

I N T R O D U C T I O N :
T H E F I N A N C I A L R O O T S O F
D E M O C R A C Y



No Man whatever having lent his Money to the Government on the Credit of a Parliamentary Fund has been Defrauded of his Property. . . . The Goodness of the Publick Credit in England, is the reason why we shall never be out of Debt. . . . Let us be, say I, a free Nation deep in Debt, rather than a Nation of Slaves owing Nothing.¹

The author of these words, an anonymous English pamphleteer writing in 1719, was expressing an idea that was just starting to take hold—that there was a connection between political freedom and public debt. The idea gained ground in the following decades, and one hundred years later it had become almost a commonplace. In 1815, a French Minister of Finance could state simply that “liberty and credit are always united.”² By that time, France had suffered a century of military defeats, political revolutions, and counterrevolutions as it attempted to come to grips with this political insight.

Nowadays the idea of a link between public debt and democracy comes as an initial surprise to almost everyone to whom I have expressed it. The connection has been lost for reasons that will become apparent by the end of the book. However, the thread has been taken up by some recent historians seeking to explain the very questions that challenged eighteenth-century thinkers: Was the necessity of borrowing vast sums of money to finance the ever-increasing cost of war altering the political landscape? Was it perhaps England’s parliamentary government that explained the country’s astonishing ability to outborrow and outspend France in spite of having a population less than half the size? One high-ranking French official, writing in 1774, worried that this was indeed the case: “If people believe [Louis XVI] to be a despot it will be impossible to open loans, or, if that

route is taken, they will be so costly that England will always finish by having the last *écu* in any war.”³

That the rise of the bond market had irrevocably changed the political arithmetic was dramatically demonstrated in August 1788, when the Bourbon government of France was forced to declare bankruptcy, and then found itself obliged to summon the Estates General as the only way to escape from its financial predicament. The bankruptcy of August 1788 ushered in the Revolution of 1789. The history of public finance therefore provides a crucial perspective on one of the most important questions of our times—the rise of democracy.

In recent decades this rise has started to appear almost unstoppable. However, it was not always so. Indeed, for most of recorded history it would have appeared absurd to predict the long-term success of democratic government at all. The history of the world showed that the most sophisticated and advanced societies had invariably been headed by emperors, not elected officials. Apart from a few brief historical moments, such as Athens in the fourth and fifth centuries B.C., civilization and autocratic rule appeared to go hand in hand. Furthermore, it seemed that democratic government could only be practiced in small, intimate societies, such as city-states, whose existence was always threatened by larger and more powerful empires. Even if a city-state managed, like the Roman Republic, to circumvent the risk of being conquered by conquering others, this would lead to insurmountable political tensions that could only be resolved by one-man rule. Only a lunatic or a clairvoyant would have forecast that the day would come when the world’s most advanced and most powerful states would be democracies.

The inevitable question is, Why is democracy taking on the appearance of an unstoppable force now, when it appeared doomed to the margins of the civilized world for so long? The standard explanation centers on the Industrial Revolution and the dramatic increase in economic development that has occurred in its wake. High levels of technology require an educated workforce, and a high-output economy requires wealthy consumers. These parallel forces push inexorably toward mass participation in politics; and it seems that above a certain level of income per capita it is hard to prevent democracy from taking root even in autocratic societies. Conversely, societies that insist on retaining rigid state control are unable to advance economically beyond a certain point.

I do not seek to challenge or dismiss this line of reasoning, which is undoubtedly valid as far as it goes. However, such arguments can only address the modern world. The requirements of an advanced economy cannot explain the English, American, or French Revolutions—the three seminal

events of the rise of modern democracy. After all, these countries were still at “Third World” levels of development.

This is where the history of war finance enters the picture. Once wars could only be financed by borrowing, the outlook for autocracy dimmed. But even the rise of the bond market in eighteenth-century Europe leaves two crucial questions unanswered. First, where did public borrowing and bond markets come from? Are they a purely fortuitous development, a *deus ex machina* in the political life of the planet? Is it merely a coincidence that they first emerged in Europe, the same continent that gave birth to the democratic revolutions of the seventeenth and eighteenth centuries?

Second, what about earlier examples of democratic government, such as the republics of the ancient world? Their existence certainly cannot be ascribed to high levels of income per capita, nor can it be attributed to the workings of sophisticated financial markets. Are they, therefore, entirely unconnected to modern democratic states? This was not the view of seventeenth- and eighteenth-century political philosophers. They looked back to ancient liberties that had been enjoyed not only by the city-states of classical Greece, but by primitive peoples everywhere before the rise of the state. Political freedom, in their view, was a primeval birthright that had been usurped by kings and emperors (an argument most memorably expressed by Jean-Jacques Rousseau: “Man was born free, but is everywhere in chains”). Countries where liberty reigned, such as England and Holland, had merely fought back against royal usurpations more successfully; and it was up to other nations to do the same if they wished to recover their freedom.

