britain to restructure its national debt towards a greater share of funded debt were associated with the financial developments in France.

1. Lowering the Cost of Debt

1) Interest Rate Flexibility and Creditor Confidence

From the perspective of creditors, interest rate can be an important indicator in understanding the risk associated in the investment. Investors in general demand higher interest payment to states with low credibility or high political instability. The higher the risk of default, the higher the arranged interest rate to compensate for the possibility of the reneging of loans. In other words, interest rates follow investor perceptions about the credit worthiness of a country to a great extent. On the other hand, the investors’ perception of the borrower’s credit does not necessarily reflect the actual financial accounts of the borrower. If enough investors begin to suspect that debt is not being controlled sufficiently, they perceive that the risk of defaults has risen, even if it is still very low. Thus a state’s credibility is extremely vulnerable to its financial reputation, and more so was this the case in the eighteenth century European setting where investors lacked sufficient channels to gain knowledge over the balance sheets and fiscal records of the borrowing state.

To the government, interest rate for loans is an indicator to gauge the availability of the extra cash flow for government spending. A government has high interest in maintaining a low interest rate for loans for two reasons: to secure access for future credits and lower the cost of debt. However, this preference only applies to states with particular interest to consistently support debt-servicing policies. If Britain did not have to commit to long run debt-servicing policies, Britain would have benefited far greater in maintaining high interest rates for loans instead of lowering its interest rate. This is because high interest rates generate the conditions for greater risk-taking behavior for the investors and encourages speculation over a steady stream of debt to be sold on.

One counterfactual question that helps us understand the role of inter-state rivalry in the development of a state's credit is to ask if Britain would have committed to its loans had it not been the case that Britain were to compete with France over the access of loans. Choosing to commit to its loans meant that Britain would forgo the inflow of short run speculative loans. Moreover, in the case of eighteenth century Britain, attaining consistency over the government preference for debt servicing was particularly difficult as Britain was yet an emerging economy and debt repayment created economic winners and losers.[56] However, Britain chose to commit to its debt and implemented policies to lower the interest rate of loans. Why? Subsequent section shows that the decision to lower the interest rate in Britain was to compete with the lowered interest rate in France. Britain consistently competed with France to generate investor confidence for the investors and secure a steady channel of credit and this in turn pushed for structural changes and modernization of the British debt system.

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[56] Jeff Frieden, "Sectoral Conflict and Foreign Economic Policy, 1914-1940," *International Organization* 42:1(1988), pp.59-90.

2) Financial Innovations and the Low Interest Rate in France

France had long saw with envy at British financial developments that followed the financial innovation of the Dutch Republic. A historical essay of a Dutch Jew investor, Isaac de Pinto *Traité de la Circulation et du Crédit [An Essay on Circulation and Credit] (1771)* notes,

> "that before the reign of King William no method was known of railing money for the exigencies of the year, except that of levying equivalent taxes or impositions; which, when great, as must necessarily happen in times of war, were much felt and complained of by the people in general, without any part of them being gainers by the public loss … But now a method was happily devised of abundantly supplying the Crown without burthening the people."[57]

In the outset of the eighteenth century, France was experimenting with various financial initiatives to develop cheaper and more flexible methods of short-term finance in competition against the Anglo-Dutch alliance. France re-implemented the Caisse des Emprunts in 1702 and the French savings banks offered an interest rate of 5 percent on demand deposits. Moreover, the issue of money notes by the French Treasury enabled the circulation of notes in France by a significantly low interest rate as low as 4 percent.[58] The French fiscal policies were in sharp contrast to the policies of the British Treasury who circulated notes by an interest rate of 8 percent.[59] As Macdonald (2002) notes, France was advancing various initiatives to "develop cheaper and more flexible methods of short-term finance" to compete

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[57] Allan Ramsay, *An Essay on the Constitution of England* (London: T. Becket & P.A. De Hondt, 1765), p.84.

[58] French Treasures notes were interest-free in the first year. See, James Macdonald, *A Free Nation Deep in Debt* (New York: Farrar, Straus and Giroux, 2003), p.181-184.

[59] House of Commons, *Public Income and Expenditure*, 1868-69 (366) (366-I), Part II.

with England and the Dutch.[60] The lowered interest rates for French Treasury notes generated fear within the British political circles under the belief that the facilitated circulation of credit in France would significantly give France more fiscal-military competitiveness over Europe.

