Checks and Balances in the ancien regime: tax farming, venal offices, and the outsourcing of public administration

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Abstract:

Tax farming has typically been explained as a mechanism for information revelation and control of agents. Tax farming does control agency problems, but those are problems of sovereign commitment. Tax farming served to limit the sovereign's ability to raise taxes without the cooperation of his creditors. By giving his creditors a veto power over fiscal and administrative decisions, the sovereign could greatly expand his borrowing power as well as induce investment in fixed capital. Administrative outsourcing thus served the same purpose as the creation of legislative bodies but functioned differently with different long-term effects. In particular, in order for administrative outsourcing to work, the administrative apparatus had to be organized into separate non-overlapping bodies in order to preserve the barriers to entry that induced reliance. Such compartmentalization impeded the dissemination of information about asset prices, best practices, and discouraged productive and procedural innovation.

Administrative non-transparency of the kind that prevailed in Ancien Régime France and continues in contemporary corporatist economies has its benefits as well as its costs. In this paper, I explore the various tradeoffs to non-transparency.
I. Introduction

Recent experience in transition economies and the collapse of the old development paradigm have coincided with a greater appreciation of the institutional prerequisites necessary for growth. Much of the current work in development is closely related to, and indeed dependent upon new understandings of the historical bases of growth in Western Europe.\(^1\) The favorite object of study is England, which by the eighteenth century had developed those institutions which were to lead to "self-sustained" growth. They correspond to a climate which we would call one of low "political risk".\(^2\) In particular, the property rights regime was stable, the risk of expropriation or radical changes in the regulatory environment were minimal. Matters of fiscal policy were open to public debate, and much of the state's expenditure was funded through a hierarchical system of professional managers and through a consolidated public debt, governed by a central treasury.\(^3\) That debt as well as the debt of other hierarchically managed organizations was freely traded on an active and fairly liquid market. It is not accidental that the security of government debt instruments coincided with that of private investment outlays, for both are dependent on the state's not reneging on obligations both to repay contracted debt and on promises not to seize investment in fixed capital once invested, either outright or by refusal to enforce contracts. It is often instructive to view all capital as a liability of the government, because it is subject to political risk. This is generally agreed upon.

What has received less attention is the close relation between the industrial organization of the economy both in the private and public sectors and the system of public finance. The existence of large-scale hierarchically organized institutions, both private and public, which allow for increases in economies of scale and scope, with centralized and standardized information gathering and processing, and professional, salaried managers is made possible only by the credibility of the sovereign.\(^4\)

The success of the British system has been attributed to the existence of a single corporate body, comprised of members who were representative of the broader commercial and property owning groups,

\(^1\) Most influential have been North [1981] and North and Thomas [1973].
\(^2\) North and Weingast [1989] and Weingast [1993].
\(^3\) Dickson [1967]
\(^4\) My discussion of hierarchies is based on Chandler [1977] and Williamson [1975].
which had effective monopoly control over access to the credit which constituted the sinews of the state.  

The difficulties encountered in maintaining corporate solidarity, have been chronicled by many historians.  The main problem encountered in maintaining that solidarity was in preventing the defection of some subgroup, which could provide resources to the crown, enabling it to ignore the sanction of parliament.

In contrast, France presents us with a set of institutions which on the face are very different. The economic organization of the ancien regime economy, which does not allow us to make the distinction as readily between public and private sectors, has been the frequent object of historical inquiry, and despite of the lack of archival materials, relative to England, its workings have received extensive treatment. It is rare however for any student of the French fisc to come away from his or her study without a belief that the system was inferior to the British both in terms of extractive ability, coherence, and accountability, especially in light of their respective fates.

Older explanations of English superiority in the Whiggish tradition emphasized the weakness of the English state. The state was argued was under-funded, indecisive and unable to control its agents. Thus, taxation and regulation of the private sector was impeded and the market was allowed to flourish. This tradition lives on in the public choice literature. Ekelund and Tollison in a still influential book, argued that the cost of rent seeking was higher in Britain because the fragmentation of government enforcement made agreements with the government less likely to be honored. They contrast that situation with the French where a strong centralized monarch was able to enforce grants of privilege effectively, lowering the cost of rent-seeking. The strength of the monarchical institutions was responsible for the inefficient industrial organization of corporate groups and monopolies.

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1The importance of representative bodies is stressed by Barzel [1991] and Bates and Lien [1985]. A similar argument is made by Allen [1993]: Corporations engaged in activities whose productivity is relatively easy to measure do not require the kind of information that diversified ownership can bring. Similarly, since evaluation of input is relatively easy, outsourcing substantial elements of production is not problematic. In comparing the Japanese and American organizational forms, Allen takes the technologies appropriate for each of the economies as exogenous.

2Ekelund and Tollison [1981]
There exists an alternate literature which accepts the relative strength of the French monarch and weakness of the English one, but which argues that that ought to result in a more efficient set of property rights in the autocracy. In general, if the state is non-autonomous and must coexist with powerful interest groups, it has no incentive to implement efficient property rights. If, however, the state is autonomous, and is in fact a predatory ruler, with a residual claim on the productive assets of the economy, he has every incentive (but not necessarily the ability) to maximize production by instituting efficient property rights.\footnote{Mancur Olson has made this point in a number of talks based in part on insights drawn from Peltzman [1976] and Becker [1983].}

In recent years, that conundrum has been overcome as the Whiggish history of British minimalism versus French absolutism has been more or less replaced by a realization that the market institutions praised by the Whigs were a product of the strength of British state institutions.\footnote{See especially North [1981].} The level of British taxes was higher and the penetration of the tax bureaucracy more complete.\footnote{See Ertman [1993] for an overview. The distinction has been made between the centralization of decision making and the penetration of centralized institutions has been made by Michael Mann [1986].} Belief in the discretion claimed by the French monarch has been replaced by an appreciation of the rules to which he was subject. By the eighteenth century, self-enforcing contracts with multiple corporate bodies had restricted the discretion of the king to the point were there were virtually no general defaults after Law’s system and none of the chambres de justice which had plagued the financiers in earlier centuries. Indeed the rules were so confining that the king was ultimately deprived of the financial means to continue and driven to calling the Estates-General which ultimately sealed his fate. Those rules and inescapable obligations, which together constituted a French fiscal constitution, deserve analysis, not just criticism, and the interesting question concerns not its ultimate failure but is persistent success. Aware of the story’s end we sometimes view that which preceded it as disequilibrium. Yet most of its general features, or at least the ones that distinguished it from the English model were remarkably persistent. More work needs to be done to show why the ancien regime system of public finance constituted an equilibrium. Or as the joke has it, "When we economists see something working in practice, we should wonder whether it will work in theory."
II. Problems

In general, the features that require an explanation because they are seen as inferior are:

1. French tax collection, debt management, and the provision of many public services was contractually outsourced to various individuals and corporate bodies, through the system of farming, used primarily for indirect taxes, venality of offices, used primarily for direct taxation, and the sale of monopoly privileges and exemptions.