These ideas have fallen out of favor. Although anthropologists may agree that tribal life is indeed characterized by an absence of autocratic state power, few, if any, political theorists or historians are willing to see a direct chain of descent from such primitive freedom to modern democratic constitutions.* Moreover, if the rise of modern democracy is attributable to economic development, then it makes little sense to delve into the ancient world.

This book, however, takes a different path. It looks back centuries, even millennia, before the events of the eighteenth century and comes up with some surprising conclusions.

First, the origins of public debt. Nowadays the bond market is seen as an impersonal, almost superhuman force that responds only to the laws of economics and that passes harsh judgment on the shortcomings of human

*Semantically, however, the chain still exists—an inheritance from the eighteenth century. It is enshrined in the word *Senate*—taken from the venerable Roman institution that started out as the council of elders of the Roman tribe, and whose root is the word *senex*, or “old.”

politics—favoring those forms of government that are most likely to ensure that debts are paid promptly, without any special preference for one system or another. However, a study of history reveals a different story. Public borrowing is not politically neutral, but has a particularly intimate relationship with democracy. It is no coincidence that public borrowing and parliamentary government both originated in Europe. For the bond market was not a *deus ex machina*; it was the product of the quest for political freedom.

The second conclusion is equally surprising. The financial origins of democracy are not to be found in the seventeenth and eighteenth centuries. They can be traced to the earliest recesses of human history.

In order to understand this conclusion, it is necessary to look at the origins of the state. When one does so, it soon becomes clear why the laws of economic efficiency seemed to suggest that the future lay with autocracy, not democracy. It was autocracies who could best concentrate power and wealth in the hands of the state and then use that concentration both for military expansion and for economic development.

There was, however, a potential chink in the economic armor of the great empires. Few states have found it easy to deal with emergencies (especially warfare) merely by raising taxes, because of the economic disruption and political unrest that this can cause. Until quite recently, the solution to this problem was to store up treasure; and states with the greatest ability to accumulate were assumed to have an inherent advantage in the struggle for survival. But the “treasury” solution contained an in-built economic inefficiency. Societies mined precious metals to act as currency at enormous economic cost. They then proceeded to hoard these same metals for a rainy day in a process that was tantamount to mining in reverse. (The Persian Empire, possibly the greatest hoarder of the ancient world, actually melted down its gold again before burial underground, making the analogy quite literal.) It is not difficult to see the superiority of a system that allowed this hard-earned wealth to circulate in the general economy, to be tapped only insofar as necessary. Hence the economic utility of public debt.

To state that public borrowing is a superior method of dealing with emergencies is not sufficient to explain its existence. With the benefit of hindsight, public borrowing may have the appearance of inevitability; but from a historical perspective, it was not an obvious development. Where did the idea come from? The great states of the ancient world were conspicuous for their ability to store up surpluses (take the story of Joseph in Egypt, for example), but public borrowing was an entirely alien concept. Why would a pharaoh, a god in human form with the power to compel his

subjects to build veritable mountains of stone to house his mortal remains, think of borrowing? Whatever he needed was his by right.

What was required was an alternative form of government in which public borrowing was an organic growth. Only then was it conceivable that public debt might flower into a force sufficiently powerful to change the world. The thesis of this book is that the alternative form of government was democracy. Not the democracy that has become familiar since the political revolutions of the eighteenth century, but precisely those earlier forms of democracy whose existence cannot be explained by high levels of income per capita.*

What was the crucial element that made public borrowing natural in democracies, but unnatural in autocracies? The standard explanation for the superior creditworthiness of constitutional governments is that they are limited by law and therefore make more trustworthy counterparts for the private individuals who lend them money. However, this explanation does not answer the question of whether public borrowing is in some way *indigenous* to democracy. The true answer lies in the identity of borrowers and lenders. Divine, or semidivine, autocrats are unlikely to perceive lenders as their equals. In democracies, the opposite is true. As long as the state borrows from its citizens, there is no divergence of interest between borrower and lenders, for the two are one and the same. This is a far more powerful reason for the inherent creditworthiness of democracies than mere constitutional constraint. But it is important to note that the argument holds good only for domestic borrowing—when the lenders are citizens. The argument does not apply to external borrowing. A democracy may have a natural inclination to respect the rules of credit when dealing with foreign creditors, because democracies are, on the whole, readier than autocracies to adapt to the purely economic logic of credit markets. But it was not the ability to borrow abroad that counted in the struggle between rival forms of government. It was above all the symbiosis of borrowers and lenders inherent in domestic borrowing that turned public debt into a powerful weapon capable of upsetting the long-term advantage of autocratic government.