3) The Tory Ministry and the Lowered Cost of Credit

When the Tory ministry came to power in 1710, Britain was heavily involved in the War of the Spanish Succession (1701-1714) where England, the Dutch Republic and the Holy Roman Empire joined forces to balance their power against France to stop Philip V, the second-eldest grandson of King Louis XIV of France, succeeding the inheritance of Charles II, the last Habsburg king of Spain. While the Tory ministry represented the mercantile, aristocratic and landed interests during the Williamite England, the new moderate Tory ministry led by Lord High Treasurer Godolphin continued to support for Britain's involvement in the war against France.[61] It was also in the Tory's interest to uphold the anti-French foreign policy in order to protect British commercial interests abroad from the French influence, although many Tories who preferred for a stricter maritime strategy disliked Malborough's push for a more aggressive and deeper involvement in the Continental War.[62]

In terms of finance, it was expected by many spectators that the Tory ministry would lack incentives to actively expand and promote institutions for public borrowing. This was because Tories have traditionally been in opposition to the

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[60] James Macdonald, *A Free Nation Deep in Debt* (New York: Farrar, Straus and Giroux, 2003), p.184.

[61] Bromley, John Selwyn. 1970. *The New Cambridge Modern History, Volume 6: The Rise of Great Britain and Russia, 1688-1715/25*. London: Cambridge University Press, p.414.

[62] Bromley, John Selwyn. 1970. *The New Cambridge Modern History, Volume 6: The Rise of Great Britain and Russia, 1688-1715/25*. London: Cambridge University Press, p.416.

Whigs that represented the monied interests and government debt was managed by the Bank of England, an institution that predominately included many members of the Whigs, in large shares. Thus, for Tories to expand sovereign debt and its institutions for public borrowing would lead to feeding their political enemies with great financial power and fiscal control over public expenditures.

The Tories, in fact, increasingly grew concerned for the servicing of the already accumulated debt, which was consuming an unprecedented portion of government tax revenues. Almost 50 percent of the state's income was spent on interest payments and the political concern that France would gain financial leverage over Britain pushed the Tory Ministry to take active actions for the repayment of debt. As Table V-1 indicates, public debt was the highest in the first years of the Tory ministry whereby the deficit ratio reached an unprecedented level of 86% in 1710 and 192% in 1711. The Tory ministry, however, was quick to keep the deficit ratio lower than they were during the Whig's rules, reaching as low as 15% of its national revenue by 1714.

Table V-1. Public borrowing of English Government from 1708-1714

Majority	Year	Revenue (£)	Deficit (£)	Deficit /Revenue
Whig	1708	37,243,933	18,249,527	0.49
Whig	1709	37,229,631	28,294,519	0.76
Tory	1710	37,529,985	32,275,787	0.86
Tory	1711	37,036,546	71,110,168	1.92
Tory	1712	41,105,631	15,209,083	0.37
Tory	1713	41,334,473	4,133,447	0.10
Tory	1714	38,338,081	5,750,712	0.15

Source: Values for the deficit were recalculated from revenue and deficit to revenue ratio data provided by Dincecco, Mark. *Political Transformations and Public Finances: Europe, 1650-1913*. Cambridge University Press, Political Economy of Institutions and Decisions Series, 2011

When interest rates are lowered, governments gain a clear advantage by having access to large sums of money bearing the minimum cost. However, decreasing the interest rate is not an easy task because it confronts creditor rights and privileges: unless the creditor has confidence in sovereign credibility, it is difficult to bargain for a lower interest. This was particularly the case when the Tory majority in the House of Commons tried to lower the interest rate in 1711 against the "Whig" Bank of England and the East India Company.

The Tories achieved their goal to lower the interest rate by setting up a new trading company, the South Sea Company to overturn the Bank of England's increasing monopoly on government funding. To override the Bank of England and set the South Sea Company as the dominant institution managing government finances, the South Sea Company commenced its operation by suggesting 6 percent of interest rate on loans, which was 2 percent lower to what the Bank of England had offered in the past 14 years since its establishment. The Bank of England, in order to compete with the South Sea Company had no other choice but to lower its interest to 6 percent in 1711 as illustrated in Table V-2.

Table V-2. Private Sector Interest Rate on Public Borrowing, 1694-1750

	Bank of England	South Sea Company	East India Company
1694-1698	8		
1699-1710	8		8
1711-1720	6	6	5
1721-1750	6	5	4