2. Public debt was not consolidated into a single set of instruments, underwritten and made liquid by a single body and traded freely in the market, but rather consisted of direct claims on those intermediaries mentioned above, (billets de fermes, rescriptions, assignations, and rentes on the various corporate bodies), who in turn invested their capital in the price of their offices or privileges or in the form of security deposits or anticipations of tax revenues. The liquidity of these claims was limited.

3. Secrecy pervaded the system. Much has been made of the king keeping his budget secret from the public. Less noted is that the workings of much of the fiscal apparatus was kept secret from the king. The revenues and expenses generated by the treasury and by all of the corporate bodies and officials were kept confidential and were not known with any great precision except to the person or body who owned the caisse. The mingling of private and public funds and the lack of accountability was seen as giving rise to widespread corruption.

These features are often examined in individually, but it is impossible to make sense of these features in isolation. In this paper, I would like to point out some lines of inquiry which I believe have not been adequately addressed, and which I hope will shed new light on those features mentioned above. This paper comes out of work done on a formal model, and so will seem highly stylized. I will focus the bulk of my attention on the first part, the outsourcing of fiscal administration, which I will for convenience

10 Bien [1973] and Bosher [1970] are the most forceful advocates of this position.
11 Ardant [1975:169] stresses the difficulty in examining these features in isolation.
call "localized discretion" examining explanations for its existence. Implications about the liquidity of financial markets and secrecy will be implicit in the analysis.

III. Path dependence:

In general there are two levels at which we can seek to explain the characteristics of the equilibrium outcome. We can view them as organizational responses to exogenous constraints or we can in turn examine the constraints as resulting from prior responses. If we work at the second level, we must explain the stickiness of those solutions which give rise to the path dependent outcome. It is not enough to claim that the fiscal constitution of the ancien regime was a product of prior deals without explaining why those deals could not be undone. A question which vexes students of the ancien regime familiar with the Coase theorem is: why couldn't the privileged groups be bought out. Why not just buy up all the offices, refund the deposit on the farms and start anew? Or to put it another way: what prevented the corporate groups from striking deals with one another to rationalize the system or from merging into one comprehensive corporate group?.  It is not enough to point to entrenched interests without explaining their ability to entrench themselves. To paraphrase de Tocqueville, we must ask how a "financial expedient" can "crystallize into an institution". In short, why was the French system virtually “reform proof.” How did the farmers, officeholders and privileged corporate bodies make themselves indispensable to the functioning of the French administrative apparatus?

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12 These sorts of question give rise to the question of the existence of "static inefficiency" See Binger and Hoffman [1989].
13 de Tocqueville [1955: 102].
14 An anecdote that will illustrate the point I wish to make involves reforms attempted in the wake of Philadelphia’s municipal fiscal crisis in 1990. The newly appointed director of Sanitation was instructed to make more efficient the operations of municipal garbage collection. Upon arrival in office, he discovered that there existed no centralized records of the routing of garbage pickup, and no one would tell him what the routing was, making the rationalization of the routing very difficult. A local newspaper broke the story that one region of the city was receiving twice weekly pickup while others had biweekly. It turns out that the region that received twice weekly pickup was the home district of a powerful city councilman back in the 1950’s, long deceased. In order to obtain his approval of an unrelated bill, his district was granted extra pickups, but the only people who were aware
Contemporaries and future commentators alike are not quite sure as to who profited most from the French system of outsourcing. One the one hand, the king is criticized for his lack of foresight or short time horizon. In immediate need of cash, he would periodically alienate future revenue streams in the form of privilege. On the other hand the purchasers of those privileges are criticized for their lack of foresight, in light of the frequency with which the king reneged on his promises of future benefits. It is difficult to know whether the *financiers* and holders of privilege should be vilified or felt sorry for.

Assuming lack of foresight on the part of all the parties to the contracts which made up the *ancien regime* constitution results in an unsatisfactory explanation. It is difficult to believe that lack of foresight could persist for so long. Frequent recourse is made to the lack of foresight of the sovereign. This violates the first rule of positive political economy, rational expectations. If we assume that all parties are aware of the future effects of their current actions, then the institutional responses can be seen as attempts to solve real economic problems.

It is tempting to argue that the entire system was fraught with risk, giving rise to premia which gave no one abnormal returns. It is a mistake I believe to do so. Risk should not be confused with asymmetric information and opportunistic behavior, which at some level can not be overcome through adjustment of price.

In explaining path dependent outcomes, we make frequent reference to the existing stock of capital, especially human capital. It is that existing stock, a form of sunk cost which makes the maintenance of prior institutions a less costly than investment in alternatives. Institutional change can

\footnote{de Tocqueville [1955: 105] was of this opinion: "For the sake of some paltry sums of money the central power deprived itself of the right to supervise efficiently the work of its own agents and to keep them under control."}
\footnote{Riley [1986] characterized the venal officers as "captive...creditors who could be pushed around."}
\footnote{Ardant [1975: 172] notes the ambiguity and the ease with which we could just as easily "draw up a long martyrology" of financiers as a history of their corruption.}
\footnote{Bates [1990].}
\footnote{Akerlof [1972] and Stiglitz and Weiss [1981]}
\footnote{Liebowitz and Margolis [1995].}
result from a shock which dramatically reduces the switching cost by either making the alternative much more lucrative or by wiping out the value of prior capital stock. Such shocks often take the form of revolutions. Alternatively, they may be incremental, resulting from the use of existing capital in ways which are compatible with new institutional forms.

