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Carlos Álvarez-Nogal , Christophe Chamley
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Introduction

The book presents a history of the reign of Philip II of Spain viewed through the lens of his finances. It is not a comprehensive financial history, but it presents a narrative that highlights the logic of Philip's actions in fiscal, financial, and related political matters. In addition to material that we published in scholarly journals during the last twelve years, we have conducted a significant amount of additional research. Hundreds of footnotes have been included for scholars. All this information has been pruned to have a clear and concise representation of Philip's financial challenges that is accessible to any reader with a strong interest in the finances of the superpower of the sixteenth century.

Philip II has been maligned for centuries, and up to the present day, by a propaganda tinged by cultural racism. Our financial approach shows that he dealt adroitly with institutional constraints and that he was not an autocrat. The purpose of this Introduction is to bring the reader to see the world as he did.

The World of Philip II

Philip II was born at a time when part of the Iberian Peninsula had become one of the most vibrant regions of Europe. Society and institutions had been shaped by the Reconquista, which had gradually pushed the Muslims south after their sudden conquest in 711. To populate and stabilize the frontier zones, incentives were offered to settlers. As early as the ninth century, cities in the north were granted rights through charters (*fueros*). This environment led to the first representative assemblies in history, which included city delegates who were not ecclesiastical or aristocratic (Cortes de Aragón, 1162, Cortes de León, 1188). Because of its gradual construction, the social fabric combined local life with a sense of unity under a king, reinforced by geography, the military, and a common religious faith.

In 1470, the territory of present-day Spain consisted of two kingdoms, Castile, the main one, and, in the eastern part, Aragon. In addition, a

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small Muslim enclave remained in the south (the Kingdom of Grenada). The final unification was achieved first in 1469, when Isabel, heir to the Castilian throne, eloped with Ferdinand of Aragon at the age of eighteen, and second, when the fall of the Alhambra in Grenada completed the Reconquista (on January 1, 1492). Spain had acquired its present borders (with some later adjustments in the north) centuries before any other country in Europe. The Iberian Peninsula of that time has been called a monarchy of urban republics, content with its natural borders south of the Pyrenees and which was not yet aware of the immense resources of the recently discovered Americas.

In the pre-modern era, medieval rules of inheritance still dictated who could claim a throne or territory. The political landscape was constantly shifting, subject to the hazards of marriage, birth, and death. The high mortality rate created opportunities for new connections. While the pool at the top was small, the church could break the rules against consanguinity, as in the case of cousins Isabel and Ferdinand. The Habsburgs, the "House of Austria," dominated this political game of "mergers and acquisitions." By the end of the fifteenth century, they emerged in this game as the most skillful and successful family in Europe.

A central part of the narrative in this book is Flanders, which roughly included what is now northern France, Belgium, and the Netherlands. The reader may wonder how on earth Castile, protected by the Pyrenees, got involved in Flanders. Were these colonies? In the spirit of the time, not at all. It started with the fateful decision, in 1496, of Isabel and Ferdinand to marry their daughter Juana, who was only third in line to the Castilian throne, to Philip "the Handsome", son of the head of the Habsburg family, Maximilian I. Philip (Philip I in the history of Spain) was the fruit of the marriage of Maximilian I to Mary, Duchess of Burgundy, whose territories included Flanders, one of the richest regions on the planet.

The son of Juana and Philip, Charles was born in Ghent (in present-day Belgium) in 1500 and educated in Flanders by Flemish tutors. He was catapulted by a rapid succession of events to the dominant position in Europe. Almost immediately after his birth, the last heir to the throne of Castile died. Then, at the age of six, the untimely death of his father (Philip the Handsome) made him heir to the Habsburg Empire and caused his mother (who was heir to the throne of Castile) to lose her mind and to become known as Juana la Loca. Castile received the fateful Habsburg inheritance that would draw it into the European theater and centuries of military and religious strife.

