Chapter 10: Exporting the Revolution—the early adopters

> "He who…reduces the budget to such a point that the whole business of government comes to an end, is only fit for a madhouse."
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> —King Wilhelm I of Prussia, 1863 (quoted in Bismarck 1899, p. 336).

The Glorious Revolution is perhaps the single most important seedbed of western constitutionalism. As other European nations pondered Great Britain's military and economic successes, they adopted features of what they took the Revolution settlement to be. This chapter investigates the earliest adopters of English parliamentarism—the major states of west and central Europe in the late 18th and 19th centuries—focusing on how they sought to control public expenditures.

The most obvious step toward imitating English fiscal practices was to require that national budgets—plans or promises of expenditure to be made in the coming year—be annually approved by parliament. Yet, annual statutory budgets were not enough. Much depended on what happened if MPs refused their support—or on what I call the budgetary reversion. The English made sure that either (a) the executive's legal authority to *collect* revenues automatically lapsed or (b) the executive's legal authority to *spend* public revenues automatically lapsed or (c) both. Thus, a budget deal had to be done or parts of the government—including the military—would be forced to "shut down."

As I will show, not all 19th-century imitators of Britain's constitution mandated shutdown reversions. If no agreement could be reached with parliament, some allowed the executive to carry on with the previous year's budget, while others allowed the executive simply to promulgate the budget by decree. Both of these alternative budgetary reversions avoided the madhouse situation decried by King Wilhelm I but in the process they substantially undercut parliament's bargaining leverage. To explore how annual budgets coupled with differing budgetary reversions affected state revenues, I rely on the data assembled by Dincecco (2011; Dincecco et al. 2011).

The English budget

As noted in chapter 2, English MPs used two basic methods to punish the crown, in case it should spend appropriated revenues contrary to statutory intent. The earliest method was to ensure that the crown's legal authority to collect certain taxes lapsed after a date certain.[1] Thus, if the crown misappropriated revenues, MPs could retaliate simply by allowing revenues to lapse.

A second method, which the American colonists enshrined in their constitution of 1787, was to ensure that authority to expend public revenues automatically lapsed. The appropriation clause of the US Constitution effectively required a "government shutdown," should the annual appropriations bill for one or another part of the government machinery not be enacted.[2]

Because either tax or expenditure authority would lapse every year, forcing portions of the government to "shut down," parliamentarians were assured the crown would seek a new budget every year, whereupon they could bargain for attainment of their various goals. As Madison (2009[1788], p. 298) put it, "This power over the purse may…be regarded as the most complete and effectual weapon with which any constitution can arm the immediate representatives of the people, for obtaining a redress of every grievance, and for carrying into effect every just and salutary measure."

Montesquieu (1989[1748], pp. 164) had earlier stressed the complementary point that disabling the power of the purse risked tyranny: "If the executive power enacts on the raising of public funds without the consent of the legislature, there will no longer be liberty, because the executive power will become the legislator on the most important point of legislation." In other words, the legislature's right to deny the funds requested by the executive was essential to ensure it could check and balance the latter's ambitions. As the Whig leader Charles James Fox put it, writing a few years before Madison, "To withhold the demanded funds is the most powerful of all weapons… [and] makes the difference between a free people and the slaves of an absolute monarchy" (1784, quoted in Stourm 1917, p. 385).

A typology of budgets

Before investigating how much the early imitators of British fiscal practices took Fox's maxim to heart, it is useful to describe the wider menu of budgetary processes from which they might have chosen. Budgetary processes can be divided into categories, depending on who has the *de jure* right to (a) set the budget; (b) levy taxes; and (c) revise the budget. Table 10.1 displays four of the most commonly observed combinations of these three variables in European history. First, if the executive sets

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[1] Redlich (1908, vol. III, p. 126) notes that, even in the 20th century, the commons continued to insist that a few important tax grants should automatically expire.

[2] There were only two ways to avoid this result. First, Congress might explicitly provide for temporary funding, via what eventually came to be called a continuing resolution. Second, Congress might provide for what were effectively "permanent appropriations," as for example in the Anti-Deficiency Act. As long as Congress did not offer a permanent appropriation that was too generous, its bargaining position was similar to the English parliament's. In particular, mere congressional inaction would cause a painful contraction of expenditure.

the budget by decree, levies taxes by decree and revises the budget at will, then the budgeting process is "absolutist." Second, if the executive sets the budget plan by decree, parliament votes the taxes after hearing that plan, and the executive then spends without being legally constrained by the original plan, then budgeting is "Machiavellian."

Table 10.1 about here.

A third possibility is that the executive determines the budget plan but it is then placed in a statute (this can be accomplished, for example, when the budgetary reversion is the executive's proposal). After seeing the plan, parliament votes the taxes; and, when it comes times to disburse the funds, the executive is constrained by the originally announced plan (because it is statutory). In this case, we have what I call a *Rechtsstaat* budget. The logic of such a budget is that the executive will remain fully in control of setting the plan of expenditure but will then be constrained to honor the promises contained in that plan (or at least more constrained than it had been when budgets were purely royal documents).[3]

Finally, in a rule-of-law budgeting process, only parliament can set the budget, levy taxes or revise the budget. This was the system set up by the English after the Glorious Revolution.

In chapters 2 and 3, I examined what happened to English revenues when England transitioned from a mostly Machiavellian budgeting process before 1688 to a mostly rule-of-law process thereafter. In this chapter, I examine a panel of European states, some which made the same transition, and some which transitioned from Machiavellian to *Rechtsstaat* budgets. Even the latter polities made important structural improvements in the credibility of their budgets vis-à-vis the *ancien régime*. These improvements, which stemmed from annual publication and statutory entrenchment, can be explained as follows.