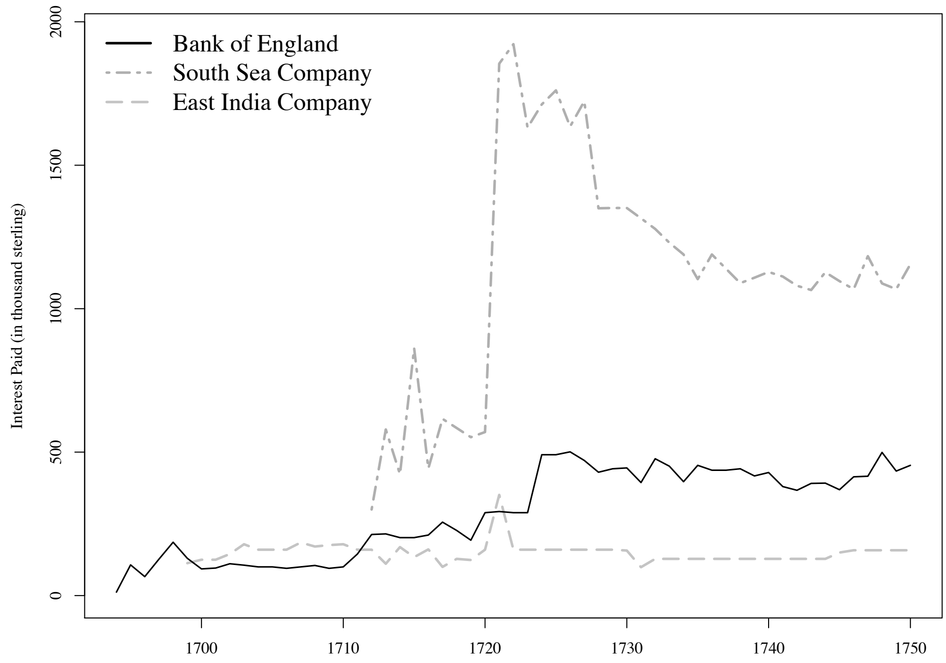
Source: House of Commons, *Public Income and Expenditure*, 1868-69 (366) (366-I), Part II.

Note: There is irregularity in the interest rates of the East India Company where in the year 1709, the interest rate was five percent, and not eight percent.

The founding of the South Sea Company, therefore, enabled a major reduction of debt charges via a lowered interest rate. This in turn enabled the expansion of the funded debt, since the funded debt was cheaper and preferred over the unfunded debt by the government. Moreover, channels for public borrowing were no longer monopolized by the Bank of England, but instead were open to competition, especially over the cost of its supply.

Furthermore, the Tories actively restructured expensive unfunded debt and terminable annuities to relatively cheaper funded debts. Holders of departmental notes were allowed to exchange them for shares in the South Sea Company and through this method 9.2 million pounds of short-term debt were voluntarily tendered for shares in the South Sea Company in 1711. By 1719 the South Sea Company takes up another leap in its share in controlling the national debt, illustrated in Figure V-1, for reasons that were different to its increase in share in the year 1711. The next section deals with the circumstances of 1719 and the subsequent South Sea Bubble that broke out in 1720 in relations to the Whig efforts to gain control for the funded debt.

Figure V–1. Interest Paid to Bank of England, South Sea Company and East India Company, 1688-1750



Source: House of Commons, *Public Income and Expenditure*, 1868-69 (366) (366-I), Part II.

2. The Grand Redemption Scheme

1) Deficit Reduction and State Credibility

At the most basic level, what creditors expect, and especially the creditors of the bond markets expect, is a reassurance that borrowers will be able to repay their debts. Naturally when the amount of debts held by the host government become excessive, lenders get apprehensive and nervous. From the perspective of the host country, in order to soothe the anxiety of the investors and secure the availability of future credit, the host government would produce a deficit reduction plan which involves paying back the principal. The bigger the redemption scheme, the less nervous the lenders feel about the prospect of debt repayments.

The readiness of borrowers to repay the debt can also be interpreted as a healthy sign that the borrowing government is taking the problem of indebtedness seriously. Creditors naturally find the adoption of redemption policies by the government as a 'credible' attempt to reduce indebtedness. As a consequence deficit reduction plans are found credible in the financial markets.

The redemption plan in the eighteenth century Britain may have been a strong indicator to her creditors because unlike the contemporary government borrowing that is used to finance productive investment that have prospects of higher future flow of credit, British government borrowing in the eighteenth century was purposed to finance wars and therefore the principal was consumed without financial yield. Therefore, the 'willingness' of the British government to repay the debt, or the 'credibility' of a deficit reduction plan, would have mattered in great extent to the investors of Britain even if the actual repayment was not under process. In fact, this section shows that while Britain was not obliged to pay back the principal for the funded debt, according to the characteristics of the funded debt, she implemented redemption policies to compete against France over the securitization of future channels to finances.

2) The Mississippi Company and the Cheap Debt in France

When the War of the Spanish Succession ended in 1714 with the financial exhaustion of the major power involved, reducing the volume of public debt was one of the prioritized fiscal agenda for each state. The first powers to repay the debt and reduce their fiscal baggage meant that they would have advantages when war were to break out again.[63] France actively sought to reconstruct its fiscal institutions after the war via the founding of the Banque Générale in 1716 and the

[63] John, Brewer, *The sinews of power: War, money, and the English state, 1688-1783* (London: Harvard University Press, 1990), p. 98-99.

