Paths toward the Modern Fiscal State: England (1642-1752), Japan (1868-1895), and China (1850-1911)

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ABSTRACT:

This dissertation examines the rise of the modern fiscal state, which enabled the state to use centrally collected revenues from indirect taxes to mobilize financial resources either through long-term borrowing or issuing paper notes. The modern fiscal state greatly enhanced state capacity and stimulated financial development; it thus represented a crucial stage in the transformation from early modern to modern state and economy. My comparative analysis of England, Japan, and China shows multiple sequences and outcomes. All three cases had well-established early modern states and sophisticated market economies. Under the pressure of increasing spending demands, state actors conducted similar experiments, such as short-term borrowing, issuing of paper notes, and the collection of taxes upon domestic consumption. England became a modern fiscal state by the 1750s when its government used the revenues from excises and the customs to service its massive long-term debt. Japan made the leap in the late 1880s when tax revenues were employed to back up paper money, i.e., banknotes issued by the Bank of Japan. China, however, failed to develop into a modern fiscal state.

I put forward a temporally-based causal mechanism which resulted from the interactions between a profound state credit crisis and socio-economic conditions. Such credit crises were caused by excessive dependence upon fictitious credit instruments such as bills of short-term borrowing unfunded by tax revenue in England or non-convertible paper notes in Japan. As these credit crises were an unintended consequence of earlier policies or events, they were exogenous to subsequent institutional development. As a problem that had to be solved, they forced experimentation, "selected" effective institutional arrangements and competent financial officials, and facilitated a continuous learning and accumulation of effective elements in a process full of uncertainties. Socio-economic conditions, such as the size of consumption and the degree of concentration of production, were important to sustain this process in which various elements came to form a mutually reinforcing system. The lack of such an interactive process is used to explain the absence of a modern fiscal state in China. This institutional model reconciles the uncertainties and multiplicity of possible outcomes in the early stages of the process and the eventual observed outcome. This dissertation contributes to the study of institutional dynamics, which aims to understand how specific institutions emerge and consolidate.

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Chapter 1 Introduction: the Rise of the Modern Fiscal State and its Implications for the Political Economy of the State

I. Introduction

We are living in an age of great institutional transformation. The transition to democracy and market economy involves issues of how to establish and consolidate new political and economic institutions. Facing the challenge of globalization, advanced industrial economies are also adjusting their institutions in both production and provision of social welfare. There are several important lessons drawn from the study of institutional change. First, institutions are deeply embedded in particular socio-economic environments, and thus no institutional model is universally optimal across contexts.[1] Second, institutional change is a temporal process in which several factors interact with one another: different ideas, aspirations and interest concerns among actors, various institutional arrangements, and variations in the socio-economic structure.[2] Politics, moreover, plays a crucial role, because various institutional arrangements have different impacts on the interest redistribution in society.[3]

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[1] For the embeddedness of institutions in advanced market economies, see Suzanne Berger and Ronald Dore, eds., *National Diversity and Global Capitalism* (Ithaca: Cornell University Press, 1996); J. Rogers Hollingsworth and Robert Boyer, eds., *Contemporary Capitalism: The Embeddedness of Institutions* (Cambridge: Cambridge University Press, 1997); and Peter A. Hall and David Soskice, eds., *Varieties of Capitalism* (Oxford: Oxford University Press, 2001).

[2] For a discussion of the interactive nature of institutional change, see Avner Greif, *Institutions and the Path to the Modern Economy* (Cambridge: Cambridge University Press, 2006), pp. 14-20; Paul Pierson, *Politics in Time: History, Institutions, and Social Analysis* (Princeton, N.J.: Princeton University Press, 2004), chapter 5.

[3] For emphasis on the politics of distribution of interests that is involved in institutional change, see Jack Knight, *Institutions and Social Conflict* (Cambridge: Cambridge University Press, 1992).

However, social scientists are ill-equipped to explain the emergence and consolidation of specific institutional arrangements over time in the highly interactive and political process of institutional change. The literature of institutionalism is overwhelmingly concerned about how particular institutions affect policy outcomes or shape actors' preference. Yet the powerful analytical tools used to understand how institutions function in politics and economy do not address the dynamic question of how institutions emerge and consolidate.[4] Moreover, the process of institutional change often covers a long time span, which cannot be handled by methods or theories with a short time horizon.[5] Finally, interactions among actors, institutional arrangements, and the socio-economic environment often endogenously generate unobservable factors that significantly affect the eventual institutional outcome. As a result, the observed institutional outcome is often one among the multiplicity of possible outcomes, rather than an inevitable one of prior causal factors.[6] How can we find a causal mechanism that not only has the necessary temporal dimension to cover the course of institutional change but also can explain the observed outcome out of the multiplicity of possible outcomes during interactive process of institutional change?

[4] On the importance of studying institutional change and development over time, see Kathleen Thelen and Sven Steinmo, "Historical institutionalism in comparative politics," in Sven Steinmo, Kathleen Thelen, and Frank Longstreth, eds., *Structuring Politics: Historical Institutionalism in Comparative Politics* (Cambridge: Cambridge University Press, 1992), pp. 16-22; Paul Pierson, *Politics in Time*, p. 103; and Barry R. Weingast, "Rational Choice Institutionalism," in Ira Katznelson and Helen Milner eds., *Political Science: The State of the Discipline* (New York: W. W. Norton, 2002), p. 675.

[5] Regarding temporality in causal explanations of socio-political processes, see Paul Pierson, *Politics in Tim*, chapter 3; Paul Pierson and Theda Skocpol, "Historical Institutionalism," in Ira Katznelson and Helen Milner eds., *Political Science: The State of the Discipline* (New York: W. W. Norton, 2002), p. 698; Andrew Abbott, *Time Matters: On Theory and Method* (Chicago: The University of Chicago Press, 2001).

[6] Ira Katznelson, "Structure and Configuration in Comparative Politics," in Mark Irving Lichbach and Alan S. Zukerman, eds., *Comparative Politics: Rationality, Culture, and Structure* (New York: Cambridge University Press, 1997), pp. 93-94; Peter A. Hall, "Aligning Ontology and Methodology in Comparative Research," in James Mahoney and Dietrich Rueschemeyer, eds., *Comparative Historical Analysis in the Social Sciences* (Cambridge: Cambridge University Press, 2003), pp. 382-384; Charles Tilly, "Mechanisms in Political Processes," *Annual Review of Political Science*, 4 (2001), p. 25.

In this dissertation, I investigate a phenomenon of institutional transformation in public finance which I term the rise of the modern fiscal state. I characterize the modern fiscal state as a state that has the institutional ability to use the tax revenues it collects in an amalgamated way to mobilize long-term financial resources from the markets, through either long-term borrowing or issuing paper money. Compared with a state which has not yet developed such an institutional ability, the modern fiscal state achieves an economy of scale in using its tax revenues to mobilize financial resources. In so doing, it greatly increases the spending capacity of the state and fundamentally changes the interactions between the state and economy. By examining the dynamic process of how the modern fiscal state emerged over time in specific historical cases, we can better understand how the state and economy interact in building effective institutions to collect taxation and manage state finance. This may be helpful not only to students of the past but also to governments in developing countries and emerging market economies that are experiencing similar processes.[7]

In order to identify a causal mechanism that leads to the rise of the modern fiscal state, I choose three cases for comparative historical analysis: England between 1642 and 1752, Japan between 1868 and 1895, and China between 1850 and 1911. These are special cases in the study of the state and economy. All had long and continuous histories as

[7] For discussions of the consequences of a lack of effective state institutions in taxation and finance in emergent market economies, see David Woodruff, *Money Unmade: Barter and the Fate of Russian Capitalism* (Ithaca: Cornell University Press, 1999); John L. Campbell, "An institutional analysis of fiscal reform in postcommunist Europe," *Theory and Society*, Vol. 25, No. 1 (February 1996): 45-84.

sovereign territorial states.[8] The state as a political entity had become highly institutionalized in England by the seventeenth century, and in Japan and China by the nineteenth century. In this sense, they are quite different from many new states that came into being only after the end of colonialism in the twentieth century.[9] Meanwhile, they also had sophisticated market economies. The degree of monetarization in economic life was quite high in Japan and China by the nineteenth century, and was comparable to that found in England by the early eighteenth century.

Nonetheless, these three special cases have general significance for the study of institutional transformation as they all experienced, at different times, an inadequacy of the existing institutions of public finance to the greatly changed socio-economic environment. The traditional reserves of revenue such as the domain revenue in England and the land tax in Japan and China became insufficient to meet the ordinary spending of the state. Yet the state did not have an institutional ability to extract revenue from the expanding commercial sectors. The exhaustion of old institutions appeared particularly serious in England between the 1600s and 1620s, in Japan between the 1820s and 1860s, and in China between the 1820s and 1850s. In the process of searching for new methods and institutions, state actors in all three countries conducted many similar experiments, such as short-term borrowing, the collection of taxes from domestic consumption, the issuing of state fiduciary credit instruments such as paper notes, etc. The outcomes at the

[8] England, Japan, and China in the eighteenth century were also empires which included territories under different administrative and legal institutions: Scotland and Ireland in the case of England; Mongolia, Manchuria, Qinghai, Xinjiang, and Tibet in the Qing dynasty, and Hokkaido in Tokugawa Japan. I therefore use the term of state in reference only to England (instead of Britain), Japan proper, and China proper. Major institutional changes in public finance happened within the territory of the state.
[9] See the discussion of these "new states" that formed after the World War II in Edward Shils, *Political Development in the New States* (Paris: Mouton, 1968).

end of each episode to be examined varied. While England and Japan transformed – by different means – into modern fiscal states, China did not. Analyzing the three historical cases allows us to investigate complete processes of institutional emergence and consolidation and of failure. This privilege is not available to the study of contemporary institutional changes, which are still on-going.

The rest of this chapter goes as follows. In section II, I discuss the institutional features of the modern fiscal state in more detail, as well as its implications for the study of state-economy interactions. In section III, I examine some important parallels in the development of the state and market economy in England, Japan, and China, which constitute the common background against which we may compare their subsequent institutional transformations in public finance. In section IV, I analyze the general institutional features of the modern fiscal state which are common to both England in the 1750s and Japan in the 1890s, two countries in quite different domestic and international circumstances. The perspective of the modern fiscal state also casts new light on the collapse of state power in China in the late nineteenth century. In section IV, I discuss the difficulties in explaining the rise of the modern fiscal state and the variations of outcome across the three cases.

II. The concept of the modern fiscal state and its implications:

The existing literature on the state ignores the modern fiscal state. The Weberian definition of the state as the political organization which monopolizes legitimate coercive force over a given territory says nothing about the institutional character of the state in public finance.[10] From the economic point of view, Weber defines the modern state by its capacity to achieve monetary consolidation, or the monopoly of the creation of money.[11] This definition is too strong, as even England, the undisputable leading country in the development of modern capitalism, did not achieve monetary consolidation until the second half of the nineteenth century.[12]

From the perspective of public finance, the literature on state-building usually makes a distinction between the fiscal state (or tax state in Schumpeter's term), which rests upon revenue obtained from taxing the economy, and the domain state (or demesne state), which draws income primarily from crown-owned property such as estates, forests, mines, and so on. The transition from domain state to fiscal state was a significant change in early modern Europe as taxation redefined the interaction between state and society.[13] As the generic feature of the domain state is to derive revenue from sources other than regular taxation, it may exist in the age of industrial economy when the state rests upon revenues from state-owned enterprises. In light of this broadly definition, the domain state remained persistent in Prussia, where it derived the majority of its revenue

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[10] Max Weber, "Politics as a Vocation," in H. H. Gerth and C. Wright Mills, eds., *From Max Weber: Essays in Sociology* (Oxford: Oxford University Press, 1958), p. 78.

[11] Max Weber, *Economy and Society*, volume I (Berkeley: University of California Press, 1978), p. 166.

[12] Throughout the entire eighteenth century, the English economy suffered from a serious shortage of currency, particularly currency of small denominations. This was mitigated mainly by privately minted copper money and privately issued and locally circulated "token-money." See Patrick K. O'Brien, "Central government and the economy, 1688-1815," in Roderick Floud and D. N. McCloskey, eds., *The Economic History of Britain Since 1700,* volume I, Second edition (Cambridge: Cambridge University Press, 1992), pp. 235-40; Peter Mathias, "The people's money in the eighteenth century: the royal mint, trade tokens and the economy," in Peter Mathias, *The Transformation of England: Essays in the Economic and Social History of England in the Eighteenth Century* (London: Methuen, 1979).

[13] For the discussion of the domain state, see Richard Bonney, "Revenues," in Richard Bonney ed., *Economic Systems ands State Finance* (London: Oxford University Press, 1995), especially pp. 447-63. See also the detailed case-study of the transition from domain state to fiscal state in Western Europe in Richard Bonney ed., *The Rise of the Fiscal State in Europe, 1200-1815* (New York: Oxford University Press, 1999).

originally from state properties and later from state-owned enterprises, in particular, railways.[14] In the twentieth century, former socialist countries are essentially domain states as the state derives the majority of its income from directly managing state-owned enterprises; and the petrol-states are also typical domain states.[15]

In the study of late development, Kiren A. Chaudhry contends that the lack of necessary administrative institutions to collect tax revenue often forces the state in many developing countries to directly own and manage industrial enterprises for revenues.[16] This policy is basically a replica of the domain state. However, only a few countries in the world are (un)lucky enough to have an industry of natural monopoly, such as petroleum and natural gas, from which the state can generate large revenues through direct management at low administrative costs. For the rest, mismanagement and inefficiency in running state-owned enterprises often make this substitute for the building of tax institutions ineffective in practice. In this light, one important issue for a developing country is how to build efficient tax institutions to meet state spending while allowing economic actors to deal with risks and opportunities in running enterprises for profit, in other words, how to build a fiscal state.[17]

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[14] For discussions of the domain state in Prussia from the eighteenth century to the early twentieth century, see D. E. Schremmer, "Taxation and public finance: Britain, France, and Germany," in Peter Mathias and Sidney Pollard eds., *The Cambridge Economic History of Europe,* volume VIII (Cambridge: Cambridge University Press, 1989), pp. 411-455. For the fiscal importance of railways to the Prussian and later German state, see Richard Tilly, "The Political Economy of Public Finance and the Industrialization of Prussia, 1815-1866," *Journal of Economic History*, Vol. 26, No. 4 (December 1966), p. 493; and Rainer Fremdling, "Freight Rates and State Budget: the Role of the National Prussian Railways, 1880-1913," *Journal of European Economic History*, Vol. 9, No. 1 (Spring 1980), p. 32.
[15] Terry Lynn Karl, *The Paradox of Plenty: Oil Booms and Petro-States* (Berkeley: University of California Press, 1997).
[16] Kiren Aziz Chaudhry, "The Myths of the Market and the Common History of Late Developers," *Politics and Society*, Vol. 21, No. 3 (September 1993), p. 252.
[17] In this light, the ongoing process of post-communist transition is also a transition from the domain state to the fiscal state.

Thus far, the concept of the fiscal state has been defined solely by the source of the state's income, i.e., tax revenue. This conceptualization, however, is too broad and includes some quite different kinds of economies. For example, a fiscal state, by definition, may rest upon taxation in kind, or in coin, or in paper money. Yet it is obvious that the relationships between the state and economy are quite different in nature among these three kinds of fiscal state. Even more importantly, the existing definition of the fiscal state does not distinguish among the different ways that the state uses its tax revenues. For this reason, I make a further distinction between *the modern fiscal state* and *the traditional fiscal state*. The former uses its tax revenue as a means to leverage more financial resources through long-term liabilities, while the latter uses its tax revenue mainly as income to meet its current spending. The traditional fiscal state is not a static concept as it may use some of its tax revenue to raise short-term loans in emergencies. But once the emergency has passed, it clears its debt and goes back to its previous condition. These two kinds of fiscal states are quite different both in their fiscal operation and in their interactions with the market.

The central institutional feature of the modern fiscal state is the establishment of an institutionalized connection between the amalgamated tax revenue of the state and its long-term participation in the financial markets. Such a connection can be realized either through the state's long-term borrowing or through issuing paper money, which is a de facto long-term state liability. In both cases, the modern fiscal state uses its collected tax revenue not as simple income but as security to sustain the creditworthiness of its long-term borrowing or its issued paper notes. In other words, it uses its tax revenue to leverage more financial resources from the economy.

The successful operation of a modern fiscal state depends upon two important institutional components. First, it should have a stable and highly centralized means to collect at least the majority of tax revenue. This enables the central government to use the collected revenue *as a whole* to achieve an economy of scale in using tax revenues to mobilize financial resources from the markets. Centralized collection also helps ensure predictable inflows of revenue into the central government, which is crucially important to safeguard the creditworthiness of state's long-term liabilities in the financial markets. Second, it should possess effective institutions to manage government expenditures and borrowing so as to ensure that they would be secured by anticipated receipts of tax revenue or to safeguard the convertibility of the issued paper notes.

The close connection of the modern fiscal state with the economy through these long-term liabilities and centralized tax collection makes the smooth operation of the modern fiscal state contingent upon two necessary economic conditions. First, it is impossible to attain a highly centralized collection of tax revenue if taxes are collected in kind or if the collected revenue is transported in the bulky form of specie. A centralized taxation system is impractical where it takes months to send the collected tax revenue from localities to the central government and another several months for the central government to assign revenues to cover local government expenditures. The use of credit instruments such as bills of exchange to remit the collected revenues and government funds is thus a necessary condition for building the modern fiscal state. Moreover, the speedy transmission of tax revenue to the central government helps ensure the predictability of the coming of revenues, which boosts the confidence of creditors and ordinary holders of the state's paper money.

Second, it is necessary to have a variety of sources of tax revenue, including both direct taxes (the land tax, income tax, property tax, etc.) and indirect taxes (taxes upon consumption and the customs). Such diversification of the tax base can make the modern fiscal state less vulnerable to fluctuations in the economy and thus further safeguard the creditworthiness of its long-term liabilities in the markets. Moreover, indirect taxes, particularly the consumption taxes on liquor and tobacco, are elastic in yield and politically less costly to collect because they fall not directly on individual consumers but rather on big producers and wholesalers who can transfer the tax burden to consumers through raising retail prices. In contrast, direct taxes such as the land tax and property tax are either inelastic in yield or politically difficult to collect as they target powerful social groups. In this light, the modern fiscal state is unlikely to appear in an economy which has neither inter-regional financial networks to transfer money through credit instruments nor a tax base to tap indirect taxes.

Although the rise of the modern fiscal state is dependent upon the economy, its emergence in turn changes that economy and state-economy interactions. This is because the scale and regularity of the state's tax revenue are unrivalled by those of any private economic actors. In particular, before the age of mass communication, information regarding the creditworthiness of the state could reach much larger segments of society than could similar information about private financiers, which was generally confined to their specific trading or personal networks. The long-term involvement of amalgamated tax revenues in the financial markets greatly stimulates the effective use of credit instruments such as paper notes and state bonds. In other words, the rise of a modern fiscal state may prompt a coin-dominated economy to transform into a credit-based one.

As the state establishes the institutional ability to mobilize financial resources from the markets, it vastly increases its spending capacities. This was a salient advantage in the ruthless power struggles in the eighteenth and nineteenth centuries. Moreover, the maintenance of the modern fiscal state depends heavily on keeping a balance between the tax revenue and the state's long-term liabilities. The state actors who manage public finance thus have a strong motivation to try to accurately estimate taxation potential and the elasticity of major sources of revenue. They also have incentives to encourage the expansion of the economy as it directly means the growth of tax revenue and state ability to mobilize funds. Therefore, the interaction between the state and economy in the modern fiscal state is more intensive than that found in previous states. The rise of the modern fiscal state represents a "great transformation" in both the state and economy. In order to further illustrate this point, let us first examine the relationship between the state and economy in England, Japan, and China before their transition to the modern fiscal state.

III. Parallels in the state and economy: early modern England, Japan, and China

In England, an early modern state was well-entrenched in political life by the early seventeenth century. According to the English historian Michael J. Braddick, it had the following institutional characteristics. First, the central government was the ultimate source of political power and the final arbiter of the legitimization of the use of political power in localities. It also claimed the sovereign power in coinage and foreign affairs. Second, the execution of political power was centrally coordinated through highly impersonal, formal, and institutionalized ways, which were mainly embodied in the procedures of issuing, transmitting, and preserving government documents. Third, the organization of the central government became more institutionalized and differentiated, and the regular administration of government was handled by officials rather than by the king or his personal retainers. In the early modern English state, the monarch was a sovereign subject to the constraints of both formal institutions of government and informal conventions, such as "taking counsels" from Privy Council and Parliament. In consequence, the centrally-coordinated network of political power which imposed a unitary judicial and administrative conformity upon society reflected the will of the state rather than of the personal will of the monarch.[18]

Braddick's characterization of the early modern state in England sheds new light on our understanding of the state in Japan and China in the eighteenth century. When we envision the early modern state along the lines described for England, we find similar phenomena in eighteenth-century Japan and China. In the case of China, because the central coordination of political power in administration was carried out through highly

[18] Michael J. Braddick, *State Formation in Early Modern England c. 1550-1700* (Cambridge: Cambridge University Press, 2000), chapter 1.

formal and complex institutions consisting of six ministries and the Grand Council, it makes little sense to talk about the emperor's personal rule.[19] The highly centralized political system was also flexible in the actual execution of political power as the central government permitted a certain degree of administrative autonomy to provincial governments operating under very different socio-economic conditions.[20] As an example, although coinage of copper cash remained the sovereign power in theory, the central government granted provincial governments the autonomy to mint copper cash with various content and fineness of copper according to their respective conditions to accessing copper supply. But provincial governments must report to the Board of Revenue the model of minted copper cash and annual amount of mintage; and the purchase of copper of provincial mints was under strict supervision of the center. Moreover, the government allowed foreign currencies, particularly the Spanish and Mexican silver dollar, to widely circulate in coastal provinces for the sake of the "people's convenience" (*minbian*). The state only required that foreign silver dollars be converted into the official silver *tael* when paying taxes. This resembled the situation in eighteenth-century England in which the central government allowed foreign coins and private token money to circulate in the English economy.

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[19] See the emphasis on the relative autonomy of the state apparatus from society and the impersonal nature of bureaucratic posts in William T. Rowe, *Saving the World: Chen Hongmou and Elite Consciousness in Eighteenth-Century China* (Stanford: Stanford University Press, 2001), pp. 330-331. The development of centralization in bureaucracy or the political system (*zhongyang jiquan* in Chinese) can be traced back to the Tang-Song period. Note this development is more about the role of the central government in coordinating the use of political power and in adjudicating its legitimacy, which formally distinguished the state apparatus from both the ruler and the ruled, than about the state's ability to control society. See the description of this political development in China in Wu Zongguo, ed., *Zhongguo gudai guanliao zhidu yanjiu* [A Study of the Development of Bureaucracy in Ancient China] (Beijing: Beijing daxue chubanshe, 2004), chapters on Sui-Tang and Song.

[20] In eighteenth-century China, provincial governors often asked for adjustments of the policies issued by the central government so as to suit the particular conditions in their provinces. The central government often allowed, and sometimes even encouraged, such adjustments in economic and social policies. In the administrative terminology at the time, this was called *yindizhiyi* (to adjust a policy according to local conditions).

State formation in Japan can be traced back to the late sixteenth and early seventeenth centuries.[21] In the eighteenth century, the political authority of the shogunate (the Bakufu) in Edo (Tokyo) grew steadily in both administration and regulation, even though the emperor in Kyoto remained the nominal sovereign. The shogunate became the ultimate arbitrator of the legitimacy of the use of political power in localities.[22] The shogunate itself also became more institutional and bureaucratic so as to handle increasingly complicated administrative and legal matters.[23] The monetary consolidation achieved in the eighteenth century was particularly impressive. In 1636, the shogunate began to mint official currency, forbade the use of foreign currency (particularly Chinese copper cash) in Japan, and declared counterfeiting of currency a capital crime.[24] Through the recoinage in 1736 (Genbun *kaityū*), the shogunate stabilized the value between the

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[21] Mary Elizabeth Berry, "Public Peace and Private Attachment: The Goals and Conduct of Power in Early Modern Japan," *Journal of Japanese Studies*, Vol. 12, No. 2 (Summer 1986): 237-71; Eiko Ikegami, *The Taming of the Samurai: Honorific Individualism and the Making of Modern Japan* (Cambridge, MA.: Harvard University Press, 1995), chapters 7 and 8. For a succinct introduction of the emergence of the shogunate as the central government in the execution of state power in Japan between 1680 and 1750, see Takano Toshihiko, "18 seiki maehan no Nihon – taihei no naka no tenkan [Pre-eighteenth century Japan: a realm in the great peace]," in *Iwanami kōza Nihon tsūshi*, Vol. 13, *Kinsei* 3 (Tōkyō: Iwanami Shoten, 1994).

[22] For the emergence of the shogunate as the central power in eighteenth-century Japan, see James W. White, "State Growth and Popular Protest in Tokugawa Japan," *Journal of Japanese Studies*, Vol. 14, No. 1 (Winter 1988): 1-25; and Takano Toshihiko, "18 seiki maehan no Nihon – taihei no naka no tenkan," in *Iwanami kōza Nihon tsūshi*[A General History of Japan], Vol. 13, *Kinsei* 3 (Tōkyō: Iwanami Shoten, 1994).

[23] For a succinct introduction to the bureaucratization of the Tokugawa shogunate and the codification of its legal system in the first half of the seventeenth century, see Tsuji Tatsuya, "Politics in the eighteenth century," in John W. Hall ed., *The Cambridge History of Japan,* volume 4, *Early Modern Japan* (Cambridge: Cambridge University Press, 1991), pp. 432-456. For a recent stress on bureaucratization, such as the formalization of administrative and legal precedents, systematic use of formal documents in administration, and the separation between the shogunate's public governance and the Shogun's private affairs in the Kyōhō Reform (1716-1736), see Ōishi Manabu, "Kyōhō kaikaku no rekishiteki ichi [The historical place of the Kyōhō Reform]," in Fujita Satoru, ed., *Bakuhansei kaikaku no tenkai* [The Development of the Reforms in the Bakufu-han System] (Tōkyō: Yamagawa Shuppansha, 2001), pp. 31-51.

[24] Yasukuni Ryōichi, "Kahei no kinō [Functions of currency]," in *Iwanami kōza Nihon tsūshi*[A General History of Japan], Vol. 12, *Kinsei* 2 (Tōkyō: Iwanami Shoten, 1994), pp. 155-6.

standard gold coins and the supplementary silver and copper coins.[25] In 1772, it began to mint denominated silver coins (*nanryō nishugin*) and circulate them gradually in the economic circle of western Japan centered in Osaka, which had previously been dominated by silver by weight.[26] The issue of paper notes by domain governments in the eighteenth century had to receive permission from the shogunate. Moreover, these paper notes were denominated in units of small currency minted by the shogunate and were used mainly to alleviate the inadequacy of small cash in local transactions.[27]

Although these three states are all recognizably early modern in light of the nature of political power, their structures of public finance were distinct. In England, there was a discernable trend toward the fiscal state in the period between 1336 and 1453 when the royal government increasingly relied upon direct and indirect taxes to raise its income.[28] Nonetheless, the English state that formed in the sixteenth century and became firmly established in the early seventeenth century was essentially a domain state. The crown's ordinary revenue came from royal estates, the customs, and the Crown's feudal rights such as purveyance and wardship, instead of coming from regular domestic taxation.[29]

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[25] See the emphasis on the importance of the 1736 recoinage to the economic development in Japan in Shimbo Hiroshi and Saitō Osamu, "Gaisetsu – 19 seiki e [An overview: toward the nineteenth century]," in Shimbo Hiroshi and Saitō Osamu, eds., *Kindai seichō no taidō* [Gathering Momentum for Modern Growth], volume 2 of *Nihon keizaishi* [An Economic History of Japan] (Tōkyō: Iwanami Shoten, 1989), p. 27.

[26] Mikami Ryūzō, *En no tanjyō* [The Birth of the Yen], revised version (Tōkyō: Tōyō Keizai Shinpōsha, 1989), pp. 59-63.

[27] Shimbo Hiroshi and Saitō Osamu, "Gaisetsu – 19 seiki e," in Shimbo Hiroshi and Saitō Osamu, eds., *Kindai seichō no taidō* [Gathering Momentum for Modern Growth], pp. 26-31.

[28] For more details, see Gerald Harriss, "Political Society and the Growth of Government in Late Medieval England," *Past and Present*, No. 138 (February 1993), p. 40; and W. M. Ormrod, "England in the Middle Ages," in Richard Bonney ed., *The Rise of the Fiscal State in Europe, 1200-1815* (New York: Oxford University Press, 1999), particularly pp. 27-33.

[29] The customs had a ambivalent status as it belonged to the crown's ordinary revenue yet it was a kind of regular tax. For the importance of domain revenue to the state in the early Tudor, see B. P. Wolffe, *The Crown Lands 1461 to 1536: An Aspect of Yorkist and Early Tudor Government* (London: Allen and Unwin,

Only in emergencies such as invasions or foreign wars could the crown ask Parliament for "extraordinary revenues," which were levied upon both property and income in the country. As the historian Richard W. Hoyle has emphasized, these extraordinary supplies were justified by the special obligation of subjects to aid the crown in emergencies and they were not normal taxes collected annually.[30] It is important to note that the crown's ordinary revenue supported not only the royal household but also the royal government in providing governance, domestic order, and justice in peaceful times.[31] That "the king should live of his own" is thus a fiscal creed of the domain state in England.

The state in eighteenth-century Japan was an incomplete fiscal state. In sharp contrast to the unitary system of currency that the shogunate established in Japan, it collected taxes only in the territories under its direct governance, even though it had the authority and power to order domain governments to share public expenditures in river works, famine relief, and national defense.[32] The state in eighteenth-century China was a fiscal state which received most of its tax revenue from land taxes and the salt tax. The fiscal system in eighteenth-century China was politically highly centralized, with the Board of Revenue in the central government supervising the accounts of annual collection and expenditures

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1970), p. 25; idem, *The Royal Demesne in English History* (London: Allen and Unwin, 1971), chapter 1; Penry Williams, *The Tudor Regime* (Oxford: Clarendon, 1979), p. 58; G. R. Elton, *England Under the Tudors*, Third Edition (London: Routledge, 1991), pp. 47-57.

[30] See the discussion of the fundamental difference between regular taxation and irregular extraordinary supplies in Richard. W. Hoyle, "Crown, Parliament and Taxation in Sixteenth-Century England," *English Historical Review*, Vol. 109, No. 434 (November 1994), pp. 1192-6.

[31] This lack of institutional distinction between the crown's personal expenses and the costs of civil government remained unchanged in England until 1830, even after the crown's ordinary revenue was replaced by the Civil List in 1697. See Basil Chubb, *The Control of Public Expenditure: Financial Committees of the House of Commons* (Oxford: Clarendon, 1952), pp. 9-10.

[32] Mark Ravina rightly pointed out the incompleteness in extracting tax revenue of the shogunate, but he underestimates its political authority in ordering daimyos to share the expenditures of the central government in providing for social policies such as infrastructure and famine relief. See Mark Ravina, *Land and Lordship in Early Modern Japan* (Stanford: Stanford University Press, 1999), pp. 24-28.

created by provincial governments.[33] Unlike the domain state in England, the finances of the imperial household and of the state were institutionally separated in eighteenth-century China. Despite different fiscal structures, the actual operation of the fiscal system in all three cases was decentralized, as a large proportion of state revenue was assigned for particular purposes without being transferred to the central government.[34]

One important condition for the smooth operation of the early modern state with decentralized fiscal systems is a common paternalistic justification of state power cast in general moral terms of protecting the subjects' welfare.[35] This was embodied in various "social policies" such as famine relief, improvement of transportation, maintenance of water-conservancy, river management and so on.[36] These "social policies" are crucially important if we are to understand the broader political significance of public finance. They defined the moral obligation of the state in providing protection for society, justified the state's revenue extraction, and implanted an element of "public-ness" in

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[33] For a description of the politically centralized fiscal system after the reforms of the 1720s, see Madeleine Zelin, *The Magistrate's Tael: Rationalizing Fiscal Reforms in Eighteenth-Century Ch'ing China* (Berkeley: University of California Press, 1992).

[34] On decentralization in the fiscal operation in sixteenth-century England, see Patrick K. O'Brien and Philip A. Hunt, "The Rise of a Fiscal State in England, 1485-1815," *Historical Research*, Vol. 66, No. 160 (June 1993), pp. 141-142. For eighteenth-century Japan, see Ōguchi Yūjirō, "Bakufu no zaisei [The public finance of the shogunate]," in Shimbo Hiroshi and Saitō Osamu, eds., *Kindai seichū no taidō* [Gathering Momentum for Modern Growth], p. 132. For eighteenth-century China, see Wang Yeh-chien, *Land Taxation in Imperial China* (Cambridge, MA: Harvard University Press, 1973), pp. 12-18.

[35] See the emphasis on the autonomy of the state through legitimating the state power in Quentin Skinner, "The state," in Terence Ball, James Farr, and Russell L. Hanson, eds., *Political Innovation and Conceptual Change* (Cambridge: Cambridge University Press, 1989), pp. 117-118.

[36] On the legitimation of state power through government spending to improve societal welfare in early modern England, see Michael J. Braddick, *State Formation in Early Modern England*, chapter 3; Steve Hindle, *The State and Social Change in Early Modern England, c. 1550-1640* (New York: Palgrave, 2000), chapters 2 and 6. For the case of eighteenth-century Japan, see Ōguchi Yūjirō, "Bakufu no zaisei," pp. 153-7. For eighteenth-century China, Zelin emphasizes the role of government expenditures to promote public welfare; see Madeleine Zelin, *The Magistrate's Tael*, p. 304. For famine relief in eighteenth century China, see Pierre-Étienne Will, *Bureaucracy and Famine in Eighteenth-Century China*, trans. Elebrg Forster (Stanford: Stanford University Press, 1990); and Pierre-Étienne Will and R. Bin Wong, *Nourish the People: The State Civilian Granary System in China, 1650-1850* (Ann Arbor: The University of Michigan Press, 1991).

government finance. It was upon this moral basis that the central government could require local governments to share costs, while local governments in turn could make their case for demanding funds from the center. Nonetheless, this important role of early modern states in providing public goods has often been neglected by scholars who consider warfare the driving force behind state-building.[37]

The state in all three cases provided domestic stability and protected basic property rights, which were indispensable to the development of a market economy.[38] The legal protection of property rights does not distinguish the development of the market economy in early modern England from that in early modern Japan and China. Recent scholarship has forced us to re-evaluate the degree to which the concept of property rights was recognized in East Asia and the actualities of economic and legal practice in England.[39] The market economy in early modern England itself functioned largely through informal social networks rather than being coordinated through the formal legal institutions of the

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[37] For the (over) emphasis on the role of warfare in state building, see Charles Tilly ed., *The Formation of National States in Western Europe* (Princeton: Princeton University Press, 1975); idem, *Coercion, Capital, and European States, 990-1992* (Cambridge: Blackwell, 1992); Brian Downing, *The Military Revolution and Political Change* (Princeton, N. J.: Princeton University Press, 1992). For the discussion of the roles that early modern states played in providing social welfare, see Michael J. Braddick, "The Early Modern English State and the Question of Differentiation, from 1550 to 1770," *Comparative Studies in Society and History*, Vol. 38, Issue 1 (January 1996): 92-111; Stephen R. Epstein, "The rise of the West," in John A. Hall and Ralph Schroeder, eds., *An Anatomy of Power: The Social Theory of Michael Mann* (Cambridge: Cambridge University Press, 2006), p. 247.

[38] Stephen R. Epstein emphasizes that public goods provided by the state such as protection of property rights, law and order, and defense facilitated economic growth in the early modern period. Stephen R. Epstein, *Freedom and Growth: The Rise of States and Markets in Europe, 1300-1750* (London: Routledge, 2000), p. 9.

[39] Neo-institutional economists often consider the role of formal legal institutions the distinctive feature of the market economy in England. See Douglass C. North, *Structure and Change in Economic History* (New York: Norton, 1981), pp. 154-157; idem., *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990), pp. 114-117. For the legal protection of property rights in China during the Qing dynasty, see Kathryn Bernhardt and Philip C. C. Huang eds., *Civil Law in Qing and Republican China* (Stanford: Stanford University Press, 1994); Philip C. C. Huang, *Civil Justice in China: Representation and Practice in the Qing* (Stanford: Stanford University Press, 1996); and Madeleine Zelin, Jonathan K. Ocko, and Robert Gardella, eds., *Contract and Property in Early Modern China* (Stanford: Stanford University Press, 2004).

state. In the eighteenth century, many English laws were not only imprecise but even hostile towards common business activities.[40] On a practical level, the protection of the courts was simply beyond the reach of most tradesmen, manufacturers, and retailers. In this situation, English businessmen "generally resorted to their own informal, cheaper and more speedy systems of arbitration conducted by trade associations, guilds, chambers of commerce and other peer groups who applied commercial rules to disputes." And "English common law did not establish a national hegemony over economic matters until rather late in the nineteenth century."[41] The use of informal social networks to coordinate economic transactions and settle business disputes on the basis of trust and reputation is familiar to students of the economic history of early modern China and Japan. It is thus a mistake to overemphasize the role of the state in *creating* a market economy, which is often seen in the school of historical institutionalism.[42]

The development of a market economy in England from the sixteenth century onward is well-known.[43] Less recognized are similar developments in eighteenth-century Japan and China. From a comparative perspective, features of economic societies in eighteenth-century Japan and China exhibited many surprising similarities with those

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[40] See the literature review in David Sugarman and G. R. Rubin, "Introduction: Towards A New History of Law and Material Society in England, 1750-1914," in G. R. Rubin and David Sugarman eds., *Law, Economy and Society, 1750-1914: Essays in the History of English Law* (Abingdon, Oxon. : Professional Books, 1984).
[41] Patrick O'Brien, "Central government and the economy, 1688-1815," p. 217 and p. 230.
[42] See such examples in Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Boston: Beacon Press, 1957), pp. 63-65 and 73-76; Kiren Aziz Chaudhry, "The Myths of the Market and the Common History of Late Developers," p. 250; Randall Collins, "Weber's Last Theory of Capitalism: A Systematization," *American Sociological Review* 45 (December 1980): 925-942. Max Weber is ambivalent on the role of state's formal laws in the development of capitalism. See the discussion of this point in Roger Cotterrell, "The Development of Capitalism and the Formation of Contract Law," in Bob Fryer, Alan Hunt, Doreen McBarnet and Bert Moorhouse, eds., *Law, State and Society* (London: Croom Helm, 1981).
[43] John Hicks, *A Theory of Economic History* (Oxford: Oxford University Press, 1969).

seen in early eighteenth-century England. These included increasing commercialization of agricultural production; proto-industrialization in the economic core areas (the Lower Yangzi Delta in China and the Kinai region in Japan); the expansion of the urban economy; the growth of inter-regional long-distance trading of staple goods such as grain, cotton cloth, silk, and so on, which gave birth to a unified national market and further stimulated regional division of labor; de facto labor mobility; and the rise of businessmen and entrepreneurs whose money-making activities were seen as morally legitimate.[44] The consolidation of a market economy in the three societies prepared two necessary conditions for the rise of a modern fiscal state. One is a sophisticated private financial network connecting major cities and market towns which was able to transfer money across time and space with speedy credit instruments such as bills of exchange.[45] This constituted an important domestic pool from which state actors could draw useful ideas, financial techniques, and even advisors when they tried to mobilize more financial

[44] For a discussion of the development of a market economy in China in the eighteenth century, see Kenneth Pomeranz, *The Great Divergence: China, Europe, and the Making of the Modern World Economy* (Princeton: Princeton University Press, 2000), chapters 1 and 2; R. Bin Wong, *China Transformed: Historical Change and the Limits of European Experience* (Ithaca: Cornell University Press, 1997), pp. 13-43; Wu Chengming, *Zhongguo zibenzhuyi yu guonei shichang* [Capitalism and the Domestic Market in China] (Beijing: Zhongguo shehui kexue chubanshe, 1985), particularly pp. 217-46 and pp. 247-65; and Li Bozhong, "Zhongguo quanguo shichang de xingcheng: 1500-1800 [Emergence of a national market in China, 1500-1800]," *Qinghua daxue xuebao*, Vol. 14, No. 4 (1999): 48-54. For Japan, see Thomas C. Smith, *Native Sources of Japanese Industrialization, 1750-1920* (Berkeley: University of California Press, 1988); Edward E. Pratt, *Japan's Protoindustrial Elite: The Economic Foundations of the Gōnō* (Cambridge: The Harvard University Asia Center, 1999); David L. Howell, *Capitalism From Within: Economy, Society and the State in a Japanese Fishery* (Berkeley: University of California Press, 1995); Hayami Akira and Miyamoto Matao, eds., *Keizai shakai no seiritsu: 17th-18th seiki* [The Formation of an Economic Society: seventeenth and eighteenth centuries], volume 1 in *Nihon keizaishi* [An Economic History of Japan] (Tōkyō: Iwanami Shoten, 1988).

[45] The financial networks in seventeenth-century England were mostly concentrated in London. In eighteenth-century Japan, the dense financial networks centered on Osaka and extended mainly to Kyoto and Edo. In China, the Shanxi bankers had established financial networks which connected 24 major cities and market towns in China by the 1850s. See Eric Kerridge, *Trade and Banking in Early Modern England* (Manchester: Manchester University Press, 1988); Y. Shikano, "Edo-ki Osaka ni okeru ryōgaeshō no kinyū kinō o megutte [On the financial functions of the moneychangers in Osaka in the Edo period]," *Keizaigaku ronsō*, Vol. 52, No. 2 (December 2000), pp. 237-41; Huang Jianhui, *Shanxi piaohaoshi* [A History of Shanxi Bankers], revised version (Taiyuan: Shanxi jingji chupanshe, 2002), pp. 137-150.

resources using tax revenue. The other is a large commercialized sector in the economy which constituted an important potential base for the state to tap indirect taxes on domestic consumption.[46]

The three cases also illustrate that the institutions of public finance do not necessarily develop in tune with the market economy. In particular, the old state had little institutional ability to deal with new problems that accompanied the development of a market economy. For example, the price revolution in England between the 1450s and 1650s and in Japan between the 1820s and 1860s, and in China throughout the eighteenth century severely eroded the fiscal bases of their respective governments.[47] The situation in China was a bit special it encountered a prolonged deflation between the 1820s and 1850s when opium smuggling and reduction in China's exports to Europe greatly reduced China's domestic silver stocks. The severe domestic deflation led to widespread tax arrears and unemployment.[48]

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[46] According to Saitō Osamu's estimation, non-agricultural sectors (commerce, finance, service, and so on) accounted for about 50 percent of the GDP of Japan in the 1860s. See Saitō Osamu, "Bakumatsu-ishin no seiji sanjutsu [Political arithmetic and Japan in late Tokugawa and early Meiji Restoration]," in the Society of Modern Japan eds., *Meiji ishin no kakushin to renzoku* [The Innovation and Continuity of the Meiji Restoration], volume 14 of *Nenpō kindai Nihon kenkyū* (Tōkyō: Yamagawa Shuppansha, 1992), p. 278. In Wu Chengming's estimation, the total value of major commodities transacted in the national market in China around 1840 amounted to 387million *tael* of silver. See Wu Chengming, *Zhongguo zibenzhuyi yu guonei shichang* [Capitalism and the domestic market in China], p. 251.

[47] For the price revolution in England between 1450 and 1649, see the overall review of the price revolution in England in C. G. A. Clay, *Economic Expansion and Social Change: England 1500-1700*, volume I (Cambridge: Cambridge University Press, 1984), chapter 2. For the upward trend in prices in Japan, particularly after the 1820s, see Shimbo Hiroshi, *Kinsei no bukka to keizai hatten: zenkōgyō shakai e no sūryōteki no sekkin* [Prices in the Early Modern Period and Economic Development: A Quantitative Approach toward a Preindustrial Society] (Tōkyō: Tōyō Keizai Shinpōsha, 1978). For the slow yet steady price rise in eighteenth-century China, see Wang Yeh-chien, "Secular Trends of Rice Prices in the Yangzi Delta, 1638-1935," in Thomas G. Rawski and Lillian M. Li, eds., *Chinese History in Economic Perspective* (Berkeley: University of California Press, 1992): 35-68.

[48] See a description of this deflation in Lin Man-houng, *China Upside Down: Currency, Society, and Ideologies, 1801-1856* (Cambridge, MA.: Harvard University Press, 2006), chapter 3.

Insufficient government income seriously weakened the institutional basis of the autonomy and capacity of the state in all the three countries.[49] The already difficult fiscal conditions were greatly exacerbated by new challenges from abroad requiring increased military expenditures. In this situation, seemingly minor occurrences may end up producing huge political upheavals when the state lacks the necessary financial resources to deal with emergent situations. It is thus not coincidental that big political events took place as the states became financially exhausted: the outbreak of the English Civil Wars in 1642, the collapse of the Tokugawa regime in the Meiji Restoration of 1868, and the beginning of the Taiping Rebellion in China in 1850 (perhaps the largest civil war in world history). This explains the choice of the starting year for each case. In this sense, the emergence of (or failed emergence) of a modern fiscal state is not a process of building a state from scratch, but rather a transformation in the institutions of public finance in an already well-established state in such a way that a new institutional basis for state the autonomy and capacity, and a new kind of state-economy relationship, emerges.

In each episode, state actors faced the same problems: how to increase revenue with low administrative and political costs so as to contain challenges from within and without. As they searched for new methods and institutions in public finance so as to rebuild the state's autonomy and capacity, they conducted many similar experiments in public finance. They tried to raise credit in the markets, to collect domestic consumption taxes, to issue paper money, to seek collaboration from private financiers, etc. They also made

[49] For the importance of institutions of public finance to the autonomy and capacity of the state, see Theda Skocpol, "Bringing the State Back In: Strategies of Analysis in Current Research," in Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol, eds., *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985); Michael Mann, *The Sources of Social Power* (Cambridge: Cambridge University Press, 1986).

similar mistakes, which led to huge discounts of state credit instruments in the market. In each process of institutional experimentation in public finance, we also observe intensive interactions between the state actors and private financiers. State actors tried to use the current tax revenue to mobilize more financial resources from the market, both domestic and foreign. Moreover, the most powerful private financiers all had close connections with government (or with certain factions in government). This phenomenon of influential political merchants (*zhengshang* in Chinese and *seishō* in Japanese) in public finance is universal, in spite of their distinctive political traditions and cultures.

The end results and sequences of institutional transformation in the three cases are different, however. England first transformed from a domain state into a fiscal state in the late 1640s and the fiscal state had been firmly established in the 1650s.[50] A centralized bureaucracy to collect the customs and excises on liquor had been established in 1672 and 1683 respectively. After the Glorious Revolution in 1688, England entered into consecutive expensive wars with France in the so-called Second Hundred Years War (1689-1815). In order to fund the growing military expenditures after 1689, the English state mainly depended upon borrowing, though the option of issuing paper notes was brought up in the early 1690s. After 1713, the English government began to convert its remaining unfunded short-term debts into funded long-term debts and try to reduce the interest rates of its funded long-term borrowing . The modern fiscal state emerged in the

[50] For the emphasis on the importance of the Civil Wars to the rise of fiscal state in England, see Patrick K. O'Brien, "Fiscal Exceptionalism: Great Britain and its European rivals from Civil War to triumph at Tranfalgar and Waterloo," in Donald Winch and Patrick K. O'Brien eds., *The Political Economy of British Historical Experience, 1688-1914* (Oxford: Published for The British Academy by Oxford University Press, 2002), p. 246; Michael J. Braddick, *The Nerves of State: Taxation and the Financing of the English State, 1558-1714* (Manchester: Manchester University Press, 1996), p. 16.

1720s when the perpetual redeemable annuities came to dominate government borrowing. The receipts from the customs and excises collected by the centralized bureaucracy were used to make prompt and regular interest payments on these long-term borrowings. By the 1750s, the new institutions of modern fiscal state had been consolidated.

In contrast to England's dependence upon short-term financing prior to the establishment of a modern fiscal state, the new Japanese government formed in 1868 depended heavily on de facto inconvertible paper notes to meet government spending. From the late 1870s onward, it began to turn to indirect taxes rather than the land tax to increase revenue. Due to the unequal treaties imposed by Western powers, which set the level of customs duties at 5 percent, the option to increase revenue through raising the customs duties was not available. Given this restriction, the government tried hard to extract revenues from taxes levied on major consumption goods such as sake, liquor, tobacco, soy sauce, etc. The modern fiscal state emerged in Japan in the mid-1880s when the new institutions of public finance enabled the government to stabilize the value of paper money issued by the Bank of Japan. The centrally collected tax revenue was vital to sustain the creditworthiness of the Bank of Japan. The modern fiscal state was consolidated in Japan by 1895.

In contrast, China shows why institutional experiments and developments in public finance do not necessarily lead to transformation into a modern fiscal state. Although the Chinese government issued paper notes between 1853 and 1863 to meet government spending in repressing the Taiping Rebellion, this monetary experiment failed to have much impact on institutional development. Nevertheless, there were significant changes in the institutions of public finance in China after the 1860s. As in England and Japan, the receipts from the customs and the domestic consumption tax (the *lijin* duty collected from wholesalers) became the major pillar of government finance. Nevertheless, fiscal operations remained decentralized, with a large number of specific sources of revenue being assigned by the central government directly for particular purposes without being transmitted to Beijing. Thus the central government never gained the institutional ability to use its tax revenue in an aggregated way to mobilize financial resources. A discernible trend toward a modern fiscal state did not appear until 1895. It was disrupted by the Boxer Incident in 1899. The resulting indemnities financially broke the state, which finally collapsed in 1911.

IV. The modern fiscal state in the mirrors of England, Japan, and China

Having outlined the case for the comparability of England, Japan, and China in economy and state formation, I now attempt to demonstrate briefly how a comparative approach allows us to isolate the crucial feature of the modern fiscal state. This is the institutional linkage between the state's centrally collected revenue and its long-term involvement in the financial markets. Its importance to state capacity and autonomy becomes apparent when we compare China with England and Japan. Moreover, the three cases examined here – two successes and one failure – also illustrate that there may be more than one path toward the modern fiscal state.

Let us first turn to the case of England. The discovery by recent scholarship of a "strong state" with an efficient tax bureaucracy overthrows the old view of the eighteenth-century English state as an amateurish *laissez-faire* state which had an underdeveloped bureaucracy and which depended upon decentralized local governance by the gentry.[51] The well-known "financial revolution" in eighteenth-century England, which allowed the government to take on huge sums of long-term debt for the prosecution of wars, was in the past often attributed to its developed market economy.[52] Thanks to the work of Peter Mathias, Patrick O'Brien, John Brewer, and other historians, we now have a better understanding of the part played by taxation in this financial revolution. The creditworthiness of the English government was based upon a surprising ability to extract tax revenue from the economy, which made eighteenth-century England one of the most heavily taxed countries in the world.[53] The contemporary fiscal system was highly centralized as local taxes accounted for only 10 percent of the levies of central government before the 1770s.[54] The composition of English tax revenue underwent significant change over the course of the century as it came to rely more and more on

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[51] The image of eighteenth-century English administration as a decentralized gentry-administration which did not have a large state apparatus can be found in Max Weber, *Economy and Society,* volume II (Berkeley: University of California Press, 1978), pp. 1061-1064. For more recent examples, see Gabriel Ardent, "Financial Policy and Economic Infrastructure of Modern States and Nations," in Charles Tilly ed., *The Formation of National States in Western Europe* (Princeton: Princeton University Press, 1975), p. 196; Charles Tilly, *Coercion, Capital, and European States*, p. 159; Bruce G. Carruthers, *City of Capital: Politics and Markets in the English Financial Revolution* (Princeton, N. J.: Princeton University Press, 1996), p. 22.

[52] The level of debt of the English government rose from almost nothing in 1688 to £16.7 million by 1697, £76 million by 1748, and £245 million by 1783. See John Brewer, *The Sinews of Power: War, Money and the English State 1688-1783* (New York: Alfred A. Knopf, 1989), p. 114.

[53] Peter Mathias and PatricK. O'Brien, "Taxation in Britain and France, 1715-1810: A Comparison of the Social and Economic Incidence of Taxes Collected for the Central Governments," *Journal of European Economic History*, Vol. 5, No. 3 (1976): 601-50; Patrick K. O'Brien, "The political economy of British taxation, 1660-1815," *Economic History Review*, New Series, Vol. 41, No. 1 (February 1988): 1-32.

[54] Peter Mathias, "Taxation and industrialization in Britain," in Peter Mathias, *The Transformation of England: Essays in the Economic and Social History of England in the Eighteenth Century* (London: Methuen, 1979), p. 117.

indirect taxes. The receipts from the customs and excises accounted for 70-80 percent of the total government annual income for most of this time. In particular, the proportion of revenues from excises in the total revenue rose from 26 percent in 1696-1700 to 36 percent in 1711-1715 and to 51 percent in 1751-5.[55]

As Patrick K. O'Brien has pointed out, the vast expansion of receipts from indirect taxes was not only a result of the expansion of the economy but also a consequence of an administrative revolution in public finance.[56] John Brewer further demonstrates that the establishment of a highly centralized bureaucracy staffed by salaried officers gave the English state an institutional ability to collect elastic and reliable revenues from the indirect customs and excises. In particular, Brewer points out that the Excise Department, the biggest department in government during this period, approximated the Weberian ideal type of rational bureaucracy.[57]

The Excise Department played exactly the role that Max Weber expects a rational administrative bureaucracy to play in the development of capitalism, i.e., reliability and predictability in administration.[58] In contrast to the bureaucracy in Prussia which

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[55] Cited from Table 2 in J. V. Beckett, "Land Tax or Excise: the levying of taxation in seventeenth- and eighteenth-century England," *English Historical Review*, Vol. 100, No. 395 (April 1985), p. 306.
[56] For example, the excises and stamp duties increased from £0.4 million in 1685 to £2.8 million in 1720 while the estimated national income (at current prices) increased only from £41.76 million in 1680 to £53.92 million in 1720. See Patrick K. O'Brien, "The political economy of British taxation, 1660-1815," *Economic History Review*, New Series, Vol. 41, No. 1 (February 1988), p. 3 and p. 9.
[57] Relevant characteristics included: recruitment by examination, professional training, meticulous bookkeeping, centralized supervision based upon standardized bureaucratic procedures for the assessment and collection of excises, and promotion on the basis of seniority. Brewer, *The Sinews of Power*, p. 68.
[58] For Weber's discussion of the contribution of rational bureaucracy, see Max Weber, *Economy and Society,* volume II (Berkeley: University of California Press, 1978), pp. 974-975 and pp. 1393-1394. Had Weber known more about the Excise Department in eighteenth-century England, he might have incorporated it into his theory of capitalism. The Excise Department has also been neglected by Bernard S. Silberman, who traces the beginning of a rationalized bureaucracy in England to around 1790. See Bernard

managed state enterprises for fiscal revenue, the centralized bureaucracy in eighteenth-century England specialized in collecting indirect customs and excises. As Brewer has emphasized, the receipts from the customs and excises, particularly from the highly efficient Excise Department, enabled the English government to make regular interest payments on the issued stocks of perpetual annuities. This was vital to the success of the perpetual annuity which dominated the English government's borrowings after the 1740s. In comparison, the collection of the land tax was firmly controlled by land owners themselves. As a result, underestimation and evasion in the collection of the land tax were widespread. Moreover, the local gentry who collected the land tax often retained the money for one or two years before sending it to the central government.[59]

The success of the eighteenth-century English state in extracting the indirect customs and excises and its remarkable abilities to mobilize financial resources provided a solid institutional basis for state capacity and autonomy. In possession of a centralized bureaucracy whose agents collected the vast majority of tax revenue, the government enjoyed more autonomy than did those states which could only depend upon local powers for revenue collection. With a relatively diversified tax base consisting of the direct land tax and indirect customs and excises, the English state was more autonomous than those states which relied upon a single source of taxation. Perhaps most importantly, by using

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S. Silberman, *Cages of Reason: The Rise of the Rational State in France, Japan, the United States, and Great Britain* (Chicago: The University Press of Chicago, 1993), p. 7 and chapters 10-12.

[59] For the underassessment and evasion of the land tax, see W. R. Ward, *The English Land Tax in the Eighteenth Century* (Oxford: Oxford University Press, 1953), particularly section II. For the local gentry's use of the collected revenue from the land tax to set up country banks, invest in projects such as canals and turnpike trusts, or simply earn interest, see L. S. Pressnell, "Public Monies and the Development of English Banking," *Economic History Review*, Vol. 5, Issue 3 (1953), pp. 378-97. For the political considerations behind the central government's tolerant attitude to mismanagement of the land tax, see Colin Brooks, "Public finance and political stability: the administration of the land tax, 1688-1720," *Historical Journal*, Vol. 17, No. 2 (1974): 281-300.

the tax revenues to secure the stocks of perpetual annuity which the state issued to the investing public, the English state was autonomous vis-à-vis big financiers. This autonomy was impressive; as the English government was able to reduce the interest rates of its issued redeemable perpetual annuities from over 6 percent in 1717 to 3 percent by 1752. From the 1740s on, it mainly used the stocks of perpetual annuities to raise long-term loans from the public, although the Bank of England was entrusted to manage state annuities. In the eighteenth and nineteenth centuries, the centralized customs and excise bureaucracy became civil service departments in government, which reflected another aspect of the autonomy of the state.[60]

How shall we characterize the institutional development in public finance in eighteenth-century England? The term "fiscal-military state" coined by Brewer nicely captures the close interactions between the institutional development of public finance in the eighteenth-century English state and the many expensive wars that it fought from 1689 to 1815. Nevertheless, this concept concentrates mainly on the use of the state's fiscal resources and does not directly address the institutional feature of the state's public finance. In regard to this, Brewer does point out the remarkably centralized fiscal system which appeared in the late seventeenth century. According to Brewer, the Treasury managed both receipts and disbursements of all government departments in this centralized fiscal system, which distinguished the English state from other European states by its institutional ability to "keep full accounts of total government revenue and expenditure."[61]

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[60] Brewer, *The Sinews of Power*, chapter 3.
[61] Brewer, *The Sinews of Power*, p. 129.

However, Brewer overestimates the degree of centralization in the management of government spending in eighteenth-century England, which was much lower than in the collection of the customs and excises. For example, the Treasury before the mid-eighteenth century did not have access to itemized information on expenditures of the army and navy, the two biggest spending departments, and could only approve the estimates of the sum of expenditures required by them.[62] Fully centralization in the Treasury's management of government expenditures was not realized until the second half of the nineteenth century when government departments uniformly adopted double-entry bookkeeping.[63] By contrast, collection of excises was extraordinarily centralized, as the accounts and records of excise officers all over England had to be sent to London for regular scrutiny.[64] The centralized management of the Excise Department is thus the exception rather than the rule in the English state in the eighteenth century.

Patrick K. O'Brien and Philip A. Hunt describe these changes after the 1640s as "the rise of a fiscal state" and they highlight the growing importance of domestic tax revenue in the English government's income since the mid-sixteenth century.[65] However, the term of "fiscal state" by its definition can neither capture the special institutional developments in public finance from the 1710s onward nor distinguish it from fiscal states in other parts of the world, such as in eighteenth-century China where the state rested upon tax

[62] J. E. D. Binney, *British Public Finance and Administration, 1774-92* (Oxford: Clarendon, 1958), p. 140 and p. 151.
[63] Henry Roseveare, *The Treasury 1660-1870: The Foundations of Control* (London: Allen & Unwin, 1973), pp. 71-4.
[64] Brewer, *The Sinews of Power*, pp. 102-111.
[65] Patrick K. O'Brien and Philip A. Hunt, "England, 1485-1815," in Richard Bonney ed., *The Rise of the Fiscal State in Europe, 1200-1815* (New York: Oxford University Press, 1999).

revenues. As O'Brien and Hunt have pointed out, the powerful English state from 1720s onward greatly benefited from two interrelated fiscal developments, i.e., the highly centralized bureaucracy to collect increasing indirect tax revenues from the customs and excise, which service the regular interest payments of the market-based system of permanent debt of the state.[66] This characterization makes the fiscal state in eighteenth-century England a modern one which distinguishes it from a traditional fiscal state bearing no perpetual liabilities.

I argue that the concept of the modern fiscal state is more important for understanding the general institutional features of the eighteenth-century English state than is the particular use of state revenues for military purposes. This new kind of state emerged during the 1730s when the institutional linkage between the revenue collected by the centralized bureaucracy and the interest payments on the English government long-term debt under the management of financial institutions such as the Bank of England became firmly established. The institutions of the modern fiscal state enabled the English government to mobilize necessary financial resources to afford expensive wars, in spite of widespread waste and corruption in government spending, especially in the army and navy.[67] More importantly, recognizing the central institutional feature of the modern fiscal state makes it easier to put the eighteenth-century English state, which emerged in a very special historical context characterized by successive conflicts and the enormous expansion of

[66] Ibid., p. 65.
[67] For details about the extensive venality and corruption in eighteenth-century British Navy, see Daniel A. Baugh, *British Naval Administration in the Age of Walpole* (Princeton, N.J.: Princeton University Press, 1965), particularly chapters 8 and 9. Systematic reforms to clear government corruption did not begin until the nineteenth century. For these reforms, see Philip Harling and Peter Mandler, "From 'Fiscal-military' State to Laissez-faire State, 1760-1850," *Journal of British Studies*, 32 (January 1993): 44-70; Philip Harling, *The Waning of "Old Corruption": The Politics of Economic Reform in Britain, 1779-1846* (Oxford: Clarendon Press, 1996).

the Atlantic trade, into a broader comparative perspective. For example, the Japanese state in the mid-1880s had developed into a modern fiscal state even though it had not fought any large-scale international wars and was in a marginal position in the global trade and capital markets of the time. In contrast to the long-term borrowing of the eighteen-century English state, the Meiji government's permanent liabilities were embodied in the convertible paper notes.

Political economists of late development have focused on the direct means that the Japanese state used in this period to promote modern industrial development. Japan has often been held up as the perfect example of state-led economic growth.[68] However, mismanagement and inefficiency in the new government's direct investments in industrial projects is now well-known.[69] It is now widely accepted that the establishment of the Bank of Japan in 1882 and its importance in stabilizing the value of paper money and curbing a severe inflation between 1878 and 1881 was more important to Japan's economic modernization than the government's direct industrial investment.[70] The stable

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[68] See for example the description of the role of the state in Japan's industrial development in G. C. Allen, *A Short Economic History of Modern Japan* (London: Macmillan, 1981).

[69] For an empirical study of the mismanagement of these state-owned enterprises, see Yamamura Kozo, "Entrepreneurship, ownership, and management in Japan," in Peter Mathias and M. M. Postan eds., *The Cambridge Economic History of Europe,* volume VII, *The Industrial Economies Capital, Labour, and Enterprise, Part 2, The United States, Japan, and Russia* (Cambridge: Cambridge University Press, 1978), pp. 226-230; Takamura Naosuke, *Nihon bōsekigyōshi josetsu (jō)* [Introduction to the History of the Japanese Textile Industry – 1] (Tōkyō: Hanawa Shobō, 1972); S. McCallion, "Trial and error: the model filature at Tomioka," in W. Wray ed., *Managing Industrial Enterprise, Cases from Japan's Prewar Experience* (Cambridge: Harvard University Press, 1989).

[70] The period between 1885 and 1890 witnessed the first economic boom in Meiji Japan as both the number of corporations and the paid-up capital doubled. See Nakamura Takafusa, "Makuro keizai to sengo keiei [Macroeconomy and post-war management]," in Nishikawa Shunsaku and Yamamoto Yūzō, eds., *Sangyōka no jidai (ge)* [The Age of Industrialization: Part 2], volume 5 in *Nihon keizaishi* [An Economic History of Japan] (Tōkyō: Iwanami Shoten, 1990), p. 10. For the importance of the financial reforms in the early 1880s, see Richard Sylla, "Financial Systems and Economic Modernization," *Journal of Economic History*, Vol. 62, No. 2 (June 2002), pp. 277-92; Henry Rosovsky, "Japan's Transition to Modern Economic Growth, 1868-1885," in Henry Rosovsky ed., *Industrialization in Two Systems: Essays in Honor of Alexander Gerschenkron* (New York: John Wiley & Sons, 1966).

macroeconomic environment that the Bank of Japan helped create in the second half of the 1880s facilitated the transfer of idle money from non-agricultural sectors (commerce, service, finance, etc.) into industrial development; it was these funds which were the main source for industrial investment in Japan in the late nineteenth and early twentieth centuries.[71]

Centralized tax collection was crucial to sustain the Bank of Japan. While England in the 1750s consolidated the modern fiscal state by using tax revenues as security for long-term loans, Japan established a modern fiscal state in the late 1880s by employing tax revenues to safeguard the value of banknotes issued by the Bank of Japan, the legal tender. The government channeled the centrally collected tax revenues into the reserves of the Bank of Japan and granted it a monopoly in note-issuing, which was the most important business of the Bank in its early stages. The fiscal system in Japan in the mid-1880s was highly centralized, as all the collected revenue was at the disposal of the central government. The transfer of collected tax revenue had previously been made through bills of exchange. After 1882, the central government even required officials to use telegraphs to send the bills of collected tax revenue to Tokyo.[72] Centralized fiscal system helped the Bank of Japan gradually establish corresponding relationships with other national or private commercial banks and thus fulfill the function of the central bank in the Japanese economy in the late 1890s.

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[71] For the contribution of non-agricultural wealth to industrial investment in Meiji Japan, see Teranishi Jūrō, "Kinyū no kindaika to sangyōka [The modernization of finance and industrialization]," in Nishikawa Shunsaku and Yamamoto Yūzō, eds., *Sangyōka no jidai (ge)* [The Age of Industrialization: Part 2], p. 63.
[72] Muroyama Yoshimasa, *Kindai Nihon no gunji to zaisei* [The Military and Public Finance in Early Modern Japan] (Tōkyō: Tōkyō Daigaku Shuppankai, 1984), p. 68.

In terms of the composition of government tax revenue, the shift to increasing reliance upon indirect consumption taxes, particularly the taxes levied upon sake and liquor, was quite noticeable. The revenue from duties levied upon the production of sake and liquor (*shuzōzei*) rose from 12.3 percent of the annual total tax revenue in 1878 to 26.4 percent in 1888. In 1899, this percentage reached 38.8 percent (49 million Yen), which for the first time exceeded the land tax (35.6 percent, or 45 million Yen).[73] This dramatic increase within two decades resulted more from improved collection rather than the expansion of domestic consumption. As with the excise collection in England, the duties levied upon sake and liquor in Japan were collected by the bureaucrats of the Ministry of Finance.[74] From 1891 to 1895, debates in the newly established Japanese parliament, the Diet, turned mainly on the purpose of the newly established institutions of the modern fiscal state: were they to be used to collect funds for military expansion or to promote domestic welfare and local infrastructure?[75]

The establishment of the modern fiscal state in Japan in the period between 1886 and 1895 was a great institutional achievement as it successfully attained the convertibility to silver of the banknotes issued by the Bank of Japan and thus safeguarded their value as the legal tender in the domestic economy. Moreover, it had a great impact on the

[73] Cited from Fujiwara Takao, *Kindai Nihon shuzōgyōshi* [A History of Sake Brewing in Modern Japan] (Kyoto: Mineruva Shobō, 1999), p. 2. For a discussion of the rising importance of indirect taxes in Japan after 1868, see Hayashi Takehisa, *Nihon ni okeru sozei kokka no seiritsu* [The Formation of the Tax State in Japan] (Tōkyō: Tōkyō Daigaku Shuppankai, 1965).
[74] Ibid., pp. 101-108.
[75] The liberals in Japan advocated a "reduction of the tax burden on the people" (*minryoku kyūyō*) and opposed the government's agenda of "rich state, strong army" (*fukoku kyōhei*). In particular, they demanded the reduction of military expenditures and an increase in government spending on local infrastructure. See Banno Junji, "Meiji kokka no seiritsu [The establishment of the Meiji state]," in Umemura Mataji and Yamamoto Yūzō, eds., *Kaikō to ishin* [The Opening of Japan and the Restoration], volume 3 in *Nihon keizaishi* [An Economic History of Japan] (Tōkyō: Iwanami Shoten, 1989), pp. 102-5.

government's ability to influence the economy and to achieve its goals. Although the total government expenditures between 1888 and 1892 accounted for only 7.9 percent of GNP, the Japanese government could play an indirect yet effective role to foster industrial investment.[76] For example, even though the over-heated economy, particularly the boom in the formation of join-stock companies in the late 1880s, led to a severe financial panic in 1890, the Bank of Japan continued to discount bills issued by banks which accepted the shares of major railway companies as security. This policy greatly encouraged investment and capital formation in railway construction.[77] Moreover, the new institutions of a modern fiscal state improved the Japanese government's creditworthiness. In addition to the state liability in the form of banknotes issued by the Bank of Japan, the Japanese government in 1886 successfully issued a long-term Navy Bond of ¥17 million with an annual interest of 5 percent in the domestic market to modernize the Japanese navy.[78]

In a negative way, China shows the importance of building a modern fiscal state. China had been ruled by traditional fiscal states which rested upon tax revenues rather than royal estates since perhaps the tenth century. In the eighteenth century, the government collected up to 80 percent of its tax revenue in silver. Yet the fiscal state remained persistent in China. Despite its long experience with tax institutions, it did not transform

[76] This was quite low as compared with 16.2 percent in France, 13.2 percent in Italy, and 12.5 percent in Sweden in the same period. Cited from Yasukichi Yasuba, "Did Japan Ever Suffer from a Shortage of Natural Resources Before World War II?" *Journal of Economic History*, Vol. 56, No. 3 (September 1996), p. 549.
[77] Ishii Kanji, "Japan," in Rando Cameron and V. I. Bovykin, eds., *International Banking: 1870-1914* (New York: Oxford University Press, 1991), p. 226.
[78] Muroyama Yoshimasa, *Kindai Nihon no gunji to zaisei* [Public Finance and the Military in Modern Japan], pp. 133-134.

into a modern fiscal state. In order to have a better sense of this puzzle, let us review some important fiscal developments in nineteenth-century China.

Although there was no alteration in the government ruling China between 1850 and 1911, as occurred in England and Japan, significant changes happened in public finance. Many of these paralleled the developments in England and Japan. First, the average annual tax revenue of the Qing government more than doubled from some 40 million *tael* in the 1830s to about 90 million *tael* in the early 1890s as a result of expansion in both domestic and international trade after the 1860s. Second, the composition of the state tax revenue became more diversified. While the percentage of the receipts from land taxes in government annual income dropped from more than 70 percent in the 1840s to some 40 percent in the 1880s and 1890s, the receipts from the indirect taxes such as customs, the domestic consumption tax (*lijin* duties), and the salt tax grew to some 50 percent over the same period.[79]

As in both England and Japan, the method to transmit government tax revenue became more reliant upon the use of bills of exchange, which were first introduced into state fiscal operations in the 1860s. In the period between 1875 and 1893, about one-third of the tax revenues which the central government ordered sent to Beijing were transmitted by private bankers through bills of exchange.[80] The vast majority of tax revenues sent to Beijing from the provinces of Sichuan, Fujian, Guangdong, and Zhejiang, and from the

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[79] Zhou Yumin, *Wan Qing caizheng yu shehui bianqian* [Public Finance and Social Change in the Late Qing](Shanghai: Shanghai renmin chubanshe, 2000), p. 239, table 4-3.
[80] Song Huizhong, "Piaoshang yu wanqing caizheng [Shanxi Bankers and Public Finance in Late Qing]," in *Caizheng yu jindaishi lunwenji* (shangce) [Collected Papers on Public Finance and the Early Modern History: Part 1] (Taipei: Academic Sinica, 1999), p. 402.

customs offices in Fujian, Zhejiang, and Guangdong, were also transmitted by private bankers through bills of exchange.[81] The inter-provincial transfer of official funds under the supervision of the central government also depended upon private bankers. In both England and Japan, the use of speedy bills of exchange to transfer government tax revenue was crucially important for the government to centralize the management of its annual income. And centralization in tax collection was one key step toward the building of the modern fiscal state.

