**France 1709: Le Crunch**

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*Already rocked by defeats in the War of the Spanish Succession, Louis XIV’s France faced economic meltdown as the chaotic nature of its finances became apparent. Guy Rowlands discovers striking parallels with the current credit crunch as he charts the crisis that was to lead, ultimately, to the French Revolution.*

Louis XIV (1638–1715), by Hyacinthe Rigaud (1701)Confronted by the banking collapse and credit crunch of 2008, most commentators have sought comparisons with the Wall Street Crash of 1929, the event that heralded the Great Depression of the 1930s. But for historians inclined to delve a little further into the past, there are equally calamitous financial meltdowns from which to seek instruction. The financial crisis that troubled France in 1709, for example, has not received anything like the attention it deserves. It came at the very worst moment for Louis XIV, during the long War of the Spanish Succession, which had begun in 1701 and was to last until 1714. It was a crisis so deep that the finances of the French monarchy never recovered properly.

By 1709, Louis’s martial prowess was on the wane. His fleets were no longer able to put to sea and the Bourbon armies had been pushed back onto the defensive in both northern France and Castile. The dire military situation alone created a crisis of confidence, but the financial hurricane that was about to engulf France was the result of the disastrous condition of the state’s finances.

At the best of times the French monarchy’s financial machinery was incoherent, depending for revenue collection on a variety of tax agents, all of whom were ultimately responsible to the king’s comptroller-general of finances. Royal officials at the centre regularly signed agreements with tax agents who were then contracted to supply to the crown a fixed proportion of the sums that they expected to be able to collect. In principle these sums were then to be handed over to other officials in charge of the crown’s expenditure. So the expenditure of the crown was reliant on the assignments of the funds expected from the tax agents: provincial revenue receivers and the tax farmers.

However, the flow of money gathered from taxpayers could never be synchronised with the spending requirements of the crown or with the deadlines the crown had set the tax agents for handing  over funds. Built into the system, therefore, was the expectation that tax collectors would use their own credit to raise private short-term loans in order to fulfil their contracts. Moreover, the crown would also turn to these sources for additional advances of short-term credit, creating the situation in which the crown’s tax agents often lent the king what in reality was his own money! Under the loose supervision of the comptroller-general and his colleague the secretary of state for war, funds were distributed on a massive scale by the principal military paymasters, the treasurers-general of the privately organised ‘Extraordinaries of War’ treasury. But these men too were expected to use their personal credit to provide stopgap funding to cover delays or shortfalls in the financial resources reaching them.

Even in the early years of the war it was obvious that the money flowing to the Extraordinaries was not enough to finance Louis XIV’s military enterprises. The government consequently authorised its revenue officials and the Extraordinaries to raise massive loans to cover the shortfalls by selling interest-bearing fiduciary notes (in effect promises backed not by gold or silver, but relying entirely on their personal credit ratings). As the total level of state debt mounted, the government failed to make adequate provision for liquidating this debt in an orderly way. By 1707 the comptroller-general Michel Chamillart had lost any grip on the assignment of revenue flows, often allocating the same resources several times over to different outlets. On top of this, other tricks that had worked during the previous conflict, the Nine Years’ War (1688-97), stopped producing results. By 1708 the market for selling potentially lucrative administrative and judicial offices was saturated and most incumbents of these offices were so financially exhausted that further monies could no longer be extorted from them. By this time, the official state borrowing agency, the *Caisse d’Emprunts*, had also ceased to have any serious credibility.

One further expedient resorted to, which contributed to the 1709 crash, was the crown’s systematic manipulation of the currency after 1689. The French monetary system was based on a theoretical unit, the *livre*, but the actual coinage, the gold *louis d’or* and the silver *écu d’argent*, was denominated in alterable multiples of livres. The manipulation of the value of these coins in livres was designed to produce liquid profits for the king and, most importantly, to channel money in the form of gold and silver directly to the armed forces. A succession of such ‘reformations’ drove much coinage out of circulation or abroad and, to offset this, in 1703 the government changed the legal status of the bills which were issued by the Paris Mint as receipts for old coins deposited with it as part of the process of switching over to newly minted ones. By decree these bills were now given the status of tradable interest-bearing credit notes. Mint bills quickly came to play a leading role as backing for short-term loans to state agents, but they were issued in excessive quantities and the market in them became highly volatile.

