Banking - The Financing of War

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Early history , Crusades and the emergence of Government Bonds

Early History

For centuries, and until very recently in many parts of the world, the Ruler of a country (or City State) would pay for war from his own pocket, and often also from those of his Lords, who were generally expected to join the Ruler in the fighting, bringing along their own troops etc., including perhaps Levies, the Saxon Fyrd for example.

The money in his/their pockets came from a variety of sources. Plunder gained from enemy territory was a good source of wealth, it often made a war pay for itself. Enemy captives could be ransomed for large sums of cash or specie, or sold as slaves. In the Hundred Years War, many English Lords and Knights made fortunes from the ransoming of French aristocracy captured at the Battles of Crecy, Poitiers and Agincourt. Viking raiders with their captives turned Dublin into the largest Slave Trading centre in Europe. Demanding of money with menaces was not confined to the ransom of prisoners, the levying of taxes upon their own people was a huge part of the wealth of a monarch, and since monarchs were absolute rulers, they could levy anything they wanted.

One exception to this method of paying for making war was used by Rome. Rome's armies were paid for by the State, not by individual Lords and Monarchs. The State was run by elected men, for at least some of its history, and the taxes were not thus completely arbitrary. Rome also used plunder and slave trading in a big way, of course. The conquest of Gaul not only made Julius Caesar an extremely rich man, the State did very well also, as they did with Pompey's conquests in the East. Of course, the larger Rome became, the larger the tax base became, because taxes were not only levied on Rome's citizens in Italy, but on the inhabitants (some of whom were citizens too) of the conquered territories as well.

Also, a major source of revenue came from import and export taxes. For example, during the time of Emperor Caesar Augustus, 1st Century AD, the annual value of imported goods from the Indian Ocean region (including silks and spices) was approximately 1000 million Sesterces which yielded 250 million in import dues to the Roman State. A further 25 million was garnered from export taxes on the 100 million Sesterces worth of goods that were exported to that region. Rome certainly needed that money. The cost to the State of the Roman Army and its Auxiliaries, which policed Rome's borders as well as conquering new territories, was at that time an annual 640 million Sesterces.

The Crusades

Issues of finance influenced the goals and military success of crusade expeditions and also determined the nature of participation in them.

In the early Crusades, individual crusaders had to muster the funds for the arms and supplies necessary for themselves and their dependents, together with cash for their journey and sustenance on campaign. They did this in many different ways, including calling in debts, levies on their vassals, gifts received, selling or mortgaging land and resorting to moneylenders. This last led to Popes granting crusaders a temporary moratorium on paying the principal of their debts, exemption from payment of interest, and freedom from taxes and tolls.

Later Crusades obtained a great deal of finance from the Church, which at that time was immensely rich. Papal levies on Monastic orders, even at one fortieth, yielded a great deal of money. Later taxes included a triennial twentieth to fund the Fifth Crusade in 1217. This was levied upon almost all ecclesiastics, and was enforced by threat of ex-communication for non-payment or attempted fraud.

Successful collection of these sums of money and their transfer to Crusaders wherever they happened to be required considerable progress in the sophistication of accounting and administration. The need to collect, store, transport, and efficiently disburse the money amassed for the crusades partly drove advancements in effective record keeping, currency exchange and transferral of funds. The military orders such as the Knights Templar developed considerable expertise in these matters which was often utilized by individual crusaders, secular governments, and the Curia. In the later Middle Ages, Italian bankers, such as the House of Albizzi, served a similar function, transferring Crusader revenues from local depositories or the Templar houses in London and Paris to the papal Camera or the crusade front, or advancing money in expectation of revenues yet to be collected.

Thus Crusade finance and taxation aided the evolution of social, financial, and legal institutions. Crusaders' quests to realise assets made property more available and increased the circulation of coinage. Levies for various crusades also contributed to the development of centralized financial administrations and the growth of papal and royal taxation.