Mississippi Company in 1719. Banque Générale (later renamed as Banque Royale in 1719) and the Mississippi Company (later renamed Compagnie des Indes) devised by John law aggressively modeled the British or Dutch financial practice with the aim to make Paris the financial rival of Amsterdam and London.[64] Banque Générale issued deposit notes or "paper money" that were repayable at a constant amount of specie. This liberated France from the use of the unstable livre. The development of the Banque Générale was threatening to Britain because Banque Générale lent money at 6% initially and then lowered its interest rate to 4%, a significantly lower rate compared to what Britain's private sector was offering. Deposits poured in to Banque Générale, and by the end of 1718, there were 149 million Banque Générale notes in circulation. Moreover, South Sea Company had provided the model for the flotation of the Mississippi Company, a vehicle to permit the government to change short-term into long-term debt by adding the lure of trading profits to the basic interest income. The Mississippi Company that was granted a monopoly in France's Mississippi territory in North America, started to absorbed the other French chartered trading companies. This rapid development of the Banque and the Mississippi Company generated fears in Britain that France would recover from the ruins of war faster than expected.

3) South Sea Company and the Bargain for Private Ownership of Debt

After the signing of the Treaty of Utrecht in 1714 and the advent of peace, Britain was faced with the task to clear the enormous amount debt that had accumulated during the protracted war against France. The British government actively sought to show their determination to service its debts to the creditors and to eventually reduce the principal of its debt. This commitment was forwarded particularly in awareness of the fiscal recovery in France. As expressed by Charles Davenant and

[64] Macdonald, p.179

re-quoted by Brewer, "every attempt at debt retrenchment was made by English government with one eye warily watching events on the other side of the Channel [France]."[65]

In response to the financial developments in France after the war, Britain also found active measures to expand the funded debt by extending corporate ownership or private sector claim over the national debt. When the Whig gained back their majority in the Commons in 1715, the national task to reduce the debt faster than France was an ongoing agenda. Subsequently, another redemption plan called the "sinking fund" was suggested by Earl Stanhope and established by Robert Walpole in 1716. The scheme was to group together the many little items of revenue that was each mortgaged to some particular debt, in to four large funds: the Aggregate, South Sea, General and Sinking funds.[66] The first three were composed of permanent taxes, and it secured the interest charges on three great blocks of public debt. The fourth was made up of the surpluses of the first in which after satisfying all charges upon its original debt, additional sums would be transferred to the fourth block. It was called the "sinking fund" because it was appropriated to the sinking of the national debt and to no other purpose.[67] This allowed flexibility in the growing system of finance where surplus yielded in one category could be allocated to repay the debt.

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[65] See Charles Davenant, "Discourses on the Public Revenues, and on the Trade of England, in Two Parts [1698]," *The Political and Commercial Works of that Celebrated Writer, Charles Davenant…Collected and revised by Sir Charles Whitworth* (London, 1771), vol. 1, p. 172; John, Brewer, *The sinews of power: War, money, and the English state, 1688-1783* (London: Harvard University Press, 1990), p.100.

[66] Edward A. Ross, "Sinking Funds," *Publications of the American Economic Associations* 7:4(1892), pp.9-106.

[67] Edward A. Ross, "Sinking Funds," *Publications of the American Economic Associations* 7:4(1892), p.2

Table V-3. Public borrowing of English Government from 1716-1720

Majority	Year	Revenue (£)	Deficit (£)	Deficit /Revenue
Whig	1716	39,918,516	10,777,999	0.27
Whig	1717	47,692,660	0	-0.10
Whig	1718	43,995,121	1,759,805	0.04
Whig	1719	44,044,324	880,887	0.02
Whig	1720	45,646,541	0	-0.05

Source: Values for the deficit were recalculated from revenue and deficit to revenue ratio data provided by Dincecco, Mark. *Political Transformations and Public Finances: Europe, 1650-1913*. Cambridge University Press, Political Economy of Institutions and Decisions Series, 2011

The sinking fund created a psychological effect of relief, which eased the public concerns over the mounting funded debt of the British government. As Ross (1892) points out, even when the British government was borrowing loans placing itself to further debt obligation, the existence of the sinking fun effectively lulled people to believe that the national debt was being swiftly and surely extinguished. Despite the fact that the sinking fund only lasted until 1733 where Walpole broke into the fund for his personal needs and the sinking fund eventually was obscured by 1752, the existence of the fund was enough to boost public credibility and extend the creation of funded debt further. Table V-4 shows that the funded debt started out small which amounted to £856,000 in 1716 jumps to £ 1,112,000 in 1717 and doubles to £1,716,000 in 1720.

Table V-4. Debt Charges of Britain 1716-1720

Debt Charges (£)				
Year	Total	Funded	Terminable Annuities	Unfunded
1716	3,027,000	856,000	1,689,000	461,000
1717	3,440,000	1,112,000	1,870,000	458,000
1718	2,839,000	1,383,000	1,073,000	375,000
1719	2,706,000	1,465,000	1,003,000	208,000
1720	2,769,000	1,716,000	943,000	96,000

Source: Values were extracted from B. R. Mitchell, *British Historical Statistics* (London: Cambridge University Press, 1998).