Transferring the unprecedented sums required by Louis XIV’s armies in Europe was expensive. Sending such funds abroad accounted for between eight and 50 per cent of the capital involved, a crippling extra burden on Louis’s shrinking revenues. It made him heavily dependent on the international banking fraternity whose stability, at a time of virtually no financial regulation, relied solely on honour and trust. The bankers’ favourite device for moving the royal funds was the ‘negotiable bill of exchange’, an instrument which had started life as a way of paying for traded goods but had long since been transformed into a means by which governments could move money within their own borders and abroad. If such bills were to remain effective financial instruments, it was essential they should be used prudently; at all costs the issuer of a bill had to ensure that he had sufficient credit with the person finally called on to ‘acquit’ (i.e. honour) it; if for any reason the final acquitter ‘protested’ (i.e. refused to honour) the bill, then the issuer’s credit rating would be seriously damaged. In practice, during the War of the Spanish Succession the creditworthiness of both those who issued such bills on behalf of Louis XIV and those who finally acquitted them was only as strong as the resources they had been given by the king’s ministers to back their transactions.

This international transfer system was further compromised by its increasing dependence after 1701 on Lyon as a financial centre. The Lyon financial market used a quarterly settlements system known as *les paiements*: four periods a year, each lasting for four weeks, during which time exchange rates were fixed and in the course of which outstanding contracts could be settled, new loans contracted or outstanding debts rescheduled for settlement. This system for financial transfers had not been designed for the volume of money market trans-actions now thrust upon it and by 1708 it was struggling to cope. Lyon’s essential position in the international system was based on its close links with sources of capital in nearby Geneva. These relationships with Geneva’s merchant bankers were fostered by a number of Huguenot financiers who had converted to Catholicism to avoid persecution after the Revocation of the Edict of Nantes by Louis in 1685 and who had remained in France. The most important of these was Samuel Bernard, whose operations increasingly came to dominate the Lyon *paiements* in the years after 1701. Regarded as a financial wizard by his contemporaries, he became indispensable to the king as one of a tiny number of individuals able to arrange reliable international transfers based on credit. In 1701 Bernard became the international banking associate of the treasury of the Extraordinaries of War. From 1703 to 1706 he was the dominant figure shaping French financial and monetary policy. Between 1702 and 1708, Bernard channelled no less than 30 million *livres* a year to the crown’s forces and its agents at a time when the state’s total disposable annual revenue was only between 40 and 60 million *livres*. In order to achieve this feat, however, he had to enter into a number of partnerships, tying him more closely to Genevan banking houses, and had to borrow more and more heavily from international merchants through Bertrand Castan of Lyon.

France’s financial situation was fast becoming precarious. From late 1707, though he remained a dominant force in the money markets, Bernard lacked sufficient control over state finances to ensure the underlying stability of his financial operations. Moreover, although the appointment of the astute Nicolas Desmaretz as comptroller-general in February 1708 prevented the immediate collapse of the French financial system, both he and the king well knew that the over-anticipation of prospective revenue had gone so far by then that France was teetering on the edge of the financial precipice. Desmaretz’s assistant later recounted what Louis XIV had said to the minister on his appointment:

His Majesty told [Desmaretz] that He did not demand the impossible from him; that He saw as well as him the bad state of His finances; that if [Desmaretz] could procure for Him the help which was necessary to sustain the war, in order to determine His enemies to make peace, he would be rendering Him a great service; and that, if his cares and his work did not produce the hoped-for effect, then He would not at all impute [adverse] events to [Desmaretz].

In 1708 the previously indomitable Samuel Bernard suffered the humiliation of having some of his bills of exchange ‘protested’. To shore up his credibility he was forced to provide additional guarantees of good faith by handing over unstable Mint bills to his correspondents. Well aware of his precarious position, Bernard turned to speculation on a huge scale in the hope of gambling his way out of trouble. In December he presented a plan to the royal council under which the government would set up a chartered note-issuing bank under his leadership, with capital to the tune of 12 million livres to be provided by other leading financiers. In a nutshell, Bernard’s aim was that the bank would either withdraw or boost confidence in Mint bills so that at least some could continue to be used for payments. Already invested to the hilt in Mint bills, Bernard proceeded to buy even more of them in the hope that the launch of his new bank would boost their market value, thus rescuing him financially.

Meanwhile he had to remain solvent. Unknown to most of his fellow financiers, he somehow persuaded the Lyon city authorities to postpone the December 1708 *paiement*, allowing him time to reschedule some of his debts. However, to meet his obligations he also needed help from Bertrand Castan in Lyon. He borrowed some 36 million livres from him against bills of exchange. At the same time he handed over to Castan and to other creditors additional securities for their loans in the shape of 28 million *livres*’ worth of Mint bills, which would be returned to him when he liquidated the bills of exchange. For Bernard to remain afloat it was essential that his bills of exchange and his Mint bills were not separated. He would need them again as backing for further loans.