Under the *ancien régime*, the publication of budgets was a rare event. In Prussia, for example, "only five budgets were published between 1815 and 1847" (Tilly 1966, p. 491); and in pre-1790 France there was just Necker's "Account to the King" of 1781. Once annual budgets commenced, subjects had a substantially clearer idea of what expenditures the state had promised to undertake in the coming year. Thus, the sovereign promises contained in the budget could be more effectively monitored for compliance.

In addition, embedding budgets in statutes made it harder for a government to legally revise its budgetary promises. In the *ancien régime*, the crown could engage in

[3] I call this a *Rechtsstaat* budget because it seems to fit with the limited aims of German liberalism, as described e.g. in Mork (1971), Hahn (1977) and Flynn (1988).

impoundment (the refusal to spend funds for the purpose originally promised) or virement (the expenditure of funds, originally earmarked for one purpose, for another instead) at will. Few would even know of these royal changes, because the budget had never been published in the first place. Once budgets became annual and statutory, unilateral virement and impoundment by the executive were put on the political agenda. Most constitutions regulated virement, whereas the *ancien régime* did not.

Although *Rechtsstaat* budgets clearly improved the credibility of sovereign promises about how public revenues would be spent, they fell short of what could be attained in rule-of-law processes. In particular, because the budgetary reversion gave the government great discretion in setting the budget, it could not make credible commitments about future budgets. Thus, a version of the credibility problem afflicting Machiavellian processes persisted.

All told, the credibility of a state's commitment to expend public revenues as promised in the state's budget clearly improved as it moved from absolutist or Machiavellian budgets to *Rechtsstaat* budgets, and improved further with a move to rule-of-law budgets. In this chapter, I investigate whether MPs became more willing to authorize tax increases when the government could better commit to spending the resulting revenues in specific ways.

The early imitators

In important work, Dincecco (2011) has examined the revenue consequences of limited government in Europe. He counts a government as becoming "limited" in the "year that parliament gained a stable constitutional right to control the national budget on an annual basis" (Dincecco 2011, p. 28); and measures tax revenues in grams of gold per capita.

To give a flavor of his findings, Table 10.2 shows the mean pre- and post-reform revenues in each of eleven cases for which data exist to make the calculations.[4] As can be seen in the last two columns, mean revenues per capita consistently increased after annual statutory budgets were introduced. Moreover, Dincecco has shown that this basic finding persists in panel regressions, on which more below.

Table 10.2 about here.

Do the results just noted support the expectations laid out in the previous section? They do in part, because Dincecco's judgment of when parliament "gained a

[4] The table excludes Belgium, Denmark and Italy because Dincecco has no data on revenues for these countries prior to their adoption of annual statutory budgets (in 1831, 1848 and 1861 respectively). It excludes England because she adopted limited government long before the period on which I focus here (1790-1913). It adds Piedmont from Dincecco et al. 2011.

stable constitutional right to control the national budget on an annual basis" largely coincides with my judgment of when annual statutory budgeting began. However, my approach requires examining not just whether parliament must approve the national budget but also whether non-approval entails a government shutdown. The dose of credibility-enhancing reform that governments received, when they first allowed parliament to annually approve the budget, should have depended substantially on the budgetary reversion. Where the reversion was a government shutdown, meaning the country had implemented rule-of-law budgeting, the response should have been larger. In contrast, where the reversion favored the executive, revenues should have grown less robustly.

To explore these predictions, I first consider the cases of Denmark, Spain and Prussia in some detail. I then turn to panel regressions in the next section.

Denmark's provisional period

Like many other European polities, Denmark adopted a liberal constitution in the aftermath of the revolutions of 1848 (and Dincecco accordingly counts its government as "limited" thereafter). Two years after losing Schleswig and Holstein to Prussia, however, Denmark adopted the Revised Constitution of 1866. Article 25 of this charter gave the king recess decree powers. Although recess decrees had to be presented to parliament at its next sitting, the latter had little chance to reject them, because any resolution by the *Folketing* had to be sanctioned by the king before attaining legal force (Article 24).

In 1875, Jacob Estrup became prime minister of Denmark, leading a minority conservative party at a time when debates over military preparedness dominated domestic politics. In 1877, after failing to secure support in the *Folketing*, Estrup convinced the king to issue the budget as a provisional law under Article 25.

Although elements of the opposition called for a retaliatory "taxpayer revolt," others took a more pragmatic approach. For the next few years, they made sure that parliament passed the budget, typically after severe cuts to the military budget (Woodhouse 1974, pp. 207-209). By the mid-1880s, however, disputes over military preparedness hardened and Denmark embarked for ten years (1885-94) on the so-called *provisorietid* [provisional period]. As Woodhouse (1974, p. 212) describes it, "for nine Rigsdag sessions from 1884/85 through 1892/93, the Folketing's rejection of the government's proposed budget was followed, every April 1, by a Provisional Finance Act." Moreover, whereas Estrup had confined the budget of 1877 to areas of agreement between the two chambers of parliament, during the *provisorietid* no such niceties were observed (p. 211). In particular, massive fortifications protecting Copenhagen were built.

During the *provisorietid*, then, parliamentary refusal to support the government's budget led simply to the promulgation of that budget by decree. In other words, the budgetary reversion was the executive's choice.

After Copenhagen's fortifications were *faits accomplis*, the government and opposition reached the settlement of 1894, under which budgets were again approved by parliament. When the conservatives suffered electoral losses in 1901, the king finally appointed a left-wing government and publicly accepted the so-called *systemskifte* [change of system]. Although the principle would not be formally incorporated in the constitution until 1953, henceforth the king lacked the right to promulgate the budget by decree (pp. 216-17).