While, on one level, then, this book deals with the hard facts of money and credit markets, its underlying motif is the relationship of the state with

*It is often argued that nothing short of universal adult suffrage qualifies as true democracy. By this standard, most forms of government before the twentieth century fall short. For the purposes of this book, however, governments are allowed to be essentially democratic as long as they are controlled and run by their citizens through a process of voting, even if the citizens form only part of the population. For it is the element of citizen control that separates such governments most crucially from autocratic rule.

its citizens. Its hero is the citizen creditor—a subspecies of *Homo sapiens* not hitherto recognized or given his due. Indeed the role of the citizen creditor in history did not end in 1789. In many ways, his greatest days were in the twentieth century, not the eighteenth.

But there remains a further mystery. Public borrowing may be a form of public finance naturally suited to democratic government; but where did the idea first come from? The answer is that it always existed in nascent form within the simple customs of primitive tribes. These customs may seem very distant from the complex paraphernalia of modern government, but they contain within them the financial roots of political freedom. This book uncovers a chain of descent that links tribal financial practices to modern public debts; and this leads to an intriguing reflection. The political philosophers of the seventeenth and eighteenth centuries sought the roots of democracy in the political customs of their tribal ancestors. Their views have often been dismissed as unhistorical wishful thinking. But it now seems that the ideas of the old philosophers may have contained an element of truth. Political liberty may have descended from tribal customs—but for hitherto unsuspected reasons.

The first chapter of the book traces the story of public finance and political freedom from the end of the Bronze Age to the end of the Dark Ages. The outer boundaries of this field of vision are not chosen by chance. For the possibility of a challenge of any sort to the apparently unstoppable tide of autocracy lay in a cyclical pattern of world history in which great civilizations were slowly built up, and then disrupted by waves of “barbarian” invasion. These invasions allowed the periodic reintroduction of tribal customs into the historical mix before the tide resumed its advance. The story starts with the first of these great waves, which marked the end of the Bronze Age, and which introduced into the historical landscape many of the peoples who later dominated the era of classical antiquity. It ends with the second of these waves, which heralded the end of that era, and which, crucially, had effects that were more profound and lasting in Western Europe than elsewhere.

The book then moves to medieval Europe. Although the roots of democratic public finance can be traced to the ancient world, the examples of public borrowing to be found there amounted to no more than tantalizing experiments that came to an end with the rise of the Roman Empire. It was the role of the city-states of medieval Italy to resurrect the idea and transform it into a viable financial strategy. The system that they created, al-

though in one way fatally flawed, set off a chain of events with results that no one could have predicted.

The following several chapters of the book describe the attempts of the states of Europe to come to terms with the implications of the Italian invention. On one level, the question they faced appeared to be purely technical: How could the exhilarating freedom of borrowing be reconciled with the dull constraints of solvency? But there was a second question of equal importance, without which there could be no definitive answer to the first: Were the benefits of public borrowing available to states that did not enjoy the symbiosis between borrowers and lenders of the Italian cities? The answer to this question was finally delivered in August 1788 when the Bourbon monarchy threw in the towel, admitting bankruptcy and agreeing to recall the Estates General, the parliamentary institution that it thought it had consigned to the history books nearly two hundred years earlier.

The final section of the book looks at the events that followed the French Revolution. The outcome of the Napoleonic Wars demonstrated the superiority of a political system based on the alliance of parliamentary government and public debt, but now there was a new question: Would a system created in a world where participation in politics was confined to those with property prove compatible with universal suffrage? For the story of public debt and political freedom is interwoven with a parallel theme: the story of public debt and class warfare. Public borrowing may have represented political freedom—but whose freedom? Only that of the wealthy who had money to lend? It was the role of the nineteenth century to find a solution to this problem. In the devastating wars of the first half of the twentieth century, this solution was put to the test. The First World War was the apotheosis of “democratic” public finance, the Second its swan song.

One final introductory comment: Although the book is, on one level, about politics, it necessarily deals with the other side of public credit: the logic of the market. The lay reader can rest assured, however, that the financial jargon has been kept to a minimum, and the critical terms (none of which are very complicated) are explained as they occur. A glossary is also provided at the end of the book. Inevitably, in covering several millennia of history, I refer to a number of different currencies. A detailed appendix describes them and sets out their relationships in historical context.