IV. Localized Discretion

Tax farming, venal offices, and the sale of privileges can be seen as variants of a single principle. In exchange for a lump sum or contractually specified set of payments, the purchaser obtains a bundle of rights, either the right to perform some service or to be exempt from the necessity to perform a required service. The rights contractually purchased from the sovereign are property right of the farmer, officier or privilege-holder.

The alternative is for the sovereign to raise revenue through a hierarchical bureaucracy. By the eighteenth century, much of English public administration resembled a hierarchy. For instance, the alternative to farming the excise taxes as did the French monarchs, is to have, as did the English, a hierarchical administration in charge of collecting excise taxes and customs duties. The alternative to selling a monopoly of trade with the east Indies is to tax that trade with salaried bureaucrats or hire employees to trade on the king's behalf.

The distinction is less easy to make in practice as many French office holders received what looked like a salary rather than a residual claim, still others a compensation package which had elements of both. Further, many French officeholders did not appear to perform any public service. The French system would often have salaried commissioners and venal officeholders with competing and overlapping jurisdictions. This was true in the collection of the direct taxes, where the Intendants and the receivers-general both had responsibilities.

To the extent that an administration is hierarchical, the discretion of agents is limited. The returns to their occupation are contractually specified, and they are bound to a set of rules, deviance from which

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Olson [1982].
results in a sanction such as termination of employment. As a result the sort of human capital necessary for the agent to make procedural decisions is low. Discretion is located centrally, and is implemented through the creation and revision of the rules to which the agents are bound. Selecting and enforcing the rules requires a comprehensive system which gathers information about the effects of the rules and standardizes it in a way which permits rational decision making. 22

To the extent that an organization is run in this manner, it is self-regulating and operates like a machine. It has characteristics which allow it to function without the need for repeated interventions in the lower levels of decision making. 23 Consequently, it is more susceptible to political risk. An outsider can take it over without interruption of its activities.

The alternative is to locate discretion in the subsidiary or agent. In tax farming for instance, the farmer has varying degrees of discretion in determining the tax rate, the methods used for assessment and collection, the organization of the production process, method of financing, and the composition of employees specific to his sphere of operation. The farmer may for instance implement a hierarchical bureaucracy reporting to himself, or he may further localize discretion by subfarming, or contractually outsourcing himself. 24

Another method of localizing discretion is to negotiate with groups of taxpayers. Rather than assessing and taxing each individual asset holder or transaction, the sovereign may allow a group in the form of a corporate body to purchase exemption from the tax through the payment of a lump sum. To the extent that the method of payment of that lump sum is determined by the corporate body, discretion is localized. The sovereign knows little about the costs of assessing the tax and the distribution of the burden.

Similarly, if a salaried official is assigned the responsibility of raising a fixed amount of taxes, and there is some discretion in his allocation of the burden, there is less than total hierarchy. In the ancien

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22 See Marglin [1974].
23 Stinchcombe [1990].
24 Much of the analysis concerning the sovereign's choice of organization could be applied to the organization of the farmer himself. These sub-farmers, for instance, may be required to post a bond, to the farmer. Bonney [1979: 23].
regime, the taille was raised in this fashion. Rather than a fixed percentage assessment on land values determined each year, the total amount of the tax was determined and then subdivided by the descending layers of officials.

The distinguishing characteristic in localized discretion in the collection of taxes is the presence of lump sums contracted for by the sovereign. Although it is a gross simplification to refer to all tax collection methods which rely on this feature as “tax farming,” the existing literature has focused for simplicity on this variant, and so I will use this term.

Our discussion will focus on the role of the receivers-general, venal “accountants” responsible for the collection and dispersion of tax revenues in the ancien regime, in particular the direct taxes, of which the taille was the major component. They were held accountable for the use of the funds which passed through their hands, and received payment for their duties through a combination of fixed income, their gage, and a proportional cut of the revenue collected, their salaire. They constitute an interesting case, because although their discretion in the collection and dispersion of state funds became increasingly limited, and was subject to frequent audit, their discretion in the structuring of their operation and in the use of the funds in their possession was wide. Their activities do not exactly fit the model, for their role is assessment and physical collection was limited. Their main role was in the management of that collection and the transmission of funds.25

V. Theories

For simplicity, I have grouped explanations of localized discretion or tax farming into three categories. The first and oldest explanations involve risk aversion on the part of the sovereign. The second are agency costs models which emphasize control of the tax collector by the sovereign. The third are credit models which see tax farming as a way of binding the monarch to future obligations.

VI. Risk Aversion.

25 For a summary of their duties, see Bosher [1970, ch.4] and Bruguiere [1987].
Contemporary explanations of tax farming stressed the need of the sovereign for consistent and predictable revenue estimates. Implicit in this explanation is a belief that the sovereign was risk averse and sought to shift risk onto the farmers. This explanation is unsatisfactory, for three reasons. First, if tax revenues are random, then it is not clear why there would be other parties with a greater capacity to bear risk than the sovereign. It would seem that he is in a better position to diversify than any other party, given that he is holder of a wider portfolio of revenue streams.

Secondly, if the argument is that he wishes to smooth income, it is unclear why he could not do so through borrowing and lending. If other parties have access to credit and he does not, this deserves to be explained and would enter the realm of our third class of explanations.

VII. Agency model

In an agency model of localized discretion, emphasis is placed on the difficulty faced by a predatory sovereign who seeks to maximize his revenue. The revenue maximizing production process, i.e. the method of assessing and collecting the taxes is exogenous. The cost of alternative informational and monitoring inputs are seen as exogenous. The choice between a hierarchical apparatus with centralized decision making and rule bound agents and that of localized discretion with contractual obligations which are more loosely specified such as a lump sum fee is a function of those exogenous costs. Where the costs of determining incentive rules for agents which are compatible with revenue maximization and monitoring adherence to those rules are greater, the agency model predicts the use of localized discretion.

a. Single period

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26 Wolfe [1972].
27 Cheung [1969]
The simplest way to begin an agency model with a revenue maximizing sovereign would assume that the sovereign lacks both information about the extent of taxable wealth, the owners of that wealth, and the costs of appropriating that wealth in a given region. For simplicity sake let's assume that there is only one sort of tax, a tax on the value of land. In a simple transactions cost framework, two solutions exist: make or buy, hierarchy or outsourcing. If the king does it himself, he needs to operate through the labor market, hire officials who would assess the land's value and its ability to bear taxes, and collect them.