With this brief vignette in mind, consider Figure 10.1, which presents Dincecco's data on tax revenues per capita in Denmark 1866-1913. Two features of the data merit comment. First, in the period 1866-1900, revenues grew at an average annual rate of .094 grams of gold per capita. In contrast, after the onset of parliamentarism, revenues per capita grew at an annual rate over four times as fast (.427). Second, during the *provisorietid*, there was no revenue growth at all. Thus, per capita revenue growth in Denmark was closely tied to how parliamentary the sovereign promises embedded in the budget were.

Figure 10.1 about here.

Spain's budgetary reversion

Dincecco finds a relatively small increase in Spain's tax revenues after the onset of limited government, which he dates to 1876.[5] I would highlight two features of Spain's 1876 Constitution that substantially weakened the *Cortes*' fiscal control, relative to the English benchmark. First, Article 53(7) gave the king full power of intra-departmental virement and (by implication) impoundment. Second, Article 85 ensured that "If the budget cannot be voted before the first day of the next fiscal year, that of the previous year shall remain in force…"

Article 85 meant that, if the Deputies refused to approve a budget, then the consequences would not be anything like the immediate shutting down of key parts of the government. Rather, the government could carry on with last year's budget, re-allocating funds (per Article 53(7)) as it saw fit within very broad budget categories. The bargaining position of the Congress of Deputies under Spain's Constitution of 1876 was thus markedly inferior to that of the House of Commons after the Glorious Revolution.

If the *Cortes*' *de jure* grip on the purse was debile under the Constitution of 1876, might its *de facto* grip have been stronger? This seems unlikely because Spain had

[5] Dincecco's coding gibes with the Polity IV project's, which rates executive constraint in Spain at the highest level, 7, over the period 1876-1922.

recently experienced governments prolonging budgets by decree. Under the Constitution of 1845, which did not explicitly define the budgetary reversion, ministers nonetheless "frequently recurred to governmental decrees to prolong" the budget. Moreover, "some governments…abused the extensions" (Comín 2010, p. 228).

Spain did not institute a budgetary reversion favorable to the *Cortes* until the brief Second Republic, for which I have no data on taxation. After that, Spain operated under fiscal absolutism until 1978, when the *Cortes*' control over taxation was restored and a budgetary reversion closer to England's was finally adopted. In Figure 10.2, I plot the available data on Spanish tax revenues per capita from 1965-2005. Before 1978, revenue per capita grew at rate of .02 per annum. Afterwards, revenues grew over ten times faster (.27 per annum).

Figure 10.2 about here.

Bismarck's Prussia

King Friedrich Wilhelm IV of Prussia granted a liberal constitution in 1848, revising it somewhat in 1850. Both charters mandated annual statutory budgets and Dincecco accordingly counts Prussia as limited beginning in 1848.

When Otto von Bismarck became Prussia's Minister President in 1862, the *Landtag* refused to accept the national budget, pressuring Bismarck to change his initially announced policies. The Minister President responded by observing that the constitution said nothing explicit about what should happen, when a budget was not approved, and arguing that his responsibility was to keep the government running. Accordingly, he submitted the budget directly to the pliant *Herrenhaus*, which approved it.[6] Prussia's budgets continued to be enacted in this fashion through 1866 (Stourm 1917, pp. 21-22).

After securing military victories against Denmark (1864) and Austria (1866), Bismarck extended an olive branch to parliament. The government returned to a more regular budgetary process. In return, parliament enacted an Indemnity Bill which retroactively legalized the state budgets from 1862 to 1866 and indemnified state officials (Mork 1971).[7]

Bismarck continued to push executive prerogatives thereafter. After a dissolution of parliament and a fervent appeal to patriotism, he succeeded in extracting the first of a series of *Septennats*—seven-year military budgets—from the *Reichstag* in 1874 (Mork 1971). I take this date as ending the period in which mainstream German liberals actively fought for the principle of annual budgets.

[6] The crown appointed the members of the *Herrenhaus* (per Articles 65-68).
[7] The text of the Indemnity Act can be found at *germanhistorydocs.ghi-dc.org*.

The *Reichstag* was not merely a rubber stamp thereafter. It frequently amended government bills; it temporarily blocked a *Septennat* in 1885; and it made trouble on taxes right up to World War I (Mork 1971; Flynn 1988; Berman 2001). However, Prussia differed substantially from the English model. The military budget—which constituted 90% of federal expenditures after unification—was typically voted every seven years, not annually. Budgets were proposed by ministers who were not meaningfully responsible to the *Reichstag* (Hahn 1977). Moreover, given the ambiguity of the Prussian and Imperial constitutions, future governments might have resorted again to budgets enacted by one chamber or promulgated the budget by decree.[8,9]

Figure 10.3 displays Prussian revenues per capita from 1790 to 1913. As can be seen, revenues declined gently from the 1820s to the dawn of the constitutional era in 1848. In the early years of the new constitutional regime, per-capita revenues grew by 0.3 grams of gold per year. During the period of constitutional crisis under Bismarck (1862-74), revenues *declined* by 0.2 grams per year. After Bismarck established a precedent for seven-year military budgets in 1874, revenues grew by 0.6 grams of gold per year. Indeed, revenues grew so fast that, by the eve of the Great War, the government's ability to secure further grants from the *Reichstag* was increasingly questionable (Berman 2001).

Figure 10.3 about here.

