

Debt policy under constraints between Philip II, the Cortes and Genoese bankers

Abstract

Under Philip II, Castile was the first country with a large nation-wide domestic public debt. A new view of that fiscal system is presented that is potentially relevant for other fiscal systems in Europe before 1800. The credibility of the debt, mostly in perpetual redeemable annuities, was enhanced by decentralized funding through taxes administered by cities making up the Realm in the Cortes. The accumulation of short-term debt depended on the refinancing through long-term debt. Financial crises in the short-term debt occurred when the service of the long-term debt reached the revenues of its servicing taxes. They were not caused by liquidity crises and were resolved after protracted negotiations in the Cortes by tax increases and interest rate reductions.

Keywords: debt funding, sovereign loan defaults, financial crises, parliaments.

JEL codes: N23, N43, H63, F34.

Debt policy under constraints between Philip II, the Cortes and Genoese bankers

Philip II, as head of the first modern super-power, managed a budget of a scale that had not been seen since the height of the Roman Empire¹. No country before had faced such extraordinary fluctuations and imbalances, both in revenues and expenditures and both in times and places. Large military expenses were required by the politics of Europe and the first revolution in military technology. The variability in both revenues and expenses, with a large foreign component, was met by large public borrowings up to modern levels, a historical innovation that, in later centuries, would be followed by the Netherlands, France and England. As in eighteenth century England, but at an earlier stage of the development of capital markets, Castile (about 80 per cent of current Spain), drew its military supremacy from its superior ability to mobilize large resources through borrowing.

The debt to GDP ratio exceeded fifty per cent according to some estimates, and the ratio between interest service and tax revenues at the end of the century was about fifty per cent, as in England or France two centuries later. These impressive numbers were achieved with no central administration to collect tax revenues and without the centralized capital market that facilitated the management of the public debt in later centuries. At the same time, four "defaults" are alleged to have occurred. These financial crises have attracted considerable attention. Contrary to common wisdom, the crisis did not affect the interest charged to the Crown. (The trend was actually downwards). What kind of fiscal system supported the credibility of the Crown's debt? This study attempts to provide an answer.

The unprecedented size of the debt and the repeated financial crises raise the central issue of the credibility of the public debt. For any country, then and now (*e.g.*, the crises in today's public debts), the credibility of the public debt is closely connected to the structure of the entire fiscal system, including the political decision making. We present a new view of that system and a new interpretation of the financial crises.

¹ At 6 million ducats (the average around 1560), with a ducat at 35 grams of silver, it amounted to 210 tons of silver per year with a population of about 5 million, while the Roman empire's budget was between 500 and 1000 tons for a population of 50 million. Hopkins, 'Rome, Taxes, Rents and Trade'. The size of the monetized government revenues and expenditures, per capita, had been small throughout the Middle Age in Western Europe. Bean, 'War and the Birth of the Nation State'.

Our line of argument follows the chain of rational mechanisms that enhances the credibility of the public debt. The dominant part of the debt was the domestic debt, mainly in perpetuums, called *juros*. These supported the credibility of the short-term debt, *asientos*, that could be swapped into long-term *juros*. The credibility of the *juros* was enhanced by the decentralization of the interest payments. The main part of the *juros* was serviced locally by taxes that were raised locally, at the level of cities (including their surrounding region), and under the control of local governments. The credibility of these bonds was thus established by the alignment² of the bond holders and the people in charge of the collection of the revenues for their service. Each city contributed a fixed lump-sum contribution per year and the amounts were established in the meeting of 18 cities, in the *Cortes*. Hence, the total contribution established *de facto* a ceiling on the service of the public debt. When the ceiling was reached, the short-term debt could be no longer be converted into long-term debt. The financial crises on the short-term *asientos* were generated by protracted negotiations in the *Cortes* when no more long-term debt could be issued³. The structure thus explains both the large amount of debt, its credibility, and the repeated crises.

The Castilian system was in effect a generalization of the public debt that Italian city-states had developed during the previous three centuries. The lack of central administration to control and enforce tax revenues⁴ reinforced the capability of the Crown to borrow because it restricted its capability to divert tax revenues away from the service of the debt. Indeed, the interest rate on the domestic debt decreased during the century despite the large borrowings⁵.

The three financial crises under Philip II (1557-60, 1575-77, 1596-97), did not affect the long-term debt whose service was secured. They affected the short-term loan contracts, the *asientos*. Following the routine of the previous century⁶, the Crown converted any significant accumulation of the short-term debt into long-term domestic debt. In that context, the main part of the *asientos*, was collateralized, explicitly or implicitly, by the secure long-term term *juros*. Swaps from *asientos* to *juros* required a capacity to issue

² The alignment of tax collectors and debt holders has been critical for the credibility of large levels of the public debt in all centuries. See also Stasavage, 'Partisan politics' for Britain's financial revolution' and Epstein, *Freedom and Growth*.

³ The process is reminiscent of the deadlock that almost took place last summer in the US between the legislative and the executive branch of the government.

⁴ Such an administration began in England just before the Glorious Revolution. Brewer, *The Sinews*.

⁵ Pérez-Prendes and Torres López, *Los Juros*.

⁶ Andrés Díaz, *El último decenio*.

new *juros*, that is to service them by secure tax revenues. Each of the three crises under Philip II broke out when the service of the long-term debt reached the ceiling of the tax revenues that had previously been agreed upon by the cities in the Cortes.

The previous economics literature on these crises focuses on the negotiations between the Crown and the Genoese bankers. The relation between the Crown and the cities played a central role for the fiscal policy and cannot be separated from the dealings between the Crown and the Genoese bankers⁷. The argument implies that the fiscal policy of Philip II cannot be analyzed from the perspective of a standard modern economy with a centralized government that would face an IMF program. The sustainability of the debt cannot be analyzed with respect to the total revenues. Furthermore, within total revenues, the large and highly variable component of silver revenues was a poor basis to issue long-term debt.

The crises were not short-term liquidity crises⁸. In a standard liquidity crisis, the borrower meets the refusal of the lenders to fill a gap in short-term lending. Here, each of the crises was not triggered by such a constraint but by a payment stop of Philip II. The most important crisis, in 1575, could have easily been avoided if Philip II had asked a moderate increase of tax revenues from the cities instead of embarking on a power play to triple these revenues.

At the end of each crisis, the entire stock of the short-term debt was converted into long-term debt. The crises were resolved by a mix of tax increases and reductions of the interest rates on some *juros*.

The financial crises under Philip II have been labeled in the recent literature as bankruptcies⁹. Such a Procustean classification neglects the historical features of the financial instruments in Castile and confuses interest reduction and debt reduction. Most of the domestic debt was in perpetual annuities redeemable at par (*juros al quitar*): the Crown could repay the principal at any time. That feature had been introduced in the fifteenth century and by the end of that century, the Crown had routinely used the redeemability of the annuities to lower their interest rate as the market rate decreased

⁷ Historians have either specialized on the relations between the Crown and the Cortes (e.g., Fortea Pérez, *Monarquía y Cortes*), or on the relations between the Crown and the bankers (Carlos Morales, *Felipe II*, and the cited literature).

⁸ That is the interpretation of Drelichman and Voth, 'The Sustainable Debts', p. 816. For example, the statement that "a compromise [between Philip II and the Cortes] emerged in 1575, too late to prevent a default on short-term debt" is contrary to historical evidence of the protracted negotiations that we discuss in our detailed account of the 1575 crisis.

⁹ Reinhart and Rogoff, *This Time is Different*.

gradually over the century. Each interest reduction was not forced and included the provision that the debt holder could choose instead the cash payment of the face value of the principal.

Interest reductions were conducted during the settlements of crises in 1575-77 and 1596-97. At the same time, some of the debt was reduced. This paper is the first to emphasize that interest reductions were not default as often alleged. Much more work is needed on this issue, but so far we suspect that the actual debt reductions were relatively small.

The paper is organized along the lines of the main argument. The instruments of the long-term debt are presented in Section I. The sources of funding that debt are analyzed in Section II; specifically, in relation to their capability to ensure the credibility of the long-term debt. The properties of the financial instruments in that debt (market, redeemability) are related to the structure of revenues. Section III discusses the theory of debt policy under the constraint of quantum adjustment of taxation. Some accumulation of short-term debt can be efficient despite its higher cost, and it is entirely converted into long-term debt when there is a tax adjustment, as actually occurred under Philip II. In Section IV, each of the three crises, 1558-60, 1575-77, 1596-97, is analyzed in view of our main argument.

I

The center of the fiscal system of Castile was its long-term debt. Its credibility rested on its funding system and that credibility supported the credibility of the short-term debt. In order to understand the funding mechanism and the interest reductions on the debt, we have to examine the financial instruments of this long-term debt.