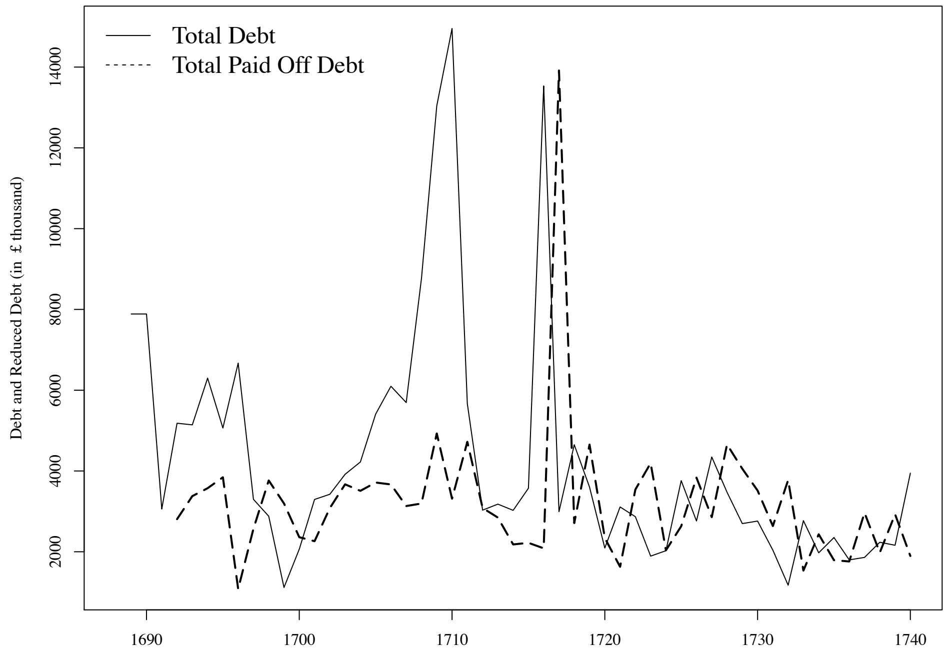
With the increasing share of the national debt to the private sector, competition between the private institutions over greater shares for the sovereign debt became intense. By the late 1710s, party identification of the private institutions including the South Sea Company and the Bank of England became obscure as many Whig investors had shares in the South Sea Company and vice versa. Therefore the British parliament held private institutions in competition and gave preference to the institution that provided with greater sums of loans bearing the minimum cost. Macdonald (2003) notes that parliamentary records also indicate that the South Sea Company and the Bank of England proposed at the parliament in January 1720 for the ownership over the entire national debt.[68] Both of the corporations proposed an offer to cancel existing debts in exchange for the perpetual redeemable annuities paying 5 percent.

In the process of granting more ownership over national debt to the private sector, the British government was able to reduce some of the existing debts as

[68] Macdonald, p.178.

well as save charges on future debts. The outcome of the bargaining was the extension and allocation of a greater share of the national debt to the funded debt. The share of the British national debt held by the Bank of England, the East India Company, or the South Sea Company rose from zero in 1690 to 80 percent in 1720.[69] Exchequer tallies, Exchequer bills, and Bank of England notes all rested on the credit of the private sector.

Figure V–2. Total Debt and Reimbursement of Britain, 1688-1740



Source: House of Commons, *Public Income and Expenditure*, 1868-69 (366) (366-I), Part II.

Efforts of the British government to repay the debt faster and make the cost of debt cheaper in competition to its counterpart, France, was successful. Figure V-2 shows that the reimbursement is made proportionally to the debt after 1710. The

[69] Quinn, p.2

reimbursement was the outcome of active commitment. The most extensive amount of reimbursement came with South Sea Bubble in 1720.

Brewer (1989) provides a swift yet insightful analysis in explaining the three factors contributed to the South Sea Bubble in 1720: British government's haste to reduce the cost of national debt in competition with France, the rivalry between the Bank of England and the South Sea company over the ownership of public debt and unresolved debt charges from the traditional forms of debt which were the terminable annuities. The South Sea Bubble, in essence, was the British government effort to transform old forms of debt, the terminable annuities, to modern forms of debt. In the process annuitants were advised to voluntarily exchange their annuities stocks in on the private institutions. Once the annuitant transferred their securities to redeemable stocks, the government could reduce their cost paid to the large number of irredeemable securities via a lowered interest assigned to the stock. While annuitants lacked the incentive to convert their annuities to stocks, the government pressured for their action by passing the South Sea Act of 1720 that enabled the South Sea Company to provide cash or newly create stocks to lull the annuitants. Such government effort to reduce the cost of debt, would ultimately not have been pushed for if the British government was not in competition with France. As Brewer notes, "in the short term, the South Sea Bubble was a major disaster…[but] In the long run its consequences were more beneficial" in successfully restructuring the national debt to modern forms of debt.