Revenue growth in 19th-century European polities

In this section, I examine revenue growth in Dincecco's sample of European countries more systematically.[10] I sort the countries into three classes, based on how large a dose of fiscal reform their constitutions administered at the onset of stable annual budgeting. France, the Netherlands and Sweden took large doses, combining annual budgets with shutdown reversions and thus implementing rule-of-law budgets. Austria, Denmark, Portugal, Prussia and Spain took smaller doses, counteracting the effects of annual budgets by opening the possibility of budgets by decree (Austria[11],

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[8] Although King Wilhelm I promised in 1866 not to pass budgets only with the *Herrenhaus*' consent again (Stourm 1917, p. 22), the Imperial Constitution of 1871 did not address the ambiguity that Bismarck had exploited in the Prussian constitution. This failure to clarify parliament's right to deny supply must have represented a victory for those who advocated multi-year budgets and executive control.

[9] The Prussian Constitution (Article 63) afforded recess decree powers that approximated those in Denmark.

[10] The only countries that do not have revenue data for the full period (1790-1913) are Austria (1818-1910), Belgium (1831-1913), Denmark (1864-1913), Italy (1862-1913) and the Netherlands (1803-1913). In the latter case, there are data for 1790-95, followed by a gap 1796-1802. I include only the contiguous block of years in the analysis here.

[11] Finer (1999, vol. III, p. 1605), describing Austria's "extraordinary Article 14," which conferred recess decree powers similar to Denmark's, notes that "this power was used extensively to sail right over the head of the *Reichsrat* at the emperor's pleasure." I would simply add that Article 14 explicitly allowed decisions to spend public revenues to be taken during recesses.

Denmark, Portugal[12], Prussia) or authorizing the automatic extension of the previous budget (Spain). Meanwhile, Belgium, England and Italy experienced no constitutional change during the period for which the dataset contains observations on their revenues.[13]

To explore the consequences of these different doses of limited government, I use ordinary least squares with panel-corrected standard errors (Beck and Katz 1995), as did Dincecco. The specification is

$$R_{jt} = \alpha_j + \beta_1 Annual_{jt} + \beta_2 Shutdown_{jt} + \beta_3 Centralized_{jt} + \{\text{controls}\} + \text{error} \quad (1)$$

Here, R_{jt} denotes per capita revenues (in grams of gold) in country j at time t; α_j is a country-specific fixed effect; $Annual_{jt}$ is Dincecco's variable indicating the onset of annual budgeting; $Shutdown_{jt}$ is a new variable indicating that, when annual budgeting began, it was combined with a shutdown reversion; and $Centralized_{jt}$ is a dummy variable indicating that the national government could set uniform tax rates for the entire country. In Model 1, I use Dincecco's battery of control variables—which focus on warfare, urbanization and changes in the global gold stock. Model 2 adds a time trend to the list of controls. The error includes a common AR1 term and adjusts for both contemporaneous correlations and panel heteroscedasticity.

Table 10.3 presents estimates of both models. Among the control variables, the most important driver of revenues was warfare, measured by the population of the alliance against which a country was fighting, if any. One way to summarize the effect of warfare is to say that the major powers—those involved in more and bigger conflicts—extracted substantially more revenues per capita, holding constant their constitutional structures. Circa 1900, for example, Austria and Prussia had much higher revenues per capita than Spain and Portugal; while England and France had much higher revenues than Sweden and the Netherlands.

The centralization of taxation does not show large effects in the post-1790 sample. Most countries centralized before they adopted limited government, so estimating the effect of centralization is substantially affected by truncating the pre-1790 data.

Table 10.3 about here.

[12] The Portuguese Constitution of 1826 gave the crown exclusive control of the armed forces (Article 116) and imposed a broad and vague mandate to use them as the crown saw fit to protect public safety (Articles 75(4) and 75(15)). In addition, it conferred substantial emergency powers (Article 145(34)). In essence, then, the crown had a sort of "blank check" to spend money to maintain internal order, even if not envisaged in the budget.

[13] Dincecco's revenue data for England do go back before the Glorious Revolution but my analysis here focuses on the years after 1790. Although England did reduce the Civil List in 1830, I do not count this as a significant enough reform to alter its coding for purposes of this analysis.

The other control variables show results similar to those reported by Dincecco. After warfare, the most important control is for changes in the global gold stock. The rate of urbanization is also important (in Model 1) but washes out in the presence of a time trend (Model 2).

Since revenues were trending upward across the continent, I focus on Model 2 here. As can be seen, the onset of regular annual budgeting boosted per capita revenues by about .81 grams of gold, while annual budgeting combined with shutdown reversions boosted per capita revenues by .81+1.69 = 2.50 grams of gold. In other words, taking a full dose of reform produced over three times the fiscal response on average as taking a limited dose.

A difference-in-differences approach

A somewhat different approach is to examine pairs of similar countries just before and after one of them introduces fiscal reforms. An example is provided in Figure 10.4, which displays revenues per capita in France and Prussia ten years before and after the Franco-Prussian War of 1870. Both states exhibited gently declining revenues per capita 1860-69 and gently inclining revenues 1870-79. The big difference is that French revenues step up by over 60% in 1870, when Emperor Napolean III fell from power and the Third Republic was instituted, while Prussian revenues show no response in that year.

Figure 10.4 about here.

France's fiscal response in 1870 might of course have been due to losing the war and paying reparations. We cannot observe the counterfactual world in which Napolean III remained in power, in order to see whether he would have been able to boost revenues in a comparable fashion. We can, however, run a panel regression including both year and country fixed effects. To the extent that countries share a common trend in revenue growth, this difference-in-differences approach should estimate the causal effect of annual budgeting with shutdown reversions, based on a series of comparisons similar to that illustrated in Figure 10.4.