Government Borrowing

During the Early Modern era, (ie from the early 15th Century to the start of the Industrial Revolution) European monarchs would often default on their loans or arbitrarily refuse to pay them back. This generally made financiers wary of lending to the King and the finances of countries that were often at war remained extremely volatile. For example, this volatility was part of the reason Charles I lost his head. Also, his son, Charles II, instigated the "Great Stop of the Exchequer" in 1672, which bankrupted a considerable number of bankers. In effect, Charles stole their gold!

The Great Stop was a contributor to the later creation of the first Central Bank in England, which was an institution designed to lend to the government (ie: the Monarch) and was initially an expedient by used by William of Orange for the financing of his war against France (the Nine Years War). His thinking was clearly based on the Dutch experience of banking during the earlier part of that Century. William engaged a syndicate of City traders and merchants to offer for sale an issue of government debt. This syndicate soon evolved into the Bank of England, leading to the financing of the wars of the Duke of Marlborough (War of Spanish Succession) and all Britain's later wars.

The establishment of the bank was devised by Charles Montagu, 1st Earl of Halifax, in 1694, to the plan which had been proposed by William Paterson three years before, but had not been acted upon. He, Paterson, proposed a loan of £1.2m to the government; in return for which the subscribers would be incorporated as *The Governor and Company of the Bank of England* with long-term banking privileges including the issue of notes. The Royal Charter was granted on 27 July through the passage of the Tonnage Act (1694). By the way, Paterson soon had a disagreement with his colleagues and left the Bank in 1695, returning to Edinburgh where he was hugely instrumental in the ill-fated Darien Project, and later campaigned successfully for the Act of Union of 1707.

The founding of the Bank of England not only revolutionised public finance by putting an end to Heads of State defaulting on their debts, but it provided a means for the British Government to raise the money to cover the huge costs of the wars against France in the Eighteenth Century. These costs were inflated by the enormous subsidies that Britain paid to other European countries to buy their support in these wars. France had no such method of fund-raising at its disposal and the French Crown was forced to raise internal taxes, and it was this high taxation, as well as its discriminatory nature that was a contributor to the French Revolution. Also, France could not afford the size of subsidies that England could, and was thus often fighting at a disadvantage.

Thanks to the Bank's formation, the British Government would never fail to repay its creditors. By the end of the Napoleonic War, the British Government owed more than 200% of the country's GDP. A GDP moreover, that was a great deal higher than most other European nations, thanks to its early start in the Industrial Revolution. Nevertheless, the debt was eventually paid in full, in the second decade of this Century.

Later, of course, and mostly in the Nineteenth Century, other countries in Europe and around the world adopted similar financial institutions to manage their government debt.

Government Bonds

The first general Government Bonds were issued by the city of Amsterdam in 1517, since the Netherlands did not yet exist as a State. They merged into later issues which were made by the Government of the Netherlands. The average interest rate at the time was around 20%, happy days for investors!

However, the first official government bond issued by a national government was issued by the Bank of England on its formation in 1694 to raise money to fund the Nine Years War against France. The form of these bonds was both lottery and annuity.

In 1751, the British Government began issuing “Consols” (originally short for consolidated annuities, but subsequently taken to mean consolidated stock). It was a name given to Government debt issues in the form of Perpetual Bonds, with no maturity date, but redeemable at the option of the government. The following year all redeemable Government stock was converted into one Bond, called Consolidated 3.5% Annuities, in order to reduce the interest rate paid on the government debt.

In 1757, the annual interest rate on the stock was reduced to 3%, leaving the stock as Consolidated 3% Annuities and it remained at this rate until 1888. Consols are mentioned in literature of the time (eg: Jane Austen's Pride and Prejudice) and were a very popular investment.