3. Chapter Summary

This chapter focused on the British financial developments between 1710 and 1720 to explain how Anglo-French rivalry triggered consistent government preference for debt servicing despite the shifting powers in the House of Commons between the Whigs and the Tories.

In the first section of the chapter, I argued that the Tory ministry's effort to continue the debt servicing policy by inducing interest rate flexibility of loans was triggered by the financial innovation in France in 1702, where the French had re-established their saving banks and facilitated the flow of Treasury notes to develop cheaper and flexible methods of short-term finance. In response to these French developments the Tory ministry set up a new trading company in 1711, the South Sea Company to lower the interest rate and overturn the Bank of England's increasing monopoly on government funding. Consequently, low interest rates encouraged speculation in the debt market of Britain which helped the private financial market to develop further.

The second section of the chapter elaborated on the second government scheme implemented by the Whigs to support the debt servicing policies. The redemption scheme to repay loan principals via the establishment of the sinking fund was triggered by the founding of the Banque Générale in 1716 and the Mississippi Company in 1719 which gave France the financial leverage in circulating her credit. Britain was pressured to adopt measures to provide better debt services to that of what was provided in France. As a solution, Britain implemented redemption policies even though she was not obliged to pay back the principal for the funded debt, according to the characteristics of the funded debt. As a result, repayment of debt enhanced investor confidence and in the funded debt in general. This enabled the restructuring of the national debt to greater proportions of the funded debt.

VI. Conclusion

This dissertation focused on the eighteenth century Anglo-French rivalry underpinning British financial growth to argue that the pressure to financially outperform France provided Britain the incentives to implement schemes that restructured the debt market, from public ownership of debt to modern forms of private holdings. The two grand schemes were to convert the unfunded debt to the funded debt by inducing interest rate flexibility of loans and reducing the cost of debt via the sinking fund and the South Sea Bubble. The implementation of each scheme was triggered by financial developments in France. As a result, the two schemes committed Britain to lower the cost of its national debt and institutionalize private sector control over the national debt.

Specifically, I argued that focusing on the financial developments from 1700 to 1720 was important because when distinguishing the different types of debt, the twenty years starting from 1700 to 1720 is the transitional period where old forms of debt are restructured to modern forms of funded debt. Put in other words, the ownership of the national debt restructures from the public sector to the private sector, typically in forms of the bond market. This dissertation has divided the twenty years into 1700-1710 and 1710-1720 to analyze major financial developments that enabled the restructuring of the national debt.

From 1700 to 1710, two political events affected Britain to compete for its fiscal-military reputation over France, in order to secure finance in the debt market. Britain's military outperformance over France and internationalization of the British debt market, made Britain increasingly reluctant to forgo its future finances by reneging its commitment. To sustain the inflow of investment from foreign creditors, reputation fiscal-military mattered and especially Britain had the pressure to consistently manifest her devotion to consistent implementation of debt servicing policies despite domestic complexities.

From 1710 to 1720, Britain implemented two grand schemes that restructured

British national debt from unfunded debt to modern forms of funded debt. Each of the schemes was achieved in response to the financial developments in France. The first scheme to lower the interest rate of the national debt was implemented by the Tories in 1711 via the founding of the South Sea Company. This scheme was triggered by developments in 1702 France where their saving banks were re-established and their Treasury notes were circulating faster via the lowered interest rate on the Treaty notes. The second scheme to repay the debt was implemented by the Whigs in 1716 in response to the seemingly rapid fiscal recovery of France via the development of the Mississippi Company in 1716. In response, Britain actively sought to repay their public debt via the sinking fund and lower the cost of debt further by generating the South Sea Bubble that encouraged the private sector to provide speculative incentives to absorb the old forms of debt to modern forms of government bonds.

The thesis, thus, provides two significant implications for international political economy. First, this thesis shows how inter-state relations influence the trajectories of financial growth for a state. I argued that the international dimension or the Anglo-French rivalry provides a better explanation in explaining the restructuring of old forms of national debt to modern forms of national debt. Recasting the international dimension to the discussion suggests that international factors can equally, and more powerfully explain government finance.

More importantly, however, this thesis provides implications for hegemonic rivalry and its effect on financial growth. Great Britain, a passive engager to the continent in the early 18th century would not have risen as a European hegemon by the end of the century, if it were not for the restructuring of the debt market that efficiently channeled war finances. While the rise of fiscal-military state is only proportional to a state's fiscal ability to secure finances, access to unprecedented levels of finances via financial restructuring can be triggered by hegemonic rivalry.