Domestic long-term bonds, called *juros*, had been introduced in the 12th century as pension rewards for services during the *Reconquista*¹⁰. Their marketability increased gradually over the centuries. Given the stage of development and the institutions in the sixteenth century, there was no central market with price quotations as, centuries later, in the Netherlands or England. More importantly, in the political structure of Castile, there could not be such a market. The *juros* were serviced at the city level to ensure their credibility. Thus, for a *juro* issued in Sevilla, the coupons had to be collected in Sevilla and not in Madrid. The same office would service the *juros* and collect the local

¹⁰ See Barthe Porcel, *Los juros*; Toboso Sánchez, *La deuda pública*; Pérez-Prendes and Torres López, *Los Juros*.

sales tax revenues on which the service of *juros* had first claim. *Juros* were also ranked by local order of seniority according to their date of issuance. No default took place on *juros* in the sixteenth century, but there could be local delays of payment. *Juros* were traded and not attached to a particular holder (transactions had to be registered). They were not homogeneous like the 3 or 4 per cent annuity found in eighteenth century England, but they could be traded in the entire Realm.

Juros were either perpetual and redeemable annuities (*juros al quitar*), or life annuities (*juros de por vida*)¹¹, which were also redeemable. *Juros al quitar* had a face value, the principal, which could be paid back by the government at any time. The redeemable feature enabled the government to reduce the debt in a time of surplus and, more importantly, to refinance when the interest rate decreased. Such interest reductions had taken place in the fifteenth century, from 10 to 7 per cent and from 8 to 6 per cent. At the same time, the Crown sold new *juros* at rates of 7 and 6 per cent¹². The definition of life annuities (*juros de por vida*) is less clear at this stage. They seem to have had a longer term than the standard life annuities found later in other countries, such as France or England.

The redeemability of the perpetual annuities is a central issue in the fiscal policy of Castile. *Juros al quitar* could not be redeemed *in toto* in sixteenth century Castile, contrary to the English debt two centuries later¹³. First, as described before, the market for *juros* was fragmented. Second, in the Castilian tradition, the interest rate on the annuities was not reduced by a decrease of the annual income for a fixed face value of the capital, but instead by an increase of the face value of the capital for a fixed annyal income. A *juro* was defined by the capital amount needed to generate 1000 *maravedis* (mrs), thus reflecting the motive of a stable rent (*juros* were appreciated by widows and monasteries). For example, “14.000 *al millar*” means an interest of 7.14 per cent. An interest reduction was called a *crecimiento* because the holder of the *juro* was given the choice between either receiving its face value in cash, along the terms of the contract, or paying the difference with the new face value. For example, in a reduction from 7.14 to

¹¹ The fraction of *juros al quitar* was 76% in 1559, 82% in 1575 and about 90% at the end of the century. Artola, *La Hacienda*.

¹² Andrés Díaz, *El último decenio*.

¹³ Chamley, 'Interest Reductions'.

5 per cent, the holder of a *juro* that was "increased" to 20000 had to make a payment of 6000 in order to keep the *juro* in which case, the new face value would be registered¹⁴. The very definition of the *juros* provided a commitment device against a forced reduction. When the interest was reduced, the "invariant" was not the principal (as for an annuity in seventeenth century France or eighteenth century England), but the annual income. When the face value is the invariant, it is relatively easy to force a reduction of the annual income. But when the invariant is the annual income and the only way to reduce the interest rate is to increase the principal, such a forced "reduction" is much more difficult to impose on the *juro* holder. No *juro* had its annual income reduced during the reign of Philip II. All interest reductions were voluntary. The issue will be discussed again in the context of the 1575-77 and the 1596-97 crises.

In a perfect capital market with competitive agents, interest reductions through dividend reductions and capital increases are trivially equivalent. In Castile, a reduction, either gradual or *in toto*, of the interest rate on the long-term debt could have been achieved by a combination of *crecimientos* and trade with the market prices anticipating the probability of *crecimientos* in a perfect capital market. This context was no more relevant in sixteenth century Castile than in eighteenth century England. Since the method of the *crecimiento* generated an increase of the capital stock, it had to be applied gradually on different *juros* with different rates that coexisted at the same time.

II

The funding of the domestic debt should, above all, have a stable basis. The standard method to increase its credibility, since the creation of public debts in the Italian cities of the Middle-Age, has been its close association with the servicing taxes. In Castile, *juros* were defined with respect to their funding.

Table 1

Table 1 presents an overview of the revenues according to their capability for debt servicing. There are four parts in the table, each defined by its reliability for the servicing of the public debt.

¹⁴ The market value of old *juros* (that carry a high dividend ratio) was affected by the expectation about future *crecimientos*. It is therefore impossible to infer the long-term "market interest rate", if there were one, from transaction prices of old *juros*: take a "market rate" of 5%. If the *crecimiento* is expected in the near future, the price of a 7.14% *juro* is 14,000. If that *crecimiento* is expected never to occur, the market price is 20,000. Suppose now that the market price is 18,000, because the market rate is 5.5% and the probability of a *crecimiento* of that particular *juro* is very small. In that case, the holder of a *juro* should accept the *crecimiento* to 20,000, although the market rate is higher than 5%.

- (i) On the left side, the *ordinary revenues* provided a stable source of funding. In the top part, the fixed contribution of cities, which was determined in the *Cortes*, provided the most reliable base. In the lower part, the taxes that were administered directly by the Crown (e.g., import duties, monopolies) were less reliable.
- (ii) On the right side, the *extraordinary revenues* were of two types. In the top, the contributions of the cities were stable but they had no permanent legal status and had to be renewed by votes in the *Cortes* every few years. In the lower part, the revenues were neither politically nor economically stable.

Throughout history, the most important feature of a credible public debt (with low interest rates) has been the alignment between the debt holders and the people who control and enforce the taxes that service the debt. That alignment was achieved in the Italian city-states of the High Middle Age¹⁵ where the ruling class was at the same time holding the city's debt and in control of the determination and the administration of the taxes that serviced that debt. What was good for a city-state could also be used by a state that included cities. The Italian system was generalized in the sixteenth century to states that included cities¹⁶.

In Castile, the generalization of the system of "borrowing through cities" had an ideal setting: most of the Castilian realm was represented by eighteen cities, with their surrounding regions, and negotiations between the Crown and the Realm were centralized in the *Cortes*.

The main tax in Castile was the *alcabala*¹⁷, a sales tax collected by tax farming before 1536, with a nominal rate of 10 per cent that acted more like a legal maximum. The actual rate was much lower, possibly around 2 per cent¹⁸. The *Cortes* of 1536 established the system of the *encabezamiento general* by which each city was committed to an annual lump-sum payment that was set for about six years. These amounts were adopted in the *Cortes* by majority voting. Each readjustment of the *encabezamientos* would require protracted negotiations and that cost imposed some

¹⁵ Pezzolo, 'Government Debts'.

¹⁶ For the Low Countries under Carlos V, see Tracy, *A Financial Revolution*, especially chapter 3. In 1522, Francis I issued the Rentes sur l'Hôtel de Ville de Paris. Vührer, *Histoire de la Dette Publique*.

¹⁷ Zabala Aguirre, *Las alcabalas*.

¹⁸ Artola, *La Hacienda*, p. 50.

interval of time between these negotiations. After 1536, the *encabezamiento* provided the most stable basis of the servicing of the *juros*.

The lack of a central administration to directly collect the *alcabalas* prevented the central government to divert revenues from the service of the debt. It thus enhanced the borrowing capability of the government. The delegation of tax revenues and the debt service was a commitment device that enabled the Crown to increase the domestic debt to a level that was unprecedented in the sixteenth century.

Juros were administered by cities, but they were legal contracts between holders and the Crown, not contracts between holders and cities. They could thus be traded in the entire realm with registered sales and transfers¹⁹. Because of the delegation of revenues collections, there was no centralized market (as in eighteenth century England) and it should not be surprising that the coupon rates for apparently similar *juros* were not identical.

The central government collected customs and profits from regulated monopolies. As the government had no tax administration, and these taxes were collected at specific locations (e.g., customs, salt production), it was relatively easy to subcontract their collection to local entrepreneurs through tax farming. These revenues were under direct control from the central government and thus did not benefit from the special protection that was given to the taxes collected by the cities. They provided a base for debt funding, but that base was not as stable as the *encabezamientos* because of the direct control by the central government, the fluctuations in trade and general economic activity, and because of the risk of default by the tax farmer. Accordingly, they supported *juros* of lesser grade.

The extraordinary revenues, on the right of Table 1, could not provide a good source of funding for the public long-term debt. Few *juros* were written on these revenues, at least in the sixteenth century, and they traded at a discount. Between 1560 and 1575, some *juros* were funded by the revenues of the *Casa de la Contratación* that managed the silver revenues and was directly controlled by the Crown²⁰. Not surprisingly, they were traded at a significant discount. In this sense, there cannot be a meaningful relation between the revenues of silver and the debt service.

¹⁹ See working paper and data in web page, AHN, Consejos Juros, leg. 1733, folio 7. AGS, Contaduría de Mercedes, leg. 227.

²⁰ Ruiz Martín, 'Un expediente financiero'.