Charles, at the age of nineteen, was elected Holy Roman Emperor with the help of a loan from the richest man of the time, Jakob Fugger.

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In addition to the Iberian Peninsula, his empire included the Habsburg territories of Austria, Bohemia, Transylvania, Flanders, part of eastern France, the Milan region, and the southern half of Italy, including Sicily. This empire was cracked by the Reformation, despite Charles's tireless efforts. Shortly before his death, the first European emperor since Charlemagne bequeathed the eastern part of his empire to his brother and the western part to his only son Philip, who, unlike his father, had been raised to be a true Spanish monarch.

Philip (Philip II after the death of his father, Charles V) had been regent of Spain before ascending the throne, and one of his main duties was to raise money for his father, who was fighting in Germany. He wrote to him:

> The main foundation on which the war can be sustained is money and credit and without those, one cannot do anything.[1]

When he was about to succeed his father, he wrote to him:

> I would very much like to explain my actions before the world, to show that I have no claims to the territory of others, but I would also like it to be understood that I must defend what Your Majesty has granted me.[2]

One of his most important bankers and financial advisors, Juan Fernández de Espinosa, later reminded him:

> His Majesty is Lord of the States of Flanders and is determined to keep them and not to lose them. He is also lord of the kingdoms of Naples and Sicily, and is determined to preserve them and not to lose them. The same could be said of Milan and the other kingdoms of Spain and Aragon, namely that He is determined not to lose them… And in the end it all comes down to providing sums of money to maintain the armies.[3]

During his reign, Philip fought against France, the Ottoman Empire, the Dutch rebels, and England in an unbroken succession of conflicts. On the day of Philip's death, the ambassador from Venice wrote to his senate, "He was a prince who fought with gold rather than with steel."[4]

Philip had far more resources than any other ruler in Europe, but it was never enough during the military revolution in Europe. Military spending soared as success depended on large armies with an expensive combination of highly trained infantry (the famous *tercios*) and firepower, and it

[1] (Carande Thovar, 1965: II, 125). [2] (Kamen, 1997: 60). See AGS, E, 808, nº 54.
[3] (Lovett, 1977: 93).
[4] (Kamen, 1997: 315 and footnote 100). See Calendar of State Papers, Venice, IX, 342–343.

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would rise further in the second half of his reign in siege warfare against the new "Italian line" of defense.[5]

This book presents a historical account of the reign of Philip II from the perspective of his finances. It traces how he addressed a series of fiscal and financial challenges in their historical sequence, which the book follows. The central theme is the tension between Philip's imperial revenue demands and the cozy oligarchies in the cities of Castile. (Aragon's contribution to the revenue was small).

Castile never fully accepted responsibility for financing the Habsburg inheritance. This resistance gradually increased during the reign, especially in the second part of it, when most of the expenditures were made in Flanders which was a land foreign to the Castilian elite. The primary locus of their resistance was the Cortes of Castile.

Following a four-century tradition of representation, the Cortes of Castile in the sixteenth century included a representation of eighteen cities of Castile and their surrounding territories. As elsewhere in Europe at the time, the Cortes had to be convened by the king, who, as in previous centuries, called them when he needed money. They could not oppose the king directly, but through procedural maneuvering, long speeches, and legal wrangling, they could impose costly delays on the king. The power of the Cortes stemmed from the fact that, under the implicit constitution of Castile, their approval was required for half of the ordinary revenues (to be explained in the book), which were the only revenues that could pay the interest on most of the king's debt, the juros, which were long-term annuities. The details of these restrictions will be crucial to the story told in the book.

Philip's debt gradually increased in a standard process of high spending and economic growth. The service of this debt – the payment of its interest – required an increase in the type of revenue that was subject to the approval of the Cortes. Three times during his reign, Philip found himself in the situation where the debt service had reached the level of ordinary revenues and he had to ask the Cortes for an increase. The Cortes, whose interests did not align with those of the king, resisted. This struggle is conceptually related to a recent struggle in the US Congress, when some Republicans tried to leverage the legal ceiling of the federal debt to reduce the size of government spending. In that case, the opposition to raising the limit failed because of the risk of a credit crisis. During Philip's reign, the opposition of the Cortes twice led to such a credit crisis in 1575 and 1596.