I have run such regressions, including the same controls for warfare and gold supply as in Table 10.2. The results are very similar. Introducing annual statutory budgets boosts revenue but the boost is significantly larger when shutdown reversions are also implemented.

Discussion

In the next section, I consider how much the fact that countries choose to reform for particular reasons interferes with our ability to assess the impact of those reforms. Pending that discussion, my interpretation of the results presented above is that they support a weakest-link view of executive constraint. While the monarchs of Austria, Denmark, Portugal, Prussia and Spain did accept annual statutory budgets, their constitutions offered them avenues of escape, either clearly (Austria, Spain) or debatably (Denmark, Portugal, Prussia) within their legal rights to take, should bargaining with MPs become too difficult. The existence of these potential avenues of escape eroded MPs' ability to control expenditure. Thus, MPs in these countries should—all else equal—have been more reluctant to authorize higher taxes than their counterparts in more fiscally limited monarchies. The evidence is consistent with such an interpretation.

Why were annual statutory budgets instituted?

Why did particular countries institute annual statutory budgets when they did? Relatedly, if annual budgets boosted credibility and hence revenues, why did rulers wait until the 19th century to imitate British practices?

When an absolutist monarchy granted annual budgets, the crown was trading its ancient *de jure* right to control public expenditures, in order to secure financing for projects that it could not swing on its own. For example, in England after the Glorious Revolution (see chapters above), in Piedmont before the *Statuto Albertino* of 1848 (see Dincecco *et al.* 2011), and in Prussia before the Constitution of 1848 (see Tilly 1966), business and commercial elites convinced the crown that substantial new fiscal-military investments could be made if and only if parliament were granted a more credible role in state finances. The reason for fiscal reform was to carve out a credible enough role for parliament to clinch a mutually profitable deal.[14]

If commercial elites lobbied for those reforms, then why not say that the rise of the commercial elite was the root cause, at least in these cases? Even if we posit that a united front among business elites caused annual statutory budgets to be instituted in some particular cases, there are still two possibilities as regards the effect of such reforms. One is that the fiscal reforms had no further significant effect on the credibility of state budgets, above and beyond the increase in credibility one would expect from the appearance of a united business elite. In this case, it might be reasonable to say that the rise of the commercial elites was the fundamental cause. However, another possibility is that the fiscal reforms had some significant additional effect. In this case, the rise of commercial elites drove the reforms but those reforms were important, even crucial, in enhancing credibility—which is why the business elites demanded them.

My view is that English, Prussian and Piedmontese business leaders knew what they were doing. They could have allowed the Machiavellian budgetary process to

[14] In the smaller German states prior to unification, leaders similarly "viewed constitutions and parliaments as assuring a 'bargain' to ease the process of taxation," although here the aim was more to ease the burden of past war debts than to gear up for new wars (Ziblatt 2006, p. 117).

continue, hoping that their united front would allow them to punish repudiations by the crown more severely. Instead of taking the Machiavellian option, however, business elites sought fiscal reforms. They presumably realized that their ability to punish repudiations would require constant organization and that, even then, they would need to carefully calculate the crown's "credit limit."

With fiscal reforms, business elites could secure two kinds of more permanent and secure advantages. First, statutory budgets would be harder to change and thus more reliable. Second, annual budgets with shutdown reversions would effectively give parliament the right to control public expenditures. To the extent that business elites had influence in parliament, they could then protect themselves against unwanted future changes of budgetary course.

In other words, entrepreneurs investing in fiscal-military states, just like venture capitalists investing in private corporations, wanted control rights to protect themselves against *ex post* opportunism (Bolton and Dewatripont 2005, p. 527). They thus made fiscal reform the *sine qua non* of their cooperation. Once in place, the reforms deeply affected the credibility of state budgets, quite independently of how they came into being. In that sense, the story told here is a thoroughly institutional one.

Why not sooner?

If Europe's absolutist rulers could not achieve high per-capita tax revenues by force or Machiavellian deals, then why did they wait so long to improve the credibility of their expenditure plans? The problems were several.

The crown's reluctance to trade

Absolutist rulers were trading away control rights whose value they knew well. Indeed, the right to dispense public revenues was the foundation of their power. Such rulers, moreover, would have understood that granting annual statutory budgets, much less shutdown reversions, would permanently reduce their ability to control expenditures in future. Given the immense and durable value of the control rights they were trading, monarchs needed a very good reason to alienate some of that power. Thus, one answer to "why not sooner?" is simply that historical circumstances had to arise in which the crown so desperately wanted immediate financing for a valuable project that it was willing to sacrifice slices of *de jure* power to get it.

In the weaker Iberian regimes, imperial collapse after the Napoleanic wars forced the crown to deal, as the price for staying in power. In the healthier absolutist regimes, such as Piedmont and Prussia, the opportunity for railway-led industrialization—in imitation of Britain, the world's first industrial nation and global hegemon—finally convinced the crown to deal.

Commitment problems and the instability of the *Rechtsstaat* monarchies

Even when a compelling reason to alienate control over expenditure presented itself, however, commitment problems plagued bargaining. In particular, a version of the old credibility deficit plaguing the *ancien régime* remained in the *Rechtsstaat* monarchies.

To illustrate, consider a polity in which the government can promulgate the budget by decree, if it fails to secure parliamentary support. After a fiscal shock, suppose the executive and parliament reach a deal on a package of new taxes and expenditures. Can the entire deal be implemented within a single year? If not, then parliament must either ensure that the taxes expire annually; or trust that the executive's future budgets will continue to implement whatever deal has been struck. But the executive can effectively dictate future budgets and secure their passage against the will of mere parliamentary majorities. Thus, any promises it makes about future budgets are not credible.