Appendix 1. Total Revenue of England and France, 1680-1740

£	England	France		England	France
1680	13099741	58007433	1711	37036546	45746624
1681	11039453	59848632	1712	41105631	50451968
1682	9455799	62564212	1713	41334473	51522240
1683	9893995	60662285	1714	38338081	53041408
1684	9963183	72886425	1715	39668221	74178496
1685	9701804	66799614	1716	39918517	74178492
1686	14468141	67167746	1717	47692660	75891200
1687	16028732	63034991	1718	43995122	53855700
1688	15052402	63271993	1719	44044324	44205067
1689	22071219	73523267	1720	45646541	31409419
1690	22071219	68842335	1721	43426220	41851764
1691	22071219	74548428	1722	44992943	62605767
1692	31603894	73363797	1723	43761986	47649214
1693	29082348	72111179	1724	42224906	41061676
1694	30781317	65261375	1725	43613176	46701470
1695	31780710	70078395	1726	40416816	68392827
1696	33706809	70161108	1727	44701672	66234194
1697	23048944	70653809	1728	48982500	62529677
1698	31994562	54706314	1729	45532310	65627419
1699	36929276	57464007	1730	45635082	62497742
1700	31065216	55966340	1731	44397276	65467742
1701	26953223	58749519	1732	42354682	62465806
1702	34819645	54894821	1733	40256493	69268065
1703	39768340	47402049	1734	39763624	82744839
1704	38574074	55176079	1735	41088640	82393548
1705	37844642	55646506	1736	42055433	74090323
1706	37787431	64672761	1737	44333732	63775161
1707	39124723	66154365	1738	41749084	66681290
1708	37243933	54995339	1739	42568674	68980645
1709	37229631	53691702	1740	42039882	67351935
1710	37529985	43094016			

Appendix 2. Total Military Spending of England, 1691-1760

(in £ thousand sterling)	Army	Navy	Ordnance	Military Total
1691	5200	3098	659	8957
1692	1900	1239	254	3393
1693	2346	1925	380	4651
1694	2119	2132	239	4490
1695	2559	1890	417	4866
1696	1749	1922	253	3924
1697	2646	2822	521	5989
1698	1343	877	49	2269
1699	1018	1232	44	2294
1700	359	819	73	1251
1701	442	1046	50	1538
1702	1102	2094	117	3313
1703	1770	1724	173	3667
1704	2107	1630	157	3894
1705	2146	1772	183	4101
1706	2741	1949	271	4961
1707	3188	2297	287	5772
1708	3183	1909	229	5321
1709	2969	2117	282	5368
1710	4463	2422	276	7161
1711	4853	7476	334	12663
1712	2837	1776	165	4778
1713	1267	1457	95	2819
1714	884	1043	76	2003
1715	924	1205	90	2219

1716	2151	792	180	3123
1717	980	443	39	1462
1718	1204	1350	120	2674
1719	1186	1293	159	2638
1720	965	1181	108	2254
1721	754	705	99	1558
1722	1011	1666	108	2785
1723	895	827	89	1811
1724	856	630	120	1606
1725	773	601	95	1469
1726	992	695	100	1787
1727	1191	833	115	2139
1728	1378	1539	201	3118
1729	1293	925	164	2382
1730	1203	1033	123	2359
1731	1353	815	140	2308
1732	1012	700	113	1825
1733	791	555	148	1494
1734	707	2079	462	3248
1735	1037	1545	155	2737
1736	1185	1390	142	2717
1737	835	933	327	2095
1738	846	819	115	1780
1739	1066	988	156	2210
1740	1418	1607	187	3212
1741	1776	2419	320	4515
1742	2523	2795	340	5658
1743	2878	2736	363	5977

1744	3227	2709	364	6300
1745	2790	2688	345	5823
1746	3729	2396	579	6704
1747	3679	3176	516	7371
1748	4172	3361	571	8104
1749	2339	5606	536	8481
1750	1338	1385	228	2951
1751	1383	895	102	2380
1752	976	1854	154	2984
1753	1140	849	133	2122
1754	1071	944	150	2165
1755	1399	1814	177	3390
1756	2396	2714	426	5536
1757	3210	3595	520	7325
1758	4586	3893	547	9026
1759	5744	4971	729	11444
1760	8249	4539	682	13470

Appendix 3. Total Debt Charges in Britain, 1688-1750

	Debt Charges (in £ thousand sterling)			
	Total	Funded	Terminable Annuities	Unfunded
1688-91	189			189
1692	199			199
1693	222			222
1694	442	12	111	319
1695	581	107	190	284
1696	651	66	262	323
1697	1044	127	283	634
1698	1467	186	469	812
1699	1484	243	305	898
1700	1251	218	331	701
1701	1200	222	304	675
1702	1174	256	315	603
1703	1042	285	307	450
1704	977	260	338	374
1705	1036	260	435	367
1706	1078	268	449	350
1707	1846	322	680	842
1708	1637	315	735	585
1709	2014	311	1070	602
1710	1754	317	733	584
1711	1813	347	763	612
1712	2360	709	1080	485
1713	2888	943	1414	531
1714	3021	834	1604	583