In 1888, the Chancellor of the Exchequer converted these Consolidated 3% Annuities, along with Reduced 3% Annuities (issued in 1752) and New 3% Annuities (1855), by Act of Parliament into a new bond, known as $2\frac{3}{4}$% Consolidated Stock. Under the Act, the interest rate of the stock was reduced to $2\frac{1}{2}$% in 1903, and the stock given a first redemption date of 5 April 1923, after which point the stock could be redeemed at par value by Act of Parliament. In 1927 Chancellor Winston Churchill issued a new government stock, 4% Consols, as a partial refinancing of the National War Bonds issued in 1917 during the Great War.

Final redemption of all these Bonds did not occur until this century. They were all redeemed between February and July 2015 under the provision of Section 124 of the 2015 Finance Act, which made the legal provision for the ending of Consols.

Later, when governments in Europe started following the trend by forming central Banks they too began issuing Perpetual Bonds (bonds with no maturity date) to fund wars and other government spending. The issue of Perpetual Bonds ceased in the 20th century, and currently all Governments issue bonds of limited term to maturity.

Appendix – Finance of Crusades

Finance of Crusades

Issues of finance influenced the goals and military success of crusade expeditions and also determined the nature of participation in them.

Problems of Crusade Finance

Initially, individual crusaders mustered the funds for the arms and supplies necessary for themselves and their dependants, together with cash for their journey and sustenance on campaign. If insufficient funds were forthcoming from debt collection and loans or gifts from lords, allies, or relations, crusaders from the landowning classes often donated, sold, or mortgaged produce from land, livestock or forests, rights and revenues, or, as a last resort, property in exchange for cash or gifts of equipment. These transactions often took the form of a settlement of long-standing disputes over land, combining financial transactions with the confirmation of legal rights and the promise of spiritual benefits regarded as essential for crusaders to depart in peace. Crusaders also turned to moneylenders for loans, leading popes to grant crusaders a temporary moratorium on paying the principal of their debts, exemption from payment of interest, and freedom from taxes and tolls. Intended to aid crusaders in fulfilling their vows, these financial privileges in effect often ruined their credit rating, so that individuals occasionally waived them to obtain loans. These provisos could also threaten the income of rulers who relied on taxation of Jewish and Christian usurers for income crucial for fulfilling their own crusade vows or ensuring the safety of the realm.

Although the hordes of non-combatants who accompanied many crusading armies may have hoped to join the entourage of a lord or knight or to subsidize their meagre financial resources by foraging or plunder, the latter proved negligible in offsetting the often ruinous costs of a crusading expedition. Many noblemen, prelates, and kings, including Richard I of England and Louis IX of France, sought to keep crusade armies from dissolving by retaining at their own expense fighters who had run short of cash; in surviving records, these impecunious crusaders and waged knights are often almost indistinguishable from professional mercenaries. Fleets from England and Italy and crusading contingents from urban areas organized themselves after corporate models familiar to them from domestic confraternities and communal governments, forming sworn associations whose members shared the financial burden of the expedition. Affluent prelates and magnates contributed to communally organized and disbursed funds for needy crusaders, while formal agreements regarding the division of deceased crusaders' mobile possessions were often drawn up to ensure the equitable redistribution of resources within the crusading army rather than their bequest to relatives back home. Armies often also adopted elaborate rules for the partitioning of spoils, which were frequently put into a common pool and dispensed in payments scaled according to each category of crusader within the camp.

While a lack of material resources or military reverses could create a unified atmosphere characterized by penitential rituals and the perceived necessity of divine aid for success, infusions of booty or aid from home, which should in theory have bolstered an army's defensive and offensive capabilities, could render it liable to paralysis by debauchery or dissension over the partitioning or theft of resources.