Moreover, the customs and the *lijin* duty were collected by salaried staffs. Under the management of western officials employed by the Qing government, the Imperial Maritime Customs became a highly centralized and efficient bureaucracy in collecting the customs revenue.[82] Meanwhile, most of the officials who collected the *lijin* duty in nineteenth-century China were expectant-officials (*houbu guanyuan*). The Board of Revenue in Beijing required every provincial government to send the name list of collecting officials in each collection station and report on their performance twice a year. Official-candidates who collected *lijin* duties were subject to the rules of formal officials. For example, they were not allowed to serve in their birth-places, and good performance in tax collection gave them priority for promotion in the bureaucratic system.[83] This was similar to the basic principles in the management of the Excise Department in eighteenth-century England.

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[81] Ibid., pp. 401-402.

[82] It is important to note that the western officials in the Imperial Maritime Customs were only collecting agents, who had no power or authority to decide the spending of the collected customs revenue. On this point, I benefit from discussing with Ren Zhiyong at Beijing University.

[83] For the importance of salaried officials in the collection of *lijin*, see Susan Mann, *Local Merchants and the Chinese Bureaucracy, 1750-1950* (Stanford: Stanford University Press, 1985), p. 104; Luo Yudong, *Zhongguo lijinshi* [A History of *Lijin* in China] (Shanghai: Shangwu yinshuguan, 1936), pp. 84-5. I will talk about the management of *lijin* collection in detail in chapter 7.

Like in England, some 77 percent of the government's short-term foreign loans between the 1860s and 1880s were used for military purposes, all secured by the tax revenue from the customs and *lijin* duties.[84] Estimated at 44 million *tael* of silver, this was a substantial amount. The revenues collected from indirect *lijin* duties and the customs, along with these short-term loans, were vital to support the building of a western-style navy and to fund the expensive expeditions to re-conquest Xinjiang in the period between 1873 and 1883 and the conflicts on both land and sea with France in the Sino-French War in 1884-1885.

Looking back on these three cases, we can see that recognizing the institutional characteristics of a modern fiscal state sheds new light on the study of state capacity. Scholars who study this issue in the third world through the lens of state extraction of revenues from the economy often focus on the land tax rather than looking at indirect taxes such as consumption taxes.[85] Overemphasizing the land tax leads many scholars to measure state capacity by its ability to penetrate into the village or sub-village level so as to extract more revenues from the land tax or otherwise from the peasants.[86] We need to reconsider this approach, especially when we deal with an economy which has already

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[84] Zhou Yumin, *Wan Qing caizheng yu shehui bianqian* [Public Finance and Social Change in the Late Qing], pp. 282-83.

[85] Joel S. Migdal, *Strong Societies and Weak States: State-Society Relations and State Capabilities in the Third World* (Princeton, N. J.: Princeton University Press, 1988), chapter 2.

[86] This neglect of the commercial sectors as an important source for the state to tap revenues so as to strengthen state capacity is particularly strong in the study of state transformation in China and Japan in the late nineteenth century. For example, Thomas C. Smith attributed Japan's success to effective local governance at the village level dating from in the Tokugawa period, particularly in the collection of land taxes. See Thomas C. Smith, *The Agrarian Origins of Modern Japan* (Stanford: Stanford University Press, 1959). For China, see the measurement of state power by its ability to penetrate into rural areas in Prasenjit Duara, *Culture, Power, and the State: Rural North China, 1900-1942* (Stanford: Stanford University Press, 1988); Philip A. Kuhn, *Origins of the Modern Chinese State* (Stanford: Stanford University Press, 2002), chapter 3.

developed large commercial sectors and financial networks such as Japan and China in the nineteenth century.

In eighteenth-century England, and in Japan and China in the second half of the nineteenth century, indirect consumption taxes proved more important than the land tax for state actors to raise revenue. Accordingly, state power and capacity in these and similar societies should be judged by the state's institutional ability to collect indirect consumption taxes. Moreover, the receipts from consumption taxes also supported the state's autonomy in the international arena as they came from domestic consumption. This domestic source to increase tax revenue was particularly important to Japan and China, two countries that had lost the sovereign power to raise government income through raising customs rates. Furthermore, the use of tax revenue to mobilize financial resources even just from the domestic market is far more effective in enhancing state capacity than is direct extraction from peasants, as illustrated by the case of Japan.

Nevertheless, a puzzle arises when comparing the absence of the modern fiscal state in China with its rise in England and Japan. In China, reliance upon indirect taxes for raising revenues and the extensive employment of bills of exchange to transfer tax revenue did not prompt centralization in collection. Instead, the fiscal operation remained to a significant degree decentralized, as specific items of revenue collected in various provinces were directly assigned by the central government for particular purposes without being transferred to Beijing. In contrast to England and Japan, where the state began to use its current revenue to raise long-term credits in the financial markets, the Qing government prior to 1895 always paid back its short-term borrowing when the emergency was over. Had the Qing government used its current tax revenue, even just the elastic revenue from consumption taxes and the customs, to either raise long-term loans or establish a central bank, modern China history might have been different. Any explanation for the lack of the modern fiscal state in China by 1911 must address simultaneously two different yet closely related questions: the important institutional changes that had already happened in public finance *and* the absence of the institutional linkage between tax revenues and the state's long-term involvement in the financial markets.

V. The issue: how to explain the rise of the modern fiscal state?

How shall we explain the rise of a modern fiscal state in England and Japan but not in China? Some alternative explanations can be excluded at the very beginning. As the modern fiscal state is characterized by the institutional linkage between a centralized tax collection and the state's long-term liabilities secured by tax revenues, the relative size of tax revenue and state liabilities does not matter. In other words, what matters is not the absolute scale of the state's tax revenue but whether the state actors use its revenues, particularly those extracted from the indirect consumption taxes and customs, to institutionally secure the state's long-term liabilities in the financial markets.

This greatly simplifies a comparative study of three countries in quite different circumstances. For example, the territorial size of China is not an insurmountable obstacle to building a modern fiscal state because private financial networks had connected all the major cities and market towns in China in the second half of the nineteenth century. They transferred huge sums of money regularly, including a large proportion of government tax revenues. Meanwhile, the ongoing debates about the "real" scale of domestic consumption and trade in nineteenth-century China are not relevant, because, as I will show later, China would have become a modern fiscal state had it centralized its current rather than "potential" tax revenues to mobilize long-term financial resources in the markets.

Different sequences are possible in building a modern fiscal state. Early development as a traditional fiscal state seems to give no advantage in making the transition to a modern fiscal state, as we can see by comparing China and England. Past history of political centralization also appears to have no bearing on the establishment of a centralized fiscal system; Japan attained this goal before 1880, while China did not. Whereas the English state began with short-term debts and then made a transition to long-term borrowings, the Japanese state started in 1868 with long-term liabilities in the form of government paper notes. England had established a centralized bureaucracy in collecting the customs and excises in the 1680s before it had accumulated huge debts between 1689 and 1713. In contrast, the Japanese government had huge amounts of liabilities in the form of non-convertible paper notes before centralized taxation was introduced in 1871. England had an institution of political representation – Parliament – prior to the rise of the modern fiscal state in England. However, a modern fiscal state emerged in Japan *before* the opening of the Japanese Diet in 1891, which suggests that an institution of political representation may not be a necessary condition for building a modern fiscal state.

Neither are international wars necessary for the creation of a modern fiscal state. Japan did not fight any large-scale international wars in the period between 1868 and 1895. Moreover, financial difficulties forced its government to try hard to avoid military confrontation with China and Russia both in the 1870s and 1880s. In contrast, the Chinese government launched expensive military campaigns in the northwest and Xinjiang between 1866 and 1883 and fought the Sino-French War in 1885. Yet a modern fiscal state emerged in Japan but not in China. It is true that a "rich state, strong army" (*fukoku kyōhei*) was one of the most important goals of the Meiji government.[87] Yet very few Japanese officials between 1868 and 1882 considered the government's extreme reliance upon inconvertible paper notes the means to achieve that goal. In fact, the financial crisis associated with the excessive issue of paper notes between 1868 and 1890 remained the major factor to contain several schemes for overseas adventures. Instead of war prompting institutional development in public finance, it was the establishment of the institutions of the modern fiscal state that gave the Meiji government the confidence to challenge China over the issue of Korea in 1894-5.

The lack of an industrial economy in China in the late nineteenth-century is does not explain China's failed transformation into a modern fiscal state. The modern fiscal state emerged in England in the 1730s, before the first industrial revolution (often dated to the 1750s). Likewise, when the Japanese government built a modern fiscal state in the late 1880s, the Japanese economy at the time was far from an industrial one. A modern fiscal

[87] Richard J. Samuels, *"Rich Nation, Strong Army": National Security and the Technological Transformation of Japan* (Ithaca: Cornell University Press, 1994), chapter 2.

state is apparently not a product of an industrial economy. Therefore, theories that try to explain the lack of large-scale industrialization in China in the late nineteenth and early twentieth centuries are not directly related to our understanding the absence of the modern fiscal state in China by 1911.[88]

A comparative lens and attention to historical process help us notice some shortcomings in the existing explanations of particular cases. In regard to the success of market-based long-term borrowing in eighteenth-century England, for example, neo-institutionalists often attribute the rapid growth of the English government's tax revenue to the institution of Parliament. In Margaret Levi's view, for instance, Parliament as an institution represented the interest of powerful constituents in the management of public finance. It therefore ensured a quasi-voluntary compliance from tax payers, reduced transaction costs in collecting taxes, and thus contributed to the rise of tax revenue.[89] Closer examination of the workings of public finance casts doubt on this view. The English Parliament at the time was dominated by land owners, yet the increased tax revenue mainly came from the customs and excises, which fell upon ordinary consumers. It is hard to argue that Members of Parliament represented the interest of ordinary consumers. As excises were regressive and were widely detested by the English people in the

[88] This literature has paid scant attention to the role of the institutions of public finance in economic development in general and industrial development in particular. For the representative works, see Mark Elvin, *The Pattern of the Chinese Past: A Social and Economic Interpretation* (Stanford: Stanford University Press, 1973); Philip C. C. Huang, *The Peasant Economy and Social Change in North China* (Stanford: Stanford University Press, 1985); Li Bozhong, *Jiangnan de zaoqi gongyehua, 1550-1850* [The Early Industrialization in the Lower Yangzi Delta, 1550-1850] (Beijing: Shehui kexue wenxiang cubanshe, 2000).
[89] Margaret Levi, *Of Rule and Revenue* (Berkeley: University of California Press, 1988), p. 97 and p. 118.

eighteenth century, "quasi-voluntary compliance" does not well describe payment of excises by ordinary English people.[90]

The theory of the collective action problem provides a better explanation for the rise of excise revenue. The number of ordinary consumers of goods subject to excises such as beer and ale was quite large. The cost of monitoring participation in the anti-excise campaign was thus formidably high. Yet the benefit of falling retail prices is an inclusive "public good," which anyone could enjoy regardless of whether he participated in the anti-excise movements. This made it difficult to organize consumers politically to oppose the government's efforts to raise excise rates, a typical collective action problem.[91]

Because the royal government depended upon its own bureaucracy to collect the customs and excises, local elites was unlikely to control the royal government through taxation.[92] Big producers and wholesalers of major consumption goods had no way easily hide their immobile assets from government officials so as to increase their bargaining power with the government in issues of taxation.[93] However, as along as they could transfer the

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[90] Until 1736, according to Stephen B. Baxter, "the excise officers were required to carry arms to defend themselves." Stephen B. Baxter, *The Development of the Treasury, 1660-1702* (Cambridge: Harvard University Press, 1957), p. 101. For examples of popular resentment of excises, see Peter Mathias, *The Brewing Industry in England: 1700-1830* (Cambridge: Cambridge University Press, 1959), p. 345; Edward Hughes, *Studies in Administration and Finance 1558-1825* (Manchester: Manchester University Press, 1934), pp. 327-8 and pp. 332-3.

[91] See the classic discussion in Mancur Olson, *The Logic of Collective Actions* (Cambridge: Harvard University Press, 1965).

[92] For example, Jean-Laurent Rosenthal argues that the political power of the English elites over the crown came from their control over fiscal sources. See Jean-Laurent Rosenthal, "The Political Economy of Absolutism Reconsidered," in Robert H. Bates, et al., *Analytic Narratives* (Princeton, NJ.: Princeton University Press, 1998).

[93] Robert Bates and Da-Hsiang Lien argues that in an affluent economy, property owners who have more mobile assets are able to increase the transaction costs of government in collecting taxes by hiding their

burden of increasing taxes to ordinary consumers, they lacked the motivation to oppose the government over heavy consumption taxes. The theory of collective action problem also explains why revenue from indirect taxes upon domestic consumption quickly became the major pillar of public finance in Japan and China in the late nineteenth century, neither of which had an institution of political representation.

In a pioneering study of how institutions affect economic performance, North and Weingast used the Parliament after the Glorious Revolution in 1688 to explain the success of the English government's long-term borrowing in the eighteenth century. There are two different kinds of explanation in this classic paper. One relies upon the role that the post-1688 Parliament played in ensuring the government's credible commitment to protect the property rights of creditors of the English government. But it can hardly explain the dominance of short-term unfunded borrowing in the Nine Years War (1689-1697), which accounted for more than 70 percent of the total government debt.[94] Even the new institution of the Bank of England, which was funded in 1694 to make loans to the government, was by no means a permanent institution at the time. As J. Lawrence Broz and Richard S. Grossman have pointed out, Parliament could legally withdraw the charter of the Bank of England by returning the principal of its loans to the government.[95] In this light, Parliament as an institution itself does not have a necessary

wealth. Bates and Lien then argue that property owners thus have greater bargaining power to force the government to make political concessions. See their formal argument in Robert Bates and Da-Hsiang Donald Lien, "A note on taxation, development, and representative government," *Politics and Society*, Vol. 14, No. 1 (1985): 53-70.

[94] Calculated from B. R. Mitchell, *Abstract of British Historical Statistics* (Cambridge: Cambridge University Press, 1962), p. 401.

[95] J. Lawrence Broz and Richard S. Grossman, "Paying for privilege: the political economy of Bank of England charters, 1694-1844," *Explorations in Economic History*, 41 (2004): 48-72.

temporal dimension to explain the gradually rising importance of long-term borrowing in the War of the Spanish Succession (1701-1713) and thereafter.[96]

Nonetheless, North and Weingast also provide a second, dynamic explanation which has been largely neglected. In their view, as the society became more familiar with the "predictability and commitment" of the new political institution in safeguarding property rights, the perceived risk of lending to the English government was reduced. As a result, state long-term borrowing continued to grow.[97] This explanation implies a self-reinforcing process between the government's punctual interest payments and the increasing confidence of creditors. But when did this self-reinforcing mechanism start? Certainly not from 1693, as North and Weingast suggest. As Brewer has noted, even in 1697 England's success at building a market-based system of long-term borrowing was by no means self-evident, let alone an inevitable outcome of her entry into European power struggles in 1688.[98] It is well-known that creditors' confidence in the English government's creditworthiness vis-à-vis long-term borrowing was not securely established until the 1720s, when the government demonstrated its ability to service interest payments by reliable collection of revenues from the customs and excises.

The problem of timing is more obvious when we consider that the centralized bureaucracy to collect the customs was formed in 1672 and the Excise Department in

[96] David Stasavage also notes that post-1688 Parliament as an institution is less able to explain why the system of long-term borrowing at low interest appeared thirty years. David Stasavage, *Public Debt and the Birth of the Democratic State: France and Great Britain, 1688-1789* (Cambridge: Cambridge University Press, 2003), p. 5.
[97] Douglass C. North and Barry R. Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeen-Century England," *Journal of Economic History*, Vol. 49, No. 4 (December 1989), pp. 823-4.
[98] Brewer, *The Sinews of Power*, p. 138.

1683, both prior to the Glorious Revolution. Nor can the post-1688 Parliament explain these two institutional innovations.[99] Edgar Kiser and Joshua Kane have tried to address this development mainly by looking for factors such as "the development of efficient communication, transportation, and record-keeping" that could increase the monitoring capacity of the central government so as to overcome the principal-agent problem in collecting indirect taxes. However, there were in fact no technological breakthroughs in transportation or communication which greatly enhanced the royal government's ability to supervise its agents in the period between 1660 and 1683.[100]

To account for the rise of bureaucracy in managing public finance in Europe, Thomas Ertman highlights the importance of timing of participation in the European geographical struggles. In his view, the necessary condition for the rise of bureaucratic management of public finance is that previous development in education and finance had prepared a pool of competent and well-educated financial officials from which the state could recruit officials. Therefore, countries that entered the geographic struggles prior to the availability of such a pool (e.g., before 1450) had to rely on patrimonial practices such as "proprietary officeholders, tax-farmers, and officeholder-financiers" to meet state fiscal needs.[101] Yet the causal effects of this timing are not salient in the case of England. As

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[99] Edgar Kiser also notes that the timing of the establishment of bureaucracies in collecting the customs duties and excises in Restoration England poses a puzzle which cannot be explained by the Glorious Revolution in 1688. See Edgar Kiser, "Markets and Hierarchies in Early Modern Tax Systems: A Principal-Agent Analysis," *Politics and Society*, Vol. 22, No. 3 (September 1994), p. 299.

[100] Edgar Kiser and Joshua Kane, "Revolution and State Structure: The Bureaucratization of Tax Administration in Early Modern England and France," *American Journal of Sociology*, Vol. 107, No. 1 (July 2001), p. 187, and p. 195. They are wrong to use the managerial and organizational methods that the centralized Excise Department used to monitor its agents in the 1680s as the causes which led to its establishment, which is a fallacy of functionalism.

[101] Thomas Ertman, *Birth of the Leviathan: Building States and Regimes in Medieval and Early Modern Europe* (Cambridge: Cambridge University Press, 1997), p. 28.

Ertman acknowledges, England got involved in European geographical struggles from the 1100s to the 1480s. In the end, he mainly appeals to enhanced parliamentary supervision *in conjunction* with two wars with the Dutch (1665-6 and 1672-4) to explain the emergence of centralized bureaucracies in the collection of the customs and excises.[102] However, in the Restoration period, the customs and excises belonged to the crown's ordinary revenue, in which Parliament had neither authority nor power to intervene.[103]

Turning to the case of Japan, we find scholars appealing to the concept of "corporate coherence" among Meiji leaders to explain the creation of a powerful central government.[104] However, this "corporate coherence" simply does not exist when we examine the power struggles among different political factions which had conflicting institutional schemes.[105] Moreover, we shall not interpret the institutional development after the Meiji Restoration in 1868 as a unilinear road toward centralization. First, foreign threats did not necessarily lead to centralization; fiscal decentralization was compatible with national defense. Second, in 1870 even the advocates of political and military centralization had to admit that centralized governance was not practical as the new government did not have the financial resources to extend its governance over the whole territory of Japan. As the Japanese historian Haraguchi Kiyoshi has pointed out, centralization between 1868 and 1870 simply referred to an administrative conformity

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[102] Ibid., pp. 171-8 and pp. 187-207.
[103] Henry Roseveare, *The Treasury 1660-1870: The Foundations of Control* (London: Allen & Unwin, 1973), pp. 52-54.
[104] See Ellen K. Trimberger, *Revolution from Above: Military Bureaucrats and Development in Japan, Turkey, Egypt, and Peru* (New Brunswick, NJ.: Transaction Books, 1978).
[105] For the detail of the fierce factional struggles within the early Meiji government, see Michio Umegaki, *After the Restoration: The Beginning of Japan's Modern State* (New York: New York University Press, 1988).

between domain governments and the Meiji government, which itself governed only the lands of the former shogunate.[106] Thus the political centralization that occurred after abolition of the domain system in 1871 was far from a well-planned strategy (I will discuss it in more detail in the chapter of Japan). For example, the Meiji government in 1872 adopted the highly decentralized national banking system of America and rejected the centralized British model.[107]

In regard to public finance, the initial policy orientation in institution building after the Meiji Restoration was not even toward a fiscal state. Instead, the early Meiji government adopted the fiscal policy of a domain state, i.e., to raise government income by directly owning and managing enterprises in mining and railway building and by granting monopolies to privileged merchants in organizing the export of Japanese goods.[108] The failure of these policies left the government confronting a huge deficit, and forced the sale of unprofitable state-owned enterprises; profitable ones in gold-mining were retained.[109] Even after the officials of the Finance Ministry in 1878-80 turned to indirect taxes levied upon consumer goods such as sake, liquor, tobacco, etc. to raise government

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[106] Haraguchi Kiyoshi, "Haihan chiken seiji katei no hitotsu kōsatsu [An investigation of the political process of abolishing the domain system]," *Meijo shogaku*, No. 29, special issue (January 1980): 47-94.

[107] Nakamura Naoyoshi, *Ōkuma zaisei no kenkyū* [A Study of the Policies of Public Finance of Ōkuma] (Tōkyō: Azekura Shobō, 1968), p. 38.

[108] For an important discussion of the fiscal purpose of the industrial policies in early Meiji and their connection to the concept of a domain state (*kasan kokka*), see Yamamoto Hirofumi, "Shoki shokusan seisaku to sono shūsei [The early industry-promotion policy and its revision]," in Andō Yoshio, ed., *Nihon keizai seisaku shiron (ge)* [The History of Economic Policy in Japan (I)] (Tōkyō: Tōkyō Daigaku Shuppankai, 1973); Nagai Hideo, "Shokusan kōgyō seisaku no kichō: kanei jigyō o chūshin to site" [The basic tunes in the industry-promotion policies], originally published in *Hokkaidō daigaku bungakubu kiyō*, No. 10, November 1969, reprinted Nagai Hideo, *Meiji kokka keiseiki no gaisei to naisei* [Foreign Relations and Domestic Governance in the Formation Period of the Meiji State] (Sapporo: Hokkaidō Daigaku Tosho Kaikōkai, 1990).

[109] Thomas C. Smith pointed out that Meiji government sold the state-owned enterprises after 1881 simply to get rid of the burden on public finance. Thomas C. Smith, *Political Change and Industrial Development in Japan: Government Enterprise, 1868-1880* (Stanford: Stanford University Press, 1955), chapter 8.

income, the economic policy implemented by the new Finance Minister Matsukata Masayoshi in 1882 caused a severe domestic deflation, which was disastrous to the collection of consumption taxes.[110] How could a government implement policies which were disastrous to its major source of revenue?

The above difficulties in explaining the eventual rise of the institutions of the modern fiscal state appear more perplexing when we consider the functions and distributional effects of these institutions. In a study of the relationship between political institutions and economic growth, Daron Acemoglu and James A. Robinson raise a very important question: why are political powerful groups or state actors not in favor of economic growth as it "would provide more resources for these groups to take over or tax, increasing their economic returns"?[111] Their answer to this question is based upon the concern of elites about the distributional effects of economic growth. In their view, politically powerful groups oppose economic growth only when they know that economic changes will weaken their established power base by enriching potential political rivals. Likewise, the success of the financial revolution in eighteenth-century England has been attributed to the political dominance of the Whig party between 1714 and 1746. As it was closely associated with the monied class and represented the interest of creditors to

[110] The revenues collected from domestic consumption dropped from 17 million Yen in 1882 to 2.9 million Yen in 1885. Cited from Table 18 in Hayashi Takehisa, *Nihon ni okeru sozei kokka no seiritsu* [The Formation of the Tax State in Japan], p. 64.
[111] Daron Acemoglu and James A. Robinson, "Economic Backwardness in Political Perspective," *American Political Science Review*, Vol. 100, No. 1 (February 2006), p. 115.

the English state in both Parliament and the executive branch, the Whig regime, it has been argued, greatly reduced the risk of default on state debt.[112]

Such a political explanation is not convincing, however. Why would a Tory government default on long-term borrowings which bore low interest rates and greatly enhanced the state's spending capacity? As the increasing scale of long-term borrowing was serviced by revenues collected from the indirect customs and excises, landed political elites did not shoulder the ever-rising burden of taxation. The collective action problem prevented ordinary consumers from organizing effective opposition movements against the rising indirect taxes. While state actors benefited from much enhanced spending capacity, the subscribers to the state's perpetual annuities, including members of the landed class, benefited from punctual interest payments on annuities. In this light, political elites in England should have had every reason to embrace the institutions of the modern fiscal state. We must ask why did these institutions not appear *earlier* in England? Moreover, state actors in a commercialized economy should have every reason to welcome the institutions of the modern fiscal state. But if so, why did the modern fiscal state not emerge in China, and why did it not appear *earlier* in England and Japan? These questions remind us that it is highly problematic to assume that politically powerful groups possess perfect information about the distributional impact of institutional or economic changes, an assumption which Acemoglu and Robinson implicitly take in their model of political institutions and economic growth.

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[112] For two prominent examples of political explanation of the English financial revolution, see Carruthers, *City of Capital*, chapter 6; David Stasavage, *Public Debt and the Birth of the Democratic State: France and Great Britain, 1688-1789* (Cambridge: Cambridge University Press, 2003), chapter 5.

As Mark Blyth has emphasized, we must take into account the uncertainty in actors' recognition of the distributional effects of institutional change.[113] In explaining the phenomenon of the modern fiscal state, the uncertainty is to a large degree caused by the interactive nature of institutional change and the politics involved in the process of institution building. On the one hand, the modern fiscal state is not an automatic result or a spontaneous development of a market economy. Private economic actors, no matter how creative, simply cannot invent by themselves the financial institutions and techniques which involve the use of the state's tax revenue. On the other hand, state actors, no matter how capable, cannot create the institutions of the modern fiscal state in isolation from the economy and society. They were in general unfamiliar with the arcane techniques already developed in the private financial markets of the early modern period. Nor could state actors simply use coercion to force economic actors to accept the credit instruments issued by the state. In this case, it was beneficial for state actors to seek cooperation from private financiers who had already developed financial networks to transmit money across time and space.

At the same time, state actors involved in building the modern fiscal state had to overcome the information asymmetry problem between the central government as the principal and officials who collected taxes as "agents" for the state. Moreover, in appreciating the difficulties of this process, we must bear in mind how things appeared to people at the time. As noted earlier for England, if the state could not demonstrate its

[113] Mark Blyth, *Great Transformations: Economic Ideas and Institutional Change in the Twentieth Century* (Cambridge: Cambridge University Press, 2002), pp. 30-4.

institutional ability to use tax revenue to sustain the creditworthiness of its long-term liabilities, economic actors would be unwilling to supply long-term credit. To contemporary state actors, such resistance to long-term liabilities was more likely to make state actors doubt the feasibility of the state's long-term credit instruments, rather than urging them to reform the tax institutions. Finally, both taxation and the state's use of long-term credits are highly political issues as they significantly affect the interest distribution in society. Even the effort of state actors to gather information about revenue potential would encounter strong societal resistance.

In this light, the success of England and Japan and the failure of China in building a modern fiscal state are far from inevitable at the beginning of each episode. In order to overcome the problem of indeterminacy in early stages of institutional change and avoid a deterministic explanation of the rise of the modern fiscal state in England and Japan but not in China, I conduct a "deep" comparative historical analysis of the three cases in this dissertation. By a "deep" historical analysis, I mean two things. First, I historically reconstruct the specific multiple possible outcomes at different stages of this interactive process. In light of these possible alternatives, the eventual observed institutional outcome ceases to appear as an inevitable result. The purpose of this historical examination is to avoid the "within-case" selection bias that is often seen in small-N case-studies.[114] This bias is mainly caused by implicitly taking the observed phenomenon as the only end-result while neglecting other possible outcomes. Adding more causally homogenous cases to the analysis does not necessarily remove the within-

[114] For a discussion of this kind of selection bias in the use of history in the social sciences, see Ian S. Lustick, "History, Historiography, and Political Science: Multiple Historical Records and the Problem of Selection Bias," *American Political Science Review*, Vol. 90, No. 3 (September 1996): 605-618.

case selection bias.[115] Second, I focus on the concrete rather than assumed goals and constraints that historical actors actually took into account in their specific contexts of time and place; I attempt to understand what kind of uncertainty they faced in their decision-making.[116] As much as possible, I try not to put information or knowledge that was not available ex ante to historical actors into the making of their "rational" considerations.

As Pierson and Skocpol have pointed out, the emergence and consolidation of institutions is often a process that takes place "over a substantial stretch of years, maybe even decades or centuries."[117] The mechanism to explain the rise of the modern fiscal state thus should have a significant temporal dimension. That is to say, the explanatory factors must have happened earlier than the outcome to be explained, and there must have been a mechanism to carry the causal effects throughout the time interval between the causal factors and the eventual outcome.[118] A temporally-based explanation raises two basic questions. First, how far back shall we go in our search for causes without running into

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[115] For emphasis on the different nature of "within-case" selection bias and "across-case" selection bias, see David Collier and James Mahoney, "Insights and Pitfalls: Selection Bias in Qualitative Research," *World Politics*, Vol. 49, No. 1 (1996): 56-91. See the difference between causally homogenous and heterogeneous cases in comparative studies in Charles C. Ragin, *The Comparative Method: Moving Beyond Qualitative and Quantitative Strategies* (Berkeley: University of California Press, 1987), chapter 2.

[116] Game theorists who deal with games with a multiplicity of equilibria are paying increasing attention to the specific contexts so as to decide which equilibrium would have a "deep stability" and thus is more likely to appear in the real world. See Avner Greif, *Institutions and the Path to the Modern Economy*, chapter 11; Robert H. Bates, et al., *Analytic Narratives* (Princeton, NJ.: Princeton University Press, 1998), pp. 13-14.

[117] Paul Pierson and Theda Skocpol, "Historical Institutionalism," p. 698.

[118] For the discussion of historical causation in social science, see John C. Harsanyi, "Explanation and Comparative Dynamics in Social Science," *Behavioral Science* 5 (April 1960), p. 137 and Jon Elster, *Nuts and Bolts for the Social Sciences* (Cambridge: Cambridge University Press, 1989), p. 3. For the discussion of the importance of periodization to comparative historical analysis, see Evan S. Lieberman, "Causal Inference in Historical Institutional Analysis: A Specification of Periodization Strategies," *Comparative Political Studies*, Vol. 34, No. 9 (November 2001), pp. 1017-23.

the problem of infinite regress in historical causation?[119] Second, how shall we escape the fallacy of spurious causality in historical causation? The longer the time interval between the explanatory factors and the eventual institutional outcome, the bigger the danger of spurious causality. In other words, something which happened during this interval may better explain the outcome than the originally designated explanatory factors.[120] Shortening the time interval between explanatory factors and outcome helps avoid this trap. However, it may omit some causally relevant factors prior to the temporal span that we set for our causal exploration.[121] For example, if we try to find the causes of the rise of the modern fiscal state in post-1720 England or post-1880 Japan, we miss crucially important institutional developments, such as the centralization of tax collection (established in England in the 1680s and in Japan in the late 1870s).

In the study of the rise (or not) of the modern fiscal state in England, Japan, and China, how shall we determine the periodization for each case so as to avoid the pitfall of infinite regress? How shall we identify the temporal causal mechanism which would carry its causal effects throughout the temporal processes of building and consolidating

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[119] In the trap of infinite regress, there are always some prior causal factors, backward perpetually into the past. On this problem in historical causation, see James Fearon, "Causes and Counterfactuals in Social Science: Exploring an Analogy between Cellular Automata and Historical Processes," in Philip E. Tetlock and Aaron Belkin, eds., *Counterfactual Thought Experiments in World Politics: Logical, Methodological, and Psychological Perspectives* (Princeton: Princeton University Press, 1996), pp. 39-67. Regarding infinite regress in the construction of causal chains in general, see Gary King, Robert O. Keohane, and Sidney Verba, *Designing Social Inquiry: Scientific Inference in Qualitative Research* (Princeton, N.J.: Princeton University Press, 1994), p. 86.

[120] For a general discussion of spurious causality in comparative historical analysis, see Edgar Kiser and Michael Hechter, "The Role of General Theory in Comparative-historical Sociology," *American Journal of Sociology*, Vol. 97, No. 1 (July 1991), p. 7. William Sewell pointed out that Skocpol made this mistake in her explanation of the revival of the Chinese Communist Revolution. See William H. Sewell, Jr., "Three Temporalities: Toward an Eventful Sociology," in Terrence J. McDonald, eds., *The Historic Turn in the Human Sciences* (Ann Arbor: The University of Michigan Press, 1996), pp. 256-7.

[121] See Paul Pierson, *Politics in Time*, chapter 3; Paul Pierson and Theda Skocpol, "Historical Institutionalism," pp. 703-4.

the institutions of the modern fiscal state? How could such a temporal causal mechanism reconcile the indeterminacy caused by the multiplicity of possible outcomes in the initial stages of the highly interactive process of institutional change with the emergence of the eventual institutional outcome? I turn to the next chapter to discuss these questions.

Chapter 2 A Model of Institutional Learning: A Path-dependent Account of the Rise of the Modern Fiscal State

I. Introduction

In the study of institutional change, scholars such as Avner Greif, David Laitin and Kathleen Thelen have stressed that a good theory of institutional change should be able to account for the stability of the same institutions, and vice versa.[122] This insight is particularly important to the study of how *existing* institutions change in response to variations in social, political, and economic environments. This kind of institutional change can be incremental and continuous, or it can lead to opposing end results, such as survival or demise of these institutions.[123] However, I argue it is difficult to apply the analytic tools which have been developed to understand the stability and change of existing institutions to the study of fundamental institutional change characterized by emergence and consolidation of new institutions, particularly when various institutional elements have not yet formed a mutually reinforcing system to yield new beliefs and regularities of behaviors among actors.

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[122] Avner Greif and David D. Laitin, "A Theory of Endogenous Institutional Change," *American Political Science Review*, Vol. 98, No. 4 (November 2004), p. 636; Kathleen Thelen, "Historical Institutionalism in Comparative Politics," *Annual Review of Political Science*, 2 (1999), p. 369.

[123] The endogenous model of institutional change proposed by Avner Greif and David D. Latin is mainly about the survival or demise of *existing* institutions such as political regimes or cleavages when there are changes in socio-economic environments. See Avner Greif and David D. Laitin, "A Theory of Endogenous Institutional Change," *American Political Science Review*, Vol. 98, No. 4 (November 2004): 633-52. For the study continuous institutional changes such as institutional layering and conversion, see Kathleen Thelen, "How Institutions Evolve," in James Mahoney and Dietrich Rueschemeyer, eds., *Comparative Historical Analysis in the Social Sciences* (Cambridge: Cambridge University Press, 2003), pp. 225-230; idem., *How Institutions Evolve: The Political Economy of Skills in Germany, Britain, the United States, and Japan* (Cambridge: Cambridge University Press, 2004); Wolfgang Streeck and Kathleen Thelen, eds., *Beyond Continuity: Institutional Change in Advanced Political Economies* (New York: Oxford University Press, 2005).

The rise of the modern fiscal state is characterized by two closely connected institutional innovations in public finance: a centralized tax institution and a financial institution which uses the amalgamated tax revenue to mobilize long-term financial resources in the form of either state bonds or paper notes. Therefore, it is a fundamental institutional change, even though some old institutions may be incorporated into or endowed with new functions in this new kind of state. As this institutional transformation not only centralizes the operation of state public finance but also significantly affects the distribution of interest in society, the rise of the modern fiscal state is a highly political process in which actors have different ideas, political agendas, and institutional preferences. At the same time, socio-economic conditions, such as the scale of the commercial sector and the development of inter-regional trade, affect the viability of the institutional elements with which actors experiment. The process which gives rise to the modern fiscal state is thus rife with intensive interactions among actors, institutional arrangements, and socio-economic conditions. How shall we identify a causal mechanism which has a temporal dimension and can handle the multiplicity of possible outcomes and the uncertainty which are endogenously generated by these interactions? This is the central question for analyses of fundamental institutional change.

In conceiving a temporal causal mechanism to explain the observed institutional outcomes, i.e., the rise of a modern fiscal state in England and Japan and its absence in China, the first thing is to determine the beginning point of such a mechanism so as to avoid the problem of infinite regress in historical causation. In this dissertation, I choose to start from a critical event in each case which initiates the causal journey for subsequent institutional change in public finance, i.e., the outbreak of the English Civil Wars in 1642, the Meiji Restoration in 1868, and the beginning of the Taiping Rebellion in 1850 in China. The selection of these critical events is not arbitrary, nor simply for the sake of convenience. Instead, they represent a special moment common to the three cases to be studied, i.e., the inability of the old institutions of public finance to sustain the autonomy and capacity of the state under new socio-economic circumstances. As a result, the state that did not possess the necessary tax and financial institutions found itself unable to handle disruptions in the market economy, the resulting social dislocations, and threats from abroad. Meanwhile, these critical events mark the beginning of a search for alternative institutions. The three cases thus have one common generic sequence in the process of institutional change: 1), the stickiness of existing institutions which are unsuitable to new socio-economic circumstances; 2), the critical event that provides a "window opportunity" for seeking alternative institutions; 3), experimentation with various institutional arrangements.

But why did state actors prior to these critical events not implement fundamental changes in institutions of public finance to enhance the capacity of the state? What prevented them from developing centralized institutions to extract revenues from commercial sources? To answer these questions, I argue it is important to put the fiscal difficulties of the state before the critical events in an institutional perspective. Problems in meeting government spending did not necessarily lead to efforts to centralize institutions in public finance, although centralization could bring increased flows of revenue. Instead, the initial responses of state actors were to adjust, rather than jettison, the existing institutions. Meanwhile, states that started with decentralized fiscal operations could rely upon their established political authority and transfer to local governments or even local communities the spending burden of state affairs such as provision of social welfare, infrastructure maintenance, and even national defense. The concern shared by the center and local governments to maintain social and political order in these three early modern states thus helped sustain old institutions even as they became unsuited to the socio-economic environment. The reliance upon fiscal decentralization in this situation is self-reinforcing, i.e., the more the center transferred the burden of spending to local governments, the more difficult for it to centralize its fiscal operation. We therefore do not observe state actors actively seeking alternative institutions in public finance. The exhaustion of existing institutions in dealing with new challenges was by no means self-evident to actors at the time.

Even when state actors were forced to search for new institutions, they had little help from existing institutions. Institutionalists have emphasized that institutions, both formal and informal, are important for actors in a world of incomplete information to decipher the socio-economic environment in policy-making.[124] However, when the existing institutions in public finance failed to support the capacity and autonomy of the state in new circumstances, they also burdened state actors with a huge information problem. The ability of state actors to conceive or design alternatives was severely constrained by

[124] For a discussion of the cognitive function played by both formal and informal institutions, see Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990), p. 96; Paul J. DiMaggio and Walter W. Powell, "Introduction," in Paul J. DiMaggio and Walter W. Powell, eds., *The New Institutionalism in Organizational Analysis* (Chicago: The University of Chicago Press, 1991): 1-40; Peter A. Hall, "Policy paradigms, social learning, and the state," *Comparative Politics*, Vol. 23 (1993): 275-96.

existing institutions which could not provide the information necessary to creating new institutions of the modern fiscal state. For example, actors had no means yet to obtain reasonably accurate estimates of the size of domestic consumption and its potential for taxation, an assessment of the distribution of wealth in society, an estimate of the potential of direct taxation such as the land tax and property tax, the scale of lending in the economy upon which the state could rely, and so on. Actors thus had to grapple with a great deal of uncertainty in their search for alternative institutions.

An institutional examination of the fiscal difficulties that the state experienced in each case prior to these critical events thus has two important implications. First, causes of the rise of the modern fiscal state are unlikely to occur prior to the critical events. Second, even though these critical events mark the end of the viability of existing institutions in public finance, a huge degree of uncertainty about what alternatives may come next remains. In this light, the rise of the modern fiscal state is distinct from the kind of institutional development described for critical junctures. In this literature, the mechanism of reproduction is mainly based upon the use of political power helps sustain the institutional outcome formed at the critical juncture, such as a regime type, a pattern in the union-state relationship, a coalition of social classes, etc.[125] In contrast, actors at

[125] Political power is the crucial element in the mechanism of reproduction in this literature. For representative examples of (positive) critical junctures, see Ruth Berins Collier and David Collier, *Shaping the Political Arena: Critical Junctures, the Labor Movement, and Regime Dynamics in Latin America* (Princeton: Princeton University Press, 1991); Gregory M. Luebbert, *Liberalism, Fascism, or Social Democracy: Social Classes and the Political Origins of Regimes in Interwar Europe* (New York: Oxford University Press, 1991); Evelyn Huber and John D. Stephens, *Development and Crisis of the Welfare State: Parties and Policies in Global Markets* (Chicago: The University of Chicago Press, 2001). In the formation of the petro-state, oil revenue also constitutes the key material basis for the use of state power; see Terry L. Karl, *The Paradox of Plenty: Oil Booms and Petro-States* (Berkeley: University of California Press, 1997), particularly chapters 4 and 5. For an emphasis on the importance of social and economic resources in sustaining such a mechanism of reproduction in the literature of (positive) critical juncture, see

the critical events in England in 1642, Japan in 1868, and China in 1850 had no effective institutions to maintain but rather had to grope in opacity for new institutional arrangements. This uncertainty and opacity did not change even where new political actors came to seize state power. After all, the failure of the old institutions to generate necessary information for conceiving or designing new institutions was a constraint on both the state and on societal actors. Therefore, the emergence of new political actors (e.g., a rising merchant class) itself does not suffice to dispel uncertainty in explaining the outcome of subsequent institutional change.[126]

There is a noticeable time interval between the critical events at which actors began to search for new financial institutions and the eventual outcome of the rise (or not) of the modern fiscal state: from 1642 to 1752 in England, from 1868 to 1895 in Japan, and from 1850 to 1911 in China. The uncertainties of the environment in which actors, socio-economic circumstances, and institutional elements interact intensively engender a multiplicity of possible outcomes during this time interval. In this light, the modern fiscal state is far from the only possible outcome. The rise of the modern fiscal state also differs from those institutional changes where there is only one outcome after reaching the critical moment of change, such as in the tipping-point model.[127] What kind of causal

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Kathleen Thelen, "Historical Institutionalism in Comparative Politics," *Annual Review of Political Science*, 2 (1999), pp. 391-2.

[126] For an example of the use of new political actors to explain institution change, see Daron Acemoglu, Simon Johnson, and James Robinson, "The rise of Europe: Atlantic trade, institutional change and economic growth," *American Economic Review*, Vol. 95, No. 3 (June 2005), pp. 563-5.

[127] For applications of the tipping-point model, see Thomas Schelling, *Micromotives and Macrobehavior* (New York: W. W. Norton, 1978); David D. Laitin, "National revivals and violence," in John R. Bowen and Roger Petersen, eds., *Critical Comparisons in Politics and Culture* (Cambridge: Cambridge University Press, 1999): 21-60.

mechanism can explain the observed outcomes from the interactive process of institutional changes?

In section II of this chapter, I briefly survey the institutional background of state financial difficulties in England between the 1600s and 1630s, in Japan between the 1820s and 1860s, and in China between the 1820s and 1840s. In section III, I examine the implications of the dysfunction of existing institutions for the rise of alternative institutions. In particular, I argue that the exhaustion of the old institutions in dealing with new challenges from within and without represents an appropriate starting point for understanding the rise of the modern fiscal state. In section IV, I discuss how uncertainties that the old institutions generated for subsequent institutional changes made the eventual outcome of the modern fiscal state far from inevitable. I then analyze why we need a causal mechanism which has a temporal dimension to handle this problem of indeterminacy caused by a multiplicity of possible outcomes. In particular, I focus on evolutionary and path-dependent approaches, which try to explain the observed outcome while taking into account uncertainty, contingency, and multiple possible outcomes in the process of change. I examine their merits and shortcoming in explaining the specific empirical case of the rise of the modern fiscal state.

In section V, I outline a model of institutional learning which can reconcile the multiplicity of possible outcomes in the initial stages of institutional development with the final observed outcome. Its major feature is the conjunction of a severe credit crisis and appropriate socio-economic conditions. The origin of the severe credit crisis is exogenous to subsequent institutional development, yet it constitutes a pressing problem which forces actors to try various institutional arrangements, regardless of their individual political ideas, interests, and agendas. The socio-economic circumstances are necessary conditions which allow actors to realize the mutually-reinforcing effects between fiscal centralization and the state's long-term liabilities in the financial markets. These in turn lead to the emergence and consolidation of one particular institutional outcome. The model of institutional learning thus is endogenous to the process of institutional change and has a strong path-dependent feature.

II. Exhaustion of old institutions under new socio-economic circumstances: England (1600s-1630s), Japan (1820s-1860s), and China (1820s-1840s)

As mentioned in the introduction, the financial basis on which the early modern state rested varied across the three cases in this study: the domain state in England, the incomplete fiscal state in Japan, and the (traditional) fiscal state in China. Nonetheless, they all experienced a period of fiscal difficulties when the state's income was inadequate to meet its spending. The root cause of the tremendous fiscal problems was the fact that the existing institutions of public finance had come to lag terribly behind the greatly changed socio-economic environment. Relevant factors included the increasing presence of state power in society, population growth, increasing population mobility, the deepening monetarization of economic life, the development of inter-regional trade and financial networks, the expansion of the urban economy, and so on. In consequence, price fluctuations – either inflation or deflation – not only had widespread impact on society but also directly affected the income and expenditures of the state.

In contrast, traditional pillars of the state finance, such as the domain revenues in early Stuart England and the land taxes in Japan and China before the early nineteenth century, had become either depleted or inelastic. None of these states had yet developed the institutional ability to tap new tax bases in the economy, particularly the commercial sectors. As it was impossible for a well-established early modern state to massively reduce its expenditures for national defense, maintenance of political and legal order, and the provision of social welfare such as calamity relief, all three states experienced great trouble in meeting spending with current income. In England this occurred between the 1600s and 1630s, in Japan between the 1820s and 1860s, and in China between the 1820s and 1840s. Let us examine the institutional background and socio-economic circumstances for each case.

The domain state formed in England by the mid-sixteenth century did not rely upon regular domestic taxation but derived its ordinary revenues from royal estates, the customs, and the crown's feudal rights such as wardship and purveyance. Domestic taxation appeared less urgent when the Tudor monarchs in the late 1530s began to plunder the vast wealth of the Church, which owned about 20-25 percent of the land in England in the 1530s.[128] Among the total income of the royal government between 1534 and 1547, the revenue from traditional sources and newly plundered ex-monastic land amounted to about 60 percent while the revenues derived lay taxation and ecclesiastic

[128] In 1535, the revenues of the Church amounted approximately to £400,000 while the revenues from the king's lands were only £40,000. See W. G. Hoskins, *The Age of Plunder: King Henry's England 1500-1547* (London: Longman, 1976), p. 121.

taxes contributed only 30 percent.[129] Nonetheless, the expensive wars with France forced the royal government to sell ex-monastic and chantry lands in the period between 1540 and 1552, which provided up to 32 percent of the total war expenditures of some £3.5 million.[130] Of course, this was not sustainable in long run. From 1588 to 1603, sales of royal lands could only cover 13 percent of some £4,978,054 of military spending in the Anglo-Spanish war and the colonial wars in Ireland, while 71 percent were funded by lay and clerical subsidies.[131]

The early Stuart regime in 1603 thus inherited much depleted reserves of domain revenue, yet it had to face the pressure of rising expenditures. The "military revolution" in Western Europe after the mid-sixteenth century greatly increased the scale and duration – and thus the cost – of warfare on both land and sea by intensive use of gunpowder, heavy arms, new warships, and siege tactics.[132] Meanwhile, the period from 1450 to 1649 witnessed a "price revolution" in England, as well as in other countries in Western Europe. Over this period, the average grain price in England increased 700 percent, that of industrial products 210 percent, and the real wages of agricultural laborers 200 percent. Prices did not become stable until the 1650s.[133] [Figure 2.1] This

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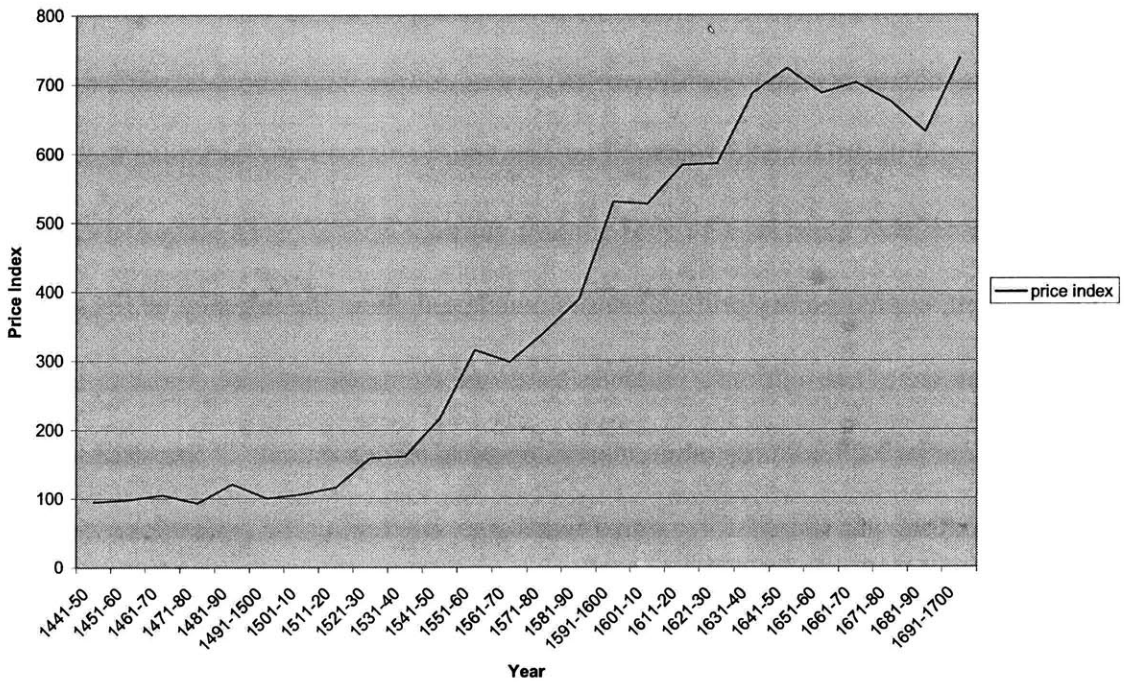
129 Calculated from Table 5.1 in Peter Cunich, "Revolution and Crisis in English State Finance, 1534-47," in W. M. Ormrod, Margaret Bonney, and Richard Bonney, eds., *Crises, Revolutions, and Self-sustained Growth: Essays in European Fiscal History, 1130-1830* (Stamford: Shaun Tyas, 1999), p. 123.
130 Penry Williams, *The Tudor Regime* (Oxford: Clarendon Press, 1979), p. 69.
131 Calculated from the figures in R. W. Hoyle, "Crown, Parliament and Taxation in Sixteenth-Century England," *English Historical Review*, Vol. 109, No. 434 (November 1994), p. 1193.
132 The spiraling cost of fighting wars is been well-accepted, even though scholars hold divergent views on the continuity, chronology, and the causes of the military revolution in early modern Europe. See Clifford J. Rogers, ed., *The Military Revolution Debate: Readings on the Military Transformation of Early Modern Europe* (Boulder: Westview Press, 1995). For the impact of the military revolution on England in the early seventeenth century, see Conrad Russell, *Unrevolutionary England, 1603-1642* (London: Hambledon, 1990), p. 126.
133 For an overall review of the price revolution in England in C. G. A. Clay, *Economic Expansion and Social Change: England 1500-1700*, volume I (Cambridge: Cambridge University Press, 1984), chapter 2.

price revolution resulted from the interplay of several slow socio-economic trends, such as population growth, the expansion of the urban economy and non-agricultural sectors, and the increasing monetarization of the English economy.[134]

Figure 2.1 Index of price of foodstuffs in England: 1451-1700



Source: R. B. Outhwaite, *Inflation in Tudor and Early Stuart England*, second edition (London: The Macmillan Press, 1982), p. 12.

In contrast, the nominal value of the crown's total ordinary revenue rose only from £170,000 in 1547 to £300,000 by 1603, which represented a 40 percent fall in real

[134] For a general review of the price revolution in Europe between the mid-fifteenth and mid-seventeenth centuries, see R. B. Outhwaite, *Inflation in Tudor and Early Stuart England*, second edition (London: The MacMillan Press, 1982). For an emphasis on the contribution of urbanization, see Jack A. Goldstone, "Urbanization and Inflation: Lessons from the English Price Revolution of the Sixteenth and Seventeenth Centuries," *American Journal of Sociology*, Vol. 89, No. 5 (1984): 1122-60. For a discussion of the increasing monetary input as a cause of the price revolution, see Douglas Fisher, "The Price Revolution: A Monetary Interpretation," *Journal of Economic History*, Vol. XLIX, No. 4 (December 1989): 883-902.

terms.[135] As a result, the early Stuart government started with constant deficits in ordinary accounts even in the years of peace and good harvests between 1603 and 1618.[136] Two-thirds of the deficit was caused by subsidies to the colonial government in the newly conquered Ireland.[137] Studies of early Stuart history have convincingly demonstrated that the increasing discrepancy between expenses to maintain the state and the shrinking ordinary revenue was the primary cause for the "functional breakdown" of the government in the 1610s and 1620s.[138]

At this moment, contemporary political actors concerned about the urgency of fiscal reform were aware of two options. One was to rescue the traditional domain state by cutting government expenditures while increasing yields from sources of the ordinary revenue. The other was to transform into a fiscal state by turning the parliamentary supplies from irregular extraordinary revenues granted only in emergencies into regular taxation to fund the government in both peace and war. The latter seemed more practical as royal estates had been shrinking and feudal revenues such as purveyance became obsolete in the changed economic circumstances.[139] As early as 1593, there had been a

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[135] Penry Williams, *The Later Tudors: England 1547-1603* (Oxford: Clarendon, 1995), p. 147; Conrad Russell, *The Addled Parliament of 1614: The Limits of Revision,* The Stenton Lecture 1991 (Reading: University of Reading, 1992), p. 10.

[136] Alan G. R. Smith, *The Emergence of a Nation State: The Commonwealth of England 1529-1660,* second edition (London: Longman, 1997), p. 254. By 1610, the royal government was facing a debt of £400,000 and an annual deficit of £140,000 in the ordinary account. John Cramsie, *Kingship and Crown Finance Under James VI and I* (London: Royal Historical Society, 2002), p. 118.

[137] Ronald Hutton, *Debates in Stuart History* (New York: Palgrave Macmillan, 2004), pp. 60-1.

[138] See a succinct review of this literature in Thomas Cogswell, Richard Cust and Peter Lake, "Revisionism and its legacies: the work of Conrad Russell," in Thomas Cogswell, Richard Cust and Peter Lake eds., *Politics, Religion and Popularity in Early Stuart Britain* (Cambridge: Cambridge University Press, 2002).

[139] For example, after decades of inflation, purveyance – the crown's prerogative rights to have the royal household supplied at prices far below the current market prices – stirred waves of grievances, particularly from regions that provided these goods, such as Kent and Essex. Cited in Eric N. Lindquist, "The King, the people and the House of Commons: The problem of early Jacobean Purveyance," *Historical Journal*, Vol. 31, No. 3 (1988), pp. 550-556.

proposal to create an annual land tax of £100,000 to fund wars.[140] However, in the negotiations of the Great Contract in the 1610s, the royal government failed to reach an agreement with Parliament as to how to use a national land tax to replace the crown's two major feudal revenues, namely, wardship and purveyance.[141] In addition to the disagreement over the appropriate level of annual taxation, many Members of Parliament considered the levy of a national land tax by the central government unacceptable. Some argued that even Parliament had no authority to impose it. The landed class was particularly hostile to the national survey that the levy of land taxes would require.[142]

At the same time, the fiscal principle of a domain state which formally separated the crown's ordinary revenue from the extraordinary revenue granted by Parliament in emergency remained influential among political actors.[143] Moreover, parliamentary supplies became less attractive to the royal government as their assessment and collection were controlled by local gentry, which led to severe under-assessment and even widespread evasion.[144] For instance, the yield of a granted subsidy fell from £137,000 in 1559 to £55,000 in 1628, only one-fifth of the 1559 level in real terms.[145] The situation remained the same even in the religious wars with France and Spain between 1625 and

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140 John Cramsie, *Kingship and Crown Finance Under James VI and I*, p. 68.
141 Conrad Russell, *The Addled Parliament of 1614: The Limits of Revision*; Eric N. Lindquist, "The Failure of the Great Contract," *Journal of Modern History*, Vol. 57, No. 4 (December 1985): 617-51.
142 Eric N. Lindquist, "The King, the people and the House of Commons: The problem of early Jacobean Purveyance," p. 561 and p. 565; idem, "The Failure of the Great Contract," p. 645, particularly footnote 108, and p. 648.
143 R. W. Hoyle, "Crown, Parliament and Taxation in Sixteenth-Century England," *English Historical Review*, Vol. 109, No. 434 (November 1994): 1174-96.
144 Roger Schofield, "Taxation and the political limits of the Tudor state," in Claire Cross, David Loades, and J. J. Scarisbrick eds., *Law and Government under the Tudors: Essays Presented to Sir Geoffrey Elton* (Cambridge: Cambridge University Press, 1988); Conrad Russell, *The Causes of the English Civil War* (Oxford: Clarendon, 1990), pp. 169-70; idem, *Parliaments and English Politics, 1621-1629* (Oxford: Clarendon, 1979), pp. 49-51.
145 Derek Hirst, *England in Conflict, 1603-1660: Kingdom, Community, Commonwealth* (New York: Oxford University Press, 1999), p. 26.

1628. Parliament supported the war by voting extraordinary supplies, yet the actual yields were disappointing.[146] The royal government lacked the necessary institutions to improve the collection of granted parliamentary supplies.

In the 1610s, both Parliament and the royal government looked back at the consolidation of the domain state in the late fifteenth and early sixteenth centuries in their search for remedies for the current fiscal crisis.[147] Financial officials of the royal government still believed that it was possible to increase the yields from the ordinary revenue through better management. To this end, they attempted to uncover the "concealed" rents and lands that belonged to the crown, to disforest and sell timber, to drain the fens, to encroach on commons, etc.[148] They even sought to increase ordinary revenues by reviving some medieval feudal rights, such as knighthood and forest fines, and by selling general pardons, titles of baron and peer, and even offices.[149] They also implemented "mercantilist policies," such as granting monopolies to commercial projects, and hoped to share the expected business profit.[150] These measures to save the obsolete domain state, however, were fiscally unproductive and politically unpopular.

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[146] Parliament did not intend to use "fiscal means" to block the king's war efforts. For Parliament's support of the war of 1625-8, see Thomas Cogswell, *The Blessed Revolution: English Politics and the Coming of War, 1621-1624* (Cambridge: Cambridge University Press, 1989).
[147] G. L. Harriss, "Medieval Doctrines in the Debates of Supply, 1610-1629," in Kevin Sharpe ed., *Faction and Parliament: Essays on Early Stuart History* (Oxford: Clarendon Press, 1978); John Cramsie, *Kingship and Crown Finance Under James VI and I*, p. 190.
[148] On these entrepreneurial projects, see Joan Thirsk, "The Crown as projector on its own estates, from Elizabeth I to Charles I," and Richard Hoyle, "Disafforestation and drainage: the Crown as entrepreneur?" Both in R. W. Hoyle ed., *The Estates of the English Crown, 1558-1640* (Cambridge: Cambridge University Press, 1992).
[149] John Cramsie, *Kingship and Crown Finance Under James VI and I*, p. 141 and p. 147.
[150] John Cramsie, "Commercial Projects and the Fiscal Policy of James VI and I," *Historical Journal*, Vol. 43, No. 2 (2000): 345-364; Kevin Sharpe, *The Personal Rule of Charles I* (New Haven: Yale University Press, 1992), p. 122.

As the English historian Conrad Russell has reminded us, we need to view the conflicts between the royal government and Parliament in this period as taking place within an institutional framework accepted by both sides.[151] For example, the granting of monopoly was not itself controversial. Rather, it was the private enforcement of government regulation by monopolists that stirred up strong protests.[152] Opponents were concerned about the ill influence that the abuse of monopolies had on the health of the body politic, which the monarch and his councilors had a duty to preserve.[153] And the royal government was prepared to repeal many unprofitable measures such as patents of inns, alehouses, and gold and silver thread while preserving a few fiscally productive ones such as the monopoly of tobacco.[154] Likewise, the disputes between crown and Parliament over the customs duties in the 1620s occurred in the shared recognition of the king's prerogative to raise the obsolete rates of customs duties.[155]

One major constitutional debate between Parliament and the royal government were over the annual collection of ship money, a non-parliamentary levy whose annual collection was extended to the whole country in 1635. As its annual collection was based upon the directly assessed individual wealth in each county and major town, ship money became a *de facto* nation-wide direct tax. The collected ship money was used for the newly established professional royal navy rather than being diverted for other purposes, such as

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[151] Conrad Russell, *The Addled Parliament of 1614: The Limits of Revision*, p. 18.
[152] Linda Levy Peck, *Court Patronage and Corruption in Early Stuart England*, p. 138; Conrad Russell, *Parliaments and English Politics, 1621-1629*, p. 100.
[153] David Harris Sacks, "The countervailing of benefits: monopoly, liberty, and benevolence in Elizabethan England," in Dale Hoak, ed., *Tudor Political Culture* (Cambridge: Cambridge University Press, 1995), particularly pp. 280-281.
[154] John Cramsie, *Kingship and Crown Finance Under James VI and I*, p. 177;
[155] Michael J. Braddick, *The Nerves of State: Taxation and the Financing of the English State, 1558-1714* (Manchester: Manchester University Press, 1996), pp. 53-54.

to raise a standing army or for the crown's personal expenses.[156] However, according to the fiscal constitution of the domain state, ship money did not belong to the crown's "ordinary revenue," and therefore its levy could only be justified by emergencies and voted only by Parliament. In the peaceful years of 1634-35 there was no imminent danger to England. In making its case, the royal government appealed to the crown's duty to protect the realm under the new circumstances of naval warfare, which made it urgent for England to replace the conscription of merchant ships by a professional navy.[157] The continued collection of ship money, in spite of its unsettled legal status, best illustrates the tension between the obsolete institutions of domain state and the new reality.

Several factors contributed to the stickiness of the institutions of the domain state in early Stuart England. The severe fiscal crisis in the 1610s forced the royal government to implement retrenchment which saved some £63,000 in the period between 1617 and 1620 by reducing the expenditures of the royal household, wardrobe, pensions, navy, ordnance, and garrison. These continued into the reign of Charles I (1625-1642).[158] The English government could not afford costly offensive strategies, as illustrated in the debacle of the expeditions of Cadiz and the Isle of Rhé in the wars in 1625-28. Because of the

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[156] Andrew Thrush, "Naval finance and the origins and development of ship money," in Mark Charles Fissel, ed., *War and Government in Britain, 1598-1650* (Manchester: Manchester University Press, 1991); Kevin Sharpe, *The Personal Rule of Charles I*, pp. 594-5.

[157] For details of these debates, see Kevin Sharpe, *The Personal Rule of Charles I*, pp. 717-729; Glenn Burgess, *The Politics of the Ancient Constitution: An Introduction to English Political Thought, 1603-1642* (London: Macmillan, 1992), p. 202-11.

[158] John Cramsie, *Kingship and Crown Finance Under James VI and I*, pp. 160-162; idem, "Crown Finance and Reform: The Legacy of the 'Addled Parliament'," in Stephen Clucas and Rosalind Davies eds., *The Crisis of 1614 and the Addled Parliament* (Burlington: Ashgate, 2003), p. 39; Kevin Sharpe, "The Personal Rule of Charles I," in Howard Tomlinson ed., *Before the English Civil War: Essays on Early Stuart Politics and Government* (London: Macmillan Press, 1983), p. 60.

English Channel, it could retreat from the power struggles going on in Continental Europe.[159] This defensive strategy made it possible for the royal government to stop various non-parliamentary means undertaken to raise revenues to meet military expenditures, such as the benevolence and the forced loans in 1626-28.

More importantly, the royal government shifted its fiscal burden to localities. Fiscal decentralization intensified as the royal government transferred much of the financial costs of national defense, the implementation of the poor law, famine relief, maintenance of order and infrastructure, and so on to localities. Local gentry collected various local "rates" to disburse these state affairs on the local level.[160] The major role for the central government was to provide coordination and guidance.[161] Only when local governments were reluctant to strictly implement measures to prevent the spread of plagues, such as isolation and confinement, did the central government take more initiative.[162] The shared agenda of center and local elites to legitimate the state power thus complemented the entrenched fiscal decentralization.[163]

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[159] For the emphasis on the role the Channel played in preventing the escalation of England's military spending in the 1630s, see Conrad Russell, *Unrevolutionary England*, p. 135.
[160] John Guy, *Tudor England* (Oxford: Oxford University Press, 1990), p. 385; Conrad Russell, *The Causes of the English Civil War*, p. 175
[161] For assessments of the active role of the center in guiding local governance in early Stuart England, see Michael J. Braddick, "State Formation and Social Change in Early Modern England." *Social History*, Vol. 16, No. (1991): 1-17; Paul Slack, *From Reformation to Improvement: Public Welfare in Early Modern England* (Oxford: Oxford University Press, 1999); Michael J. Braddick and John Walter, eds., *Negotiating Power in Early Modern English Society* (Cambridge: Cambridge University Press, 2001).
[162] Michael J. Braddick, *State Formation in Early Modern England*, pp. 124-8.
[163] For emphasis on the interdependence of the center and local governments in early Stuart England, see Steve Hindle, *The State and Social Change in Early Modern England*, chapter 1.

Ship money and the customs were the two principal pillars of the royal government which helped prevent its insolvency in the late 1630s.[164] Nonetheless, the fiscal stability in the 1630s was precarious as the central government did not have the ability to mobilize financial resources by means of its revenues. Ship money was consumed by the royal navy. The customs revenues were controlled by the syndicate of customs farmers. In 1628, the City of London refused to provide fresh credit to the royal government unless its previous debts had been satisfactorily cleared.[165] Meanwhile, fiscal decentralization and local gentry control over the assessment and collection of both parliamentary supplies and non-parliamentary levies such as ship money to a large extent contained the tension between the center and localities. The royal government's intention to excessively extract revenues from society could be effectively blocked by the non-cooperation of local elites.[166]

In contrast to the domain state in England in the 1600s, the Japanese state in the early nineteenth century rested upon tax revenues. Yet it was an incomplete fiscal state because the shogunate (the Bakufu), acting as the central government, did not collect taxes in the whole territory of Japan but only from the territories under its governance. This resulted from the previous history of state formation in Tokugawa Japan (1603-1868). The fiscal institutions of the Bakufu, which unified Japan in 1603, were not fully consolidated until the 1730s. In the early seventeenth century, Japan was one of the

[164] Kevin Sharpe, *The Personal Rule of Charles I*, p. 129 and p. 593.
[165] Robert Ashton, "Revenue Farming under the Early Stuarts," *Economic History Review*, new series, Vol. 8, Issue 3 (1956), p. 317.
[166] See the emphasis on this point in Richard Cust, *The Forced Loan and English Politics, 1626-1628* (Oxford: Clarendon Press, 1987), pp. 142-3; Conrad Russell, *Parliaments and English Politics, 1621-1629*, pp. 64-5.

major gold and silver producing countries in the world. The Bakufu derived its income mainly from three sources: the land tax (*nengu*), which was paid in rice for paddy fields or in cash for dry lands; the profit from the gold and silver mines which it monopolized; and government-regulated foreign trade through Nagasaki.[167] However, the output of gold and silver sharply declined after the mid-seventeenth century. Meanwhile, foreign trade led to huge outflows of silver to China in return for imports such as raw silk. In order to prevent silver drainage, the Bakufu in the 1630s began to tightly control foreign trade and encouraged domestic production of raw silk as "import-substitution." In 1668, it prohibited the export of silver.[168]

As the land tax became the principal source of government income, the Bakufu in the famous Kyōhō Reform (1716-1736) tried to improve its yields. It encouraged reclamation of new lands, endeavored to update the assessment of agricultural output, and began to collect the land tax according to a fixed rate.[169] Over the course of the eighteenth century, the income of the Bakufu became inadequate to sustain its ever-expanding role in governing Japan. In response, it transferred the burden of increasing public expenditures in river management, calamity relief, and infrastructure maintenance to domain governments (*han*) that acted as local governments. These measures included the imposition of levies such as construction services (*kuniyaku bushin*), the handover

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[167] According to Ōno Mizuo, the profit from mines of gold and silver was almost equivalent to the revenue collected from the land tax in this period. See Ōno Mizuo, *Edo bakufu zaisei shiron* [A Study of the Fiscal History of the Bakufu] (Tōkyō: Yoshikawa Kōbunkan, 1996), pp. 32-1.

[168] For an important discussion of these economic considerations in the Bakufu's "closure policy" (*sakoku*) between 1630s and 1660s, see Tashiro Kazui, "Tokugawa jidai no bōeki [Foreign trade in the Tokugawa period]," in Hayami Akira and Miyamoto Matao, eds., *Keizai shakai no seiritsu: 17th-18th seiki* [The Formation of an Economic Society: Seventeenth and Eighteenth centuries], pp. 130-64.

[169] Furushima Toshio, "The village and agriculture during the Edo period," in John W. Hall ed., *The Cambridge History of Japan,* volume 4, *Early Modern Japan* (Cambridge: Cambridge University Press, 1991), pp. 495-8.

river management and flood control projects (*otetsu bushin*), etc.[170] Transfer of the costs of state affairs to domain governments stabilized the incomplete fiscal state in practice.

In the period between 1760 and 1786, the Bakufu implemented active mercantilist policies (the Tanuma Reform) to both expand its tax base and tap revenues from the non-agricultural sectors, including foreign trade. It imposed new taxes upon sake, soy sauce, water wheels, and so on, which were collected through the intermediaries of villages, business guilds (*nakama*), wholesale agencies (*tonya*), and government-granted monopolies (*kabunakama*). To ease the economic distress of daimyos and earn profit, the Bakufu forced important merchants in Osaka to provide it with low-interest loans (*goyōkin*) and then re-lent these monies to daimyos. The Bakufu also sought to raise revenues from the commercial development of the colony of Ezo (today's Hokkaido) and from the export of Japanese goods such as copper and dried sea products to Chinese and Dutch merchants through Nagasaki. Fiscal productiveness to a large extent determined the fate of these policies. The Bakufu was forced to repeal some new levies upon silk thread, lamp oil, and cloth when collection by monopoly-holding urban merchants led to large-scale riots by small producers. The loans to daimyos and the commercial development of Ezo became fiscal drains and had to be curtailed.[171] In 1787, the Bakufu re-exerted tight control over foreign trade so as to limit the outflow of copper when it began minting increasing amounts of copper cash for the domestic economy.

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170 Ōguchi Yūjirō, "Bakufu no zaisei," in Shimbo Hiroshi and Saitō Osamu, eds., *Kindai seichō no taidō* [Gathering Momentum for Modern Growth], pp. 152-5.
171 Ōguchi Yūjirō, "Bakufu no zaisei," pp. 141-4; John Whitney Hall, *Tanuma Okitsugu, 1719-1788: Forerunner of Modern Japan* (Cambridge: Harvard University Press, 1955), chapter IV.