The *servicios* (*servicio ordinario*, *servicio extraordinario* and *millones*) were similar to the *alcabalas*. They were administered by the cities and their level was determined by centralized negotiations in the Cortes in a bargaining joint with that of the *alcabalas* (see below for 1575). But compared to the *alcabalas*, the *servicios* were a voluntary and temporary contribution of the cities that had to be renewed. They could not be used to service the domestic debt, at least until the end of the century. The evolution over time of the different types of revenues is presented in Figure 1.

Figure 1

III

Expenditures in Castile were driven by wars and thus highly variable. In the standard modern theory of public finance, the optimal fiscal policy of a central government with a frictionless economy is to minimize tax distortions through tax smoothing: the level of taxation should be, roughly, a constant fraction of the tax base, and that fraction should be adjusted to meet the government budget constraint that equalizes the present value of the expected future revenues and expenditures, including the service of the debt. Any expected mismatch between the flows of revenues and expenditures should be met by increases or decreases of the debt, with no tax change. Any unexpected event change that is and has a significant impact on the inter-temporal budget should induce an adjustment of the permanent tax level.

A textbook illustration is presented by England in the eighteenth century,²¹ which nevertheless departed from that model during the Napoleonic wars and in the distinction between the long-term funded debt and the short-term debt. The English method of debt financing became operational after a long transition, between 1690 and 1740, that has been called a “financial revolution”²². Dickson and others have emphasized that, even after the completion of that transition, the government could not issue large quantities of liabilities, both long- and short-term, without the collaboration of institutions such as

²¹Barro, 'Government Spending'.

²²Dickson, *The Financial Revolution*.

the Bank of England and the South Sea Company, and of skilled financiers (the “moneyed men”)²³.

In Castile, financial shocks were absorbed by financial contracts and short-term loans, called *asientos*. These were signed with Genoese bankers who were the indispensable “moneyed men” of Castile, the more so because there was no centralized financial market as in 18th century England²⁴. An accumulation of the *asientos* that was not transitory should be accounted for as a permanent liability of the government and therefore be refinanced through the long-term debt in *juros*.

The *asientos* specified, with some but not complete details, the payments between the bankers and the Crown (e.g., date, place, currency, exchange rate, interest rate). When the *asientos* included loans, the average maturity was about two years – however, some contracts could last up to ten years. When the exact dates for repayments were not fixed, the *asiento* often specified an interest rate. In the period of 1570-75, the standard rate was 12 per cent per annum, with some exceptions. Contrary to some descriptions in the literature²⁵, the greater share of *asientos* was not written in loans to pay the army in Flanders. For example, in 1575, less than 40 percent of the total disbursements of *asientos* were in Flanders and about half in Castile (with the rest in Italy and Besançon). The large share of domestic transactions illustrates the role of the Genoese bankers in the workings of capital markets within Castile (as the moneyed men would in England later).

Some *asientos* were collateralized by *juros* (*juros de caución y juros de resguardo*). The collateral had two purposes: first, to be a collateral; second, in keeping with the overall fiscal policy model, when the spending shocks turned out to be more than transient, the short-term loan had to be converted into a long-term loan. The lender could then sell the collateral instead of receiving cash. Such a sale should not be taken as a sign of failure from the Crown, but instead as part of an efficient overall policy. It was a standard practice for the Crown, in a regime of no crisis, to pay some *asientos* in *juros*.

²³ The interests that were represented by these institutions and people restricted the capability of the government to conduct efficient reductions of the interest rate on the public debt. Chamley, 'Interest Reductions'.

²⁴ Carlos V had a special relation with the Fuggers. Under Philip II, from 1561 on, the main players were the Genoese bankers. They had the expertise to handle the complex transactions between Castile, the Netherlands and Italy, and within Castile, they operated through letters of exchange and other short-term contracts.

²⁵ Conklin, 'The Theory of Sovereign Debt'.

Under Carlos V, the *juros* as collateral could be sold only if the Crown did not meet the terms of the *asiento* (*juros de caución*). Starting in 1561, following an initiative of the banker Juan Curiel de la Torre, some collaterals, called *juros de resguardo*, could be sold by the banker provided that he would return a similar *juro* later if the Crown met the payment schedule of the *asiento*²⁶. In this case, the service of the *juro* that had been sold would be deducted from the liability of the Crown. The system of the *juros de resguardo* enabled bankers to refinance *asientos* at a low interest rate. That system increased the profitability of the bankers' activities. However, in the context of the fragment market for *juros*, the system introduced some confusion in the definition of the net debt of the Crown. It is therefore not surprising that the crisis of 1575 was, among other things, an "information event"²⁷ in which the Crown attempted to recompute the liability it had accumulated since 1561, actualized at 12 percent, the average rate of *asientos*.

In an economy with a central fiscal authority like the Parliament of eighteenth century England, that authority has the available information about future revenue needs. In Castile, authority on expenditures was the exclusive domain of the Crown. The cities controlled the best taxes for servicing the debt and their contribution (*encabezamiento*) was set through collective bargaining in the Cortes. The Cortes could not meet independently like a modern parliament. Instead, it had to be called by the Crown. No increase of the *encabezamiento* could be done without a meeting of the Cortes and an agreement of the cities. They did not have the power to completely oppose a tax increase, but they could reduce the amount of the increase, or delay its implementation for a few years. Moreover, as shown below, the cities showed during the crisis of 1573-77 that they could successfully resist the introduction of new taxes.

The level of ordinary taxes effectively operated like a ceiling on the service of the domestic debt, or at least of the highest grade debt. The costly negotiations were equivalent to the imposition of a fixed cost to any adjustment. Hence, taxes could be adjusted only at widely separated moments in time and not continuously (as in the standard model of optimal fiscal policy).

²⁶ Ruiz Martín, 'Las finanzas españolas'.

²⁷ The modern theory of the debt (Townsend, R. M. 'Optimal Contracts') shows that debt contracts with a fixed interest rate are efficient because they reduce the fixed cost of information from the debtor to the creditor to the event of bankruptcies. In the case of Philip II, the need for information may have been greater for the debtor.

Negotiations in the Cortes could be protracted because the cities might have little interest in the "foreign" wars of Philip II. More importantly, even if the Crown and cities faced a situation of asymmetric information. That problem was well known in all feudal countries where the sovereign faced the constraint of "evident necessity" and had to justify the taxation (in men or money) for wars. A contribution to the solution of the information problem was found in 12th century in the Cortes of Aragon and the 13th century in England²⁸.

To summarize the previous discussion, the fiscal policy of Philip II had to face large fixed costs on the adjustment of taxes and the conversion of short-term debt into long-term debt. These costs arose because of divergent political interests between the Realm and the Crown and because of imperfect information between the Crown and cities and between the Crown and the Genoese bankers. These costs explain a model of debt cycles and tax adjustment. That model is illustrated by the Figure 2 that presents the evolution of the service of the *juros (situado)*, and the level of the ordinary revenues, as described in Table 1. These revenues are the sum of the *encabezamientos* that were negotiated in the Cortes and of the farmed revenues (including monopolies), which grew between 1560-70 (Figure 1), but seem to have reached their capacity in 1570. Each of the crisis is represented by a vertical line. The first two, in 1597 and 1560 are actually two steps of the same crisis. At the end of each crisis, all the outstanding *asientos* were converted into *juros*.

Figure 2

In the first phase of the cycle, which begins after a settlement, such as in 1560 and 1577, the level of ordinary revenues exceeds the debt service. Transitory shocks are financed by short-term loans (*asientos*), with no significant accumulation, and permanent (negative) shocks on the budget are absorbed by an increase in the long-term debt.

As the service of the long-term debt nears the ceiling of the ordinary revenues, as in the early seventies and the late nineties (Figure 2), refinancing the *asientos* through *juros*

²⁸ For an analysis of the role of asymmetric information in Magna Carta (1215), see Green, 'On the Emergence'.

becomes more difficult²⁹ and the Crown initiates negotiations with the cities. During this phase, *asientos* accumulate. Before the payment stops of 1557, 1575 and 1596, the amounts of outstanding *asientos*, gross of the collaterals, were 7.5, 15 and 7 million ducats, respectively. Why did Crown let *asientos* accumulate despite their higher interest (12 percent against 7 percent for the *juros*, on average)? When there are fixed cost in adjusting the budget (*e.g.*, through negotiations in the *Cortes*), it is optimal to let some short-term debt accumulate³⁰.

At a time that cannot be predicted accurately, by definition, the Crown declares a payment stop only on the short-term debt (as in 1575 and 1596). The payment stop would not be necessary if the cities would easily agree to the increase of the debt service ceiling. In a situation of asymmetric information, the payment stop may be a powerful argument to convince the cities of the “evident necessity”. In 1575, the payment stop was also an opportunity to review the dealings in the collaterals of the *asientos*.