[5] The tercios in the Surrender of Breda (1625) were illustrated in 1635 by one of Velázquez most famous paintings, *Las Lanzas*.

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The crises occurred when Philip suspended payments on the asientos, or loans from the bankers. These loans never amounted to more than 10 to 15 percent of the royal debt, and the asientos were much more than loans. The bankers, most but not all of them from Genoa, were also merchants, since many private loans were closely tied to trade. They were essential in providing the crown with the financial services for war expenditures, especially since most of them were far from Castile. Bankers provided credit, managed the flow of tax revenues to places of expenditure, and exchanged currency when that expenditure took place abroad; they sold juros of the crown which was a complicated task requiring expert knowledge of the credit market in Castile, as we shall see. At a time when the crown had no administration to collect revenues or manage its debts, the bankers were the "money men" who, two centuries later, were essential to the marketing of the British public debt.[6]

The decrees that declared a suspension of payments on the asientos in 1560 and 1575 had two parts, as we shall see. The first was addressed to the Cortes and the Castilian elite, pretending to castigate the bankers who were hated by the Castilian elite. This part was intended to convince them to accept the increase in taxes demanded by the king. The second part of the decree was to refinance the short-term debt into *juros*, which had a much lower cost. This operation, urged by some of Philip's advisors, as it would be by any modern economist, was not a debt reduction. Some of the refinancing terms may have been "below market," especially in 1560, but that was window dressing for the Cortes. For the actual terms of the refinancing, we must look at the contracts with the bankers in the years after the suspension.

These suspensions have been erroneously referred to by modern writers as "bankruptcies," a term that was never used during this period. This nomenclature has an anachronistic connotation, as it corresponds to the contemporary concept of sovereign default and the procedures associated with it. It has perpetuated a pervasive negative image of a monarch in a perpetual state of default. Not only is this perspective inaccurate, but it deserves to be corrected, not as a defense of the monarch, but as a correction of a misreading of the political economy of Philip II's reign, which was far from an absolute monarchy. Philip often complained that there was not enough money, but that is a common complaint. Ironically, to focus on Philip's relationship with his bankers is to fall into his own trap, which was to play up his conflicts with the bankers to achieve his main goal of extracting more revenue from the Cortes.

[6] (Dickson, 1967).

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Photograph I.1 The castle of Simancas, where Philip II placed his archives.

Philip was a reserved man with a keen intellect and an acute awareness of his position and authority. He preferred to "put it on paper" and made decisions based on written notes, often after very long deliberations, rather than by discussion. In 1592, during a visit to his reorganized archives in the castle of Simancas near Valladolid (Photograph I.1), he declined to attend the festivities organized by the villagers. Instead, he withdrew to the *legajos*, the files of his administration, which he bequeathed to us in this castle, where they are still preserved. We went there many times. These documents contain information on royal finances that is unparalleled for his time.

Not even his ministers knew what the king wanted until he sent his order through a secretary, which then had to be obeyed. Secrecy was often the key to the success of his strategy, as we shall see. We are no more intimate with his thinking than his ministers were, but economics is a powerful investigative tool.

The Book

This work would not have been possible without the deep scholarship of the researchers who preceded us in the study of Philip II. Ulloa, Ruiz Martin, Lorenzo Sanz, Lovett, Carlos Morales, Fortea Pérez, and

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Thompson are indispensable sources for understanding the taxation of the reign, from a qualitative and quantitative point of view, the relationship between the king and the Cortes, and the arduous and difficult negotiations on fiscal matters throughout the reign. They also illuminate the pivotal role played by the Genoese bankers in the finances of the crown the commercial dynamism of the city of Seville, and the close relationship between the king, his bankers, and the important ministers around the Council of Finance.