Nonetheless, Bakufu financial officials well understood the fiscal importance of encouraging exports of Japanese goods, if not of precious metals.[172]

However, efforts to diversify the tax base in the second half of the eighteenth century coincided with a highly hostile environment. Severe natural calamities such as unusually cold weather, droughts and volcanic eruptions frequently occurred, causing widespread crop failure and serious famine.[173] At a time when revenues were falling sharply, particularly due to reliance on the land tax, the Bakufu as the central government was obliged to provide famine relief and funds for the recovery of agricultural production; to prepare reserves of grain and funds against future incidences of famine; and to prevent the fall of rice prices through government procurement, etc.[174] In the period between 1786 and 1817, the Bakufu depended mainly upon the reduction of administrative and shogunal household expenditures, the dispensing of its cash reserves, and the transfer of larger shares of outlays for river management and other construction projects to domain governments in order to keep expenses with the limits of income.[175]

In addition to natural disasters, it was also a time of rising international tension. Disputes with the Russians over the northern frontiers and the appearance of British warships in Japanese waters between 1808 and 1818 made increased defense spending in Ezo and the

[172] Nakai Nobuhiko, *Tenkanki bakuhansei no kenkyū* [A Study of the Bakufu-han System in the Transition Periods of Hōreki and Tenmei (1751-1788)] (Tōkyō: Hanawa Shobō, 1971), pp. 153-4. The new restriction on foreign trade in 1787 mainly aimed to stop outflows of copper from Japan.
[173] See Conrad Totman, *Early Modern Japan* (Berkeley: University of California Press, 1995), pp. 238-40.
[174] Fujida Satoru, "19 seiki maehan no Nihon," in *Iwanami kōza Nihon tsūshi,* Vol. 15 Kinsei 5 (Tōkyō: Iwanami Shoten, 1995), pp. 8-12.
[175] For the detailed discussion of the limit of fiscal retrenchment in the period between 1789 and 1817, see Ōguchi Yūjirō, "Kansei-Bunkaki no Bakufu zaisei [The public finance of the Bakufu between 1789 and 1817]," in Bitō Masahide Sensei Kanreki-kinenkai ed., *Nihon kinseishi ronsō (ge)* (Tōkyō: Yoshikawa Kōbunkan, 1984), pp. 209-52.

Tōkyō Bay area urgent.[176] By 1818, the Bakufu could no longer continue the policy of parsimony in public expenditures and began to use currency debasement to raise revenues, even though this had previously been viewed as a bad policy. Officials responsible for financial affairs seemed to hope that the increased monetary input could reverse the decline of rice prices ongoing since 1810 and stimulate economic transactions, thus avoiding inflation. In order for the economy to absorb the increasing amount of minted coins, they deliberately debased the currency with smaller denominations and increased the amount of the minted copper cash.[177] By 1832, the total profit that the Bakufu had gained from recoinage was as high as 5.5 million *ryō*, an enormous sum given that its annual income was less than 1 million *ryō* at the time.[178] In response to a 75 percent rise in prices from 1818 to 1838, financial officials in 1841 attempted to use more market competition to drive down prices by ordering the dissolution of business guilds and monopolies.[179] The failure of this policy finally forced the Bakufu to stop raising fiscal revenues by recoinage in 1844.

Enormous pressure to increase defense spending continued through the 1840s as Japan observed the military superiority of the British in the Opium War (1840-42). Retrenchment was implemented again to reduce the expenditures of the shogun's household and administration, yet there was little room left for parsimony. In 1843, the

[176] The British warship *Phaeton* entered Nagasaki harbor in 1808, and British ships appeared in Uraga in 1816, 1817, and 1818. For the increasing awareness of foreign threats in Japan between 1792 and 1818, see Conrad Totman, *Early Modern Japan*, pp. 482-502.
[177] For these economic considerations, see Shimbo Hiroshi and Saitō Osamu, "Gaisetsu – 19 seiki e," pp. 30-1.
[178] Ibid., p. 31. The estimate of the Bakufu's annual income in the 1830s is cited from Ōyama Shikitarō, *Bakufumatsu zaiseishi kenkyū* [A Study of the Fiscal History of the Late Bakufu] (Kyoto: Shibunkaku Shuppan, 1974), p. 46.
[179] Fujita Satoru, *Tenpō no kaikaku* [The Tenpō Reform] (Tōkyō: Yoshikawa Kōbunkan, 1989), pp. 145-8.

Bakufu carried out serious reforms which aimed to extract more revenue from the land tax by uncovering reclaimed land that had remained untaxed, and by more accurate assessments of agricultural output, particularly the value of lands used for cultivating cash crops. However, the Bakufu did not possess the necessary administrative ability for such a formidable task.[180] Moreover, commercialization in the rural areas had produced significant social differentiation within villages. The Bakufu could not extract more tax revenues directly from the landlords or rich farmers upon whom it had to depend to maintain order and administration on the village level.[181] Many local magistrates who bore the brunt of peasant anti-tax riots strongly opposed harsh measures to extract land taxes from peasants and called for "benevolent governance (*jinsei*)."[182] In the absence of reliable and elastic tax revenues, the Bakufu's creditworthiness in the financial markets remained low. The "forced loans" (*goyōkin*) that the Bakufu imposed upon urban merchants did not satisfy its increasing fiscal needs.

Nonetheless, the stringent fiscal situation of the Bakufu did not lead to its immediate collapse. Instead, as the central government, it could mobilize domain governments to strengthen the defense of Japan and urge them to adopt Western-style cannons. The pressure of increasing defense expenditures was thus transferred to domain governments as the security of Japan was considered the "public" interest of Japan rather than the

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180 Thomas C. Smith, "The Land Tax in the Tokugawa Period," reprinted in Thomas C. Smith, *Native Sources of Japanese Industrialization, 1750-1920* (Berkeley: University of California Press, 1989), pp. 50-70.
181 Ōguchi Yūjirō, "Bakufu no zaisei," in Shimbo Hiroshi and Saitō Osamu, eds., *Kindai seichō no taidō* [Gathering Momentum for Modern Growth], pp. 138-140 and pp. 150-151.
182 Fujita Satoru, *Tenpō no kaikaku* [The Tenpō Reform], pp. 138-144.

Bakufu's "private" interest.[183] Much as in early Stuart England, fiscal decentralization was complemented by a widely shared goal to legitimate the state power in both domestic and foreign affairs.

Unlike the domain state in early Stuart England, the state in eighteenth-century China was a fiscal state which derived the vast majority of its income from the land and salt taxes.[184] In contrast to the incomplete fiscal state in Tokugawa Japan, the central government in China taxed the whole territory governed directly by its administrative institutions (China proper). After the fiscal reforms in the reign of the Yongzheng emperor (1723-1735), the management, if not the actual operation, of the fiscal system of Qing China became more centralized as the Ministry of Revenue supervised and audited the annual accounts of both the collections and expenditures of provincial governments.[185] By 1750, the assessment and collection of land taxes was much simplified when the government converted the value of the head tax and miscellaneous labor services into standard land taxes collected by fixed quotas.

After the resumption of foreign trade in China in 1685, huge amounts of silver flowed from overseas into the country in return for raw silk, tea and porcelain. According to the

183 On the role of the Bakufu as the central government in organizing national defense, see Fujita Satoru, *Bakuhansei kokka no seijishi teki kenkyū* [A Study of the Political History of the Bakuhan System] (Tōkyō: Azekura Shobō, 1987), pp. 213-4. For a discussion of the transfer of defense expenditures to domain governments, see Ōguchi Yūjirō, "Bakufu no zaisei," p. 166; Fujita Satoru, "Tenpō kaikakuki no kaibō seisaku ni tuite [A study of the policies of seaborne defense in the Tenpō period]," *Rekishigaku kenkyū*, No. 469 (1979), especially pp. 20-24

184 In 1753, the revenues from the land tax accounted respectively for about 73 percent and the salt tax about 12 percent of the annual government income. Calculated from Table4.2 in Wang Yeh-chien, *Land Taxation in Imperial China* (Cambridge, MA: Harvard University Press, 1973), p. 72.

185 Madeleine Zelin, *The Magistrate's Tael: Rationalizing Fiscal Reforms in Eighteenth-Century Ch'ing China* (Berkeley: University of California Press, 1992).

historian Wang Yeh-chien's estimates, silver inflows caused a 280 percent increase in the silver stock in China between 1680 and 1830.[186] As a suitable medium for inter-regional trade, silver greatly stimulated the monetization of the Chinese economy and the development of a national market. Meanwhile, the development of a market economy in eighteenth-century China further benefited from many liberal economic policies implemented during the reign of the Qianlong emperor (1736-1796). The government permitted Chinese merchants to engage in foreign trade, encouraged private investments in mining, repealed transit duties on the grain trade in times of peace, and reduced taxes levied on commercial transactions and the surcharges on salt.[187] These new economic policies to a large extent represented a changing attitude on the part of government officials toward the new reality of a market economy. The greatly expanded domestic economy and the development of long-distance trade provided the state with a growing tax base. Although the government fixed the rates in the collection of the land tax, lightly taxed the commercial sectors, and often granted tax remission to regions struck by natural calamities (even nation-wide exemption from land taxes), it could still afford to govern a

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[186] Calculated from Table 1.2 in Wang Yeh-chien, "Secular Trends of Rice Prices in the Yangzi Delta, 1638-1935," in Thomas G. Rawski and Lillian M. Li, eds., *Chinese History in Economic Perspective* (Berkeley: University of California Press, 1992), p. 61. For the silver inflows into China in the seventeenth and eighteenth centuries, see Andre Gunder Frank, *ReOrient: Global Economy in the Asian Age* (Berkeley: University of California Press, 1998), pp. 143-9.

[187] For government encouragement of commercial development, see Gao Wangling, *Shiba shiji Zhongguo de jingji fazhan he zhengfu zhengce* [The Economic Development in Eighteenth-century China and Government Policy] (Beijing: Zhongguo shehui kexue chubanshe, 1995); Zhang Xiaotang, "Qianlong nianjian Qingzhengfu pingheng caizheng zhi yanjiu [Fiscal adjustments during the reign of Qianlong]," *Qingshi yanjiuji*, Issue 7 (Beijing: Guangming ribao chubanshe, 1990), pp. 47-59; Xu Tan and Jing Junjian, "Qingdai qianqi shangshui wenti xintan [A new study of commercial taxes during the Qing dynasty]," *Zhongguo jingjishi yanjiu*, No. 2, (1990): 87-100. On state support for private investment in the mining of copper, see Chiu Peng-sheng, "Shiba shiji diantong shichang zhong de guanshang guanxi yu liyi guannian," *Zhongyang yanjiuyuan lishiyuyan yanjiusuo jikan*, Vol. 72, Part 1 (Taipei: Academia Sinica, 2001): 49-119.

large territory and to pay for expensive military campaigns in Central Asia, Tibet, and Burma.[188]

As in the well-established early modern states of early Stuart England and Tokugawa Japan, legitimation of state power in eighteenth-century China required government expenditures toward maintaining social order and providing for the public welfare throughout measures such as famine relief, maintenance of water conservancy, and so on. Nevertheless, with the development of a market economy, China also experienced a slow yet steady inflation as the level of prices rose some 300 percent over the eighteenth century. As tax rates and quotas of the budgets for provincial governments remained fixed, there was an increasing discrepancy between government income and spending. In response, the central government appealed to extraordinary revenues through the sales of nominal titles (*juanna*) and levies of "contributions" (*baoxiao*) upon the privileged big merchants who were granted monopolies in selling salt and in doing business with Westerners. Local governments, at both the provincial and prefectural levels often collected surcharges besides the official state taxes to cover their inadequate funds. Although to some extent this bred corruption, such surcharges were primarily a necessary means to sustain the operation of the state given the fixed quotas in tax collection.[189]

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[188] Despite these expenses, the amount of silver deposited in the Ministry of Revenue was as high as 80 million *tael* silver by 1795. See Zhang Xiaotang, "Qianlong nianjian Qingzhengfu pingheng caizheng zhi yanjiu," p. 27. For the contribution of commercial resources the imperial wars and expansion in the eighteenth century, see Peter C. Perdue, *China Marches West: The Qing Conquest of Central Eurasia* (Cambridge, MA.: The Belknap Press of Harvard University Press, 2005) and Dai Yingcong, "The Qing State, Merchants, and the Military Labor Force in the Jinchuan Campaigns," *Late Imperial China*, Vol. 22, No. 2 (December 2001): 35-90.

[189] On the supplementary roles of these local surcharges to the maintenance of the state, see Wang Yeh-chien, *Land Taxation in Imperial China*, p. 19; Iwai Shigeki, *Chūgoku kinsei zaiseishi no kenkyū* [A Study of the Fiscal History of Early Modern China] (Kyoto: Kyoto Daigaku Shuppankai, 2004), pp. 43-62.

As it entered the nineteenth century, the Qing government encountered a severe deflation which it had no institutional ability to overcome. This deflation was mainly caused by outflows of silver due to the opium trade in the period between the 1800s and 1850s. China's reduced exports between the 1810s and 1850s, which resulted from an economic depression in Europe and America, further reduced the inflow of silver into China.[190] As a result, China's domestic silver stocks are estimated to have fallen some 40 percent between 1820 and the 1850.[191] From 1820 onward, the consequences of the intensified silver drainage were no longer confined to the coastal areas but spread to the whole economy.[192] This caused a severe deflation and widespread unemployment throughout the country. Moreover, the scarcity of silver raised the exchange rate between silver (*kuping tael*) and copper cash (*wen*) far above the official rate of 1:1000; this reached 1200-1500 in the 1830s and even went above 2000 in the 1840s (*yingui qianjian*). As taxation was paid in silver, the rising value of silver vis-à-vis copper cash greatly increased the tax burden on peasants and salt merchants even though official tax rates remained unchanged. In consequence, chronic and nation-wide arrears in land and salt taxes appeared.[193]

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[190] Lin Man-houng, "Zhongguo de baiyin wailiu yu shijie jinyin jianchan," *Zhongguo haiyang fazhanshi lunwenji*, No. 4 (1991).

[191] Wang Yeh-chien, *Zhongguo jindai huobi yu yinhang de yanjin: 1644-1937* [The Evolution of Currency and Banking in Early Modern China: 1644-1937] (Taipei: Institute of Economic Research, Academia Sinica, 1981), p. 27.

[192] For the process of how silver outflows began to affect the national economy from the 1820s on, see Lin Man-houng, "Yin yu yapian de liutong ji yinguiqianjian xianxiang de quyu fenbu: 1808-1854," *Zhongyang yanjiuyuan jindaishisuo jikan*, Vol. 22, Part 1 (Taipei: Academia Sinica, 1993): 91-135.

[193] For a detailed discussion of unemployment and shortage in government tax revenue between the 1820s and 1850s, see Lin Man-houng, *China Upside Down: Currency, Society, and Ideologies, 1801-1856*, chapter 3.

The Qing government between the 1810s and 1840s was forced to make several adjustments. The central government reduced administrative expenditures, dispensed the reserved silver in the Ministry of Revenue, introduced more competition into the sales of salt, and frequently appealed to the sale of nominal official ranks to raise revenues.[194] Facing inadequate funds assigned from the center, provincial governments became more dependent upon the collection of surcharges from both agrarian and commercial sources, which were permitted yet not supervised by the Ministry of Revenue.[195] Moreover, in order to ease its burden in providing social welfare, the government encouraged local gentry in both urban and rural areas to take responsibility through such measures as local granaries, prevention of plagues, maintenance of infrastructure, and so on.[196] However, the effectiveness of these fiscal reforms within the boundaries of existing institutions was limited as they did not remove the root cause of the crisis, i.e., the severe deflation caused by silver drainage.

The fiscal difficulties between the 1820s and 1850s exposed a fundamental deficiency in the institutions of public finance, in spite of the development of a market economy during the eighteenth century. The Qing government only minted denominated copper cash with the smallest unit in market exchanges (1 *wen*) (like one cent in the American economy).

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[194] Zhou Yumin, *Wan Qing caizheng yu shehui bianqian* [Public Finance and Social Changes in Late Qing], pp. 71-4 and pp. 96-102. On the legalization of "private sales" of salt as a means to raise revenue from the salt tax in the reforms in the 1830s, see Okamoto Takashi, "Shinmatsu hyōhō no seiritsu [The establishment of salt-license in the late Qing]," *Shigaku zasshi*, Vol. 110, No. 12 (December 2001): 36-60.
[195] Yamamoto Susumu, *Shindai zaiseishi kenkyū* [A Study of the Fiscal History of the Qing Dynasty] (Tōkyō: Kyūkoshoin, 2002), particularly chapters 2-6; idem., "Shindai kōki Shizen ni okeru chihō zaisei no keisei [The formation of the provincial fiscal system in Sichuan province in late Qing]," *Shirin*, Vol. 75, No. 6 (November 1992): 33-62.
[196] Yamamoto Susumu, "Shindai kōki Kōse no zaisei kaikaku to zendō [Fiscal reforms and charity in Jiangsu and Zhejiang provinces in late Qing]," *Shigaku zasshi*, Vol. CIV, No. 12 (December 1995): 38-60; idem., "Shindai kōki Shizen ni okeru chihō zaisei no keisei [The formation of the provincial fiscal system in Sichuan province in late Qing]," particularly 33-48.

It did not mint denominated silver currency. Nonetheless, this bimetallic monetary system is not a parallel standard system of silver and copper (*yinqian fubenwei*), for silver was the de facto standard currency which was used in wholesale and inter-regional trade. Therefore, silver was the unit used to measure value and cost in economic transactions; and copper cash was only the subsidiary currency (or currency of small denomination) for daily transactions.[197] The low-valued and bulky copper cash could not replace silver in interregional trade, while silver as a currency by weight was too inconvenient for daily transactions and retail. The high transaction costs caused by the lack of a standardized token silver currency and the intermediary units between 1 *wen* copper cash and 1 *tael* silver (equals 1000 *wen*) were to a large extent alleviated by the widespread use of promissory notes denominated in copper cash and issued by money-exchangers, pawn-houses, and even shopkeepers, and also by bills of exchange or banknotes issued by big merchants and bankers. The Mexican silver dollar had become the de facto currency in economic life in the coastal areas by the early nineteenth century.[198] This background accounts for why many influential statecraft officials and scholars advocated non-intervention by the state in monetary issues during the great debates over the scarcity of silver and unbalanced exchange rates between silver and copper cash between 1820s and

[197] The monetary historian Ye Shichang has pointed out that silver was the de facto standard currency in eighteenth-century China, yet he does not consider copper cash as a subsidiary currency. In fact, even in the gold-standard economy in late eighteenth-century England, copper coins were important to retail sales because they were the currency of small denominations. See Ye Shichang, *Yapian zhanzheng qianhou woguo de huobi xueshuo* [The Monetary Theories in China in the Years Before and After the Opium War] (Shanghai: Shanghai renmin chubanshe, 1963), p. 6. For the importance of copper cash in the English economy in the eighteenth century, see Peter Mathias, *The Transformation of England: Essays in the Economic and Social History of England in the Eighteenth Century* (London: Methuen, 1979), chapter 10.

[198] Just imagine the American economy with only two units of currency: pennies and ten dollar bills! For the complementary roles of privately-issued notes denominated either in silver or copper cash to the deficiencies in the state's monetary system , see Wang Yeh-chien, *Zhongguo jindai huobi yu yinhang de yanjin: 1644-1937* [The Evolution of Currency and Banking in Early Modern China: 1644-1937], pp. 12-26.

1850s.[199] However, the lack of effective intervention by the state in a period of deflation can be disastrous to the economy.

In an economy where the state mints a denominated standard currency, the state can use currency debasement, i.e., the reduction of the content or fineness of precious metals such as gold or silver used in mintage, to maintain the level of the domestic monetary supply and thus avoid deflation caused by deficits in foreign trade. This is equivalent to a policy of currency devaluation as a response the chronic deficits in foreign trade. However, as discussed above, the Qing government used silver by weight as the standard currency. It could not therefore use the debasement of silver currency as a devaluation policy to overcome the severe deflation caused by silver drainage through foreign trade.[200] Lacking the necessary monetary institutions, the Qing government could do little to overcome domestic deflation and the ensuing fiscal crisis. In this light, we shall not assume that the development of a market economy in eighteenth-century China would automatically continue into the nineteenth century.[201] Nor can we attribute the fiscal difficulties and weakened state capacity in the first half of the nineteenth century solely to factors such as population growth, extension of territories, and corruption.[202]

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199 For the details of these debates, see Lin Man-houng, "Two Social Theories Revealed: Statecraft Controversies over China's Monetary Crisis, 1808-1854," *Late Imperial China*, Vol. 12, No. 2 (December 1991): 1-35. In this otherwise excellent empirical study, Lin fails to realize the role of state's monetary policy in overcoming deflation and thus over-evaluates the proposals of non-interference in her comments on the debates.

200 This is similar to the case of deflation in a country which sticks to the gold standard or pegs its currency to a strong currency even when it suffers from deficits in foreign trade.

201 The leading scholars who have emphasized economic development in eighteenth-century China, such as Li Bozhong, R. Bin Wong, and Kenneth Pomerantz, often ignore the economic deflation between the 1820s and 1850s and its implications for the sustained development of the Chinese economy.

202 The widespread unemployment caused by deflation often leaves an impression of "overpopulation" among researchers. See the criticism of creed of overpopulation in Qing China in James Lee and Wang Feng, *One Quarter of Humanity: Malthusian Mythology and Chinese Realities* (Cambridge, MA.: Harvard University Press, 1999). For the association between extension of territory and a weakened state in Qing

III. Implications of the exhaustion of old institutions to the search for alternative institutions

Against the background described above, we shall not attribute the causes of the fiscal difficulties of an already institutionalized early modern state to the ruler only. Issues of public finance in all the three cases had clearly become sufficiently complicated that the ruler could not handle them personally. Important policies in public finance were always deliberated among ministers and financial officials before a final decision was reached. Moreover, the collection of revenues and the expenses related to state affairs involved thousands of officials (either salaried or non-salaried) all over the country. Finally, the fiscal condition of the state was already heavily influenced by the market economy, particularly the ups and downs in prices, which was out of the control of the ruler.

The institutions of public finance in the three cases share one common feature: the state did not possess the ability to collect indirect taxes from domestic consumption, which remained lightly taxed. Without the institutions to both raise reliable revenues and manage available revenues efficiently, none of these states could effectively mobilize financial resources in the markets. However, these deficiencies in public finance did not imply an immediate bankruptcy or collapse of the state. Instead, the old institutions proved sticky as each state made adjustments to alleviate the pain of fiscal crisis,

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China, see G. William Skinner, "Introduction," in G. William Skinner ed., *The City in Late Imperial China* (Stanford: Stanford University Press, 1977), p. 20. This thesis, which underestimates the potential of the expanded economy in China proper to sustain the state's territory expansion in the eighteenth century, cannot explain the chronic tax arrears between the 1820s and 1850s. If such chronic and nation-wide tax arrears were produced by corruption of officials, then one can hardly imagine how such an incompetent regime could manage to survive till 1911.

particularly through mobilizing local governments and even local communities to share the increasing cost of managing state affairs.

When it comes to this issue, neo-institutionalists often hold a surprisingly non-institutional approach as they attribute these problems to the rulers' arbitrary violation of property rights through predatory taxation.[203] In the three cases examined here, the state simply did not have the necessary institutions to tap revenues from the commercialized sectors in the economy. Therefore, the ruler's personal will did not necessarily imply any actual influence on the economy. Take early Stuart England as an example. Even if James I or Charles II desired to extract predatory taxes, he still lacked the necessary institutions to do it. If the wealth of the property-owning class was outside the reach of the government's "grabbing hand", why should merchants bother to use force to overthrow the government? In light of the institutional ability of the state to collect revenues from commercial sectors, we shall not take for granted that there is a direct conflict of interest between the rising merchant class and the old state.

Meanwhile, maintenance of state power does not imply that the state has to aggregate to the center as much revenue as possible. Instead, in these three well-established early modern states, we see a common complementary effect between fiscal decentralization and local participation in the maintenance of political order and provision of social welfare. The shared concern to maintain the social and political order thus tied the center

[203] Taxation is often characterized as the direct conflict between the monarch and society, or the game between the monarch and the subjects. See examples in Daron Acemoglu, Simon Johnson, and James Robinson, "Institutions as the Fundamental Cause of Long-run Growth," NBRE Working Paper, Series 10481, 2004, p. 9; Edgar Kiser and Michael Hechter, "The Role of General Theory in Comparative-Historical Sociology," *American Journal of Sociology*, Vol. 97, No. 1 (July 1991), pp. 19-20.

and localities together. This political condition was indispensable for the transference of the financial burden from center to localities, which helped mitigate the spending pressure on the center and prevented an immediate collapse of the state. Intensified fiscal decentralization further decreased the urgency to search for new tax schemes and alternative institutions.

In England, for example, the Privy Council in 1627 proposed a nation-wide excise upon beer, ale and cider as a non-parliamentary levy justified by the demands of war. Because hostilities with France and Spain ended in 1628, this remained on paper through the 1630s.[204] In Japan, the Bakufu between 1844 and 1853 did not experiment with new taxation but relied mainly upon the land tax and "forced loans" from urban merchants; the latter became a kind of long-term (return in twenty years) form of borrowing with an annual interest rate of 12.5 percent. In China, the Shengjing General Xi En in 1843 proposed that the government levy a tax of 10 percent upon the net profit of a wide-range of business establishments such as banks, pawns, shops, and warehouses. In addition to an estimated annual yield of several million *tael*, he also pointed out that such a levy was equitable as the heavy tax burden on peasants and light tax on businessmen violated the principle of impartiality in state affairs. After deliberating this proposal collectively, the Grand Council and the Board of Revenue turned it down on the grounds that such a

[204] Paul Christianson, "Two Proposals for Raising Money by Extraordinary Means, c. 1627," *English Historical Review*, Vol. CXVII, No. 471 (April 2002):355-73.

collection would disrupt market transactions and it was administratively too difficult to check the accounts of each shop.[205]

In this light, the social, economic, and political factors that gave rise to the financial difficulties of the early modern state in England, Japan, and China did not indicate any specific direction for subsequent institutional changes. The causes of the rise of the modern fiscal state are unlikely to appear earlier than 1642 for England, 1868 for Japan, and 1850 for China. Nonetheless, the readjustment in the old institutions of public finance turned out to have its own limit and the political stability achieved in this way was highly precarious. As intensified fiscal decentralization weakened the capacities of the central government, it was unable to contain unexpected domestic disruptions or shocks coming from abroad.[206]

In England in the 1630s, religious tensions in English society began to escalate when Charles I tried to use coercive means to impose religious conformity upon the three separate kingdoms of England, Scotland, and Ireland. Yet he did not have the fiscal and military capacity to attain his goals. Charles I's religious wars with Scotland in 1637-40 provided an opportunity for the Irish to rebel in 1640. The war on two fronts thus seriously weakened the crown's ability to deal with his political opponents within England. The escalating mutual mistrust between Charles I and the Long Parliament

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[205] Zhongguo diyi lishi danganguan ed., *Jiaqing Daoguang liangchao shangyu dang* 嘉庆道光两朝上谕档 [Edicts during the Reigns of Jiaqing and Daoguang] (Guilin: Guangxi shifan daxue chubanshe, 2000), Volume 48, pp. 331-4.

[206] This is similar to Theda Skocpol's argument that a financially bankrupt state is the necessary condition for the outbreak of large-scale revolution, even though her structural prescription of the bankruptcy of the state is over-simplistic. See Theda Skocpol, *State and Social Revolutions: A Comparative Analysis of France, Russia, and China* (Cambridge: Cambridge University Press, 1979).

ultimately led to their armed conflict in 1642. The huge crack within the ruling class was seized upon by radicals who advocated parliamentary, and later popular, sovereignty; this turned a traditional rebellion into a great republican revolution.[207]

In Japan, the precarious stability began to shatter after the arrival of Perry's fleets in 1853. This first intensified fiscal decentralization as the Bakufu permitted domain governments to retain funds which should have been handed over to the center (*agenakin*) for strengthening local defenses.[208] From 1854, the Bakufu had to turn to mintage for fiscal purposes. When Japan was forced to open its ports to foreign trade in 1858, the gold standard established since 1772 collapsed quickly as gold currencies flew to the West.[209] In order to avoid the resulting domestic deflation, the Bakufu in 1860 was forced to switch to a de facto silver standard.[210] Between 1860 and 1867, it relied too much upon the mintage of silver and copper currencies to raise revenues, particularly by using the Mexican silver dollar acquired through foreign trade as minting materials.[211] In

[207] The religious policy of Charles I and the British perspective of "three kingdoms" provide the most compelling account for the outbreak of the English Civil War in 1641. The studies of religious and economic conflict in the English society then complement the story by accounting for the escalation and prolonging of the Civil War. For the former school, see Conrad Russell, *The Cause of the English Civil War*, chapter 5; idem., *The Fall of the British Monarchies, 1637-1642* (Oxford: Clarendon, 1991). For the latter school, see Ann Hughes, *The Causes of the English Civil War*, second edition (Basingstoke: Macmillan, 1991); David Wootton, "From Rebellion to Revolution: The Crisis of the Winter of 1642-3 and the Origins of Civil War Radicalism," *English Historical Review*, Vol. 105, No. 416 (July 1990): 654-69.
[208] Ōguchi Yūjirō, "Bunkyūki no Bakufu zaisei [Shogunal finance in the period of 1861-64]," in Kindai Nihon Kenkyūkai, ed., *Bakumatsu ishin no Nihon*, volume 3, *Nenpō kindai Nihon kenkyū* (Tōkyō: Yamagawa Shuppansha, 1981), pp. 54-5.
[209] The exchange rate between gold and silver was 1:5 in Japan as compared to 1:15 abroad. See the discussion of this phenomenon in Ohkura Takehiko and Shimbo Hiroshi, "The Tokugawa Monetary Policy in the Eighteenth and Nineteenth Centuries," *Explorations in Economic History*, 15 (1978), pp. 112-115.
[210] Between 1861 and 1868, the Bakufu only minted 667,000 *ryō* of its nominal standard gold currency (Man'en *koban* and *ichibukin)*, yet minted 47 million *ryō* (Man'en *nishu-gin*), which made it the standard silver currency in the economy. See Miyamoto Matao, "Bukka to makuro keizei no henka [Changes in prices and macroeconomy]," in Shimbo Hiroshi and Saitō Osamu, eds., *Kindai seichō no taidō* [Gathering Momentum for Modern Growth], p. 88.
[211] The total amount of silver currency minted between 1860 and 1867 is estimated to be 81.68 million *ryō*. Ōkura Takehiko, "Yōgin ryūnyū to bakufu zaisei [The inflow of the Mexican silver currency and the

1863, the profit from mintage accounted for 52.6 percent of the Bakufu's total annual income.[212]

As it transferred escalating defense expenditures to domain governments, the Bakufu lost control over their financial matters. Nonetheless, most domain governments did not have effective fiscal policies but simply appealed to the issue of paper notes to meet spending. A few domains, particularly Satsuma (one of the leading domains in the Meiji Restoration in 1868), raised income mainly by counterfeiting the Bakufu's currency.[213] In consequence, the amount of currency in Japan is estimated to have increased from 53 million *ryō* to 130 million *ryō* between 1860 and 1867.[214] As a result, the price level rose more than 200 percent in the same period. Hyperinflation not only weakened the Bakufu's fiscal capacity but also damaged its legitimacy.

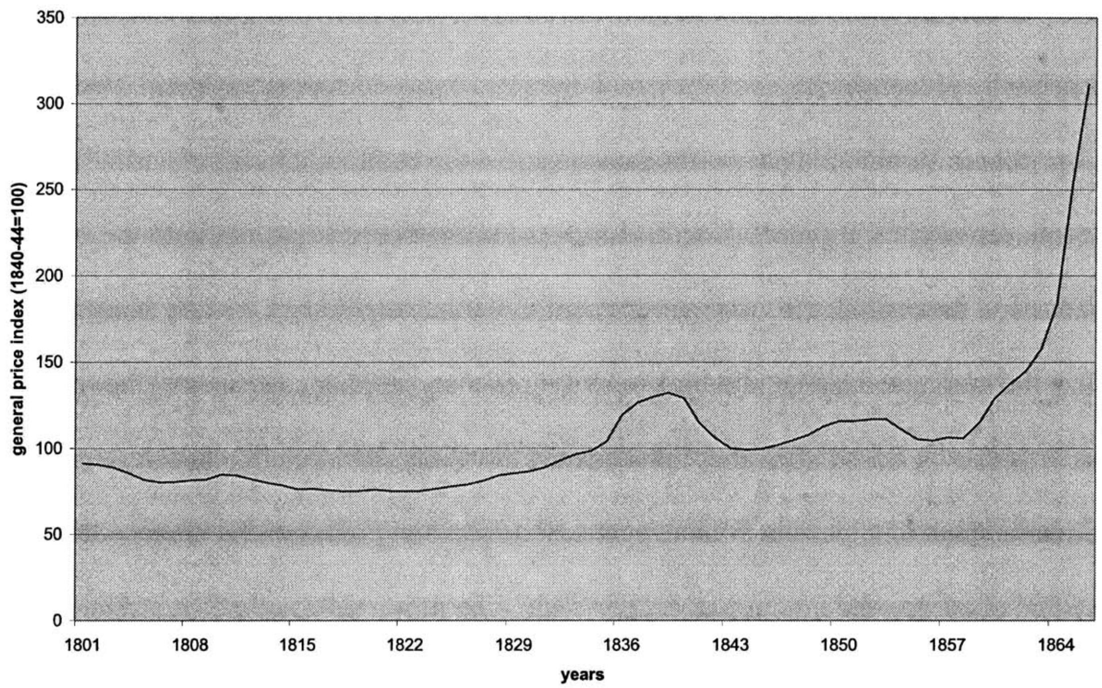
Bakufu's fiscal system]," in Kamiki Tetsuo and Matsuura Akira, eds., *Kindai ikōki ni okeru keizai hatten* [Economic Development in the Transitional Years to the Modern Period] (Tōkyō: Dōbunkan, 1987), p.255.

[212] Ibid., Table 7-3, p. 250.

[213] The net profit that Satsuma gained from counterfeiting Bakufu's currency was as high was 2 million *ryō* between 1862 and 1865. See Ishii Kanji, Hara Akira, and Takeda Haruhito, eds., *Nihon keizaishi I: Bakumatsuishinki* [An Economic History of Japan (I): The Late Tokugawa and Early Meiji Period] (Tōkyō: Tōkyō Daigaku Shuppankai, 2000), p. 16. The scale of counterfeiting in Satsuma was big as about 4,000 laborers worked in the counterfeiting workshops. See Mōri Toshihiko, *Meiji ishin no saihakken* [A Rediscovery of the Meiji Restoration] (Tōkyō: Yoshikawa Kōbunkan, 1993), p. 70.

[214] Of the total amount of currency in 1867, about 15 to 21 percent was the paper notes issued by domain governments. See Miyamoto Matao, "Bukka to makuro keizei no henka," in Shimbo Hiroshi and Saitō Osamu, eds., *Kindai seichō no taidō* [Gathering Momentum for Modern Growth], p. 33 and p. 89.

Figure 2.2 The trend of prices in Japan, 1800-1867



Source: Ōkura Takehiko and Shimbo Hiroshi, "The Tokugawa Monetary Policy in the Eighteenth and Nineteenth Centuries," *Explorations in Economic History*, 15 (1978), pp. 119-120.

The political situation in the 1860s was highly unstable as there had been deep division over the issue of opening to the West among the Court, major domains, and the Bakufu. This eroded the consensus upon which the maintenance of the cooperation between the center and local governments rested. The Bakufu did not have the capacity to either contain domestic political opponents or to reject the unequal treaties imposed by western powers. This was the crucial background behind the regime change known as the Meiji Restoration of 1868.

In sharp contrast to the Bakufu's use of recoinage to mitigate the deflationary pressure caused by the outflow of Japanese gold, the Qing government in China could do little to overcome the deflation caused by silver drainage. Its past experience in monetary policy primarily concentrated on how to alleviate the scarcity of copper cash (the currency of small denomination) which raised the exchange rates between copper cash and silver and therefore caused trouble to both public finance and daily economic transactions in the eighteenth century.[215] By increasing the output of minted copper cash in both the provinces and the capital, the Qing government in the late eighteenth century managed to stabilize the market exchange rate between silver *tael* and copper cash around the official rate of 1: 1000.[216] Based upon these precedents, the Qing government's initial response to the rising value of silver vis-à-vis copper cash in the early nineteenth century was to reduce and even stop the mintage of copper cash. The rationale was that the reduction of minted copper cash would drive up its value and thus the official exchange rate with silver would be resumed.[217]

The failure of this method prompted heated debates over monetary policy among scholars and officials from 1820 onward. Prior to the 1840s, these centered on three approaches.

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[215] In the first half of the eighteenth century, the market exchange rate between silver (*tael*) and copper cash was 1: 700-800 as compared with the official exchange rate of 1:1000. The main cause was a great reduction of imported Japanese copper after 1715. Copper from Japan had been the main raw material for the mintage of copper cash in China since 1683. See Chen Chau-nan, *Yongzheng Qianlong nianjian de yinqian bijia biandong* [A Study of the Fluctuations of the Exchange Rates between Silver and Copper Cash during the Reigns of Yongzheng and Qianlong] (Taipei: Zhongguo xueshu zhuzuo jianzhu weiyuanhui, 1966), p. 42. For the emphasis on the importance of minted copper cash to small economic transactions in the Chinese economy, see Adachi Keiji, "Shindai zenki ni okeru kokka to zeni [The State and Copper Cash in Early Qing]," *Tōyōshi kenkyū*, Vol. XLIX, No. 4 (March 1991): 47-73. On the measures to mitigate the scarcity of copper cash in the reign of Qianlong (1736-1795), see Kuroda Akinobu, "Kenryū no sentaka [The High Value of Copper Cash in the Reign of Qianlong]," *Tōyōshi kenkyū*, Vol. XLV, No. 4 (March 1987): 692-723.

[216] Hans Ulrich Vogel, "Chinese Central Monetary Policy, 1644-1800," *Late Imperial China*, Vol. 8, No. 2 (December 1987): 1-51.

[217] See the details in Lin Man-houng, "Jiadao qianjian xianxiang chansheng yuanyin 'qianduo qianlie lun' zhi shangque [A study of the falling value of copper cash vis-à-vis silver in the period between 1808 and 1850]," in Zhang Bingcun and Liu Shiji eds., *Zhongguo haiyang fazhanshi lunwenji*, volume 5 (Taipei: Academia Sinica, 1993): 357-426.

Many suggested abandoning the use of silver in public finance, which was equivalent to replacing the silver standard with a copper one. However, recognizing that the low-valued and bulky copper cash was not suitable for interregional trade and wholesaling, especially in a large country like China, they proposed two supplementary measures. One was to mint copper cash with bigger nominal values (*zhudaqian*), such as 5 *wen* (*dangwu*), 10 *wen* (*dangshi*), and even 1000 *wen* (*dangqian*). The other was to issue paper notes denominated in copper cash (*xingchao*) for both public finance and interregional trade.[218] Yet both measures were so controversial that the government was reluctant to implement them. A few officials advocated the minting of a denominated silver currency. Provincial governments in Jiangsu, Fujian, and Zhejiang in the 1830s also experimented with the minting of token silver currency, but it could not compete with the high-quality and well-established Mexican silver dollar which was already widely used in coastal areas in China, and thus it could not circulate in the markets.[219] The third proposal was to seek out new silver mines and to curb silver drainage by prohibiting the opium trade.

Whereas both conversion to a copper standard and the mintage of silver currency represented fundamental changes in the monetary regime, this last approach could be adopted within the existing institutional framework. It is thus not surprising that the Qing government ultimately chose this option. However, the prohibition of the opium trade in the late 1830s triggered the Opium War (1840-42). After China's defeat, the opium trade

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[218] Ye Shichang explicitly points out that in all proposals for issuing paper notes, paper notes were denominated in copper cash rather than in silver. See Ye Shichang, *Yapian zhanzheng qianhou woguo de huobi xueshuo* [The Monetary Theories in China in the Years Before and After the Opium War], p. 39.
[219] Wei Jianyou, *Zhongguo jindai huobishi* [A History of Currency in Early Modern China] (Hefei: Huangshang shushe, 1984), pp. 116-8.

continued and thus both domestic deflation and fiscal crisis persisted throughout the decade. Meanwhile, the search for silver mines was unsuccessful as China is poorly endowed with silver deposits. Inevitably, the attention of government officials and scholars turned again to the question of how to convert to a copper standard, yet no consensus emerged from their debates.[220] The financially exhausted government became increasingly unable to mitigate the rising unemployment, or to provide relief to regions struck by natural disaster. As a result, in 1850 the Taiping Rebellion originated in Guangxi province, where there had been devastating unemployment, and soon escalated into a prolonged civil war.[221]

The onset of three critical events – the Civil War in England in 1642, the Meiji Restoration in 1868, and the Taiping Rebellion in China in 1850 – were turning points for subsequent institutional development in public finance. The ensuing wars provided a window of opportunity for actors in all three cases to put into practice many financial and fiscal measures that had hitherto been merely questions for debate or had existed on the books only. These included the levy of taxes on domestic consumption and the massive issuing of state fiduciary instruments of credit such as bills of short-term borrowing and paper notes. In this sense, these big events initiated the search for new fiscal and financial institutions. How did this search end up with the particular institutions of the modern fiscal state?

IV. Temporal causal mechanisms and the multiplicity of outcomes

[220] Eguchi Hisao, "Ahen sensōgo ni okeru ginka taisaku to sono zasetsu [The Frustration of the proposals in regard to the price of silver after the Opium War]," *Shakai keizai shigaku*, Vol. 42, No. 3 (1976):22-40.
[221] A reference of unemployment and the outbreak of Taiping Rebellion?

From a functional perspective, state actors should embrace the institutions of the modern fiscal state for their potential to extract revenues from millions of ordinary consumers and to achieve economies of scale in using tax revenue to mobilize long-term financial resources. This is, however, a perspective from hindsight. Given the uncertainty involved, contemporary actors did not know what specific institutional arrangements would provide a solid fiscal and financial foundation. They could not even know the distributional effects of new institutional proposals or arrangements. They thus could hardly reach consensus on the specifics of the new institutions in their strategic bargaining.[222] The use of political power per se is not sufficient to dispel such uncertainty. They may mistakenly reject those institutional arrangements that would be ultimately beneficial to their interests in the long run.[223] In this situation, we cannot explain the modern fiscal state as a result of actors' intentional design or strategic bargaining. Nor can we expect a "corporate coherence" to emerge among state actors over the issues of institutional building in public finance when there were quite divergent policy options.[224]

Although the search for new institutions is many ways alike a trial-and-error process, the political actors involved have conflicting ideas, interests, and institutional solutions. Experiments with new institutional arrangements are always complicated by power

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[222] See the discussion of the limits of rational design in the study of institutional dynamics in Paul Pierson, "The Limits of Design: Explaining Institutional Origins and Change," *Governance*, Vol. 13, No. 4 (October 2000), particularly pp. 477-86.

[223] On how politically powerful actors select and strengthen the specific institutional arrangements which are beneficial to their interests, see Jack Knight, *Institutions and Social Conflict* (Cambridge: Cambridge University Press, 1992).

[224] For examples using "corporate coherence" among state actors to explain the emerge of strong states, see Alfred Stepan, *The State and Society: Peru in Comparative Perspective* (Princeton, NJ.: Princeton University Press, 1978) and Ellen K. Trimberger, *Revolution from Above: Military Bureaucrats and Development in Japan, Turkey, Egypt, and Peru* (New Brunswick, NJ.: Transaction Books, 1978).

struggles among actors who hold divergent views not only on the specifics of institutions but also on politics. Obviously, political circumstances do not allow actors to try out and objectively evaluate various institutional arrangements one by one until they find the right solution. There is always a political cost to pay if an experiment in public finance fails, as rivals are waiting for the opportunity to come to power and try their own favored institutional designs. The first movers into institutional experimentation are therefore more likely to fail, thence to be replaced by their rivals.

Beyond the level of individual actors, these institutional experiments were influenced by structural factors in the socio-economic environment – both domestic and international. These included the overall scale of domestic consumption, the composition of various sectors of the domestic economy, and the status of a country in the global economy. They could not be changed or manipulated by actors in the short run, yet they significantly determined the effectiveness of fiscal and financial policies. For example, the degree of concentration in the production and sale of major consumer goods directly affected the administrative costs of collecting taxes on domestic consumption. The more concentrated, the easier to collect. At the same time, the domestic economy also interacted with the international economy. The failure of the English government's recoinage policy in 1697 was due to the higher value of silver overseas, particularly in East Asia. As a result, it was profitable to export the newly minted coins, and silver coins soon disappeared in England, leading to a severe domestic deflation.[225] Likewise, the conversion to the gold standard among major economic powers in the 1870s made silver

[225] J. Keith Horsefield, *British Monetary Experiments: 1650-1710* (Cambridge: Harvard University Press, 1960), pp. 23-61.

flow back to East Asia. The deficiencies of silver by weight as a currency became less apparent in China while making it enormously difficult for the Meiji government to maintain the gold standard adopted in Japan in 1869.

Considering these complex interactions among various factors, we cannot assume that there would be a cumulative learning among the political actors involved in these experiments. For one thing, the political powerful are not necessarily those with better learning capacities. Moreover, it is difficult for actors under conditions of uncertainty to diagnose the real causes of institutional failure. Was failure the outcome of inherent inadequacies in the institutional arrangements? Or was it due to a lack of competent officials to run theoretically sound institutions? Or was it simply a temporary result from the general recession in the economy? When learning is further complicated by power struggles and conflicts of interest among politicians, it is more unlikely for them to reach consensus on what lessons should be learned from previous experiences. In this light, cognitive factors such as ideas among actors are not sufficient to reduce uncertainties in the process of institutional change.

The inadequacies of learning in explaining the direction for subsequent institutional development can be illustrated by the case of Meiji Japan, a paramount example of a "learned modernization." The willingness to learn from the West does not suffice to create a consensus among politicians on what and how to study. This is particularly the case in public finance. From 1868 on, deep disagreements existed among major factions in the Meiji government over the issue of inconvertible paper notes. Various options to solve this problem – each of which implied quite different directions of institutional development – were closely tied to fierce power struggles among these factions. If nothing else, there were quite different banking systems available for study: the decentralized national-banking system in America, the centralized system of note-issuing in England, and the system of universal-banking in Germany and Belgium. This situation was further complicated by power struggles within the government and conflicts between the newly established Meiji regime and society.[226] Learning in the political world is by no means a cumulative and naturalistic process.

In the collection of the indirect taxes upon domestic consumption, as Edgar Kiser has pointed out, there is a severe information-asymmetry problem between the central government as the principal and the officials who work as "agents" for the state in collecting indirect taxes.[227] How could the central government monitor tax collection efficiently so as to ensure that the collected revenues flowed to the center? As the center did not have the institutions to estimate accurately the scale of domestic consumption, it is difficult for them to evaluate the performance of collecting officials. If the central government cannot determine the potential yield of domestic consumption, it can hardly press its collecting officials for more revenue. At the same time, the agents (either officials or tax farmers) who collect the indirect taxes on consumption would not reveal

[226] Even D. Eleanor Westney, who has emphasized the interaction between the imported Western organizations and the Japanese environment, pays inadequate attention to the politics involved in this process. See D. Eleanor Westney, *Imitation and Innovation: The Transfer of Western Organizational Patterns to Meiji Japan* (Cambridge, MA.: Harvard University Press, 1987).
[227] Edgar Kiser, "Markets and Hierarchies in Early Modern Tax Systems: A Principal-Agent Analysis," *Politics and Society*, Vol. 22, No. 3 (September 1994): 284-315.

their "private information" about the potential yield to the central government as they could make profits by taking advantage of this information asymmetry.

Thus, neither the actor-centered mechanism nor the learning effect is adequate to explain the rise of the modern fiscal state. Indeed, we must recognize that the interactions among actors, institutional arrangements, and the socio-economic structure generate endogenously a multiplicity of possible outcomes in the process of searching for new institutions in public finance. In this light, the rise of the modern fiscal state is simply one possible outcome rather than the inevitable one. Any causal mechanism to explain the rise of the modern fiscal state as the eventual outcome thus has to avoid both determinism and indeterminacy. If we take the observed eventual outcome – either the rise of the modern fiscal state or not – as given, and neglect other possible outcomes, our efforts to identify a causal mechanism may suffer from a selection bias. Nonetheless, if all the possible outcomes have the same probability to occur, then we will have no causal account but merely a throw of the dice. What is at issue is whether we can uncover a causal mechanism which can reduce the degree of uncertainty over time and thus increase the likelihood of the emergence of the modern fiscal state.

Causal mechanisms based on sequences and timing are inadequate to explain the specific outcome of the modern fiscal state through highly interactive processes. Given the multiplicity of possible outcomes, sequence-based temporal mechanisms beg the question of why one particular sequence is causally more important than other possible sequences which yield other outcomes. In the studies of the "inherent sequentiality" of a tightly linked sequence of events, the observed sequence turns out to be caused by the mechanism of reproduction based upon the use of political power.[228] Meanwhile, a particular reactive sequence of events can hardly maintain itself over a long duration. For example, an attack by one country would definitely trigger a reactive event from the country being attacked. Yet as the war goes on, there will be a range of strategic considerations and policy options and thus multiple possible event-sequences. In this sense, neither the use of political power nor wars are sufficient conditions for the creation of effective institutions of public finance. Wars may exert pressure on state actors to increase tax revenue, yet they could also destroy the domestic economy and disrupt foreign trade, making it more difficult to extract revenues and raise credit. A politically and militarily powerful government may quickly collapse if it lacks the fiscal revenues to support its seemingly mighty military machine.

In regard to timing in institutional change and development, it is important to distinguish two kinds. If actors intentionally choose the moment of action, then timing is simply a derivative of actors' strategic calculations, i.e., to seize the opportunity. As I have pointed out, strategic calculation is not helpful under conditions of huge uncertainty. The other kind of timing is essentially a structural constraint upon actors, but it does not dictate how actors respond. The timing in Gerschenkron's theory of late industrialization is such an example. Well-established steam-powered big industry in the nineteenth century did not preclude the viability of alternative ways of industrial development for

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[228] See the discussion of the sequence of causally linked events in James Mahoney, "Path dependence in historical sociology," pp. 526-32 and Paul Pierson, "Not Just What, but When: Timing and Sequence in Political Process," *Studies in American Political Development*, Vol. 14 No. 1 (Spring 2000), pp. 84-89;

various late-industrializing countries or regions.[229] Likewise, the timing of participation in the European geographical struggles that Thomas Ertman uses to explain the development of bureaucracy in public finance is similar to a structural constraint. What is at issue for Ertman is not timing per se but whether previous development in education and finance had prepared a pool of competent and well-educated financial officials from which the state could draw. Countries that became involved in the geographic struggles before the availability of such a pool (e.g., before 1450) had to rely on patrimonial practices such as "proprietary officeholders, tax-farmers, and officeholder-financiers" to meet the state's fiscal needs.[230] Yet the causal effects of timing in Ertman's theory are not salient to the rise of the modern fiscal state. England's early entry into geographical struggles (from the 1100s to 1480s) did not prevent the emergence of bureaucracy in public finance after 1683. In both late Qing China and late Tokugawa Japan, the development of education and of a market economy also supplied the state with officials who were competent in administrative and financial affairs.[231]

The common feature of the evolutionary and the path-dependent approaches in studying socio-economic change is that they take into account uncertainty and contingency. Both try to explain how a specific outcome unpredictable by rational actors *ex ante* would

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[229] Alexander Gerschenkron, "Economic Backwardness in Historical Perspective," in Alexander Gerschenkron, *Economic Backwardness in Historical Perspective* (Cambridge: Harvard University Press, 1962). For various alternative ways of industrial development other than that of relying upon steam-powered big industry in nineteenth-century Europe, see Rondo Cameron, "A New View of European Industrialization," *Economic History Review*, Vol. 38, Issue 1 (February 1985): 1-23; Patrick. K. O'Brien, "Do We Have a Typology for the Study of European Industrialization in the XIXth Century?" *Journal of European Economic History*, Vol. 15, No. 2 (Fall 1986): especially pp. 304-23; Charles Sabel and Jonathan Zeitlin, "Historical Alternatives To Mass Production: Politics, Markets and Technology in Nineteenth Century Industrialization," *Past and Present*, 108 (1985): 134-76.

[230] Thomas Ertman, *Birth of the Leviathan*, p. 28.

[231] In both Japan and China, the statecraft scholarship school (*jingshi* in Chinese and *keisei* in Japanese), which studied various practical issues relevant to governance, administration, and public finance, had been highly influential since the eighteenth century.

emerge eventually through a process characterized by a multiplicity of possible outcomes in the initial stages. Nevertheless, the evolutionary theory is not appropriate to the study of the rise of the modern fiscal state. The world of politics does not have a competition mechanism as strong as that found in a free market economy to select the "efficient" or "optimal" institutional arrangement.[232] Moreover, the evolutionary approach rests upon one important pre-condition, i.e., the existence of a big pool of trials so that a large number of "variations" is available simultaneously for the "selection mechanism" to choose ex post facto the potentially optimal variant (e.g., a product, a technology, an organizational form, etc.).[233] However, within one country, it is impossible to have different groups of actors experimenting with a large number of institutional arrangements in public finance at the same time.

The theory of path dependence aims to integrate into one unified explanation both contingency and multiple possible outcomes at the initial stage and irreversibility at the later stage toward an eventual outcome which is unpredictable *ex ante.*[234] The mechanisms in the path-dependent process include increasing returns, externalities (positive or negative), complementary effects (or self-reinforcement), and lock-in.[235]

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[232] Paul Pierson, "The Limits of Design: Explaining Institutional Origins and Change," pp. 486-8.
[233] For a review of the evolutionary theory of economic and technological changes, see Richard R. Nelson, "Recent Evolutionary Theorizing about Economic Change," *Journal of Economic Literature*, Vol. 33, No. 1 (March 1995): 48-90.
[234] See the emphasis on the importance of the theory of path-dependence to the study of social and political change in Paul Pierson, "Increasing Returns, Path Dependence, and the Study of Politics," *American Political Science Review*, Vol. 94, No. 2 (June 2000): 251-67; James Mahoney, "Path dependence in historical sociology," *Theory and Society*, Vol. 29 (2000): 507-48 and Jack A. Goldstone, "Initial Conditions, General Laws, Path Dependence, and Explanation in Historical Sociology," *American Journal of Sociology*, Vol. 104, No. 3 (November 1998): 829-45.
[235] Regarding the generic features of path-dependent processes, see W. Brian Arthur, *Increasing Returns and Path Dependence in the Economy* (Ann Arbor: The University of Michigan Press, 1994) and Paul A. David, "Clio and the Economics of QWERTY," *American Economic Review*, Vol. 75, No. 2 (May 1985):

Note that a path-dependent process is a "branching process" which has a multiplicity of equilibria. In the initial stages, one cannot know which equilibrium is to be dominant in future. In this sense, the path-dependent explanation is tightly coupled with a counterfactual argument of "what might have happened" in the event of other possible outcomes, i.e., alternative paths that the process might have taken.[236]

Yet the theory of path dependence does not tell us how to get from the initial multiplicity and uncertainty to that "damned point," after which the path moves irreversibly toward a specific outcome. Although the effects of small accidents or disturbances in the earlier stage may be amplified by a path-dependent mechanism, we cannot tell *ex ante* which small event will trigger a particular path as the path-dependent process is a non-deterministic dynamic process.[237] In this sense, the path-dependent mechanisms are only necessary rather than sufficient conditions for the eventual observed outcome. Its explanatory power is not retrospective to the early stage of socio-economic change when it is still open to various possible outcomes. As actors cannot foresee the subsequent effects of path-dependent mechanisms, they cannot realize ahead of time the "criticalness" of the moment when a path begins toward move toward one possible outcome. For example, few competitors would have realized that the introduction of the

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332-7. The four causes of path dependence are cited from Scott Page, "Path Dependence," *Quarterly Journal of Political Science*, Vol. 1, No. 1 (2006), p. 88.

[236] For discussion of the counterfactual nature of a path-dependent explanation, see R. Cowan and P. Gunby, "Sprayed to death: path dependence, lock-in, and pest control strategies," p. 521. The counterfactual argument in path dependence is similar to what the historian John L. Gaddis calls the "plausible counterfactual arguments" which "would have seemed feasible to decision-makers at the time." On the use of counterfactual argument in historical study, see John L. Gaddis, *The Landscape of History: How Historians Map the Past* (New York: Oxford University Press, 2002), p. 102.

[237] On the non-deterministic nature of path-dependent process and its implications to policy-making, see Paul A. David, "Path dependence, its critics and the quest for 'historical economics'," in P. Garrouste and S. Ioannides, eds., *Evolution and Path Dependence in Economic Ideas: Past and Present* (Cheltenham: Edward Elgar Publishing, 2001), pp. 20-21 and p. 31; Scott Page, "Path Dependence," p. 91 and p. 102.

DOS system or the QWERTY keyboard to the market was a momentous event. And when they did realize, it was often too late to reverse the effect of externalities which had helped establish the dominance of the two technologies. It is thus an error to conflate the theory of critical junctures with path dependence.[238]

Meanwhile, claims that a path-dependent process is approaching irreversibly toward or is "locked" in one particular equilibrium can be falsified if the process is swamped or disrupted by external shocks (e.g. new innovation or foreign invasion). Paul David thus points out that one important precondition in the study of a path-dependent process is that it should remain "structurally unperturbed."[239] For example, a state of "lock-in" in technology such as the keyboard layout or the use of chemical pesticides may be mainly due to the absence of superior alternatives, and not to the fact that the path-dependent mechanism prevents a switch to an already proved better alternative.[240] The precondition is implicitly assumed in the theoretical discussion of path dependence. However, it is often violated when we apply the theory of path dependence to specific contexts of institutional change in the real world.[241]

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[238] See such examples of conflation in James Mahoney, *The Legacies of Liberalism: Path Dependence and Political Regimes in Central America* (Baltimore: The Johns Hopkins University Press, 2001), p. 6-7; Juliet Johnson, "'Past' Dependence or Path Contingency? Institutional Design in Postcommunist Financial Systems," in Grzegorz Ekiert and Stephen E. Hanson, eds., *Capitalism and Democracy in Central and Eastern Europe* (Cambridge: Cambridge University Press, 2003), p. 291; and Terry L. Karl, *The Paradox of Plenty*, p. 197.

[239] Paul A. David, "Why are institutions the 'carriers of history'?: path dependence and the evolution of conventions, organizations and institutions," *Structural Change and Economic Dynamics*, Vol. 5, No. 2 (1994), p. 208.

[240] For the story of keyboard layout, see S. J. Liebowitz and S. E. Margolis, "The Fable of the Keys," *Journal of Law and Economics*, Vol. 33, No. 1 (April 1990): 1-26. See the case of chemical pesticides in R. Cowan and P. Gunby, "Sprayed to death: path dependence, lock-in, and pest control strategies," *Economic Journal*, Vol. 106, No. 436 (May 1996): 521-42.

[241] Paul Pierson has already noted this in his discussion of the relative status of "lock-in." Yet he fails to realize that the same point also applies to the early stage of the path-dependent process, which makes the

Applying the notion of path dependence to socio-economic change in general and institutional development in particular involves dealing with the initial indeterminacy among multiple possible outcomes. In the study of socio-political change, Paul Pierson has identified four sources of increasing returns or positive feedbacks, i.e., the large start-up costs in collective action; actors' investment in acquiring specific skills encouraged by tightly complementary institutions; the use of political power which strengthens a specific pattern of power-distribution in society; and the resilience of existing institutions.[242] In his view, a path-dependent explanation still helps us understand *ex post*, if not predict *ex ante*, the specific outcome, even though it only provides us a necessary rather than sufficient causal account.[243] Gerard Alexander also observes the indeterminacy in path-dependent explanations. He comments that the possible sources of path dependence such as institutional density, large set-up costs, coordination effects, and adaptive expectations, do not suffice to cause an irreversible path toward the consolidation of certain institutions in the early stage of democratic consolidation. At that point, it is still possible for political actors to actively compete to modify the institutional arrangements to advance their respective interests.[244]

"irreversibility" of a path problematic in empirical studies. See Paul Pierson, "Increasing Returns, Path Dependence, and the Study of Politics," p. 265.

[242] Paul Pierson, "Increasing Returns, Path Dependence, and the Study of Politics," pp. 257-63. For further discussion of "asset specificity" as a source of path-dependence where existing institutions shape the evaluation of other institutional alternatives among political actors, see Paul Pierson, *Politics in Time*, p. 148.

[243] Paul Pierson, "Increasing Returns, Path Dependence, and the Study of Politics," p. 256.

[244] See Gerard Alexander, "Institutions, Path-dependence, and Democratic Consolidation," *Journal of Theoretical Politics*, Vol. 13, No. 3 (2001), pp. 257-60.

In response to the problem of indeterminacy in the initial stages of socio-economic change, Jeffrey Haydu argues that reiterated problem solving may provide the needed causal linkage between events in different time periods when a common problem forces different, and even rival, actors to come up with solutions to the problem.[245] Nonetheless, Haydu does not lay out why and how a problem becomes a common one for actors with quite different interests, ideas, and political agendas. Moreover, his examples include some very general social issues such as the conflict between the employer and union, labor mobility, poverty, and so on. We cannot expect solutions to these general problems to necessarily converge upon one particular direction of institutional development. Instead, any solution may simply generate divergent directions of future problems, which implies a multiplicity of institutional outcomes.

V. A model of institutional learning as the temporal causal mechanism to explain the rise of the modern fiscal state

In order to identify a temporal causal mechanism to account for the emergence of the modern fiscal state, I go back to the generic character of the path-dependent process, i.e., the probability distribution of the eventual outcome is dependent upon previous events through time. Douglass North has argued that in an historical process which has many choices at every step and in which each choice represents a real alternative, path dependence "is a way to narrow conceptually the choice set and link decision making through time."[246] In such a path-dependent process of institutional change, we should

[245] Jeffrey Haydu, "Making Use of the Past: Time Periods as Cases to Compare and as Sequences of Problem Solving," *American Journal of Sociology*, Vol. 104, Issue 2 (September 1998), particularly pp. 353-9.
[246] Cited from Douglass C. North, *Institutions, Institutional Change and Economic Performance*, p. 98.

observe increasing interconnections between formal institutions and actors' behavioral patterns and cognitive frameworks through time.[247]

In order to apply path dependence to the study of institutional change, we need to figure out the complete set of choices that are available to the actors in their original contexts: not only those that they choose but also those over which they have deliberated carefully and which thus represented real policy options. As I have argued in section III, the temporal causal mechanism for the rise of the modern fiscal state is unlikely to originate prior to the critical events, i.e., 1642 for England, 1868 for Japan, and 1850 for China. Meanwhile, in the initial stages of the critical events, we can expect to see one common development in public finance across all three cases. This is the rising importance of revenues from previously under-taxed sources, especially taxes on domestic consumption. In contrast, the revenues from the taxes which had proved administratively or politically difficult to collect in the past, such as the land tax or the tax upon property and income, would remain inelastic. State actors desperate for revenue should quickly find new elastic items to tax.

It is more difficult, however, to explain the emergence of centralized institutions in collecting the indirect taxes on domestic consumption and the customs duties. As discussed above, the effectiveness of new fiscal or financial institutions depends significantly upon socio-economic structures largely beyond actors' control. For example, the ability of the state to centralize the collection of indirect taxes upon

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[247] See the emphasis on this point in Scott Page, "Path Dependence," p. 89 and Douglass C. North, "Five Propositions about Institutional Change," in Jack Knight and Itai Sened, eds., *Explaining Social Institutions* (Ann Arbor: The University of Michigan Press, 1995), p. 25.

domestic consumption is closely connected with the scale and the degree of concentration of the consumption sectors in the economy. The more concentrated the production and sale of major consumer goods, the less costly for the state to centrally collect as it only needs to supervise a limited number of big producers and wholesalers, usually in urban areas. The state may deliberately encourage the formation of monopolistic wholesalers or producers with an eye to reducing the cost of tax collection. In so doing, the state basically divides the monopolistic profit with these large-scale producers or wholesalers. Nonetheless, the effectiveness of such a policy depends significantly upon the nature of the production and sale of the consumer goods. The easier it is for small producers or retailers to evade the barrier of entry, the more difficult it is for the state to promote monopolies to facilitate tax collection.

In this light, factors such as the use of political power, the start-up costs in setting up certain new institutional arrangements, and the actors' investment in acquiring skills specific to new institutional arrangements are not sufficient to push institutional development toward centralization. Instead, the first or earlier movers in the process of institutional experimentation may encounter a high probability of failure, rather than the "advantage of first mover," and thus have to leave the political stage or lose power. Not surprisingly, there should be a strong risk-averse disposition among state actors; they are unlikely to implement new institutions in public finance unless they have no other option. Therefore, we shall not assume that actors are always motivated to keep searching for and experimenting with new institutional arrangements until they establish the institutions of the modern fiscal state.

Moreover, we shall not take for granted that the complementary effects in various institutional arrangements in public finance would necessarily generate a self-reinforcing mechanism toward the modern fiscal state. In the initial stages, actors are unlikely to simultaneously implement institutional arrangements that would immediately reinforce each other. As a result, an important institutional innovation may seem ineffective due to the absence of complementary institutional elements. For example, there can be a mutually reinforcing relationship between the state's long-term borrowing and its tax institutions. In order to safeguard the state's creditworthiness, state actors may try hard to ensure reliability in the collection of tax revenues. Reliable tax revenues in turn boost creditors' confidence in the state's long-term borrowing, which attracts more subscribers for the state-issued bonds. Nevertheless, the process can easily go in the opposite direction. The lack of reliable tax revenue may undermine creditors' confidence in newly introduced credit instruments of long-term borrowing; the ensuing poor performance may make state actors doubt the feasibility of long-term borrowing. Such a failed experiment could then remove the motivation to make the collection of tax revenue more reliable. A vicious cycle thus replaces a potentially virtuous cycle.

In this dissertation, I examine what factors after these critical events could have long-lasting effects on subsequent institutional development and make actors keep searching for centralizing institutions in public finance, in spite of divergent political agendas and power struggles. In particular, my strategy is to explore events which are exogenous to subsequent institutional development in public finance yet which may force the actors' efforts towards a certain specific direction. In this sense, these events do not result from actors' intentions to build their preferred institutional arrangements. These events can be small or big, domestic or international, one single event or a chain of tightly connected events. Yet they share one common feature, i.e., they produce a huge credit crisis for the state that is caused by an enormous issue of state fiduciary credit instruments – bills of short-term borrowing or paper notes – to meet urgent spending.

The credit crisis, whose origin is exogenous to subsequent institution development, brings the central government to the brink of bankruptcy. It thus constitutes a pressing problem which must be solved, regardless of which political actors come to power. It imposes a relatively "hard criterion" upon institutional experiments. As overcoming the credit crisis becomes a common agenda for state actors across political camps, it acts as a *de facto* selection mechanism which is not frequently observed in the complex and opaque political world. In its absence, political actors would have more chance to manipulate solutions to suit ideological agendas.[248] Given this shared problem, different groups of state actors would have strong incentives to preserve any effective institutional arrangements left by their predecessors, along with key personnel who have demonstrated their expertise in running these new institutional arrangements. The credit crisis thus exerts long-lasting effects on subsequent institutional development.

Meanwhile, the central government which issued the credit instruments now bears all the financial risk of redeeming them. It cannot simply pass the responsibility to local

[248] See the discussion of the lack of a selection mechanism that is based upon competition or efficiency-enhancement in Paul Pierson, "Increasing Returns, Path Dependence, and the Study of Politics," p.261.

governments. This situation thus changes the risk distribution between the center as the principal and local governments and the collectors of tax revenues (either tax farmers or officials) as its "agents." This forces the center to centralize tax collection so as to minimize its own risk. In this light, the credit crisis provides one means to break the "lock-in" of fiscal decentralization and overcome the uncertainty and indeterminacy of the early stage of institutional change.

The institutional development induced by the credit crisis resembles a "learning process without an agent." Effective institutional arrangements are preserved and accumulate over time. Competent officials in public finance are separated out from those who know little about financial issues. As state actors, regardless of their individual political standpoints, grappled with the same credit crisis, officials in public finance can learn lessons from both their own experiences and from the policy mistakes of their political rivals. This process is also institutional as a new framework comes into being when accumulated elements begin to reinforce each other. This process of institutional learning leads to the emergence of a modern fiscal state, an outcome not anticipated by any political actors prior to the credit crisis. Socio-economic circumstances in turn are necessary conditions to sustain this process by which actors under the pressure of the credit crisis experiment with various institutional arrangements until effective ones accumulate into a mutually reinforcing system. Instead of appealing to any single factor such as ideas, or interest calculations, the model of institutional learning relies upon the accumulation of effective institutional arrangements and competent officials in public finance over time that gradually reduces the uncertainty in the process.

When it becomes apparent that the accumulated institutional arrangements can overcome the credit crisis, state actors turn their efforts to consolidating the emerging institutions. In this case, reliable tax revenues sustain the creditworthiness of the state's long-term borrowing or paper notes, and state actors in turn strengthen the management of centralized tax institutions. In the process of consolidation, state actors become more confident in the newly established institutions of the modern fiscal state. The consolidation of the modern fiscal state is by no means followed by a long period of institutional stasis as suggested in the "punctuated equilibrium" model of institutional change.[249] As new social and political environments alter existing political coalitions and power distributions, political actors actively contest both the normative implications and functional forms of these institutions.[250] In the case of public finance, political actors constantly struggle over the fairness of the tax burden and the purpose of government spending, over the form of specific institutional components and the substance of policies. However, these continuous and incremental changes do not compromise the core feature of the modern fiscal state: the institutional linkage between tax revenues and the state's long-term involvement in the financial markets.

In the following chapters, I explore through empirical studies how the conjunction of a severe credit crisis with an appropriate set of socio-economic circumstances work together to allow the unfolding of an institutional learning process over time. In the three

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[249] Stephen D. Krasner, "Approaches to the State: Alternative Conceptions and Historical Dynamics," *Comparative Politics*, Vol. 16, No. 2 (January 1984), pp. 242-3.

[250] See the discussion of the political nature of institutional change in Kathleen Thelen, *How Institutions Evolve: The Political Economy of Skills in Germany, Britain, the United States, and Japan* (Cambridge: Cambridge University Press, 2004), pp. 31-33.

instances, decentralization and centralization are two major possible institutional outcomes. Nonetheless, in the case of England (1642-1757), two credit crises caused by excessive issuing of short-term credit instruments in 1665-1672 and 1689-1713 forced state actors to search for alternative centralized institutions. Both credit crises were unintended consequences of war. In the former case, England fought against Holland even though the fiscally unprepared English government did not intend to fight. In the latter case, the two almost consecutive wars with France turned out unexpectedly expensive and prolonged. Yet the redemption of the credit instruments constituted a common problem for state actors. Socio-economic circumstances, particularly the central position of London in the English economy and the under-development of domestic financial networks in this period, significantly affected state actors' efforts to convert short-term credits into long-term liabilities. Instead of turning them into banknotes floating in the whole economy, an option that actors explicitly considered in the late 1710s, the English government converted them into low-interest stocks of perpetual annuities.

In the case of Japan (1868-1895), the credit crisis originated from the issue of non-convertible paper notes to fund the military campaigns of the Meiji Restoration in 1868. As the new Meiji government had to meet huge spending needs before it established institutions to collect taxes, it had no option but to continue its reliance upon the de facto non-convertible paper notes. The Japanese government's decision to adopt the gold standard in 1871 ended up exacerbating the credit crisis due to the rise of the value of gold in international markets after the mid-1870s. The convertibility of paper notes thus constituted a pressing problem for state actors to solve. The vibrant economy and the development of domestic financial networks in Japan turned the direction of institutional development toward how to safeguard the value of the paper notes already floating in the economy.