A crisis after a payment stop lasts until the Crown settles first with the cities, then with the bankers in the *Medio General*. The bankers may take a haircut, but the empirical evidence about debt reductions is not very clear at this point. The cities accept higher taxes in the settlements of 1560 and 1577. In 1598, taxes are not increased but the interest rate is reduced on some *juros*. However, that settlement should be viewed as a prelude to the next negotiations of 1607, as the temporary settlement of 1558 preceded that of 1560. A key feature of each settlement is the conversion of all the *asientos*, net of any haircut, into long-term *juros*. That feature has been neglected in the literature but reinforces our interpretation of the debt policy.

IV

The service of the long-term debt reached the ceiling imposed by ordinary revenues three times during the reign of Philip II. We now analyze these three events in more detail.

²⁹ Because of the decentralization of the *juros*, some towns may be up to the revenue constraint before the aggregate service reaches the aggregate ordinary revenues (Figure 3).

³⁰ Assuming rates on *juros* and *asientos* of 6 and 12%, respectively, and an exogenous probability of avoiding the tax increase (through a peace treaty) at six per cent per year, one can show (See working paper and data in web page), that the maximum accumulation of short-term debt should be twice the fixed cost of adjustment. That rule is satisfied the short-term debt is equal to 5 million (a plausible estimate for the debt in 1575, net of the *juros de resguardo*) and the fixed cost is 2.5 million ducats. That cost is equal to the postponement of the increase of the *encabezamiento* that the Crown declared in 1575. Actual negotiations lasted more than two years.

The events of 1557-60 have to be considered as a whole, which fits well into the general framework that is presented in the previous section. The events were triggered by the constraint on the service of the domestic debt. They ended with an increase of that ceiling and a complete conversion of *asientos* into *juros*.

At the beginning of his reign in 1556, Philip II inherited from his father, Carlos V, a debt of 7.5 million ducats in *asientos*³¹. He quite naturally ordered a review of the accounts and began negotiations with some bankers to refinance *asientos* into *juros*. But the service of the debt was reaching the total amount of ordinary revenues, leaving no room for more *juros* (Figure 2). On April 17, 1557, Philip II declared his first payment stop from London, where he was spending time with his wife, Mary Tudor, queen of England. The suspension affected only the repayments that were due on the *asientos* but not the service of the *juros* - as for any stop payment of Philip II.

The decree did not intend to repudiate the debt, even partially. It declared a swap of some *asientos* into *juros* at 5 per cent - the bankers could sell these on the market³². That swap did not apply to the Fuggers who were, at the time, some of the main creditors, and it did not address the main problem, which was the ordinary revenue-derived ceiling. The second part of the policy was the promulgation on 30 April 1558, by the regent in Castile, the princess Doña Juana, of a new tax on the exports of wool. New customs were also created between Portugal and Castile on 30 January 1559³³.

Genoese bankers had accepted the *juros* at 5 per cent in order to settle the negotiations. However, *juros* at 7.14 per cent were obviously selling faster than *juros* at 5 per cent. The bankers therefore proposed to convert the swap into *juros* at the rate between 7.14 and 10 per cent in the following years while they would grant new *asientos*. That policy which was probably viewed as a stopgap, was initiated by Nicolao de Grimaldo in May 1558 and followed by all other bankers between 1558 and 1560.

The suspension of 1557 and the following negotiations were not concluded by a general settlement (*Medio General*) because each banker settled separately with the Crown. In

³¹ Carlos Morales, *Felipe II*. See also a report in March 1557 (AGS, Estado, leg. 121, fol. 61) that is referenced by Toboso Sánchez, *La deuda pública*, p. 115. The computation of the short-term debt is always an approximate. *Asientos* were not traded in a market and the indebtedness on a particular contract at a particular point of time depends on assumptions about the interest rates and the exchange rates. There is no such thing as “the interest rate”, in today's economies and *a fortiori*, in the fragmented capital market of Castile.

³² Ruiz Martín, 'Un expediente financiero' reports that for the year 1552, redeemable *juros* (47% of all *juros*) were at 7.14% (for a fraction of 47.6%), 5.5% (5.2%), 5% (30%). The remaining 16% paid other rates.

³³ Ulloa, *La Hacienda Real*.

the current state of knowledge, it is doubtful that the first payment stop of Philip II generated any default on the *asientos*.

When Philip II returned from Flanders to Castile for the first time as king on 8 September 1559, he intended to bring the finances of the Crown in order. He summoned the Cortes in Toledo and ordered a general review of the budget. The stock of *juros* was 21.7 million ducats with an interest service of 1.5 million³⁴. The debt in *asientos* was 4.5 million³⁵, as the 1557 decree had refinanced only some of the short-term debt. Negotiations would last for the entire year, 1560. On 14 November 1560, the king declared his second suspension of payment (always on the *asientos*). One motivation for this payment stop was probably similar to that of the other two stops in 1575 and 1596, namely, to convince the cities of the “evident necessity” to raise the level of taxation.

Refinancing through funded debt was achieved through the agreement with the 1559-60 Cortes that specified an increase of 37 per cent of the *alcabalas*, effective in 1562. In agreement with the model of the previous section, all *asientos* were converted into *juros*. There was no *Medio General* after the payment stops of 1557-60. After the settlements, which were made separately between individual bankers and the Crown, the signing of new *asientos* resumed rapidly³⁶. From 1562 onwards, *juros de resguardo* on the new *alcabalas* would be used.

The main crisis of the 1573-77 was a pivotal moment for the finances of Philip II. Studies by economic history focus on the negotiations between the Crown and the foreign bankers and do not provide a convincing explanation, as discussed in the introduction. In our view, the center stage should go to the play between the Crown and the cities³⁷.

Following the Dutch revolt in the late 1560s, military expenditures increased rapidly during the early 1570s, both in Flanders and on the sea (battle of Lepanto, 1571). As revenues from the Indies had decreased during this period (Figure 1), the deficit increased. The *encabezamiento* had been fixed, in nominal terms, in 1562. During the

³⁴ Pulido Bueno, *La Corte*, p. 76.

³⁵ Neri, *Uomini d'affari*, p. 83.

³⁶ Some *asientos* were written with non tradable collaterals (*juros de caución*) at 7.14% (14,000 al millar). At the same time, one million of the pre-1560 debt that had been paid in *juros* at 5% in the 1560 decreto, the rate was increased to 7.14%. The episode illustrates that the amount of debt reduction was raised in later negotiations with the bankers. One cannot take the terms of a *Medio General* for an accurate estimation of the actual debt reduction. The gradual conversion of *juros* on the *Casa de la Contratación* into *juros* of higher grade was implemented through contract clauses in new *asientos*. Ulloa, *La Hacienda Real*, p. 763.

³⁷ For the historical descriptions, see reference works Fortea Pérez, *Monarquía y Cortes*; idem '¿Impuestos o servicios?'

1560s, the Crown increased the ordinary revenues through higher rates on existing taxes and through the introduction of new taxes and new regulated monopolies³⁸. Figure 2 illustrates the rise of these revenues. The growth of these revenues stopped in the early 1570s for two reasons. First, there were just so many opportunities for an increase of the tax base or of the existing rates. Second most of these revenues were related to trade and that activity suffered after the beginning of the Dutch revolt. In any case, all these ordinary revenues were farmed out and could not support the "AAA" rating of the juros that were funded by the encabezamientos, which had not been modified since 1562.

Everyone could envision the service of the debt absorbing most of the Crown's ordinary revenues (Figure 2). As juros were issued against revenues from cities, the local constraints on these revenues were biting in some cities, for example in Burgos or in Murcia (Figure 3).

Following the model described in the previous section, the situation called for an increase of tax revenues for the funding of the public debt, and therefore the meetings of the Cortes. The crisis developed in two phases. In the first, from 1573 to 1575, the Crown attempted to get an increase of revenues from the cities. When that process failed, the Crown promulgated through the *Decreto*, in September 1575, a stop on the short-term debt payments, and conducted negotiations on two fronts with the cities and the bankers. That second phase lasted until the final settlement first with the cities at the end of November 1577, and immediately after with the bankers in the *Medio General*³⁹. The crisis began in April 1573, when Philip II summoned the Cortes and, as in previous negotiations in 1559, proposed a 30-year plan to get rid of the public debt (*desempeño*)⁴⁰: higher taxes would generate a surplus for 20 years and, for the last ten years, the burden would be reduced to finish off the remaining debt. Initially, the cities accepted the plan's general idea; however they continued to negotiate through the Cortes. No stable agreement could be achieved without the formal approval of all the cities.

While negotiations dragged on, Philip II tried his second plan in December 1573: a new flour tax would be created that would be applicable without exemption. The emphasis

³⁸ In 1559, the customs tax base was extended. The import tax rate from the Americas was raised in 1566. Additional tax on wool exports were introduced in 1558 and 1566. After 1564, a regulated monopoly was introduced to increase the revenues from the salt tax up to 0.2 million ducats (1/6 of the *alcabalas*). In 1563, another monopoly was introduced on the production of mercury.