1715	3276	1237	1540	492
1716	3027	856	1689	461
1717	3440	1112	1870	458
1718	2839	1383	1073	375
1719	2706	1465	1003	208
1720	2769	1716	943	96
1721	3314	2857	362	88
1722	3012	2544	212	232
1723	2919	2523	267	105
1724	2864	2461	281	115
1725	2796	2432	268	86
1726	2667	2353	224	88
1727	2783	2448	203	122
1728	2335	2006	208	121
1729	2284	1998	184	97
1730	2280	2001	187	85
1731	2120	1850	186	83
1732	2217	1959	182	66
1733	2143	1888	182	73
1734	2052	1792	182	76
1735	2174	1863	186	125
1736	2127	1829	179	119
1737	2105	1808	181	114
1738	2059	1753	184	122
1739	2047	1762	181	103
1740	2102	1790	185	128
1741	2032	1727	177	128
1742	2041	1690	182	170

1743	2117	1725	170	181
1744	2178	1824	154	191
1745	2259	1855	153	169
1746	2316	1945	172	189
1747	2716	2208	210	282
1748	2842	2306	219	194
1749	2981	2449	217	162
1750	3218	2817	214	186

Appendix 4 Interest Paid to the Private Sector, 1680-1740

Year	Bank of England	South Sea Company	East India Company
1694	12,000		
1695	107,000		
1696	66,000		
1697	127,000		
1698	186,000		
1699	130,000		113,000
1700	93,000		125,000
1701	96,000		125,000
1702	111,000		145,000
1703	106,000		179,000
1704	100,000		160,000
1705	100,000		160,000
1706	95,000		160,000
1707	100,000		185,000
1708	105,000		171,000
1709	95,000		176,000
1710	100,000		179,000

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국 문 초 록

본 연구는 18 세기 영국의 국가 재정 발전사를 통해 영국의 부상을 설명한다. 강대국 간의 패권 경쟁이 치열했던 18 세기 유럽에서, 적국보다 더 많은 전비와 투자금을 확보하는 것은 모든 국가들의 핵심 목표였다. 18 세기 초까지만 해도, 재정 및 군사적 차원에서 변방이었던 영국은 재정-군사 국가(fiscal-military state)의 기틀을 다지기 위해 정부 부채를 본격적으로 확대했으며, 이를 위해 유럽의 열강들보다 한 발 앞서 '민간 은행의 채무 증서 발행'을 통한 근대적 의미의 정부 부채 시스템을 도입하는데 성공했다.

이 글은 영국과 프랑스의 경쟁이라는 대외적 요인이 영국의 근대적 정부 부채 시스템 도입을 촉진했다고 주장한다. 이를 보이기 위해, 영국 국가 부채 시스템의 근대 이행기였던 1700 년부터 1720 년을 분석했다. 해당 시기, 영국은 프랑스의 금융 발전에 대응하여 두 가지 정책을 시행했다. 첫째, 1702 년 프랑스가 정부 부채의 상환 이자를 인하시킴으로써, 부채 비용을 감소시키자, 영국은 남해회사 (South Sea Company) 설립을 통해 자국의 부채 상환 이자를 인하했다. 둘째, 1716 년 프랑스가 프랑스 은행 (Banque Générale)의 국고증권(treasury note) 발행을 늘리는 한편, 단기 부채를 장기 부채로 전환시키면서 국가 대출 비용을 낮추자, 영국은 1716 년부터 국가 조세 수입의 미지출분을 통해 자국의 국채 원금을 상환함으로써 국가 신용도를 증진시켰다.

프랑스와의 경쟁 속에서 영국이 더 많은 투자를 확보하기 위해 실시했던 정책들은 영국 정부의 부채를 민간 부문으로 이양시켰다. 그 결과,

영국은 국가 보유고보다 훨씬 더 많은 자본을 창출할 수 있었다. 이러한 재정적 기반을 밑거름 삼아 영국은 재정 강대국으로 부상하게 되었다.

본 연구는 다음과 같은 국제정치경제적 함의가 있다. 첫째, 본 연구는 국가 금융 발전 과정에서 주목받지 못했던 '국제적 요인'의 설명 변수로서의 중요성을 조명했다. 이런 주장은 국내 정치적 요인(납세 문화, 의회 민주주의)에 집중했던 기존 연구를 보완한다.

둘째, 이 글은 국가의 정치적 선택이 국가 금융 발전의 전환에 결정적인 영향을 미친다고 주장했다. 금융 발전을 단선적으로 해석한 역사학과 시장 논리를 통해 해석한 경제학은 정치적 결단의 중요성을 과소평가했다. 본 연구는 프랑스와의 패권 경쟁에서 도전국의 위치였던 영국이 금융 패권으로 자리매김 한 데에는, 영국의 전략적 선택이 있었음을 보였다.

주요어: 금융 발전, 국가 부채, 영-불 경쟁, 패권 경쟁, 남해 회사, 대영제국

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