The case of China (1850-1911) illustrates the consequence of the lack of an institutional learning process. When the Qing government issued paper notes in 1853 to cover its huge fiscal deficit, the Chinese economy was suffering from a highly destructive civil war. The disrupted domestic economy and inter-regional financial networks could not support institution building which aimed to promote the circulation of paper notes in the economy. The failure of the experiment of paper notes in the 1850s made state actors reluctant to try to introduce the use of credit instruments in public finance even when the domestic economy and inter-regional financial networks not only recovered but also expanded in the 1870s and 1880s. The absence of a credit crisis in this period contributed significantly to the persistence of the traditional fiscal state and its decentralized institutions. Using the indemnity to Japan in 1895 as a proxy for a credit crisis on the center, I examine institutional developments after 1895 and discuss why the modern fiscal state is a possible institutional outcome.

Chapter 3 Events, Socio-economic conditions, and Institutional learning in England's Path toward a Modern Fiscal State: 1642-1752

I. Introduction

In England's transformation into a modern fiscal state between 1642 and 1752, we can discern a clear sequence in which previous institutional achievements provided a basis for subsequent institutional development. A fiscal state that rested upon the customs, the monthly assessment (the predecessor of the land tax in 1692), and excises became firmly established after the English Civil Wars (1642-1652). In the Restoration period (1660-1688), the management of the income and spending of the royal government became more centralized, and the royal government established centralized institutions to collect the customs in 1672 and excises on liquors in 1683. In fighting the Nine Years War (1688-1697) and the War of the Spanish Succession (1702-1713), the English government came to increasingly depend upon long-term borrowing funded by tax revenue, particularly those collected from the indirect excises and customs. As the economic historian Larry Neal has pointed out, after the English government in the 1720s established the creditworthiness of its perpetual annuities in the markets, it began to experience the "joys of debt financing"; the pressure to serve the ever-increasing debt by punctual semi-annual interest payments forced it to ensure efficient revenue collection from indirect taxes. From then on, in Neal's view, the path toward the dominance of stocks of perpetual annuities at 3 percent, the famous system of "3 percent Consol," became ineluctable.[251]

By the 1750s, the institutions of the modern fiscal state had consolidated. They were characterized by the state's institutional ability to extract elastic and reliable revenues from the indirect customs and excises to service regular interest payments of low-interest perpetual annuities. The stocks of perpetual annuities were also highly liquid assets which could be freely transferred in the securities markets. Liquidity and punctual interest payments made them an ideal investment for ordinary investors in both England and abroad, including professionals, middle-class women, and landed gentry.[252] The Bank of England efficiently managed the transfer of and interest payments on the issued stocks of perpetual annuities. These institutions significantly mitigated conflicts of interest between land owners and the government and between land owners and the monied class as the landed wealth did not bear the increasing burden of taxation. The collective action problem undermined the resistance of ordinary consumers to the rising excise rates on major consumer goods such as beer, ale, candle, soap, and so on. Internationally, the enhanced financial capacities of the English state contributed to its rise as the great power in the early nineteenth century. Domestically, they allowed the executive branch to build up widespread networks of political patronage and use lucrative sinecures and pensions to manipulate Members of Parliament. These factors led to a

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[251] Larry Neal, "The monetary, financial, and political architecture of Europe, 1648-1815," in Leandro Prados de la Escosura, ed., *Exceptionalism and Industrialization: Britain and Its European Rivals, 1688-1815* (Cambridge: Cambridge University Press, 2004), pp. 180-1.

[252] For the emphasis on these two features of the English government's redeemable annuities, see Larry Neal, "The finance of business during the industrial revolution," in Roderick Floud and D. N. McCloskey, eds., *The Economic History of Britain Since 1700*, volume I, second edition (Cambridge: Cambridge University Press, 1992), p. 165 and pp. 172-3.

stable oligarchic regime rife with corruption in the second half of the eighteenth century.[253]

But how did institutional development in public finance reach that "damned point" of the 1720s, after which the path toward the modern fiscal state became ineluctable? Why did the self-reinforcing process between reliable and elastic receipts from indirect taxes and punctual interest payments on the government's market-based system of long-term borrowing not appear earlier? For example, why did not it emerge during the Interregnum (1649-1660) when the English government extracted domestic taxes, borrowed short-term loans and fought not only colonial wars in Scotland and Ireland but also international wars with Holland and Spain? Given that the collection of the customs and excises had become efficient and centrally managed before 1688, why was the system of long-term borrowing not established before the 1720s? When we consider the contribution of the institutions of the modern fiscal state to the spending capacity of the state and their distributional effects, resistance by political powerful land owners will not explain the "delay" in the establishment of the modern fiscal state in England. Why, then, did political elites in England not establish these institutions earlier?

These questions remind us that we must not take for granted a sequence that becomes apparent only in hindsight. It is far from self-evident to actors in the process of

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[253] For the discussion of the relationship between the state's financial capacities and the stable oligarchy in England after the 1730s, see J. H. Plumb, *The Growth of Political Stability in England, 1675-1725* (London: Macmillan, 1967); Geoffrey Holmes and Daniel Szechi, *The Age of Oligarchy: Pre-industrial Britain 1722-1783* (London: Longman, 1993). The severity of "Old Corruption" over the course of the eighteenth century is illustrated by the large proportion of professionals and bureaucrats among the rich in Britain in the early nineteenth century. See W. D. Rubinstein, "The End of 'Old Corruption' in Britain 1780-1860," *Past and Present*, No. 101 (November 1983), pp. 55-6.

institutional development, who cannot know *ex ante* the functions and distributional effects of institutions yet to be created. When we move with historical actors through this process, the eventual outcome of a modern fiscal state ceases to be inevitable and several other possible outcomes emerge. Take fiscal centralization as an example. Centralization in public finance appeared in the early 1650s, but it did not continue to develop. Instead, in the early years of the Restoration period, the degree of fiscal decentralization resembled that of the early Stuart period (1603-1642) and the government relied upon tax farmers for both the collection of its ordinary revenues and for short-term credit. This situation could have been a "lock-in" equilibrium. Inability to directly collect revenues made it difficult for the royal government to establish its credibility in the financial markets, which forced it to rely upon tax farmers for credit. Meanwhile, in a country which had not established institutions of long-term borrowing and where the idea of a debt-free state remained deep-rooted, the prospect of a state with massive perpetual debt seemed quite remote to most political actors. As a result, instead becoming dominant during the Nine Years War or even earlier, long-term borrowing began to grow only in the War of the Spanish Succession. Meanwhile, the perpetual annuities which came to dominate the English government's long-term borrowing did not fully secure the confidence of creditors until the 1720s.

Given the stickiness of existing institutions and their impact on actors' belief, behavior, and cognitive capacity, actors do not easily jettison them for some unknown alternative institutions. In this situation, exogenous shocks are necessary to break "lock-in" situations such as fiscal decentralization and dependence upon tax farming. Nonetheless, the collapse of existing institutions does not automatically indicate a definite direction of future institutional development for actors. In a process of institutional development which has multiple possible outcomes, exogenous shocks that upset the previous "lock-in" equilibrium will not necessarily exert long-lasting effects which force actors to search for alternative institutions in a specific direction. For example, international wars may compel state actors to search for institutions that can extract more revenue and borrow more money. Nonetheless, the protection of the English Channel made it possible for England to withdraw from expensive power struggles in Continental Europe. Instead of rising military spending necessarily pushing actors to search for new institutions, fiscal decentralization or inadequate financial ability could simply have led political actors in England to avoid expensive international wars. In regard to the self-reinforcing process between centrally collected revenue and the increasing amount of long-term borrowing, it is equally possible at the initial stages for unreliable or insufficient tax revenues to *reduce* the confidence of creditors in the government's long-term borrowing. The ensuing difficulty in raising long-term credits would reduce the pressure on government to reform its institutions of tax collection. A self-reinforcing process can turn out to be either a virtuous or a vicious cycle.

How shall we explain the eventual outcome of the modern fiscal state in England in the 1750s out of a historical process which was rife with multiple possibilities, contingencies, and uncertainties? In this chapter, I explore how two credit crises triggered a process of institutional learning which led to fiscal centralization and ultimately to the outcome of a modern fiscal state. The two credit crises were associated with international wars but the nature of the crisis was not determined by war per se. The common feature that defines the two credit crises is the state's dependence upon credit instruments that it created to meet its spending needs. Such a credit crisis is thus different from an economic crisis or a general fiscal crisis characterized by huge deficits. One credit crisis happened between 1666 and 1672 when the government depended heavily upon the fictitious Treasury Orders, a credit instrument of short-term borrowing when the government did not received any actual lending. The other resulted from the accumulation of massive debts during the two consecutive expensive wars, the Nine Years War (1689-1697) and the War of the Spanish Succession (1702-1713). They included both unfunded debts in the form of tallies, exchequer bills, and bills issued by the army and navy to cover their deficits, and funded loans bearing high interest rates.

Both crises were exogenous to subsequent institutional development as they were unintended consequences of events which were out of the control of actors. However, the redemption of the issued credit instruments constituted a pressing problem that had to be solved, no matter which political factions came to power. They thus initiated a process of institutional learning in which actors experimented with various institutional elements to solve the problem; hence, effective institutional blocks, useful experiences in managing public finance, and competent officials were preserved. The end result was a new set of institutions: the centralized management in the collection and spending of the crown's ordinary revenue, the establishment of centralized bureaucracies in collecting the customs (1672) and excises (1683), and the forging of an institutional linkage between indirect taxes and punctual interest payments on the state's perpetual debts in the 1720s. The model of institutional learning triggered by exogenous factors thus contains endogenous factors which can explain the timing of the emergence of new institutions.

Socio-economic conditions between the 1640s and 1750s significantly shaped the process of institutional development in public finance. These conditions included the dominance of London in the English economy and the financial markets, the concentration of wealth in London and its surrounding regions, and the increasing scale of production of major consumer goods such as beer. Actors involved in institutional development could not "manipulate" these conditions according to their institutional preferences or blueprints. Yet these socio-economic conditions affected the feasibility of the English government's floating of credit instruments such as tallies and exchequer bills and influenced the institutional development of centralization in fiscal operation. In particular, the geographic distribution of England's financial networks, which were overwhelmingly concentrated in London and its environs in this period, determined the specific outcome of institutional development in the direction of perpetual borrowing instead of the issuing of paper notes for the domestic economy.

This chapter proceeds as follows. In section II, I examine the fluid process of institutional development in public finance between 1642 and 1688, which was characterized by fluctuations between centralized direct tax collection and tax farming. Distributional politics significantly affected the stability of various institutions with which the government experimented from 1642 to 1660, when fiscal decentralization came to replace the centralized institutions which had emerged in the early 1650s. I then explore the institutional learning process triggered by the massive issue of fictitious Treasury Orders and analyze its contribution to the centralized management of the royal government's ordinary revenue and the establishment of the central collection of the customs and excises. In particular, I analyze the development of central collection of excises and how the Excise Department overcame the information asymmetry problem in monitoring collection in the 1680s.

In section III, I examine the institutional learning process triggered by the credit crisis which arose from debts accumulated between 1689 and 1713. I argue that the political conflicts between the Whigs and Tories did not affect the continuous accumulation of effective institutional elements, experience, and competent officials in the government. In particular, I argue that there were two different directions of institutional development available after 1713 by which the state could have sought to overcome the crisis. One was to turn unfunded short-term debt into long-term liabilities; the other was the issuing of paper notes, as embodied in the banknotes issued by the Bank of England. Between 1713 and 1720, the combined effects of the government's dependence upon private corporations to solve its debt problem and the political and financial difficulties involved in circulating the banknotes throughout England rather than only in London significantly affected subsequent institutional development. As a result, the path of building institutional linkages between the state's tax revenue and its perpetual redeemable annuities became dominant; the path represented by paper notes was abandoned. Section IV concludes.

II. Credit crisis and the path toward fiscal centralization: 1642-1688

The decade of the English Civil Wars (1642-1652) was a period of great fiscal experimentation. After the outbreak of hostilities, both the king and the Long Parliament felt the same pressure to raise money to fight. Despite their political differences, both sides adopted similar fiscal expedients such as the sequestration of enemies' property, borrowing, and the levy of excises. Military urgencies forced the Long Parliament to impose two new taxes in 1643, the excise and the weekly assessment.[254] The weekly assessment was a direct tax which was imposed upon the property and income of each county and town with fixed quotas. In 1646, it became the monthly assessment. In the period between 1646 and 1654, the Parliamentary government sold the land confiscated from the crown, the Royalists, the bishops, the deans, and the chapters to clear its debts to creditors and the arrears of payment to soldiers and officers.[255] In consequence, a fiscal state emerged in England in the 1650s which derived its income from revenues collected from the customs, excises, and the monthly assessment.[256]

Important changes occurred in fiscal management as the Parliamentary government centralized the management of its income and expenditures. The Parliamentary government directly collected the customs. For the monthly assessment, Parliament in

254 Excises first fell on "tobacco, wine, cider, beer, groceries, silks, hats, lace, linen, and furs" and were expanded to "meat and salt, alums, coppers, hops, starch, etc" in 1654. M. P. Ashley, *Financial and Commercial Policy under the Cromwellian Protectorate* (Oxford: Oxford University Press, 1934), p. 66.

255 See the details of these sales in H. J. Habakkuk, "Public Finance and the Sale of Confiscated Property during the Interregnum," *Economic History Review*, New Series, Vol. 15, No. 1 (1962): 70-88; Ian Gentles, "The Sales of Crown Lands during the English Revolution," *Economic History Review*, New Series, Vol. 26, No. 4 (1973): 614-35; idem., "The Sales of Bishops' Lands in the English Revolution, 1646-1660," *English Historical Review*, Vol. 95, No. 376 (July 1980): 573-96.

256 On the importance of tax revenue to the Parliamentary government, see James S. Wheeler, *The Making of a World Power: War and the Military Revolution in Seventeenth-Century England* (Stroud: Sutton, 1999), pp. 118-9.

1645 ordered that the collected monies were not to be consumed by local forces but be sent monthly to the Treasurers at War in London's Guildhall.[257] In 1654, the Council of State in the Protectorate regime revived the Exchequer as a means to strengthen the central management of public finance and ordered the customs, excises, and other sources of revenue to be paid directly to the Exchequer.[258] In the historian James Wheeler's view, this trend toward fiscal centralization represented "a step toward a truly modern concept of state finance in which revenues would be consolidated and expenditures paid out of the general revenue fund, rather than out of designated revenues."[259]

Meanwhile, the Commonwealth regime in the 1650s adopted a system of deficit financing in anticipation of its future tax revenue to support its navy and army. For example, the Navy treasurers issued bills of imprest and warrants to the contractors who provided the navy with goods and services. These short-term credit instruments, which could be assigned or sold in the markets, filled the interval between the expenditures and the arrival of tax revenue, and they were cleared when the government received its collected tax revenues.[260] Wheeler sees the deficit-financing system and the centralized fiscal system in the 1650s as the origin of the financial revolution in eighteenth-century England.[261] But did these institutions have a self-reinforcing mechanism which could lead to a path toward long-term borrowing? To answer this question, it is important to

[257] Wheeler, *The Making of a World Power*, p. 109.
[258] Ashley, *Financial and Commercial Policy under the Cromwellian Protectorate*, pp. 40-41.
[259] Wheeler, *The Making of a World Power*, p. 141.
[260] James S. Wheeler, "Navy Finance, 1649-1660," *Historical Journal*, Vol. 39, No. 2 (June 1996), pp. 459-60.
[261] Ibid., p. 458.

examine contemporary socio-economic conditions and their impact on institutional development in public finance.

The unique position of London in the English economy facilitated government attempts to centralize the collection of taxes. In the collection of the customs, some 70-80 percent of the revenue was collected in London. Moreover, London and its surrounding areas were the richest regions in England. Of the £53,436 monthly assessment that Parliament levied on the area under its control in 1645, over two-thirds came from the eastern and home counties.[262] In regard to the excise revenue collected from 30 September 1647 to 29 September 1650, London contributed 56.7 percent.[263] Centralized tax collection was thus easier to attain when more than half of government income was collected in London and its environs.

Nonetheless, there were still no nation-wide financial networks to transmit money in England in the 1650s. As result, between 1654 and 1659, the vast majority of tax revenues into and government expenditures out of London were still transported in specie rather than via more speedy credit instruments such as bills of exchange.[264] Payments to the New Model Army were also made in coins, which were sent out from London once a

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[262] The specific amounts were: London and Middlesex (£8060), Norfolk (£7436), Suffolk (£7070), Kent (£7070), and Essex (£6750). Cited from Ian Gentles, *The New Model Army in England, Ireland, and Scotland, 1645-1653* (Oxford: Blackwell, 1992), p. 28.

[263] Wheeler, *The Making of a World Power*, p. 157. This percentage was even as high as 60.2 percent in the period from March 1658 to August 1660. Ibid., p. 166.

[264] In this period, even taxation in kind was not infrequent as shown in "an ordinance of the interregnum [which] expressed willingness to accept payments in kind" and the fact that only half of taxes were required to be paid in cash. See Michael J. Braddick, *Parliamentary Taxation in Seventeenth-Century England: Local Administration and Response* (London: The Royal Historical Society, 1994), p. 153, particularly footnote 155.

month to regiments scattered in various locations.[265] Transport of a large quantity of specie was time-consuming. It was therefore more convenient to assign the revenues from places of collection directly to destinations of spending. For example, parts of the excise were collected and disbursed locally rather than being sent to London.[266] In the 1650s, centralization of the monthly assessment began to decline as Cromwell permitted the receivers-general to make payment directly to garrisons or regiments instead of transmitting all the receipts to London.[267] In this light, more centralized management and supervision of government accounts in this period did not imply that the central government could aggregate its income to allocate expenditures or to raise credits from the financial markets in London.[268]

Meanwhile, the central government in the 1650s did not possess the institutional ability to extract elastic revenues. Although the Commonwealth and Protectorate governments directly collected the customs, the customs amounted to only 20 percent of the government's total income between 1650 and 1659.[269] The boom in England's foreign trade did not come until the second half of the seventeenth century. In the collection of excises, the parliamentary government originally tried to depend upon its own salaried officers to both assess and collect excises. However, direct collection aroused many anti-excise riots between 1644 and 1649, which forced the Parliamentary government to

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[265] Gentles, *The New Model Army in England, Ireland, and Scotland*, p. 48.
[266] Wheeler, *The Making of a World Power*, p. 158. Yet the exact percentage of the excise being spent locally remains unknown.
[267] Ashley, *Financial and Commercial Policy under the Cromwellian Protectorate*, p. 82. For the details of the decentralized system of assignments in tax revenue in Hampshire, see Andrew M. Coleby, *Central Government and the Localities: Hampshire 1649-1689* (Cambridge: Cambridge University Press, 1987), pp. 47-8.
[268] I am grateful to Patrick K. O'Brien for reminding me this point.
[269] Calculated from Wheeler, *The Making of a World Power*, p. 213.

repeal the excises levied upon meat and home-brewed beer.[270] Due to the small scale and dispersed distribution in the production of excisable goods in this period, the administrative cost of direct collection of excises under different local circumstances was quite high. In response, the Protectorate government after 1650 had to gradually farm out the collection of excises to local elites who were much better informed about local circumstances.[271] Local gentry also firmly controlled both the assessment and collection of the monthly assessment. In the 1650s, the Protectorate government was unable to establish its own bureaucracy to replace local elites in the collection of the monthly assessment and excises.[272]

Dependence upon local elites reduced the administrative cost in tax collection; yet these elites were unlikely to sacrifice local interests for the benefit of the center.[273] The central government thus was unable to press for more excise revenues. Meanwhile, that fact that the Major-Generals in the Protectorate regime made the suppression of ale-houses a high priority between 1655 and 1657 may have further reduced the receipt of excises.[274] As a result, the monthly assessment remained the principal source of the Protectorate government's income, amounting to almost half of the government's total revenue in

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[270] On the attempt to centralize the collection of excises and the anti-excise riots in the 1640s, Patrick K. O'Brien and Philip A. Hunt, "Excises and the Rise of a Fiscal State in England, 1586-1688," in ," in W. M. Ormrod, Margaret Bonney, and Richard Bonney, eds., *Crises, Revolutions, and Self-sustained Growth: Essays in European Fiscal History, 1130-1830* (Stamford: Shaun Tyas, 1999), pp. 209-14; Braddick, *Parliamentary Taxation in Seventeenth-Century England*, pp. 179-190; idem., "Popular Politics and Public Policy: The Excise Riots at Smithfield in February 1647 and Its Aftermath," *Historical Journal*, Vol. 34, No. 3 (September 1991): 597-626.

[271] Braddick, *Parliamentary Taxation in Seventeenth-Century England*, pp. 191-193

[272] See the succinct discussion of Cromwell's abortive efforts to build centralized governance in David Underdown, "Settlement in the Counties, 1653-1658," in G. E. Aylmer ed., *The Interregnum: The Quest for Settlement, 1646-1660* (London: Macmillan, 1972).

[273] Braddick, *Parliamentary Taxation in Seventeenth-Century England*, pp. 135-136.

[274] Peter Clark, *The English Alehouse: A Social History, 1200-1830* (London: Longman, 1983), p. 177 and Peter Haydon, *The English Pub: A History* (London: Robert Hale, 1994), p. 71.

1654.[275] This led to severe conflicts of interest between the government and land owners. In June 1657, mounting opposition to the heavy burden of the monthly assessment forced the Protectorate government to reduce the monthly rate from £120,000 to £35,000.[276] This caused an annual loss of more than £1 million which the government was unable to cover from other sources.

Inadequate taxing ability reduced the credibility of the Protectorate government in the financial markets. After 1652, the City of London refused to make loans to the government as their past debts had not been cleared yet.[277] In 1658, it did not even accept the government's anticipated income as security for lending.[278] In the 1650s, contractors to the army and navy played a dominant role in the government's deficit financing. The vast majority of the total new debt incurred by the navy between 1651 and 1660 was owed to the victuallers of the navy.[279] However, these contractors lacked the resources to hold government debts longer in hopes of higher future returns. Instead, they needed money back on time as they had to use cash to procure goods from their suppliers. When the Protectorate government was unable to clear its previous short-term debts within one or two years, the contractors had to demand cash payments for their services.[280]

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275 Ashley, *Financial and Commercial Policy under the Cromwellian Protectorate*, p. 96.
276 Wheeler, *The Making of a World Power*, p. 193.
277 Ashley, *Financial and Commercial Policy under the Cromwellian Protectorate*, pp. 98-99.
278 Ibid., p. 107.
279 The percentage varied between 60.5 percent and 82.2 percent in the period between 1651 and 1660. Cited from Wheeler, "Navy Finance, 1649-1660," p. 463.
280 For example, the contractor William Burton, who was a committed radical refused to supply any more goods on credit in 1660. Cited from Bernard Capp, *Cromwell's Navy: The Fleet and the English Revolution 1648-1660* (Oxford: Clarendon, 1989), p. 364. See the state's lack of credit among contractors in Wheeler, "Navy Finance, 1649-1660," p. 465.

When the Protectorate government failed to make sufficient profit from the war with Spain in 1656 to overcome its fiscal problems, its financial bankruptcy significantly contributed to its collapse and the restoration of the Stuart monarchy in 1660. As Wheeler notes, the total debt of about £2.2 million of the Protectorate government in 1659 "was equivalent to only one year's average revenue, a level of short-term debt comparable to the average debt of the period 1660-90, and *considerably less than* that after 1700 (italics added)."[281] The underdevelopment of financial networks and small scale of production in England in the 1650s severely constrained institutional development toward long-term borrowing.

The newly emerged fiscal centralization of the early 1650s was thus short-lived. In the early years of the Restoration, government fiscal operations became highly decentralized. In 1660-2, the Cavalier Parliament reasserted the traditional separation between the crown's ordinary revenue and the extraordinary revenue granted by Parliament. It settled with the royal government the level of £1.2 million as the crown's annual ordinary revenue, which came from the customs (£400,000), excises on liquors (£300,000), and the hearth tax (£300,000, added in 1662).[282] Nonetheless, the newly settled ordinary revenue was in arrears as it took time for both the government administration and the economy to recover from the political upheavals and severe depression of 1659-1660.[283] The restored royal government suffered from tremendous financial difficulties from the

[281] Wheeler, "Navy Finance, 1649-1660," p. 460.
[282] The excise on domestically produced beer, ale, and cider accounted for up to 90 percent of the total excise revenue in the Restoration. Cited from C. D. Chandaman, *The English Public Revenue, 1660-1688* (Oxford: Clarendon, 1975), p. 41.
[283] Chandaman, *The English Public Revenue*, p. 206; Paul Seaward, *The Cavalier Parliament and the Reconstruction of the Old Regime, 1660-1667* (Cambridge: Cambridge University Press, 1989) p. 104.

very beginning.[284] Desperate need for regular income forced the government to rely on tax farming, especially when the performance of direct collection of the customs and excises was disappointing in 1660-1662. In 1662, the government farmed the collection of the customs revenue and excises. Under fiscal decentralization, particular items of revenue became more important in securing loans than the government's total nominal income. For example, when the City of London lent to the government, it did not receive payment from the Exchequer but directly from the collector of specific items of revenue which had been assigned as security.[285] The royal government thus did not have a chance to build institutions which could aggregate its ordinary revenue to raise credit directly.

Tax farmers, as the historian Robert Ashton has pointed out, were important suppliers of short-term credit to the government.[286] In 1667, new financiers, particularly the two most powerful goldsmith bankers Sir Robert Viner and Edward Backwell, became farmers of the customs. They accepted deposits from merchants, gentry, and professionals in both London and the provinces and were therefore more able than previous tax farmers to provide better terms of farming to the royal government. Meanwhile, their creditworthiness in the markets was enhanced by the regular tax revenue at their disposal interest-free prior to its transfer to the government (ranging from a quarter to half a year). As tax farmers had a close relationship with government, short-

[284] In June 1660, the total cash available to the Exchequer was only £141 while the monthly charge of the inherited army and navy was £100,000. Cited from Glenn O. Nichols, "English Government Borrowing, 1660-1688," *Journal of British Studies*, Vol. 10, Issue 2 (May 1971), p. 89 and Chandaman, *The English Public Revenue*, p. 196.
[285] Nichols, "English Government Borrowing, 1660-1688," p. 89.
[286] The financial function of big tax farmers in the early Stuart period that Robert Ashton discussed applies to those of the Restoration as well. See Robert Ashton, "Revenue Farming under the Early Stuarts," *Economic History Review*, New Series, Vol. 8, Issue 3 (1956), pp. 311-313.

term loans to government departments were the most profitable and secure investment for them to attract deposits from creditors.[287] Government reliance upon big tax farmers thus had a strong self-reinforcing tendency. Major tax farmers utilized both lending to the government and possession of the collected revenue as a liquid asset to strengthen their power in the financial markets. They thus could offer terms of lending to the government with which ordinary financiers were unable to compete. As a result, the government found it harder to find alternative sources of credit to rid itself of its dependence upon tax farmers.

Fiscal decentralization also affected the government's deficit financing of issuing Exchequer tallies in anticipation of its future income.[288] As the royal government did not centrally manage its ordinary income, it turned the responsibility of redeeming the Exchequer tallies over to treasurers of government departments. Upon receiving tallies, the treasurers had to either sell them or use them as security to borrow cash from private financiers. In this situation, private networks of treasurers in both the government and the financial markets were more important than government institutions in securing the redemption of tallies.[289] The informal and privately-based redemption of the Exchequer

[287] In the case of Backwell, more than 90 percent of his investment in 1666 was lent to the government. See Henry Roseveare, *The Financial Revolution, 1660-1760* (London: Longman, 1991), p. 20.
[288] The restored royal government issued both the tally of *sol* and the tally of *pro* on its anticipated income to the treasurers of government departments for their current spending. The former was guaranteed by a particular source of revenue; it could not be sold or assigned to others and thus had low liquidity. The latter, in comparison, could be sold or assigned to others and thus had high liquidity. Yet it was not secured by any specifically assigned item of government income and its redemption at the Exchequer was highly uncertain if their holders did not have right connections in the government. On the use of tallies for deficit financing in the early Stuarts, see Robert Ashton, *The Crown and the Money Market, 1603-1640* (Oxford: Clarendon, 1960), pp. 48-50. For their use in the Restoration period, see Chandaman, *The English Public Revenue*, pp. 287-294.
[289] For example, Sir Stephen Fox, the Paymaster of the Guard in 1661 and later the Paymaster of the forces and garrison and of the royal household, was able to have his tallies cashed at the Exchequer on time and he thus profited handsomely in the process of handling government expenditures. See Christopher Clay,

tallies thus limited the amount that the government could issue to treasurers of departments. As such, Exchequer tallies could neither prompt fiscal centralization nor help the government end its reliance upon tax farmers for credit.

The second Anglo-Dutch War (1665-67) fully exposed the financial inability of the English government. As the impending war tightened credit in the markets, London financiers who lacked confidence in the government's creditworthiness refused to provide fresh credit to the already indebted royal government.[290] The English government in 1665 was forced to adopt the Order system proposed by Sir George Downing, a Teller at the Exchequer.[291] The main goal of Downing's proposal was to raise credit directly from the public by issuing a new government credit instrument, the Treasury Order bearing an interest rate of 6 percent. The Treasury Orders were secured on a parliamentary supply of £1.25 million in two years and they could be sold or assigned in the markets. Their semi-annual payments through the Exchequer were made according to a strict chronological order determined by the date when the subscribers paid their money into the Exchequer. In less than two years, the Order system raised nearly £200,000 from about 900 subscribers.[292]

Public Finance and Private Wealth: The Career of Sir Stephen Fox, 1626-1716 (Oxford: Clarendon, 1978), particularly chapters 3 and 4.

[290] Seaward, *The Cavalier Parliament and the Reconstruction of the Old Regime*, pp. 239-240, and p. 303.

[291] Downing had some practical experience in public finance under the Protectorate government and had observed first-hand how the Dutch government established its creditworthiness by efficiently managing its tax revenue and thus could borrow easily from the financial markets. For the early background of Sir George Downing and its relevance to his invention of the Order system, see Jonathan Scott, "'Good Night Amsterdam'. Sir George Downing and Anglo-Dutch Statebuilding," *English Historical Review*, Vol. CXVIII, No. 476, (April 2003): 334-56.

[292] Henry Roseveare, *The Treasury 1660-1870: The Foundations of Control* (London: Allen & Unwin., 1973), p. 18 and pp. 24-26.

As the English government could not mobilize the necessary financial resources to fund the Second Anglo-Dutch War, it soon suffered a humiliating defeat. This, however, was insufficient to force the government to overhaul its financial institutions, particularly when the end of the war removed the pressure to increase military spending. Although the Commons in December 1666 established the Commissions of Public Accounts to audit the accounts of extraordinary supplies which Parliament had granted for the war effort, this political strategy did not imply an attempt to fundamentally reform public finance. On the one hand, the highly informal way of using Exchequer tallies and the absence of standard bookkeeping in government departments seriously restricted the effectiveness of the audit of the Commons.[293] On the other hand, the Commons was mainly interested in finding scapegoats for the defeat.[294] The royal government might have appealed to both fiscal retrenchment and new loans from private financiers rather than choose to radically reform its financial institutions.

However, the royal government could not receive any fresh credit in 1667 to cover its deficits because the financial markets had not yet recovered from the disruptions of the war, the Great Plague in 1665, and the fire of London in 1666. Its average yield of ordinary revenue fell to £686,000 a year between 1665 and 1667, while the annual deficit stood at some £600,000.[295] Nor could it seek higher advances from tax farmers as their contracts had not expired yet.[296] As peace was resumed, it could hardly request

[293] As Roseveare has pointed out, in the case of the navy it is extremely difficult for the Commons to tell fraudulent activities from the necessary methods to maintain the operation in practice. Ibid., pp. 52-3.
[294] J. R. Jones, *The Anglo-Dutch Wars of the Seventeenth Century* (London: Longman, 1996), p. 96.
[295] Chandaman, *The English Public Revenue*, pp. 211-212; Seaward, *The Cavalier Parliament and the Reconstruction of the Old Regime*, p. 317.
[296] 1673 in the Hearth tax, 1671 in the Customs, and 1668 in the excise. See Chandaman, *The English Public Revenue*, pp. 215-216.

extraordinary revenues from Parliament. The royal government thus had no option but to extend Downing's Order system to meet its spending needs. In contrast to the Orders issued during the war, which were secured by parliamentary extraordinary supplies, the newly issued Orders were safeguarded by the crown's ordinary revenues. Between 1667 and 1670, the amount of the issued Orders stood at a level of some £1.2 million a year.[297] As the English historian Chandaman has emphasized, these Orders were fictitious credit instruments because there was no lenders' money actually paid into the Exchequer in advance. Meanwhile, Chandaman has also argued that they resembled paper notes as they were issued in small denominations for ordinary transactions in the economy.[298]

However, there was one big difference between the fictitious Treasury Orders and paper notes. The Orders were interest-bearing short-term credit instruments, which had to be redeemed on their due dates (usually a year) at the Exchequer. In contrast, paper notes could have a longer term. As long as the government ensured their convertibility, paper notes could continue to circulate, and their holders did not need to redeem them in the short run. Moreover, subscribers to the Orders were limited to wealthy financiers and merchants. In comparison, the government could issue a larger amount of paper notes if they were used in general transactions in the economy. In this sense, the potential for the government in issuing paper notes was much bigger than that in issuing Treasury Orders. The former might lead to inflation, but mild inflation which reduced the government's debt burden did not immediately threaten the survival of the government. In contrast, excessive issue of Treasury Orders which had to be redeemed within a year could lead to

[297] Ibid., p. 216 and p. 219.
[298] Ibid. p. 297; Nichols, "English Government Borrowing, 1660-1688," p. 99.

bankruptcy of the government. Both the pressure on and urgency of the royal government to redeem the short-term Treasury Orders were significantly greater than to ensure the convertibility of paper notes.

The massive floating of fictitious Treasury Orders from 1667 thus constituted a credit crisis for the royal government. As these newly issued Orders now were secured by the crown's ordinary revenue rather than the parliamentary supplies, its direct consequence was to force the royal government to reform the institutions which managed the ordinary revenues so as to ensure timely redemption. In June 1667, Charles II appointed a new Treasury Commission consisting of young and competent officials such as Sir Thomas Clifford, Sir William Coventry, and Sir John Duncombe. Sir George Downing was appointed as Treasury Secretary. The appointment of these officials, who had no aristocratic background but did have practical experience in managing financial affairs, was a result of the dire situation of government finance.[299] The regular "pipeline-like" redemption of the issued Orders according to their consecutive dates of issue significantly affected the direction of institutional changes implemented by these Treasury Commissioners.

In order to increase the amount of money available to ensure the punctual redemption of the issued Orders at the Exchequer, the Treasury Commissioners needed more central management of the crown's expenditures so as to reduce chances for speculation and avoid arbitrary spending. Meanwhile, as the Exchequer was responsible for redeeming

[299] Howard Tomlinson, "Financial and Administrative Developments in England, 1660-88," in J. R. Jones ed., *The Restored Monarchy, 1660-1688* (Totowa, N.J.: Rowman and Littlefield, 1979), pp. 96-7.

the due Orders, the Treasury Commissioners had to not only increase the crown's ordinary revenue but also ensure its speedy transmission into the Exchequer. This meant that they had to centralize the management of both accounts and actual cash flows. From 1667 on, the Treasury Commissioners established a meticulous book-keeping system in government departments, ordered speedy transfer of the collected tax revenues into the Exchequer, and demanded weekly certificates from spending departments to allow for regular checking of accounts.[300] In the course of these institutional reforms, the Treasury came to be more independent from the Privy Council and the Secretaries of State, and had more power to discipline the management of the finance of the royal government.[301]

Nonetheless, the effectiveness of these important administrative reforms was limited in practice as the Treasury did not have the political authority to control the level of departmental spending, which was crucially important to implement retrenchment policies so as to increase the surplus to redeem the Treasury Orders.[302] Although the ordinary revenue increased from less than £650,000 a year in 1665-7 to £954,000 in 1669-70, the total government debt rose to nearly £3 million by 1670.[303] On the eve of the Third Dutch War (1672-74), the value of outstanding Orders was more than £1.1 million, and their repayment would have reduced the government's disposable revenue to less than £400,000.[304] In January 1672, the government announced it was postponing

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[300] For the details of these reforms, see Roseveare, *The Treasury 1660-1870*, pp. 22-36; Chandaman, *The English Public Revenue*, pp. 213-214; Stephen B. Baxter, *The Development of the Treasury, 1660-1702* (Cambridge: Harvard University Press, 1957), pp. 180-184.
[301] Tomlinson, "Financial and Administrative Developments in England, 1660-88," pp. 98-9.
[302] Roseveare, *The Treasury 1660-1870*, pp. 27-8.
[303] Chandaman, *The English Public Revenue*, p. 220.
[304] Ibid., p. 226.

repayment for one year and would pay 6 percent interest.[305] This decision was a severe blow to the four goldsmith bankers/tax farmers who had bought Orders in the markets at great discount and thus held up to 80 percent of the total outstanding Orders in 1672.[306] Instead of an intentional default, the Stop of the Exchequer was mainly caused by the government's inability to use its current income to meet both it current spending and the payment of its outstanding short-term debts.[307]

Although it was crucial for the Treasury Commissioners to increase the royal government's income, they were subject to the political constraint of Parliament and the traditional separation between the ordinary and extraordinary revenues. Throughout the Restoration period, additional income from increasing the customs duties or the excise rates, as well as the monthly assessment, was carefully safeguarded by Parliament as extraordinary revenue.[308] Nonetheless, the Commons in this period did not succeed in overseeing the accounts of the crown's ordinary revenue.[309] The royal government had full discretion to decide the specific methods used in collecting the crown's ordinary revenues. In this light, an *extensive* approach to increasing government income by broadening its tax base was not available to the royal government. It thus had to turn to

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[305] Nichols, "English Government Borrowing, 1660-1688," pp. 100-101.

[306] Among them, Robert Vyner held 32 percent, Edward Backwell 22.5 percent, the Meynells 19 percent, and Colville's successor 6.5 percent. Cited in Roseveare, *The Financial Revolution 1660-17*, p. 22.

[307] After 1674, the royal government managed to make interest payments on this debt out of its ordinary revenue. See J. Keith Horsefield, "The 'Stop of the Exchequer' Revisited," *Economic History Review*, new series, Vol. 35, No. 4 (November 1982): 511-28.

[308] Chandaman, *The English Public Revenue*, pp. 47-49. For the political significance of parliamentary control over the granting of extraordinary revenues, see Henry Roseveare, *The Treasury 1660-1870*, pp. 54-56 and J. R. Jones, *Country and Court: England, 1658-1714* (Cambridge: Harvard University Press, 1978), pp. 192-6.

[309] Roseveare, *The Treasury 1660-1870*, p. 54.

"intensive means," i.e., to maximize the receipts from the already settled ordinary revenues of the customs, excises on liquors, and the hearth tax.

In regard to the collection of the crown's ordinary revenues of the customs, excises, and the hearth tax, the floating of fictitious Treasury Orders to some extent reduced the royal government's reliance upon tax farmers for short-term credit. The pressure to redeem them forced the government to extract more from the tax farmers. In the renewal of the contract of customs farming in 1670, when the customs farmers tried to get more concessions from the government, the Treasury Commissioners decided to directly collect the customs. A board of six Commissioners, which included the competent Sir George Downing, was appointed to manage the new centralized collection. This system inherited the whole framework of local administration and personnel, along with the manuals of instruction that the farmers of the customs had established. From 1678 onward, the Surveyors-General (later the Commissioners themselves) periodically inspected the collection in major ports.[310]

In comparison, direct collection of excises on liquors all over England was a formidable task. The excise farm in 1662 was very dispersed as about 75 percent of the country farms went to local gentry in various regions.[311] The Treasury Commissioners had a strong incentive to negotiate farming contracts with a few major financiers to reduce the transaction costs and receive higher rent from farming. Meanwhile, the latter were interested in using the collection of regular excise revenues to enhance their power in the

[310] Ibid., p. 34.
[311] Chandaman, *The English Public Revenue*, p. 54.

financial markets. A single excise farm was thus to the benefit of both the royal government and big financiers.

From 1668 on, the government supported the plan of the goldsmith banker William Bucknall and his associates, who had farmed the London excises, to take over the farm of country excise which had been previously controlled by local elites. By 1671, the Bucknall group controlled nearly 75 percent of the entire excise in England.[312] In 1672, the Stop of the Exchequer discredited the issue of fictitious Treasury Orders. The royal government had to use its real income to secure new sources of credit, particularly under the pressure of the Third Anglo-Dutch War (1672-4). As it was difficult for the royal government to get extraordinary parliamentary supplies when the Commons was against the foreign policy of Charles II, the idea of a total excise farm became very appealing to the Treasury. From the perspective of the government, a syndicate of financiers who held the new post of Receiver-General of a single excise farm could use the aggregated excise revenue to mobilize more credit for the government. For the financiers, the control of the total excise revenue was very profitable, especially when collectors were required to send their daily receipts to the Receiver-General.[313] The development toward a single excise farm was not disrupted by fierce power struggles within the government, including the fall of Clifford as the Chief Treasury Commissioner and the rise of Danby as the Lord Treasurer in 1673. Private financiers associated with different political patrons shared

[312] Ibid., pp. 59-61. For the ousting of local gentry from excise farms between 1667 and 1677, see Hughes, *Studies in Administration and Finance*, pp. 148-152.
[313] Chandaman, *The English Public Revenue*, pp. 62-64.

the same plan of using total excise revenue to raise credit for the government, and their competition simply gave the government better terms of rent and advance money.[314]

The syndicate of a single excise farm had to confront a serious information asymmetry problem with their employees who served as "agents" in collecting excises. Edgar Kiser has argued that the motivation for profit maximization pushed tax farmers to develop effective organizational methods to monitor the performance of their collecting agents.[315] However, the same concern for maximum profit can lead to three contractual relationships between the principal and the agent under different distributions of risks. When the principal is more risk-averse than the agent, he gives a rental contract to the agent, which is equivalent to the sub-farming of a single excise farm. When the agent is more risk-averse, a share contract is optimal. When the principal bears all the risk, a pure wage contract prevails. In order to understand the emergence of bureaucratic management in excise collection, it is thus important to analyze the risk that the syndicate had to bear.

The syndicate of excise farmers played an important role in supplying short-term credit to the royal government, and they bore both financial and political risks. Control of a larger amount of regular excise revenue as liquid capital enhanced their ability to mobilize financial resources in the markets, which allowed them to renew farming contracts by

[314] In 1673, the group of Sir John James, Major Robert Huntingdon, and Captain Richard Kingdon, who were associated with Danby, offered better terms for a farming contract than the group associated with Clifford. For the competition between the James group and Sir Stephen Fox over the control of the Receiver-General of the excise farm, see Clay, *Public Finance and Private Wealth*, pp. 98-100.
[315] Edgar Kiser, "Markets and Hierarchies in Early Modern Tax Systems: A Principal-Agent Analysis," *Politics and Society*, Vol. 22, No. 3 (September 1994), p. 294.

offering terms unrivalled by their competitors. This was the financial risk for the syndicate of excise farmers. Politically, in order to secure government favor and protection, they had to be able to provide short-term credit whenever the government demanded. Both risks required them to firmly control the internal cash flows in the organization of excise farming. Their best strategy was to adopt a wage contract with their collecting agents. In order to overcome the moral hazard of agents in the wage contract, the syndicate of excise farmers had to develop the necessary methods to both motivate and discipline their salaried employees and thus ensure efficiency in collection.

As the syndicate of excise farmers derived profit mainly from using the total excise revenue to mobilize credit in lending to the government, they did not resist the attempt of the Treasury in 1674 to send Deputy Comptrollers to check the account books and vouchers in the country areas and to "issue an independent quarterly report of all excise receipts" to the Comptroller. This allowed the government for the first time to know the "precise annual value" of the excise in England.[316] In this situation, the bigger actual receipts of excises than the rent fixed in the farming contract inspired the Treasury to replace excise farming with direct collection. The organization that the syndicate of excise farmers had established to manage their salaried agents paved the way for government direct collection. When the government began to directly collect excises in 1683, it took over the entire organization of the total excise farm. The profits from using the regular excise revenue as security to raise credits made it easy for the government to

[316] Chandaman, *The English Public Revenue*, p. 64.

attract some former excise farmers and goldsmith bankers to manage the Excise Department.[317]

In order to improve the management of collection, the Excise Department between 1683 and 1688 endeavored to standardize the methods of gauging, assessing, and book-keeping in the 886 districts or divisions of excise collection in England.[318] Standardization in excise assessment and collection was an important means to overcome the principal-agent problem and make the Excise Department an efficient bureaucracy. First, it facilitated the supervision and evaluation of excise officers by their superiors, who regularly circuited to inspect local collection. Second, it made each excise officer essentially "substitutable" in his post, which paved the way for their regular rotation among districts. This not only prevented excise officers from colluding with local interests but also effectively disciplined them by regular mutual checks of collection accounts. Standardization was thus the crucial means to ensure and maintain the efficiency of the centralized management of the Excise Department.

Economic conditions in the 1670s and 1680s were favorable to the institutional development toward central collection of the customs and excises. The yields of the directly collected customs grew with the expansion of England's foreign trade. The average annual net yield of the customs rose from the highest rent of £400,000 in the farming contract of 1670 to £570,000 in 1681-84 and £590,000 in 1685-87.[319]

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[317] Ibid., pp. 72-73.
[318] See Miles Ogborn, "The capacities of the state: Charles Davenant and the management of the Excise, 1683-1698," *Journal of Historical Geography*, Vol. 24, No. 3 (1998), especially pp. 295-306.
[319] Chandaman, *The English Public Revenue*, p. 35.

Meanwhile, rising real wages and declining grain and malt prices due to good harvests stimulated domestic consumption, particularly the consumption of beer and ale, the principal daily beverages at the time. This facilitated the development of large-scale common brewers, especially in economically advanced eastern and southern England.[320] The government also encouraged the development of large-scale brewing houses by giving them favorable allowances of waste and leakage.[321] For the government, large-scale brewers reduced the collection cost of excises as they could hardly evade the inspection of excise officers. They were also better able than small brewers to bear the burden of high excise rates. As a result, the receipts of excises on liquors were as high as £620,000 per year between 1686 and 1688.[322]

Even though the true potential of the customs and excises still remained unknown to the government which did not have modern institutions to regularly survey the economy, the rising receipts greatly consolidated the confidence of the royal government in centralized collection of the customs and excises. In comparison, it was difficult to achieve administrative efficiency in collecting the hearth tax given the political and administrative costs of searching individual households. Moreover, the hearth tax was highly inelastic in the short run even when the economy was growing. The performance of direct collection of the hearth tax was disappointing in this period, and its net annual yield only reached £216,000 by 1688.[323]

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[320] Clark, *The English Alehouse: A Social History*, p. 184.
[321] Peter Mathias, *The Brewing Industry in England: 1700-1830* (Cambridge: Cambridge University Press, 1959), pp. 363-4.
[322] Chandaman, *The English Public Revenue*, p. 75.
[323] Ibid., pp. 88-106.

The new institutions to directly collect the customs and excises that emerged in the 1680s were to a large extent an unintended consequence of the financial settlement between the crown and Parliament in 1660-1662. At that time, the estimated yields of the hearth tax ranged from £300,000 to £1 million, which were higher than that of the excises. The royal government thus welcomed the Cavalier Parliament's decision to include the hearth tax rather than the extended excises in the crown's ordinary revenue.[324] Although the Commons firmly controlled the grant of the direct monthly assessment and additional excises as parliamentary extraordinary revenue, no one could have anticipated the productivity of the direct collection of the customs and the excises on liquors.

Between 1685 and 1688, the average annual income of the crown's ordinary revenue rose to about £1.6 million.[325] It enabled James II to afford to maintain a large standing army of some 20,000 soldiers, which was the average size of a standing army in contemporary Europe.[326] The crown did not even have to ask Parliament for extraordinary revenues. As the growing government income mainly came from indirect customs and excises, it did not generate any direct conflicts of interest between the government and land-owners. Thus, neither Parliament nor domestic opponents could challenge James II.[327] Nonetheless, there is no apparent sign of an endogenous development toward an institution of long-term borrowing before 1688. Instead, the Receivers-General of the

[324] Seaward, *The Cavalier Parliament and the Reconstruction of the Old Regime*, p. 111
[325] C. D. Chandaman, "The Financial Settlement in the Parliament of 1685," in H. Hearder and H. R. Loyn, eds., *British Government and Administration: Studies Presented to S. B. Chrimes* (Cardiff: University of Wales Press, 1974), pp. 151-152.
[326] See John Childs, *The Army, James II, and the Glorious Revolution* (Manchester: Manchester University Press, 1980), p. 2 and p. 5.
[327] In Holmes' words, "it is hard to find evidence that even in the midsummer of 1688, let alone in the Spring, James was faced with the threat of a rebellion." Geoffrey H. Holmes, *The Making of A Great Power: Late Stuart and Early Georgian Britain* (London: Longman, 1993), p. 177.

customs and excises were both the official receivers and cashiers of government tax revenue and private financiers in the financial markets. They used their respective revenues as security to raise short-term loans from the markets and re-lent to the government. Instead of seeking permanent liabilities, the royal government in this period tried to clear its previous debts.[328] The traditional idea that a good kingship should be free from debt remained intact.

III. Credit crisis and the emergence and consolidation of a modern fiscal state: 1689-1752

The Dutch invasion in November 1688 was a big event in and of itself. As the historian Jonathan Israel has emphasized, it was caused largely by Dutch strategic calculation in the fight with Catholic France rather than the domestic opponents of James II in England.[329] When the Dutch brought England into its conflict with France in 1689, no Englishman could have anticipated that it was the beginning of two almost continuous and extremely expensive wars, the Nine Years War (1689-1697) and the War of the Spanish Succession (1702-1713).[330] Although the vast majority of Parliament favored a limited defensive naval war, William III and later Queen Mary adopted the Continental strategy advocated by the Junto Whigs, which committed English forces to wars both on land and sea.

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[328] In Chandaman's estimate, James II spent nearly £1 million prior to 1688 to clear previous government debts. Chandaman, "The Financial Settlement in the Parliament of 1685," p. 152.

[329] Jonathan I. Israel, "The Dutch Role in the Glorious Revolution," in Jonathan I. Israel ed., *The Anglo-Dutch Moment: Essays on the Glorious Revolution and its World Impact* (Cambridge: Cambridge University Press, 1991).

[330] A contingent event – the death of Carlos II, the king of Spain, in 1699 – was vital to the resumption of conflicts in 1702 as France, the United Provinces, and England were all too financially exhausted to fight another major war so soon.

The mounting military spending, heavy taxation, and economic recessions during the Nine Years War led to severe confrontation between the royal government and Parliament. As Members of Parliament could not determine the making of foreign policy, which was the prerogative of the crown at the time, they tried hard to strengthen their political power by controlling public finance. The Convention Parliament in 1690 not only voted William III and Mary an inadequate ordinary revenue but also voted the customs, which had been the crown's permanent income since Henry VI, for only four years. As the historian Clayton Roberts has pointed out, this was an intentional strategy to ensure the regular presence of Parliament in national politics.[331] The Triennial Act passed in 1694 for the first time guaranteed regular convention of Parliament. More importantly, Parliament in 1698 passed the Civil List Act to abolish the century-old separation between the crown's ordinary revenue and the parliamentary extraordinary revenue, which was the last vestige of the domain state. From now on, the three pillars of government income (the land tax, the customs, and excises) became regular parliamentary supplies, and Parliament allocated a lump sum of Civil List (£700,000 a year) to cover the costs of the royal household and the executive branch of the government.[332] Meanwhile, the Commons in 1690 established the Commissions of Public Accounts to check the expenditures of major government departments such as the army and navy, between 1691-97, 1702-04, and 1711-13.

[331] The crown's ordinary revenue was set as less than £700,000 a year, which would lead to an annual deficit of between £200,000 and £300,000 even in peace time. Clayton Roberts, "The constitutional significance of the financial settlement of 1690," *Historical Journal*, Vol. 20, No. 1 (1977): 59-76.

[332] The Civil List covered the Royal Household, the secret service in diplomacy, and the peacetime operations of the royal government. See the details in E. A. Reitan, "From revenue to civil list, 1689-1702: the revolution settlement and the 'mixed and balanced' constitution," *Historical Journal*, Vol. 13, No. 4 (1970): 571-88. In 1777, Parliament raised the amount of the Civil List to £900,000 a year.

These important institutional developments, however, did not suffice to result in a system of long-term borrowing. The fact that the parliamentary taxes had become permanent in 1698 did not imply that they would be used to sustain the state's perpetual debt. The effect of parliamentary supervision of public finance needs to be put in perspective. In this period, the biggest obstacle to parliamentary oversight of government spending was an absence of standardized and unitary bookkeeping in government departments, particularly in the army and navy, the two biggest spending departments. According to the reports of the committee appointed by the Commons in 1695 to investigate the financial management of the army, the regimental accounts were in "endless confusion" which prevented any kind of reasonable estimate of total accounts. The paymaster of the army between 1688 and 1702, the Earl of Ranelagh, kept his accounts "extremely general and vague," not even listing the dates and itemization of particular warrants.[333] In the case of the navy, the Treasury and the Commons could only receive a very general estimate of its annual expenditures, and accurate information regarding specific items of spending thus remained immune to any outside inquiries. The navy could issue its own Navy bills to cover deficits in its current spending *before* being approved by the Treasury or Parliament.[334] Under these conditions, parliamentary inquiries into government accounts soon lost their significance.[335]

Parliament after 1688 did not immediately encourage a longer time horizon among creditors in lending to the English government. The Dutch financial experts who came to

[333] John Childs, *The British Army of William III, 1689-1702* (Manchester: Manchester University Press, 1987) p. 142 and p. 144.
[334] See the details in Daniel A. Baugh, *British Naval Administration in the Age of Walpole* (Princeton, N.J.: Princeton University Press, 1965), pp. 452-480.
[335] Brewer, *The Sinews of Power*, pp. 149-153.

England with William III's army did not introduce new financial methods to raise long-term credit. The Bank of Amsterdam at the time was mainly a clearing house for trading merchants, and it did not lend directly to the Dutch government. As in England, the Dutch government depended upon General-Receivers of various tax revenues for short-term lending.[336] The English government appealed to its familiar methods of raising short-term credits to meet the needed military expenditures when it entered the war in 1689. It issued Exchequer tallies in anticipation of future tax revenue, which were similar to the Treasury Orders issued in 1665 as they were assignable but could only be redeemed at the Exchequer. However, the mounting war expenditures forced the English government to issue fictitious tallies in 1690 to treasurers of government departments to meet their spending. These were not backed by any received loans or specifically assigned revenue and were similar to the Orders issued in 1667.[337] From 1688 to 1693, the total amount of short-term borrowing bearing interest rates of 7-8 percent rose to £15 million, including a lot of bills issued by the Navy, Ordnance, and Victualling board, which were not secured by any pre-assigned tax revenues.[338] These short-term credit instruments, which had to be redeemed within a year, became heavily discounted in the markets in 1693-4

This urgency forced the English government in 1693 to seek long-term credits such as long-term borrowing and the issue of paper notes, which had been discussed in England

[336] Marjolein 'T Hart, "'The Devil or the Dutch': Holland's Impact on the Financial Revolution in England, 1643-1694," *Parliament, Estates and Representation*, Vol. 11, No. 1 (June 1991), pp. 50-52.
[337] P. G. M. Dickson, *The Financial Revolution in England: A Study in the Development of Public Credit 1688-1756* (London: Macmillan, 1967), p. 351.
[338] The amount of short-term borrowing is calculated from Table 53, ibid., p. 344.

since the 1680s.[339] However, the low creditworthiness of the government at the time led to poor performance of the tontine, the lottery, and the single-life annuities, the three methods that it used to directly raise long-term credit from the public.[340] Despite high interest rates (ranging from 6 percent to 14 percent) and the security of loans on parliamentary taxes, the government could only raise £1.3 million between 1693 and 1697.[341] In addition to direct borrowing from the public, the English government also arranged long-term loans from corporations that received monopolies in overseas trade or issuing banknotes. These loans were redeemable as the government could repeal the charter by returning the principal of the loan. In this way, the government raised £2 million from the New East India Company in 1698.[342]

In contrast to the New East India Company, the lending from the newly chartered Bank of England in 1694 represented an important monetary experiment with paper notes. Between 1691 and 1693, the English government received at least three proposals of issuing bills as legal tender, including the one from the early promoters of the Bank of England. Yet Parliament found the idea of floating paper notes too risky.[343] It granted the Bank of England a charter as a note-issuing corporation in return for a long-term loan of £1.2 million at 8 percent to the government, which was made in banknotes issued by the Bank. Four-fifths of the Bank's initial capital stock consisted of the government's

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[339] For various proposals in England in regards to creating paper credit to either increase the government income, to replace coin, or to stimulate trade between 1680 and 1697, see J. Keith. Horsefield, *British Monetary Experiments: 1650-1710* (Cambridge: Harvard University Press, 1960), pp. 114-122.
[340] Among these methods, the English preferred annuities rather than tontines. See David R. Weir, "Tontines, Public Finance, and Revolution in France and England, 1688-1789," *Journal of Economic History*, Vol. 49, No. 1 (March 1989): 95-124.
[341] Calculated from Table 2 (No.1, No. 2, No. 3, No. 4, No. 6, and No. 7) in Dickson, *The Financial Revolution in England*, pp. 48-49.
[342] Ibid., p. 49.
[343] Horsefield, *British Monetary Experiments*, p. 126.

outstanding tallies, which were discounted in the markets at over 30 percent at the time. In this way, government short-term tallies were converted into banknotes which were long-term credit instruments. Meanwhile, as the Bank of England was a fractional note-issuing bank, the pressure to maintain the convertibility of issued banknotes was smaller than that to ensure the redemption of all outstanding tallies. Nonetheless, the English government's initial experiment with paper notes was tentative. It did not give the Bank the exclusive right to issue banknotes, let alone make them the legal tender.[344] Meanwhile, the credibility of the banknotes in the early years of the Bank was also low due to the low ratio of cash reserves. In 1697, the Bank had to temporarily suspend the convertibility of its banknotes.[345]

The Bank of England's issue of banknotes on the face value of heavily discounted government tallies aroused much suspicion and even hostility in both Parliament and the royal government. In 1696, the "country party" consisting of both moderate Whigs and Tories which dominated the Parliament attempted to charter a national Land Bank. They planned to provide long-term loans to the government with banknotes backed by specie and the tangible wealth of land. Nonetheless, as the proposed Land Bank required cash instead of heavily discounted tallies to subscribe the stocks, this plan could not even get started while the market was glutted with the heavily discounted tallies; and the recoinage in 1696-7 caused a severe scarcity of cash in England.[346] The failure of the Land Bank

[344] Roseveare, *The Financial Revolution, 1660-1760*, p. 37.
[345] In 1696, it fell to 12.8 percent in the spring and even 2.7 percent by the autumn. See Horsefield, *British Monetary Experiment*, p. 264.
[346] For the support of Parliament and the royal government for the proposed Land Bank, see Dennis Bubini, "Politics and the battle for the Banks, 1688-1697," *English Historical Review*, Vol. 85, No. 337 (October 1970): 693-714.

prompted the government to issue its own paper credit, the interest-bearing Exchequer bills. The government sought cooperation from some provincial bankers to spread their use in areas outside London. To facilitate their circulation, the Exchequer bills were issued in small denominations (£10 and £5). In order to stabilize their value, the government in 1697 set the limit of outstanding Exchequer bills at no more than £2 million.[347]

The low credibility of the English government's long-term borrowing between 1693 and 1697 was largely due to its inability to extract adequate tax revenues to service its rapidly rising debt. Parliament granted various levies of direct taxes on both real and personal property, such as the Aid, the monthly assessment, the poll tax, and even duties on marriages, births, burials, houses, and hawkers. Due to the administrative and political difficulties in assessment and collection, the levy of direct tax in the 1690s fell upon the assessed landed property in both country and town, and Parliament gave up the effort to extract revenues from personal income.[348] Although Parliament rejected the scheme of general excise, it raised extra rates on existing excises and added new items into the list of excises (such as sea-borne coals, salt, and spices). Nonetheless, severe economic recessions, disruptions of foreign trade, and the cash scarcity caused by the recoinage in 1696 greatly reduced the receipts from both excises and the customs.[349] The mismanagement of the new excise commissioners that William III put onto the Excise

[347] For the initial issues of the Exchequer bills, see Dickson, *The Financial Revolution in England*, pp. 368-372.
[348] J. V. Beckett, "Land Tax or Excise: the levying of taxation in seventeenth- and eighteenth-century England," *English Historical Review*, Vol. 100, No. 395 (April 1985): 285-308.
[349] For the severe disruption of England's foreign trade, see D. W. Jones, *War and Economy in the Age of William III and Marlborough* (New York: Basil Blackwell, 1988), chapter 2. On the sharp reduction of domestic consumption, see William J. Ashworth, *Customs and Excise: Trade, Production, and Consumption in England, 1640-1845* (Oxford: Oxford University Press, 2003), pp. 113-4.

Board and political purges of excise officers further reduced the efficiency of excise collection.[350]

When the Nine Years War ended in 1697, the English government had £12.2 million in unfunded short-term liabilities and £5.1 million funded long-term borrowings.[351] This was an enormous debt for a government whose annual total income was around £4 million in the 1690s and £5 million in the 1710s. In contrast to the Protectorate regime which collapsed under a total debt of about £2.2 million in 1659, the English government in the 1690s could seek help from powerful financiers to settle its debts. Religious toleration in England after the Glorious Revolution also attracted Protestant refugees to bring to England not only their wealth but also financial innovations in long-term borrowing and international financial networks.[352] Dissenters and nonconformists were vital to joint-stock companies such as the Bank of England and the New East India Company, both as directors and investors.[353] These powerful joint-stock companies, particularly the Bank of England, replaced the General-Receivers of the customs or excises in providing credit to the government. In this situation, the government was more concerned about how to extract more revenue to service its debt. In the collection of

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[350] Brewer, *The Sinews of Power*, p. 74 and p. 94; Hughes, *Studies in Administration and Finance*, pp. 192-4.

[351] B. R. Mitchell, *Abstract of British Historical Statistics* (Cambridge: Cambridge University Press, 1962), p. 401.

[352] Larry Neal, *The Rise of Financial Capitalism: International Capital Markets in the Age of Reason* (Cambridge: Cambridge University Press, 1990), pp. 10-12.

[353] Bruce G. Carruthers, *City of Capital: Politics and Markets in the English Financial Revolution* (Princeton, N. J.: Princeton University Press, 1996), p. 139.

excises, the Treasury after 1697 worked hard to improve efficiency in the collection of excises and strengthen the centralized management of the Excise Department.[354]

Nonetheless, the path toward long-term borrowing was by no means irreversible in 1697. Among the joint-stock companies, the East India Company provided long-term credit to the government in return for a monopoly of the trade with Far East. Once it received the charter, it did not need to take extra risks to take over the government's unfunded short-term debt. Inherent fluctuations in overseas trade also limited its ability to expand long-term lending to the government. In comparison, the Bank of England had more potential to convert government short-term debt into long-term liabilities. In 1697, Parliament renewed its charter to 1719 and guaranteed it as the only note-issuing bank authorized by Parliament. In return for this privilege, the Bank added £1,001,171 into its capital stock, among which four-fifths came from government tallies at their face value (even though they were discounted at 40 percent in the markets) and the rest came from the Bank's own banknotes. Its banknotes also ceased to be interest-bearing bills and became real banknotes.[355] In the same year, Daniel Defoe suggested that the Bank increase its capital to £5 million, issue banknotes worth £10 million, and establish branches in every town in England so as to remit money to and from London.[356] In this scheme, the Bank would become a real bank of England rather than the "Bank of London," which concentrated all

[354] John Brewer, "The English State and Fiscal Appropriation, 1688-1789," *Politics and Society*, Vol. 16, No. 2-3 (September 1988), p. 367.
[355] J. H. Clapham, *The Bank of England: A History*, volume I (Cambridge: Cambridge University Press, 1945), pp. 22-23; A. Andréadès, *History of the Bank of England: 1640 to 1903*, 4th edition (London: Frank CASS, 1966), pp. 111-2.
[356] Cited from Horsefield, *British Monetary Experiments*, p, 140.

its business in metropolitan London. If Parliament made its banknotes the legal tender, the Bank could greatly increase the amount of banknotes.

However, the Bank in the late 1690s remained a private "investment trust" which profited mainly from lending to the government. Parliament did not offer the status of legal tender to its banknotes, which had to compete with the banknotes issued by other private financiers and Exchequer bills in the markets. This restricted the further expansion of the Bank by the method of "engrafting" the government's outstanding tallies in peaceful years. Although the Bank was well-known as a Whig-dominated institution, it refused in 1697 to hold another £10 million government tallies as its capital stock, which was proposed by Montagu, the Chancellor of Exchequer and a major Whig in the government.[357] Business calculation outweighed political alliance as the Bank did not have a ready market to increase the issue of its banknotes and the government did not have sufficient revenue to secure these tallies.

Meanwhile, politics compounded the issue of government debt. When the Nine Years War ended in 1697, the "country party" which consisted of both the Tories and the "country Whigs," was dismayed at both corruption and mismanagement in the government's war finance.[358] These land owners were also resentful of economic recession, high interest rates, and heavy taxes on landed property. In their eyes,

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[357] Henry Horwitz, *Parliament, Policy and Politics in the Reign of William III* (Newark: University of Delaware Press, 1977), pp. 187-8.

[358] For example, cashiers of the government departments often made handsome profits by using the heavily discounted Exchequer bills at their par value to pay taxes. See David Ogg, *England in the Reigns of James II and William III* (Oxford: Oxford University Press, 1957), pp. 88-89; Dickson, *The Financial Revolution in England*, p. 416.

government borrowing was simply a transfer of the landed wealth to a small group of financiers. The land-owners in 1697 could not know that the rising revenue in future could come from the customs and excises rather than the land tax. They could not know that the future interest rate on the government's long-term borrowing would fall to as low as 3 percent. In this situation, land owners preferred rather to clear the principal of government debt.

Between 1697 and 1701, the Commons passed a series of acts to cut down the scale of the standing army and expenditures and reduce the influence of government financial officials in Parliamentary debates.[359] Meanwhile, the magnitude of government debt in 1697 made the clearance of the principal at least a possible option. In 1698, the English government had £12.2 million of unfunded short-term borrowings and £5.1 million funded long-term debts.[360] As both the domestic economy and foreign trade recovered, the net tax revenue of the government rose to more than £4 million while government expenditures were cut to £3 million in 1700. [Figure 3-1] In 1701, the amount of unfunded short-term and funded long-term debt was reduced to £9.4 million and £4.7 million respectively.[361]

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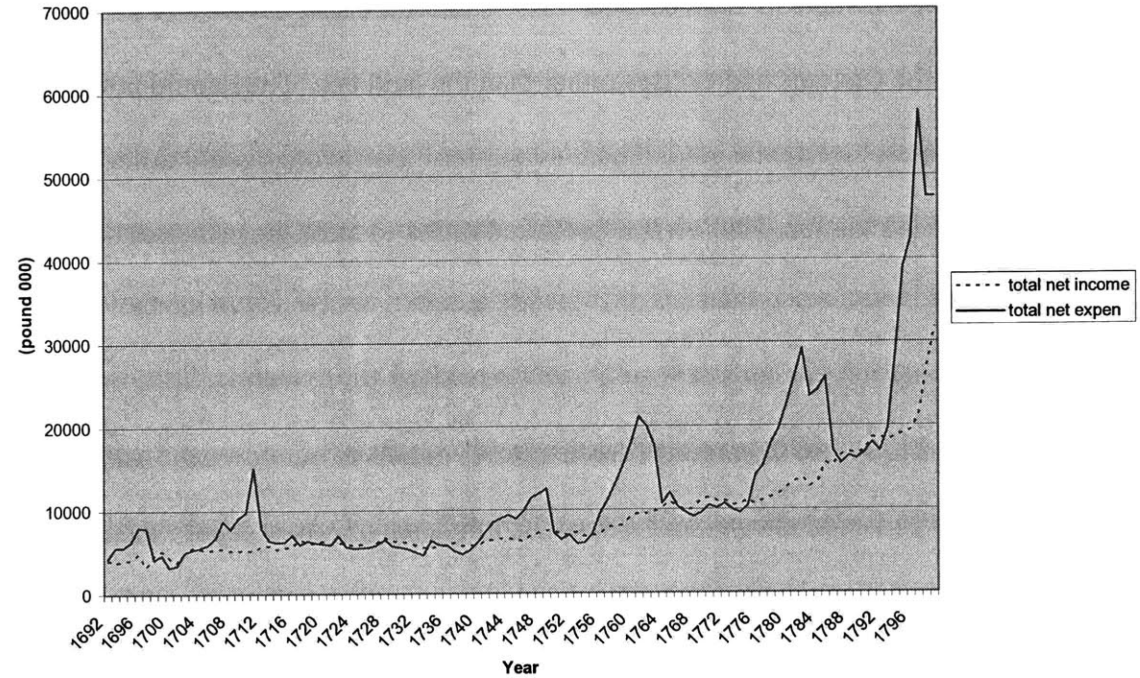
[359] Henry Horwitz, *Parliament, Policy and Politics in the Reign of William III*, chapters X and XI.
[360] B. R. Mitchell, *Abstract of British Historical Statistics*, p. 401.
[361] Ibid., p. 401.

Fig. 3-1 English government's total net income and expenditure: 1692-1799



Source: B. R. Mitchell, *Abstract of British Historical Statistics* (Cambridge: Cambridge University Press, 1962), pp. 386-391.

However, the War of the Spanish Succession completely changed the situation. When this war ended in 1713, the total debt of the English government had risen to 48 million. The long-term borrowings included £12.5 million "irredeemable" annuities (the longer annuities ended in 1792-1807 at 9 percent, the shorter ones ended in the 1740s at 7 percent) and £27.5 million "redeemable" loans owned to both the public and the three government-chartered corporations, the Bank of England (£3.37 million), the East India Company (£3.2 million), and the South Sea Company (£9.2 million). Even so, there was still a total of £7.5 million of unfunded short-term debts such as the Exchequer bills and the bills issued by the Navy, Ordnance and Victualling Board to meet their spending.[362] The magnitude of the total debt in 1714, whose annual interest payments consumed more

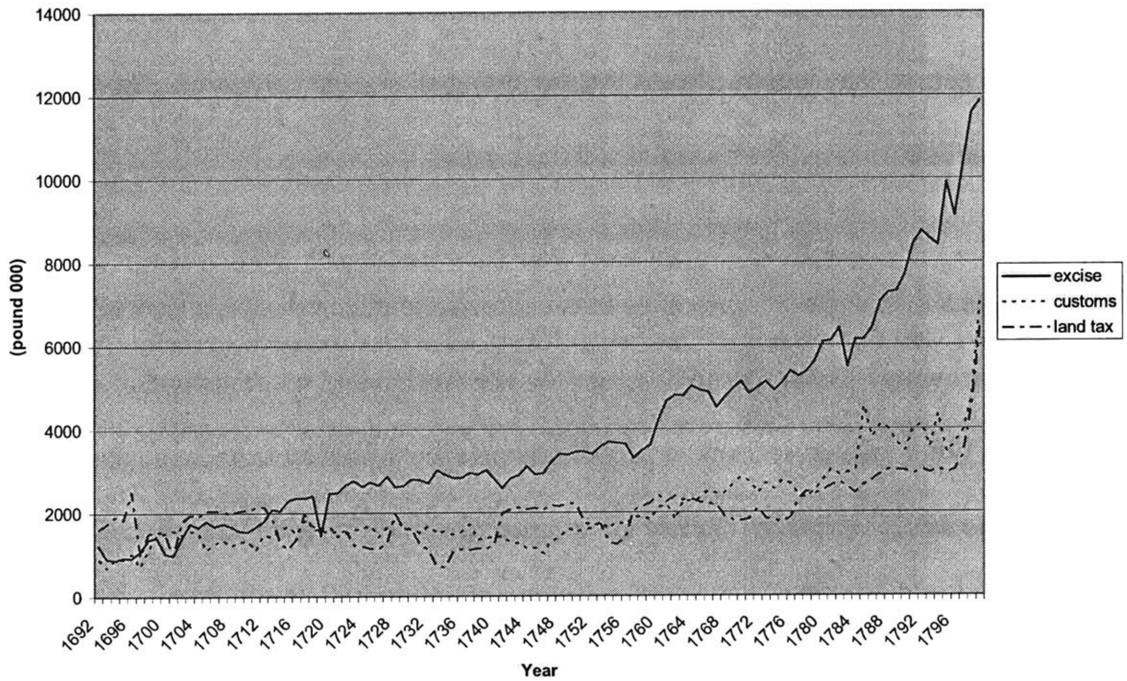
[362] Roseveare, *The Financial Revolution, 1660-1760*, pp. 52-3.

than half of the annual government expenditures, thus forced the English government to find some means to live with its debt perpetually. The direction of problem-solving was quite clear to actors; they had to convert the remaining short-term unfunded debt into long-term liabilities and reduce annual interest payments.