³⁹ Lovett, 'The Castilian Bankruptcy', idem 'The General Settlement'.

⁴⁰ Fortea Pérez, *Monarquía y Cortes*, p. 45.

was on an equal share throughout the Spanish realm of the increased tax burden. The flour tax, even at a small rate, would have provided a huge extension of the tax base⁴¹ and was strongly resisted by the cities. Indeed, the cities insisted on a commitment to a permanent reduction of taxation in the future and to a stop on the sales of offices⁴². The Cortes was suspended at the end of 1573 to enable the delegates to return to their cities for consultation. Heated discussions delayed the resumption of the Cortes until June 1574.

Each delegate came back with special *ad hoc* demands, much like the “pork” in the current US Congress. There was a further complication in that the taxation of the clergy required a papal decree. During the summer of 1574, other issues were discussed such as the formal transfer of the *juros* in quotas to the cities, which would then be free to choose how to service or redeem it, or the sharing of the tax burden between the cities. The cities were particularly concerned with the unfunded debt of the *asientos* and the role of the Genoese bankers⁴³. The strong popular sentiment against *asentistas*, similar to the reaction today against finance, was used in the following year by Philip II in his *decreto* of payment suspension to the bankers. Unable to find a compromise, the Crown took a different strategy.

The Crown now abandoned the pretense of the *desempeño*, although the cities continued to insist on it⁴⁴, and invoked instead the large increase in expenditures, and the imbalance between the *encabezamiento* at its level of 1562 compared to the increase of other tax revenues. During these protracted negotiations, the gap between the ordinary revenues and the service had continued to close.

On 20 September 1574, Philip II simply tripled the *encabezamiento general* from 1.2 to 3.7 million⁴⁵. The procedure was extraordinary in its timing and in the amount of the increase. All the previous levels of the *encabezamientos* in 1536, 1547, 1552 and 1562 had been determined during meetings with the Cortes. Without the agreement of the cities, the tax would could not have been expected to be stable. Legally, it was just

⁴¹ The tax could have yielded between three and four million ducats. Ibid., footnote 7.

⁴² Furthermore, they were skeptical regarding the Crown’s commitment to a budget surplus – a claim no more credible in the 16th century than it would be in the 21th.

⁴³ The city of Salamanca instructed its delegates to reject the redemption plan unless a commitment was made to throw out of the kingdom all foreigners who dealt with *asientos*. Fortea Pérez, *Monarquía y Cortes*, p. 62.

⁴⁴ Ibid., p. 73.

⁴⁵ It was expected that a large part of the increase would be an extension of the tax base to bread, wine, fruits and agricultural products that had been exempted de facto so far, and that would now be taxed at about 4 %. Ibid., p. 71.

another extraordinary levy. Despite the effort of Philip II to employ a special task force of “administrators, tax-farmers and public inspectors”⁴⁶, it is doubtful that the decree of 1574 was actually collected⁴⁷. Why Philip II insisted on such a large increase is not clear. Obviously, a smaller increase would have provided sufficient room for larger debt service - as was the case for another ten years after the final settlement of 1577. The crisis of 1575 was not a liquidity crisis and could have been avoided but the Crown was in a power play with the cities.

Philip II signed the *Decreto* that put a stop on payments to the Genoese bankers on 1 September 1575. There had been discussions of the plan before but the exact date may have been chosen to shortly follow the arrival of the fleet⁴⁸ that came in on 11 August 1575. During 1574, new *asientos* were issued to an amount of 6.219 million ducats, close to the record level of 1572 (6.248 million ducats). That total included 2.658 million ducats to be paid in Flanders, about 3 million ducats in Castile and the rest in Italy⁴⁹.

The year 1575 was critical. A complete list of all the *asientos* signed between January and the payment stop is presented in Table 2. For the eight months before the suspension on 1 September 1575, Genoese bankers signed new *asientos* for 4.8 million ducats, the highest amount within such an interval of time. Between March and July, Nicolao de Grimaldo made the most important loans, by far, for a total amount of 1.9 million ducats. The first one (1.3 million ducats) provided for disbursements during 1575 and repayments by the king during the same year in three tranches after each *cuatrimestre* (37.5 per cent for each of the first two). The short term of that loan shows that Grimaldo was prudent. All bankers must have been cognizant of the financial situation of the Crown. As moneyed men, they had close ties with the government in Castile. Some may even have participated in financial committees of the government. The king had tripled the *alcabalas*. The cities would resist the increase, but the bankers were confident that the base for higher taxes was there. *Asientos* for almost a million ducats were written during spring 1575 on the promise for higher *alcabalas* in 1575 and after. The situation is easy to picture in the context of the current (2010-11) financial

⁴⁶ Jago, 'Philip II and the Cortes', p. 31. Hernández Esteve, *Establecimiento de la partida doble*.

⁴⁷ Thompson, 'Castile: Polity, Fiscality' claims that revenues could even have decreased, in reaction to the tax jump. See also working paper and data in web page.

⁴⁸ Revenues from the Indies in 1575 were 0.9 million ducats, about half more than the average in the previous three years.

⁴⁹ AGS, Contadurías Generales, leg. 86.

crises in lending to Greece. The bankers knew that the situation was risky but they would not have made these record loans in spring 1575 if they had anticipated the suspension in September.

After Philip II had given through the *Decreto* in September, a clear signal both of his need for more revenues and of his toughness towards resented *asentistas*, he called again the *Cortes* to begin negotiations in November. The business of the *Cortes* was to readjust three types of taxes, the *encabezamiento* of *alcabalas*, the ordinary and the extraordinary service. The usual sequence was to grant first the ordinary and the extraordinary service, and then to bargain on the *encabezamiento*, which was the main item. This time however, the *Cortes*, in order to increase their bargaining power, reversed the order and requested first a reduction of the 1574 decree (that had tripled the *encabezamiento*), before voting on the two services. Cities were fired by bitter feelings against the bankers and these cities rejected the higher taxes – taxes which were perceived as bankers' profits, the more so because of the lack of information⁵⁰.

Negotiations were very slow. An important issue is why Philip II did follow the facile advice of impatient aides to use force. We think that he had at least two motivations. First, he knew that he had to play a political game with the cities that represented the realm and that the game was likely to be repeated. Second, Philip II was rational and he probably anticipated the eventual consequences of the payment stop on the credit market and the trading activities of the cities. We discuss briefly this issue at the end of the paper.

It took almost a year, until August 1576, to agree on the agenda that the negotiation on the *encabezamiento* would take place between the granting of the *servicio ordinario* and the discussion on the *servicio extraordinario*. That negotiation took more than another year, until 29 October 1577. In previous adjustments of the *encabezamiento*, increases had been roughly proportional across cities. For the contract of 1577, however, the shares of some cities jumped up: Sevilla from 10.2 per cent in 1557 to 17.5 per cent in 1577, Toledo from 5.8 to 7.6 per cent. Grenada's share dropped from 9.2 to 5 per cent⁵¹. After the parties had finally come to an agreement on the *encabezamiento*, the voting on the *servicio extraordinario* was sped up and an agreement was reached in the following month.

⁵⁰ Fortea Pérez, *Monarquía y Cortes*.

⁵¹ Zabala Aguirre, *Las alcabalas*, chapter 2 and especially table 9, p. 64.

For the Crown and also the bankers, the payment stop did not mean that the debt would not be paid. Before the end of the year, the Crown set the principle that all debt would be paid at 12 per cent. The issue was which debt? The recent literature has emphasized the role of bankruptcy as the outcome of an efficient loan contract that saves the cost of information that must be acquired by the lender⁵². In 1575, one could argue that the need for more information was on the side of the borrower, Philip II. A simple theoretical model cannot capture the complexity of the network of *asientos* and their related side contracts. Because of these intertwined side-contracts, especially on the collaterals, there was a dire need for a review of all the contracts. That review had to be comprehensive because of the inter-connections between loans and collaterals in *juros*, and in order to achieve an orderly swap of the entire short-term *asientos* into the long-term *juros*.

The sales of the collateral (*juros de resguardo*) by the bankers, their returns with *juros* of a possibly different type created a confusing situation in which the liabilities of both parties would be difficult to determine. This justified the Crown's claim to review all the *asientos*. The Crown set very soon the principle that it would pay all its debt to the bankers. The issue was obviously the amount of the debt. A commission reviewed all the *asientos* signed since 14 November 1560: 296 contracts with 66 people (Nicolao de Grimaldo 35, Lucian Centurion 34, Lorenzo Spinola 32, and so on). The balance of each active *asiento* was bringing past payments to the current date with an interest rate of 12 per cent, the rate that was standard in the terms of the contracts⁵³.

The Crown and the bankers soon agreed on the amount of 15.2 million ducats, as stated in the final settlement. The larger part of the debt was not in unpaid arrears, but in repayments that were contractually scheduled for the future. We have examined all the *asientos* that were initiated between 1570 and 1575 (and some before 1570), and extracted those that specify contracts after 1575. The total amount of the payments scheduled after 1575 exceeded 12 million ducats. Given the average maturity of these remaining liabilities, an approximate estimate of the present value of the scheduled repayments is about 10 million ducats. Arrears would then represent about 5 million ducats⁵⁴.