We refer to all the works that we trust and often admire, although we often do not share some of their interpretations of historical facts and archival documents. Such differences are part of historical work. This book, although it contains hundreds of references for the scholar, is intended for the non-specialist. Rather than criticizing the interpretation of a particular author – the specialist will know whom – we prefer to present our coherent narrative, which radically differs from the conventional "serial defaulter" reading of Philip's reign, but is not new. Three scholars, Fortea Pérez, Thompson, and Stasavage, have suggested it, but they did not elaborate.

We firmly believe in the value of documents and texts. Our objective is to provide readers with direct access to these texts. We offer a narrative surrounding the texts, but we do not instruct the reader to think in our way. We encourage readers to form their own vision of the history of this period.

Some chapters are based on our articles published during the last ten years. We have added a significant amount of additional research through an exhaustive consultation of the original documents preserved in various archives, especially in the General Archive of Simancas. As a rule, when a document is cited, we have consulted the document in person at the archives, even if it has been used and cited by other authors. The archives contain not only the king's asientos, or credit contracts with his bankers, but also the discussions of his ministers in the councils, the reports of the *corregidores* on the opinion of the cities on fiscal matters, hundreds of accounting books of the accountants of the Royal Treasury on income and expenses, and the letters written to the king by his subjects denouncing injustices or those of his bankers claiming their rights. It is essential to consult these documents, not only the asientos, to understand the fiscal and financial problems of the monarchy during the reign of Philip II.

This archival work has allowed us to establish different series on the amount of asientos signed in Madrid, to make an estimate of those signed in Flanders, and to analyze in detail innumerable financial operations carried out by the bankers, in order to better understand and explain the

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framework designed by the crown to finance its expenditures worked. This book and our interpretation are based on a foundation of primary documents. For additional information, we have created a website dedicated to this book.

The book is divided into five parts, each chapter being short and focusing on one topic.

Castile in the Sixteenth Century: Markets, Banks, and Credit

The first part presents the main elements of the public finances of Castile. It provides the building blocks and the theoretical framework for understanding the narrative in the following parts of the book.

Chapter 1 describes the life of the cities at the time of Philip II and shows that Genoese bankers were already well integrated into the financial activities in Castile before his reign. In Chapter 2, the biennial trade fairs of Medina del Campo are shown to be the timing mechanism for financial contracts, especially in the first part of the reign. The public banks of Castile, in Chapter 3, have often been neglected. They were important institutions of financial intermediation, much like today, and their response to financial crises will provide useful observations of their function.

Chapter 4 is devoted to the administration of tax collection. The crown had no capacity to collect taxes itself. The collection system had two components: first, the task of collection was delegated, that is, outsourced to private collectors or to cities that organized and collected their local taxes; second, powerful accountants and audit chambers verified that the collection complied with the royal decisions. An important feature of Castile was its fragmentation into regions and cities, each with its own institutional customs.[7] We will see that this fragmentation had a critical impact on the structure of taxation and of the public debt.

Chapter 5 emphasizes that understanding the distribution of royal revenues by type is crucial for interpreting the financial events of the reign. Chapter 6 describes the long-term debt, mostly in perpetual annuities, the juros, which were paid from local revenues. This fragmentation of the capital market was due to its historical development, but it somewhat prevented the crown from diverting the revenues that serviced the juros. This safeguard lowered the rate demanded by investors, which was consequently to the crown's advantage.

[7] This issue has been studied in detail by Grafe (2012) for the period after Philip II. The causes were even more relevant in the sixteenth century. See also Irigoin and Grafe (2008).

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As the century progressed, the downward trend in interest rates allowed the crown to refinance its debt at lower rates. Because of the definition of juros, this reduction in yield was achieved by a special method, a crecimiento, in which a juro was refinanced by increasing its face value, rather than by reducing its coupon, as would be done in the centralized capital market in England two centuries later. This method of reducing the yield was not a default. It is described in detail for the first time in Chapter 7. Crecimientos took place throughout the reign. They became important in resolving the financial crisis of 1575–1577 and were essential in resolving that of 1596.