Meanwhile, few disputed the importance of tax revenue to the credibility of government long-term borrowing. Despite deep divergence over foreign and religious policy, both the Tory and Whig ministries came to rely more upon the indirect customs and excises rather than the direct land taxes to raise government income.[363] The increasing reliance upon the customs and excises to raise tax revenue continued after 1713. [Figure 3-2] The pressure to extract reliable indirect tax revenues to service government long-term debts motivated the English government to improve efficiency in collecting excises. Party conflicts prompted the Excise Department to become a neutral administrative department after 1717 as the Treasury wanted reliable revenue; excise officers for their part wanted to avoid being purged for taking a wrong political line.[364]

[363] The Whig ministry put candles in the excise list in 1710. In 1711, the new Tory ministry added hops, hides, and water-borne coal, and in 1712 soap, paper, starch, printed calicoes, hackney chairs, cards, and dice. See T. S. Ashton, *Economic Fluctuations in England, 1700-1800* (Oxford: Clarendon, 1959), p.28.
[364] Brewer, *The Sinews of Power*, p. 75; Hughes, *Studies in Administration and Finance*, pp. 272-3.

Fig. 3-2 Sources of English government's total net income: 1692-1799



Source: B. R. Mitchell, *Abstract of British Historical Statistics* (Cambridge: Cambridge University Press, 1962), pp. 386-388.

Even though the path toward perpetual liabilities sustained by indirect taxes became irreversible after 1713, there still remained two distinct ways of doing this. One was to convert it into perpetual annuities with lower interest rates, on which the government only needed to make interest payments. The other was to transform it into paper notes used in the economy, which made their holders de facto creditors of the state. Prior to 1713, the English government had experimented with both these methods of raising long-term credit.

During the War of the Spanish Succession, the position of the Bank of England in public finance underwent significant changes. It became the major short-term lender to the government, and took government tallies as securities.[365] In return for its rising role and thus bigger risk in providing government short-term financing, the Bank actively sought a monopoly in note-issuing so as to rid itself of competition in the issuing of banknotes.[366] In the renewed charters in 1708 and 1713, Parliament granted it the right to be the only corporation with more than six partners in the business of banking. Moreover, when the Bank began to underwrite Exchequer bills issued by the Treasury in 1707, it not only removed one major rival to its banknotes but also consolidated its importance to the government's short-term finance.[367] As the vast majority of its capital stock came from exchequer tallies or bills, government's punctual clearing of these outstanding tallies and bills was vital for the Bank to secure the credibility of its banknotes. Therefore, the Bank was quite selective in taking over government debts, and it had little interest in holding short-term bills which were not secured by pre-assigned parliamentary revenues, such as the Navy, Ordnance, and Victualling bills.

In this situation, the Tory government in 1711 chartered the South Sea Company to convert some £9.5 million outstanding Navy, Ordnance, and Victualling bills at their nominal value into redeemable long-term annuities at 6 percent. The South Sea Company could use the annuities as security to raise capital in the markets. In return for this, Parliament granted it a monopoly of trade with the Spanish Empire. As Larry Neal has emphasized, the South Sea Company represented an important method to settle unfunded government debt. Even though the South Sea Company did not have any

[365] Dickson, *The Financial Revolution in England*, p. 416.
[366] When the Bank of England experienced a major financial crisis in 1707, private financiers rejected the Bank's notes so as to weaken its power in the financial market. Andréadès, *History of the Bank of England*, p. 120.
[367] Dickson, *The Financial Revolution in England*, pp. 373-376.

profitable overseas trade, its stock-holders could always benefit from both the annuity payments from the government and the liquidity of Company stocks, which could be freely transferred in the securities market. The poor performance of the South Sea Company after its founding was mainly due to government inability to make punctual annuity payments to stock holders of the Company. As the government's fiscal condition improved after the end of war in 1713, the stock of the South Sea Company gradually reached its par value in 1716.[368]

Therefore, when the English government invited the South Sea Company and the Bank of England to bid for the right to convert the remaining £31 million of irredeemable and redeemable annuities into redeemable annuities included in their stocks in 1717, there were two different ways for the government to live with perpetual liabilities. These two chartered corporations offered distinct approaches to establishing an institutional linkage between tax revenue and the state's perpetual liabilities in the financial markets. The South Sea Company represented the path of perpetual annuities, the Bank of England that of floating paper notes. This business was profitable as the English government had demonstrated its ability to raise tax revenues from indirect sources from 1713 on. Both companies were well connected; the Bank actually had more favor within the government due to its financial services during wartime.

The Bank, however, could only pay the government a maximum of £5.4 million for this right while the South Sea Company offered £7.6 million. Meanwhile, the Bank in its proposal set the nominal value of its stocks in exchange of the assets of government

[368] Larry Neal, *The Rise of Financial Capitalism*, p. 91.

creditors, which meant the Bank would take 25 years to extinguish the government debt.[369] In contrast, the South Sea Company refused to set such a ratio in advance, and it therefore could propose to convert the same amount of government debt within 5 years.[370] The scheme of the South Sea Company was certainly more attractive to the government. But why did the Bank not offer better terms in the contest for the right to convert the huge amount of government debt? To answer this question, we need to examine the contemporary socio-economic conditions.

The issue of banknotes was the most important business for the Bank of England. Yet its issued banknotes amounted to a mere £1.5 million in 1700, and this number only grew to £4 million in 1750. In the same period, the amount of coin in the economy rose from £7 million to £18 million.[371] Meanwhile, the monetary stock in England was estimated to be around £14.5 million in 1700 and £30 million in 1750. In this light, there was a huge potential for the Bank of England as a fractional reserve bank to increase the amount of banknotes if the notes could circulate in the whole English economy instead of only in metropolitan London.

Nonetheless, the path of floating paper notes was full of business and political risks. The Bank of England in 1719 had not opened any branch outside of London, even though the idea of a "national bank" having branches in major cities to remit money and circulate

[369] For the details of the Bank's proposal to gradually convert government debt, see William R. Scott, *The Constitution and Finance of English, Scottish and Irish Joint-Stock Companies to 1720*, volume III (Bristol: Thoemmes, [1912]1995), pp. 305-6.
[370] Ibid., p. 306.
[371] Forrest Capie, "Money and economic development in eighteenth-century England," in Leandro Prados de la Escosura, ed., *Exceptionalism and Industrialization: Britain and Its European Rivals, 1688-1815* (Cambridge: Cambridge University Press, 2004), Table 10.2, p.224.

notes had been discussed in England since 1696.[372] Even in mid-eighteenth century London, major goldsmith bankers did not have large deposits in the Bank of England.[373] As goldsmith banks were not corporations, they could legally issue their own banknotes. Meanwhile, the Bank of England in the first half of the eighteenth century was far from a public bank which managed the transmission of tax revenue and official funds. For example, the Paymaster General of the Forces and the Navy Treasurer did not put their funds in the Bank of England.[374] Although the Bank had expressed interest in taking over the remittance of tax revenue, it did not succeed due to the resistance of private bankers.[375] In this light, the Bank of England as a private corporation would have confronted mounting political opposition if it attempted to behave like a public bank which transmitted tax revenue and government spending, and issued banknotes as the legal tender.

As the Bank of England chose to retain the status quo in 1720, it could not expand the issuing of its banknotes to the level determined by the monetary demand of the English economy. It thus did not have much advantage over the South Sea Company in the bidding for the right to convert government debt. At this point, the South Sea Company held £11.7 million in redeemable annuities and the Bank of England £3.4 million. The profit in note-issuing seemed to be the major factor that prevented the Bank of England from out-bidding its rival. If the Bank of England was to engraft the £31 million of

[372] Clapham, *The Bank of England: A History*, volume I, pp. 105-6.
[373] Dickson, *The Financial Revolution in England*, p. 390.
[374] It was only in the 1780s that the Bank of England began to manage the funds of the Paymaster General of the Land Forces and the Treasurer of the Navy. See J. E. D. Binney, *British Public Finance and Administration, 1774-92* (Oxford: Oxford University Press, 1958), p. 147.
[375] Ward, *The English Land Tax in the Eighteenth Century*, p. 48.

government debt into its capital stock within 5 years, it would have to enormously increase the issue of its banknotes. But how could the markets in the short run absorb the swelling number of banknotes so as to avoid their depreciation? The Bank could hardly expect a sudden huge expansion in the volume of transactions (both domestic and foreign) in London and its surrounding areas, which might demand more banknotes as the medium of transactions.

The South Sea Company could have taken a gradual approach to convert government debt, including the long-term irredeemable annuities which the government could not use the threat of repaying the principal to force their subscribers to accept lower interest rates before the fixed expiration dates. Nonetheless, the irredeemable annuities did not constitute an insurmountable obstacle for the South Sea Company to use its newly issued stocks to make the holders of irredeemable annuities "voluntarily" exchange their assets into stocks, which bore an interest of only 4 percent after 1727. As Larry Neal has pointed out, these had very low liquidity as they could only be traded in whole rather than in part; and the transferring and cashing procedures at the Exchequer were slow and cumbersome. In contrast, if they were converted into corporation stocks, they had high liquidity as they could be traded in the securities market.[376] This may have been one important incentive for the holders of irredeemable annuities to exchange them for the stocks of government-chartered corporations. Moreover, the government could prompt this transition by deliberately delaying their interest payments at the Exchequer as ordinary holders of irredeemable annuities did not constitute a powerful political group. In fact, one factor that prompted the creditors of the 1710 Lottery Loans to convert their

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[376] Neal, *The Rise of Financial Capitalism*, pp. 93-94.

assets into the stocks of the South Sea Company in 1717, even at a lower interest rate, was the arrears of the government in making interest payments.[377] Apparently, this way to convert irredeemable annuities into redeemable annuities would take a long time.

In practice, however, the necessary time to convert irredeemable annuities into the stocks of the South Sea Company was greatly reduced by the infamous South Sea Bubble in 1720. The rising value of the stocks of South Sea Company made it to issue more stocks to exchange the assets of the holders of irredeemable annuities who were enticed by the rapidly rising values of Company stocks between January and June.[378] When the Bubble burst in same year, the effect was to dramatically change the composition of government debt, as 80 percent of the irredeemable annuities and 85 percent of the redeemable annuities had been converted into stocks of the South Sea Company. These were turned into perpetual annuities at 3 percent in 1727.[379] From now on, England moved irreversibly in the direction of building an institutional linkage between the state's tax revenue and the interest payments on its redeemable long-term annuities.

When the interest rates were low in the markets, the English government could force holders of redeemable annuities to accept lower interest rates by a credible threat of repaying the principal of debt. The opportunity cost for creditors who refused this offer was to find new investment opportunities for their money. Once the English government

[377] Dickson, *The Financial Revolution in England*, p. 87.
[378] Their prices kept rising from £128 in January to the peak of £950 (recorded price) in June, and then fell to £155 in December in 1720. On the background and impact of this financial fraud, see Julian Hoppit, "The myths of the South Sea Bubble," *Transactions of the Royal Historical Society*, Vol. 12 (2002): 141-65. For the analysis of this financial fraud and the behaviors of investors, see Richard S. Dale, Johnnie E. V. Johnson, and Leilei Tang, "Financial markets can go mad: evidence of irrational behaviour during the South Sea Bubble," *Economic History Review*, Vol. 58, No. 2 (May 2005): 233-71.
[379] Dickson, *The Financial Revolution in England*, p. 134.

had demonstrated its ability to extract rising revenues from indirect customs and excises to make punctual interest payments to its annuitants, the stocks of its redeemable annuities became an ideal investment for small investors. Their low interest rate was compensated for by their remarkable security and liquidity in the markets.[380] Extraction of reliable and elastic tax revenues from the indirect customs and excises now became vital to a self-reinforcing process: demonstrated punctual interest payments attracted more subscribers of perpetual annuities, which motivated the government to maintain efficiency in collecting excises. The outcome of this self-reinforcing process came in 1752 when the English government consolidated its long-term debt into the famous "Three Percent Consol," the redeemable perpetual annuities bearing an annual interest rate of 3 percent.

The distribution effects of these institutions, which consolidated after the 1720s, significantly contributed to their stability. The increasing reliance upon the customs and excises to raise government income greatly mitigated tensions with land owners.[381] The Whig ministry continued to use the reduction in land tax as a political strategy to appease the Tories. In comparison, ordinary consumers fell victim to the collective action problem and were unable to resist the rising excises.[382] The low interest rate on the government's long-term borrowing also reduced the conflicts of interest between the

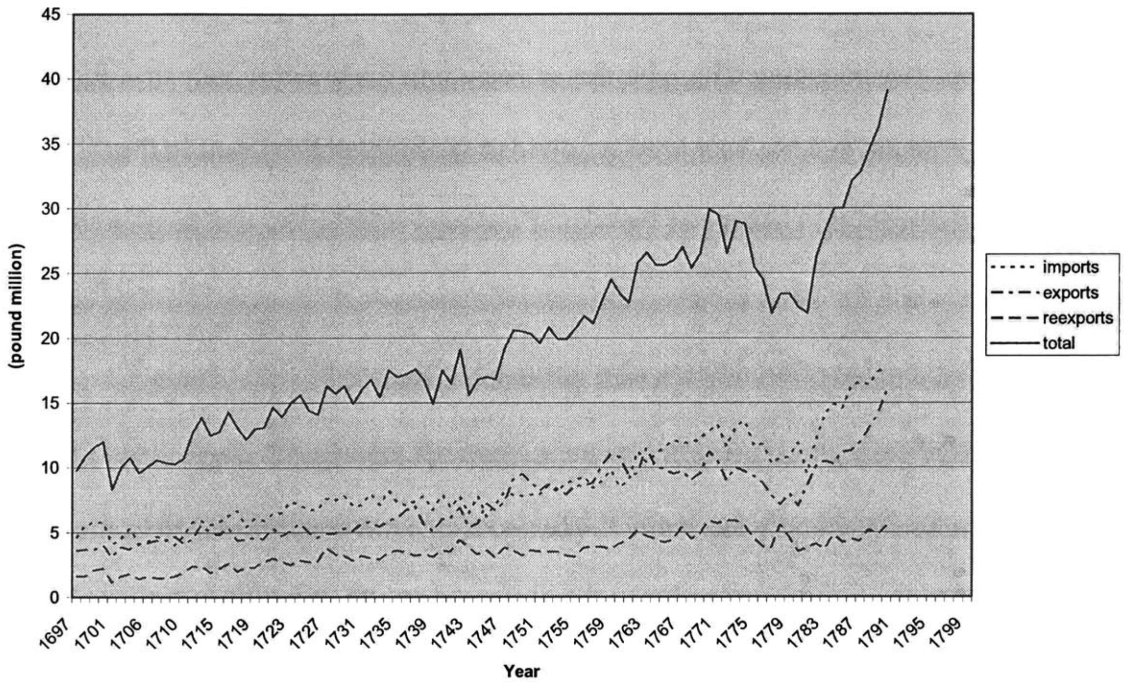
[380] Neal, "The finance of business during the industrial revolution," p. 165 and pp. 172-3.
[381] Beckett, "Land Tax or Excise," p. 305.
[382] Big anti-excise protests occurred in 1733 when Sir Robert Walpole tried to use extra excise rates on imported tobacco and wine to replace their tariff duties. They were instigated mainly by wealthy tobacco merchants who had benefited from smuggled tobacco, rather than by ordinary consumers. On the role of big tobacco merchants in this "excise crisis", see Paul Langford, *The Excise Crisis: Society and Politics in the Age of Walpole* (Oxford: Clarendon, 1975); on the role of American tobacco planters in these protests, see Jacob M. Price, "The Excise Affair Revisited: The Administrative and Colonial Dimensions of a Parliamentary Crisis," in Stephen B. Baxter, ed., *England's Rise to Greatness, 1660-1763* (Berkeley: University of California Press, 1983).

monied class and land owners who had blamed high mortgage rates on high interest rates due to government borrowing in the 1690s and 1700s. The distribution effects of the institutions of the modern fiscal state that emerged in the 1730s also explains why the efficiency of the Excise Department described by Brewer was an exception rather than the norm in the English government in the eighteenth century. As long as there were sufficient revenues to make punctual interest payments on perpetual annuities, neither Parliament nor the government had the political motivation to further improve efficiency in public finance. The management of the land tax declined considerably after the 1720s, which led to widespread under-assessment and evasion.[383] The collection of the customs was damaged by patronage politics, sinecures, and the ensuing mismanagement.[384]

Socio-economic conditions in the first half of the eighteenth century were favorable to the English government's experimentation with various means of long-term credit. In contrast to the economic recession, bad harvests, scarcity of coins, and disruption of foreign trade in the Nine Years War, the Wars of the Spanish and Austrian Successions did not disrupt England's foreign trade with the Americas, even though they greatly raised the level of government debt. England's foreign trade expanded steadily after the 1700s. In particular, the re-export of goods from North America and India to European markets via England began to grow rapidly and accounted for 40 percent of total exports by the 1750s. [Figure 3-3] Rising volumes of foreign trade in this period contributed significantly to the rise of the customs revenue, even though the collection of the customs remained inefficient and mismanaged.

[383] Ward, *The English Land Tax in the Eighteenth Century*, chapter VII.
[384] See Binney, *British Public Finance and Administration*, pp. 31-32; Brewer, *The Sinews of Power*, pp. 101-2.

Fig. 3-3 England's imports, exports, and reexports: 1697-1792



Source: B. R. Mitchell, *Abstract of British Historical Statistics* (Cambridge: Cambridge University Press, 1962), pp. 279-281.

The steady expansion of the domestic economy made it able to bear the rising excise rates on major consumer goods, particularly beer and ale. In the collection of excises, the scale and concentration in the production or wholesaling of excisable goods significantly affected efficiency. The bigger producers or wholesalers, the less able they were to evade excise officers, and the more likely to bear higher excise duties. Take the excise upon beer as an example. This contributed a quarter of the total excise revenue in the first half of the eighteenth century. The size of common brewers of beer in London had been growing since the late seventeenth century. In the 1720s, technological innovations in beer brewing led to the development of mass production and distribution of beer in

London and the larger provincial towns.[385] As small brewers were driven out of the market and the big common brewers increasingly controlled retail outlets, it became much easier to collect the excises on beer.[386] High excise rates and allowances favorable to big producers thus constituted high barrier of entry into the brewing industry. In this sense, the government and big beer brewers divided the monopolistic rent in the production and distribution of beer at the cost of ordinary consumers, the former got excise revenue while the latter received the remaining monopolistic rent.[387] The same trend toward bigger size of production also occurred to the production of salt.[388]

In comparison, the Excise officers found it hard to collect excises from small and dispersed producers. For example, due to the dispersed nature of malting, higher malt duties turned out to be counterproductive as excise officers were unable to overcome the ensuing evasion.[389] For the same reason, the efficiency of excise collection in the provinces was noticeably lower than that in metropolitan London.[390] Likewise, excise officers found it difficult to extract excises from gin consumption as there were millions of scattered distilleries.[391] Due to widespread evasion and smuggling, duty was paid on only 44 percent in the 14 million gallons of gin consumed in England in 1736.[392]

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[385] By 1748, more than 40 percent of beer in London was produced by the twelve biggest common brewers. See Mathias, *The Brewing Industry in England*, p. 26.

[386] For the development of big brewers' control of retailing channels, see Clark, *The English Alehouse: A Social History*, p. 184;

[387] As William Ashworth has pointed out, "many of the larger members of the brewing industry were against the abolishing the excise duties and the licensing system in 1830." See Ashworth, *Customs and Excise*, p. 220.

[388] Ibid., p. 238.

[389] Mathias, *The Brewing Industry in England*, p. 342.

[390] Ibid., p. 342.

[391] There were two million distilleries in UK in 1714 and this number reached five million by 1735. See Haydon, *The English Pub: A History*, p. 89.

[392] Ibid., pp. 95-6. For various methods to evade the excise duty levied on distillers, see Ashworth, *Customs and Excise*, pp. 226-9.

At the same time, the dominance of London in England's inland and foreign trade and in the financial markets significantly shaped England's path toward the modern fiscal state. There was a segment of wealthy financiers and investors in London who had enough resources to take enormous amounts of the heavily discounted government short-term bills for future speculative profits between the 1690s and 1710s. These factors provided the necessary time to experiment with various schemes to convert short-term borrowings into long-term debt. As the domestic market in the first half of eighteenth-century England was not fully integrated, the tremendous government borrowing in this period did not attract investors from the whole country.[393] Instead, some 90 percent of the 60,000 subscribers to the English government's stock of long-term annuities in the 1750s lived in London and the south-east.[394] Meanwhile, the international financial markets between London and other major financial centers in Western Europe (particular Amsterdam) had been integrated in the early eighteenth century.[395] As a result, the percentage of foreign holdings of the English government's long-term borrowing rose from 10 percent in 1723-24 to 20 percent by 1750.[396] Moreover, the Bank of England began to play the role of the lender of last resort for international finance in Western

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[393] Integration of the financial markets in England did not appear until the second half of the eighteenth century. See Moshe Buchinsky and Ben Polak, "The Emergence of a National Capital Market in England, 1710-1880," *Journal of Economic History*, Vol. 53, No. 1 (March 1993): 1-24; Julian Hoppit, "Financial Crises in Eighteenth Century England," *Economic History Review*, New Series, Vol. 39, Issue I (February 1986), pp. 52-56.
[394] Roseveare, *The Financial Revolution*, p. 68.
[395] For the financial integration between London and Amsterdam in the early eighteenth century, see Neal, *The Rise of Financial Capitalism*, chapter 3. On the dense networks that London bankers established with their merchant-agents in discounting bills of foreign exchange in the London-Amsterdam nexus, see Larry Neal and Stephen Quinn, "Networks of information, markets, and institutions in the rise of London as a financial centre, 1660-1720," *Financial History Review*, Vol. 8, No. 1 (April 2001): 7-26.
[396] Ibid., p. 74.

Europe in as early as in the 1720s, more than a century before it played the same role for the English domestic economy.[397]

The position of London also significantly facilitated the English government's endeavors to achieve fiscal centralization. This was apparent in the collection of the customs as more than half of England's foreign trade went through London in the eighteenth century. In the collection of excises, London was also heavily regulated due to its importance to excise revenue, and about 18 percent of all excise field officers worked in London in the late eighteenth century.[398] The geographic concentration in the receipts of excises was also considerable as some 80 percent were collected in either London or its neighboring counties and cities such as Hertford, Surrey, Bristol, Rochester, Suffolk, and Norwich. In contrast, the North, the Midlands, and Wales contributed only 20 percent.[399] The concentration of the excise collection in the most developed region in England made it much easier for private bankers in London (who were often tax receivers) to collaborate with excise collectors in the provinces to remit the collected excise revenue through secure and speedy bills of exchange drawn on London.[400]

IV. Conclusion

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[397] Eric S. Schubert, "Innovations, Debts, and Bubbles: International Integration of Financial Markets in Western Europe, 1688-1720," *Journal of Economic History*, Vol. 48, Issue 2, The Tasks of Economic History (June 1988), pp. 304-5.

[398] Miles Ogborn, *Spaces of Modernity: London's Geographies, 1680-1780* (New York: Guilford, 1998), p. 194.

[399] Of the 80 percent, London itself accounted for one-third. T. S. Ashton, *Economic Fluctuations in England*, p. 29.

[400] D. M. Joslin, "London Private Bankers, 1720-1785," *Economic History Review*, New Series, Vol. 7, Issue 2 (1954), p. 169. According to Hughes, the remittance of excise revenue by bills of exchange seems to have become the norm in the 1700s. Hughes, *Studies in Administration and Finance*, p. 214.

The process of institutional development in England between the 1640s and 1750s ended up with the institutions of the modern fiscal state. These used centrally collected customs and excises to service the government's massive perpetual annuities. However, the functions and distributional effects of these institutions, which contributed significantly to their stability, can hardly be invoked to explain how they emerged and consolidated.

Historical actors' efforts to build new institutions are constrained by socio-economic conditions that they cannot manipulate in the short run. The self-reinforcing process between punctual interest payments and increasing confidence in the English government's long-term borrowing, which became evident after the 1720s, depended heavily upon the development of financial markets in London and increasing scale in the production of major excisable goods. It could not unfold when the necessary socio-economic conditions are not available, as illustrated by the institutional development in the 1650s. Even though the path toward perpetual liabilities became irreversible after 1713, the overwhelming concentration of financial networks in London and its surrounding areas significantly shaped the path of institutional development toward perpetual annuities rather than paper notes.

Meanwhile, this institutional development was a process with multiple possible outcomes, such as fiscal decentralization and dependence upon tax farming in the early 1660s and a fiscal state which did not actively seek long-term borrowing in the 1680s. Each of these could "lock-in" historical actors, who were groping in uncertainty for solutions and could not know *ex ante* the institutional features of the modern fiscal state as it emerged after the 1720s. The external shocks that break these "lock-in" equilibria are not the result of actors' strategic calculations to initiate new institutions. Nor can they suffice to determine the direction of subsequent institutional development. In this situation, the credit crises which resulted from events, such as the massive issue of fictitious Treasury Orders between 1667 and 1672 and the enormous amount of unfunded short-term credit bills between 1689 and 1713, become important for us to understand the specific direction of institutional development. They not only forced state actors to experiment with various institutional arrangements but also tested their "effectiveness" at solving urgent problems. During this process of overcoming a crisis common to all state actors, effective elements, competent officials, and relevant experience accumulated continuously in spite of power struggles within the government. Once these elements were sufficient to yield a self-reinforcing process, the path toward the observed outcome became ineluctable: centralized collection of excises and the customs and the modern fiscal state.

Chapter 4 Uncertainty, Credit Crisis and Institutional Development in Late Tokugawa and Early Meiji: 1853-1871

I. Introduction:

By the early 1890s, the Japanese government had not only built centralized institutions to collect taxes and manage government spending but also safeguarded the convertibility of the banknotes issued by the Bank of Japan. These institutions of a modern fiscal state contrast sharply with the monetary chaos, fiscal decentralization, and low creditworthiness of paper notes issued by various domain governments only two decades earlier. How shall we explain this institutional outcome given the uncertainty and opacity of institutional development faced by political actors in the Meiji Restoration of 1868?

Can we use an actor-centered approach to explain this achievement? It is true that the coming of the western powers after 1853 led to a widespread sense of crisis among political actors in Japan, and they shared the common aim of protecting Japan's sovereignty and independence. The defeat in military conflicts with western powers in the early 1860s stimulated both domain governments and the shogunate (Bakufu) to introduce western weapons, reform military organizations, send officials and students to study in western countries, and so on.[401] Both the Bakufu and major domains such as Satsuma and Chōshū endorsed the same slogan of "rich state and strong army" (*fukoku kyōhei*). The similarity of Bakufu and domain modernization policies prior to 1868 has led some historians to claim that a different result in the civil war between the Bakufu

[401] See a succinct discussion of these similar modernization programs in major domain governments and the Bakufu in Marius B. Jansen, "The Meiji Restoration," in Marius B. Jansen, ed., *The Cambridge History of Japan*, volume 5 (Cambridge: Cambridge University Press, 1989), pp. 345-53.

and Satsuma-Chōshū would not have mattered as the winner would implement the same modernization policies and continue to learn from the west.[402] From this perspective, uncertainty in institutional development in early Meiji is not a severe problem because consensus over the direction of future institution building prevailed even among conflicting political actors in power struggles.

Such characterizations of the Meiji Restoration make it hard to understand why Satsuma and Chōshū took up arms to overthrow the Bakufu in the first place. If both sides truly shared the same modernization program and attitude toward the west, why did they go to a civil war? Moreover, most contemporary political actors in Japan were keenly aware of the threat of the western powers, which could only be exacerbated by the outbreak of civil war. If political leaders in Satsuma and Chōshū were truly concerned about national security, how could they launch the war against the Bakufu, which did not appear as if it would be a quick campaign in 1868?

The historiography of the Meiji Restoration in recent decades casts new light on these questions by stressing the fundamentally different ideas, agendas, and institutional designs among major competing political camps in the 1860s. Although there were advocates of the institution of assembly in both reforming domains and the Bakufu, political conservatives in the Court and Satsuma and Chōshū were in favor of imperial despotism. The armed conflict that toppled the Bakufu and established the Meiji regime

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[402] This view is often seen in recent characterizations of the Meiji Restoration. For such examples, see Philip D. Curtin, *The World and the West: The European Challenge and the Overseas Response in the Age of Empire* (Cambridge: Cambridge University Press, 2000), p. 163; Peter Duus, *Modern Japan*, second edition (Boston: Houghton Mifflin Company, 1998), p. 85.

in 1868 did not produce one political group or coalition which could immediately dominate future institutional development. Nor did it erase the previous divergences among major rival political groups. Power struggles existed not only between the Satsuma and Chōshū factions, which controlled the central government after 1868, but also between them and a group that demanded representative institutions to guarantee more "public discussion" (*kōgi*) in the process of policy making. Even among the westernizing officials, there were significant divergences about the priorities and speed of transplanting foreign models into the different socio-economic circumstances of Japan.

Therefore, the Meiji regime cannot be seen as a coherent political entity. Power struggles did not take place among political actors who shared the same ideas and institutional blueprints. When divergences among major political camps have significant impact on the distribution of political power and interests, some actors are willing to use force to attain their end. Such a background is crucially important to understand the opacity and uncertainty in the early years after the Meiji Restoration. As no political camp in early Meiji had the necessary power to dictate subsequent institution building, the deep differences among political actors over institutional development imply multiple possible outcomes. This makes it difficult to explain the rise of a particular institutional outcome over time.

This is particularly true in public finance where there were quite different models in the west. In addition to examining western models, the reforming leaders in the Meiji regime such as Itō Hirobumi also tried to find useful experiences in Japan's past for building new institutions.[403] For example, important officials of public finance in the early Meiji government such as Yuri Kimimasa and Ōkuma Shigenobu were "fiscal experts" in their respective domain governments. The mercantilist economic policies which various domain governments had implemented to encourage production and commerce in the late Tokugawa period were important legacies for the early Meiji government, particularly in its efforts to float paper notes.[404] However, the mercantilist practices of domain governments to organize business monopolies to control the production and sale of major commodities within domains also resulted in inefficiency and government deficit. Critics called for bringing more business competition and private initiative into production and commerce.[405] Moreover, it remained highly opaque in early Meiji whether the mercantilist policies previously implemented in domains would work for the national economy of Japan. In this light, historical experiences themselves were not sufficient to dispel the uncertainty in institutional development in public finance at the time.

Fierce power struggles among political factions also complicated institutional development. Institutions and policies in public finance bear the brunt of the conflict of interests both within government and between the state and society. In the early stage of institutional building, the probability of making mistakes was high. When there were

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403 Richard J. Samuels, *Machiavelli's Children: Leaders and Their Legacies in Italy and Japan* (Ithaca: Cornell University Press, 2003).

404 For an emphasis on the continuity between mercantilist economic policies in domain governments and the economic policies of early Meiji, see Luke S. Roberts, *Mercantilism in a Japanese Domain: The Merchant Origins of Economic Nationalism in 18th-century Tosa* (Cambridge: Cambridge University Press, 1998); Nishikawa Shunsaku and Amano Masatoshi, "Shohan no sangyō to keizai seisaku [The industrial and economic policies of domains]," in Shimbo Hiroshi and Saitō Osamu, eds., Kindai seichō no taidō [Gathering Momentum for Modern Growth], volume 2 of *Nihon keizaishi* [The Economic History of Japan] (Tōkyō: Iwanami Shoten, 1989), pp. 206-10.

405 Hirakawa Arata, "Chiiki keizai no tenkai [The development of a regional economy]," in *Iwanami kōza Nihon tsūshi,* Vol. 15 (*kinsei 5*) (Tōkyō: Iwanami Shoten, 1995), pp. 139-43.

major political rivals waiting to take advantage of policy mistakes made by those in power, the political cost appeared quite high for actors who initiated institutional experimentation. Meanwhile, legitimation of the new Meiji regime did not dispel uncertainties in institutional development. For example, legitimation through international power struggles demanded massive military expenditures; yet rising taxation could destroy the weak domestic political basis upon which the new regime rested. In this situation, even if we characterize the institutional development in public finance in early Meiji as a trial-and-error process, we should not take for granted that experiments with different institutional arrangements and policies which implied quite different directions of institutional development would necessarily result in continuity or accumulation in institution building along one particular direction.

In this chapter, I examine the evidence of continuity and accumulation in the institutional development in public finance in spite of significant ideological and political differences among major political actors. I argue that this was largely caused by the credit crisis of non-convertible paper notes, which was an unintended consequence of the civil war in 1868-9. The mounting expenditures that the new Meiji regime had to dispense *before* it was able to mint sufficient new currency and build the necessary taxing institutions in the early years of the Restoration forced the Meiji government to continue its reliance upon paper notes. Although the origin of this credit crisis was exogenous to subsequent institutional development in public finance, the convertibility of the issued paper notes constituted a common problem as it significantly affected not only the operation but also the legitimacy of the new regime. The credit crisis of paper notes thus exerted long-lasting effects on institutional development.

Regardless of which political faction came to power, it had to face the same problem of how to secure the value of paper notes, to which the creditworthiness of the new regime was tied. The severity of the credit crisis, which threatened the survival of the Meiji regime, significantly constrained available policy options. Meanwhile, it provided an opportunity for some young but capable officials such as Ōkuma Shigenobu, Inoue Kaoru, and Itō Hirobumi, as well as former Bakufu officials, such as Shibusawa Eiichi, to quickly rise to power and play vital roles in public finance. It also effectively protected westernizing officials in the Ministry of Finance (*Ōkurashō*) from political purges mounted by conservatives in the politically turbulent years after the Restoration. Thus, the credit crisis not only prompted officials of public finance to experiment with various institutional elements and policies but also facilitated a continuous accumulation of effective institutional experiments and personnel.

The structure of this chapter is follows. In section II, I describe the power struggles among major political actors who had divergent ideas, interests, and institutional preferences in the period between 1853 and 1868. Uncertainty in the power struggles produced an unintended consequence, the excessive dependence upon non-convertible paper notes by the early Meiji government. In section III, I discuss features of contemporary institution building and argue that neither westernization nor centralization was inevitable in the period immediately after the Restoration. In section IV, I explore how the credit crisis of paper notes prompted actors to experiment with various institutional elements and produced a particular path of institutional development in a context of multiple possible outcomes. In particular, I examine the accumulation of effective institutional arrangements in public finance in spite of fierce power struggles within the government. Section IV concludes.

II. Uncertainty, divergence in institutional designs, and the origin of the credit crisis: 1853-1868

The early modern state formed in eighteenth-century Japan was characterized by a dual sovereignty. The Bakufu as the central government administered the political system, monopolized state power in foreign affairs and coinage, and even put the Court under its firm control and supervision. Yet during the same period, the scholars of the nativist school (*kokugaku*) developed a theory (*taisei ininron*) which considered the political authority of the shogun as delegated by the Emperor, the *de jure* sovereign. This vision of the ultimate source of political power had significant implications as it provided a legitimate framework for criticism of policy mistakes by the Bakufu.[406]

In the early nineteenth century, both domestic and foreign factors increased the political ascendance of the Court. The inadequate ability of the Bakufu to handle fluctuations in the economy and social dislocations made the Court an attractive alternative symbol to

[406] As early as 1744, about 20,000 peasants gathered in Kyōto to appeal to the Court to reduce the heavy land taxes levied by the Bakufu. During the Tenmei Famine in 1787, some 10,000 people prayed in the direction of the Court for good harvests. Ōguchi Yūjirō, "Kokka ishiki to tennō [State consciousness and the Emperor]," in *Iwanami kōza Nihon tsūshi,* Vol. 15 (*kinsei 5*) (Tōkyō: Iwanami Shoten, 1995), pp. 207-8.

express discontent with and criticisms of the Bakufu.[407] The Mito School, the most influential intellectual movement in Japan during the late eighteenth and early nineteenth centuries, emphasized the role of the Emperor as the sovereign and advocated that the Court become the means to unite the Japanese in response to increasing domestic instability and threats from the west (*sonnōron*).[408] Nonetheless, the urgency to strengthen maritime defense in the 1830s and 1840s did not strike a fatal blow to the existing political system. The Emperor in theory "delegated" the affairs of national defense to the Bakufu, which in turn mobilized domain governments, particularly those located in strategic locations such as Chōshū, Satsuma, and Mito, to strengthen defense.

Nonetheless, this political system was under great strain following the arrival of Perry's fleet in 1853. When the Bakufu in 1854 consulted with daimyos about their attitudes toward the opening of Japan, replies varied significantly. The hardliners, such as the lords of Chōshū, Tosa, Kuwana, and Mito, wanted to use force to expel the foreigners. The majority of daimyos, including the lord of Satsuma, were concerned about the military superiority of western powers and thus preferred to avoid immediate conflict. They proposed the opening of some ports as a means of appeasement, which would give the government time to prepare militarily. The lords from the domains where the so-called "western learning" (mainly via the Dutch) had flourished, such as Sakura, Tsuyama, and Nakatsu, considered Japan's trade with the west an unavoidable trend in

[407] In the well-known Ōshio Heihachirō revolt in 1837 in Ōsaka, Ōshio openly used the exclusion of the Court from politics as a point of critique. Harold Bolitho, "The Tempō crisis," in Marius B. Jansen, ed., *The Cambridge History of Japan*, volume 5 (Cambridge: Cambridge University Press, 1989), p. 167.

[408] Bitō Masahide, "Sonnō jōi shisō [The thought of revering the Emperor and expelling the barbarians]," in *Iwanami kōza Nihon rekishi*, Vol. 13 (*kinsei 5*) (Tōkyō: Iwanami Shoten, 1977), pp. 78-80.

the new international circumstances. They advocated enriching Japan through active participation in foreign trade.[409]

As the Court and the Bakufu split over the issue of opening and the treaty terms with western powers, the division among domain governments became de-stabilizing. Realistic concessions that the Bakufu made to western powers simply provided ammunitions for anti-foreign elements in the domains and the Court to attack the Bakufu. For example, the first commercial treaty that the Bakufu council negotiated with the American in 1857 had better terms than those in the treaty that Western powers imposed on China after the Opium War.[410] Nonetheless, the draft of the treaty and the agreed opening of Yokohama, Nagasaki, Niigata, and Hyōgo (Kōbe) aroused much opposition among influential political figures such as Tokugawa Nariaki, the most prominent hardliner in the Bakufu, and the lords of Satsuma, Mito, and Chōshū, as well as among the broader ranks of samurai. Emperor Kōmei in 1858 refused to approve the treaty.

Foreign pressure forced the Bakufu to sign the treaties with the Americans, Dutch, British, French, and Russians without imperial sanction. This act, however, clearly violated the "delegation theory of political authority" and immediately made the Court the rallying point for anti-foreign radicals. The alignment of loyalty to the Emperor with the expulsion of westerners greatly damaged the Bakufu's legitimacy. In 1860, anti-foreign

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[409] Ono Masao, "Daimyō no ahen sensō ninshiki [Daimyos and the knowledge about the Opium War]," in *Iwanami kōza Nihon tsūshi,* Vol. 15 (*kinsei 5*) (Tōkyō: Iwanami Shoten, 1995), pp. 299-310.

[410] Although both had a fixed 5 percent tariff rate on exports and the creation of consular courts, the Bakufu did not grant American businessmen or missionaries the right to travel freely in Japan, nor did it allow most-favored-nation status. See Marius B. Jansen, "The Meiji Restoration," in Marius B. Jansen, ed., *The Cambridge History of Japan*, volume 5 (Cambridge: Cambridge University Press, 1989), footnote 11 in p. 316.

radicals dominated the Court and mounting calls to "immediately expel the western barbarians" reached a peak in 1863 when Emperor Kōmei ordered the repeal of the treaties and the expulsion of foreigners by force (*hayaku jōi*). Radicals in Chōshū, the stronghold of *jōi* activists, bombarded western ships. Clashes also broke out between Satsuma and the British. For the anti-foreign radicals, the Bakufu should be toppled if it opposed the Emperor's *jōi* order.[411] The retaliation by four of the treaty powers – Britain, France, Holland, and the US – forced the realistic hardliners in Satsuma to collaborate with the Bakufu to purge anti-foreign radicals in Chōshū, Mito, and the Court so as to avoid the possibility of even more humiliating treaties that would inevitably come after military defeat.

By this point, the Bakufu had clearly ceased to be the undisputed representative and guardian of the "public interest" of Japan. Both the Court and major "outside" daimyos (*tozama*) became involved in the making of foreign policy, which was unprecedented in the Tokugawa period. Although powerful daimyos failed to establish an institution, such as an assembly of lords, to formally participate in policy making, the Bakufu had to take seriously their opinions regarding treaties.[412] Meanwhile, the Bakufu was unable to mobilize domain troops if daimyos considered the action not to be in the national interest, as illustrated by the fiasco of the second punitive expedition against Chōshū in the

[411] See the succinct account of these anti-foreign movements in Peter Duus, *Modern Japan*, second edition, pp. 72-4. On the plan to overthrow the Bakufu, see Yasumaru Yoshio, "1850-70 nendai no Nihon: ishin henkaku [Japan between the 1850s and 1870s: restoration and change]," in *Iwanami kōza Nihon tsūshi*, Vol. 16 (*kindai 1*) (Tōkyō: Iwanami Shoten, 1994), pp. 20-21.
[412] Sasaki Suguru, *Bakumatsu zeiji to Satsuma han* [Satsuma and the Politics in Late Tokugawa] (Tōkyō: Yoshikawa Kōbunkan, 2000), pp. 281-6.

summer of 1866.[413] This failure, as the historian Conrad Totman has pointed out, formally marked the end of the Bakufu's political dominance.[414] In the autumn of 1866, Matsudaira Shungaku, a powerful Tokugawa relative and former lord of Fukui, proposed that the Bakufu return sovereign powers in diplomacy, command of the daimyos, and coinage to the Court and that policy decisions be made consequent upon "public discussion" among representatives from domains and the Bakufu, instead of by the Bakufu alone. Shungaku's plan was supported by Satsuma, the most powerful domain at the time.[415] How to establish alternative political institutions thus became a pressing problem for political actors in late 1866.

At the same time, they were also split over the implementation of the signed treaties. Major leaders of the realistic hardliners, such as Kido Takayoshi of Chōshū and Ōkubo Toshimichi and Saigō Takamori of Satsuma, rejected the radicals' demand for "immediate expulsion of western barbarians"; yet they considered the treaties that the Bakufu had signed a "national dishonor." In their view, once Japan became militarily prepared, it should have the autonomy to decide whether to open ports and to revise the unequal treaties with the West.[416] When the British and French envoys in March 1867 requested the opening of Hyōgo according to the signed treaties, leaders of Satsuma proposed that the Court should be in charge of diplomacy and important foreign policies should be decided upon the basis of "public discussion" among the Court, the Bakufu,

[413] Most daimyos, particularly those in southwestern Japan, refused to follow Bakufu orders because they considered this campaign to go against national security at a time when Japan was under threat from western powers. For a discussion of this point, see Aoyama Tadamasa, *Meiji ishin to kokka keisei* [The Meiji Restoration and State Formation] (Tōkyō: Yoshikawa Kōbunkan, 2000), pp. 211-21.
[414] See Conrad Totman, *The Collapse of the Tokugawa Bakufu, 1862-1868* (Honolulu: University of Hawaii Press, 1980), chapter 8.
[415] Aoyama Tadamasa, *Meiji ishin to kokka keisei* [The Meiji Restoration and State Formation], pp. 233-4.
[416] Sasaki Suguru, *Bakumatsu zeiji to Satsuma han* [Satsuma and the Politics in Late Tokugawa], p. 220,

and great lords.[417] However, the western powers did not give time for the Japanese to settle their internal divisions. In June 1867, the Bakufu had to agree to open Hyōgo before obtaining the agreement of the great lords. This decision severely alienated the lords and became a turning point for re-alliance of major political actors.[418]

At this moment, Japan's future political institutions remained highly opaque as there were three major political camps with different ideas, agendas, and blueprints. The first was the Restoration Camp, consisting mainly of the anti-Bakufu Court nobles, and hardliners in Satsuma and Chōshū. Many of these Court nobles, including Iwakura Tomomi, had been had been purged and disciplined for their support of the anti-foreign radicals in 1860-4. They returned to the Court after a general pardon was issued at the succession of the new Emperor Mutsuhito (the future Meiji Emperor) in February, 1867. Politically, this was a highly conservative camp as it planned to restore an imperial government in which the Emperor governed with the aid of his ministers. It was willing to use force to overthrow the Bakufu.

The second camp is often referred as the Camp for Assembly (*kōgi seitai*) in the recent historiography of the Meiji Restoration. Leaders of this camp included Yamauchi Yōdō (lord of Tosa), and Matsudaira Shungaku (lord of Fukui). It also had some prominent westernizing thinkers such as Yokoi Shōnan from Echizen. They were in favor of a system resembling "monarchical constitutionalism." The Emperor would be sovereign, yet important policies were to be made by a bicameral legislature (*gijiin*). The Upper

[417] Aoyama Tadamasa, *Meiji ishin to kokka keisei* [The Meiji Restoration and State Formation], pp. 240-2.
[418] W. G. Beasley, *The Meiji Restoration* (Stanford: Stanford University Press, 1972), p. 269.

House would be an "assembly of daimyos" and the Lower House made up of "competent and virtuous" people regardless of their social status.[419] In the meeting with Sir Harry Parkes in September 1867, Gotō Shōjirō from Tosa expressed an interest "to adopt in Japan the English-style parliament and constitution."[420] In the summer of 1867, Satsuma and Tosa reached an agreement that state power should return to the Court (*ōsei fukko*), and Japan should seek new treaties with western powers. However, the leaders of Tosa did not want to overthrow the Bakufu but planned to let the shogun join the future legislature along with other lords.[421] The Assembly Camp also represented the interest of many daimyos as the proposed bicameral legislature provided them an institutional basis to participate in national politics.

The third camp was the Bakufu, which was working out its own scheme for Japan's future political institution. Bakufu officials who had returned from studying in Holland, such as Nishi Amane and Tsuda Mamichi, planned to preserve the Bakufu as the administrative institution and build a new bicameral legislature. The Upper House was to be an assembly of daimyos and the Lower House composed of samurai-representatives from each domain. The shogun was the real sovereign, in charge of not only administration but also the Upper House, while the Emperor became a nominal sovereign with no real political power but only ritual authority.[422]

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419 Cited in Sasaki Suguru, "Taiseihōkan to tōbaku mittyoku [Returning power to the Emperor and the secret imperial order to overthrow the Bakufu]," *Jinmon gakuhō*, No. 80 (March 1997), p. 4.

420 Inoue Katsuo, *Bakumatsu ishin seijishi no kenkyū* [Studies in the Political History of late Tokugawa and Early Meiji] (Tōkyō: Hanawa Shobō, 1994), p. 343.

421 See the emphasis on the key difference between Tosa and Satsuma in Sasaki Suguru, "Taiseihōkan to tōbaku mittyoku [Returning power to the Emperor and the secret imperial order to overthrow the Bakufu]," p. 14.

422 Tanaka Akira, "Bakufu no tōkai [The fall of the Bakufu]," in *Iwanami kōza Nihon rekishi*, Vol. 13 (*kinsei 5*) (Tōkyō: Iwanami Shoten, 1977), pp. 338-42.

While the Restoration Camp was actively mobilizing troops for a coup to topple the Bakufu, leaders of the Assembly Camp were worried that a civil war between the Bakufu and Satsuma-Chōshū would invite western intervention and thus threaten the security and independence of Japan. In their view, there was no big difference between a Court under the control of the Bakufu and one manipulated by Satsuma and Chōshū. The idea of a bicameral legislature formed the common ground for the Assembly Camp to reach compromise with the Bakufu, especially when the latter agreed to be demoted to an equal status with other great daimyos in the future legislative institution. In November, 1867, the shogun Yoshibonu agreed to return "sovereign power" to the Court after months of negotiation with representatives of Tosa and Echizen, two leading domains in the Assembly Camp. On January 3, 1868, Yoshibonu formally consented to resign and to return the Bakufu's large territories to the new imperial government. If these plans were carried out, the Restoration Camp would lose any legitimate excuse to use force against the Bakufu.[423]

Given the differences among these three political camps, the political stakes were huge and concrete. How these power struggles played out had significant bearings on subsequent institutional development in Japan. Coalition between the Assembly Camp and the Bakufu would greatly strengthen the political power of the advocates of a bicameral assembly, particularly if they had enough time to take over the Bakufu's administrative machinery and competent bureaucracy. This would have been a nightmare

[423] Haraguchi Kiyoshi, *Nihon kindai kokka no keisei* [The Formation of the Modern State in Japan] (Tōkyō: Iwanami Shoten, 1968), p. 35.

for the conservatives in the Restoration Camp. Fear of such a scenario may explain why the military leaders of Satsuma were desperate to provoke conflict so as to find an "excuse" to attack the Bakufu. Provocation by Satsuma troops soon led to a fight with the Bakufu forces in Toba-Fushimi on January 27, 1868. The ensuing anti-Bakufu military campaigns, which lasted for more than a year (*boshin sensō*), were thus hardly a well-planned one in advance.

For the Restoration Camp, there was an optimal sequence to take over political power. As the Bakufu had formally agreed to turn its vast territories over to the newly established imperial government, the Restoration Camp should have taken control of this important tax base before hostilities began.[424] Or the Restoration Camp should at least have taken the Mint *before* commencing military action. The Mint was not only a symbol of the sovereign power, but also an important source of revenue. If the Bakufu refused to turn the Mint over to the Court, then there would be a legitimate reason for the Restoration Camp to use force. The fact that the Restoration Camp did not take this sequence indicates how pressing the political situation had become.

One direct consequence of launching the war prior to securing financial resources was that the Restoration Camp was totally unprepared to fund its military campaigns. As the restored imperial government had little creditworthiness in the financial markets at the beginning, it could hardly borrow from big merchants. By June 1868, it only received 230,000 *ryō* in Ōsaka and 17,250 *ryō* in Kyōto through "forced loans" (*goyōkin*). Yet the

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[424] In January 1868, the estimated rice output of the territory under the Court's control was only 100,000 *koku*, compared to 8 million *koku* in the Bakufu's territory.

estimated expenditures of the Eastern Expedition against pro-Bakufu troops exceeded 3 million *ryō*.[425] As a result, by June 1869 the Meiji government had issued 48 million *ryō* of non-convertible paper notes denominated in gold (*dajōkansatsu*), most of which was used to meet the government's fiscal needs.[426] This exigent fiscal measure aroused strong opposition even within the Restoration Camp; but there was no plausible alternative.[427] The origin of the credit crisis of paper notes was thus an unintended consequence of the complicated power struggles in 1868 and exogenous to subsequent institutional development in public finance.

III. Multiple possible outcomes and the unintended consequences of abolishing domains: 1868-1871

The military victory in the Toba-Fushimi battle gave the Restoration Camp more power to politically dominate the Assembly Camp which had been advantageous prior to this battle.[428] Nonetheless, the Meiji Restoration in 1868 as an event did not erase the deep divergences over the future direction of institutional development between the Restoration Camp and the Assembly Camp. From the very beginning, the institution building of the Meiji regime was rife with internal power struggles among political groups having divergent agendas, ideas, and interests.

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425 Fujimura Tōru, *Meiji zaisei kakuritsu katei no kenkyū* [A Study of the Process of Building the Public Finance of the Meiji Regime] (Tōkyō: Chūō Daigaku Shuppansha, 1968), p. 14.

426 More than 60 percent was used to dispense the Meiji government's expenditures, 20 percent was lent to various domain governments, and 14 percent was used to "encourage businesses" (*kangyō*). Calculated from Sawada Akira, *Meiji zaisei no kisoteki kenkyū: ishin tōsho no zaisei* [A Study of the Foundation of Public Finance of the Early Meiji Regime] (Tōkyō: Hōbunkan, 1934), p. 121.

427 Fujimura Tōru, *Meiji zaisei kakuritsu katei no kenkyū* [A Study of the Process of Building the Public Finance of the Meiji Regime], pp. 27-28 and p. 38.

428 See Haraguchi Kiyoshi, "Meiji shonen no kokka kenryoku [The State Power in the Early Meiji]," in *Taikei Nihon kokkashi* [A History of the State in Japan], volume 4, *kindai* 1 (Tōkyō: Tōkyō Daigaku Shuppankai, 1975), pp. 80-2.

Leaders of the Assembly Camp attempted to advance the agenda of establishing a legislative institution which would represent the interest of domain governments and secure their participation in national politics. In June 1868, Fukuoka Takachika (from Tosa) and Soejima Taneomi (from Hizen) drafted the Proposals of Political Foundation (*seitaisho*), which called for a separation of powers among the administration, legislation, and jurisdiction as the fundamental political principle of Japan. Leaders of the Assembly Camp, such as Yamanōchi Yōdō (lord of Tosa) and Akizuki Tanetatsu not only evaluated various legislative systems in western countries but also invited former Bakufu officials who had studied western constitutionalism, such as Kanda Takahira, Katō Hiroyuki, and Tsuda Mamichi, to join their cause. On April 18, 1869, a deliberative institution (*kōgisho*) based upon the model of the Lower House in Holland was established.[429]

However, political conservatives in the Restoration Camp endorsed the idea of "imperial sovereignty," i.e., the divine authority of the Emperor as the ultimate source of state power and legitimacy. They had no interest in any kind of representative assembly. Military victories in 1868-1869 gave them more power to affect the institution building in the new Meiji regime. When the pro-Bakufu troops were completely repressed in June 1869, Court nobles and leaders of Satsuma and Chōshū cam to control the new institution of the Council of State in the central government. They reorganized the *kōgisho* as a mere consultative organization (renamed as *shūgiin*, "House of Deliberation") that had no authority in policy making. They expelled prominent figures in the Assembly Camp such

[429] Yamazaki Yūkō, "Kōgi chūshutsu kikō no keisei to hōkai [The formation and collapse of the institutions of public discussion]," in Itō Takashi ed., *Nihon kindaishi no saikōchiku* [The Reconstruction of the Modern History of Japan] (Tōkyō: Yamagawa Shuppansha, 1993), pp. 60-61.

as Yamanōchi Yōdō, Akizuki Tanetatsu, Katō Hiroyuki, and Tsuda Mamichi from the *shūgiin*. Anti-western Court nobles such as Ōhara Shigenori dominated the *shūgiin* and turned it into a forum to attack officials who advocated learning from the west.[430]

At the same time, anti-foreign radicals who had been mobilized by the Restoration Camp to overthrow the Bakufu persecuted Japanese Christians and attacked foreigners.[431] Strong reaction from western powers forced the leaders of the new Meiji regime to continue the former government's appeasement policies, which in the past had been severely criticized by the Restoration Camp. In this situation, anti-foreign radicals turned their anger toward the westernizing officials in the Meiji government and prominent advocates of western learning. Yokoi Shōnan, a famous westernizing thinker, was assassinated on February 15, 1869. Ōmura Masujirō, a proponent of a western-style conscript army, was killed in the same year. Many high-ranking officials in the Meiji government, such as Sanjō Sanetomi, Soejima Taneomi, and Ōhara Shigenori, were openly sympathetic to the assassins.[432] On the whole, the early Meiji was not a regime that was eager to learn from the west.

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[430] Kasahara Hidehiko, *Meiji kokka to kanryōsei* [The Meiji State and Bureaucracy] (Tōkyō: Roshohō, 1991), p. 41.

[431] On February 4, 1868, samurai soldiers from Bizen attacked foreigners in Kōbe. On March 8, samurai soldiers from Tosa domain attacked French soldiers in Sakai. In May, the Meiji government arrested more than one hundred Christians in Nagasaki. From November onward, the persecution of Christianity spread to eighteen domains, including Saga and Satsuma, and by February 1870 more than 3,400 Christians had been put into prison. See Miyaji Masahito, "Haihan chiken no seiji katei [The political process of abolishing the domains]," in Banno Junji and Miyaji Masahito eds., *Nihon kindaishi ni okeru tenkanki no kenkyū* [Studies of the Transition Period in the Modern History of Japan] (Tōkyō: Yamagawa Shuppansha, 1985), pp. 70-71.

[432] Ibid., pp. 70-71.

In regard to the relationship between the center and domain governments, the Meiji government did assert its sovereign power in monetary issues. For example, it succeeded in persuading Satsuma and Tosa to stop counterfeiting Bakufu coins and forbade domain governments from issuing their own paper notes.[433] It also prohibited domain governments from borrowing from foreigners without the approval of the center.[434] However, the central government at the time did not have the necessary fiscal and military capacities to initiate full-fledged centralization. Without full control of the institutions of taxation to extract revenues from the former Bakufu territories, it could not retain the troops that had been mobilized in the anti-Bakufu campaigns as a standing army. As a result, these samurai soldiers were sent back to their respective domains, even though Itō Hirobumi had proposed that the Court should select from them "competent soldiers" to form a central army.[435]

Military decentralization in early Meiji was thus worse than that of the late Tokugawa period, as the Bakufu had at least had its own large army. In this situation, the central government could hardly take over the tax bases of domain governments. Major domain governments could obstruct fiscal and military centralization. For example, domains with large numbers of samurai troops, such as Satsuma, Chōshū, Saga, Tosa, Kurume, and Akizuki, rejected the central government's request to turn half of their military

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[433] Niwa Kunio, *Chiso kaiseihō no kigen: kaimei kanryō no keisei* [The Origin of the Reform Laws of Land Taxation: The Formation of the Enlightened Bureaucrats], pp. 62-63 and p. 75.
[434] Matsuo Masahito, *Haihan chiken no kenkyū* [Research on the Abolishing of Domains] (Tōkyō: Yoshikawa Kōbunkan, 2001), pp. 81-84.
[435] Senda Minoru, *Ishin seiken no chokuzoku guntai* [The Army of the Restoration Regime] (Tōkyō: Kaimei Shoin, 1978), p. 56.

expenditures over to the center.[436] In late 1870, Yamagata Aritomo, who had just returned from investigating the military system in Europe, had to admit that it was premature to replace military decentralization with a centralized conscription army.[437]

At the same time, domain governments initiated various reforms to reduce expenditures by cutting the stipends of their vassals and the size of their samurai armies. Domain governments in Tosa, Hisai, and Wakayama proceeded to replace samurai-based domain troops with peasant recruits.[438] Domain governments in Tosa, Hikone, Chōshū, Fukui, and Yonezawa issued bonds to dissolve their obligations to provide hereditary stipends to samurai vassals.[439] In October 1870, the conference on reforming domain institutions held in Tōkyō finally reached an agreement that the level of the military budget of domain governments should not exceed 9 percent of their rice output (reduced from the originally proposed 18 percent), half of which was to be sent to the center and half kept to support their own domain armies.[440] Although domain rulers ceased to be hereditary and had to be nominated by the central government, the central government did not penetrate into the administration of domains. The center itself turned its attention to strengthening the administration and reforming the taxation system in the territories that it inherited from the Bakufu. At this point, leaders in the center did not consider the abolition of the

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[436] Banno Junji, "Meiji kokka no seiritsu [The formation of the Meiji state]," in *Nihon rekishi taikei*, volume 4, *Kindai*, No. 1 (Tōkyō: Yamagawa Shuppansha, 1987), p. 274.
[437] Senda Minoru, *Ishin seiken no chokuzoku guntai* [The Army of the Restoration Regime], p. 162.
[438] Ibid., p. 116 and pp. 180-8.
[439] Tosa adopted this method in November 1870, the other four domains between May and August in 1871. All occurred before the abolition of the domains. See Senda Minoru, *Ishin seiken no chitsuroku shobun: tennōsei to haihan chiken* [The Restoration Regime's Commutation of the Stipends of Lords and Samurai: The Emperor System and the Abolishing of the Domains] (Tōkyō: Kaimei Shoin, 1979), p. 421.
[440] Ibid., p. 116.

domains a practical strategy.[441] Fiscal centralization was far from inevitable in Japan in 1868, even though the sovereign power of the center in matters such as monetary unification and administrative conformity was accepted by domain governments.

The political situation in 1870 was thus similar to a federal system with a unified monetary and legal system in which domain governments retained much autonomy in reforming their governance according to their respective past customs and current circumstances.[442] As the central government did not have a large-scale standing army between 1868 and 1871, it did not have the power to impose centralization upon domain governments, particularly those such as Satsuma, Chōshū, and Tosa that still had sizeable troops. Concerns of national security and defense did not push the Meiji government to centralize the army as this end could be achieved with military and fiscal decentralization. In contrast to England after the Glorious Revolution in 1688, where the protection of Protestant succession and the war against Catholic France remained an effective means to legitimate the new regime, it was financially impossible for the new Meiji regime to use international warfare to justify itself. In February 1869, fiscal conditions forced it to reject Kido's proposal to invade Korea. For the same reason, the Meiji government tried hard to avoid direct confrontation with the Russian over the issue of the Kurile Islands.[443]

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[441] Takahashi Hidenao, "Haihan chiken ni okeru kenryoku to shakai" in Yamamoto Shirō ed., *Kindai Nihon no seitō to kanryō* [Political Parties and Society in Modern Japan] (Tōkyō: Sōmotosha, 1991), p. 23.
[442] On the attempt to imitate the American federal system in the first years of the Meiji Restoration, see Inoue Katsuo, *Bakumatsu ishin seijishi no kenkyū* [Studies in the Political History of late Tokugawa and Early Meiji] (Tōkyō: Hanawa Shobō, 1994), p. 411.
[443] Fumoto Shinichi, "Ishin seihu no hoppo seisaku [The Northern Policy of the Restoration Regime]," *Rekishigaku kenkyū*, No. 725 (July 1997), p. 25, particularly footnote 86.

Nonetheless, this balance of power between center and domains was disrupted by anti-foreign radicals. The problem became more severe when financially exhausted domain governments, particularly Satsuma, Chōshū, and Tosa, began to cut the numbers of their domain troops in 1869. Thousands of samurai soldiers who were dissatisfied with the terms of their demobilization fled to Kurume, Kumamoto, and Akita, whose daimyos were well-known for their endorsement of the immediate "expulsion of foreigners." In October 1870, these domains actively colluded with anti-foreign Court nobles such as Toyama Mitsutsune and Otagi Michiteru and planned to launch a "Second Restoration" to reverse the appeasement policy and purge the "wicked" westernizing officials from the central government.[444] On February 1871, radicals assassinated Hirosawa Saneomi, a senior leader and an important advocate of a western-style conscription army in the Meiji government. The central government, which only had a small-scale army, had to request the lords of Satsuma, Chōshū, and Tosa to send troops to protect it from the attacks of radicals. On March 30, 1871, some 8,000 samurai soldiers from the three domains came to Tōkyō to form the imperial army. A new round of power struggles broke out in the center.

The realistic hardliners such as Saigō Takamori and Ōkubo Toshimichi from Satsuma thus were powerful figures in the central government. In addition to protecting the central government and containing anti-foreign radicals, they had their own political agendas. Saigō Takamori considered the westernizing projects, such as railway building,

[444] Miyaji Masahito, "Haihan chiken no seiji katei [The political process of abolishing the domains]," pp. 104-107. See the details of the political crisis of the Meiji regime in 1870 also in Shimoyama Saburō, *Kindai tennōsei kenkyū josetsu* [A Study of the Tennō System] (Tōkyō: Iwanami Shoten, 1976); Satō Shigerō, *Kindai tennosei keiseiki no kenkyū* [The Study of the Formation Period in the Tenno System] (Tōkyō: San'ichi Shobō, 1987).

"mindless imitations" of the west; he believed they were wasteful and responsible for government fiscal difficulties.[445] He particularly disliked westernizing officials in the Ministry of Finance, such as Ōkuma Shigenobu, Inoue Kaoru, and Shibusawa Eiichi. In Saigō's view, these "vulgar officials" did not understand the importance of "virtue" but only knew how to calculate interest.[446] According to Saigō and Ōkubo, the correct ways to overcome the government's fiscal difficulties were to reduce government expenditures by "stopping the projects of railway and steam power" and eliminating "redundant officials," by which they mean Ōkuma, Inoue, Itō and the former Bakufu bureaucrats employed by the Ministry of Finance.[447] In response, Kido Takayoshi, the leader of the Chōshū faction in the center tried to protect these officials so as to consolidate his own power base.

Meanwhile, Itagaki Taisuke from Tosa and officials from domains such as Higo, Tokushima, and Yonezawa formed a political group which demanded "fairness and impartiality" in policy making. Aiming to break the control of the central government by Satsuma and Chōshū, they called for the establishment of a national institution which could represent the interests of other domains.[448] The wrangling over the institutional

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[445] Ishii Takashi, "Haihan no katei ni okeru seikyoku no dōkō [Political trends in the process of abolishing the domains]," originally published in *Tōhoku Daigaku Bungakubu Kenkyū Nenpō*, No. 19 (July 1969). Reprinted in Matsuo Masahito ed., *Ishin seiken no seiritsu* [The Establishment of the Restoration Government] (Tōkyō: Yoshikawa Kōbunkan, 2001), p. 268; Fukuchi Atsushi, *Meiji shinseiken no kenryoku kōzō* [The Power Structure of the New Meiji Government], p. 6.
[446] Fukuchi Atsushi, *Meiji shinseiken no kenryoku kōzō* [The Power Structure of the New Meiji Government], p. 8.
[447] Ibid., p. 18; Niwa Kunio, *Chiso kaiseihō no kigen: kaimei kanryō no keisei* [The Origin of the Reform Laws of Land Taxation: The Formation of the Enlightened Bureaucrats], p. 235 and pp.239-40.
[448] Matsuo Masahito, *Haihan chiken no kenkyū* [Research on the Abolishing of the Domains], pp. 282-291.

design of the center lasted for a few months and ended up with an abrupt decision to abolish the domain system on August 29, 1871.[449]

At this moment, institutional development in public finance was not determined by the outcome of the power struggles among major political groups only. Different institutional designs put forward by various political factions in the government were now subject to one common constraint, the credit crisis in the form of the paper notes upon which the Meiji government depended. In the next section, I examine how the non-convertible paper notes which started as an exigent fiscal measure in the civil war of 1868-1869 developed into a credit crisis, to which both the legitimation and creditworthiness of the new Meiji regime were closely tied.

IV. The credit crisis of paper notes and its impact on institutional development

The Meiji government depended heavily on the issue of non-convertible paper notes (*dajōkansatsu*) to fund the wars against pro-Bakufu troops, which amounted to 48 million *ryō* by June 1869. At the time, the monetary system in Japan was in complete chaos. Coins minted by the former Bakufu, Bakufu currencies counterfeited by some domain governments, particularly Satsuma, Tosa, and Saga, paper notes issued by domain governments (*hansatsu*), and foreign currencies such as the Mexico dollar circulated in the opened ports.[450] It took time to establish a new unified monetary system and to mint

[449] On the role of these reforming domains in the decision to abolish the domains, see Takahashi Hidenao, "Haihan chiken ni okeru kenryoku to shakai," pp. 59-64; Matsuo Masahito, *Haihan chiken no kenkyū* [Research on the Abolishing of the Domains], pp. 295-9.

[450] By1869, 208 kinds of paper notes issued by various domain governments were in circulation, which amounted to 24 million Yen. Fujimura Tōru, *Meiji zaisei kakuritsu katei no kenkyū* [A Study of the Process of Building the Public Finance of the Meiji Regime], p. 102.

new currencies. In July 1869, the Meiji government announced the exchange of all government paper notes for newly minted currency by the end of 1872. As it had to meet spending needs while gradually taking over tax collection in the former Bakufu territories, it had no option but to continue to rely upon paper notes. [Table 4.1]

Table 4.1: Percentage of issued paper notes in the Meiji government's total income: 1868-1872

No. 1: Jan. 1868 to Jan. 1869	72.6 %
No. 2: Feb. 1869 to Oct. 1869	69.5
No. 3: Nov.1869 to Oct. 1870	25.5
No. 4: Nov.1870 to Oct. 1871	10.0
No. 5: Nov.1871 to Dec. 1872	35.3

Source: Fujimura Tōru, *Meiji zaisei kakuritsu katei no kenkyū* [A Study of the Process of Building the Public Finance of the Meiji Regime] (Tōkyō: Chūō Daigaku Shuppansha, 1968), pp. 154-155.

The formidable problems of how to stabilize the value of the paper notes, meet government spending, and achieve monetary unification provided an opportunity for officials who had previously demonstrated ability in managing finance and paper notes in domain governments to rise to the center. In order to overcome the financial difficulties, officials in the Ministry of Finance experimented with various methods. These included collaborating with privileged merchants to circulate government paper notes, generating revenue through government-owned enterprises, and extracting taxes from both direct and indirect sources. The first two methods were essentially measures that various domain governments had used under the name of *kokueki* economic policies in the late Tokugawa period. For example, a domain government lent its paper notes to privileged merchants, who formed business monopolies (*shōhō kaisho* or *kokusan kaisho*) to organize the production of local commodities and then sell them to the central markets in Ōsaka, Kyōto, and Tōkyō to earn hard currency. Political power per se could not dictate the course of institutional development as both the socio-economic circumstances and state-society interactions significantly influenced the effectiveness of implemented institutional arrangements.

Yuri Kimimasa, who was responsible for the original issue of Meiji paper notes, was recommended by the lord of Echizen to the central government for his prior success in managing paper notes for the domain government of Echizen.[451] Yuri first established the Bureau of Commerce (*shōhōshi*), which was staffed by government officials and managers from big merchant houses such as Ono, Mitsui, and Shimada. These privileged merchants took out loans from the government in government paper notes and were granted monopoly rights to organize the production and export of major Japanese export goods, such as raw silk and tea.[452] However, Yuri's policies did not work at the national level. The privileged merchants could not compete with the traditional commercial guilds (*kabunakama*), which had built dense commercial networks with local traders, producers and farmers.[453] Moreover, they could not monopolize exports due to the

[451] Sawada Akira, *Meiji zaisei no kisoteki kenkyū: ishin tōsho no zaisei* [A Study of the Foundation of Public Finance of the Early Meiji Regime], p. 115.
[452] Mamiya Kunio, "Shōhōshi no soshiki to kinō [The organization and functions of Shōhōshi]," *Shakai keizai shigaku*, Vol. 29, No. 2 (1963): 30-58.
[453] Yunoki Manabu, "Hyogo shōsha to ishin seihu no keizai seisaku [The Commercial House of Hyogo and the Economic Policy of the Restoration Government]," *Shakai keizai shigaku*, Vol. 35, No. 2 (1969), p. 17.

opposition of foreign merchants.[454] The paper notes of *dajōkansatsu* were discounted at some 60 percent in Tōkyō, Ōsaka, and Kyōto and could not even circulate in the provinces.[455] Yuri had to resign in March 1869.