⁵² Townsend, 'Optimal Contracts'.

⁵³ Carlos Morales, *Felipe II*, p. 164.

⁵⁴ The existence of arrears is also confirmed by the terms of some *asientos* signed before 1575 that included clauses for the payments of arrears.

The terms of the final settlement between the Crown and the bankers had been set in March 1577, but the signing of the settlement had to wait, with no significant change, until the end of the negotiations in the *Cortes* which took most of the rest of the year. The *Medio General*, was signed on 5 December 1577, immediately after the Crown had concluded its negotiations with the Cortes.

The long delay between the agreement with the bankers in March 1577 and the signature in December after the closing the *Cortes* is additional evidence that the difficult agreement between the Crown and the cities was the major cause of the payment stop. Why did the *Cortes* eventually settle? The issue may be one of the most fascinating in that episode.

We have seen that a large fraction of the *asientos* was internal to Castile⁵⁵. As the moneyed men in eighteenth century England, the Rothschild with Napoleon, or modern bankers, the main role of Genoese bankers was to underwrite loans, and not to lend on their own funds. The funds for the *asientos* that were disbursed in Castile came from Castile. Some *asientos* specify their interest rate that depends on the interest rate in the commercial market between the trade fairs that took place at specific locations and time intervals. The payment stop on the *asientos* froze the deposits of the commercial traders and the commercial credit market in Castile.

The *Decreto* that stopped the payments on the *asientos* put also a stop on the main fairs, at Medina del Campo. None could be held until the Cortes had come to an agreement. They eventually resumed, in 1578, but they had lost their preeminence in the network of commercial fairs and never regained it. Philip II did not have to use force. The "patient king" had only to wait until the credit squeeze would bring the cities to the agreement. The debt of 15.2 million ducats was divided into two parts: 10.4 and 4.8 million ducats, respectively⁵⁶.

1. The first part, 10.4 million ducats, corresponded to *juros*: 8 million ducats were paid by *juros de resguardo* that had been written at 7.14 per cent and were reduced to 5 per cent. The remaining 2.4 million ducats corresponded to *juros* written on the *Casa de la Contratación* and were accounted for at their market value, 55 per cent of the face value.

⁵⁵ For the year 1574, about half of the *asientos* were internal to Castile. That ratio is about 35 % in 1575. Some *asientos* were disbursed in Castile and abroad with unspecified ratios.

⁵⁶ We use rounded numbers. The *Medio General* specified exact numbers that can be found in the literature (Carlos Morales, *Felipe II*). Here, the exact amount is 15,184,464 ducats.

2. The second part of the debt, 4.8 million ducats, was divided into two parts. Two-thirds were paid by *juros* on salt at the rate of 3.3 per cent (30,000 *al millar*) and the other third by *vasallos* and *jurisdicciones* from the Church, granted by the Pope Gregorio XIII to the Spanish Crown in the bull April 6, 1574. The value of these effects was estimated between 6.5 and 2.35 per cent (16,000 and 42,500 *al millar*) depending where they were situated in Castile.

We now analyze in more detail each part of the settlement. As shown in the description of the *juros*, the reduction of the interest rate from 7 to 5 per cent could not be a default, contrary to previous literature that was cited in the introduction. As emphasized previously, the reference to a unique interest rate would be a-historical because of the fragmented credit market. Second, the reduction of the interest on old *juros* through the *crecimiento* implied necessarily the coexistence of *juros* with different interest rates, that had different expectations to redemption and were arbitrated by the market. The real criterion about the interest rate on *juros* is the marketability of new *juros*. Ruiz Martín had provided some evidence of *juros* at 5 per cent that traded during the period of 1570 to 1575 for 17,000 *al millar*⁵⁷, which is equivalent to a rate of 5.88 per cent. In the archives of Simancas, there are numerous documents that show sales of *juros* at 5 per cent, or even lower (see below), throughout the 1570s⁵⁸.

After the signing of the *Medio General*, the Crown issued a number of orders to specify the details of the payments. Under some special provisions bankers could be in charge of applying the *crecimiento* to some *juros* and to recover the proceeding in reimbursement for *asientos*.

On the second part of the debt (4.8 million ducats), the terms of the *Medio General* do not enable us to have a precise evaluation of the terms of the settlement. The rate of the *juros* written on the salt farm was equal to 3.33 per cent (30,000 *al millar*). There is some indication that the “market rate” of such *juros* was below 5 per cent, but this issue remains to be researched in the archives. When we apply the same discount to the other third of the debt of 4.8 million ducats, the upper-bound of the haircut of the 1575 short-term debt is equal to 1.6 million, that is, 11 per cent of the total.

In 1588, the disaster of the Great Armada in the summer of 1588 was for all to see, without asymmetric information on the revenue needs of the Crown, as mentioned in the account of the 1589 Cortes. Although the debt service was much below ordinary

⁵⁷ Ruiz Martín, 'Las finanzas españolas'.

⁵⁸ For more details, see working paper and data in web page.

revenues (Figure 2), the cities quickly granted a special tax. It was levied like the *alcabalas* under the *encabezamiento*, but the cities insisted on the specific purpose of the tax, which was given a different name, the *servicio de Millones*, and the payment was limited to the one-time loss of the fleet for a term of six years.

When the *Millones* ended in 1596, as scheduled, the service of the long-term debt, which had gradually increased since the previous settlement, had reached the level of the funding revenues (Figure 2). The Crown first attempted to renew the *Millones*, under a different name, the *cuentos*⁵⁹. After no majority agreement could be reached in the *Cortes*, the government abandoned the project, leaving its implementation to the next king, Philip III.

As in the previous crisis of 1575, the crisis of 1596 was not caused by a liquidity problem but by the refusal of the cities to raise the taxes that imposed a ceiling on the domestic debt⁶⁰. If the ratio between the service of the long-term debt and the funding revenues had been the same as in the early 1590s, no crisis would have occurred.

The decree was published 29 November 1596⁶¹, to the surprise of the *asentistas* and the satisfaction of the cities. The total debt recognized by the king was 7 million ducats⁶². Contrary to 1575, the stop was not used as a device to increase ordinary revenues. Economic activity had stopped growing since the 1580s, thus explaining the stationary ordinary revenues (Figure 1). The Crown and the *Cortes* probably felt that higher domestic taxation would be difficult to enforce. On the other hand, interest rates on *juros* had decreased since the previous financial crisis. The conversion of *asientos* in *juros* was achieved by a combination of interest reduction and issuance of *juros* on some available ordinary revenues that were less stable⁶³. For the interest reduction not to be a partial default, but an exercise of the redeemable option by the government, individuals had the choice between the par value of old *juros* in cash and new *juros*.

V

The fiscal system of Philip II was much more ingenious than described so far in the literature. We have attempted to show how it was adapted to the constraints of its time

⁵⁹ Fortea Pérez, *Monarquía y Cortes*.

⁶⁰ The short-fall of the *Millones* (1.33 million ducats) was compensated by the high silver revenues, 6.2 million and 3.5 million ducats in 1595 and 1596, compared to an average of 1,225 million for 1591-94 (Figure 1).

⁶¹ Ulloa, *La Hacienda Real*, p. 820.

⁶² 7 million for Sanz Ayán, 'Procedimientos', and 7,831,251 for Castillo Pintado, 'Los juros'.

⁶³ For details, see working paper and data in web page.

and that its evaluation according to the standards of 21th century economies can lead to serious misinterpretations. The main achievement of the government of Philip II was to mobilize large financial resources through the transformation of his apparent weakness in fragmented political and market institutions into a strength for the build up of a domestic public debt of a modern magnitude.

The payment stops of Philip II were not caused by liquidity problems but were part of the overall efficiency of the system. Thompson, who is an exception in the literature, was the first to express that point of view⁶⁴. To apply the expression “serial defaulter” to Philip II is a deception. Although the issue of debt reduction is not the main one in this paper, we actually doubt that the payments stops were followed by significant debt reductions. Preliminary evidence about the actual dealings between the government (*Tesoro General*) and the bankers shows that what seemed like debt reductions may actually have been transactions at prices closed to the market. Many issues in the finances of Castile under Philip II, large and small, remained to be examined. For this task, the archives in Simancas contain a large amount of information.

In future work, the fiscal system of Philip II should also be considered from the point of view of the history of political institutions. Our point of view converges with recent reinterpretations by historians about the political system of Castile, which emphasize more than before the high degree of autonomy of the cities.

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⁶⁴ "This very periodicity [of fiscal crisis] suggests that rather than the manifestation of 'crisis' these 'bankruptcies' were an integral part of the financial system of the Monarchy. The term 'bankruptcy' can be misleading" (Thompson, 'Castile: Polity, Fiscality', p. 160).