That winter, France was hit by appallingly cold weather in early January and late February and, when the thaws followed, they brought disaster: famine, mass migration, disease and endemic crime. Between the two great freezes the final financial crisis was precipitated in mid-February by the comptroller-general Desmaretz taking emergency measures, including the suspension of various state payments. This sent out the strong message that he was expecting serious shortfalls in royal revenues as a consequence of the problems that the winter had created. Later in February some holders of Bernard’s and Castan’s bills of exchange began selling the Mint bills that they held as extra guarantees for their loans. The biggest culprit was Lullin Brothers of Geneva, on whom Bernard had come to rely for his supplies of foreign credit. Lullins was clearly anticipating a major collapse of French state revenues and, therefore, of Bernard’s ability to settle his bills of exchange. They were selling the Mint bills and accepting a modest loss compared with the much larger losses they would suffer once the price of Mint bills had collapsed. Castan, Bernard’s principal correspondent in Lyon, also began to cut his potential losses in the same way. Lullins and Castan almost certainly intended to buy Mint bills back again later at a much reduced price in order to replace Bernard’s securities. This was an early example of the ‘short-selling’ technique employed by speculators which contributed to the 2008 banking collapse.

That spring the royal council turned down Bernard’s bank plan, wary of handing him too much power and unconvinced that he could raise the required capital. Though Desmaretz was still giving him further revenue assignments, Bernard was unaware that his assets (the Mint bills) had been decoupled from his liabilities (the Lyon bills of exchange). He was assuming that his Mint bills would get him through the next Lyon *paiement*. But on April 8th, a week after this new *paiement* opened, Bernard’s creditors presented his bills of exchange for payment, demanding coin and refusing to consider any further rescheduling of the debts. It then became apparent that Bernard’s Mint bills had been sold and that he did not have enough other assets with which to pay his creditors. There was an immediate explosion in the protestation of bills of exchange and the price of Mint bills fell to only half their face value. Castan, pressed by Bernard’s creditors and clearly guilty of personal speculation, fled to Bern and Bernard conveniently fell ill to avoid having to go to Lyon to face the music. In Geneva there was a total breakdown of investment and lending confidence, producing alarming numbers of bankruptcies with knock-on effects for the manufactures of the luxury goods that underpinned the city’s economy. In Lyon, though, things were even worse: there the entire *paiement* disintegrated, merchants defaulted on their settlements across the board, and inter-bank lending dried up.

The state now had little choice but to make a supreme effort to prop up the entire financial and economic architecture of France. The next three Lyon *paiements* were officially dragged out for months, contributing to a severe contraction in liquidity and virtually cutting off the flow of cash to the armies. It was fortunate for Louis that Marshal Villars was able to inflict such heavy casualties on the Duke of Marlborough’s victorious allied army at the bloody Battle of Malplaquet in September 1709 that an invasion of northern France could not be pressed home. The prolongations of the *paiements* at least bought time to try to rescue the indispensable Bernard. In 1701 and in 1707-08 the crown had allowed bankers and treasurers who had overextended themselves to go to the wall, providing just enough of a rescue package not to destroy state credit. With Bernard it was different, as his personal ruination would destroy the Bourbon dynasty’s chances of holding on to Spain. In May 1709 Desmaretz accordingly provided Bernard with another 14 million livres in revenue assignments to pay off some of his 38 million livres of liabilities. Far from cutting and running, Bernard now had the courage to hold onto his assets rather than sell them for what he could get. He entered into negotiations with his creditors, who were desperate to acquire any liquidity on offer in order to get their own payments moving again.

By August 1709, with the king’s direct agent, the intendant of Lyon, overseeing his operations, Bernard had managed to liquidate, or reach agreements on liquidating, 20 million *livres* of debts, but the situation was still alarming. On August 26th Desmaretz told the king:

For four months all circulation of money has ceased ... The falls of sieurs Hogguer, Bernard and Nicolas, that of sieurs Tourton and Guignes and others who operated the banking system with the highest credit ratings have thrown into disorder the markets of Lyon, Paris, Geneva and all others. No resources can be hoped for from the bankers.