The problem here is in monitoring the performance of agents. Corruption and lack of effort would be difficult to detect, and consequently, even if the mean value of the tax were known, it would be difficult to distinguish the random effects from those of poor performance.

The king can auction off the rights to collect taxes in that domain to the highest bidder, who would then establish his own form of assessment. The king would then receive a lump sum. In an environment where the sovereign lacks information about the taxable assets and monitoring of performance of salaried officials is costly, and in which the production process and asset values are exogenous, a system which induced the revelation of information and reduced the need for monitoring would dominate. In this case corruption does not matter, because the benefits of corruption would presumably be factored into the price of the office.

Maximum information revelation and revenue collection would be obtained where there is a widespread distribution of information among potential bidders and collusion is difficult. The right to collect the taxes would be purchased by the party with the ability to raise the highest level of taxes either

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29 Phil Hoffman [1994] makes this assumption. Given the diversity of the country, the many exemptions, the cost of assessing wealth, and the cost of monitoring agents, which he takes as exogenous, localized discretion makes sense. See pp. 229-32. This fails however to explain why investment could not be made in overcoming those information and agency obstacles.

30 Both Hoffman [1994] and Kiser [1994] argue that the taxable value of land was easy to determine and relatively steady. While this is certainly true in relation to commerce and other sources of tax revenue, Ardant [1975: 195] argues that assessments were often very inaccurate, resulting in abandoned land.

31 Holmstrom [1979].

32 Barzel [1982] argues that the comparative advantage in measurement of the asset's value will determine the holder of the property right.

33 Vishny and Schleifer [1994]
because of an informational or enforcement advantage. If the collection process requires some input from
the sovereign, such as enforcement, a system of shares would develop to the extent that output was
measurable. To the extent that this constitutes 'rent-seeking," there does not seem to be anything wrong
with it. This simple model corresponds to much early farming in the medieval period, where domains
were farmed via candle auctions.

If, however, information is not distributed widely, but hoarded, and if there is collusion or some
sort of corporate behavior, the bargaining power of the sovereign is weaker. If there is a local
administrative body or powerful official, which can increase the cost of any competitor, they will
effectively eliminate other bids. In that scenario, that party would obtain the right at a price that is bound
to be relatively lower. Sometimes the King would induce cooperation by granting a share of the revenue to
the local power and they would jointly sell. Other times, a corporate body such as a town would purchase
the right through an exemption, which was a form of negotiated self-assessment. In any case, the
sovereign would want to encourage a widespread diffusion of information, discourage collusion and

34 Reid [1973].
35 Cowen, et.al. [1994].
36 Many have made the argument that negotiating with groups or preexisting corporate
ties dominates because it lowers transaction costs. Bien [1987]: "Needing money
and lacking administrators, the embryonic medieval state treated with religious
corporations, municipalities, and whole regions as if the members or inhabitants were a
unit and collectively responsible for this or that payment.....For the state, it was easier to
negotiate lump sum payments with groups than to deal with the endless litigation." To
argue that negotiating lump sum payments with corporate bodies was easier because the
state lacked administrators to some extent begs the question. It assumes the lack of
administrators as an exogenous condition. The real question is why investment in an
administrative hierarchy would be unprofitable. Similarly, Dent [1973: 38]: "The initial
impulse towards the institution of tax farming was the wish of the government to ease its
administrative load...With larger farms, the state found that it had to negotiate with fewer
people."
37 In many areas, especially in the pays d'etat a fixed percentage of the taille and other
taxes was ceded to powerful local interests.
38 A composition or abonnement. Or in the case of officials an augmentation de gage.
Lump sum payments in exemption from the aides had a long history. See Strayer [1939].
Later attempts to make taxation more equitable, such as the dixieme ended the same way.
See Bonney [1993].
eliminate barriers to entry in the form of corporate organization. If this were not possible, a hierarchical organization would dominate.

Since the ancien régime was characterized by corporate bodies, collusion, and poorly diffused information, the choice of outsourcing requires an explanation that the single period model fails to provide.

b. Multi-period

Complications arise in a multi-period model, where the value of the farm in later periods is not entirely random, because of endogenous factors such as the behavior of the farmer. The potential value of the farm could be reduced through capital depletion as a result of over-farming, giving rise to lower future productivity or increasing the rewards to collective resistance. Similarly, the value of the farm could be increased by better management, or the acquisition of new processes of assessment and collection.

To prevent capital depletion through the abuse of his authority, it has been pointed out that he is required to post a bond. The bond is a very poor solution to the agency problem under these conditions because of the high costs of monitoring. It would be costly to specify a set of conditions which would result in the loss of the bond for the same reasons why it would be costly to employ salaried managers.

Another way to induce incentive compatibility would be to offer longer contracts, allowing the tax farmer to recover the gains to increased productivity and suffer the losses of over-farming. To eliminate any last period problem, the length of the contract could be made infinite by establishing the office as the real property of the office holder, allowing for free sale or hereditary succession.

But in extending the duration of the contract, what is gained in incentive compatibility is lost in information revelation. To the extent that termination of the contract is costly, and to the extent that some of the increased productivity is due to the accumulation of proprietary innovations and learning curve effects, held in the form of human capital, there exist barriers to the entry of competitors. The relationship would be one of bilateral monopoly.

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39 Bonney [1979] notes that smaller farms resulted in greater revenues.
40 Ann Carlos [1992] illustrates the bonding process used by the merchant companies.
41 Herman and Zeckhauser [1985]. This concept is elaborated in Gary Miller [1992].
42 With perfect information, bilateral monopoly can be efficient (See Truett and Truett [1993]), but with asymmetries, that result breaks down.
negotiated as lump sums through a system of trial and error, bargaining and threats. repricing would take
the form of ratcheting. With the receivers general as with other officials, the ratcheting in the price of
their office took the form of augmentations, negotiated increases in the interest bearing caution or bond
posted as collateral against malfeasance.

The longer the contract, the more difficult it is to assess the performance of the supplier, thus
reducing the supposed advantages of farming over hierarchy. The costs of assessing performance would
be higher as a result of longevity of tenure. In order to assess the performance of the farmer, the king
would have to establish parallel channels of information gathering, i.e. a court system, a bureaucracy of
surveillance and extensive auditing facilities, which, in time, would eliminate the information asymmetry
and the need for farming in the first place.