Ōkuma Shigenobu, Yuri's successor, also had experience of managing paper notes and rescuing the finances of the domain government in Saga.[456] When Ōkuma was in charge of the financial affairs of the Meiji government, he asked some privileged merchants in major ports opened to foreign trade and in commercial centers to form the Finance Companies (*kawase kaisha*). The government lent paper notes to these Companies, which in turn issued commercial bills and lent these bills to the business monopolies that had been established by domain governments (*shōhō kaisho* or *kokusan kaisho*).[457] As the Meiji government forbade domain governments to issue paper notes, Ōkuma attempted to utilize these business monopolies to circulate the paper notes issued by the central government. Nonetheless, the business monopolies of domain governments could not compete with private businessmen, particularly in the most profitable businesses of

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[454] Shimbo Hiroshi, *Nihon kindai shinyō seido seiritsu shiron* [The History of the Establishment of the Credit System in Modern Japan] (Tōkyō: Yūhikaku, 1968), p. 16. Nakamura Naoyoshi also emphasizes that the semi-official, semi-private nature of Tsūhōshi and the concentration of its lending on lords were the main reasons for its failure. See Nakamura Naoyoshi, *Ōkuma zaisei no kenkyū* [A Study of the Policies of Public Finance of Ōkuma] (Tōkyō: Azekura Shobō, 1968), pp. 29-30.

[455] Yamamoto Yūzō, "Meiji ishinki no zaisei to tsūka [Finance and currency in the Meiji Restoration]," in Umemura Mataji and Yamamoto Yūzō, eds., *Kaikō to ishin* [The Opening of Japan and the Restoration], volume 3 in *Nihon keizaishi* [The Economic History of Japan] (Tōkyō: Iwanami Shoten, 1989), p. 129.

[456] In 1864, Ōkuma and other samurai officials in Saga opened trading houses in Ōsaka and Nagasaki to promote the sales of commodities made in Saga and used the monies earned to back up the paper notes issued by the Saga government. Nakamura Naoyoshi, *Ōkuma Shigenobu* (Tōkyō: Yoshikawa Kōbunkan, 1961), pp. 27-28.

[457] Shimbo Hiroshi, *Nihon kindai shinyō seido seiritsu shiron* [The History of the Establishment of the Credit System in Modern Japan], p. 32.

tea and raw silk.[458] The government also interfered in the management of these Finance Companies and required them to lend to the government.[459]

Under pressure to increase government income, westernizing officials in the Ministry of Finance also tried to use state enterprises in railways, silk weaving, and mining to earn profits. This policy represented the fiscal principle of the domain state and was against the trend of increasing private entry into the mining of gold and silver which had begun in the late Tokugawa period.[460] The fiscal concerns of state enterprises put the government in direct conflict of interest with private businessmen. In order to monopolize profits from mining, the Meiji government excluded entries of not only foreigners but also Japanese private businessmen. Likewise, the Meiji government tried to monopolize railway building and rejected the railway project between Tōkyō and Yokohama proposed by Yokohama merchants in November 1869.[461] Nonetheless, these state enterprises in modern industries became a huge financial burden. Instead of turning a profit, more than 10 million yen had been spent on railway building by 1871, including 4.8 million in loans at 9 percent borrowed from the British Oriental Bank.[462] Political

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458 Ibid., p. 33.

459 Ōkuma later admitted the inefficiency and mismanagement of officials of the Bureau of Promoting Commerce. See Ōkuma Shigenobu, "Proposal to build offices of credit" (1875), *Ōkuma monjo*, volume 3, A11, p. 161.

460 See the emphasis on the fiscal purpose of government-owned enterprises in modern industry in the early Meiji in Yamamoto Hirofumi, "Shoki shokusan seisaku to sono syūsei [The early industry-promotion policy and its revision]," in Andō Yoshio, ed., *Nihon keizai seisaku shiron (jō)* [The History of Economic Policy in Japan], volume I (Tōkyō: Tōkyō University Press, 1973), p. 23; Nagai Hideo, *Meiji kokka keiseiki no gaisei to naisei* [The External and Domestic Politics in the Formation Period of the Meiji State] (Hokkaidō Daigaku Shuppankai, 1990), pp.220-2;

461 Okada Shunpei, "Meiji shoki no tsūka kyōkyū seisaku [The policy of monetary supply in the early Meiji]," p. 22.

462 Nagai Hideo, "Shokusan Kōgyō seisaku no kichō: kanei jigyō o chūshin to site [The basic tune of the industry-promotion policies]," p. 225.

conservatives attributed the fiscal difficulties of the Meiji government to these westernizing projects.

Although officials in the Ministry of Finance initiated various institutional elements of public finance, their effectiveness was largely determined by socio-economic circumstances in Japan, such as dense business networks which private economic actors had developed in organizing the production and sale of commodities. The Meiji government simply could not replace these social resources in the economy by its privileged merchants. Nor could the Meiji government control the domestic market as it wished. For example, the government's order on June 28, 1868 to forbid the use of private banknotes and commercial bills issued by private bankers caused a huge panic in Ōsaka. Although the government repealed the prohibition within the month, several well-established banking houses in Ōsaka, including the famous Konoike House, went bankrupt; and the highly developed financial networks centered in Ōsaka were almost destroyed.[463]

In regard to taxation, the unequal treaties made it impossible for the Meiji government to raise revenues by charging higher customs duties. It thus had to first depend upon taxes extracted from the former Bakufu territories. For this reason, many former Bakufu officials who were experienced in local administration were retained to continue the collection of taxes.[464] Under the pressure of fiscal difficulties, Ōkuma did not allow

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[463] Umemura Mataji, "Meiji ishinki no keizai seisaku [The economic policies in the period of Meiji Restoration]," *Keizai kenkyū*, Vol. 30, No. 1 (January 1979), p. 36.
[464] Sekiguchi Eiichi, "Min-Kura bunri mondai to Kido Takayoshi [The issue of the separation of the civil affairs from the Ministry of Finance]," *Hōgaku*, Vol. 39, No.1 (March 1975), p. 42.

reduction in or exemption from land taxes in spite of poor harvests in 1868 and 1869.[465] These harsh measures caused large-scale peasant riots in Hita, Shinshū, and Fukushima. Local magistrates, who bore the brunt of the protests, demanded "benevolent policies" so as to consolidate the legitimacy the new Meiji regime.[466] Peasant resistance to land taxes prompted officials of public finance to tax the commercial sectors so as to reduce the burden of land taxes. In March 1869, the Guidance for the Administration of Cities and Prefectures of the central government clearly stated that "as commerce prospers, the commercial taxes should be gradually collected [and] we could expect a great success when the methods of taxing commercial sectors are ultimately formulated."[467]

The credit crisis of paper notes had a great impact on the operation of the fiscal system of the newly established Meiji government. In order to quickly receive the collected revenues, the government on January 1869 ordered 50 traditional bankers (*ryōgaeshō*), including the Ono, Mitsui, and Shimada houses, to transmit tax revenues and government expenditures. After the abolition of the domains in 1871, they served as the government's money transmitters (*kawasekata*) and extended their networks to the whole country.[468] Private financiers also facilitated the government's efforts to convert the land

[465] Matsuo Masahito, "Ishin kanryōsei no keisei to Dajōkansei [The formation of bureaucrats of the Restoration regime and the Council of State]," in Kindai Nihon Kenkyūkai, ed., *Kanryōsei no keisei to tenkai* [The Formation and Development of Bureaucracy], volume 6, *Nenpō Nihon kindai kenkyū* (Tōkyō: Yamagawa Shuppansha, 1986), p. 18.
[466] Sekiguchi Eiichi, "Min-Kura bunri mondai to Kido Takayoshi [The separation of the Ministry of Civil Affairs and the Ministry of Finance and Kido Takayoshi]," *Hōgaku*, Vol. 39, No.1 (March 1975), pp. 43-47; Matsuo Masahito, "Meiji shonen no seijyō to chihō shihai [The political situation and local governance in the early Meiji]," *Tochi seido shigaku*, No. 91 (April 1981), p. 48.
[467] Senda Minoru and Matsuo Masahito, *Meiji ishin kenkyū josetsu: ishin seiken no chokkatsuchi* [An Introduction to the Study of the Meiji Restoration: The Territories under the Direct Administration of the Restoration Government] (Tōkyō: Kaimei Shoin, 1977), pp. 253-4.
[468] In April 1872, the total number of prefectures where the Ono house had offices and branches (or planned to do so) was 35, Mitsui, 13; and Shimada, 8. See Iwasaki Hiroshi, "Kokuritsu ginkō seido no

tax collected in rice into money as their branches received the rice from peasants and sent bills to their headquarters in Tōkyō. Although the Ministry of Finance ordered them to send the collected taxes on the 15th and the last day of each month to Tōkyō by bills of exchange, they still benefited from having government funds and revenues at their disposal even for brief periods.[469] The relatively stable flows of government revenue and funds enhanced the reputation of these private banks in the markets; and the government avoided the burden of transporting species.

In contrast to the failed experiment with government enterprises or government-run financial intermediaries, the issue of paper notes was a success story. The Ministry of Finance relied upon the coercive power of the state to circulate government paper notes in the domestic economy. On the one hand, it excluded "competing money" and thus created a demand for its paper notes. For example, in September 1869, the Meiji government prohibited the use of specie in domestic transactions, and it used government paper notes (*dajōkansatsu*) to exchange all sorts of paper notes issued and coins minted by previous domain governments.[470] On the other hand, government paper notes also provided a standard medium which could reduce transaction costs for economic actors who had suffered from the monetary chaos of the 1860s.

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seiritsu to fuken kawasekata [The establishment of the national banking system and the money-transmitters of cities and prefectures]," *Mitsui bunko ronso*, No. 2 (March 1968), p. 215.

[469] Ibid., p. 212.

[470] Okada Shunpei, "Meiji shoki no tsūka kyōkyū seisaku [The policy of monetary supply in the early Meiji]," in Okada Shunpei ed., *Meiji shoki no zaisei kinyū seisaku* [The Fiscal and Financial Policies in the Early Meiji] (Tōkyō: Seimeikai Sōsho, 1964); Niwa Kunio, *Chiso kaiseihō no kigen: kaimei kanryō no keisei* [The Origin of the Reform Laws in Land Taxation: The Formation of the Enlightened Bureaucrats], p. 67.

The economic circumstances in early Meiji were beneficial to the circulation of government paper notes. The civil war in 1868-9 did not significantly disrupt the domestic economy. After Shogun Yoshinobu peacefully surrendered Tōkyō to the Meiji government, battles of limited scale were fought in regions that were marginal to the Japanese economy. The expanding exports of Japan after the opening of ports to foreign trade greatly stimulated the domestic economy and the development of interregional trade. The Meiji government thus benefited from an economy of scale in issuing paper notes that was not available to the more limited domain governments. By mid-1870, paper notes began to be used according to their face value, even though the government's specie reserves were far from sufficient to sustain convertibility.[471] [Table 4.2] In order to consolidate trust in government paper notes, Ōkuma publicly promised to make them convertible by 1872. Success on circulating non-convertible paper notes in the domestic economy then in turn posed a new challenge – how to establish the necessary institutions to ensure their convertibility.

[471] Yamamoto Yūzō, "Meiji ishinki no zaisei to tsūka [Finance and currency in the Meiji Restoration]," p. 133.

Table 4.2: Cash reserves of government paper notes between 1868 and 1871

(Unit: 1,000 yen)

Year	Government paper notes	Specie reserves	Reserve ratio %
1868	24,037	--	0
1869	50,091	2	0
1870	55,500	4	0
1871	60,272	191	0

Source: Harada Mikio, *Nihon no kindaika to keizai seisaku* [Economic Policies and the Modernization of Japan] (Tōkyō: Tōyō Keizai Shinpōsha, 1972), p. 174.

The institutional environment prevailing in the central government was favorable to experimenting with new institutional arrangements. The Council of State did not have effective control over government ministries, particularly the Ministry of Finance. In September 1869, the Ministry of Finance became the most powerful ministry when it incorporated the Ministry of Civil Affairs so as to strengthen its supervision over tax collection in the territories of the former Bakufu. Ōkuma gathered many young westernizing officials such as Inoue Kaoru and Itō Hirobumi around him. Moreover, he invited many former Bakufu bureaucrats who had rich administrative experience in managing public finance to join him. The most prominent of them was Shibusawa Eiichi. Among the 13 members of the Office of Reform, the think-tank of the Ministry of Finance, nine were former Bakufu bureaucrats. Under the leadership of Shibusawa, the Office of Reform formulated plans on a wide range of issues such as monetary consolidation, fiscal centralization, the postal system, the metrological system, household registration and management, and corporation laws.[472]

Ministry of Finance officials also came under attack from conservatives, not only for their westernizing standpoints but also for their policy mistakes. Conservatives in 1870 were shocked by a foreign loan of £3 million that these officials tried to secretly borrow for railway construction in Japan.[473] Domain governments disliked the heavy-handed measures they adopted to circulate paper notes issued by the center. Leaders in the central government, Ōkubo and Hirosawa Saneomi, worried that the Council of State was losing control over the increasingly powerful Ministry of Finance. In August 1870, Ōkubo separated the Ministry of Civil Affairs from the Ministry of Finance and put it under his control. Nonetheless, Ōkuma, Inoue, and Itō continued to manage financial affairs. Kido and Ōkuma also managed to take the bureaus of mining, railway, and other modernization projects out of the Ministry of Civil Affairs and establish a new Ministry of Industry in December 1870.

Interestingly, the issue of paper notes protected westernizing officials in the Ministry of Finance. Although Saigō and Ōkubo originally planned to purge westernizing officials in the Ministry of Finance in the institutional reform in 1871, they had to take into account the government's dire financial situation. Financial experts such as Tani Tetsuomi and Tsuda Izuru, who came to the center with Saigō's troops, did not have much experience

[472] Niwa Kunio, *Chiso kaiseihō no kigen: kaimei kanryō no keisei* [The Origin of the Reform Laws of Land Taxation: The Formation of the Enlightened Bureaucrats], chapter 3.
[473] This loan was first arranged secretly so as to avoid the opposition of conservatives. See the details in Tatewaki Kazuo, *Meiji seihu to Eikoku Tōyō Ginkō* [The Meiji Government and the British Oriental Bank] (Tōkyō: Chūō Kōronsha, 1992), pp. 74-96.

in managing paper notes in Satsuma, an economically backward region.[474] The reforming domains could not recommend anyone to replace Ōkuma other than Yuri Kimimasa, who had resigned because of his mismanagement of paper notes in 1869. Iwakura, who was a political ally of Saigō and Ōkubo in the Council of State, had to admit that Ōkuma had to be kept in the Ministry of Finance in light of the issue of paper notes.[475] Ōkubo himself even refused to be the Minister of Finance, unless Ōkuma and Inoue agreed to be his aides.[476] As a result, the issue of paper notes constrained power struggles in the center in 1871, and westernizing officials such as Ōkuma, Inoue, and Shibusawa continued to take care of financial affairs throughout the political whirlwind. In fact, even if political conservatives had replaced all these westernizing officials, the new officials in the Ministry of Finance would have faced the same problem of how to secure the value of the issued paper notes.

IV. Conclusion:

In the period between 1858 and 1871, there was no unilinear trajectory toward centralization in public finance. With the collapse of the Bakufu, political actors with different interests, ideas, and blueprints for national institutions formed and re-formed their coalitions under changing circumstances. There was no "strong state" to impose

[474] Before the end of counterfeiting Bakufu coins in September 1869, the annual profit that the domain government in Satsuma received from this practice was 1.5 million *ryō*, which was its largest item of revenue. Cited from Niwa Kunio, *Chiso kaiseihō no kigen: kaimei kanryō no keisei* [The Origin of the Reform Laws of Land Taxation: The Formation of the Enlightened Bureaucrats], p. 10.

[475] From Iwakura's letter to Sasaki Takayuki, dated June 1871. Cited from Sekiguchi Eiichi, "Haihan chiken to Min-Kura gappei: rususeihu to Ōkurasho (1) [The Abolishing of the domains and the merging of the Ministries of Civil Affairs and Finance, part 1]," *Hōgaku*, Vol. 43, No. 3 (December 1979), p. 308.

[476] Shibusawa recalled many years later, "Ōkubo was not only unfamiliar with financial affairs but also found their principles difficult to understand." Cited in Niwa Kunio, *Chiso kaiseihō no kigen: kaimei kanryō no keisei* [The Origin of the Reform Laws of Land Taxation: The Formation of the Enlightened Bureaucrats], p. 251.

modern institutions upon the society from above. Western learning remained politically controversial among major leaders of the Meiji government. Moreover, western models did not provide tools that the Meiji leaders could easily adopt to solve the specific problems they faced.

This was also a period characterized by a high degree of institutional malleability. Various institutional arrangements were implemented. Their fates were determined not only by politics but also by the socio-economic environment, as attested by the repeal of the Bureau of Commerce and the Exchange Companies. The political institutions of the central government also experienced several reshufflings during these years, most notably the separation of the Ministries of Finance and Civil Affairs.

In a situation of high uncertainty and institutional malleability, no one could foresee the outcome of the complex and interactive games underlying political struggle. As a result, events and reactions to them often produced unintended consequences which significantly affected subsequent institutional development. Neither the Meiji Restoration in 1868 nor the abolition of the domains in 1871 was a well-planned decision. The contingency and unintended consequences of major events are well-illustrated by the Meiji government's original issue of and increasing reliance upon non-convertible paper notes.

These paper notes, it must be stressed, represented a credit crisis only of the central government. They did not constitute a general economic crisis. Nonetheless, the Meiji government's excessive dependence upon them to satisfy its fiscal needs made it difficult for political conservatives to build a coin-based public finance. Ironically, it also ended up protecting the capable westernizing officials in the Ministry of Finance from being ousted, which gave them a chance to learn from their institutional experiments in public finance. In the next chapter, I examine how this credit crisis continued to have long lasting effects on the unfolding of a process of institutional learning which ended with the establishment of the modern fiscal state in the late 1880s.

Chapter 5: Credit Crisis, Institutional Learning, and Japan's Path toward a Modern Fiscal State: 1871-1895

I. Introduction:

Ever since the Meiji Restoration in 1868, the convertibility of the issued paper notes had been a pressing problem for the government. This credit crisis became more serious after the abolition of the domains in 1871 for two reasons. First, the central government took over both the expenditures and debts of domain governments *before* it had developed institutions to extract taxes from the whole country. As a result, the Meiji government had to issue more paper notes to cover its spending. Second, and more importantly, the rising price of gold in the international markets after 1874 made it extremely difficult for the Meiji government to attain the convertibility of paper notes denominated in gold. This was an unforeseen consequence of its decision to adopt the gold standard in June 1871 as no one in the government could have anticipated the steady rise of gold prices in the international markets when many European countries adopted the gold standard in the 1870s. The Meiji government could do little to prevent the flow of gold out of the country now that it was open to the international economy.

In this chapter, I examine how this credit crisis shaped the process of institutional development toward the modern fiscal state in a context characterized by uncertainty and multiplicity of possible outcomes in the period between 1871 and 1895. The new central government in 1871 faced formidable challenges: how to build administrative institutions and how to consolidate the legitimacy of the new regime. Significant divisions remained among major political groups over the appropriate direction and the necessary speed of subsequent institutional development. As the Japanese historian Banno Junji has pointed out, state actors at the time contended over three options to legitimate the new regime: foreign aggression, economic development, and creation of a parliamentary system.[477] Each had different implications for institutional development in public finance.

While military decentralization was compatible with national defense, an offensive strategy might demand more centralization in mobilizing financial resources, including tax collection. Large-scale military expansion, particularly a rapid modernization of the navy which aimed to challenge China's dominance in Korea, did not start until 1882. In the 1870s, the credit crisis of paper notes forced the Meiji government to reject a plan to invade Korea and focus instead on how to build the necessary institutions to ensure the convertibility of paper notes. In this light, war preparation was not the cause for centralization in the collection of taxes achieved by 1880, particularly in collecting indirect taxes on alcohol production.

Meanwhile, government officials drew quite different lessons from western experience. For example, after visiting western countries for more than a year with the well-known Iwakura Mission, Ōkubo Toshimichi, one major leader of the Meiji government, began to support westernizing programs for economic development. Nonetheless, Kido Takayoshi, the other principal leader, had a different change of mind after this visit. In his view, the wealth and strength of the west could not be achieved overnight. He

[477] See Banno Junji, *Kindai Nihon no kokka kōsō, 1871-1936* [Plans of the State in Modern Japan, 1871-1936] (Tōkyō: Iwanami Shoten, 1996), chapter one.

criticized the "impatient and reckless" westernizing officials in the Ministry of Finance and advocated a slower yet more stable tempo in the attempts to overcome the fiscal deficit and promote economic development.[478] His view was not unreasonable when we consider the social resistance and various problems that a rapid centralization had produced.

Besides the speed of development, officials of public finance had different diagnoses of and prescriptions for economic difficulties such as the massive gold drainage. In regard to the issue of paper notes, there was no single obvious model for the Japanese to choose. For example, there were three different banking systems in the west: the decentralized national banking system in the US; the centralized British model; and the Belgian system which mixed central banking with investment banking. It was not easy for the Japanese officials at the time to decide which model would work in the particular socio-economic circumstances of Japan. None of them could predict with any certainty the possible interactions between the borrowed model and the financial networks already in existence in Japan. Such interactions significantly affected the result of institutional transplantation.

Institution building in public finance after 1871 was a highly political process as it affected not only the distribution of interests in the society but also the relationship between the center and local governments. This is particularly true as government paper notes had become the standard medium of transactions throughout the economy by 1871.

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[478] Fukuchi Atsushi, *Meiji shinseiken no kenryoku kōzō* [The Power Structure of the New Meiji Government] (Tōkyō: Yoshikawa Kōbunkan, 1996), pp. 122-123.

As Banno Junji has emphasized, the Meiji government in the 1870s chose to use the success of its economic policies to legitimize itself and defeat the political demand for establishing a parliamentary institution.[479] However, policy mistakes stimulated the opposition in the form of the Freedom and Popular Rights Movement (*jiyū minken undō*). This movement was a continuation of the Assembly Camp in the 1860s. While it was originally dominated by ex-samurai, in the late 1870s rich peasants began to participate in this political movement in significant numbers. These political pressures not only affected power struggles within the Meiji government but also influenced policy making and the course of institutional development in public finance. The central government after abolishing the domains thus had neither coherence nor autonomy to dictate institutional development. How shall we explain the specific institutional outcome of the modern fiscal state which emerged in the late 1880s and was consolidated in the early 1890s against this background of uncertainty, political maneuvering, and the multiplicity of possible outcomes?

In this chapter, I argue that the particular credit crisis of paper notes denominated in gold, instead of a general agenda of promoting economic development, was the key factor that determined the actual substance of Meiji economic policies in the 1870s. The central concern of these policies was to increase the government's stock of gold, through both import-substitution and promotion of export to the west. At the same time, the credit crisis changed the risk distribution between the center and local governments and forced the central government to speed up centralization in tax collection and the management

[479] Banno Junji, "Seikan ronsōgō no 'naijiha' to 'gaiseiha' ['Wealth' vs. 'Power' in Early Meiji]," in Kindai Nihon Kenkyūkai ed., *Bakumatsu ishin no Nihon* [Japan in the Late Tokugawa and Meiji Restoration], volume 3 of *Nenpō kindai Nihon kenkyū* (Tōkyō: Yamagawa Shuppansha, 1981).

of government spending. In particular, the Meiji government established a centralized bureaucracy for assessing and collecting indirect taxes upon sake by 1880. As a common problem for state actors, this credit crisis led to a continuous accumulation of effective institutional arrangements even though they might be implemented by political rivals. Even when new officials came to take charge of the Ministry of Finance, they could still learn from both the policy mistakes and successes of their predecessors as they all had to confront the issue of how to safeguard the value of paper notes.

As useful institutional elements and practical experience in managing public finance accumulated over time, actors in the late 1870s reached consensus in regarding the direction of institutional development. They agreed that it was necessary to build a central bank to manage the issue of paper notes. Nonetheless, this does not imply that the establishment of the central bank was an apolitical technical issue. On the contrary, I argue that the complicated conflicts of interest between the state and society, along with power struggles within the Meiji government itself, are crucial to understanding the highly deflationary measures that Matsukata Masayoshi, the new Minister of Finance, implemented in 1882. The ensuing profound deflation in the period between 1882 and 1885, known as the Matsukata deflation, was by no means an unavoidable price that had to be paid to curb inflation.[480] Once it began, however, this deflation significantly dictated the policies of the Bank of Japan, which centered on how to mitigate the

[480] For the received view of the Matsukata deflation as the unavoidable price to pay to curb inflation, see Jackson H. Bailey, "The Meiji Leadership: Matsukata Masayoshi," in W. H. Wray, ed., *Japan Examined: Perspectives on Modern Japanese History* (Honolulu: University of Hawaii Press, 1983); Steven J. Ericson, "'Poor Peasant, Poor Country!' The Matsukata Deflation and Rural Distress in mid-Meiji Japan," in Helen Hardacre and Adam L. Kern, eds., *New Directions in the Study of Meiji Japan* (Leiden: Brill, 1997); Muroyama Yoshimasa, *Matsukata zaisei kenkyū* [A Study of Matsukata's Policy in Public Finance] (Kyōto: Mineruva Shobō, 2004).

deflationary effects, and its interactions with domestic financial markets between 1884 and 1895.

In section II, I examine the deepening of the credit crisis in the 1870s and its impact on the making of economic policy. In section III, I discuss the accumulation of effective institutional elements between 1871 and 1880, which prepared the way for the building of a modern fiscal state in Japan. In section IV, I analyze the debates over gradual and radical approaches to curb inflation and their political implications. I argue that the Matsukata deflationary policy was neither optimal nor inevitable way to attain the convertibility of paper notes. I then explore how the deflation significantly influenced the actual process of building the Bank of Japan between 1881 and 1895. Section V concludes.

II. Deepening credit crisis: 1871-1880

The new central government took on the debts of domain governments and the stipends of peers and samurai as its own responsibility after the abolition of the domains on August 29, 1871.[481] It issued 24.44 million yen in paper notes to exchange for all the paper notes issued by domain governments.[482] Although peer and samurai stipends had been greatly reduced in previous reforms, they still cost the government 18.94 million yen in 1873, accounting for some 30 percent of government annual spending. There was

[481] The Meiji government took over only half of a total debt of 78.13 million yen of domain governments. It paid 4 million yen cash to clear loans from foreign sources. For the debt of 12.82 million yen which had accrued between 1868 and 1872, it issued bonds bearing an interest rate of 4 percent and planned to repay them in 25 years. As to the 11.23 million yen debt which had accrued before 1842, it decided to return it without interest in 50 years. Cited from Yamamoto Yūzō, "Meiji ishinki no zaisei to tsūka [Finance and currency in the Meiji Restoration]," p. 147.
[482] Ibid., p. 150.

thus little dispute among the leaders of the new central government over the plan to issue bonds to dissolve its obligation to pay the hereditary stipends of ex-samurai. The only question was the speed of bond redemption.

In order to legitimize the new central government, the Iwakura Mission left Japan on December 23, 1871 to negotiate with western powers for a revision of the unequal treaties, and particularly for a resumption of sovereignty in deciding customs duties.[483] It planned to use this strategy to distinguish itself from both the appeasement policy of the former Bakufu and the expulsion of westerners espoused by the radicals. Moreover, the Ministry of Finance considered the receipt from the customs duties an important source of income, especially when the central government had not yet established institutions to collect domestic taxes.[484] However, this mission was totally unrealistic due to the resistance of the western powers.

As the abolition of the domains was not well-planned in advance, the new central government was saddled with much increased liabilities *before* it had developed the necessary institutions to tax the national economy. In this situation, the new central government planned to raise a loan of 3 million pounds (equivalent to 30 million yen) at 7 percent from America to clear its liabilities to ex-samurai and peers. However, this attempt failed as America was not yet a major capital-exporting country and the Meiji

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[483] Suzuki Eiki, "Iwakura shisetsudan hensei katei e no ashitana shiten [A new perspective on the formation process of the Iwakura Mission]," *Jinmon gakuhō*, No. 78 (March 1996), p. 43.

[484] As early as in December 1871, Inoue Kaoru and Yoshida Kiyonari had pointed out the urgency of charging higher customs duties so as to not only raise government revenue but also reduce the burden of land taxes on peasants. Inoue Kaoru and Yoshida Kiyonari, "On reforming the domestic taxation," (November 1871), cited in Nakamura Masanori et. al., eds., *Keizai kōsō* [Economic Schemes], volume 8 of *Nihon kindai shisō taikei* (Tōkyō: Iwanami Shoten, 1988), p. 145.

regime had little creditworthiness in the international capital markets.[485] The Meiji government only managed to borrow a loan of 10 million yen at 7 percent in 1873 from the British Oriental Bank, the major foreign bank in East Asia at the time. In 1874 and 1875, a total of 142,858 samurai received 16.56 million yen in Stipends Bonds (bearing an annual interest rate of 8 percent) and 20 million yen in cash to abandon their "entitlement" permanently.[486] As most of the recipients of Stipend Bonds sold them for cash and quickly fell into poverty, the Meiji government was forced to suspend this policy in March 1875.[487]

Iwakura and Kido strongly advocated a more gradual approach to settling the stipends of ex-samurai as it involved the livelihood of some 2 million ex-samurai and their family members. This was the most educated segment of the population. With the establishment of tax institutions and the subsequent growth of revenues, the Meiji government would have been able to create more employment opportunities for ex-samurai in public education, police, and civil administration. Considering the political situation in the mid-1870s, a gradual settlement of the stipend issue of ex-samurai seemed a reasonable method, especially for a new government that desperately needed to establish its legitimacy after abolishing the domains.

The political situation that the Meiji regime faced in 1873 and 1874 was very similar to that in the initial years of the Restoration. Dire fiscal conditions forced Ōkubo

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[485] Senda Minoru, "Meiji rokunen shichibu ritsuki gaisai no boshū katei [The process of raising a foreign loan at a 7 percent interest rate in 1873]," *Shakai keizai shigaku*, Vol. 49, No. 5 (December 1983): 445-70.
[486] Calculated from table 19 in Fujimura Tōru, *Meiji zenki kōsai seisakushi kenkyū* [A Study of the History of Bond Policy in the Early Meiji] (Tōkyō: Tōyō Kenkyūsho, 1977), p. 85.
[487] Ibid., p. 86.

Toshimichi, Iwakura Tomomi, and Kido Takayoshi to ally together to reject the hard-liners' attempt to legitimize the new regime by invading Korea.[488] As a result, radicals plotted to use force against the central government, as shown in the samurai rebellion in Saga in 1874. The realistic hardliners were dissatisfied at the government's westernizing projects which had caused severe deficits. Saigō Takamori resigned and went back to Satsuma in 1873. Meanwhile, Shimazu Hisamitsu, former lord of Satsuma and a prominent political figure in the Meiji Restoration, urged the government to implement "fiscal retrenchment" to overcome the fiscal difficulties.[489]

Westernizing officials in the Ministry of Finance were also concerned about the fiscal deficit caused by these various modernization programs. As the Ministry of Finance did not have the authority to control government spending, Inoue Kaoru and Shibusawa Eiichi, who were in charge of public finance while the Iwakura Mission was abroad, resigned on May 1873. They published a protest letter which for the first time exposed the fiscal situation of the Meiji government to the public: in addition to the 10 million yen fiscal deficit in 1873, the total government liabilities, including domestic and foreign borrowing and paper notes, amounted to 120 million yen.[490] Mutsu Munemitsu, the Head of Taxation, also resigned to protest the fiscal difficulties caused by the government's ambitious plans to "implement westernizing projects in jurisdiction,

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[488] Banno Junji, "Seikan ronsōgō no 'naijiha' to 'gaiseiha' ['Wealth' vs. 'Power' in Early Meiji]," in Kindai Nihon Kenkyūkai ed., *Bakumatsu ishin no Nihon* [Japan in the Late Tokugawa and Meiji Restoration], volume 3 of *Nenpō kindai Nihon kenkyū* (Tōkyō: Yamagawa Shuppansha, 1981).
[489] Banno Junji, "Meiji kokka no seiritsu [The Establishment of the Meiji State]," pp. 74-5.
[490] Inoue and Shibusawa, cited from Banno Junji, "Meiji kokka no seiritsu," in Umemura Mataji and Yamamoto Yūzō, eds., *Kaikō to ishin* [The Opening of Japan and the Restoration], volume 3 in *Nihon keizaishi* [The Economic History of Japan], p. 72.

education, military, and industry simultaneously, without paying heed to the appropriate sequence."[491]

Meanwhile, Itagaki Taisuke, Etō Shinpei, Gotō Shōjirō, and others in January 1874 called for the establishment of a parliamentary system so as to ensure that major policies were based upon wider consensus. Their demand was not only echoed among some samurai and even commoners who were concerned about government debt but also supported by the legislative branch of the Council of State (*sain*).[492] In response, Emperor Meiji issued a decree in April 1874 promising a constitutional monarchy in future. Given the dual pressure of fiscal and political difficulties, it would not have been unreasonable to slow down the tempo of modernization and the settlement of the samurai stipends to give the government more time to build institutions to collect taxes from a broader array of sources. However, the Meiji government's policy options in 1874 were constrained by the massive amount of paper notes already circulating in the economy. Fiscal retrenchment itself did not directly address the problem of how to secure the convertibility of paper notes. The government's promise in 1869 to ensure convertibility by newly minted currencies before the end of 1872 only exacerbated the situation.

After carefully reviewing both the silver and gold standard as options for the new monetary system, the Meiji government in May 1871 decided to adopt the gold standard

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[491] Mutsu Munemitsu, cited in Fukushima Masao, *Chiso kaisei no kenkyū* [A Study of the Reform of Land Taxation] (Tōkyō: Yūhikaku, 1970), p. 99, footnote 2.

[492] For the proposals from ordinary samurai and commoners in 1874 to establish a parliamentary system to supervise public finance, see Makihara Norio, *Meiji shichinen no daironsō: kenpakusho Kara mite kindai kokka to minshū* [The Great Debates in 1874: The Modern State and the People Viewed from the Proposals from the People] (Tōkyō: Nihon Keizai Hyōronsha, 1990), pp. 32-6.

and set the value of one Japanese yen as equivalent to 1.5 grams of gold.[493] As the Mint could not prepare a sufficient amount of coin to exchange the issued paper notes, the government in January 1872 exchanged all the old paper notes with new ones printed in Germany. The new, high-quality paper notes could not postpone the convertibility of paper notes forever. Nonetheless, the price of gold began to rise steadily when Germany became the second country after Britain to switch to the gold standard in 1871 and the US followed suit in 1873.[494] As the official price of gold in Japan remained almost unchanged between 1871 and 1883, gold flew massively out of Japan. [Table 5.1 and Table 5.2] In 1874, gold had disappeared from the Japanese market and the government could only mint silver currency.[495] Massive gold drainage thus greatly enhanced the difficulty of ensuring the convertibility of paper notes.

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[493] The Meiji government had decided to adopt the silver standard in December 1870. Yet when Itō Hirobumi returned from investigating the American monetary and financial system in 1871, he persuaded the Meiji government to adopt the gold standard so as to follow the "general trend" in the west. See the details of the policy change in Mikami Ryūzō, *En no tanjō* [The Birth of Yen] (Tōkyō: Tōyō Keizai Shinpōsha, 1989), pp. 210-1.

[494] For the discussion of the establishment of the gold standard in the international markets in the 1870s, see Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Princeton, N.J.: Princeton University Press, 1996), pp. 17-18.

[495] Ōkuma Shigenobu, "The second annual report of the Ministry of Finance," (July 12, 1877), *Ōkuma monjo*, volume 3, A1567, p. 276.

Table 5.1: The exchange rates between gold and silver:

Years	Market exchange rates in London	Japan's Market rates	Japan's Official rates
1871	15.57	15.55	16.01
1872	15.63	15.55	16.01
1873	15.92	15.55	16.01
1874	16.17	15.48	16.01
1875	16.59	15.85	16.17
1876	17.88	16.82	16.33
1877	17.22	16.43	16.33
1878	17.94	17.03	16.17
1879	18.40	17.87	16.17
1880	18.05	17.22	16.17
1881	18.16	17.58	16.17
1882	18.19	17.40	16.17
1883	18.64	17.82	16.17

Source: Yamamoto Yūzō, "Nai ni shihei ari gai ni bokugin ari [Paper money for domestic transactions and Mexican dollars for foreign trades]," *Jinmon gakuhō*, No. 55 (September 1983), p. 44.

Table 5.2: Outflows and inflows of gold specie in Japan: 1871-1883:

Years	Outflows of gold (unit: 1,000 yen)	Inflows of gold (unit: 1,000 yen)
1872	2,685	---
1873	2,614	2,014
1874	8,127	3
1875 (the first half)	7,139	25
1876	2,854	884
1877	6,212	---
1878	6,164	26
1879	5,896	727
1880	2,113	0
1881	1,523	1
1882	1,183	1
1883	1,141	142

Notes:
Gold included: the new and old gold currencies of Japan, foreign gold currencies, and gold bullion.

---: No information.

Source: Yamamoto Yūzō, "Nai ni shihei ari gai ni bokugin ari [Paper money for domestic transactions and Mexican dollars for foreign trades]," *Jinmon gakuhō*, No. 55 (September 1983), p. 40.

In this situation, the Meiji government could have switched back to the silver standard. However, there were two obstacles. Politically, it was under pressure from the opposition movement for a parliamentary polity organized by the leaders of the Assembly Camp such as Itagaki Taisuke and Gotō Shōjirō. As the advocates of the parliamentary system had long criticized the "arbitrariness" of policy making, switching from the gold to silver standard would have provided them new ammunition.[496] Economically, if the Meiji government promised to ensure the convertibility of paper notes with silver currency according to their denominated gold value, it would greatly increase the already heavy burden of government liabilities.

Officials of the Ministry of Finance were well-aware of the danger of gold outflows.[497] Nonetheless, in 1874 and 1875 they still considered it a feasible option to use active government policy to increase stocks of gold to guarantee the convertibility of paper notes. Most proposals discussed within the Ministry of Finance in this period concerned how to increase Japan's stock of gold rather than had to switch to a silver standard. As Ōkuma put it, "since deficits in international trade have to be covered by specie ... if the current situation continues, even if we mint a mountain of specie, it would all flow overseas and domestic specie disappears, which immediately affects the credibility of paper notes."[498] Typical measures discussed within the Ministry of Finance included:

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[496] In fact, "Chōrei bokai" (a decree issued in the morning is changed in the evening) was one of the most frequent critiques of the Meiji government's policy making.

[497] In Ōkuma's words, "the use of paper notes depended solely on the guarantee of specie in gold. ... [Therefore] the outflow of gold will ultimately ruin the credibility of paper notes and put the country in danger." Ōkuma Shigenobu, "Memorial in regard to the custom revenues" (20 July 1875), *Ōkuma monjo*, volume 3, A2341, p. 117.

[498] Ōkuma Shigenobu, "On rectifying the sources of state revenues and building the foundation of pubic finance" (January 1875), *Ōkuma monjo*, volume 3, A7, p. 104.

1. To increase exports to the European and American markets so as to earn gold.
2. To reduce imports and the number of foreigners employed by the government.
3. To organize direct exports so as to use the gold earned to directly pay the interest on the government's foreign debts.
4. To increase tariff levels and to ask foreigners to pay customs duties in gold rather than in silver currency.[499]

These measures were similar to the mercantilist economic policies many domain governments had implemented to earn coins from the central markets in Ōsaka, Kyōto, and Tōkyō to stabilize the value of their issued paper notes in the late Tokugawa period. A few officials in the Ministry of Finance, such as Matsukata Masayoshi and Kawaji Kandō, noticed that the rising price of gold in the international market might be the main cause of gold outflow from Japan. Matsukata even considered the alternative silver standard. But he still concluded that the measure most urgently needed was not adoption of a silver standard but collection of the customs in gold.[500] Kawaji Kandō proposed to raise the price of gold in Japan but did not take into account the impact of this policy on the convertibility of paper notes denominated in gold and its deflationary effect on the domestic economy.[501]

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[499] Ōkuma Shigenobu, "Memorial on clarifying sources of revenue and building the foundation of public finance" (January 1875), *Ōkuma monjo*, volume 3, A7, pp. 104-105. Matsukata Masayoshi, "Proposal on preventing the outflow of specie" (September 1875), *Matsukata Masayoshi kankei monjo: hokan* (Tōkyō: Tōyō Kenkyūsho, 2001), p. 33.
[500] Matsukata Masayoshi, "Proposal on preventing the outflow of specie" (September 1875), *Matsukata Masayoshi kankei monjo: hokan*, p. 31, p. 36, and p. 38.
[501] Kawaji Hirodō, "On the outflow of species: Memorial to Ōkuma, October 1875)" *Ōkuma monjo*, volume 4, A3415, pp.112-113, p. 114.

The desire to increase gold stocks determined the substance of the program of "fostering industry and promoting enterprise" (*shokusan kōgyō*) that the Meiji government introduced in 1875 under the leadership of Ōkubo Toshimichi. Previous industrialization programs by the Ministry of Industry, which imported modern industries such as railways and steam-powered raw silk filatures, etc., were harshly criticized for causing fiscal deficits. In Matsukata's view, the Japanese government would be bankrupt before realizing the big profit that these "grand projects might promise in future."[502] Ōkubo also complained that the foreign experts who worked for the Ministry of Industry "simply wanted to implement whatever they have learned and paid no attention to the Japanese government's fiscal condition."[503]

The new *shokusan kōgyō* program aimed to increase the gold stocks in Japan by encouraging exports to the west to earn gold and by reducing outflows of gold by import-substitution. It was not, at least in this period, a general policy of export-promotion and import-substitution. The convertibility of paper notes denominated in gold made the government give special priority to "direct exports" (*chokuyushutsu*) rather than general exports to the western markets. Government officials and political merchants organized the transportation and marketing of the exported goods to the European and American markets in order to firmly hold on to the gold earned through their sale.[504] The government encouraged import-substitution in the cotton textile, woolen textile, and

[502] Matsukata Masayoshi, "Proposal on encouraging the foundation of the country [agriculture] and cutting expenditures that are not urgently needed" (to Ōkuma, 1873), *Ōkuma monjo*, volume 2, A968, p. 2.
[503] Ōkubo Toshimichi, "Proposal on administrative reform" (December 1876), *Ōkubo Toshimichi monjo*, volume 7, p. 447.
[504] See the proposal in Ōkuma Shigenobu and Ōkubo Toshimichi, "On the cooperation of the Ministries of Finance and Internal Affairs," (November 1875), *Ōkuma monjo*, volume 3, A2410.

sugar refinery industries by choosing technologies that utilized domestic rather than imported raw materials.[505] Ōkuma also turned the stipends of ex-samurai into compulsory commutation bonds (*kinroku kōsai*), of which up to 172 million yen was issued between 1875 and 1877. The Meiji government used these bonds as capital to invest in various projects of import-substitution and government-organized "direct exports."

Instead of achieving its ambitions, the *shokusan kōgyō* program produced some severe political and economic consequences. The market values of commutation bonds for ex-samurai fell sharply as the government investments in infrastructure and the government-targeted sectors failed to generate the anticipated profit. This triggered the largest of the samurai rebellions (*seinan sensō*) in 1877. In order to repress it, the government had to issue 27 million yen in paper notes and borrow 15 million yen in banknotes from the No. 1 National Bank.[506] Unemployment among ex-samurai continued to be a serious social issue even after the samurai rebellion was put down in 1877. Among the 12.7 million yen in "enterprise-promotion" bonds that Ōkuma raised that same year to invest in infrastructure, transportation, cotton textiles and agriculture, 3 million yen were aimed directly at solving this problem and relieving their poverty.[507] Its political aim was, in

[505] Nagai Hideo, "Shokusan kōgyō seisaku no kichō: kanei jigyō o chūshin to site [The basic tune in the industry-promotion policies]," originally published in *Hokkaidō Daigaku bungakubu kiyō*, no. 10, November 1969. Reprinted in Nagai Hideo, *Meiji kokka keiseiki no gaisei to naisei* [The External and Domestic Politics in the Formation Period of the Meiji State], p. 241.
[506] Yamamoto Yūzō, "Meiji ishinki no zaisei to tsūka [Finance and money in the Meiji Restoration]," in Umemura Mataji and Yamamoto Yūzō, eds., *Kaikō to ishin* [The Opening of Japan and the Restoration], p. 158.
[507] Ochiai Hiroki, *Meiji kokka to shizoku* [The Meiji State and the Samurai] (Tōkyō: Yoshikawa Kōbunkan, 2001), p. 218.

Iwakura's words, to "gain the loyalty of ex-samurai for the state" and to prevent them from being "contaminated by European radical thoughts of freedom."[508]

The failure of government-organized direct exports made Ōkuma realize in July 1877 that it made little sense for Japan to stick to the gold standard given the lower price of silver.[509] On May 27, 1878, the Meiji government permitted the Japanese silver yen, which was previously minted for international trade only, to be used in domestic transactions and payment of taxation.[510] Japan thus returned to a de facto silver standard. Meanwhile, Kawase Hideji, the Head of the Office of Encouraging Business in the Ministry of Finance, pointed out in July 1879 that the important thing for Japan was not to try to substitute imported goods which foreigners were much more skillful in making but to increase the exports that were "appropriate to Japan's land and people."[511] However, the previous massive issue of paper notes led to inflation, which became a serious problem in 1879. Although Japan was now on the silver standard, the amount of paper notes in the economy made the convertibility of paper notes with silver currency a difficult task.

In the 1870s, the Meiji government failed in its attempt to use mercantilist economic policies to reverse Japan's position in the international economy and maintain the gold standard in Japan. Nonetheless, the credit crisis of paper notes in this period forced the

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[508] Iwakura Tomomi, "Proposal on helping the enterprises of peers and samurai" (July 1878), cited in Ochiai Hiroki, *Meiji kokka to shizoku*, p. 216.
[509] Ōkuma Shigenobu, "The second annual report of the Ministry of Finance," (July 12, 1877), *Ōkuma monjo*, volume 3, A1567, p. 267.
[510] Cited from Harada Mikio, *Nihon no Kindaika to keizai seisaku: Meiji kōgyōka seisaku kenkyū* [Economic Policy and Japan's Modernization], p. 146.
[511] Kawase Hideji, "Proposals on public finance" (July 5, 1879), in *Ōkuma monjo*, volume 2, A980, p. 103.

officials in the Ministry of Finance to not only centralize collection of revenues but also ensure their speedy transmission to the center. Peasants' resistance to raising land taxes forced the Ministry to find politically less sensitive means to raise revenue through indirect taxes, particularly those levied upon sake and liquor. In the next section, I examine these institutional developments, which laid a solid foundation for Japan's last step in the building of the institutions of the modern fiscal state in the 1880s.

III. Credit crisis and continuity in institutional development in public finance: 1871-1880

The Meiji government was overwhelmingly concerned about how to raise its tax revenue. As it was deprived of the rights to increase receipts from the customs by raising the tariff duties, it had to focus on domestic sources for revenue. Efforts to collect land taxes more effectively encountered a formidable information problem when it came to assessing the proper value of land. The Meiji government's original plan was to collect land taxes in both urban and rural areas according to the assessed market value. However, the land market in Japan, particularly in rural areas, had not developed to such an extent that the government could easily find out the market value of each piece of land. A more practical option was to levy according to the estimated productivity of rural lands. But accurate estimation still required officials to be very familiar with local customs and circumstances.[512] The "avoidance system," which required that a prefectural (*ken*)

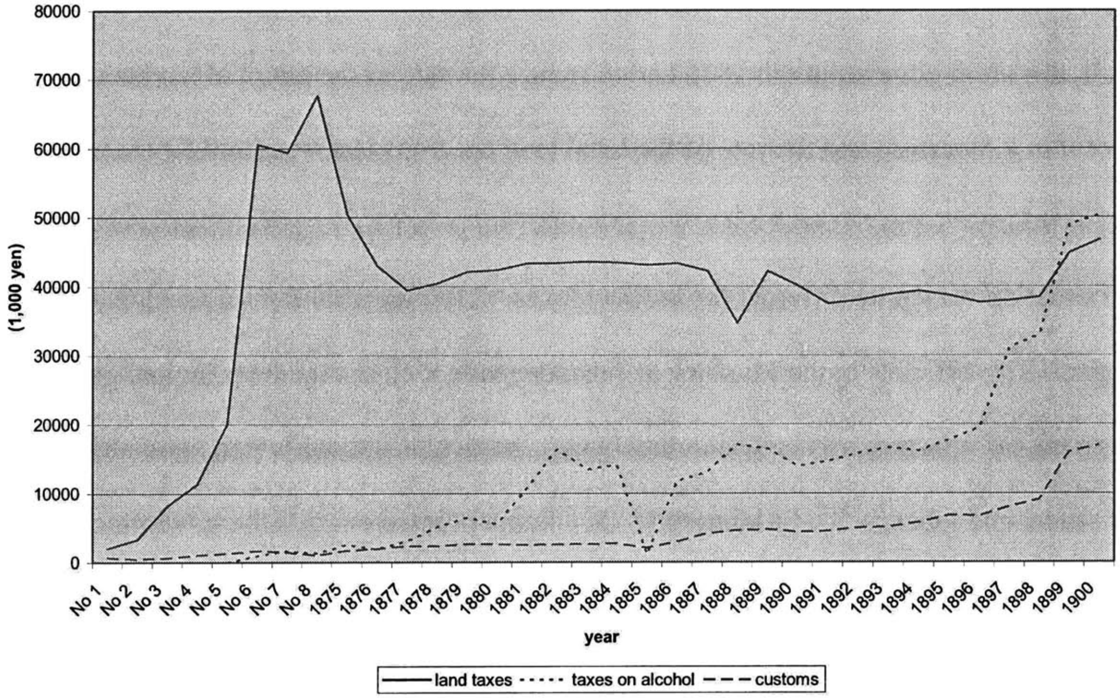
[512] See the detailed discussion in Yamamura Kozo, "The Meiji land tax reform and its effects," in Marius B. Jansen and Gilbert Rozman eds., *Japan in Transition: From Tokugawa to Meiji* (Princeton: Princeton University Press, 1986), pp.387-388.

governor come from different region than his post, made this more difficult.[513] More importantly, extraction of land taxes encountered serious resistance and even riots. As a result, the Meiji government in 1876 had to reduce the rate of the national land tax from 3 percent to 2.5 percent and the rate of the local land tax from 1 percent to 0.5 percent.

The situation was quite different for indirect taxes. After the abolition of the domains in August 1871, officials in the Ministry of Finance made it clear that the principal goal of future tax reforms was to increase indirect taxes, particularly those levied upon alcohol, soy sauce, and tobacco.[514] In January 1875, Ōkuma pointed out that the government should depend upon indirect taxes on consumption to raise income as they were politically easier to extract.[515] [Fig. 5-1] He even planned to impose heavy sale taxes on all imported items as an alternative to charging higher customs duties.[516] Although this plan did not work out in practice, it showed how important the collection of indirect taxes had become to the Meiji government.

[513] Fukushima Masao, *Chiso kaisei no kenkyū* [A Study of the Reform of Land Taxation] (Tōkyō: Yūhikaku, 1970), p. 108.
[514] Niwa Kunio, "Chiso kaisei to nōgyō kōzō no henka [The reform and land taxes and the changes in the structure of agriculture]," in Kajinishi Mitsuhaya, ed., *Nihon keizaishi taikei,* volume 5 *Kindai (jō)* (Tōkyō: Tōkyō Daigaku Shuppankai, 1965), p. 236.
[515] Ibid., p. 104.
[516] See this plan in Ōkuma Shigenobu, "Memorial on clarifying sources of revenue and building the foundation of public finance" (January 1875), *Ōkuma monjo*, volume 3, A7, p. 104.

Fig. 5-1 Composition of tax revenues of the Japanese government: 1868-1900



Source: *Hundred-Year Statistics of the Japanese Economy* (Tōkyō: Hosokawa, 1966), p. 136.

Meanwhile, the institutions to collect tax revenues from alcohol became more centralized over the period from 1871 and 1880. In 1871, the central government had no other means but to rely upon local magistrates and to collect duties upon alcohol based upon the average prices self-reported by producing houses. Starting in 1872, the central government began to conduct surveys and field-investigations to compile statistical data on the national economy, such as total population, volume of foreign trades, total yield of taxation, etc.[517] For the collection of taxes levied upon alcohol, the central government established a centralized bureaucracy in 1877, which not only set up branches in major

[517] This was a Japanese version of "political arithmetic," and former Bakufu officials such as Tsuda Mamichi and Mitsukuri Rinshōwho, who had studied statistics in Holland, made important contributions to these efforts. See Haga Shoji, "Meiji Ishin to seihyō no hensei [The Meiji Restoration and the making of statistical data]," *Nihonshi kenkyū*, No. 388 (December 1994): 49-74.

regions of alcohol production but also sent officials to check accounts and assess the actual output of producing houses. In consequence, the Ministry of Finance was able to fully centralize the collection of alcohol taxes in 1880 without involvement of local magistrates. Thus the government could not only charge license fees upon each brewing house but also levy duties directly upon the amount of alcohol output as assessed and checked by the officials of the Bureau of Taxation in the Ministry of Finance. Local inspectors in various regions used uniform book-accounting and record-keeping methods and were subjected to the supervision of their superiors.[518] The elasticity in the yields of alcohol taxes was illustrated by a sharp rise from 3.5 million to 4.5 million yen after the government improved its method of collection in 1878.[519] This institutional development enabled the Meiji government to avoid over-reliance upon direct taxes such as land taxes which were politically sensitive and administratively difficult to collect.

In regard to the operation of public finance, the Meiji government had relied upon private bankers to transmit both collected revenue and government funds. This method contained some inherent risks, as the official money was often lent out as short-term loans for profits. For example, when the government needed money to fund its expedition to Taiwan in the autumn of 1874, major private banks which had remitted government funds were totally unprepared. The Ono and Shimada houses went bankrupt for they could not take back all the government deposits that they had lent out in mining,

[518] See Fujiwara Takao, *Kindai Nihon shuzōgyōshi* [A History of Sake Brewing in Modern Japan] (Kyōto: Mineruva Shobō, 1999), pp. 88-109.
[519] Ikegami Kazuo, "Meijiki no shuzei seisaku [The tax policies on sake and liquor in the Meiji era]," *Shakai keizai shigaku*, Vol. 55, No. 2 (June 1989), p. 193.

manufacture of raw silk, real estates, etc.[520] The Mitsui house barely escaped bankruptcy by getting an emergency loan from the British Oriental Bank.[521] The government lost the money it had deposited in Ono and Shimada. Nonetheless, the Ministry of Finance continued to allow major private banks such as Mitsui and Yasuda, as well as the national banks, to transmit government money.[522] The government demanded that these private banks provide collateral for the deposited official funds.[523]

As the central government bore the risk of the credit crisis of paper notes, it had a strong motivation to centralize the management of spending by local governments and major central government departments. In 1873, Inoue and Shibusawa introduced double-entry bookkeeping into government finance and ordered all government offices and prefectural governments to regularly submit their account books and their budgets for the next year to the Ministry of Finance for inspection.[524] In February 1876, in order to put government spending under firmer control by the Ministry of Finance, Ōkuma ordered government offices and prefectural governments to return any surplus to the Ministry of Finance and announced that government spending would be disbursed from the Ministry

[520] When the Ono house declared bankruptcy, it had only 20,000 yen cash and 110,000 yen bonds and land deeds while its total liabilities were 7.5 million yen, including 4.5 million yen in government deposits. Katō Kōzaburō, "Seishō shihon no keisei [The formation of the capital of political merchants]," in Kajinishi Mitsuhaya, ed., *Nihon keizaishi taikei,* volume 5 *Kindai (jō)* (Tōkyō: Tōkyō Daigaku Shuppankai, 1965), p. 143.
[521] The Mitsui Bank borrowed three times in 1874 from the Oriental Bank; these loans amounted to 1 million pounds. Cited in Tatewaki Kazuo, *Meiji seihu to Eikoku Tōyō Ginkō* [The Meiji Government and the British Oriental Bank] (Tōkyō: Chūō Kōronsha, 1992), pp. 156-7.
[522] Sugiyama Kazuo, "Kinyū seido no sōsetsu [The establishment of the financial system]," in Kajinishi Mitsuhaya, ed., *Nihon keizaishi taikei,* volume 5 *Kindai (jō)* (Tōkyō: Tōkyō Daigaku Shuppankai, 1965), p. 210.
[523] In Meiji Japan, the national bank (*kokuritsu ginkō*) was a direct translation of the American "national bank" and it was thus not a state-owned bank but a private bank which received from the government the privilege to issue its banknotes.
[524] Ikeda Kōtarō, "Kankin toriatsuka seisaku to shihonshūgi no seiritsu [The handling of government funds and the establishment of capitalism]," Okada Shunpei ed., *Meiji shoki no zaisei kinyū seisaku* [The Fiscal and Financial Policies in the Early Meiji] (Tōkyō: Seimeikai Sōsho, 1964), p. 161.

of Finance. This was a major step toward a centralized system in supervising and managing government spending.[525]

The magnitude of the credit crisis also affected the Meiji government's efforts to build a central bank in 1871. There was a consensus among officials in the Ministry of Finance that the government must seek cooperation from private financiers to ensure the convertibility of the paper notes. They were aware of the decentralized national banking system in the US and the centralized approach taken in Britain. Itō Hirobumi considered the American model to be a "peerless method" whose adoption would "lay down the foundation of a rich country."[526] Nonetheless, officials in the Office of Reform in the Ministry of Finance, such as Shibusawa Eiichi and Maejima Hisoka, preferred the British example where the Bank of England as a central bank monopolized the issue of banknotes.[527] In 1870, Yoshida Kiyonari, who had spent seven years in England to study the English financial system, returned to work for the Ministry of Finance; he also recommended the Bank of England as the better model.[528]

On February 20, 1871, Ōkuma and Inoue planned to establish the Bank of Japan along the British lines. In August 1871, Inoue and Shibusawa urged the Mitsui and Ono Houses to jointly form a "bank of gold notes," where 60 percent of its capital would be in

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[525] Ibid., p. 164.

[526] Cited from Senda Minoru, "Kinsatsu shobun to kokuritsu ginkō [The redemption of gold notes and the national banks]," *Shakai keizai shigaku*, Vol. 48, No. 1 (1982), p. 35. The books and brochures published by the Government Printing Office of America, as well as the US National Currency Act (June 3, 1864) were also translated into Japanese. Ibid., p. 32.

[527] Their knowledge of the Bank of England mostly came from *Elements of Political Economy* written by Arthur Latham Perry, which had been translated into Japanese. Ibid., p. 32.

[528] Nakamura Naoyoshi, *Ōkuma zaisei no kenkyū* [A Study of the Policies of Public Finance of Ōkuma] (Tōkyō: Azekura Shobō, 1968), p. 38.

specie and the remaining 40 percent in government paper notes.[529] This failed as the two banks were unable to prepare the necessary specie reserves to guarantee the convertibility of the 80 million *ryō* (denominated in gold) of paper notes. In this situation, the Ministry of Finance decided to take up Itō's proposal to follow the American national banking system with the aim of dividing the burden of maintaining the convertibility of paper notes among many discrete national banks.

On December 15, 1872, the government issued the National Bank Act which required a national bank to lend government paper notes at 6 percent in return for the government-granted privilege to issue an equivalent amount of convertible banknotes. Yet the scarcity of gold led to poor performance. By 1876, only four national banks were established, and the total amount of their banknotes fell from 1.36 million yen in June 30, 1874 to 62,456 yen in June 30, 1876.[530] In August 1876, Ōkuma revised the National Banking Act, which reduced the required ratio of specie in the capital of a national bank from 40 percent to 20 percent and allowed national banks to convert their banknotes with government paper notes, instead of specie. Between 1876 and 1879, the number of national banks increased from 4 to 153, and the amount of issued banknotes jumped from 1.74 million yen to 33.93 million yen.[531] The revised National Bank Act basically converted the government's massive debts into *de facto* non-convertible banknotes issued

[529] Senda Minoru, "Kinsatsu shobun to kokuritsu ginkō [The redemption of gold notes and the national banks]," *Shakai keizai shigaku*, Vol. 48, No. 1 (1982), pp. 41-42.
[530] Nakamura Naoyoshi, *Ōkuma zaisei no kenkyū* [A Study of the Policies of Public Finance of Ōkuma], p. 45.
[531] Yamamoto Yūzō, "Meiji ishinki no zaisei to tsūka [Finance and money in the Meiji Restoration]," p. 155.

by national banks, and the government strictly controlled the total amount of banknotes that could be issued by national banks.[532]

Although inflation became serious after 1879, the Meiji government possessed most of the institutional elements necessary to build a central bank for public finance. The government had established a centralized institution to supervise the spending of prefectural governments and government ministries. It had also created a centralized bureaucracy to effectively assess and collect taxes on alcohol production. At this moment, the main institutional defect in public finance was the fact that the central government still did not have an institutional ability to use its aggregate income to regulate the domestic financial markets. In 1880, national banks and major private banks handled up to 85 percent of government tax revenues and expenditures.[533] They not only received tax revenues but also made disbursements upon orders from the Ministry of Finance. These banks could utilize the period during which they held government money to profit by providing low-risk, short-term credit in the financial markets.[534] The Ministry of Finance itself also lent government cash reserves directly to important merchants to generate more income for the government.[535]

When the government attempted to truly centralize cash flows in its fiscal system and thence establish a central bank in 1881, both domestic and international economic

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532 The government set 34 million yen as the upper limit in the issue of banknotes by national banks. For the conversion of government debt into banknotes in the new National Bank Act, see Imuta Yoshimitsu, "Nihon ginkō no hakken seido to seihu kinyū [The institution of note-issuing of the Bank of Japan and public finance]," *Shakai keizai shigaku*, Vol. 38, No. 2 (1972), pp. 125-6.
533 Sugiyama Kazuo, "Kinyū seido no sōsetsu [The establishment of the financial system]," p. 210.
534 Teranishi Jūrō, *Nihon no keizai hatten to kinyū* [Japan's Economic Development and Finance] (Tōkyō: Iwanami Shoten, 1982), p. 58
535 Ibid., p. 59.

conditions were favorable. According to a market investigation conducted by the Ōsaka Chamber of Commerce in 1879, peasant purchasing power had increased due to the reduction in the rate of land taxation in 1876 and the depreciation of paper notes. The general prosperity in rural areas attracted many urban migrants, stimulated domestic trade, and increased imports that met the needs of the rural sector even though imports of foreign luxuries had decreased.[536] The growing domestic economy, illustrated by the increase in sake production, provided an important tax base for the government to extract indirect taxes.

In an economy with vibrant inter-regional trading, national banks and other major private banks such as Mitsui and Yasuda quickly established a nation-wide correspondence network to transmit money across time and region.[537] In order to promote the circulation of banknotes issued by different national banks in Japan, Shibusawa Eiichi, the head of the No. 1 National Bank, organized a bank association to coordinate the business activities of member banks. In particular, he was interested in introducing the institution of the "clearing-house" from the US and Switzerland, which would clear liabilities and redeem bills issued by various member banks.[538] In Ōsaka, another Bank Association was formed in 1880 which consisted of 15 major national banks and the Mitsui Bank. It played an important role in coordinating bill-discounting and exchange of banknotes

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[536] Godai Tomoatsu, "Reply to the inquiry about the protection tariffs" (October 5, 1879), in *Godai Tomoatsu denki shiryō* [The Biographical Materials of Godai Tomoatsu], volume 2, pp. 254-63.
[537] The number of correspondence among the 150 national banks and the Mitsui and their respective branches increased from 10 in June 1877 to 1,027 in June 1880. Cited from Tsurumi Masayoshi, *Nihon shinyō kikō no kakuritsu: Nihon ginkō to kinyū shijō* [The Establishment of a Credit System in Japan: the Bank of Japan and the Financial Market] (Tōkyō: Yūhikaku, 1991), p. 104.
[538] Ibid., pp. 110-2.

among member banks.[539] These business networks formed among major banks thus prepared a solid basis upon which to build a central bank.

As for the international economy, the adoption of the gold standard throughout the west resulted in silver inflows into East Asia after the mid-1870s. The falling value of silver was not only an alternative to a "protective tariff" for Japan but also beneficial to Japan's exports. In June 1879, the Office of Customs in the Ministry of Finance asked the Chamber of Commerce in Tōkyō and Ōsaka to investigate the impact of imported goods on the Japanese economy and to report to the government about an appropriate level of a protective tariff. The two Chambers concluded independently that protection tariffs were unnecessary and the import of cotton yarn, sugar, and iron was beneficial to the Japanese economy and consumers.[540]

The above section has examined the continuous accumulation of effective institutional elements in public finance and of experience in managing financial issues among the officials in the Ministry of Finance during the 1870s. However, the same decade also saw numerous policy mistakes which greatly affected the process of building of a central bank in the 1880s. In the next section, I discuss the complex politics surrounding the establishment of a central bank, even though there was little dispute over the direction of this institutional development.

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539 Ten member banks were Ōsaka-based and two were Tōkyō-based. Tamaki Norio, *Japanese Banking: A History, 1859-1959* (Cambridge: Cambridge University Press, 1995), p. 45.
540 Cited from Miwa Ryōichi, *Nihon kindai no keizai seisakushi teki kenkyū* [A Historical Study of Economic Policy of Modern Japan] (Tōkyō: Nihon Keizai Hyōronsha, 2002), p. 47.

IV. Politics and Japan's last step toward a modern fiscal state: 1880-1895

By 1879, past errors in policy had produced serious political consequences which eroded the political basis of the Meiji government. Inflation, particularly the rising price of rice, greatly troubled the urban population, particularly those who depended upon fixed incomes such as ex-samurai. More ex-samurai joined the Freedom and Popular Rights Movement. In March 1880, 114 representatives of the Association of Patriots, whose members had reached 87,000, gathered in Ōsaka and presented the Meiji government with a petition for the establishment of a parliamentary system.[541] In this influential proposal, the representatives expressed their concern about the "numerous national debts, over-issuing of paper notes, and the rise in prices." They demanded that "tax issues should not be determined by the government only but should be discussed by all the Japanese people, and [thus] a parliament should be established."[542]

Peasants benefited from a *de facto* tax reduction due to the rising price of rice and the depreciation of paper notes, which they used to pay taxes. Nonetheless, rich farmers and local merchants in rural areas increasingly demanded participation in local governance, particularly in issues such as taxation and infrastructure construction. In regard to national politics, they also called for the establishment of a parliament. The political activism of rich farmers and rural merchants from 1878 onward expanded and

[541] Masumi Junnosuke, *Nihon seijishi* [A Political History of Japan], volume 1 (Tōkyō: Tōkyō Daigaku Shuppankai, 1988), p. 185

[542] Cited in Harada Mikio, *Nihon no kindaika to keizai seisaku: Meiji kōgyōka seisaku kenkyū* [Economic Policy and Japan's Modernization] (Tōkyō: Tōyō Keizai Shinpōsha, 1972), p. 162.

strengthened the Freedom and Popular Rights Movement. The number of petitions and proposals for a parliamentary institution jumped from 7 in 1879 to 85 in 1880.[543]

Previous policy mistakes also split the central government. Ōkubo Toshimichi and Ōkuma Shigenobu were the two main architects of the *shokusan kōgyō* program. After the assassination of Ōkubo by a discontented ex-samurai on May 14, 1878, Ōkuma had to bear the brunt of the critique of inflation within the Meiji government. He thus desperately needed to curb the falling value of paper notes so as to defend his position. In April and May 1879, he ordered the release of 2.4 million yen in silver from the government cash reserves to the market to stabilize the exchange rate between paper notes and silver cash.[544] This measure was ineffective, and Ōkuma had to reduce the amount of paper notes in circulation. On June 29, 1879, he planned to generate a fiscal surplus and publish the amounts of the surplus and the resulting reduction in paper notes in newspapers so as to safeguard public confidence in the government paper notes.[545] However, these measures did not improve the situation quickly enough to satisfy his critics in the government.

In February 1880, Iwakura Tomomi and Itō Hirobumi orchestrated an institutional reform. One major goal was to strengthen the role of the Cabinet, which consisted of the Ministers of the State, the Minister of Right, and all the Junior Councilors of the State. A

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[543] Emura Eiichi, *Jiyū minken kakumei no kenkyū* [The Study of the Revolution of People's Rights Movement] (Tōkyō: Hōsei Daigaku Shuppankyoku, 1982), p. 92.
[544] Harada Mikio, *Nihon no kindaika to keizai seisaku* [Economic Policy and Japan's Modernization], p. 149.
[545] Ōkuma Shigenobu, "On four measures in public finance," (June 29, 1879), *Ōkuma monjo*, volume 3, A15, p. 344, 348, and 359.

new Committee of Public Finance which included Ōkuma Shigenobu, Itō Hirobumi, and Teraji Munenori was established to take the place of the Ministry of Finance in making policy proposals, and major decisions were to be made upon consensus of members of the Cabinet. Meanwhile, the Meiji Emperor after 1880 became more actively involved in the making of government policies.[546] The political cost that Ōkuma and the Ministry of Finance paid for prior mistakes was to lose their dominance in the formation of financial policy.

At the same time, the value of paper notes kept falling. On February 28, 1880, the Ministry of Finance used 3 million yen in specie from government cash reserves as capital to form the Yokohama Specie Bank. Ōkuma hoped that this bank could not only attract deposits of specie but also earn it from abroad through organizing the exports of silk, tea, and the like. However, most of the loans were made through political connections and ended up as bad loans.[547] At the end of 1880, Inoue Kaoru, Godai Tomoatsu, and Maeda Masana proposed to the government a grand plan which consisted of a Bank of Japan, an insurance company, and a trading company to encourage exports. In this plan, the Bank of Japan lent the government's fiscal surplus and a part of specie reserves to the trading company for it to organize the export of raw silk and tea. The insurance company provided the necessary services.[548] However, the dismal

[546] Asukai Masamichi, "Kindai tennōzō no tenkai [The unfolding of the image of Emperor in modern Japan]," in *Iwanami kōza Nihon tsūshi,* volume 17 (*kindai* 2) (Tōkyō: Iwanami Shoten, 1994), pp. 236-44.
[547] Yoshihara Tatsuyuki, "Meiji zenki chūki no Yokohama shōkin ginkō [The Yokohama Specie Bank in the Early and Middle Meiji]," in Shōda Kenichirō, ed., *Nihon ni okeru kindai shakai no keisei* [The Formation of a Modern Society in Japan] (Tōkyō: Sanrei Shoten, 1995), p. 262.
[548] Kokaze Hidemasa, "Ōkuma zaisei matsugi ni okeru zaisei rongi no tenkai [The development of the discussions on public finance in the later period of Ōkuma's public finance]," in Hara Akira, ed., *Kindai Nihon no keizai to seiji* [The Politics and Economy in Modern Japan] (Tōkyō: Yamagawa Shuppansha, 1986), pp. 14-21.

performance of the Yokohama Specie Bank made similar plans to directly acquire specie from the overseas market less appealing. In April 1880, the government released another 3 million yen in specie to the market to stabilize the value of paper notes without avail. As a result, the ratio of government specie reserves to the total amount of paper notes in circulation in 1880 was as low as 4.5 percent. [Table 5.3] In this situation, how to reduce the amount of paper notes in the economy became the focal issue.