In spite of this, Desmaretz still thought that he might be able to pull some banking credit from the wreckage of Lyon and in September he granted Bernard a three-year moratorium on enforcing repayment of his bills of exchange, a policy of crown protection that would gradually be extended to dozens of financiers until the end of the war. This sent out a strong message that creditors should try to reach agreements with their debtors and in October Bernard finally did a deal with his biggest creditor, Jean-Antoine Lullin, as the latter lay on his deathbed. Reflecting the strength of their hold on his assets, Lullin Brothers ended up bearing a smaller loss than any of Bernard’s other creditors.

As events transpired, the rescue of Samuel Bernard reaped dividends for Louis XIV. Though Bernard’s remittances abroad never reached their earlier heights, during 1710 he managed remarkably to get substantial funds from hostile Holland and to channel them to Spain in what was to prove the crucial year in cementing Louis’s grandson Philip V on the Spanish throne. Desmaretz was under no illusions about his utter dependence on Bernard:

He acts on my word alone and does not await the delivery of funds to back up my pledges. This obliges me to help him, all the more so as there remain at present no other bankers nor businessmen whose credit is not exhausted by the immense advances which have been made to the king.

Bernard was still carrying personal debts of five million *livres*, but his continuation in royal service allowed him to pay off this huge sum, though only over many years. The government’s rescue plan, in tandem with an unprecedented early form of income tax introduced in 1710 on all subjects, kept sufficient flow of credit going to the crown until the war could be wound up in 1714. In the spring of 1715, though, the last great association of tax officials collapsed. It had been a very close run thing.

Did the French monarchy draw appropriate conclusions from the credit crunch of 1709 and act upon them? Certainly the comptroller-general tried to simplify crown credit. First, to avoid prolonging the king’s dependence upon international bankers for short-term credit, Desmaretz returned the dominant role in this sphere to the provincial tax officials, who were far closer to the revenue sources that backed short-term borrowing. In fact, the collapse of so many bankers left the monarchy with little choice in this regard, though Bernard remained of vital service for Spanish affairs. Second, Desmaretz made Herculean efforts to reduce the many different kinds of government credit notes, withdrawing the most worthless junk from circulation and converting it to something more creditworthy. If progress on this was slow, it was because state revenues were by then so weak.

After Louis XIV’s death in 1715, however, an already appalling situation got worse during Philippe Duke of Orléans’ regency for the child-king Louis XV. The exiled Scots financier John Law had witnessed at first hand the French problems in the 1700s. His analyses of what had gone wrong were profound and his proposals for how to deal with them persuasive. Desperate to restore French military potential by reviving the crown’s finances, Orléans allowed Law to establish more and more control over the French financial and commercial system. Ironically, one key policy that had been rejected for sound reasons in the 1708-09 period was approved a decade later. Desmaretz had been suspicious of paper money and of a national bank led by one dominant individual and in 1715 Samuel Bernard, in the light of his experiences, also became hostile to the idea. But the regent was persuaded to allow Law to turn his Banque Générale Privée, set up in 1716 with a capital mainly based on government bills and credit notes, into the Banque Royale two years later, effectively a national bank guaranteed by the crown and with a monopoly in the issue of notes and government debt. He was allowed to buy the Mississippi Company, which financed the French colony of Louisiana, and float it publicly as the Compagnie d’Occident, a joint stock company with an effective monopoly of all French colonial commerce. The regent also made Law comptroller-general of finances, thus giving him control of taxation as well. This was centralisation of financial power in one person on a scale that not even Bernard had considered in 1709. The hope was that it would generate the monopoly profits required to bring the public debt under control. Law and his bank provoked a huge speculative bubble in the shares of the Compagnie d’Occident, and when it burst in 1720 it brought the whole of the French financial system down, causing a long and deep recession. As a result, France lost all enthusiasm for a national bank until Napoleon created one in 1800.

For the rest of its existence the Ancien Régime struggled with its public debt burden. The government tried to limit its recourse to large-scale short-term credit by raising longer-term loans. But the state was never able to break away from its dependence on its own revenue and expenditure officials for supplying short-term advances to plug gaps; and these gaps were fatally allowed to widen. In the end the extra burdens put on the crown’s finances by the cost of French military and naval armament during and after the American War of Independence proved too great for the military and naval treasurers; in 1787 they both went bankrupt. This happened, disastrously, just at the moment the Assembly of Notables began meeting at Louis XVI’s behest to consider reform of the kingdom and the bankruptcies contributed heavily to the Notables’ rejection of key royal proposals. Louis XVI was, therefore, ultimately forced to summon the Estates-General for the first time since 1614, beginning the sequence of events that led directly to the French Revolution.

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