Furthermore, to the extent that increasing productivity is a result of the investment in capital, long
term contracts are not necessary in so far as the sovereign could compensate the farmer for that investment.
The cost of assessing the value of that investment would have to be high to rule out this option. In France,
in fact, the farmers were compensated for outlays on physical capital, so the portion of increased
productivity due to human capital accumulation would have to be very large and costly to value to rule out
this option.

For an agency model to explain the longevity of tenure of officials and tax farmers, the benefits of
incentive compatibility through the encouragement of human capital accumulation accruing to the
sovereign must outweigh the loss of revenue resulting from lower information revelation and bargaining
power. If this were the case, it does not seem to be a result of exogenous factors. The technology of
information gathering and monitoring of the performance of agents was not so primitive as to require
localized discretion. In particular the assessment of land values was fairly sophisticated, and the
technology required for a centralized land registry and the gathering of information on rental values were
not costly. Similarly, the English excise and customs is testimony to the existence of the managerial and
accounting technology required for the establishment of a centralized bureaucracy of salaried tax officials.

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Weitzman [1980]

This is noted by Stella [1993].
Thus, the cost of information gathering and monitoring agents should not be viewed as exogenous, but rather must be explained.

**c. Self enforcing contracts**

A problem with the above analysis is that, although it allows for contracts can not be fully specified, enforceability of that which is specified is assumed. When we drop that assumption, and require that all contracts be self-enforcing, determining the optimal location of discretion is much different.

To the extent that contracts can not be fully specified, the sovereign would want to eliminate small numbers problems and maximize the number of bidders by discouraging collusion, increasing information flows, and rely on extensive auditing and evaluation, to minimize the potential for the counterparty’s appropriation of rents.

If the sovereign succeeds in keeping the market competitive, he discourages any investment, and reduces his ability to punish his agent even in the event of blatantly obvious breach. For example, he can not ask his agent to post a bond, because there would be nothing to prevent him from seizing the bond and granting the contract to another party. To the extent that the sovereign himself is not bound to a contract, the agent is reluctant to make any investment.

Creating a self-enforcing contract requires that both parties have the ability to punish each other in the event of breach. If the agent fails to perform, the sovereign keeps the bond. If the sovereign seizes the bond and renegotiates the contract, the agent denies future services, which can only be a sanction if the market for agents is noncompetitive.

If the king has no incentive to seize the bond then he has established credit and to the extent that the bond is viewed not as incidental to the system but rather essential, we are in the province of our third class of explanations: tax farming as a system of credit.

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Brewer [1989].

For an overview of self enforcing contracts, see Kydland and Prescott [1977]. With specific reference to state finance, see Bulow and Rogoff [1989].

Helper and Levine [1992].

Holmstrom [1989]. See Eaton and White [1982] on the break down of bonding under these circumstances.

This corresponds to a hostage model. See Williamson [1983].
VII. Credit explanations.

A third class of explanations emphasizes the role of tax farming and venal offices as a system of credit. In these explanations, the bond deposited with the sovereign is not viewed as a device used to control the behavior of the agent, but rather the granting of the privilege is seen as a way of obtaining a bond. In some sense these explanations are related. They differ in the following way. In the agency hypothesis, there exists no lower cost method of controlling the agent, whereas in the credit hypothesis, although there may exist lower cost ways of controlling the agent there are no lower cost ways of obtaining a bond.

The French monarch for the most part borrowed not directly from the financial markets, but from intermediaries who were able to borrow at a lower rate as they had better credit. The receivers general provided credit in two ways. By posting a bond, the refundable price of their office, they provided long term credit. By advancing tax revenues, they provided short term credit. These funds were not provided entirely out of their own wealth, but was also raised by third parties. Thus they acted as intermediaries. It has been said that they acted as intermediaries because their credit was good. If their credit was good independent of their position as officials, why would they squander their borrowed funds on a monarch with a reputation for repudiation? Such intermediation requires that the monarch had better credit with them than with the public at large. To some extent their credit must have been good precisely because of their position as officers. Their office must in some way act as collateral. In order for them to earn a spread as intermediaries they must be providing some function to their creditors that the creditors could not perform without them. Similarly they must be performing some function that the sovereign could not perform himself.

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50 Hicks [1967].
51 The value of those bonds can be found in Matthews [1958] for the farmers and in Doyle [1984] for the officers.
52 Root [1987].
53 Campbell and Krakow [1980].
As long as there is an element of prepaying in the purchase of a farm or office, there exists credit. Since the reputation of the sovereign is inadequate to obtain unsecured credit, resort is had to the provision of collateral. If the king pawns his jewels in Venice or Amsterdam, the value of the collateral is quite obvious. What is less clear is how the tax collection mechanism can act as collateral. In the nineteenth century when nations would post their customs revenues as collateral, the sanction was easy to enforce through the direct sanction of military invasion.\textsuperscript{54}

The use of tax receivables as collateral for loans is more problematic. If the sovereign was unworthy of credit, what was to prevent the king from alienating a tax revenue stream and then seizing it back? Selling an office and then refusing payment of a \textit{gage}. Granting a privilege and then abolishing it. Were the \textit{financiers} who purchased their offices as stupid as Louis XIV’s controller-general thought they were?\textsuperscript{55}

For the same reasons why the loss of reputation is not enough to establish credit for direct financing, it could not act as a constraint in maintaining the value of offices for intermediate financing. There will always exist some threshold beyond which the discount rate of the predatory monarch will induce repudiation.\textsuperscript{56} So long as current net revenues can be increased at the expense of future revenues, there will exist the risk of repudiation. Thus some sanction must exist which results in a net revenue loss in the current period in the event of repudiation. For liens on tax revenues and privileges to serve as collateral, the tax revenue loss associated with seizure must be greater than the reduction in debt service expense. The alienation of revenues and the sale of privileges must be self enforcing. In need of financing, the sovereign will promise almost anything, but when the funds are obtained seizure must be prevented. The loan would seem to be an obsolescing bargain.\textsuperscript{57}

The purchaser of a farm or office is faced with two variants of repudiation threats to his property. First, the sovereign could seize back the revenue raising mechanism and run it himself as a part of a

\textsuperscript{54} Greif [1992] describes the difference between direct and indirect sanctions.  
\textsuperscript{55} Swart [1947: 15] quotes Ponchartrain as telling Louis “as soon as the king institutes an office, God creates a fool who will buy it.”  
\textsuperscript{56} Levi [1988] makes much the same point.  
\textsuperscript{57} Vernon [1977].
hierarchical administration. Second, he could seize it and then grant it to some other financier. Some have portrayed the financiers as a closed community, whose reputation with each other was essential to their business. In fact, financiers were continually threatened by their fellows. Financiers were continually soliciting *traîtes*, whereby the offered to replace their fellows or at least inform on them.