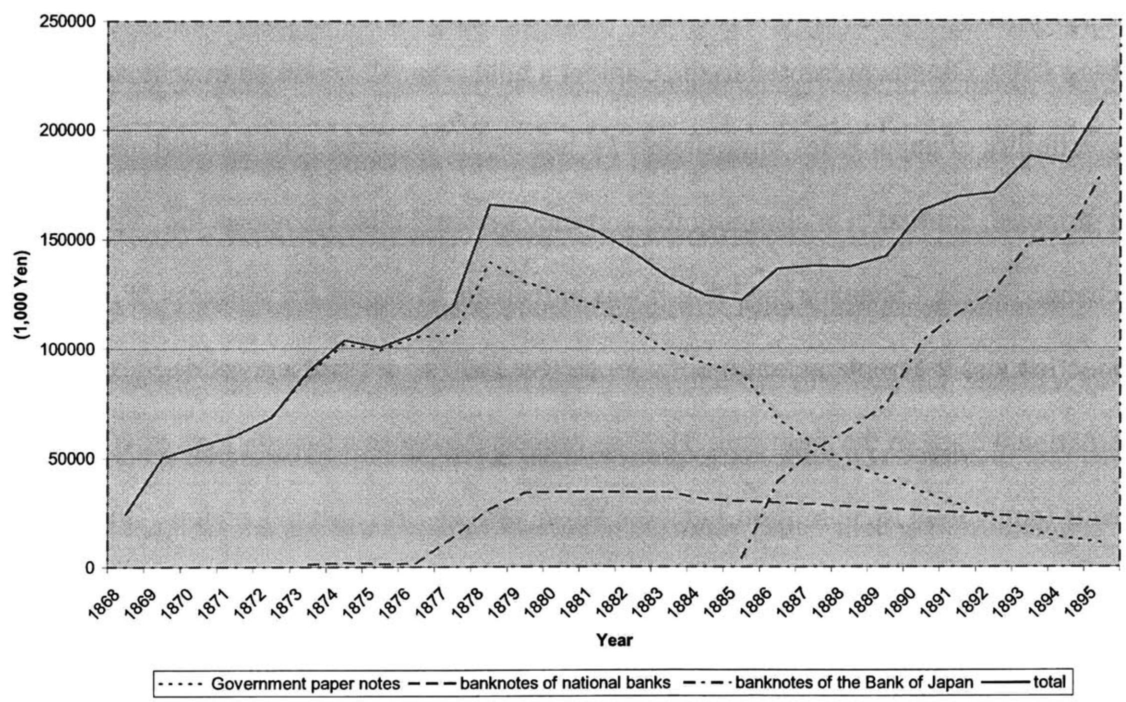
Table 5.3: Total amount of government paper notes and banknotes (unit: 1,000 yen)

Year	Government paper notes	Supplemental government notes	Banknotes	Total	Specie reserves	Reserve ratio %
1868	24,037			24,037	--	0
1869	50,091			50,091	2	0
1870	55,500			55,500	4	0
1871	60,272			60,272	191	0
1872	64,800	3,600		68,400	14,709	21.5
1873	77,281	1,100	1,362	79,743	14,819	18.6
1874	90,803	1,100	1,995	93,898	18,483	19.7
1875	91,284	7,788	1,420	100,492	14,664	14.6
1876	93,323	11,824	1,744	106,891	15,171	14.2
1877	93,323	11,961	13,353	119,150	15,115	12.7
1878	119,800	19,618	26,279	165,697	17,837	10.8
1879	114,191	16,118	34,040	164,349	9,967	6.1
1880	108,412	16,528	34,426	159,366	7,166	4.5
1881	105,905	13,000	34,397	153,302	12,699	8.3
1882	105,369	4,000	34,385	143,754	16,730	11.6
1883	97,999	0	34,276	132,275	25,876	19.6

Source: Harada Mikio, *Nihon no kindaika to keizai seisaku* [Economic Policies and the Modernization of Japan] (Tōkyō: Tōyō Keizai Shinpōsha, 1972), p. 174 and p. 229.

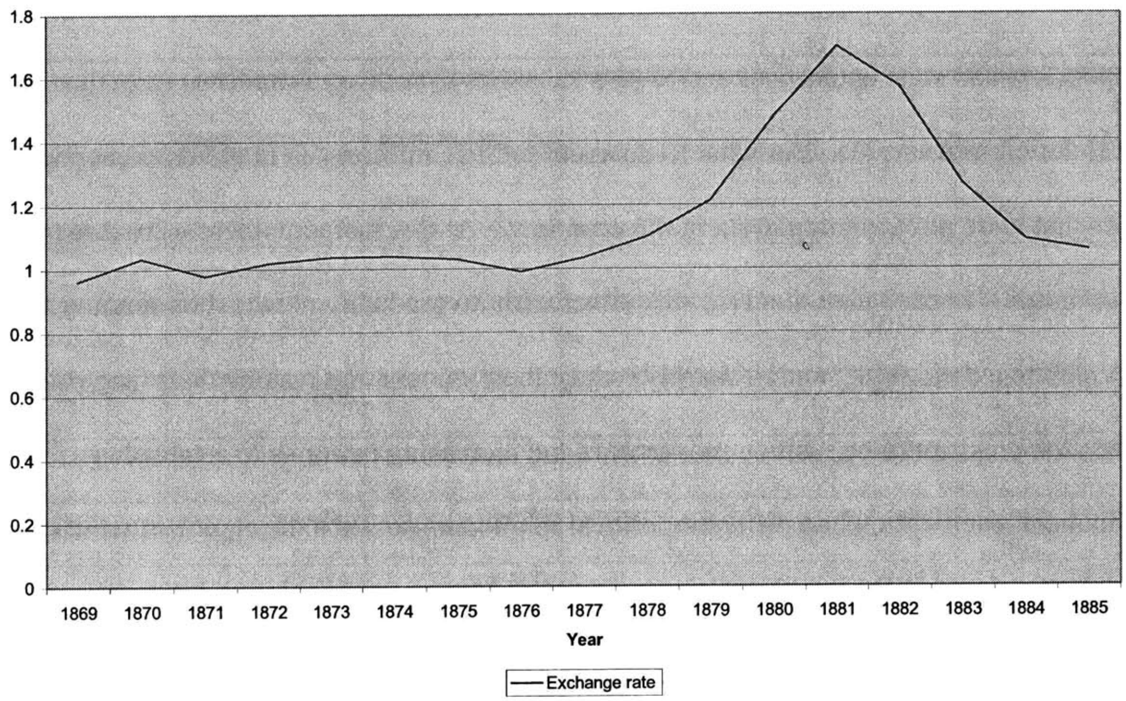
The principal cause of inflation was the Meiji government's expansionary financial policies and its disposition to issue paper notes to cover fiscal deficit. [Fig. 5-2] The increasing amount of paper notes led to the hoarding of silver, which further devaluated the notes. [Fig. 5-3] The falling value of paper notes in the markets thus forced the Meiji government to stop using paper notes to cover its fiscal deficit. In May 1880, Ōkuma proposed to sell state enterprises and to stop subsidies to primary schools so as to turn fiscal deficit into surplus. But what to do about the 121 million yen in government paper notes that were already circulating in the economy? At this moment, there were three main options: to exchange them all with silver cash; to gradually reduce their amount and thus stabilize their value; and to sharply reduce their amount and resume their face value. Given the pressure of opposition movements and increasing petitions to establish a parliament, each option had different political implications. Thus the choice of which approach to take was not determined by economic reasoning alone but was complicated by power struggles within the government and conflicts of interest.

Fig. 5-2 The amount of paper notes:1868-1895



Source: *Hundred-Year Statistics of the Japanese Economy* (Tōkyō: Hosokawa, 1966), p. 166.

Fig. 5-3 Exchange rates between paper notes and silver yen



Source: Yamamoto Yūzō, "Nai ni shihei ari gai ni bokugin ari [Paper money for domestic transactions and Mexican dollars for foreign trades]," *Jinmon gakuhō*, No. 55 (September 1983), p. 49.

In May 1880, Ōkuma presented to the Cabinet a bold plan which aimed to achieve the convertibility of paper notes immediately by borrowing from the international market. In this proposal, entitled "On changing the currency system" (also known as the "Specie Exchange Plan"), Ōkuma argued that it was unrealistic to expect the progress of domestic production and the implementation of a protective tariff to resume a possible balance in international trade in the short run. He then proposed to raise a foreign loan of 10 million pounds (equivalent to 50 million Japanese silver yen) at 7 percent in London. Combined with the 17.5 million in specie available in the Ministry of Finance, the government could exchange 78 million yen in paper notes from the market at a silver/notes exchange rate of 1:1.16. The remaining 27 million yen in paper notes still in the economy would be absorbed by banks, which used paper notes to exchange for government bonds in return for the privilege to issue the same amount of banknotes. After this exchange, Ōkuma expected that hoarded specie would reappear in the market. As to the annual interest payment of 3.68 million yen, Ōkuma proposed to increase tax rates on sake and liquor, which were expected to generate extra revenue of 6.62 million yen per year.[549]

Ōkuma's proposal aroused great debate among the members of the Cabinet. Conservatives such as Iwakura Tomomi criticized it as "selling Japan to foreigners." Itō Hirobumi, Inoue Kaoru, and Sano Tsunetami worried that such a massive foreign loan would bring a heavy interest burden and incur strong criticism from the government's opponents. Representatives from the army and navy all supported Ōkuma's plan for it did not cut current military expenditures.[550] Matsukata Masayoshi admitted Ōkuma's plan was "sound from the economic perspective." Yet he considered it "radical and dangerous" and proposed a gradual approach to increase specie reserves and reduce the amount of paper notes.[551] As the Cabinet could not reach an agreement, Emperor Meiji made the final decision to reject Ōkuma's plan in June 1880.

Although Ōkuma was overly optimistic about the ability of the Meiji government to borrow from the international markets and unaware of the extra burden that would result from the rising pound in the future, there were two important policy concerns in his scheme. First, Ōkuma appealed to devaluation of currency rather than government

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549 Ōkuma Shigenobu, "On changing the currency system" (May 1880), *Ōkuma monjo*, volume 3, A18, pp. 447-450.
550 Muroyama Yoshimasa, *Kindai Nihon no gunji to zaisei* [Public Finance and the Military in Early Modern Japan] (Tōkyō: Tōkyō Daigaku Shuppansha, 1984), pp. 28-29.
551 Matsukata Masayoshi, "My humble views on public finance," (June 1880), in *Matsukatahaku zaisei ronsakushū*, reprinted in Ōkubo Tatsumasa, ed., *Matsukata kankei monjo*, supplementary volume (Tōkyō: Daitō Bunka Daigaku Tōyō Kenkyūjo, 2001), p. 529 and p. 535.

intervention as the main method to curb Japan's deficit in foreign trade. Second, and more importantly, Ōkuma intended to achieve the convertibility of paper notes without reducing the level of currency in the economy so as to avoid domestic deflation.[552] As he warned explicitly in this proposal, a sharp reduction of paper notes might help recover their value yet it would produce a serious domestic deflation and thus greatly damage Japan's domestic commerce and manufacturing.[553] In addition to his understanding of economic principles, Ōkuma also knew from a report in July 1879 that the American government had successfully stopped the depreciation of paper notes and achieved their convertibility in December 1878 without reducing the monetary level.[554]

Ōkuma's concern about the deflationary effect of a "hard-landing" approach to curb inflation by sharply reducing the amount of paper notes was shared by leaders in the business community as well. In November 1880, Godai Tomoatsu sent a petition to the Ministry of Finance on behalf of the Ōsaka Chamber of Commerce. He pointed out that an easy way for the government to curb inflation and stop the falling value of paper notes was to "purposefully cut down the amount of notes." However, Godai warned that such a man-made scarcity of money would "block the way of financing and increase the interest rate" and thus "push the Japanese people into an extreme difficult situation." He thus

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[552] In Ōkuma's view, outflows of specie caused by deficits in foreign trade would reduce domestic prices and raise the price of imported goods, and thereafter Japan's exports would increase and its imports decrease. Consequently specie would flow back into Japan through international trade. Ōkuma called this mechanism a "natural way of recovery" (*tennen kaifuku*) in international trade, which he considered an "eternal principle" (*jōhō*) in the economy. Ibid., p. 453.
[553] Ibid., p. 454.
[554] This report was prepared by Kawase Hideji, an official in the Ministry of Finance. See Kawase Hideji, "A proposal on public finance," in *Ōkuma monjo*, volume 2, A980, p. 98.

urged the government to take the whole economy into account and adopt a gradual approach.[555]

In regard to the increase of government income, the Meiji government was afraid to raise land taxes because of the opposition movement. In September 1880, it rejected a proposal to collect 25 percent of land taxes in rice rather than in paper notes. The Meiji government was afraid that such a *de facto* increase in land taxes would arouse peasant riots and further stimulate the Freedom and Popular Rights Movement.[556] As a result, Ōkuma and Itō planned to extract 4 million yen from raising the duties on sake, liquor and tobacco. Moreover, in order increase the fiscal surplus by up to 10 million yen a year, they intended to greatly cut government expenditures by accelerating the sale of state enterprises, reducing government purchase of imported goods, and cutting central government's subsidies to and spending on local infrastructure construction, police and prisons.[557] This represented a fundamental change of policy regime in public finance, i.e., from fiscal expansion to retrenchment.

Activists of the Freedom and Popular Rights Movement welcomed this significant policy change. In response to the government's attempt to raise tax revenue, they argued that the Japanese people had the right to demand an immediate establishment of a parliament so that their representatives could participate in the making of budgets and tax policies.

[555] Godai Tomoatsu, "Views on rescuing public finance," in *Godai Tomoatsu denki shiryō* [The Biographical Materials of Godai Tomoatsu], volume 2, p. 333.
[556] Inoki Takenori, "The proposal of land taxation in rice and the adjustment of public finance," in Umemura Mataji and Nakamura Takafusa eds., *Matsukata zaisei to shokusan kōgyō seisaku* [The Matsukata Public Finance and the Policy of Fostering Production and Encouraging Enterprises] (Tōkyō: Kokusai Rengō Daigaku, 1983), p. 108.
[557] Ōkuma and Itō, "On reforming public finance," (September 1880), *Ōkuma monjo*, volume 3, A16.

Otherwise, the new Meiji regime "would be no different from the former so-called feudal polity, at least on the issue of taxation."[558] The massive retrenchment policy also significantly affected local politics. As expenditures on local infrastructure and civil works were now funded by local taxes, rich farmers and local merchants began to actively participate in local governance, particularly with regards to financial issues.[559]

The retrenchment programs not only reduced the amount of paper notes but also sent out a signal to the economy that the Meiji government would no longer issue paper notes to cover its deficit. The exchange rate of silver yen to paper notes began to fall after reaching a peak of 1.795 in April 1881, and it stabilized at around 1.63 for a few months. The price of rice also began to fall after April 1881. Meanwhile, Ōkura stopped the risky practice of lending government cash reserves to political merchants and government enterprises.[560] Under these circumstances, few would have expected the value of paper notes to fall further. When the market became more confident in the value of paper notes, the hoarded silver specie would gradually reappear, which would further consolidate the value of paper notes vis-à-vis silver specie.

However, the autocratic Meiji regime did not possess an institution, such as a parliament that supervised public finance, to consolidate the trust in government's commitment to

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[558] Ōishi Kaichirō, *Jiyū minken to Ōkuma Matsukata zaisei* [The Movement of Rights and Freedom and the Public Finance of Ōkuma and Matsukata] (Tōkyō: Tōkyō Daigaku Shuppansha, 1989), p. 246.

[559] In an article published in 1882, Fukuzawa Yukichi considered this change a significant deepening of the Movement of Rights and Freedom as "local farmers and businessmen, who were afraid to raise their heads before prefectural officials, are now sitting in government halls to supervise proposals of local taxation and discuss annual budgets." Cited from Masumi Junnosuke, *Nihon seijishi* [A Political History of Japan], volume 1, p. 199.

[560] Muroyama Yoshimasa, *Matsukata zaisei kenkyū* [A Study of Matsukata's Policy in Public Finance] (Kyōto: Mineruva Shobō, 2004), p. 127.

this fundamental change in policy regime. In the absence of a representative political institution, Ōkuma and Itō planned to use a central bank to safeguard the value of paper notes. On July 29, 1881, they jointly drafted a plan which intended to raise a credit of 50 million yen by issuing government bonds and used this as the capital to establish a "big specie bank" to guarantee the convertibility of paper notes. This "big specie bank" was to discount the bills of exchange for Japan's foreign trade, manage government revenue and expenditures, and issue convertible banknotes, "just like the Bank of England in Britain and the Bank of France in France."[561] In order to quickly raise the needed capital for this bank, Ōkuma and Itō decided to allow foreigners to subscribe to its stocks. This decision was politically less risky than the foreign loan of 50 million yen that Ōkuma had proposed in 1880, yet it was still controversial. For example, Matsukata Masayoshi in September 1881 sent a report to Sanjō Sanetomi, the Minister of the State, which warned that "the dependence on foreigners' capital [in the bank plan of Ōkuma and Itō] ... might achieve convertibility but would cause countless disasters in future and push Japan into a dire situation similar to that of Egypt, Turkey or India."[562]

The political situation in 1881 was explosive, even though the economic situation was improving. The Meiji government adopted repressive measures against the mounting waves of opposition. The number of newspapers that the government closed was as high as 46 in 1881, compared with 3 in 1879 and 12 in 1880. In April 5, 1880, the government forbade any political association and gathering if it was considered

[561] Ōkuma Shigenobu and Itō Hirobumi, "A proposal to issue new government bonds and to establish a bank," in *Ōkuma monjo*, volume 3, A21, pp. 472-474.
[562] Matsukata Masayoshi, "On public finance," (September 1881), in *Matsukatahaku zaisei ronsakushū*, reprinted in Ōkubo Tatsumasa, ed., *Matsukata kankei monjo*, supplementary volume, p. 340.

"detrimental to the security of the state," and forbade communications or correspondence among members of prefectural and city congresses.[563] However, the political consequence of the retrenchment policy was to stimulate local elites' increasing political participation. A coalition of ex-samurai, local merchants, and rich farmers in the Freedom and Popular Rights Movement would be a serious threat to the regime. In this situation, Ōkuma's advocacy of the British model of monarchial constitutionalism ignited conflict within the government. In the view of Inoue Kowashi, who was drafting a conservative constitution, the essence of the British constitutional monarchy was a republican polity of parliamentary sovereignty, in which the monarch was simply a puppet.[564] Power struggles culminated in a coup in October 1881, which expelled Ōkuma and his followers from the government. Ōkuma soon organized a "Constitutional Reform Party" as an opposition party.

After this coup, Matsukata Masayoshi became the Minister of Finance. Right before the coup, he was asked to prepare a report on public finance to Sanjō Sanetomi, the Minister of the State. In this, Matsukata rejected the charge that the government's excessive issue of paper notes caused inflation. Instead, he argued that the real cause was the government's insufficient specie reserves, which resulted from deficits in international trade. The correct solution for the government to stabilize the value of paper notes was to continue to promote domestic production so as to draw specie through increasing

[563] Yokoyama Kōichirō, "Keipotsu chian kikō no seibi [The arrangement of the institutions of punishment and security]," in Fukushima Masao ed., *Nihon kindai hōtaisei no keisei* [The Formation of Legal Institutions in Modern Japan] (Tōkyō: Nihon Hyōronsha, 1981), volume 1, p. 328.
[564] Inoue Kowashi, "Letter to Itō" (June 1881), cited in Ōkubo Toshiaki, *Meiji kokka no keisei* [The Formation of the Meiji State] (Tōkyō: Yoshikawa Kōbunkan, 1986), p. 330

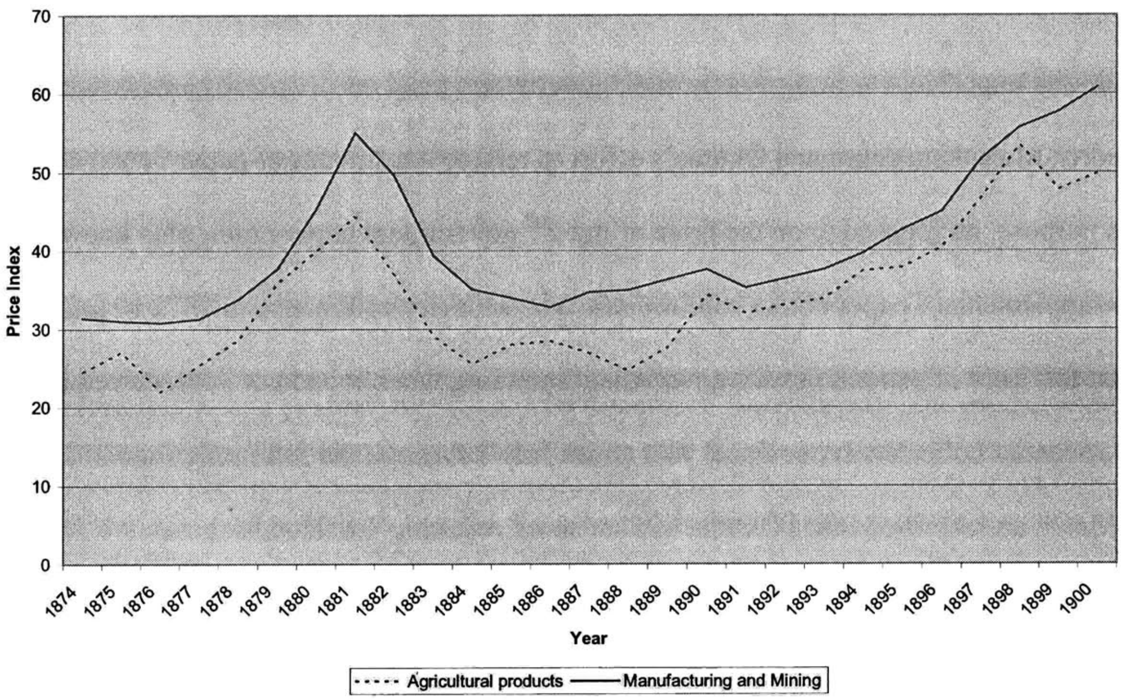
exports.[565] For this purpose, Matsukata recommended a new "mechanism of utilizing money" (*kahei unyō no kijiku*), which was a central bank supported by savings banks and investment banks. Savings banks were to channel small deposits into the central bank through the postal networks. The investment bank would then use these aggregated savings to make long-term loans with low interest rates (less than 8 percent) to encourage enterprises in agriculture, manufacturing, and transportation, accepting real estate as collateral.[566] In Matsukata's view, this plan would promote domestic production and manufacturing without the danger of inflation.[567] Obviously, this plan was impractical in the short run.

As it was impossible to immediately raise government reserves of specie by increasing exports, Matsukata continued Ōkuma's effort to reduce the amount of paper notes. For this purpose, he focused upon the issue of the 2nd government paper notes, also known as the supplementary paper notes (*yobi shihei*). The Ministry of Finance in 1872 began to issue this kind of paper notes for government spending when it had not yet received the tax revenues collected in one fiscal year (from July 1 through the following June 30).[568] In March and April of 1881, Ōkuma had set about reducing the issue of these supplementary paper notes by ensuring that revenues and expenditures from one fiscal

[565] Matsukata Masayoshi, "On public finance," (September 1881), in *Matsukatahaku zaisei ronsakushū*, reprinted in Ōkubo Tatsumasa, ed., *Matsukata kankei monjo*, supplementary volume, pp. 337-8.
[566] Ibid., p. 332, p. 334, p. 335.
[567] This was the basic scheme of the proposal to establish a central bank in March 1883. See Matsukata Masayoshi, "On the establishment of the Bank of Japan," (March 1, 1883), in *Matsukatahaku zaisei ronsakushū*, reprinted in Ōkubo Tatsumasa, ed., *Matsukata kankei monjo*, supplementary volume, pp. 356-7.
[568] Muroyama Yoshimasa, *Kindai Nihon no gunji to zaisei* [Public Finance and the Military in Early Modern Japan), p. 68.

year were not mixed up with those of the next fiscal year.[569] There was no dispute over the need to reduce the supplementary paper notes. Nonetheless, Matsukata did it in a very sudden manner which cut the amount of the supplementary paper notes from 13 million yen in 1881 to 4 million yen in 1882 and further to zero in 1883. In other words, Matsukata reduced the total amount of currency (including banknotes) by 13.7 percent, or the total amount of government paper notes by 17.6 percent, in less than two years. As the Japanese historians Fukaya Tokujirō and Muroyama Yoshimasa have pointed out, this was the crucial factor that triggered the Matsukata deflation.[570] [Fig. 5-4]

Fig. 5-4 Price Index in Japan: 1874-1900 (1934-1936 =100)



Source: Ōkawa Kazushi, Shinohara Miyohei, and Umemura Mataji, eds., *Chōki keizai tōkei*, volume 8, *Bukka* [Long-term Economic Statistics] (Tōkyō: Tōkyō Keizai Shinpōsha, 1967), p. 166 and p. 192.

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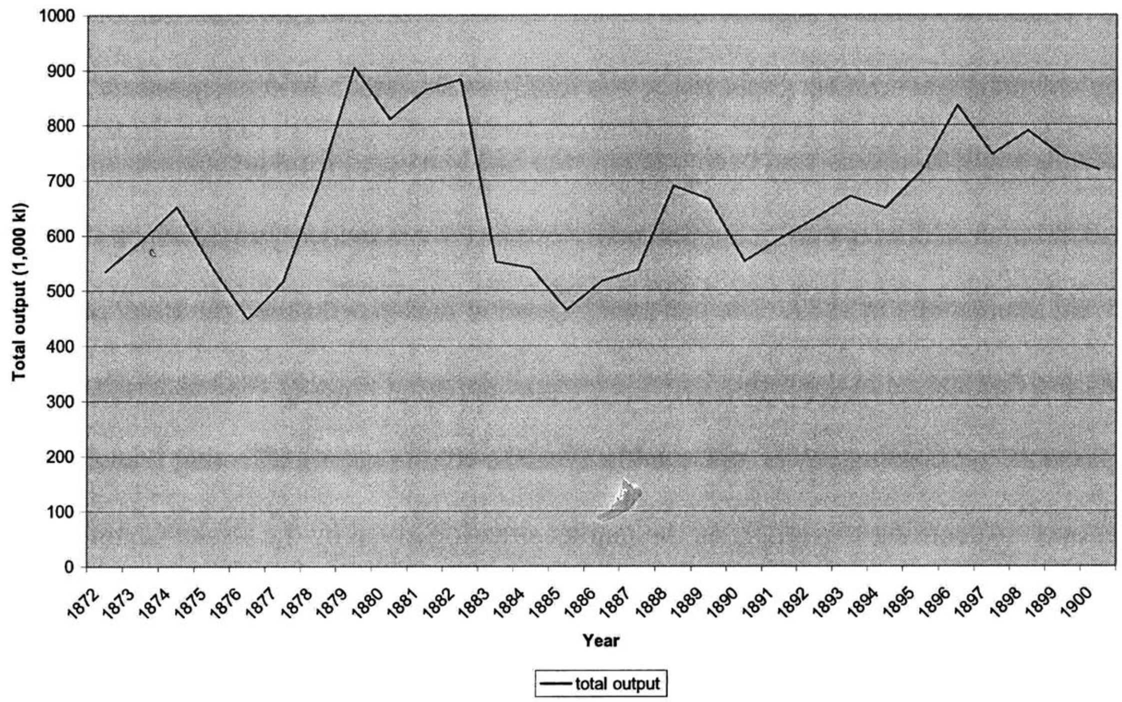
569 Ōkuma Shigenobu, "The regulation for the Department of Accounting Inspection and the rules of government Accounting," (March 1881), in *Ōkuma monjo*, volume 3, A2270, p. 465.

570 Fukaya Tokujirō, *Meiji seihu zaisei kiban no kakuritsu* [The Establishment of the Foundation of the Meiji Government's Public Finance] (Tōkyō: Ochanomizu Shobō, 1995), p. 144; Muroyama Yoshimasa, "Matsukata defureishon no mekanizum [The mechanism of the Matsukata deflation]," in Umemura Mataji and Nakamura Takafusa eds., *Matsukata zaisei to shokusan kōgyō seisaku* [The Matsukata Public Finance and the Policy of Fostering Production and Encouraging Enterprise], p. 146.

The deflationary effect was particularly severe as Matsukata's drastic reduction of the supplementary government paper notes was totally unexpected. In consequence, peasants, small landlords, and businessmen who had borrowed from local banks or financial intermediaries during the prosperity of 1881 were suddenly caught by a rise in the real interest rate in 1882. The increasing taxation further worsened the situation. The deflation that started in the spring of 1882 became apparent in early 1883 as a reduction in peasants' purchasing power and quickly caused a chain reaction affecting the whole economy. According to a report on the market situation given by the Ōsaka Chamber of Commerce on February 23, 1883, the workshops that used imported cotton yarn to weave coarse cotton cloth to meet the demand of peasants prospered in 1880 and 1881, yet most of them went bankrupt after the spring of 1882. Imported sugar also found few customers after the spring of 1882, even though most was sold to the countryside in the previous two years.[571] In 1883, the total output of sake in Japan fell 35 percent, which further dragged down rice prices.[572] [Fig. 5-5] The Ōsaka Chamber of Commerce also recognized that the deflation had triggered a vicious cycle. As the people were *expecting* further falls in prices, they became reluctant to spend or to invest with their currency. They simply deposited money in banks or purchased government bonds.[573]

[571] Godai Tomoatsu, "Reply to the Ōsaka municipal government's inquiry," (February 23, 1883), in *Godai Tomoatsu denki shiryō* [The Biographical Materials of Godai Tomoatsu], volume 2, pp. 381-2.
[572] Godai Tomoatsu, "Reply to the Ōsaka municipal government's inquiry," (January 19, 1884), in *Godai Tomoatsu denki shiryō* [The Biographical Materials of Godai Tomoatsu], volume 2, p. 484.
[573] Ibid., pp. 486-8.

Fig. 5-5 Total output of taxable sake in Japan: 1872-1900



Source: *Hundred-Year Statistics of the Japanese Economy* (Tōkyō: Hosokawa, 1966), p. 107.

It remains unclear why Matsukata took such a dramatic approach. He seems not to have anticipated the impact of domestic deflation. The failure of a military conflict with China in Korea in July 1882 made the navy and army demand a massive military expansion so as to improve their position vis-à-vis China's newly modernized navy. In response, Matsukata in September planned to raise 7.5 million yen in tax revenue annually for this purpose. However, the falling tax revenues caused by the deflation forced the Meiji government to not only reduce the scale of military expansion but also avoid direct confrontation with China over the issue of Korea.[574] Had he realized in advance the

[574] The actual expenditure on military expansion was cut by 13 percent and 22 percent from the original plan in 1883 and 1884 respectively. Calculated from Takahashi Hidenao, "Matsukata zaiseiki no gunbi kakuchō mondai [The issue of military expansion in the public finance of Matsukata]," *Shakai keizai shigaku*, Vol. 56, No. 1 (April 1990), table 3, p. 7. For the Meiji government's non-confrontational

deflationary effects of his policy, Matsukata would not have planned to fund the military expansion programs in 1882 solely through the extra income from raising taxes on alcohol and tobacco. Moreover, when the Bank of Japan began to issue convertible banknotes in 1885, Matsukata took a gradual approach to reducing the amount issued by national banks so as to avoid a reduction of the monetary level. This suggests that he may have learned from the earlier debacle with the supplementary government paper notes.[575] In this light, the political consequence of weakening the economic basis of rich farmers and peasants may not necessarily have been the intension of Matsukata's financial policies.[576]

Nor did Matsukata have effective means to deal with the nation-wide deflation. In the beginning, he refused to admit that falling prices were a serious economic problem.[577] Although he admitted that the expectation of further declines in prices would deter investment activities, he argued that a complete recovery of the value of paper notes vis-à-vis specie would cultivate virtues of "industry and thrift" among the Japanese, who would then engage in "concrete" rather than "speculative" business activities.[578]

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strategy in the 1880s, see idem., *Nisshin sensō no michi* [The Road to the Sino-Japanese War in 1894] (Tōkyō: Tōkyō Sōgensha, 1995), pp. 186-227.

575 Kamiyama Tsuneo, *Meiji keizai seisakushi no kenkyū* [A Historical Study of the Economic Policies in Meiji Japan] (Tōkyō: Hanawa Shoten, 1995), pp. 93-94.

576 This view is often implicitly assumed in some important study about the politics of Matsukata deflation. See an example in Ōishi Kaichirō, *Jiyū minken to Ōkuma Matsukata zaisei* [Freedom, Popular Rights and the Public Finance of Ōkuma and Matsukata] (Tōkyō: Tōkyō Daigaku Shuppansha, 1989).

577 In his report to the Minister of the State on November 26, 1883 and his speech to prefectural magistrates in 1884, Matsukata contended that falling prices simply reflected the recovery of the value of paper notes, and the "real" prices measured by silver yen remained the same as before. Matsukata Masayoshi, "On the regulation of the land taxes" (presented to the Minister of the State, November 26, 1883), in *Matsukatahaku zaisei ronsakushū*, reprinted in Ōkubo Tatsumasa, ed., *Matsukata kankei monjo*, supplementary volume, p. 262; idem., "Reasons for issuing the law of land taxation: to prefectural governors," (1884), ibid., p. 270.

578 Matsukata Masayoshi, "A speech in the conference of prefectural governors in the Ministry of Finance," (December 10, 1883), in *Matsukatahaku zaisei ronsakushū*, reprinted in Ōkubo Tatsumasa, ed., *Matsukata kankei monjo*, supplementary volume, p. 619 and p. 622.

However, Matsukata could not long maintain confidence in his "deflation-stimulate-investment" theory in the face of the ongoing economic collapse. In September 1883, he asked the Ministry of Finance to issue 20 to 30 million yen in short-term bonds in anticipation of incoming tax revenues to mitigate the seasonal scarcity of currency. He could have taken such a measure in 1882 as a substitute to the sudden stopping of supplementary paper notes. In order to curb the collapse of rice prices, Matsukata in October 1883 extended the period for handing in land taxes for a month so as to reduce the pressure to sell rice at low prices. Although Matsukata had strongly opposed Ōkuma's plan to take out foreign loans, lack of domestic investment in a deflationary economy forced him in 1883 to allow foreigners to subscribe to railway construction bonds.[579] In 1884 and 1885, he tried to raise foreign credit in Western Europe, but to no avail.[580]

In January 1884, the Ōsaka Chamber of Commerce urged the government to take measures to bolster the purchasing power of peasants and to raise investment in transportation and industry so as to increase the "circulation velocity of currency in the economy."[581] It also pointed out that one cause of the scarcity of currency was the 40 million yen in tax revenue which was sent to the Ministry of Finance and stayed in the government from December to the following February, when it was returned to the countryside through government expenditures. This report also mentioned that the central bank in European countries often took measures such as discounting or short-term

[579] Kamiyama Tsuneo, *Meiji keizai seisakushi no kenkyū* [A Historical Study of the Economic Policies in Meiji Japan], p. 21.
[580] Ibid., p. 29.
[581] Godai Tomoatsu, "Reply to the Ōsaka municipal government's inquiry," (January 19, 1884), in *Godai Tomoatsu denki shiryō* [The Biographical Materials of Godai Tomoatsu], volume 2, p. 488.

lending to mitigate this seasonal fluctuation of currency in the economy.[582] In Matsukata's proposal to establish a central bank, he clearly stated that one of its advantages was the ability to use such means to stabilize the supply of currency when the "currency went into the treasury in the form of tax revenues."[583]

However, the Bank of Japan that Matsukata established in October 1882 as the central bank was ill-prepared to perform such functions. Its initial capital was merely 2 million yen, and its capital only reached 5 million yen in 1883. In contrast, there were 143 national banks and 176 private banks in Japan, which had a total capital of 61.36 million yen in 1883.[584] The number of banks that opened current accounts in the Bank of Japan was 1 in 1883 and 10 in 1884. The Bank of Japan did not begin to transmit government revenues and expenditures until July 1883.[585] Given these circumstances, the newly established Bank of Japan had little power over the financial markets in Japan in the initial two years. What was worse, the post-coup government first used the Bank of Japan as a political weapon to attack Ōkuma's "Constitutional Reform Party." As the funds of this party came mainly from the Mitsubishi Company, the largest seaborne company in Japan at the time, the Meiji government in January 1, 1883 established a seaborne company, the Joint Transportation Company (*kyōdōunyu kaisha*), to weaken

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582 Godai Tomoatsu, "Reply to the Ōsaka municipal government's inquiry," (February 23, 1883), in *Godai Tomoatsu denki shiryō* [The Biographical Materials of Godai Tomoatsu], volume 2, p. 384.
583 Matsukata Masayoshi, "On the establishment of the Bank of Japan," (March 1, 1883), in *Matsukatahaku zaisei ronsakushū*, reprinted in Ōkubo Tatsumasa, ed., *Matsukata kankei monjo*, supplementary volume, p. 351.
584 Hugh T. Patrick, "Japan, 1868-1914," in Rondo Cameron, Olga Crisp, and Hugh T. Patrick eds., *Banking in the Early Stages of Industrialization: A Study in Comparative Economic History* (New York: Oxford University Press, 1967), p. 248.
585 Yagi Yoshikazu, "Meiji 14 nen seihen to Nihon ginkō [The 1881 coup and the Bank of Japan]," *Shakai keizai shigaku*, Vol. 53, No. 5 (December 1987), p. 643.

Mitsubishi.[586] The Bank of Japan provided 300,000 yen in a timed loan to the Joint Transportation Company without taking any collateral, which accounted for 46 percent of its total timed loans in the first half of 1883.[587]

Restoring the value of paper notes had been the principal goal of Matsukata's financial policy, and he used the shrinking discrepancy between paper notes and silver yen to justify his program.[588] However, this achievement itself could do little to alleviate the damage that deflation inflicted on the Japanese economy, particularly when considering the vicious cycle it set up, i.e., the expectation of further falling of prices discouraged investment, and lower investment further pushed prices downward. In the received story, Matsukata has often been characterized as an advocate of orthodox economics who rejected government intervention in favor of the market.[589] In practice, however, he had to use government intervention to encourage investment, which a deflationary market could not automatically accomplish.

Deflation increased the real interest rate and caused a distribution of wealth in favor of creditors. Yet it also reduced opportunities for profitable investment. This situation made it easier for Matsukata to issue bonds at low interest rates to raise massive amounts of capital for railway construction and the modernization of the navy and army. All the bonds he issued between 1884 and 1889 were over-subscribed. [Table 5.4] From 1886

[586] Ibid., p. 637.
[587] Ibid., p. 636.
[588] Muroyama Yoshimasa, *Matsukata zaisei kenkyū* [A Study of Matsukata's Policy in Public Finance], pp. 164-172.
[589] Henry Rosovsky, "Japan's Transition to Modern Economic Growth, 1868-1885," in Henry Rosovsky ed., *Industrialization in Two Systems: Essays in Honor of Alexander Gerschenkron* (New York: John Wiley & Sons, 1966).

on, Matsukata also used new borrowing at 5 percent to convert the state's old debt with higher interest rates (6 percent or higher) and thus reduced the annual interest payment by more than 3 million yen.[590]

Table 5.4: The Japanese government's long-term domestic borrowings, 1884-1894

	Date of issuing bonds	Interest rate (%)	Object amount of subscription (million yen)	Actual amount of subscription (million yen)
Nakayama Railway	1884 March	7	5	8.4
Nakayama Railway	1884 June	7	10	15.3
Nakayama Railway	1885 July	7	5	14.8
Navy	1886 July	5	5	16.6
Debt Resettlement	1886 November	5	10	16.5
Navy	1887 March	5	6	8.4
Navy	1888 March	5	2	3.8
Railway	1889 February	5	2	5.4
Debt Resettlement	1889 March	5	5	9.2
Navy	1889 April	5	4	5
Debt Resettlement	1891 August	5	5	5
Debt Resettlement	1892 April	5	6	7.2
Debt Resettlement	1892 July	5	4	5.8
Railway	1893 April	5	1	7.6

[590] Muroyama Yoshimasa, *Matsukata zaisei kenkyū* [A Study of Matsukata's Policy in Public Finance], p. 210.

Railway	1894 February	5	1	4.7
Sino-Japanese War	1894 September	5	30	77
Sino-Japanese War	1894 December	5	50	90

Source: Kamiyama Tsuneo, *Meiji keizai seisakushi no kenkyū* [A Historical Study of the Economic Policies in Meiji Japan] (Tōkyō: Hanawa Shoten, 1995), p. 26.

Interest payments on these new loans could not come from land taxes, as the deflation raised both the real burden of land taxes and the debt burden of rural people. In 1884, the government had to use force to repress large-scale peasant riots in Gunma, Chichibu, and other regions. Under these conditions, the Meiji government continued to extract more revenue from the indirect taxes on alcohol and tobacco. Matsukata's predecessors had prepared him with effective centralized institutions to collect these taxes. The heavy taxes on alcohol production, which rose from 2 yen per *koku* sake produced to 4 yen, drove many small-scale sake houses out of business.[591] As a result, the concentration in sake production in Japan rose considerably, which in turn reduced the government's costs in tax collection. [Table 5.5] The existence of inter-regional markets for sake was indispensable for the development of large-scale sake production.

[591] Yunoki Manabu, *Sakazukuri no rekishi* [A History of Sake Manufacturing] (Tōkyō: Yūzankaku, 1987), pp. 345-6.

Table 5.5: Ratio of sake houses with different production scales in Japan (unit: %)

Year	Below 100 *koku*	100-1,000 *koku*	Above 1,000 *koku*
1878	52	47	1
1895	6.8	65.1	28.1

Sources:
The numbers for 1878 are calculated from Table 4 in Fukaya Tokujirō, *Meiji seihu zaisei kiban no kakuritsu* [The Establishment of the Foundation of the Meiji Government's Public Finance] (Tōkyō: Ochanomizu Shobō, 1995), pp. 188-9. The numbers for 1895 are calculated from Table 3 Nakamura Takafusa, "Shuzōgyō no sūryōshi [A quantitative history of sake production]," *Shakai keizai shigaku*, Vol. 55, No. 2 (June 1989), p. 217.

Meanwhile, Matsukata wanted the Bank of Japan to use rediscounting of business bills to stimulate domestic investment. In February 1884, he even urged the rediscounting of business bills that had no pre-assigned collateral so as to reduce the use of cash in transactions. However, business leaders such as Shibusawa Eiichi considered this policy too risky. As a compromise, the Bank of Japan first experimented with discounting bills secured by deposited goods or state bonds. Nonetheless, as the Bank did not issue its own banknotes and was not allowed to use the deposited government money in its business, this experiment became a fiasco within a few months.[592]

Nonetheless, Matsukata in 1885 continued the policy of low discount rates; the annual rate was reduced from 9.49 percent in 1885 to 4.93 percent in 1886. Moreover, he ordered the Bank of Japan to accept not only bonds but also corporation stocks in railway construction, seaborne transportation, mining, and textiles as collateral for low-interest

[592] Tsurumi Masayoshi, *Nihon shinyō kikō no kakuritsu: Nihon ginkō to kinyū shijō* [The Establishment of a Credit System in Japan: the Bank of Japan and the Financial Market], pp. 157-77.

loans.[593] In consequence, the lending of the Bank of Japan rose from 16 million yen in 1885 to 105 million yen in 1889; and the lending of national banks from 649 million yen to 1,414 million yen in 1889.[594] The number of corporations formed between 1886 and 1889, most of which were in industry, railway, and mining, was as high as 1,743 and their capital was 1,086 million yen. Many of the corporation stocks were just partially subscribed in cash.[595] Although the Bank of Japan raised the interest rate in 1888, the bubble burst in the financial panic of the spring of 1890.

The risky financial policies of the Ministry of Finance between 1882 and 1890 went against both the model and the practice of central banking in Western Europe.[596] Their implementation, despite criticism within the Bank of Japan and from the business community, should be viewed against the political background of the deflation which seriously undermined the legitimacy of the Meiji government. It was politically important to end deflation earlier rather than later. Nonetheless, as Matsukata set the parity of paper notes and silver currency as the supreme goal regardless of the economic consequences, his policy options were quite limited, especially when he could not raise foreign credit. It is understandable that Matsukata might wish to rely more upon the use of business bills or corporation stocks as a surrogate for increasing monetary input as it

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[593] Ishii Kanji ed., *Nihon ginkō kinyū seisakushi* [Historical Studies of the Policy of the Bank of Japan] (Tōkyō: Tōkyō Daigaku Shuppankai, 2001), p. 27.

[594] Nakamura Takafusa, "Makuro keizei to sengo keiei [The macroeconomy and post-war management]," in Nishikawa Shunsaku and Yamamoto Yūzō, eds., *Sangyōka no jidai (ge)* [The Age of Industrialization (Part II)], volume 5 in *Nihon keizaishi* [An Economic History of Japan] (Tōkyō: Iwanami Shoten, 1990), p. 11.

[595] Nagaoka Shinkichi, *Meiji kyōkōshi josetsu* [A Study of the History of Financial Panic in Meiji Japan] (Tōkyō: Tōkyō Daigaku Shuppankai, 1971), pp. 19-21.

[596] It is well-known that the Bank of Japan was established upon the model of Belgium. However, financial crises caused by a low liquidity ratio had forced the Société Générale in Belgium to carefully keep its conventional banking business separate from its long-term investment in big industry as early as 1850. See Herman Van der Wee and Martine Goossens, "Belgium" in Rondo Cameron and V. I. Bovykin eds., *International Banking: 1870-1914* (New York: Oxford University Press, 1991), p. 118.

mitigated the scarcity of currency yet did not directly affect the convertibility of paper notes.

As the Japanese historian Banno Junji has pointed out, the financial panic in 1890 made it impossible for the Meiji government to use economic development as a means to delay the opening of a parliamentary system, a strategy to which it had appealed since 1875. When the Japanese Diet was established in 1891, public finance became the focal arena of political struggles. Representatives demanded lower taxes, increased expenditure on local welfare and infrastructure, and reduced military spending.[597] Meanwhile, westernizing officials such as Itō Hirobumi, Inoue Kaoru, and Ōkuma Shigenobu (who was invited into the government as the Minister of Foreign Affairs) planned to make significant concessions to western powers in legal affairs in return for a resumption of sovereignty in the customs. Their main consideration was to increase government income by raising tariffs on Japan's expanding foreign trade and thus mitigate the tension over the issue of domestic taxation. This strategy was fiercely resisted by hardliners. The severe domestic conflict of interests between 1891 and 1895 was greatly relieved by the military victory over in China in 1894-5 and the post-war indemnity of 360 million yen that Japan received from China between 1895 and 1898.

Nonetheless, the institutions of the modern fiscal state had emerged in Japan before the Sino-Japanese war. In the period between 1891 and 1894, even political opponents to the Meiji government did not demand the dismantling of these new institutions. The

[597] Banno Junji, *The Establishment of the Japanese Constitutional System*, translated by J. A. A. Stockwin (London: Routledge, 1992), chapter 2.

advocates in the Diet who were in favor of reducing the burden of taxation did not question the use of centralized institutions in collecting taxes. Their demand to increase expenditures on local welfare did not challenge the centralized institution for managing government finance. The Bank of Japan not only monopolized the issue of convertible banknotes but also deposited and transmitted government tax revenue and spending. Moreover, in order to relieve the financial panic in 1890, it played a bigger role as the lender of last resort. As the Bank of Japan established a wide ranging correspondence with national and major private banks, it began to regulate the Japanese economy as a real central bank. By selectively accepting stocks of corporations which had strategic importance to the Japanese economy, such as the 11 railway companies, Nihon Yusen (NYK), and Tōkyō Marine Insurance, as securities for providing loans, the Bank of Japan was important in fostering long-term industrial investment without running the risk of taking company shares as securities in general.

V. Conclusion

The period from 1868 and 1895 is a crucial period for the rise of a modern fiscal state in Japan. Prior to 1868, we find no origin or cause of the modern fiscal state which was in place by 1895. Instead, there were divergent institutional designs among major political camps. Their power struggles led to a highly contingent event, the reliance upon the issue of non-convertible paper notes in the armed overthrow of the Bakufu in 1868. As the new Meiji regime was established prior to its possession of tax institutions, it had to continue its dependence upon paper notes in the initial years after the Restoration.

The convertibility of huge amounts of paper notes thus constrained the options for institutional development. It not only helped young and competent westernizing officials rise to the center of power but also protected them from political purges attempted by politically powerful conservatives in 1871. The convertibility of paper notes as a pressing problem to solve also determined the direction of institutional development between 1871 and 1880 toward centralization in the management of government spending and the collection of indirect taxes. In the absence of such a pressing credit crisis, other institutional outcomes in public finance would have been possible, such as a decentralized fiscal system similar to that found in a federal system. Meanwhile, if the Meiji government used minted coins rather than paper notes denominated in gold, it would not have been pressured by rising gold prices in the international markets as it could easily have turned to minting silver coins. In this situation, the great debates over the direction and tempo of institutional development would have had different consequences as there would have been no urgency to use government intervention to curb gold drainage. The pace of building centralized institutions in public finance would have been slower when considering the resistance to fiscal centralization.

The economic condition of Japan was also important to sustain the unfolding of the institutional learning process between 1868 and 1895. The vibrant domestic economy and expanding exports created a strong monetary demand which could absorb the government's paper notes even though they were still *de facto* non-convertible. The dense financial networks of national banks and other private banks that transmitted money in speedy bills rather than in cash facilitated the government's attempt to build a centrally operated fiscal system. The purchasing power of ordinary consumers and the development of inter-regional trade in Japan were indispensable to the increasing concentration in sake production, which was beneficial to government efforts to heavily extract indirect taxes from sake production.

The process of institutional learning in public finance in this period was also highly political. For example, inflation caused by the excessive issue of paper notes was detrimental to the interests of those relying on fixed incomes, particularly ex-samurai. As a result, the political consequences of previous policy mistakes accumulated in the process of institutional learning. The role of politics is evident in Japan's last step toward a modern fiscal state. Although the path toward building a central bank had become irreversible by 1881, power struggles and the confrontation between society and the state produced a path characterized by a man-made deflation which was by no means inevitable. In order to mitigate deflation, the Japanese government had to use the policy of discounting commercial bills to stimulate domestic investment, even though it had stopped directly investing and managing enterprises. In the process of implementing this policy, the Bank of Japan quickly became the real central bank in the late 1890s and the core institution in the modern fiscal state in Japan.

Chapter 6 Decentralized Public Finance, Disrupted Domestic Economy, and the Failure of the Chinese State's Financial Experiments: 1850-1864

I. Introduction:

In contrast to England, which did not have a fiscal state before the English Civil Wars, and Japan, where the central government did not collect tax revenues from the whole country until 1871, China in the first half of the nineteenth century had a long history as a fiscal state. The Qing government (1644-1911) collected tax revenues from the entire territory under its direct administration (China proper). Although it depended overwhelmingly upon the receipts from land taxes, some 80 percent of these were collected in silver by the first half of the eighteenth century. However, this starting position did not facilitate China's transformation into a modern fiscal state.

As I discussed in chapter 2, the principal cause of the fiscal difficulties facing the Qing government between the 1820s and 1850s was the state's lack of an institutional ability to relieve the deflationary effect of massive silver drainage through the opium trade. It could neither debase its silver currency nor switch to the copper standard. The financially depleted state could do little to alleviate the nation-wide unemployment, which led to the outbreak of the Taiping Rebellion in 1850. To repress this massive rebellion and other uprisings that cropped up in various regions during the 1850s, the Qing government implemented many exigent fiscal measures. These included the issue of paper notes denominated in both silver and copper cash and the collection of taxes upon domestic consumption (*lijin* duties), both of which began in 1853. *Lijin* receipts quickly became an important source of state revenue which helped the Qing government put down the Taiping Rebellion in 1864 and the Nian Rebellion in the mid-1870s. Nonetheless, the experiment with paper notes turned out to be a fiasco and did not lead to a process of institutional learning resulting in the centralization of public finance. The issue of paper notes was repealed in 1864.

The interactions between the state and economy in China in the second half of the nineteenth century thus illustrate the institutional stickiness of the traditional fiscal state, even under greatly changed economic and international circumstances. From the 1870s on, the customs and *lijin* duties became the major pillars of the fiscal system. These two indirect taxes were vital in funding various modernization programs such as railway construction and the introduction of western weapons and warships. Moreover, they were used to secure short-term foreign loans for military purposes. However, their rising importance did not push the Qing government to aggregate their receipts so as to mobilize more financial resources. Instead, they were incorporated into the decentralized assignment system (*xiexiang*) in which the Board of Revenue assigned particular items of the customs or *lijin* duties from sites of collection directly to places of disbursement without passing through Beijing. Why did the experiment with paper notes between 1853 and 1863 not trigger an institutional learning process resulting in the centralization of public finance in China? Why did the short-term borrowing between 1864 and 1894 not push the Chinese state to further seek long-term credits to enhance its spending capacity? Why did decentralization of public finance persist in China? These questions are crucially important to understanding why a modern fiscal state did not emerge in China between 1850 and 1911.

The persistence of a traditional fiscal state in China has two implications for the study of the rise of the modern fiscal state. First, it illustrates that socio-economic circumstances such as vibrant interregional trade and development of nation-wide financial networks are is necessary conditions for the unfolding of a temporal process of institutional learning until state actors come to realize the feasibility of using aggregate tax revenue to mobilize long-term financial resources. Without this interval, actors who experiment with various new institutional arrangements cannot grasp the mutually reinforcing effects between centrally collected tax revenue and the creditworthiness of the state's long-term financial instruments. Second, it shows that even where socio-economic circumstances are ready to support institution building toward a modern fiscal state, actors would not automatically move in this direction if existing institutions are functioning reasonably well.

In this chapter, I examine the interactions between the state and economy in the Qing government's experiment with paper notes as a means to raise its income in the 1850s. The existing literature views the non-convertibility of these paper notes as the principal reason for the failure of this monetary experiment.[598] Nonetheless, the inconvertibility of paper notes in practice did not imply that the Qing government intended to issue non-

[598] Peng Xinwei, *Zhongguo huobishi* [A History of Currency in China] (Shanghai: Shanghai renmin chubanshe, 1965), p. 834; Yang Duanliu, *Qingdai huobi jinrong shigao* [A Financial and Monetary History of the Qing Dynasty] (Beijing: Sanlian Shudian, 1962), pp. 108-10; Peng Zeyi, *Shijiu shiji houbanqi de Zhongguo caizheng yu jingji* [The Economy and Public Finance in China in the Second Half of the Nineteenth Century] (Beijing: Renmin chubanshe, 1983), pp. 91-96.

convertible paper notes in the beginning. The historian Peng Zeyi considered the issue of non-convertible paper notes and the cast of copper cash with big nominal values (debasement of copper cash) the means by which the Qing government met its spending needs at the cost of merchants and ordinary people.[599] However, this explanation overlooks the market-friendly framework that government officials had developed in making financial and monetary policies in the eighteenth century. As I show in following sections, officials of public finance at both the central and provincial levels well understood that circulation in commercial transactions was vital to attain the goal of issuing paper notes to cover government deficits. Meanwhile, if the Qing government simply wanted to issue paper notes to raise its income, then it is hard to explain why it decided in 1855 to replace silver notes with copper notes which had smaller nominal values.

Even though officials of public finance grasped the importance of convertibility to boosting confidence in paper notes, this idea itself did not suffice to enable them to build the necessary institutions. In this light, the existing literature fails to realize that the process of creating an institutional framework that would safeguard the value of paper notes was neither determined by government officials nor government policies. Instead, socio-economic circumstances such as the demand for currency in the market and the condition of both inter-regional financial networks and long-distance domestic and foreign trade significantly affected this process of institution building. I argue that the interactions between a decentralized public finance and fragmented domestic economy

599 Peng Zeyi, *Shijiu shiji houbanqi de Zhongguo caizheng yu jingji* [The Economy and Public Finance in China in the Second Half of the Nineteenth Century], p. 96.

under the special circumstances of civil war in the 1850s caused the Qing government's failure to aggregate tax revenue to back up the creditworthiness of its paper notes. These interactions could not produce a mutually reinforcing institutional development toward a modern fiscal state.

The geographical location of Beijing makes it unlikely for China to transform to a modern fiscal state along the English path. For example, the Board of Revenue in 1853 considered issuing the bills of short-term credit (*qipiao*) secured by anticipated tax revenue and using them to disburse officials' salaries and government spending. These bills were similar to the tally of *sol* issued by the English government in the seventeenth century. However, officials in the Board of Revenue soon realized that this approach was impractical as the ongoing civil wars which were being fought in the core economic areas, such as the provinces in the middle and lower Yangzi regions, disrupted the flows of both tax revenues into Beijing and domestic trades going through Beijing. In contrast, the expanding domestic and international trade through London in the 1700s facilitated cooperation between the central government and big financiers, allowing the state to convert massive amounts of short-term credits into long-term debt. Meanwhile, the international – rather than – civil wars that the English state fought after 1689 encouraged the centralization of tax revenue in London, where it was either remitted to fund the troops in Continental Europe or to purchase materials to supply the navy.

At the same time, taking the Japanese path of floating paper notes for the whole economy was not feasible in China in this period. Like the early Meiji government, the Qing government turned to paper notes denominated in both silver *tael* and copper cash to meet its spending needs. It also tried to mobilize private financiers to set up Official Money Bureaus (*guanqianju*) at both central and local levels to help circulate them. Nonetheless, the outbreak of civil war in the economically core middle and lower Yangzi River areas made it difficult for the government to mobilize big merchants or financiers with interregional business networks to circulate these paper notes denominated in silver (*yinpiao*). Military needs necessarily consumed most of the collected tax revenues. The government could not use this money to support the role of Official Money Bureaus as fractional note-issuing financial intermediaries to ensure the convertibility of government paper notes.

As government silver notes did not widely circulate in the economy, the government in 1855 decided to increase the issue of paper notes denominated in copper cash (*baochao*). This represented a serious effort to replace a silver with a copper standard, an idea which had been intensively discussed among officials and scholars of the statecraft since the 1820s. However, this decision greatly affected convertibility. The low-value and bulky copper cash were minted by provincial mints with varied copper content and fineness. They could serve as the medium for local transactions, but could hardly support the convertibility of paper notes used across regions. In this situation, instead of becoming a pressing problem for the central government, convertibility of copper notes was handled by various local governments, and thus did not trigger any process of institutional centralization in public finance.

In section II, I examine the policy framework for monetary and financial issues that the Qing government had developed over the eighteenth century. It was based upon a rudimentary understanding of the importance of keeping a balance between supply and demand in making monetary policies. It also illustrated a clear consciousness that effective government policies had to come to terms with the operation of a market economy and the profit incentive of private economic actors. This framework as a policy legacy significantly informed the financial experiments in the 1850s and suggests that characterizations of the Qing government as anti-commercial or anti-market in the nineteenth century are overly simplistic. In section III, I explore the interactions between the decentralized public finance and fragmented domestic economy during the civil wars of the 1850s to analyze how they led to the failure to turn the Official Money Bureaus established at both central and local levels into new financial institutions to circulate paper notes in the economy. Section IV concludes by briefly comparing with the cases of England and Japan.

II. Policy legacies in managing finance and currency prior to 1850

Mounting military expenditures and tax arrears forced the Qing government to implement many financial measures to overcome the unprecedented fiscal crisis after 1850, such as issuing paper notes and minting copper cash with large nominal values (*daqian*). The design and formulation of these experiments was significantly influenced by the Qing government's previous experience in managing currency and regulating domestic financial markets. State interactions with the market over the course of the eighteenth century contributed significantly to the formation of practical attitudes among government officials in regard to commercial transactions and profit incentives.

On the issue of currency, before the value of silver vis-à-vis copper cash rose steeply between the 1820s and 1850s, the Qing government was overwhelmingly concerned about the opposite problem: the high value of copper cash in regard to silver. Although economic circumstances were quite different, the government's focus on how to maintain the official exchange rate of 1:1000 between silver and copper cash in the markets remained unchanged. During the reign of the Qianlong emperor (1736-1795), a set of market-friendly economic approaches in the management of currency emerged.[600] This had two important characteristics.

Firstly, the government aims to keep a balance between supply and demand rather than relying upon heavy-handed administrative control by the state. In response to the high value of copper cash (market exchange rates of 1 *tael* of silver were around 700-800 *wen* copper cash) in the first half of the eighteenth century, the Qing government ordered provincial governments to open mints and hoped to use the increasing output of newly minted copper cash to raise the relative value of silver. For the same reasons, the center also ordered regular exchange of copper cash deposited in local governments with silver

[600] In the making of financial and fiscal policies which involved many technical details, decisions were usually taken following deliberation among officials of the Board of Revenue; and the members of the Grand Council (军机处) and princes joined the discussion of important policies. The personal opinion of the emperor did not dominate in the process. This is one important feature of the early modern state where governance had become highly institutionalized.

in the markets.[601] In comparison, interfering measures such as prohibition of interregional transportation of copper cash and the limiting of copper cash stocked in private shops (particularly pawnshops) were considered emergent rather than "ever-lasting" policies to stabilize the exchange rate between silver and copper cash.[602]

Secondly, the Qing government took a realistic attitude toward profit-making activities in the markets and accepted that it was simply impractical to force private actors to abide by government policies that ran against their profit-calculation, especially if the monitoring cost was formidably high. For example, the Qing government by the mid-eighteenth century was greatly troubled by the counterfeiting of copper cash (*sizhu*) when copper content in official cash was low and melting of cash (*sixiao*) when it was high.[603] In a memorial in early 1736, Hai Wang, the Minister of the Board of Revenue and of the Grand Supervisor of Imperial Household (内务府总管), pointed out that these two activities were closely related to the market price of copper. In his view, people had strong incentives to melt copper cash if both copper price and copper content of minted cash were high; and to counterfeit it if copper content was low in regard to its face value.

[601] For a discussion of these policies and the underlying reasoning of supply and demand, see Hans Ulrich Vogel, "Chinese Central Monetary Policy, 1644-1800," *Late Imperial China*, Vol. 8, No. 2 (December 1987), pp. 13-14.

[602] These two measures, along with four others, were recommended to provincial governments as "effective means" to reduce the value of copper cash in Beijing in a decree dated 乾隆十年正月初九. Replies from Hunan, Hubei, Suzhou, Sichuan, Fujian, and Jiangxi provinces all considered them either impractical (e.g., to limit the stocks of copper cash in pawnshops) or unnecessary (e.g., to require the use of silver in large transactions). The Qianlong emperor admitted in his comments on the memorial from Hunan that these measures were simply temporary rectifications rather than effective measures in the long run [不过补偏救弊，非经久可行之事]. *Palace Memorials* (宫中硃批奏折), Box 60, No. 1610-1616, No. 1622-1625, No. 1637-1643, No. 1657-1661, No. 1662-1667, 1746-1750. See Qianlong's comment in No. 1610-1616.

[603] Counterfeiting was more frequent when the Qing government began to mint light copper cash (1 *qian*, circa. 3.7 g) in 1684 and the melting of copper cash was widespread when the government minted heavy copper cash (1.4 *qian*) in 1702. Kuroda Akinobu, "Kenryū no zenitaka [The High Value of Copper Cash in the Reign of Qianlong]," *Tōyōshi kenkyū*, Vol. XLV, No. 4 (March 1987), p. 694.

Instead of a state monopoly, Hai Wang argued that the government should lift restrictions on the copper trade and adjust the copper content in minted cash according to market prices of copper.[604] The Minister of the Board of Revenue Shi Yizhi further pointed out that a state prohibition of copper trade would result in a scarcity of copper in the market, which would raise its market price and thus provide more incentive to melt official copper cash. Shi's economic reasoning was highly appreciated by the Qianlong emperor.[605]

As it was impossible to frequently adjust the copper content in minted cash, the question of how to increase copper supply became the focal issue from the 1750s. For this purpose, the Qing government implemented many "liberal" economic policies to motivate private investment in copper mining and the copper trade with Japan. It opened the state-controlled mining and trade in copper to private merchants which aimed to increase not only the amount of copper for mintage but also the copper supply for private needs in the economy. These measures were in alignment with liberal economic policies in other issues such as the grain trade, which reflected a rising recognition among government officials that the government policies had to come to terms with the conditions of supply and demand in the market.[606]

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[604] 户部尚书兼内务府总管 海望，"奏请驰铜禁，以资鼓铸，以便民生", 乾隆元年二月初七，*Palace Memorials*, Box 60, No. 119-124. This famous memorial was later compiled into *Huangchao jingshi wenbian* (皇朝经世文编), the canon of the statecraft school in the nineteenth century.

[605] The emperor commented: "I am happy to read this discussion… which is clear, comprehensive, and reasonable. [此议朕嘉悦览之 … 明晰妥协，情理允当]." Both in 户部尚书署理湖广总督 史贻直，乾隆元年三月二十七日，*Palace Memorials*, Box 60, No. 142-145.

[606] For the liberal policies in the mining of copper, see Chiu Peng-sheng, "Shiba shiji diantong shichang zhong de guanshang guanxi yu liyi guannian," *Zhongyang yanjiuyuan lishiyuyan yanjiusuo jikan*, Vol. 72, Part 1 (Taipei: Academia Sinica, 2001), particularly pp. 91-104; in the grain market, see Kishimoto Mio,

As a result, domestic output of copper (mainly in Yunnan province) expanded and met both the government's increasing need to mint copper cash and the demand for copper in the market. The dearth of copper and copper cash was relieved after the 1770s and the market exchange rate between silver and copper cash approached the official rate of 1:1000.[607] Under these circumstances, the Qing government altered its previous tolerance of privately minted copper cash (*xiaoqian*) when the economy suffered from scarcity of official cash and began to exchange government minted copper cash for private copper cash from the market.[608] In so doing, the Qing government explicitly aimed to reassert the state sovereignty in coinage.[609]

Despite the emphasis on the official standard of the minted copper cash, the Qing government in practice adopted a pragmatic approach which allowed certain provincial

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"Shintyō chūki keizei seisaku no kityō [The basic tune in the making of economic policies in mid-Qing]," in Kishimoto Mio, *Shindai chūgoku no bukka to keizai hendō* [The Price and Economic Changes in Qing China] (Tōkyō: Kenbun shuppan, 1997), pp. 289-325; Helen Dunstan, *Conflicting Counsels to Confuse the Age: A Documentary Study of Political Economy in Qing China, 1644-1840* (Ann Arbor: Center for Chinese Studies, The University of Michigan, 1996), chapter 7. Dunstan also stressed that the influential liberal thinking in economic affairs alone was insufficient to explain the making of economic policies, which was influenced by other concerns of the state such as social welfare and fiscal balance. See idem., *The State or Merchants? Political Economy and Political Process in 1740s China* (Cambridge: The Harvard University Asia Center, 2006).

[607] See the increase of copper output and minted cash and the exchange rate between silver and cash in Hans Ulrich Vogel, "Chinese Central Monetary Policy, 1644-1800," p. 45 and p. 48-9.

[608] In a situation of high value of copper cash in the markets, a degree of 乾隆十四年七月二十四日 allowed the use of private and even foreign copper cash for a practical concern of mitigating dearth of cash in the economy. It further stated that once the supply of official copper cash became sufficient, the use of foreign copper cash should be strictly prohibited in accordance with sovereignty in coinage [以崇国体]. *Palace Memorials*, Box 60, No. 2443-4. Twenty years later, a decree of 乾隆三十四年六月二十八日 requested provincial governments to use minted copper cash to exchange for privately minted cash according to the market value of the content of copper in private cash. *Palace Memorials*, Box 61, No. 2482-84.

[609] A decree of 乾隆五十六年四月二十五日stated unambiguously that people's use of private copper cash was against the law [小民私用小钱已干法禁]. *Palace Memorials*, Box 63, No. 75-7.

governments to have different amounts of copper content in the cash they minted. As the historian Kuroda Akinobu has pointed out, provincial autonomy in the mintage of copper cash under the coordination of the center mainly resulted from different demands for copper cash across regions in eighteenth-century China.[610] This allowed more room for monetary experiments. For example, in 1738 the governor-general of Jiangnan and Jiangxi Na Sutu (那苏图) reported that officials in Suzhou and Jiangxi had found that the addition of tin in the process of minting could make copper cash (*qingqian*) less malleable; this in turn make it more expensive to separate out copper and discouraged the melting of cash in the markets.[611] The mints in Beijing immediately tried this out but were not successful. The center then asked the provincial government of Zhejiang to send some craftsmen who had been involved in the Zhejiang experiment to Beijing for consult.[612] The resulting success caused the Board of Revenue to recommend this method to mints across the country.[613] As the melting of copper cash ceased to be major problem in the late eighteenth century, the addition of tin in mintage of copper cash was stopped. Nonetheless, it illustrated co-existence of central coordination and provincial autonomy in the matter of mintage.

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[610] Although the official copper content for cash was set as 1.2 mace (1.2 qian, circa. 4.44 g.), the center allowed the provincial mints in Jiangsu and Hubei to mint copper cash with a copper content of 1 mace (1 *qian*) and 0.8 mace per *wen* (eight *fen*) respectively so as to meet the increasing demand for cash in the two provinces. Kuroda Akinobu, "Kenryū no zenitaka [The High Value of Copper Cash in the Reign of Qianlong]," p. 698.

[611] See the details of the experiment conducted in Suzhou in 两江总督那苏图奏，乾隆三年七月初六日. *Palace Memorials*, Box 60, No. 444-7. A similar proposal can be found in a memorial of the same year from Zhejiang province. 浙江布政使张若震奏，乾隆四年九月二十二日，*Palace Memorials*, Box 60, No. 623-5.

[612]浙江布政使张若震奏，乾隆四年十二月初六日，*Palace Memorials*, Box 60, No. 624-5.

[613] 御前大臣衲亲等人奏，乾隆五年三月十八日，*Palace Memorials*, Box 60, No. 744-5.

Prior to 1850, the Qing government only had limited interaction with the financial markets. Government fiscal operations remained independent from private financial markets as collected revenue and assignment of government expenditures were all transported in silver. Although the Qing government often lent money to merchants for interest income (*fashang shengxi*), most such loans came from the Imperial Household (*neiku*) founds rather than tax revenue managed by the Board of Revenue. With increasing numbers of bad loans due to mismanagement and corruption, the Qianlong emperor repealed this practice in 1775.[614] Thereafter, only provincial governments lent out part of the silver deposited in provincial treasuries to local, well-established pawnshops for secure interest income to cover expenditures in local public works, local academies and famine-relief.[615]

Nonetheless, the Qing government was aware of the development of private financial markets, particularly the increasing use of credit instruments such as bills of exchange, banknotes, and promissory notes. In the first half of the nineteenth century, private promissory notes denominated in copper cash (*qianpiao*) and issued by money

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614 The loans during the reign of Kangxi (1662-1722) mostly went to privileged big merchants of salt and copper. The Yongzheng emperor (1723-1735) allocated a certain amount as a fund to raise income to improve the livelihood of banner soldiers stationed throughout the country. See Wei Qingyuan, "Kangxi shiqi dui 'shengxi yinliang' zhidu de chuchuang he yunyong [The origin and use of the practice of 'interest-generating silver' during the reign of Kangxi]," *Zhongguo shehui jingjishi yanjiu*, No. 3 (1986): 60-69; idem., "Yongzheng shiqi dui 'shengxi yinliang' zhidu de zhengdun he zhengce yanbian [Policy changes and reforms in the practice of "interest-generating silver" during the reign of Yongzheng]," *Zhongguo shehui jingjishi yanjiu*, No. 3 (1987): 30-44. See the mismanagement and the final stopping of this practice in idem., "Qianlong shiqi 'shengxi yinliang' zhidu de shuaibai he 'shouche' [Decline and repeal of the practice of 'interest-generating silver' during the reign of Qianlong]," *Zhongguo shehui jingjishi yanjiu*, No. 3 (1988): 8-17.