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Table 1: Types of revenues

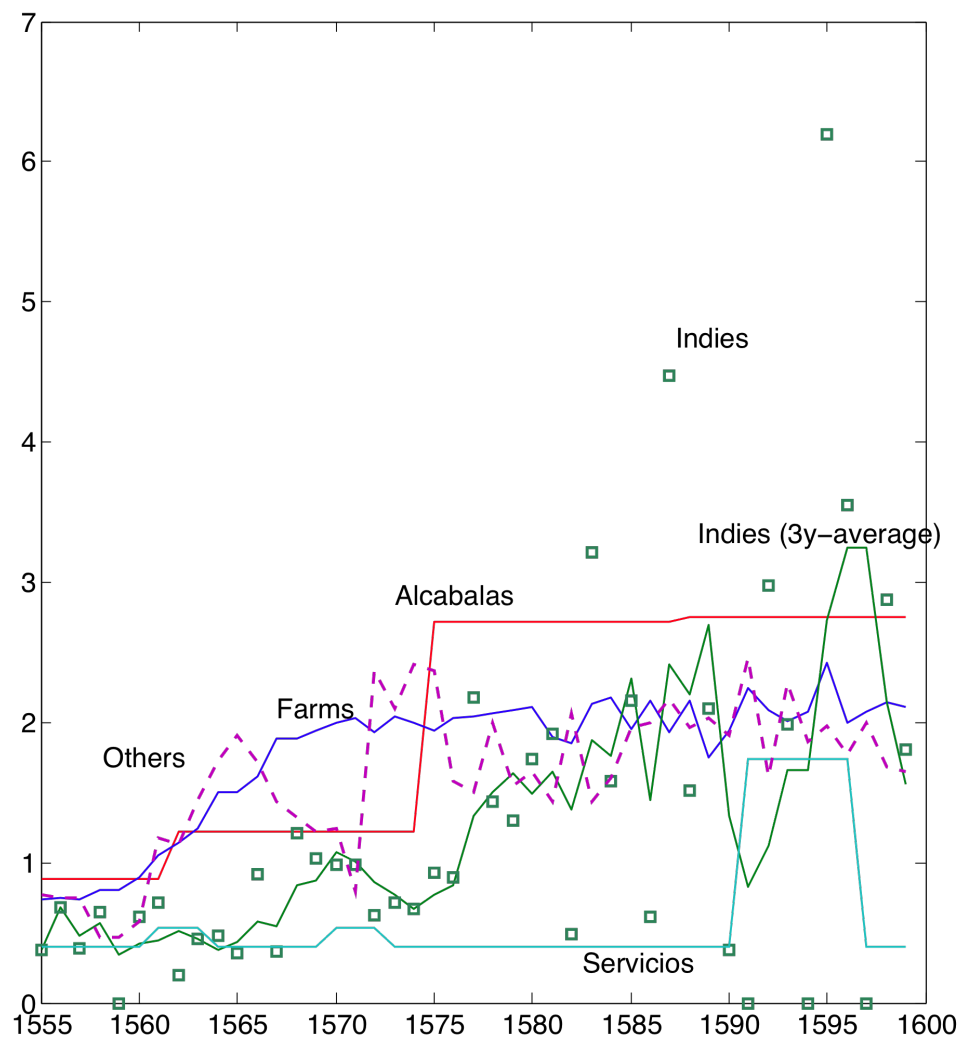
	Ordinary	Share	Extraordinary	Share
Cortes	Fixed contributions (<i>alcabalas, servicios</i>)	27%	Temporary contributions	8%
Non Cortes	Taxes set by the Crown	24%	Other revenues	22%
			Silver from the Indies	19%

Shares of revenues varied over time. The table presents averages for the entire tenure of Philip II (1556-1598). Temporary contributions include *servicio ordinario* and *extraordinario* and the *millones* (which were in place only between 1591 and 1596). Other revenues include "arbitrios" and Church revenues (on average 17 per cent). Negotiations in the Cortes were on the two items of the first line in the table.

	Date	Bankers	Ducats	Disbursement	Repayment
1	08/01/1575	Esteban Lomelin	859	Madrid (feria, october 1574)	In the same ferias, in Sevilla, the banco of Pedro de Morga, sales of titles (villas), fleet of 1576...
2	09/01/1575	Juan and Pablo Sauri	68	Spanish galleys	
3	09/01/1575	Lucian Centurion and Agustin Spinola	79	Madrid	Sales of offices, some in 1576
4	01/02/1575	Fucar		mercury	Fleet in 1575, 76 y 77
5	02/02/1575	Bernabé Centurion	103	Italy and Madrid	Increase of alcabalas
6	02/02/1575	Simon Lercaro	61	Milán	Increase of alcabalas, thirds 2 and 3 in 1575
7	14/02/1575	Juan de Curiel de la Torre	536	Cartagena and Madrid (ferias in 1574)	Feria of Augustt in Besançon and Chambery
8	28/02/1575	Esteban Lercaro and Pablo Sauri	78	Spanish galleys	Increase of alcabalas 1575
9	01/03/1575	Nicolas de Grimaldo	1.077	Flanders and Italy	Alcabalas in 1575 (first and second: 168.750.000 mrs) 3 tercio 112.500.000 mrs
10	02/03/1575	Nicolas de Grimaldo	222	Sicily (Palermo or Messina)	Alcabalas in 1575, 2 y 3 tercio, half for each third of 46.875.000 mrs
11	04/03/1575	Esteban Grillo	104	Madrid	Increase of alcabalas 1576
12	04/03/1575	Esteban Grillo	17	Flanders	Increase of alcabalas 1576
13	05/03/1575	Lorenzo Lomelín (Nicolao y Agustin Lomelin)	107	4 galleys and Besançon	Alcabalas in 1576 and others
14	14/03/1575	Esteban Grillo	133	Flanders	Increase of alcabalas
15	19/03/1575	Licenciado Miguel de Mena	57	Madrid (feria october 1574)	
16	19/03/1575	Alonso de Salinas, (citizens of Burgos)	323	Flanders	Increase of alcabalas
17	03/1575	Antonio Fucar y sobrinos	9	Germany	Letters of credit in Germany and Madrid
18	04/04/1575	Nicolas de Grimaldo	40	Partly reiumbursement of a loan for galleys	Increase of alcabalas
19	11/04/1575	Juan Curiel de la Torre	212	Besançon y Madrid	Increase of alcabalas 1576
20	19/04/1575	Nicolas de Grimaldo	465	Flandes y otros banqueros Madrid	Alcabalas 1575
21	14/05/1575	Nicolas de Grimaldo	154	Madrid (50) and Genoa	Different persons and increase of alcabalas 1576
22	25/05/1575	Esteban Lercaro and Pablo Sauri	48	Spanish galleys	Increase of alcabalas 1576
23	14/06/1575	Esteban Lercaro	16	Madrid (feria October 1574)	Increase of alcabalas 1576
24	08/07/1575	Juan Curiel de la Torre	587	Flanders	Fleet, alcabalas 1576, and others
25	23/07/1575	Nicolas de Grimaldo	107	Flanders	Fleet 1575