To minimize the likelihood of these events, the purchaser must be able to deny some crucial input necessary to the operation of his collection activity. There must be some barriers to entry, in the form of learning curve or start up costs, which would raise the costs to a competitor without his cooperation. Such costs, because they occur in the immediate aftermath of seizure, make seizure less likely when the sovereign is faced with a steep discount rate. They provide the most protection precisely when such protection is needed.

The most effective barrier would be the denial of information and expertise. If the information and expertise necessary for the execution of his function were widely distributed, his office could be seized and granted to a competitor. The risk of seizure has two effects, secrecy and the development of human capital which is specific to the operation of his office.

If information about the value of the assets and the owner of those assets were readily accessible, the barrier to entry would be low. Thus centralized land registries were not generally in place, information about the identity of individuals assets and activities were not widely known and costly to

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58 Bonney [1979: 14-5] describes examples of sovereign reneging at the behest of competing syndicates in the early part of the seventeenth century. An flagrant example is of Mazarin seizing the municipal *octrois* and granting them the farmers of the *aides*. Bosher [1970].
59 Bosher [1973]
60 See Moran [1973]
61 Kobrin [1980]
62 With many taxes, especially direct taxes, the expertise required was not as much in knowledge of the value of taxable assets, but in the transmission of funds. Thus bankers skilled in the use of bills of exchange were the best candidates as farmers. See Fryde [1973], Ehrenberg [1928], and Kaeuper [1973].
63 Cadastral surveys existed in some provinces, but they were of dubious merit. For problems with *cadastres* in the pays d'etat, see Ardant [1975: 195]. See Bonney [1993: 390] and Bosher [1965: 580] about efforts to implement a cadastral survey. Hoffman [1994: 250] notes the sanctity of notarial records which were kept secret from even the collectors of the taille.
acquire. Information was hoarded. Since the liabilities of one financier may be taxable assets to another, it was crucial that financiers keep the identity of their investors secret. Thus the use of a pretense or straw man.

Secondly, the organization of the activities performed by the tax collector was in a way which required idiosyncratic forms of human capital. If a collector standardized information flows within his organization and used managerial techniques which were widely known, the cost of a “hostile” takeover would be lessened. His operations must be impenetrable and frequently this was achieved through arcane accounting procedures.

Furthermore, the threat of replacement came not only from outside of the organization, but also within. If a clerk was responsible for the overall operation of his organization, the sovereign could repudiate his obligation to the financier and appoint his clerk in his place. Thus the level of delegation and the use of a hierarchical management structure was limited. This in turn limited the scale and scope of the operations of any one agent’s organization.

To some extent, the threat posed by competitors from both within and without could be reduced through intermarriage and through reciprocal arrangements, and restricting one’s dealings to those who could be trusted, but limits to the extent of such alliances would be quickly encountered.

In a bilateral monopoly, there must be some symmetry in the parties abilities to hold up one another. Thus, the extent to which the king could borrow from any one agent was limited by the ability of that agent to punish the sovereign by denying him the input necessary to maintain a revenue stream from

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44 Merchants accounts were immune from scrutiny except under rare circumstances See Howard [1932].
45 Ranum [1993:38] and Bonney [1993].
46 Matthews [1958].
47 Bosher [1965: 590] In noting the burning of the primary rolls and the use of 'fictitious loans', Dent [1973: 78-87] argues that the entire fiscal apparatus conspired to fool the king's representative through fraud, corruption, and illegal acts. To the extent that the practices were systemic and a product of conscious policy choices, such descriptive words seem out of place.
48 The most famous case is Desmaretz’s attempt to replace Fouquet.
49 The analogy of inside contracting is instructive. See Buttrick [1952] and Nelson [1975].
50 Greif [1989].
the source which that agent manages. Thus the greater the barriers to entry, and the greater the cost to the king of replacing the agent, the more credit he could obtain from that him.\footnote{Barzel [1992] argues that the prohibition against usury served as an effective barrier to entry against non-Jews, enabling them as a corporate group to provide ample credit to sovereigns with some assurance.} Secrecy and firm specific human capital served to increase the potential for hold up on the part of the agent and so increased the credit resources of the king. Similarly, the sale of offices was limited by the ability to create new opportunities for obstruction.

Default against any one source occurs when the magnitude of the threat is reduced. This, of course, could result from exogenous reduction in the value of that revenue source, but it could also result from a decrease in the barriers to entry. If a competitor were able to duplicate the services offered by the collector, or if the king obtained information which would allow him to perform those functions through his commissioners, such as the Intendants, the security of investment in the office would be reduced.\footnote{Veitch [1986].} The events of the 1630s and 1640s can be seen as an example of this.\footnote{See Moote [1962], Bonney [1978] and Ranum [1993]. See Mousnier [1970: 490] and [1984: ch. 26] for difficulties encountered by Intendants in acquiring information.} Attempts on the part of the sovereign to induce greater competition in the market for offices through reductions in secrecy or more comprehensive auditing of collection activities would threaten his creditworthiness. Thus, secrecy and barriers to entry in the market for fiscal agents were not exogenous but part of the fiscal strategy of the ancien regime monarch. By protecting secrecy and encouraging impenetrability, the king was using path dependence to constrain his future discretion.