Origins of Crusade Taxation

The changing nature of crusading, including the shift from overland to overseas routes to the Holy Land, reinforced endeavours by organizers to whittle down the numbers of non-combatant crusaders. Crusade finances also evolved in response to the hard lessons learned with each expedition, leading to attempts by kings and popes to create a system of legal privileges and finances to aid individuals in fulfilling their vows. Kings and noblemen also laid imposts (known as tallages) on Jews, townsmen, and peasants, and levied feudal aids from their secular and ecclesiastical vassals to finance their crusades. For example, The tax was frequently levied on English Jews during the twelfth and thirteenth centuries. Such contributions soon evolved into formal taxes. In 1166, Louis VII of France and Henry II of England declared a five-year royal tax on the property and revenues of all laypersons and ecclesiastics in France and England. The fruits of this and of a three-year tax that was levied in 1185 upon incomes, bequests, and movable possessions, were destined directly for the Holy Land. A similar tax intended to subsidise crusade preparations was levied in the same regions in 1188: the Saladin Tithe (£60,000 was levied on Guildford in 1189), as it became known, claimed a tenth of all income and movables from all except crusaders, who were entitled to receive the moneys paid by their non-crusading vassals.

Although occasional secular taxes were imposed throughout the thirteenth century, their contributions to the crusading movement were dwarfed by the papacy’s taxation of the church. The first universal clerical income tax was instituted by Pope Innocent III in 1199, who asked ecclesiastics and communes to contribute a set number of warriors or a corresponding sum of money to the Fourth Crusade (1202-1204). The papal legate Peter Capuano persuaded the French clergy to agree to contribute one-thirtieth of their annual income, provided that no precedent was set for future taxation, a sum that Innocent soon reduced to one-fortieth in the face of concerted resistance. Collection proved problematic, particularly from monastic orders claiming exemption from taxation, including the Cistercians, who eventually agreed to a reduced “voluntary” contribution.

Clergy gathering donations for the holy war.

Innocent III learned from this episode and sought formal clerical approval for a triennial twentieth for the Fifth Crusade (1217-1221); it was imposed during the Fourth Lateran Council (1215) upon all ecclesiastics, with the exception of certain religious orders. Enforced by the penalty of excommunication for fraud or non-payment, it set the pattern for future regular levies on clerical income in aid of the crusading movement, varying from a tenth to a hundredth.

Although initially attached only to crusades to the Holy Land, these taxes were soon transferred to crusades in other arenas, including the war against heretics in southern France and the anti-Staufen crusades, although not without serious protest. By the close of the thirteenth century, the tenth was also increasingly granted to secular rulers for purposes unconnected to the crusade, weakening its ties to the crusading movement.

Collection and Use of Taxes

These taxes were aided by enormous leaps in the sophistication and extension of ecclesiastical, papal, and royal accounting and administration. The precise method, however, of collection and disbursement to crusaders, the military orders, or settlers fighting in contested regions seems to have varied considerably. In England, royal agents collaborated with members of the military orders expert in the international transfer of funds and with local clergymen in the collection of the Saladin Tithe of 1188, and bishops were initially responsible for the evaluation and collection of the ecclesiastical income tax. The collection of clerical income taxes was often resisted or delayed, and its expenditure frequently shifted. For example, during the Fifth Crusade, the money collected from income tax, alms, and redemptions of vows by cash payments seems initially to have funded local contingents of crusaders departing for the Holy Land; yet as the campaign wore on, collection became increasingly centralized, and it was often diverted, in response to appeals for money, to the crusaders before Damietta.

The availability of funding directly affected those able to participate in the crusade. Poor or middling persons who took the cross hoping for subsidy from these sources could find themselves forced to redeem their vows when, as increasingly occurred, these sources of funding were granted to noblemen to organize and fund crusading contingents, and these noblemen were not minded to subsidize the participation of devout but untrained pilgrims. In response to pleas from local clergymen entrusted with gathering these moneys and to letters from crusaders, Honorius III appointed papal legates in England, Spain, Germany, Hungary, and Italy to increase the efficacy of their collection and transfer to the needy. The need to collect, store, transport, and efficiently disburse the money amassed for the crusades partly drove advancements in effective record keeping, currency exchange, transferal of funds, and banking. The military orders' expertise in these matters was often utilized by individual crusaders, secular governments, and the Curia. In the later Middle Ages, Italian bankers served a similar function, transferring crusade revenues from local depositories or the Templar houses in London and Paris to the papal Camera or the crusade front, or advancing money in expectation of revenues yet to be collected.