The inability of the crown in *Rechtsstaat* monarchies to make long-term budgetary commitments should have complicated bargaining and raised the risk of fiscal stalemate. When actual stalemate arose, however, governments would face a choice: Should they do nothing and live with the structural risk of stalemate? Should they end stalemate by repressing parliament's fiscal rights? Or should they end stalemate by accepting ministerial responsibility and a parliamentary monopoly over both taxes and expenditures?

The trilemma just noted was inherent in states with *Rechtsstaat* budgets. They had merely replaced a Machiavellian crown under the *ancien régime* with a monarch who could make credible but short-term promises about expenditure. Thus, the risk of inefficient executive-legislative stalemate remained significantly higher than in the benchmark case of Britain.

The fiscal common pool

A final reason that absolutist monarchs may have resisted for so long reforms to improve the credibility of their expenditure promises concerned the fiscal common pool. Advocates of royal power might have thought that giving parliament the right to decide state expenditures would set up an even worse system. Instead of executive moral hazard, with kings chasing military glory at the taxpayers' expense (Hoffman 2009; Cox 2011), one would have a special interest feeding frenzy, with MPs funding pet projects at the taxpayers' expense. I return to this issue in the final chapter.

Conclusion

Per-capita tax revenues grew in those European states that, in imitation of Great Britain, adopted annual statutory budgets. However, these countries differed substantially in how much *de jure* bargaining leverage they gave to their post-reform legislatures; and their revenue growth varied accordingly. Some polities gave their parliaments little leverage and experienced meager revenue growth: Portugal and Spain. Others also gave their parliaments little leverage but got more out of them: Austria and Prussia. Finally, a handful of countries gave their parliaments better leverage and, on average, experienced the greatest revenue growth: France, Netherlands, Sweden, and (after 1901) Denmark.

The process of fiscal reform constituted a trade, in which the crown gave away some of its constitutional rights in exchange for future tax revenues. Because all crowns valued their *de jure* rights to control the expenditure of public revenues, they were willing to trade those rights only for sufficient value. Parliamentary elites made the following offer: we will grant higher taxes if and only if we are given greater control rights over state expenditures. This was a credible offer which crowns eventually took, albeit only when historical conjunctures arose at which they particularly craved the additional revenues that only parliament could help them get.

A postscript on regime type and economic growth

I have argued that only two stable tax-and-spend regimes exist: absolutism and rule-of-law. If this claim is correct, then economic dynamics before and after liberalizing transitions should exhibit the following features.

Before the transition, the polity suffers fiscal stalemate, which reduces economic growth by depressing sectors involved in government contracting. Because stalemate is inefficient, however, there is room for a bargain whereby the executive grants a slice of control over expenditures, in return for parliament no longer blocking taxes. If a constitutional deal is reached, then tax revenues leap from their pre-reform stalemate level to a post-reform non-stalemate level. Thus, for example, we see large revenue responses after James II's fall in England, after Napolean III's fall in France, and after the King of Denmark accepted parliamentary budgets.[15]

One can generalize this line of thinking to explain a broader category of "democratizations." Suppose that transitions toward democracy occur mainly when some group imposes inefficient conflict on the polity at large—perhaps by active or latent violence (Acemoglu and Robinson 2005); perhaps by withholding productive effort (Przeworski and Wallerstein 1982; Cusack, Iversen and Soskice 2007); perhaps by withholding tax compliance (Ansell and Samuels 2014). Regardless of which tactic the group uses, its actions reduce the state's net fiscal resources, thereby backing up its demands for better political rights.

[15] Prussia shows that stalemates sometimes end with liberal forces stopping their campaign to refuse taxes, without gaining any structural reforms (and, indeed, accepting practices that reduce parliament's fiscal leverage).

The incumbent government may seek to end the inefficient conflict, by offering the group a larger share of control over state expenditures. If the regime lacks a rule-of-law budget, then it may offer to improve parliamentary control over the budget. If the regime already has a rule-of-law budget, then it may offer to extend the suffrage.[16] Once a reform package is agreed, we should see improved economic performance—from a depressed level reflecting fiscal stalemate in the bargaining phase, to a new level reflecting the end of stalemate and the development of cooperation.

Precisely this sort of pattern is documented by Acemoglu et al. (2014) and Kent and Phan (2014), in their examinations of the post-World War II period. Kent and Phan report (p. 2) that most democratizations occur during or soon after episodes of mass political unrest; that such unrest is a lottery, leading sometimes to democratization and sometimes to crackdown; and that unrest generates significant macro-economic downturns, regardless of the political outcome. Meanwhile, Acemoglu et al. report that "on average, democracy is preceded by a sharp and persistent fall" in log GDP per capita, followed by a substantial improvement over the first two decades after democratization (pp. 2-3).

[16] Offers to extend the suffrage when the budget is Machiavellian confer very weak control rights on the newly enfranchised. Thus, suffrage extensions are less likely to constitute offers to end stalemates in these cases.