Almost every attempt at administrative reform which was to serve the purpose of obtaining greater information about the resources available to the king was scaled back. This is why agents which began as commis, responsible only to the king, and disposable at will usually wound up as venal officers. Witness the baillis in the twelfth century, the elus,\footnote{See Hintze [1975: 293-8].} and the subdelegues of the Intendants.\footnote{Mousnier[1984: 531] and Bonney [1978].} Even the Intendants began to exhibit thoroughly venal qualities. By the eighteenth century, many Intendancies were passed on
from father to son and it could be said that they were more representatives of the province than of the king.\textsuperscript{76}

The encroachment by the Intendants on the activities of the receivers required that they expand those aspects of their activities which had greater barriers to entry. Expertise in estimating the amount and likelihood of revenue streams resulting from different strategies of direct taxation had become more diffused and was possessed by the Intendants in particular, so the receivers ability to hold up the collection of the \textit{taille} was reduced by the parallel bureaucracy\textsuperscript{77}. Their expertise was increasingly devoted to their banking activities. They had greater access to knowledge about the credit worthiness of locals and so had long engaged in lending to private parties and had funds deposited with them for safekeeping.\textsuperscript{78} Perhaps their most important banking function was the discounting of bills of exchange.\textsuperscript{79}

The bulk of the value of their office was thus by the eighteenth century derived not from their ability to collect taxation but their skill in using sterile funds as a basis for money creation through fractional reserve banking activities, which the Intendant could not replicate. Notaries served in the complementary business of funds intermediation.\textsuperscript{80} Likewise with the farmers of indirect taxes.

The need of each of the officials to jealously guard the information which was the source of his rents prevented a wider dispersal of information throughout the economy, compartmentalizing knowledge about asset values and uses, transactions and economic activity in general. The size of economic organizations and the extent of markets was limited by the need for every property right and contractual obligation to be secure against political risk. Information had to be proprietary \textit{de facto}. The potential gains to larger organizational forms were offset by the greater political risk which such enlargement entailed. So long as the tasks performed by the various officials were relatively independent, the gains

\textsuperscript{76} Mousnier [1984].
\textsuperscript{77} On how overlapping functions breaks down hold up problems, see Bendor [1985].
\textsuperscript{78} Bosher [1970: 75].
\textsuperscript{79} Usher [1916] points out that this practice was well established by the end of the seventeenth century. Since most of the bills were drawn on Paris, they could remit the bills to Paris in payment of their obligations and discount the bills either with specie or \textit{rescriptions}. This relieved the holder of the bill of the necessity of going to Paris, but also reduced the risk that the bill would be satisfied with treasury bills of limited value.
\textsuperscript{80} See Doyle [1984] and Hoffman, Postel-Vinay and Rosenthal [1995].
from economies of scale and scope were not large enough to offset the increased risk of expropriation. Greater consolidation of activities awaited larger gains.

The compartmentalization of information about the fiscal system as well as the activities and assets which provided the taxes to support it, made organization on a large scale difficult, made the effects of policy decisions difficult to calculate, and reduced the liquidity of all assets in the economy. It was difficult to borrow against assets or revenue streams when knowledge of their values were not easy to obtain.

So long as information about the operations of individual financiers was necessarily kept secret even from their peers, a market for claims on those financiers was necessarily limited. Since information was distributed so narrowly, and every security sale was a potential lemons problem, the national market for liquid instruments was limited. The short term credit operations of the receivers general will illustrate.

Royal expenditure was drawn on the different revenue sources at his disposal through the use of a number of mechanisms. Certain fixed expenditures were authorized in advance through the budgets sent to the receivers. Since the receivers managed a portfolio of the king's receivables, obligations could be offset by assigning them against those receivables, reducing the need for any movement of funds. Discretionary expenditure could be through a mandement or order to a particular official to pay over a sum to the payee or bearer. This order to pay would then be presented by the receiver as a receipt upon audit.

The value of the payment order was dependent on the availability of funds from that source and the ability to enforce payment at the source. Knowledge of funds availability was not widely known, and was best known by the receiver himself. When presented with the payment order, the receiver may offer to redeem it at a discount or not redeem it at all. Payees were thus reluctant to accept payment unless payment was guaranteed by the receiver himself. Rescriptions were guaranteed by the receiver and thus more valuable. Without confidence in the soundness of the receivers' finances, however, even the rescription may not be worth its face value. Since the receivers were engaged in speculative banking

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81 Bosher [1970: 566].
82 See Dent [1967] and Jennings and Trout [1972].
activities, *rescriptions* were not risk free. In fact, it was not uncommon for receivers to overextend themselves and go bankrupt.\(^{83}\) Thus the liquidity of even the *rescriptions* was limited.

VIII. Incorporation

David Bien and others have stressed the importance of corporate strength as contributing to greater credit.\(^{84}\) The mechanism which makes this possible deserves greater explanation. Why would financiers, acting as a group be able to provide a greater amount of credit than the sum of each of their members acting individually?

There are two credit expanding effects of incorporation. On the asset side, incorporation gave the receivers greater bargaining power with their main creditor, the king, because to the extent that the corporation can limit defection, their market power has increased. But also, on the liability side, incorporation gave their obligations greater liquidity, because they are drawn on a more diversified and secure asset base. So for a given quantity of receivables, incorporation allows greater leverage in their financing.

To the extent that financiers are acting on their own behalf their only threat is to deny the king revenue from their own source. Clearly their bargaining power would be increased if they could collude to deny credit in the event of a default against any of individual member. The revenue loss associated with a collective hold up in the form of denial of credit would be much larger. In the limit, default risk would be at a minimum if there was a monopoly source of credit.\(^{85}\) In England, access to credit by the king was effectively monopolized by a single corporate body, the Parliament and its agent, the Bank of England.\(^{86}\)

If the formation of corporate actors did in fact strengthen the corporate members and expand the credit of the king, what were the obstacles to its development? In the model above, where individual

\(^{83}\) See Bosher [1970] for examples of receivers' bankruptcies.

\(^{84}\) Bien [1987: 102-3] sees greater corporate strength as providing greater credit primarily as a result of the lower transaction costs involved in dealing with a single entity, which then raised funds from its constituents. Corporate organization raised funds more quickly, and the moral force of corporate membership enforced unanimity.

\(^{85}\) See Lipson [1988].

\(^{86}\) Weingast [1992].
financiers and holders of privilege fear one another as much as the sovereign, it is not clear how they could act as a group. After all, they could not sign cross default clauses. Any cross default clauses could be annulled by the king. The effective size of economic organization was limited by the need to hoard information, and organize in ways which used idiosyncratic techniques.

For corporate action to be effective, the individual member must have some means of enforcing his bargain with the corporation and vice versa, that is independent of exogenous enforcement. Suppose for example, that incorporation has greatly expanded the credit available to the king by the issuance of debt securities that are jointly guaranteed by each of the members. What is to prevent the king from absolving some subset of receivers from their portion of the obligation, thrusting the entirety of the debt upon the remaining subset and commencing to borrow anew from the absolved group?