Experiments with centralizing tax collection via papally appointed legates and collectors continued throughout the thirteenth century. However, the process of centralization was by no means inevitable, nor was it originally intended to enrich the papacy. Self-evaluation and collection by local clergymen and agents posed problems of efficiency, potential diversion, and lack of disinterestedness. Yet because papal collectors were often also entrusted with amassing the papal census or Peter's pence, or funds were diverted from local crusaders to those in greater need, clergymen and crusaders often accused the papacy and its collectors of attempting to profit from the crusading movement. Papal collectors countered with accusations of local obstructionism, while Innocent III and his successors stressed that the Curia was paying a tenth and more of its own revenues in support of various crusades. Yet the impression that crusade taxes were being diverted to Rome was fatally reinforced when Pope Gregory IX and his successors instituted clerical income taxes for the anti-Staufen struggle and granted levies initially intended for the Holy Land to papal allies, including Henry III of England, sparking enormous protest.

Popes continued to struggle with enormous logistical problems, including keeping assessments impartial and up-to-date, balancing impartiality and local knowledge in the appointment of local clergy or papal agents as collectors, circumventing tax evasion, efficiently transporting revenues to where they were most needed, and also keeping accurate accounts to prove that the money was actually spent on the crusade and to counteract suspicions of embezzlement or diversion to other projects. By 1274, Pope Gregory X divided Europe into twenty-six collectorates with agents for each and provided detailed guidelines for the income taxes' assessment, collection, and transport, a system that, by the pontificate of Boniface VIII (1294-1303), provided the means for collecting moneys essential for the crusading movement and the papacy's survival against various political enemies. Yet, although attempts at centralization from the mid-thirteenth to mid fourteenth centuries eventually led to greater control of collection by the papal Camera and the levying of new taxes over wider areas, it also resulted in mounting clerical resistance to crusade taxation and increasing demands for control over taxation by secular authorities whose own administrations were expanding. The French clergy deplored the relentless grant of crusade tenths throughout the thirteenth century, while English ecclesiastics protested against the levying of taxes for the papal-imperial struggle, which appeared merely to swell papal coffers. Although local resistance could only delay collection, it threatened good relations between the papacy and regional churches. Similarly, when, from the pontificate of Boniface VIII onward, crusade taxes were commonly transferred to the papal Camera, rulers felt threatened to see precious resources go to pay for foreign projects such as papal wars; their resistance contributed to a gradual loss of papal control over the tenths in France and England in the late thirteenth to early fourteenth centuries.

Despite the problems associated with the clerical income tax, including outdated valuations, slow and costly collection, and the tendency of the papacy to extract rights for clergymen from rulers in return for granting its proceeds to secular magnates, it provided a large and often quantifiable proportion of the funding for many crusades, including those of Louis IX of France. The custom of donating the tenth, vow redemptions, and other funds from a certain region to lay rulers who possessed the resources to organize a crusade also led eventually to the secular taxation of the clergy. As the crusades became increasingly intertwined with dynastic and national policies, rulers tended to spend money raised for the crusade on other more pressing projects, particularly if political considerations or a crisis led to the cancellation of a planned general departure. The failure of past crusades or planned expeditions led to increasing resentment of new taxation, while the inability to obtain sufficient funding through levies spelled the demise of many a projected expedition. Nevertheless, even after the fall of Acre to the Mamlûks (1291), strategic difficulties, rising costs, and repeated delays and diversions led some to lose hope for the recovery of the Holy Land, the collaboration of lay officials remained essential for the success of preaching tours, which used church taxes and the sale of plenary indulgences to finance crusades fought by professional soldiers in Italy, the Iberian Peninsula, and Northern Africa, as well as expeditions against the Turks and Hussites.