Table 10.1: A typology of budgeting processes

Type of budgeting process	Stage 1: Expenditure plan set by…	Stage 2: Taxes set by…	Stage 3: Actual expenditures constrained by plan?
Absolutist	Executive decree	Executive decree	No
Machiavellian	Executive decree	Parliamentary statute	No
Rechtsstaat	Executive-dictated statute	Parliamentary statute	Yes
Rule-of-law	Parliamentary statute	Parliamentary statute	Yes

Table 10.2: Per capita revenues in eight European polities

Country	Date of limited government (per Dincecco 2011)	Prior to the onset of limited government,		Average per capita revenue[1]	
		did parliament approve taxes?	were taxes set centrally?	before limited government	after limited government
Austria	1867	Yes	Yes	5.50 (1848-1866)	14.64 (1867-1913)
France	1870	Yes	Yes	11.11 (1790-1869)	30.19 (1870-1913)
Netherlands	1848	Yes	Yes	10.88 (1806-1847)	13.82 (1848-1913)
Piedmont	1848	?	Yes	4.60 (1835-1847)	6.34 (1848-1859)
Portugal[2]	1851	Yes	No	0.73 (1768-1850)	2.60 (1859-1913)
Prussia	1848	Yes[3]	Yes	3.77 (1806-1847)	12.40 (1848-1913)
Spain	1876	Yes	Yes	2.44 (1845-1875)	3.74 (1876-1913)
Sweden[4]	1866	Yes	Yes	2.89 (1750-1860)	9.85 (1866-1913)

(1) The figures are in grams of gold per capita. The figures for Piedmont are from Table 4 of Dincecco et al. (2011). All other figures are from Dincecco's (2011) posted dataset.

(2) Note that the comparison in the last two columns is between the period 1768-1850, when Dincecco codes Portugal as absolutist and decentralized, and 1859-1913, when he codes Portugal as limited and centralized.

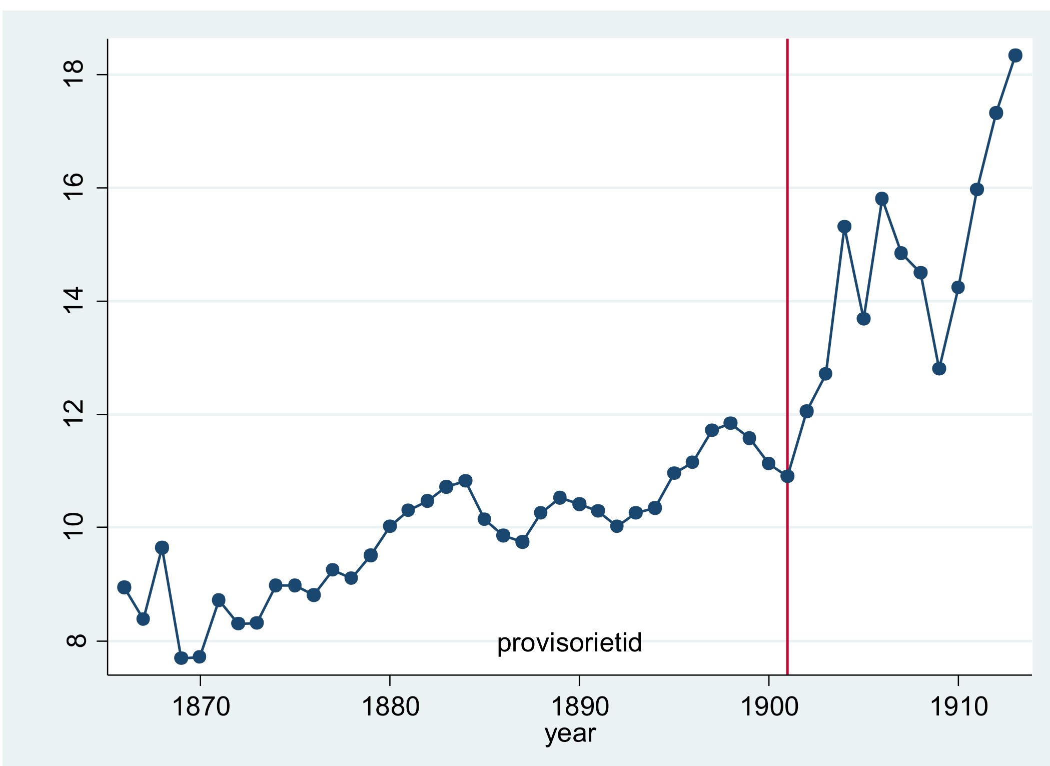
(3) This is a qualified "yes." See Tilly (1966, p. 488).

(4) Note that the comparison in the last two columns is between the period 1750-1860, when Dincecco codes Sweden as absolutist and decentralized, and 1866-1913, when he codes Sweden as limited and centralized.

Table 10.3: Panel regressions explaining per capita revenues

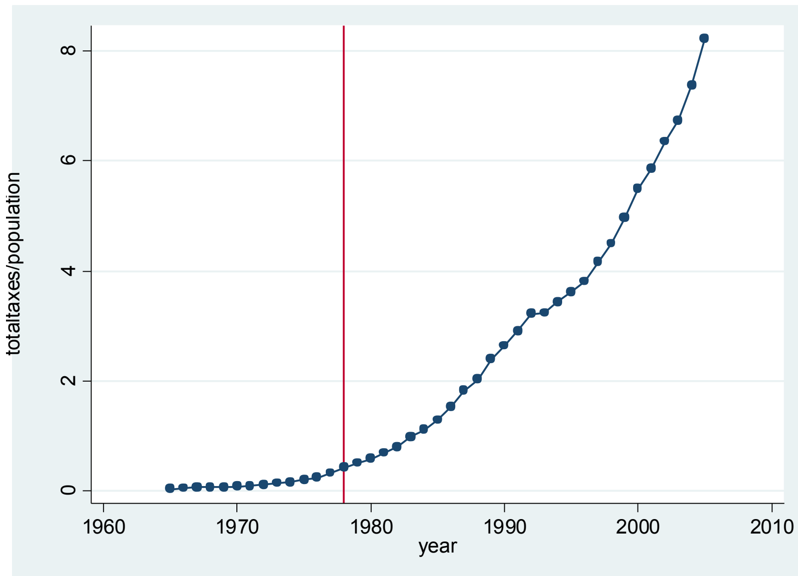
Independent variable	Model 1 Coefficient (standard error)	Model 2 Coefficient (standard error)
Annual budgets	1.41*** (.33)	.81* (.34)
Annual budgets with shutdown reversions	1.72*** (.61)	1.69*** (.61)
Centralized taxation	.01 (.31)	-.53 (.33)
War deaths	.08 (.12)	.08 (.11)
Enemy coalition size	.15*** (.05)	.15*** (.05)
Mercenary dummy	-.40 (.23)	-.37 (.23)
Internal war dummy	-.15 (.13)	-.10 (.13)
Urbanization rate	20.03*** (6.96)	1.69 (7.28)
Change in gold stock	.31*** (.05)	.16*** (.06)
Trend	-	.09*** (.02)
Country dummies	Yes	Yes
Number of observations	1138	1138
R^2	.27	.27