There must exist some interdependencies which make the corporation dependent on each member. If the purpose of their incorporation is to collude in bargaining with another party, like the sovereign, repeat play may be required to solidify cooperation. But denial of future dealings must exact some penalty which is greater than the rewards to defection. There must exist some means of directly sanctioning each member by exclusion from the corporation. Collective action for the purpose of bargaining can be brought about if there already exist selective incentives to cooperate in an independent activity.

Members must be induced to cooperate through interdependencies in their individual production functions. Avner Greif details examples of such interdependencies. With ethnic groups, such as the Maghribi traders, the sanction of exclusion exists only because there exist no equally lucrative forms of alternative employment. The forms of human capital developed by those traders was coalition specific, and had no alternative use outside of the coalition.

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87 See Lipson [1985] for the modern use of cross default clauses in sovereign lending.
88 Olson [1965].
89 Greif [1992].
90 Greif [1989]
Towns enforced solidarity through the threat of exclusion which was only effective insofar as the human capital possessed by the inhabitant was specific to that town. The solidarity of guilds was subject to this same limitation.  

The tax collection activities of the receivers were not interdependent. Tax revenues in one region could be collected without the assistance of the others. To the extent that their banking activities consisted of local borrowing and lending, there too existed no interdependencies. The limits to the profitability of such localized activities, however, induced greater interdependencies and the profits available as a result of banking on a national scale proved large enough to set in motion the move toward incorporation. Each receiver’s borrowing cost could be reduced if the liquidity of his instruments could be increased. This could be accomplished through mutual discounting and mutual guarantee of debt, through the establishment of a clearing house and issuing corporate debt securities. In addition, their discounting of bills would be subject to a lower level of risk if centralized information gathering about their value could be arranged.  

In order to achieve this, however, receivers needed to divulge information about their individual activities to each other. The extent to which this could be accomplished was limited, even if all of the members could establish trust with one another. For an organization of that size to operate effectively, the information about the individual receivers operations would have to be standardized, and rules would have to be established that limited the discretion of those operations. The extent to which such procedures were implemented however would increase the susceptibility of the organization to hostile takeover and seizure by the king. Incorporation may not reduce political risk, if, it may just move it to a different level. For  

91 See Root [1994].  
92 Bosher [1970: 181]. See also Bossenga [1986] for the difficulties encountered in creating a unified lobby for the Bureaux des Finances, which had limited interdependencies.  
93 The management of the central institutions of the corporation fell to a small subset of receivers. Brugiere [1987: 41]. The operation of a clearinghouse and the need for centralized management with access to financial information about members is described best by Gorton and Mullineux [1987].  
94 On the need for centralized information gathering, see Milgrom, North, and Weingast [1990].
incorporation to be successful, expertise and information required to effectively manage the corporation had to be just as difficult to acquire as the expertise and information required to run its previously independent subsidiaries. This placed limits on the degree to which any corporate entity could be operated through the use of centralized hierarchical management.

Effective organization of the corporation required that the form of human capital possessed by the receivers in the form of skills and knowledge become less specific to the individual caisse that he managed and more specific to the larger organization. Management of the individual caisse would be less dependent on skills possessed by the receiver and could be delegated more easily, but the value of that caisse's operations would be greatly dependent on the receivers membership in the larger corporation.  

IX. Conclusion

The transition to a hierarchically administered tax collection apparatus is made possible only by a source of credit that is capable of sanctioning the sovereign in the event that those tax revenues are not used to repay the contractually specified financing. In England, a single corporate body had effectively monopolized access to credit allowing for the centralization of discretion in the assessing and collecting of taxes.

In France, there existed multiple corporate bodies, each a source of credit. Since no one corporate body could adequately sanction the sovereign in the event of default on unsecured loans, those corporate bodies required that control of tax revenues be given to them. Effective control meant that a form of discretion be utilized that could not easily be appropriated. That form required secrecy and the possession of human capital that was unique to each organization. Efforts to create larger corporate bodies which would result in a more effective means of sanctioning the sovereign were slow and difficult precisely because of the locus and form of human capital. Success required complementarities which allowed for

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95 By the eighteenth century, all of the receivers lived in Paris. Brugiere [1987], but each maintained separate offices in their Generalite and issued their own rescriptions. Bosher [1970: 162].
interdependence of the members of the corporate bodies so that they could sanction one another, leading to corporate solidarity. In the eighteenth century, corporate bodies grew in size and strength, allowing for greater sanctions against the crown, permitting greater hierarchical administration of taxes.

The receivers general illustrate this process. Their expertise in the use of tax receipts as a basis for the discounting of bills provided a basis for interdependence, which reduced the scope for opportunism within the group. Secrecy between receivers was reduced, information and expertise became more widely disseminated within the group, enabling the corporation to act as a single entity in the sanctioning of the king. Their ability to sanction the king reduced their dependence on control of the tax apparatus as collateral, facilitating more direct, more effectively hierarchical organization of some of his taxing activities.

The extent to which economic actors can capture the gains resulting from the production and diffusion of information and investment in human capital is a critical determinant of economic growth. Securing such gains requires protection against expropriation. In an environment of high political risk, such protection is achieved through the use of secrecy and idiosyncratic production and managerial techniques. The security of property rights is achieved at the expense of their transferability, which impedes the development of a liquid market for property rights.

Managerial and financial technologies and the forms of human capital which make large scale organization of firms and markets possible require an environment of low political risk. The transfer of those technologies is limited by the degree to which sanctions exist against the sovereign in the event of expropriation. The absence of such sanctions thwarts not only the development of private sector institutions, but also the development of the state itself.

Institutional features such as secrecy, firm-specific human capital and corporate bodies should be seen as rational risk-reducing responses to environments of political uncertainty. The facilitation of such practices can be seen as a strategic means for a sovereign to encourage investment. Too often, in modeling the organization of institutions, economists are prone to consider variables such as high

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Bien [1987: 99] notes the parallel development of administrative hierarchy and corporate strength, but does not see the one as requiring the other.
information cost, asymmetric information, and the costs of collusion as exogenous variables, when they may be the result of the strategic behavior of the actors. Although we may view the French fiscal policy under the Bourbons as a failure, the French monarchy was able to maintain a much greater level of discretion for a much longer time than his English counterpart, keeping his head for an extra hundred years.