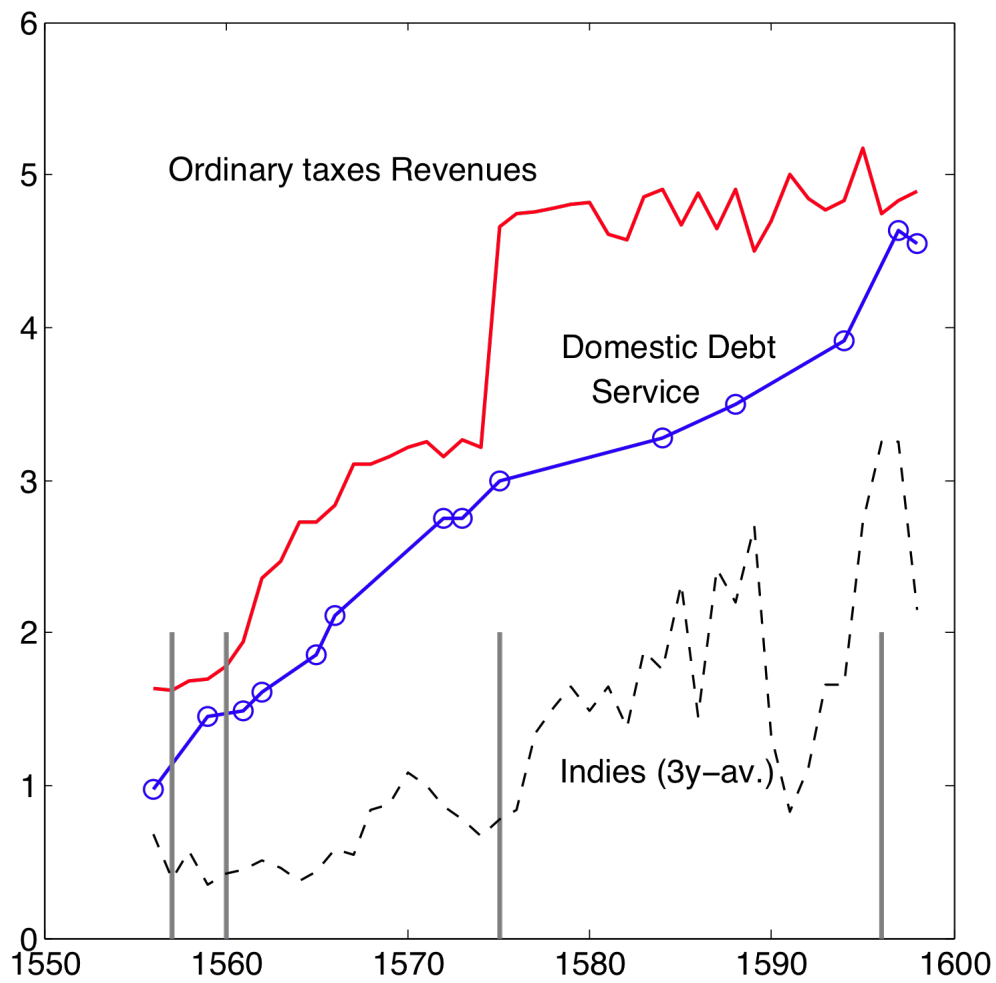
Table 2: Asientos issued in 1575

The total of the *asientos* is of 5,382.455 ducats. One ducat is equal to 375 maravedis (mrs). The *asientos* that specified bankers' payments in kind (galleys, mercury, with a total of about 560,000 ducats) are included.



Direct revenues from customs and monopolies are put together under “Farms”. Note that high variability of the revenues from the Indies that are represented in actual numbers by points and in a 3-year moving average by a curve. The *Millones* are included in the servicios-for the years 1591-1596. Amounts are in million ducats (nominal).

Figure 1: Revenues



The amounts of the debt service are collected from different sources in the years that are represented by circles. The dates of the payment stops are marked by vertical lines.

Figure 2: Debt service and ordinary taxes (in million ducats)

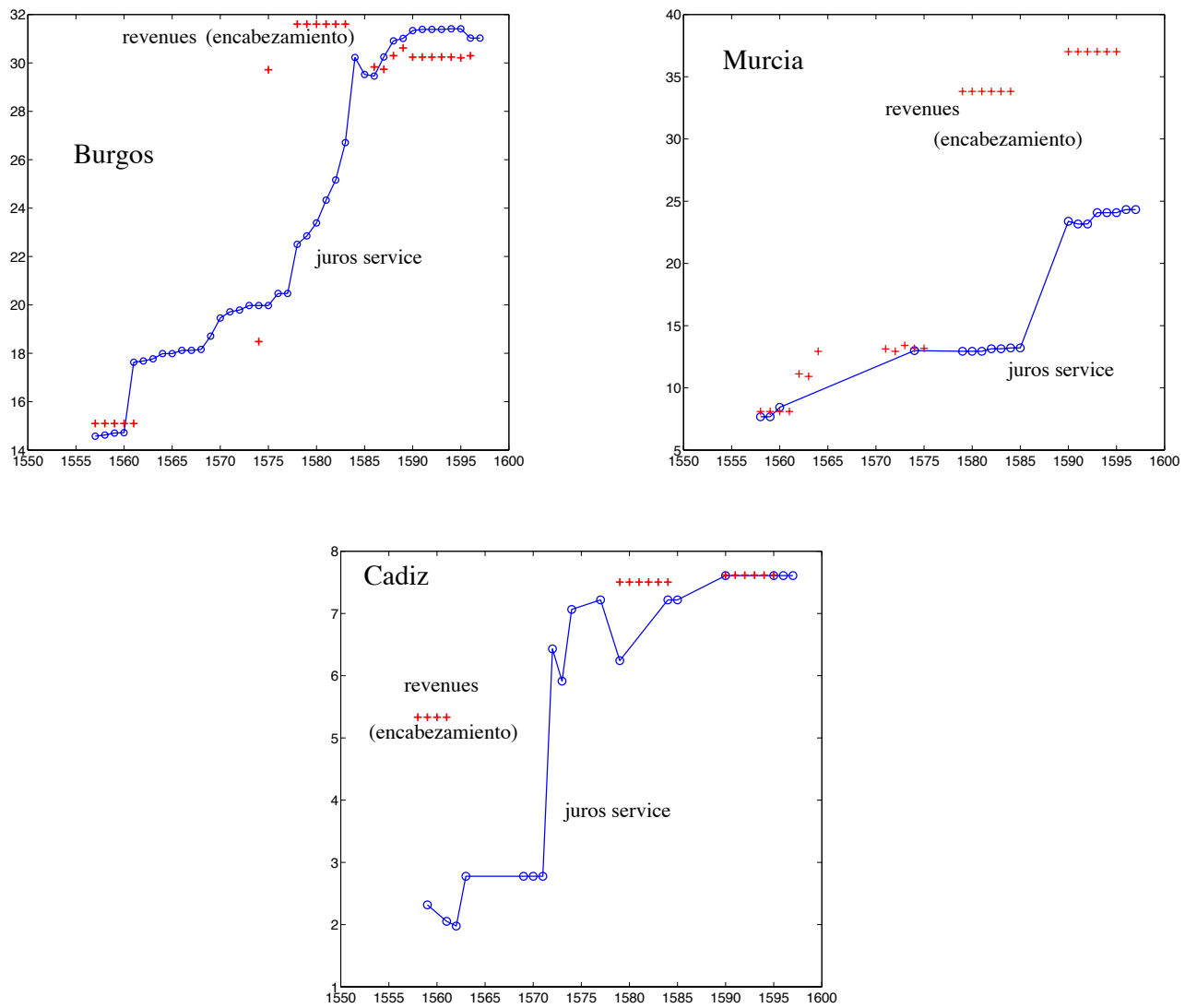
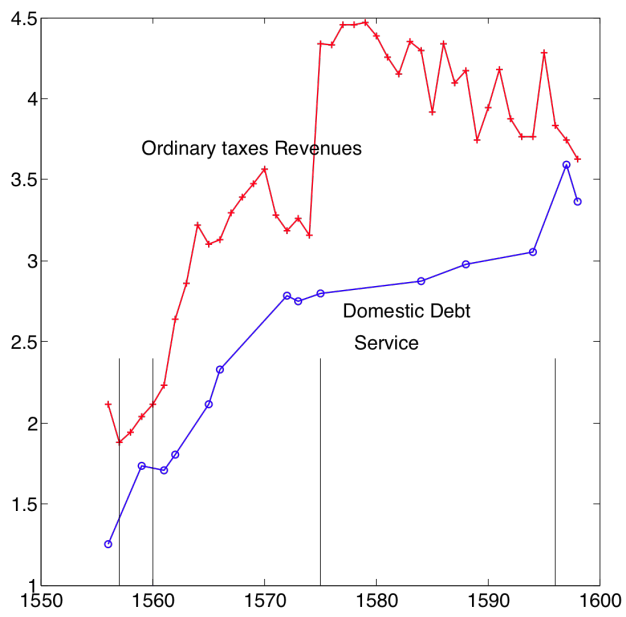
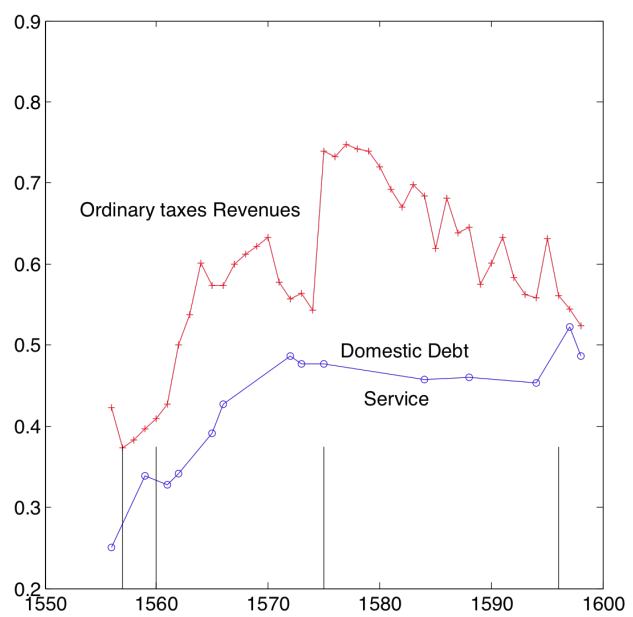


Figure 3: Service of juro and funding taxes (encabezamientos) for Burgos, the region of Murcia and Cadiz (in thousands of ducats)

Sources: Juros service: AHN, Consejos Juros, leg. 1777. Encabezado: Pilar Zabala and AGS, Contaduría Mayor de Cuentas 2º época, leg. 173.



(Real: deflated in M 1570 ducats)



(Real per capita)

Figure 4: Debt service and ordinary taxes (deflated and per capita)