At the end of the first part of this book, after setting the Castilian stage, we summarize the constraints that Philip faced in his debt financing through a simple model (Chapter 8). This provides a synthetic view of Philip's main budgetary problem.

The First Years: Triumphant Battles with the Pope, France, the Bankers, and the Cortes

After the preparation of the first part, the narrative begins and is divided into three parts, each corresponding to a phase of Philip's reign. In his early years, Philip immediately achieved brilliant victories. The first was against a pope who held a grudge against Spain. Conflict was avoided by a combination of financial and military blockade (Chapter 9). The second success was the war that France had declared against the new king and the mobilization of resources to raise an army twice the size of France's and crush it at St. Quentin. This was achieved at the same time as a financial restructuring that has been called the first bankruptcy. Careful examination shows that it was nothing of the sort, but on the contrary, excellent financial management (Chapter 10). All these successes were achieved immediately after he took over from his father in Brussels, and while he was far from Castile, shuttling between London and Brussels during the first four years of his reign.

Upon his return in 1559, the young king undertook a decisive reorganization of his finances. He completed the refinancing begun in 1557 by suspending payments in October 1560 and increasing the contribution of the cities in the Cortes of 1561. For the first time, the text of the suspension decree is carefully analyzed in relation to its actual implementation (Chapter 11), and this text is later compared with the text of 1575. The implementation demonstrates that the suspension itself was a show for the Cortes, and that, after the Cortes agreement, the crown granted terms in asientos that circumvented the decree.

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The Sixties: Turning to the South While the North Was Brewing

After this success, Philip exploited the Ottoman threat in the Mediterranean to obtain a significant increase in the church's contribution through the sale of bulls of indulgence. This was despite the simultaneous Council of Trent, called in response to the Reformation, which itself had been sparked by the sale of indulgences by the Fuggers in Germany. This phase ended triumphantly with the Battle of Lepanto in 1571 (Chapter 12). Philip then turned his attention, perhaps too late, to the north in Flanders, where a revolt had begun in 1564.

After examining the context and the fiscal issues in these provinces (Chapter 13), we turn to the famous asientos, which were key instruments for channeling revenues to military expenditures through various territories and for lending to the crown (Chapter 14). An interesting illustration is provided, not for the military, but for the project that was so dear to Philip: the construction of the largest building of the time, the Escorial. The financing of the beginning of the construction is followed through a series of special asientos, the *factorías* (Chapter 15).

The Main Confrontation with the Cities and the Crisis of 1575–1577

In this pivotal part of the book, we first examine how tensions between the Cortes and the king began to rise in the 1570s as he sought to increase his revenues because of the closing gap between ordinary revenues and the service of the debt while military expenditures increased in Flanders (Chapter 16). Philip broke the deadlock into two steps. In the fall of 1574, he decreed a tripling of the cities' contribution. This constitutional breach was rejected by the cities (Chapter 17). In the second step, after signing a record amount of asientos, Philip decreed a suspension of payments to the bankers in September 1575 (Chapter 18).

The documents and the sequence of events show that the main objective of the suspension was to obtain the higher tax–not through a formal acquiescence in the Cortes, which they had submissively signed in the winter of 1575–but by forcing an explicit agreement with the oligarchies of the cities, in accordance with the kingdom's implicit constitutional order.

The payment stop brought the fairs of Medina and the entire credit market of Castile to a halt, thus putting pressure on the cities. Meanwhile, Philip protected the bankers from the legal proceedings of their creditors who were attempting to recover their funds. We present much documentary evidence on the pain that the people of Castile suffered from the credit crisis (Chapter 19).

During this war of attrition with the cities (Chapter 20), the thorny problem of the *juros de resguardo* – collateral for asientos – had to be

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