Other Sources of Funding: Donations, Alms, Redemptions, and Confiscations

Other sources of funding included gifts and legacies (including the diversion of indistinct bequests), the confiscation of the possessions of convicted heretics or rebels, donations deposited in chests placed in local churches, alms collected by crusade preachers, and the redemption of crusading vows, including those adopted voluntarily or imposed by secular and ecclesiastical courts as a penalty for serious sins or crimes. Grave qualms arose concerning some of these categories, especially when donations to the crusade were substituted for penances or for criminal sentences; Innocent III warned bishops to avoid the appearance of extortion or bribery and to ensure that payments were scaled to the seriousness of the offense and the penitent’s means. Kings and noblemen also often exacted heavy tallages from towns and Jews to offset the extraordinary expenses incurred by participation in the crusading movement. Eventually, although not without hesitation and criticism, the incomes of vacant benefices and dubiously acquired possessions that could not be restored to the victims of the original crime (including money confiscated from Christian and Jewish moneylenders and the property of heretics and rebels) were also used for crusade projects.

Innocent III also sought to enable the financial participation of those unable to take the full crusading vow by ordering wooden chests or trunks to be installed in every church conducting the special liturgies organized in support of the crusade. He specified that those who gave alms would receive an indulgence proportionate to their devotion and the financial sacrifice their offering represented, while those who funded substitutes would receive the plenary indulgence. In a similar fashion, many urban confraternities and guilds financed by annual contributions helped to subsidize members who wished to participate in a crusade, while remissions of sin were offered to prelates, secular rulers, and communities who funded contingents of warriors from the late twelfth century onward. Although Innocent III and those he appointed to preach the crusade also encouraged all to take the cross without prior examination (perhaps intending that the fit but impoverished would be subsidized by the alms of the faithful), the reaction of military leaders who feared being burdened with hordes of non-combatants meant that the vows of many were eventually commuted to monetary donations. This led to confusion between the plenary indulgence earned by the full crusade vow and the partial indulgences granted for alms-giving. Groups of crusaders unable to fulfil their vows were soon urged to band together to send a substitute in their stead, while several Tuscan communes declared hearth taxes during the Fifth Crusade or supported a communal contingent of fighters. Those who contributed to these efforts or paid crusade taxes were often rewarded with partial indulgences.

Innocent III has been labelled a prescient innovator who encouraged indiscriminate taking of the cross in order to convert the devotion of the militarily unfit into financial support for the crusade through vow redemptions. However, it seems that this was not his original intent, but only gradually became a general policy under pressure from military leaders in charge of the crusade, who sought to restrict crusading to salaried warriors by forcing non-combatants, who they felt consumed limited resources and undermined discipline, to redeem their vows. This policy met with only partial success in the mid to late thirteenth centuries; the masses' desire for personal participation persisted, despite criticism by the chronicler Matthew Paris of the attempts of papally appointed mendicant preachers to immediately redeem the vows of the impecunious or unfit whom they deliberately encouraged to take the cross during preaching campaigns. Originally voluntary, redemption could become forced when the clerical taxes, alms, legacies, and redemptions derived from a given region were handed over to a local magnate unwilling to subsidize the devout faithful. It was only with the loss of the Holy Land in 1291, however, that the outright sale of indulgences was used by the papacy and secular rulers to finance armies made up of hired mercenaries or career soldiers.

It is clear that crusade finance and taxation aided the evolution of social, financial, and legal institutions. Crusaders' quests to realise assets made property more available and increased the circulation of coinage and precious materials within Europe. Crusading expeditions also created immense demand for victuals, supplies, weapons, and shipping, benefiting local merchants and artisans. Levies for various crusades also contributed to the development of centralized financial administrations and the growth of papal and royal taxation, at the same time aiding the development of representative bodies whose consent was required for many forms of taxation.