Figure 10.1: Tax revenue per capita in Denmark, 1866-1913



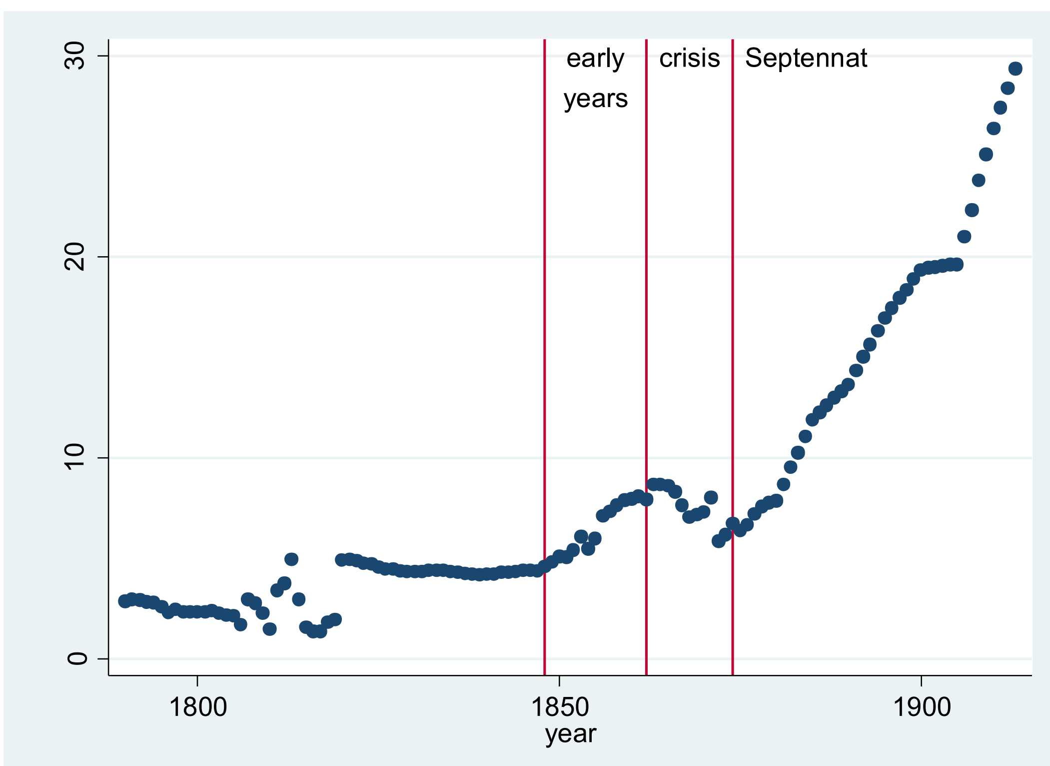
Source: Dincecco (2011).

Figure 10.2: Revenues per capita in Spain, 1965-2005



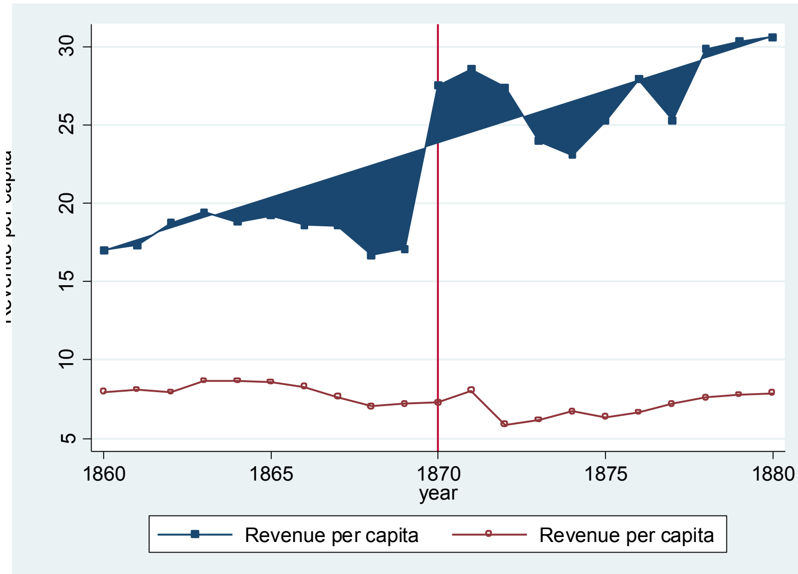
Source: stats.OECD.org.

Figure 10.3: Revenues per capita in Prussia, 1790-1913



Source: Dincecco (2011).

Figure 10.4: Revenues per capita in France and Prussia, 1870



Source: Dincecco (2011).