615 According to one memorial in 1853, half of the capital of big pawnshops came from such interest-generating government money [各省当商现均不见充裕，向以己之资本与官之帑本各半开张]. Fujian 巡抚王懿德折, 咸丰三年二月初八日, in Zhongguo renmin yinhang canshishi jinrong shiliaozu, eds., *Zhongguo jindai huobishi ziliao (shangce)* [Historical Materials of the Monetary History of Early Modern China] (Beijing: Zhonghua shuju, 1964), p. 337.

exchangers, pawnshops, and even stores of rice, salt and groceries became widely used in daily transactions in cities and major market towns. In 1836, the center asked the opinions of provincial governors on the issue of private notes. Most replies confirmed their importance to economic life and considered the prohibition of private notes either unnecessary or even harmful. Instead, they proposed to better regulate the issue of private notes so as to ensure their creditworthiness and prevent deliberate fraud.[616] Typical measures were to permit only well-established businessmen to issue private notes and to stipulate that the issue had to be jointly secured by other shops (*lianming hubao*). In handling the legal disputes over private notes, the government carefully distinguished deliberate fraud from the inability to redeem the issued notes due to low liquidity.[617]

That the eighteenth-century Qing government accumulated some knowledge of and competence in managing monetary and financial issues is illustrated by the successful mitigation of the dearth of copper cash and the ensuing decline of the value of copper cash in regard to silver around the turn of the nineteenth century. This experience constituted a "cognitive framework" for officials of public finance in policy making. For example, when the market value of silver vis-à-vis copper cash rose above the official

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[616] Wang Yeh-chien, *Zhongguo jindai huobi yu yinhang de yanjin: 1644-1937* [The Evolution of Currency and Banking in Early Modern China: 1644-1937] (Taipei: Institute of Economic Research, Academia Sinica, 1981), pp. 16-18.

[617] If a money exchanger went to the government to declare bankruptcy when he could not cash the issued notes, the government usually gave him a certain period of time to return the deposited money back to customers. If he could do so, then there was no legal punishment. If the money was deposited by wage laborers or ordinary soldiers, the period was limited to two months; in the case of commercial transactions, the period could be two years. 步军统领 莫和，舒英，富尔嵩阿奏，道光五年三月初五日, *Grand Council Memorial Copies* (军机处录副奏折), Box 678, No. 147-50. In a financial panic in 1830 when 27 money exchangers were forced to close within a month, they were granted 24 days to clear liabilities before legal proceedings began. 步军统领衙门耆英，联顺，福泰奏，道光十年十二月初四日，*Grand Council Memorial Copies*，Box 678, No. 386-389.

rate of 1:1000, the Qing government in 1794 ordered the reduction of the amount of minted copper cash, stopped mintage temporarily in certain provincial mints, and raised the ratio of silver in government spending. The basis of this policy was to rebalance the exchange rate between silver and copper cash by reducing the supply of copper cash and increasing the stocks of silver in the economy.[618]

The Qing confidence in the management of currency by balancing the supply of copper cash relative to silver collapsed after the 1820s when the value of silver continued to rise even though most mints had stopped operations. As the government only minted token copper cash and did not have any control of the silver supply in China, government officials and scholars of the statecraft school in the period between the 1820s and 1840s strove to increase the use of copper cash in the economy so as to mitigate the pain caused by the increasing scarcity of silver. In order to let the low-value and bulky copper cash minted by the government to take the place of silver in large transactions and inter-regional trade, they appealed to two main methods: issuing paper notes denominated in copper cash (*qianchao*) and raising the nominal value of the minted copper cash (*zhudaqian*). In response, officials of public finance in the center relied upon past policy legacies to evaluate these new proposals.

Paper notes with various denominated values were easier to carry than copper cash. Nonetheless, China had had mixed experiences with paper notes. Whereas their

[618] The mintage was temporarily stopped in provinces such as Hubei, Jiangsu, Guangxi, Sichuan, Jiangxi, Fujian, Hunan Zhejiang, and reduced in Shanxi, Shaanxi, Zhili, and Beijing. The payment of wages for troops switched to silver instead of copper cash in Guangxi, Sichuan, Jiangsu, Jiangxi, Shengjing, Hubei. *Palace Memorials*, Box 63, No. 1071-3, No. 1109-13, No. 1114-8, No. 1130-2, No. 1137-40, No. 1141-7, No. 1154-7, No. 1169-72, No. 1173-6, No. 1177-9, No. 1181-85, No. 1186-90, No. 1442-5.

advocates often looked to the positive experience during the thirteenth century under the Song dynasty, their opponents often referred to the hyperinflation caused by excessive issue of paper notes in the late fourteenth and early fifteenth centuries under the Ming. The early Qing government issued a limited amount of paper notes in 1645 to cover deficits and stopped this practice in 1661 when the government had adequate revenue. Meanwhile, no advocate of paper notes addressed the practical issue of how to ensure their convertibility across the country when the copper cash minted by provincial governments were far from standard. Moreover, officials of the Board of Revenue were concerned about the lack of mobility of large volumes of copper cash if government spending in silver was to be disbursed in copper cash. For example, in 1843 the censor Li Enqing proposed issuing copper notes to disburse the expenditure of 9 million *chuan* copper cash (equivalent to 6 million *tael* of silver in total, 1 *chuan* = 1,000 *wen*) for the river works in Henan province. In his plan, officials of river works would sell these notes to businessmen for copper cash, and the businessmen could use the notes to buy official titles (*juanna*) or could redeem them in the provincial treasury of Henan or with the Board of Revenue.[619] The Board of Revenue rejected it by pointing out that businessmen would have little incentive to carry bulky copper cash to the bureaus of river works in Henan to exchange for such an enormous amount of copper notes.[620]

The other method involved raising the nominal value of the copper cash by minting copper cash of 10 *wen*, 50 *wen*, 100 *wen*, 500 *wen*, and even 1,000 *wen* denominations, as

[619] 御史李恩庆折, 道光二十三年七月二十日, *Grand Council Memorial Copies*, Box 678, No. 1318-20.

[620] Quoted in the reply of the Board of Revenue, 敬徵，廖鸿荃，何汝霖等议复李恩庆折, 道光二十三年八月十九日, *Grand Council Memorial Copies*, Box 678, No. 1342-5.

shown in a memorial from the governor of Guangxi Liang Zhangju in 1838.[621] In response, officials in the Board of Revenue argued that such a big discrepancy between the nominal value and actual value of copper content in minted cash would provide great incentive for counterfeiting activities which the government could hardly curb.[622] For the same reason, the Board of Revenue rejected similar proposals from other officials in the 1840s.[623] As the Board of Revenue admitted, the government simply did not possess a technology to mint copper cash which private actors were unable to imitate.[624]

As a result, policy discussions failed to yield any concrete measure to resolve the scarcity of silver. In 1846, the center once again asked provincial governors for their views on how to increase the use of copper cash in public finance so as to reduce dependence upon silver, to no avail.[625] Inaction in monetary policy continued until the breakout of the Taiping Rebellion in 1850. In November 1851, the silver stock in the center was only

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[621] Liang explicitly proposed using government copper cash with large nominal values to take the place of the foreign silver currency circulating in China. He noted that such minted token copper cash would be as easy to carry as silver currency [现在江、浙、闽、广，东南数省习用洋钱，不过取其轻利，便于交易尔。今若铸为大钱，其用即与洋钱无异。与其用外国之所铸，何如用中国之所行]. *Zhongguo jindai huobishi ziliao (shangce)*, p. 143.

[622] The reply of the Board of Revenue to Liang Zhangju's memorial is found in *Zhongguo jindai huobishi ziliao (shangce)*, p. 144.

[623] This proposal was presented by the censor Lei Yixian in 1842, censor Zhang Xiuyu in 1843 and the Anhui 巡抚Wang Zhi in 1846 in ibid., pp. 145-9, pp. 150-3, and p. 155. In rejecting these proposals, the Board of Revenue made it more explicit that the bigger the nominal value, the more profitable to counterfeit. Ibid., p. 150 and p. 156.

[624] "且大钱若行，私铸更易，论工本则轻而又轻，论利息则倍益加倍。即谓制造精工真赝无难立辨，不知奸巧之辈何事不可以弊混，何物不可以伪为." 管理户部潘世恩等折，道光二十二年十二月初十日. *Zhongguo jindai huobishi ziliao (shangce)*, p. 150.

[625] Most replies considered it impractical due to the high cost of transporting bulky and low-valued copper cash. See such examples in *Palace Memorials*, Box 64, No. 172-5, No. 176-9; *Grand Council Memorial Copies*, Box 678, No. 1447-50, No. 1512-6, and No. 1522-5.

1.87 million *tael*.[626] However, in addition to mounting military expenditures, the Qing government had to spend millions of silver for river works and disaster relief when the bank of the Yellow River collapsed in Jiangsu province's Feng County. Extraordinary expenditures quickly rose to more than 20 million *tael* of silver by 1852. In this situation, the Qing government on the one hand appealed to some emergent measures such as the disbursement of silver stocks in the Board of Revenue and even in the Imperial Household and the sale of nominal official ranks (*juanna*). On the other hand, it was forced to try new methods to raise income.

Some of these measures were an extension of previous policies, such as encouraging private investment in copper and silver mining. For example, the Qing government tried to encourage merchants to silver or gold in border areas such as Rehe, Chengde, Mongolia, and Xinjiang.[627] This policy was ineffective as these areas did not have rich deposits of previous metals. Some proposals were too radical for the Board of Revenue even in urgencies, such as the mintage of token silver currency to raise fiscal income. In February 1854, the tutor of the Imperial Academy of learning and Imperial Clan Baoji (国子监司业宗室保极) suggested imitating the model of minted copper cash by minting silver coin (*yinbao*) so as to profit from the from the difference between nominal value and the actual value of silver used in mintage.[628] In 1855, the governor of Fujian Lü

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[626] Cited from the memorial of the Board of Revenue, 道光三十年十一月十七日. *Zhongguo jindai huobishi ziliao (shangce)*, p. 171.
[627] See the efforts in 1863 and 1864 to find silver mines in these areas in various memorials in *Grand Council Memorial Copies*, Box 678, No. 2087-9-, No. 2157-9, No. 2568-70, No. 2835-8, and No. 2842-5.
[628] In his proposal, the government would use silver of 1.5 *tael* to mint silver coins with a nominal value of 5 *tael*, silver of *2 tael* to mint 10 *tael* coins, etc. 国子监司业保极折, 咸丰四年正月二十八日 , *Grand Council Memorial Copies*, Box 678, No. 2557-60.

Quansun made a similar suggestion. He presented to the center two samples of silver currency that he had asked craftsmen in Fujian to make. Nonetheless, the Board of Revenue was afraid that the government could not force the circulation of a new silver currency in the economy and thus rejected this proposal.[629]

The most important financial innovation being intensively discussed between 1850 and 1853 was the issue of paper notes.[630] In contrast to previous policy discussions on paper notes that focused on how to use issuing of paper notes denominated in copper cash so as to make the copper standard practical, the government was now more concerned with how to use paper notes to raise its income. For this purpose, the government was very interested in issuing silver notes. Proposals considered by government officials all referred to the use of private notes and bills of exchange in the private financial markets to illustrate the feasibility of paper notes issued by the state. In their view, if paper notes issued by a private money exchanger (*qianpu*) could be accepted in the market, it was reasonable to anticipate that paper notes issued by the state could as well.[631] In particular, they pointed out two special advantages that the state enjoyed. First, a private

[629] See this memorial and the reply of the Board of Revenue in *Zhongguo jindai huobishi ziliao (shangce)*, pp. 191-4.

[630] Officials who proposed the issue of paper notes between 1850 and 1853 included the censor 王茂荫, Fujian 巡抚王懿德, Jiangsu 巡抚杨文定, and the censor 花沙纳. The proposal from 杨文定 was based upon consultation with gentry-merchants in Suzhou.

[631] In the words of Fujian 巡抚王懿德, "在铺户不过一稍有身家之人，合城皆信而用之。我皇上为天下主，酌盈剂虚，饬造宝钞，颁行各省，人人应无不乐从。" *Zhongguo jindai huobishi ziliao (shangce)*, p. 322.

bank might close, yet the state would not; second, annual tax collection constituted a significant channel for private actors to use state-issued paper notes.[632]

Officials in the Board of Revenue and provincial governors were aware of both the fiscal and economic significance of issuing paper notes. In the view of the governor of Jiangsu Yang Wending, by issuing paper notes in silver, the state could not only double its expenditures when using the same amount of silver as reserves but also use paper notes to mitigate the dearth of silver and overcome the decades-long deflation. The ensuing economic expansion would then further raise state tax income.[633] Officials in the Board of Revenue were originally concerned about how to attain convertibility of paper notes. Yet emergent situations forced them to decide to experiment anyway. In February 1853, the Board of Revenue requested that the emperor direct the censor Wang Maoyin, who was well-known for his proposal on paper notes in 1850 to the Board of Revenue, to formulate relevant policies.[634] Officials in the Board of Revenue understood that the use of paper notes in government spending and tax collection was not adequate to ensure their success; the key was their circulation in the economy. In other words, paper notes

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[632] According to officials in Jiangsu such as Yang Wending, "[宝钞] 无钱铺逃空之累 … 国家准用钞而完正供，岂有不行之理。" *Zhongguo jindai huobishi ziliao (shangce)*, pp. 333-4. These two advantages had been emphasized in the debates about state-issued paper notes in the 1830s and 1840s. See details in Lin Man-houng, "Two Social Theories Revealed: Statecraft Controversies over China's Monetary Crisis, 1808-1854," *Late Imperial China*, Vol. 12, No. 2 (December 1991): 1-35.

[633] Jiangsu 巡抚杨文定,"银与钞并行，是以国家以一百万银，而得二百万之用。银币充足，其价即可自平。银价平，则百货流通，关税可期增裕，输课较易，盐政必极振兴。"Cited from the reply to Yang Wending's memorial by the Board of Revenue, 咸丰二年十一月十三日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 327.

[634] Due to Wang's proposal to issue paper notes in 1851, the Board of Revenue considered him "well understand the principles of paper notes [该御史前奏行钞十条，臣等覆加酌覈，似于行钞之法曾经深究，得其要领… 应请… 会同臣部办理钞法，以期相互考订，详筹妥办]." Memorial of the Board of Revenue, 咸丰三年正月十九日, *Grand Council Memorial Copies*, Box 310, Vol. 4463, No. 24.

should facilitate commercial transactions and provide convenience to the people [以通商便民为要策].[635]

In regard to the tempo of this financial experiment, the Board of Revenue first planned to have Jiangsu provincial government introduce so as to accumulate experience.[636] Nonetheless, the acting governor-general of Fujian and Zhejiang (署闽浙总督) Wang Yide pointed out that this was impractical as the paper notes issued by one province could not be bolstered by inter-provincial trade. Instead, he suggested that the experiment should be conducted uniformly in all provinces under central coordination.[637] On 26 March, 1853, the Board of Revenue began to issue paper notes in silver (*guanpiao*) and in copper cash (*baochao*) in Beijing. It also established the Bureau of Silver Notes (*guanpiaoju*) and the Bureau of Copper Notes (*baochaoju*) to manage the two kinds of notes respectively. In June 1853, the Board of Revenue released a limited amount of copper cash with a nominal value of 10 *wen* (*dangshi daqian*) in Beijing and found them accepted by the markets.[638] Encouraged by this result, it then requested all provincial governments to adopt similar measures on 7 August, 1853. The aim of this

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[635] "使造一法、制一币，官自发之，官自收之，而民不肯用，则不行；即官用之于民、民用之官，而民与民不便、商与商不通，则终不行。"大学士管理户部事务Qi Junzao et. al., "The reply of the Board of Revenue to the censors He Chun and Wen Rui on the issue of paper notes," 咸丰三年二月二十七日, *Grand Council Memorial Copies*, Box 678, No. 1993-2001.

[636] 管理户部Qi Junzao et. al., 咸丰二年十一月十三日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 327.

[637] "惟是行钞之议，系为剂天下之财，而非止筹一省之便。是关天下，则当统天下之全局而统计之。"署闽浙总督王懿德折，咸丰三年三月初七日. *Zhongguo jindai huobishi ziliao (shangce)*, p. 338.

[638] 户部尚书孙瑞珍、工部尚书翁心存会折, 咸丰三年九月二十五日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 215.

bundle of new policies was not only to meet government spending but also to supplement silver and copper cash in the economy. As the imperial edict on paper notes stated, even if government revenue became adequate in future, these paper notes should continue to circulate.[639] However, the socio-economic circumstances in China at the time were very unfavorable to efforts to build the institutions necessary to attain these goals.

III. Interactions between the state and market and the failure of institutional development: 1853-1864

The Taiping Rebellion, which originated in Guangxi province in 1850, became a massive civil war as the Taiping forces entered Hunan in 1852. The battles between the Qing army and Taiping forces over the control of Hankou between 1852 and 1856 ruined this important financial and commercial center which connected the upper and lower Yangzi River areas. In March 1853, Taiping forces occupied Nanjing and made it their capital. Battle fields extended to provinces of Hunan, Hubei, Anhui, and Jiangsu. Meanwhile, the Nian rebellion broke out in northern Jiangsu in 1851 and spread to Anhui and Shandong in 1852. The Triad rebels from Guangdong and Fujian controlled the city of Shanghai (except the foreign settlement) from 1853 to early 1855. The *Arrow* War between China and the allied forces of Britain and France broke out in Guangdong in late 1856. The Tianjin Treaty signed in 1858 formally legalized the opium trade. Yet disputes over its implementation rekindled the war only a few months later, and the allied forces of Britain and France seized Beijing in 1860. Wars that fought in economically core areas severely weakened the Qing government's ability to fund its governance in frontier regions. As a

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[639] "总期上下相信，历久无弊，即使国用充裕，官票照旧通行。"The imperial decree on issuing paper notes, 咸丰三年二月二十七日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 352.

result, Muslims in Yunnan and the Miao people in Guizhou rebelled in 1856, and Muslims in Gansu and south Shaanxi too up arms in 1862.

The Qing government's efforts to repress these uprisings had a great impact on the operation of public finance. The expenditures on military campaigns and river works amounted to more than 30 million *tael* of silver in the period from 1850 to 1853. Meanwhile, the flows of tax revenues and government assigned spending were determined by emergencies in battlefields. A large proportion of collected taxes were assigned directly to the stations of military supplies (*liangtai*), including many which should have been transported to the center (*jingxiang*). Moreover, civil wars and widespread disorder severely disrupted the transportation of the collected revenue to Beijing. As a result, the annual revenue that the Board of Revenue received was far below the normal level of 8 to 9 million *tael* silver a year.[640] The annual average income for the Board of Revenue plummeted from 12.4 million *tael* between 1821 and 1834 to only 5 million between 1852 and 1861. A large proportion of this income was simply accounts reported to the center rather than real.[641] As a result, the center had to depend upon the silver stocks in the Board of Revenue to disburse civil and military expenditures in Beijing and fund its governance in Manchuria. The amount of silver reserves available to the central government plummeted from around 9 million *tael* silver in the 1840s to as

[640] The tax revenue that reached Beijing was 1.8 million *tael* silver in 1856, 2.14 million *tael* in 1857, and 2.7 million *tael* in 1858. 惠亲王绵愉会同户部片, 咸丰九年七月二十八日, *Grand Council Memorial Copies*, Box 679, No. 2002-4.

[641] Peng Zeyi, *Shijiu shiji houbanqi de Zhongguo caizheng yu jingji* [The Economy and Public Finance in China in the Second Half of the Nineteenth Century], p. 75.

low as 190,000 *tael* silver per year in the period between 1853 and 1864 and remained below 220,000 *tael* silver in this period.[642]

At the same time, economic conditions in Beijing turned quite bleak when the Taiping forces occupied Yangzhou in 1853 and cut off the transportation of tribute grain (*caoliang*) from Jiangxi, Anhui, Hunan, and Hubei to Beijing via the Great Canal. The population of some 800,000 in Beijing had to rely upon a reduced grain supply from Jiangsu and Zhejiang which were transported by sea via Tianjin.[643] In the spring of 1853, the news that the Taiping Northern Expedition Forces were approaching Tianjin caused a great panic in Beijing. Within a month, more than one hundred money exchangers closed; others, along with pawnshops, stopped their lending. Many prominent bankers from Shanxi fled from Beijing and Tianjin.[644] The special socio-economic circumstances significantly affected the Qing government's efforts to find financial solutions to its unprecedented fiscal crisis.

As mentioned above, in 1850 the Board of Revenue assigned silver notes worth 500,000 *tael* of silver for the river works in Feng County in Jiangsu. These notes were issued by the Official Money Exchanges established and managed by the Imperial Household in Beijing. The bureau of river works sold these notes to businessmen, who then took them

642 Ibid., p. 77.
643 Ni Yuping, *Qingdai caoliang haiyun yu shehui bianqian* [The Seaborne Transportation of Caoliang and Social Changes in Qing Dynasty] (Shanghai: Shanghai Shudian Chubanshe, 2005), pp. 101-2.
644 Huang Jianhui, *Shanxi piaohaoshi* [A History of Shanxi Bankers], revised version (Taiyuan: Shanxi jingji chupanshe, 2002), p. 174. In contemporary accounts, "most of the big Shanxi and Shandong merchants in Beijing had taken their capital back home, and more than one hundred money exchangers in Beijing were forced to close [现在京师银两复被山东山西铺商携回原省。自本年初间以来，钱铺接连关闭不下百十余家]." 鸿胪寺卿祥泰奏, 咸丰三年四月初三日. *Qingdai dangan shiliao congbian*, Volume 11 (Beijing: Zhonghua Shuju, 1984), p. 51.

to the Board of Revenue to buy official titles. These notes did not bear interest but served the function of bills of exchange which rid both the government and businessmen of the burden to transport silver over long distances.[645] This method postponed the government's payment of silver and thus mitigated its fiscal burden in the short run. In 1853, several officials suggested to issue this kind of silver notes to exchange silver with merchants in Shanxi province.[646] The censor Zhang Lihan pointed out particularly that the Shanxi merchants mostly invested their wealth in businesses scattered across various provinces. Yet wars had significantly decreased the chances of profitable investment, which led to a widespread hoarding of silver among Shanxi merchants. He thus proposed that the government issued officials silver notes to "borrow" silver from merchants in Shanxi province.[647] Nonetheless, the Shanxi governor Heng Chun considered this kind of "borrowing" impractical as these merchants had already made extraordinary contributions to the government, yet their business had been severely damaged by the ongoing wars.[648]

[645] In 1853 the Board of Revenue requested holders of these bills could only use 60 percent in the total amount of purchasing the title. 给事中贾世行奏，咸丰三年十二月初四日. *Zhongguo jindai huobishi ziliao (shangce)*, p. 379.
[646] Huang Jianhui, *Shanxi piaohaoshi* [A History of Shanxi Bankers], revised version, p. 191.
[647] "如山西富户，或拥资十数万两，或数十万两或百余万。大约生理居多，分置各省，现经逆匪肆扰，除失落不计外，歇业者十居八九，率皆携其资本藏于家而无所用." Although Zhang proposed to issue silver notes (*guanpiao*) to "borrow" from Shanxi merchants, the nature of the notes in his mind was closer to paper notes rather than credit of borrowing as these notes could be used to pay taxes or in commercial transactions [遇有交官各项，俱准输纳，即各省贸易亦一体通行]." The memorial of the censor Zhang Lihan, 咸丰三年十一月初七日, *Grand Council Memorial Copies*, Box 678, No. 2355-7.
[648] "晋省巨商散在各省者多遭蹂躏。所有以票易银、出票借银，此时难在举行。"Shanxi 巡抚Heng Chun, 咸丰四年闰七月二十八日, *Grand Council Memorial Copies*, Box 678, No. 3220-2. A few months later, Heng Chun reported to the Board of Revenue that he ordered to print bills of silver (*qipiao*) which he planned to exchange silver with merchants next year. Shanxi 巡抚Heng Chun, 咸丰四年十二月十五日. *Grand Council Memorial Copies*, Box 679, No. 24-5.

As civil wars caused a great drop in both tax revenue and the amount of commodities flowing into Beijing, officials of the Board of Revenue considered it unwise to issue debentures (*qipiao*) to pay the salaries of officials and princes in Beijing as they could not anticipate the regular inflow of tax revenue.[649] Meanwhile, they did not think to pay high interest rates so as to make government bills of credit, which did not bear interest rate, more attractive to merchants. Even when the fiscal crisis in 1860 forced the Board of Revenue to reconsider "borrowing" silver from domestic sources, it still turned to this kind of no-interest silver bills.[650] In the 1850s, the major financial experiment was "implicit borrowing," i.e., to issue paper notes denominated in both silver and copper cash which could not only cover government deficits but also circulate in the economy.

The Qing government first decided to issue silver notes (*guanpiao*) of 120,000 *tael* in Beijing in 5 April, 1853 as a trial. If these silver notes could circulate in Beijing, the center would extend this measure to provinces.[651] One month later, it decided to issue silver notes worth 2 million *tael* of silver and distributed them to provincial governments

[649] As they admitted, "how could we repay [the bills] at their due dates if the anticipated tax revenues did not come in future [至放期票，届期亦须给予现银，以后应解库项，亦未必能源源而来，届期又何以应之？]." A secret memorial from 管理户部事务Qi Junzao, 咸丰三年七月二十一日. *Zhongguo jindai huobishi ziliao (shangce)*, p. 361. At the provincial level, 札拉芬泰 in 1853 also suggested that provincial governments should issue bills of 500 *tael* silver to exchange for silver from merchants, yet to no avail. 札拉芬泰奏, 咸丰三年十一月十二日. *Grand Council Memorial Copies*, Box 678, No. 2370-2.

[650] The Board of Revenue intended to issue silver notes to "borrow" silver in provinces such as Zhili, Shanxi, Shanxi, Shandong, and so on. Holders of these silver notes, which bore no interest, could redeem them in silver after five years. The Qing government seemed to consider that it was repressing domestic rebellions for the benefit of the wealthy, and therefore it should not pay them extra. As shown in the words of this memorial, "际此贼燄毒遍东南，敷天共愤，即毁家纾难亦属分所当然，况暂时贷银给票，计年持票偿银，自无不鼓舞乐从，争先恐后." 瑞华会同户部折, 咸丰十年六月十八日, *Grand Council Memorial Copies*, Box 679, No. 2920-3.

[651] "先于京师行用，俟流通渐广，再行颁各省一律遵办." The Edict to issue official silver notes, 咸丰三年二月二十七日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 352.

according to their varied needs. The denominations of these silver notes were 1 *tael*, 3 *tael*, 5 *tael*, 10 *tael*, and 50 *tael*, which were clearly made for the convenience of normal transactions in the markets.[652] On 17 December, 1853, the Board of Revenue ordered the issue of copper notes (*baochao*), in units of 500 *wen*, 1,000 *wen*, 1,500 *wen*, and 2,000 *wen* respectively. The official exchange rate between the two notes was set at 1:2,000 (1 *tael* silver note equals to 2,000 *wen* copper note).[653] As conceived by the Board of Revenue, the silver notes should substitute for silver in long-distance trade and the copper notes serve for local transactions.[654] But how could the government establish trust on the face value of these notes in the markets?

The non-interventionist attitude to the market that the Qing government had developed over the course of the eighteenth century significantly influenced its experiment with paper notes. Although counterfeiting of government paper notes was declared a capital crime, the government did not intend to forbid the use of private notes in the economy.[655] Meanwhile, the relationship between the center and powerful privileged merchants had changed fundamentally over the past decades. The merchants who were granted the monopoly in the copper trade with Japan had gone bankrupt in the second half of the

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652 The memorial of the Board of Revenue on the issue of silver notes, 咸丰三年七月初三日, *Zhongguo jindai huobishi ziliao (shangce)*, pp. 352-9.

653 The memorial of the Board of Revenue on the issue of copper notes, 咸丰三年十一月十七日, *Zhongguo jindai huobishi ziliao (shangce)*, pp. 372-77.

654 "行近地以宝钞为便，行远省以官票为便." 户部行钞章程, *Zhongguo jindai huobishi ziliao (shangce)*, pp. 359.

655 "官票之行，与银钱并重… 其民间行用银钱私票仍听其便."The imperial decree of issuing paper notes, 咸丰三年二月二十七日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 352.

eighteenth century.[656] The big salt merchants, who held a similar monopoly, were most powerful in the eighteenth century; yet they had suffered greatly from the rising value of silver vis-à-vis copper cash since the 1820s. From 1831 onward, the Qing government abolished the monopoly in selling salt and attempted to sell licenses to any interested businessmen.[657] In 1853, the Board of Revenue did not consider granting special privileges to merchants to let them use government paper notes as capital to make profit in the sectors under their monopoly, as the domain governments in eighteenth-century Japan did.

The Qing government mainly relied upon government spending and tax collection to gradually introduce its paper notes into the economy. In 1853, it planned to take three years to raise the percentage of paper notes in both government spending and tax collection to 50 percent.[658] To attain this goal, the Board of Revenue first used the issued paper notes to disburse up to 20 percent of officials' salaries, soldiers' wages, and the funds for river works. Meanwhile, it requested the provincial governments to set up General Official Money Bureaus (*guanqian zongju*) in provincial capitals and open branches in important market towns and cities or the places where major troops were stationed to sell paper notes and ensure their convertibility. The Board of Revenue also asked provincial governments to mobilize well-established merchants to manage these

[656] As the cost of buying copper steadily rose while the official prices to buy copper remained unchanged, the big privileged copper merchants could not return the money they borrowed from the government. See Wei Qingyuan and Wu Qiyan, "Qingdai zhuming huangshang fanshi de xingshuai [The rise and fall of the famous imperial merchants in the Qing dynasty, the Fan family]," *Lishi yanjiu*, No. 3 (1981), pp. 140-3.
[657] Ho Ping-ti, "The Salt Merchants of Yang-Chou: A Study of Commercial Capitalism in Eighteenth-Century China," *Harvard Journal of Asiatic Studies*, Vol. 17, No. 1/2 (June 1954): 130-68.
[658] 管理户部事务Qing Junzao et. al., 咸丰三年十一月十七日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 373.

Official Money Bureaus.[659] The crucial element in this monetary experiment was the transformation of the Official Money Bureaus into financial institutions similar to a fractional private note-issuing bank which could rely upon certain cash reserves to float a larger amount of notes. As the Board of Revenue emphasized, the use of official funds as cash reserves was vital to the success of these Official Money Bureaus.[660] However, the economic circumstances and conditions of government finance at the time made it difficult for the Qing government to develop these new institutional arrangements to guarantee the convertibility of issued silver notes and thus facilitate their wider circulation.

In Beijing, the silver available for the Board of Revenue to spend was extremely inadequate when the experiment with paper notes started in 1853. According to a memorial of the Board of Revenue dated 26 September, 1853, it had some 100,000 *tael* of silver, which could not even disburse the monthly wages of the banner soldiers stationed in Beijing. Moreover, it admitted that the anticipated revenues from provincial governments could only cover 20 percent of the 4.6 million *tael* of silver in expenditure by March 1854.[661] The emergent fund of 500,000 *tael* from the silver stocks of the Imperial Household was only a temporary relief measure for the Board of Revenue. An extra-income of 670,000 *tael* silver that the Board of Revenue raised through selling

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[659] "[sic] 先就省垣议设官钱总局，或于市集银钱辐辏之区，或于提镇驻扎重兵之处，添设分局一两处，招募殷实商人承办官钱票." The memorial of the Board of Revenue on the issue of paper notes, 咸丰三年七月初三日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 354.
[660] "溯查前代钞法所以盛行，皆储官钱以供支取，是票本一节最为行票紧要关键." Ibid., p. 354.
[661]管理户部事务Qing Junzao et. al., 咸丰三年八月二十四日, *Zhongguo jindai huobishi ziliao (shangce)*, pp. 260-1.

official ranks in Beijing in 1853 was not a regular income or dependable source of income, particularly once those who could afford to buy official titles had already done so.[662]

Meanwhile, as both tribute grains to and domestic trade with Beijing were disrupted, the demand for silver dropped considerably and copper cash became valuable for the small-scale transactions of daily life.[663] As a result, the value of silver in regard to copper cash in Beijing plummeted in early 1853.[664] Moreover, as private money exchangers closed and Shanxi bankers left Beijing, there was little commercial lending available to retailers. This caused serious unemployment among wage laborers in Beijing. In response, officials urged the government to issue official cash notes and to lend them to retailers and shopkeepers as substitutes for private notes.[665] In May 1853, the Board of Revenue established four Official Money Bureaus in Beijing, which used the copper cash released from the two central mints (*baoquanju* and *baogongju)* as cash reserves to issue copper notes.[666] They followed the examples of five note-issuing Official Money Exchangers

[662] The amount of money from selling titles that the Board of Revenue received in 1853 is cited from Peng Zeyi, *Shijiu shiji houbanqi de Zhongguo caizheng yu jingji* [The Economy and Public Finance in China in the Second Half of the Nineteenth Century], p. 146.

[663] "自道途多梗，百货之贩运至京者盖寡。" 克勤郡王庆惠折, 咸丰三年十一月十七日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 372.

[664] According to the observation of the censor Chen Qingyong, the relative value of copper cash in regard to silver in early 1853 almost doubled, and sometimes people could not even exchange their silver for copper cash. The memorial of Chen Qingyong, 咸丰三年二月十六日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 342.

[665] The censor Jia Shixing proposed that the government lend official notes to money exchangers (zhangju) and pawnshops to resume their normal operation. In his view, "the dearth of private notes provides an opportunity for the circulation of official notes [当此私票短绌之际，正官票畅行之机]." The memorial of censor Jia Shixing, 咸丰三年五月初二日, *Grand Council Memorial Copies*, Box 678, No. 2095-6.

[666] They were named Qianyu, Qianheng, Qingfeng, and Qianyi.

which the Imperial Household set up in 1841.[667] The copper notes issued by these Official Money Bureaus could be converted to copper cash but not to silver. In 1854, the Board of Revenue began to rely upon these copper notes to pay the wages of banner soldiers in Beijing.

Under the pressure of silver dearth in Beijing, the Board of Revenue imposed some special regulations on the use and convertibility of silver notes in the beginning of its experiment with paper notes. It did not allow provincial governments to use silver notes when they sent tax revenues or other assigned funds to Beijing, yet it did allow them to use copper cash with large nominal values (*daqian*, mainly the copper cash of 10 *wen* in this case) for the same purpose.[668] Moreover, it only allowed silver notes to be convertible to copper notes or copper cash in the Official Money Bureaus according to market prices, but not to silver.[669] These regulations were obviously unfavorable to establishing trust in silver notes in the markets. Yet they did not result from an anti-market disposition on the part of government officials, nor did they determine the failure of the silver notes.[670] As the initial restrictions on the use and convertibility of silver

[667] They were named Tianyuan, Tianheng, Tianli, Tianzhen, and Xitianyuan. The Imperial Household allocated them 500,000 tael silver as capital. 内务府大臣Jing Zheng, 道光二十一年十二月初六日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 467.
[668] "藩库遇有协拨他省，及应行解部之款，亦准其搭解大钱，惟不准以银票搭解部库." The memorial of the Board of Revenue on the issue of paper notes, 咸丰三年七月初三日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 354.
[669] "The silver notes should disbursed from provincial treasuries and copper notes managed by Official Money Bureaus. Silver notes could exchange with copper notes and copper cash according to market prices, but with silver [银票由藩库搭放，钱票由官局开发。得银票者不准支银，而准按价支取现钱及钱票]." Ibid., p. 354.
[670]

notes immediately aroused criticism among government officials in both the center and provinces, they were subjected to modifications or even major revisions.

The censor Zhang Siheng, the Vice-Minister of the Left of the Board of Revenue (户部右侍郎) Wang Maoyin, and the Director-General of the Grand Canal (江南河道总督) Yang Yizeng pointed out that these restrictions would destroy the creditworthiness of silver notes in the markets.[671] The censor Zhang Siheng argued that both the central and provincial governments should uniformly use silver notes. In this way, official silver notes could play the role of private bills of exchange which had been stopped due to the war. Zhang based his proposal upon the operation of private bills of exchange: merchants came to Beijing to sell goods and took home silver notes, which could be converted to silver in the prefectural or provincial governments. The government would thus be freed from the burden of transporting the collected tax revenue to Beijing in silver and the merchants the burden of taking silver out of Beijing.[672]

Yang Yizeng suggested the Board of Revenue should let provincial governments use silver notes to send tax revenue or other assigned funds to Beijing. In his view, the total amount of issued silver notes came to less than 10 percent of the annual tax revenue that

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[671] In Zhang Siheng's words, "部库于官票既有不准搭解之名，小民必将疑官票为愚民之术，一存轻视，即难信行。" Yang Yizeng consulted with his subordinates and local gentry and reported to the center that they all believed that these regulations "would lead to suspicion of silver notes [部文内，有得银票者不准支银，及不准以银票搭解部库两语，难免观望迟疑]." Wang Maoyin referred to these two officials to make a case for the convertibility of silver notes. See *Zhongguo jindai huobishi ziliao (shangce)*, p. 362, p. 378, and p. 392 respectively.

[672] The memorial of the censor Zhang Siheng, 咸丰三年八月二十二日, *Zhongguo jindai huobishi ziliao (shangce)*, pp. 364-5.

the Board of Revenue received each year. Moreover, if provincial merchants had confidence in silver notes, they would continue to use these notes for the sake of convenience rather than go to Beijing to convert them into silver. The burden on the center to maintain full convertibility of silver notes would therefore be further reduced.[673] In regard to convertibility of silver notes, Wang Maoyin strongly advocated that the government allow merchants to convert the official silver notes they held to silver at prefectural governments.[674]

However, the alternatives that these officials proposed to enhance the creditworthiness of silver notes were mostly based upon normal conditions of public finance and domestic markets. Yet officials of the Board of Revenue had to face the reality that the ongoing wars had not only severely disrupted Beijing's trade with other regions, particularly central and northeastern China, but obstructed the transportation of the collected revenue to the center as well. In response to Wang's proposal to make silver notes redeemable in silver, the Board of Revenue pointed out that instead of promoting their circulation, this would lead merchants to exchange their silver notes for government silver which was already inadequate to meet the government's own needs. As a result, the government would be left with its paper notes while its silver went to merchants.[675] This reply

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673 The memorial of 江南河道总督Yang Yizeng, 咸丰三年十一月十九日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 378,

674 "今使商人持钞倾镕钱粮之银号兑取现银，则商人之用钞便，而得钞不待倾销即可解省，于银号亦便。" 户部右侍郎Wang Maoyin, 咸丰四年三月初五日. *Zhongguo jindai huobishi ziliao (shangce)*, p. 392.

675 "夫地丁、关税之现银，朝廷已徵之正赋也；州县倾镕之银号，属库应解之钱粮也。正赋钱粮徵解足额便不行钞，此理易明，岂有徵解足额之后，处处不放饷而與商者乎？" 军机户部议复王茂荫折, 咸丰四年三月初八日. *Zhongguo jindai huobishi ziliao (shangce)*, p. 395.

illustrated the deep dilemma that the Qing government faced in the initial stages of issuing silver notes. The purpose of these notes was to cover government deficits. The trust of economic actors was vital to the scheme of using limited silver stocks to mobilize larger financial resources in the form of paper notes. But how could businessmen have confidence in the value of silver notes when they knew quite well that the government was financially depleted?[676] To keep full convertibility of silver notes in such a situation could very likely result in a rapid exhaustion of government's silver stocks. Yet few people would trust these notes without a guarantee of full convertibility.

Of course, one way out of this dilemma was to use paper notes only. As the governor-general of Fujian and Zhejiang Wang Yide proposed, in order to fully benefit from issuing paper notes, all public spending and tax collection at both the central and local level should be carried out in official notes only. In Wang's view, this would show the whole realm that official notes were the only currency and thus create demand for the notes.[677] To convince the center of the feasibility of relying on paper notes only, Wang Yide reported that the Fujian provincial government had depended completely on the silver and copper notes issued by the Yongfeng Official Money Bureaus and urged the center to do the same.[678] Wang's proposal was similar to what Ōkuma Shigenobu did in

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[676] As the censor Wu Aisheng pointed out, businessmen in Beijing had ready access to the *Gazette* (邸抄), which freely copied the memorials on the financial situation of the government. The memorial of the censor Wu Aisheng, 咸丰四年四月二十四日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 402.

[677] "[sic] 不以银为银，而以钞为银，普天之下，无论钱粮、关税、捐项以及一切进出度支，以此发即以此收。示天下非钞不用，即人人无不乐于用钞。" The memorial of 闽浙总督Wang Yide, 咸丰四年三月二十七日. *Zhongguo jindai huobishi ziliao (shangce)*, p. 399.

[678] "仰恳天恩乾纲独断，明降谕旨，敕令部臣及各省督抚，以此发即以此收，无论各项进出度支，示天下以非钞不用." 闽浙总督兼署福建巡抚王懿德折, 咸丰四年六月二十八日; In regard to

Japan in 1870. Nonetheless, the effectiveness of Ōkuma's measure depended crucially upon his strict prohibition of gold and silver in domestic transactions, which made government paper notes the only legal currency in the economy. In other words, he used the coercive power of the state to establish a status of monopoly for government paper notes when the state did not have sufficient cash reserves to guarantee their convertibility. However, the Qing government at the time was militarily at a disadvantage. Its prospects of defeating the Taiping remained highly uncertain as late as in 1860. Given these circumstances, it is not surprising that the Qing government did not dare to impose its newly-issued paper notes as the only legal currency.

Nonetheless, there were clear signs to indicate these critiques caused some policy changes. In regard to the use of silver notes in public finance, the Board of Revenue actually allowed provincial governments to use them when they transferred money to Beijing.[679] Meanwhile, not all provincial governments obeyed the regulations in regard to the convertibility of silver notes. For example, the governor-general of Fujian and

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government spending in Fujian, Wang pointed out that "[闽省本年兵饷支绌]不得已于省会永丰官钱局先行挪垫，已用至数十万两之多。然并无现银，不过银票钱票彼此相互通用，即此一端，可见钞法之行，毫无窒碍." 闽浙总督兼署福建巡抚王懿德片, 咸丰四年六月二十八日。 Both in *Grand Council Memorial Copies*, Box 678, No. 3059-61 and No. 3063.

[679] In a memorial from Jiangsu co-authored by 两江总督Yi Liang and 江南河道总督Yang Yizeng, they reported that they would use silver notes issued by the Board of Revenue to replace those issued by the Jiangsu provincial government in the fund sent to Beijing or other provinces [其搭解部库及协拨他省款项并赴他省行使者，仍换用部颁官票，以符原案]." 两江总督怡良，江南河道总督杨以增折, 咸丰四年六月十七日, *Grand Council Memorial Copies*, Box 678, No. 2876-7. In a memorial of Zhejiang 巡抚He Guiqing, there is clear evidence to show that the center accepted silver notes from provinces in sending the collected tax revenue to Beijing. [又议请推广钞法案内，钦奉谕旨：凡民间完纳地丁、盐课、关税一切交官解部协拨等款，均准以官票钱钞五成为率。又议奏条陈钞法案内，以各直省正杂款项解部搭解钞票，自一成至五成，随凭外省所便]." Cited from the memorial of 浙江巡抚He Guiqing, 咸丰五年二月二十八日, *Zhongguo jindai huobishi ziliao (shangce)*, pp. 445-6.

Zhejiang and the governor of Fujian (闽浙总督兼福建巡抚) Wang Yide reported that the Yongfeng Official Money Bureau in Fujian had permitted its silver notes to be redeemable in silver or foreign silver currency and wanted to continue this practice so as to safeguard confidence in silver notes.[680] Likewise, the provincial government of Jiangsu permitted government paper notes redeemable in silver at the Official Money Bureau set up in Suzhou.[681] Meanwhile, the co-existence between the center's sovereign authority and the practical autonomy of provincial governments in the mintage of copper cash that we observed in the eighteenth century was now extended to the issue of paper notes. For example, the center granted a significant degree of autonomy to provincial governments, which permitted them to print paper notes to meet urgent needs instead of waiting for the notes issued from Beijing.[682]

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680 "闽省原开永丰官局，制造官银钱票，提发正杂各款… 又闽省局票提发各款，均准赴局支取现银现钱，并按时价兑易时钱。今部票不准支银，窃恐易滋民惑，且与已行官票亦有妨碍."闽浙总督兼福建巡抚王懿德折，咸丰四年三月初十日，*Grand Council Memorial Copies*, Box 678, No. 2687-91.

681 "[今于苏州府设官钱店] 遇有官民赴店兑换，均照市价公平交易，或取现银或需官票，悉听其便." 两江总督怡良，江苏巡抚吉尔杭阿折, 咸丰四年闰七月初六日, *Grand Council Memorial Copies*, Box 678, No. 3152-4.

682 For example, the Jiangsu provincial government found that the silver notes received from the Board of Revenue often came in denominations too big (above 5 *tael*) for ordinary market transactions. It asked the Zhonghe Official Money Bureau, which was set in the important market town Qingjiangpu, to print silver notes with smaller units ranging from 1 *tael* to 5 *tael* according to the form of silver notes issued by the Board of Revenue. In the memorial informing Beijing, the governor-general of Liangjiang and the governor of Jiangsu justified it as "adjustments in accordance to local circumstances" since it would take months to consult with the center and receive the needed notes from the center. This was approved. [若再咨部，往返需时，且费票局工本，自应在外变通，乃可因势利导。今清江… 设立中和官局… 拟即令该局制造一两暨五两官银票五种，其式即照部票，并由江宁藩司盖用印信，以昭慎重]. 怡良，两江总督杨以增折，咸丰四年六月十七日，*Grand Council Memorial Copies*, Box 678, No. 2876-7, 硃批：所拟是应随时变通者。户部知道。

The highly decentralized fiscal operations necessitated by war also gave provincial governments a large degree of autonomy in financial issues. They thus had enough space to experiment with new institutional arrangement for the Official Money Bureaus which were established to use government funds to back up the issued silver notes. Like the officials in the Board of Revenue, provincial governors were aware of the importance of commercial transactions to the circulation of paper notes in general. In the view of the Hunan governor Luo Bingzhang, to allow the people to use paper notes to pay taxes per se was not adequate to ensure their circulation in the economy. As he pointed out, "only if merchants accept paper notes in their business can ordinary people have access to paper notes; only if the people are holding paper notes can the state receive notes in collecting taxes."[683] Provincial governments also tried to recruit private merchants and financiers to establish and manage the Official Money Bureaus in both provincial capitals and major market towns and cities.

In theory, both provincial governments and private financiers could benefit from the success of this institutional experiment. Private financiers who were recruited to manage the Official Money Bureau could use regular government fund to enhance their creditworthiness in the markets. The government could meet its speeding needs if the Official Money Bureau under the management private merchants could safeguard the creditworthiness of silver notes and thus facilitate their circulation in the economy.

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[683] "惟思行钞之法，必先设立官银钱号，而官银钱号又须慎选殷实商人，令其承充，庶几行之无弊。诚以自官放之，必自商通之，而后能自民藏之。[中略] 原以官许收钞，则民知所宝贵。然必运之于商，而民始有钞之可得；藏之于民，而官始有钞之可收." 湖南巡抚骆秉章折, 咸丰六年二月二十八日, *Grand Council Memorial Copies*, Box 679, No. 604-7.

Meanwhile, as different provincial governments enjoyed a large degree of autonomy in conducting this institutional experiment according to their respective economic circumstances, the likelihood of finding a workable institutional solution is also increased. If one provincial government had a successful experience, they would report it to the center; we see this both in the eighteenth century and in the collection of the *lijin* duties (the indirect taxes levied upon wholesalers) in 1853.[684]

In practice, however, the interactions between the decentralized fiscal operation and the fragmented domestic market under conditions of civil wars in the 1850s were hostile to the unfolding of a mutually reinforcing process between the state and the market. Nation-wide interregional trade and financial networks established by the Shanxi bankers by the 1840s were severely disrupted. These financial networks had connected the major cities and market towns; they were closely tied to long-distance trade and remitted a large volume of capital through bills of exchange. In this process, the Shanxi bankers converted various standards of silver *tael* used in different regions in China into one common unit (*benping*) and thus reduced the transaction costs of long-distance trade. These private financial services were indispensable to the formation of a unified national market in China when the state did not provide a uniform silver currency.[685] Although the transportation of tax revenue and allocation of government spending remained independent of these financial networks, there were cases to show the beginning of

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[684] The local government in Jiangsu first reported it as an effective way to raise revenue to the center and the center immediately approved it and requested other provincial governments to adopt the same measure. See the details in Susan Mann, *Local Merchants and the Chinese Bureaucracy, 1750-1950* (Stanford: Stanford University Press, 1987), pp. 95-6.

[685] There were more than one thousand standards of *tael* of silver in nineteenth-century China. For the discussion of Shanxi bankers' conversion of different silver standards and its importance to long-distance trade in China, see Huang Jianhui, *Shanxi piaohaoshi* [A History of Shanxi Bankers], revised version, pp. 114-21.

connections between the state fund and private remittance networks.[686] However, many Shanxi bankers in 1853 were forced to close their business in major cities and market towns such as Beijing, Tianjin, Hankou, Nanjing, Qingjiangpu, and Yangzhou.[687] The transmission of silver through private bills of exchange became unavailable.[688] Civil war also destroyed the transportation along the Great Canal and its branch rivers and ruined domestic trade between northern and southern China.[689] Domestic markets thus became much more fragmented.[690] The reduced volume of interregional trade in the 1850s thus led to less demand for the silver notes newly issued by the government.

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[686] For example, Rishenchang, a well-established Shanxi bank, remitted from Suzhou to Tianjin certain part of the official fund to transport tribute grains from Jiangsu to Beijing (*haiyun jingfei*) in 1851 and 1852, though the amount of each remittance was probably below 100,000 *tael* silver. Cited from ibid., pp. 169-70.

[687] Ibid., pp. 173-4.

[688] Two officials pointed out that private remittance through bills of exchange had stopped in both Beijing and the provinces. The memorial of the censor Zhang Siheng, "现在京师及外省之会票局，全行停止." 咸丰三年八月二十二日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 364; the memorial of Wang Maoyin, "现在商人会票之局全收." 咸丰四年三月初五日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 392.

[689] Along the Great Canal in peaceful years, manufactured goods such as cotton cloth, tea, paper, etc. from Jiangsu, Zhejiang, Anhui, Jiangxi, and Hubei were sent to the north and grains and soy bean from Shandong, Henan, and Zhili to the south. For the importance of the Great Canal to the trade between southern and northern China, see Li Wenzhi and Jiang Taixin, *Qingdai caoyun* [The Transportation of Tribute Grains in the Qing Dynasty] (Beijing: Zhonghua shuju, 1993), pp. 482-513.

[690] In Suzhou in 1854, "苏省本商贾云集之所，近因道路梗阻，商贩甚稀，贸易日形减免." 两江总督怡良，江苏巡抚吉尔杭阿折, 咸丰四年闰七月初六日, *Grand Council Memorial Copies*, Box 678, No. 3152-4. In Henan in 1854, "道路阻隔，河禁綦严，百货不能流通." 河南巡抚英桂折，咸丰四年五月二十四日，*Grand Council Memorial Copies*, Box 678, No. 2857-9; "贼氛未靖，防河紧要，所有本地所产棉花等项不能载运出境售卖." *Grand Council Memorial Copies*, Box 678, No. 3341-44; "河南省会自去岁以来，巨商皆以歇业." 河南学政张之万折, 咸丰五年正月十二日, *Grand Council Memorial Copies*, Box 679, No. 94-8. In Hunan in 1856, "湖南兵革未休，疮痍日甚，农工废业，商贩不通。" 湖南巡抚骆秉章折, 咸丰六年二月二十八日, *Grand Council Memorial Copies*, Box 679, No. 604-7. In Fujian in 1855, "各省匪氛不靖，道路多阻，以致各商群相裹足." 闽浙总督王懿德，福建巡抚吕佺孙折, 咸丰六年九月初三日, *Grand Council Memorial Copies*, Box 679, No. 773-6.

Meanwhile, civil war not only reduced the receipts of tax revenue but also worsened the already decentralized fiscal system. Given the state of communication facilities, the center could not have full access to true information about tax collection and spending at local levels. Nor did it have the transportation capacity to mobilize silver or resources to its troops according to their different needs in the battlefield. As a result, the center had little ability to coordinate the revenue transfer among provincial governments, particularly from wealthy provinces to economically backward areas. In the absence of such central coordination, which was vital to public finance in times of peace, the transaction cost for provincial governments to cooperate in fiscal and financial matters was formidably high. Although the use of silver notes, which were much easier to transport than silver itself, had the potential to enhance the center's ability in fiscal coordination, we should not expect these newly introduced instruments be able to play the role of well-accepted silver notes for public finance. Instead, the decentralized public finance and fragmented markets of the 1850s were hostile to the institutional experiment with silver notes.

The dearth of silver was particularly severe in provinces such as Yunnan, Guizhou, and Gansu, where interregional trade was not well developed and provincial governments depended heavily upon revenues transferred from other provinces (*xiexiang*) even in normal times. Meanwhile, the disruption of transportation by the war significantly affected the interregional trade in provinces such as Sichuan and Shandong. In these regions, it was difficult to get ordinary people to use official silver notes whose value was too big for daily transactions. In the case of Sichuan, the silver notes used in government spending quickly went to the Official Money Bureau to be exchanged for copper cash.[691] In consequence, the Official Money Bureaus in these silver poor regions could only issue copper notes.[692] The economically and fiscally isolated Beijing also had to confront the scarcity of silver. As the private financiers who collaborated with the Board of Revenue in managing the Official Money Bureaus in Beijing only issued copper notes, they could not establish financial connections with merchants in other regions of China through the use of silver notes.

In the coastal and southern provinces which still had access to silver through foreign trade, the dearth of silver was not as severe as in Northern China. Their Official Money Bureaus tried to float silver notes, such as Damei in Zhejiang, Zhonghe in Jiangsu, Baofeng in Jiangxi, and Yongfeng in Fujian. The center permitted provincial governments in Jiangsu, Fujian, and Zhejiang to issue their own silver notes. Provincial governments in Zhejiang and Fujian issued silver notes denominated not only in local standard of silver *tael* but also in foreign silver currency (*yuan*).[693] Nonetheless, these Official Money Bureaus were subjected to two constraints in circulating silver notes.

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691 "[川省设官钱局以来]各文武衙门所领官票，民间既难行用，不得不赴局兑钱，是以随放随收." 兼署四川总督成都将军乐斌折, 咸丰五年二月十五日, *Grand Council Memorial Copies*, Box 679, No. 164-6. The total amount of silver notes in this case was only 330,000 *tael*.

692 The Official Money Bureaus in Gansu and Yunnan province issued copper notes.

693 As the Zhejiang governor 黄宗汉 pointed out, people in Zhejiang mostly used foreign silver currencies in commercial transactions and they were not familiar with the unit of kuping *tael* (库平两) in the silver notes issued by the Board of Revenue. He thus reported to the center that the Official Money Bureau in Zhejiang would follow the example of Fujian to issue its own silver notes with denominations of both yuan and local *tael*. [部颁银票系以库纹定平色，便于官项，未尽便于流用。浙省市肆交易多用洋钱，与福建情形相仿。因查函闽省章程，于部票之外增造银洋钱三项局票，一律推广试行.] 浙江巡抚黄宗汉片, 咸丰四年十二月初九日, *Grand Council Memorial Copies*, Box 678, No. 3499-501. The Yongfeng Official Money Bureau in Fujian issued provincial silver notes denominated in both *tael* and foreign *yuan*, Fujian [官局所出银钞台蕃各票].

Most of the collected tax revenues were assigned directly for urgent military spending. In this situation, provincial governments did not have many surplus funds to support these new financial institutions; and their initial capital was often below 100,000 *tael* of silver.[694] Meanwhile, they had to face the same dilemma in the early stage of issuing paper notes, i.e., no credibility without full convertibility, yet full convertibility limited the issue of paper notes. Without an inter-regional financial network, it was difficult for the silver notes issued by one provincial government to circulate in other provinces.[695] The inflow of silver notes into one province simply increased the burden of its provincial government to redeem them. For example, the governor of Guizhou, Jiang Weiyuan explicitly rejected responsibility for redeeming the silver notes disbursed by the Station in Jiangnan or by other provinces, citing the lack of silver reserves in Guizhou.[696]

The Board of Revenue hoped that these Official Money Bureaus could raise their capital from selling paper notes in the markets, which the people could use to pay up to 50

694 The view of 署闽浙总督王懿德 was representative, "the available silver stocks were inadequate to meet military spending and therefore there was little surplus fund [for the Yongfeng Official Money Bureau] [现在存银，则支应军需尚虞不给，实无余款可筹]." 署闽浙总督王懿德折, 咸丰三年七月二十四日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 431.

695 闽浙总督兼福建巡抚王懿德reported to the center that the silver notes issued by the Yongfeng Official Money Bureau could only circulate in Fujian. [又现行银票，系就局制用，是以仅能行之各属，不能通行他省]. 闽浙总督兼福建巡抚王懿德折，咸丰四年三月初十日，*Grand Council Memorial Copies*, Box 678, No. 2687-91. The Jiangsu provincial government also reported to the Board of Revenue that it would only use its provincially issued silver notes within Jiangsu and use silver notes received from the center to transfer fund to Beijing or other provinces [惟外制之票，只准行之本省，不得通行他省。其搭解部库及协拨他省款项并赴他省行使者，仍换用部颁官票，以符原案]." 两江总督怡良，江南河道总督杨以增折, 咸丰四年六月十七日, *Grand Council Memorial Copies*, Box 678, No. 2876-7.

696 "黔库旧存各款，因历年挪垫饷需，扫刮迨尽 ... 是以上年部发之票，再四筹办，一时尚未流通，今若江南大营之票接踵而来，无论接应为难. ...万一他省亦将钞票搭饷解黔，更难措置. 江南推行官票章程，于黔省窒碍难行." (硃批：户部知道) 贵州巡抚蒋霨远折, 咸丰五年五月三十日, *Grand Council Memorial Copies*, Box 679, No. 281-3.

percent of their taxes to the government. When the people realized the creditworthiness and convenience of using paper notes, they would begin to use them in commercial transactions. In this way, the Official Money Bureaus could gradually increase their capital and issue more paper notes, and thus became real fractional note-issuing financial intermediaries. Nonetheless, as He Guiqing, the governor of Zhejiang, pointed out, it would take a long time to attain this goal.[697] Moreover, in the initial stage of this institutional building, this potentially virtuous cycle could turn vicious. If the government could not use paper notes in its spending, it would have less incentive to accept them for tax payments, and the people would have less confidence in holding or acquiring government paper notes. The silver notes were trapped in this vicious cycle.

As mentioned above, river work and military expenditures dominated government spending in the 1850s. In both cases, however, it was difficult to recruit big merchants or financiers to promote the use of silver notes. As the transportation infrastructure in China did not allow long-distance trade in bulky, low-value goods, officials of river works had to use copper cash to purchase construction materials from nearby peasants or small producers and to pay laborers.[698] They thus had to sell the silver notes to merchants or exchange them for copper cash, both at great discount rates. These merchants did not retain the silver notes but sold them to people or officials in neighboring provinces to pay taxes. Similarly, a large proportion of military spending in the 1850s was on the food for

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[697] [部臣原奏，谓官号之钞本，俱从卖钞而来。此必待行之既久，得有存积，或可以资周转]. 浙江巡抚何桂清片，咸丰五年十二月十六日, *Grand Council Memorial Copies*, Box 310, Volume 4464, No. 3.

[698] "[河工所领银票]工员领票，祗能押购料石，其买土雇夫向用现银，显不能以官票散." 江南河道总督杨以增, 咸丰四年五月十一日, *Grand Council Memorial Copies*, Box 678, No. 2839-41.

soldiers. Only big wholesalers who had close connections with the government had both the necessary capital and trust in the government to take silver notes in providing grain to troops. Even though the Qing government often mobilized big merchants to provide logistical support for its military campaigns in Inner Asia, this was more difficult with both domestic transportation and grain outputs disrupted by civil war. Instead, troops scattered across the country thus had to be paid in copper cash which they could use to buy food in local markets.[699] Henan and Shandong military supply stations had to use silver to purchase goods from local merchants and could not force them to accept silver notes.[700] As neither the troops nor local merchants accepted silver notes, the local governments or bureaus of domestic customs which passed on received revenues to troops thus did not want to accept silver notes in collecting taxes.[701]

Both the Board of Revenue and provincial governments were concerned about the lack of circulation of silver notes in the markets. Tax collection was the most important channel for people to use paper notes which had not yet had not fully established their

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[699] For example, in response to 钦差大臣琦善 request to use silver to replace paper notes in funding the troops in Jiangsu, governors in Jiangsu promised that the notes used to pay soldiers' wages were fully convertible to copper cash at Official Money Bureaus. "兵丁盐粮，计口授食，必须逐日零星给发。若以无本之票搭解大营，散给兵丁，各兵无处取钱，势必籍端滋事." 江南河道总督杨以增，两江总督怡良，漕运总督邵Jie，江苏总督吉尔杭阿折, 咸丰四年九月初三日, *Grand Council Memorial Copies*, Box 678, No. 3314-5.

[700] "粮台购办物料，均系急需之物。现值道路梗阻，百货不能流通，无物不贵，购办已形竭蹙。此项银票须俟军务事竣方能支取，恐非商民所愿，拟请毋庸搭放，以免商民裹足." 河南巡抚英桂，咸丰四年五月二十四日，*Grand Council Memorial Copies*, Box 678, No. 2852-6; "军营采办物料及收买粮食等项，均系与商民平价交易，俱应按时价发给实银，应请免其搭放银票." 革职留任山东巡抚张亮基，咸丰三年十二月初八日，*Grand Council Memorial Copies*，Box 310, Volume 4462, No, 56-7.

[701] As 江南河道总督庚长 observed the use of silver notes, "现在藩关运库所收之款，多解大营，而兵勇不能用票。是以征收衙门籍口大营之不用，遂寝阁不办，而官票成为废纸矣." 江南河道总督庚长折, 咸丰六年六月二十四日, *Grand Council Memorial Copies*, Box 679, No. 709-11.

creditworthiness. In response, the Jiangsu provincial government on 21 August, 1854 reported to the Board of Revenue that it planned to establish three Official Money Bureaus in market towns such as Shanyang and Qingjiang and issue copper notes for the daily transactions and tax payment of small peasants and retailers.[702] These Official Money Bureaus were not only managed by local merchants, but also received tax revenues on behalf of the government.[703] The Bureaus also requested that private money exchangers in Jiangsu sell copper notes in the markets.

The Board of Revenue held similar views in regard to the cause of the lack of circulation of silver notes. They emphasized that the value of silver notes was simply too big for small peasants to use in paying land taxes.[704] Therefore, the Board of Revenue decided on 28 March, 1855 to switch from silver notes to copper notes (*gaipiao yongchao*) in tax payments of land taxes and to allow the people to pay up to 50 percent of their taxes in copper notes.[705] At the provincial level, the new commercial taxes, the *lijin* duties, had become increasingly important as an elastic source of government income. However, the receipts of *lijin* duties were directly assigned to meet urgent military needs and could not be used to back up the paper notes issued by the Official Money Bureaus. Provincial

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[702] "户部所发银钞，十两五两者居多。民间一户所纳之粮，一商所交之税，为数无多。[sic] 拟即由藩司制造若干一千、两千之钱票... 制成后由藩司发交官局，委员会同府县转给董事，作为官局钞本." 江南河道总督杨以增，两江总督怡良，漕运总督Shao Jie， 江苏巡抚吉尔杭阿折, 咸丰四年七月二十八日, *Grand Council Memorial Copies*, Box 678, No. 3054-6.

[703] "[官钱局]招募殷实绅董经理其事。凡纳粮交税者，遵照部议，搭钞票若干，赴该局买取钞票... 即由该局代为交官." Ibid.

[704] "户部前发官票自一两起至五十两止，为数过整，小民完纳钱粮多系畸零散碎，非有二两之交项，即不能搭一两之官票." 军机大臣奕口会同户部折, 咸丰五年二月十一日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 409.

[705] Ibid., pp. 409-10.

governments in economically developed regions did not have much experience in collaborating with private financial intermediaries to aggregate the receipts of land taxes paid in copper cash from various regions and then convert them into silver.[706] No provincial government opposed the switch from silver notes to copper ones in collecting land taxes, even though provincial governments in Zhili and Jiangxi reported that they would continue to accept silver notes in tax collection until they were exchanged for copper notes.

Thereafter, government silver notes were only issued for specific purposes. Military supply stations usually converted them into notes of small denominations (*liangtaipiao*) that were accepted in local transactions. Silver notes continued to be sold to people who wanted to buy official ranks or titles. In certain cases, there were also used to pay debts owed to the suppliers of military logistical stations.[707] There is no evidence of their being used in market transactions.

This policy change greatly reduced the demand for silver notes in the market. Although the Board of Revenue planned to implement this policy in Zhili, Shandong, and Henan, and gradually extend it to other provinces, it immediately affected the use of silver notes for river works in Jiangsu and Shandong. Officials of river works immediately asked the

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[706] Silver-melting house (*yinhao*) which converted the collected land taxes paid in copper cash into silver at prefectural governments were not involved in interregional business networks as private bankers.

[707] "饷票收捐" in Anhui and Henan, 户部折, 咸丰八年九月二十二日, *Grand Council Memorial Copies*, Box 679, No. 1773-82. Silver notes issued by the Board of Revenue in 1860 were used to pay suppliers of 江北粮台 in Shandong. "[江北粮台] 数载以来共欠支运送采办制造雇用项下银二十万余两…请敕下户部颁发官票十七万四千六百两解交山东巡抚衙门，以便发交江省承办委员转给该欠户等具领." (硃批：户部查照办理), 山东巡抚文煜折, 咸丰十年十一月初四日, *Grand Council Memorial Copies*, Box 679, No. 2964-66.

center to replace silver notes with copper ones in the annual funds assigned for river works so that people could use them to pay taxes.[708] In order to promote the use of copper notes, an imperial edict was issued on 22 November, 1855, ordering provincial governments to set up Official Money Bureaus within three months.[709] In addition to disbursing government spending, the Board of Revenue also hoped that copper notes would complement the use of copper cash so as to alleviate the high value of silver.[710] Fiscal deficit, falling volumes of both domestic and foreign long-distance trade, and the high value of silver converged to force the Qing government in 1856 to implement a de facto copper standard aided by the use of copper notes, an option which had been discussed since the 1820s. However, the floating of copper notes further decentralized public finance.

The conversion of government spending from silver to copper notes meant that both the central and provincial governments had to issue an enormous amount of copper notes as 1 *tael* silver was set as 2,000 *wen* in copper cash. To ensure the convertibility of the issued copper notes, Official Money Bureaus had to raise their reserves of copper cash in accordance with the increasing issue of copper notes. However, it was extremely

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[708] "本年豫东两省征收丁粮应搭解官票者又改用宝钞，是河工支款亦应以宝钞济现银之不足." (硃批：户部照数速发) 河东河道总督李钧折, 咸丰六年二月十三日, *Grand Council Memorial Copies*, Box 679, No. 575-7. 江南河道 also switched to copper notes in the same year, see 江南河道总督庚长折, 咸丰六年六月二十四日, *Grand Council Memorial Copies*, Box 679, No. 709-11.

[709] The imperial edict to urge the establishment of Official Money Bureaus, 咸丰五年十月十三日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 450.

[710] "方今银价日昂，民间土地之所产，势不能因银价之昂，而尽增其物价。及至输纳丁粮，地方官无可赔累，未有不按照银价征收钱文者。上无加赋之名，而下受加赋之实。[sic] 臣等公同商酌，非疏通钞法，使之翼钱而行，无以便民生而裕国用." 管理户部贾桢折, 咸丰五年十月十三日, *Zhongguo jindai huobishi ziliao (shangce)*, p. 448.

difficult for the Qing government in the 1850s to increase the mintage of both standard copper cash (*zhiqian*) and copper cash with big nominal values (*daqian*). Both the central and provincial mints had to face a severe scarcity of copper due to the civil wars. Most of the annual fund of 1 million *tael* of silver that the center assigned to the Yunnan provincial government to produce and procure copper (*tongbenyin*) were either consumed by military spending or could not be delivered to Yunnan.[711] Moreover, the military situation cut off the transportation of copper from Yunnan along the Yangzi River and the Great Canal to northern China. Only Jiangsu and Zhejiang could acquire limited copper from Japan. The Qing government tried to seek an alternative copper supply from Mongolia and Korea, but to no avail.[712]

The severe scarcity of the copper supply greatly affected both the amount and quality of copper cash released from government mints. The mintage of copper cash with nominal values of 1,000 *wen* and 2,000 *wen* was soon stopped as they encouraged counterfeiting, and they were replaced by copper notes.[713] Although the government could profit from minting copper cash with smaller nominal values, such as 5 *wen*, 10 *wen*, and 20 *wen*,

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[711] In 1855, the Yunnan governor reported to the center that the amount of this fund in arrears in the past three years was as high as 1.87 million silver. 云南巡抚舒兴阿折，咸丰五年四月二十八日, *Grand Council Memorial Copies*, Box 679, No. 302-4. Up to 1857, the total arrears of this fund from Zhejiang and Jiangxi amounted to 3.20 million tael silver. 户部片，咸丰七年四月二十二日, *Grand Council Memorial Copies*, Box 679, No. 1140.

[712] The Qing government inquired about whether it could purchase copper from Korea in 1857, but the natural endowment of copper was poor in Korea. 惠亲王绵愉等折, 咸丰七年二月初二日，承志，倭仁折，咸丰七年四月初一日, *Grand Council Memorial Copies*, Box 679, No. 1008-11 and No. 1090-1.

[713] In Beijing, the Board of Revenue soon realized that the market did not accept copper cash with nominal values of more than 500 *wen* and decided to use copper notes as a substitute. "当千当五百两种大钱折当过多，颇为重滞，而交官之项，又不如宝钞之多，拟以宝钞将其易回." 户部片, 咸丰四年七月十九日, *Grand Council Memorial Copies*, Box 679, No. 2985-6.

they could not circulate smoothly in the market if there were inadequate standard copper cash of 1 *wen*. Yet official mints could not afford to cast copper cash of 1 *wen* under the scarcity of copper. Officials of public finance were greatly frustrated by this conflict between the fiscal purpose of the state and the circulation of copper cash in the market.[714] Moreover, both central and provincial mints were forced to often reduce the copper content in mintage.[715] Scarcity of copper also forced the mints in Beijing, Shanxi, Zhili, Henan, and Fujian to go as far as to mint iron cash, lead cash, and even iron cash with big nominal values, which could hardly circulate by their face values in the market.

In addition to this chaos in mintage, it was highly inconvenient to transport a large amount of copper cash over long distances. This significantly affected the Qing government's effort to build institutions to ensure the convertibility of copper notes across regions after it decided to rely mainly upon copper notes rather than silver notes. This lack of mobility, exacerbated by wars, made it impossible for the center to coordinate the transfer of copper cash from surplus to deficit regions. Therefore, the Board of Revenue was unlikely to build centralized financial institutions to ensure the

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[714] The lack of balance between copper cash of 1 *wen* with copper cash of large nominal values is known in the Chinese monetary theory as 子母失衡. Yet the government had no means to resolve it. As the Board of Revenue lamented in 1854, "现当部库支绌，铜斤短少之时，若停铸大钱，则经费籍何补苴；若专铸制钱，则局铜不敷提取。上筹国计，下念民生，顾此失彼，几无两全之策." 户部折, 咸丰四年八月初三日, *Grand Council Memorial Copies*, Box 678, No. 3192-4.

[715] 陕甘总督乐斌 frankly reported to the center that the reason to reduce copper content in mintage was to save copper, and his view was representative. "从前部议当十大钱重四钱四分，当五大钱重二钱二分，若遵照鼓铸，不特工料过重，抑且多费铜铅。[甘省] 必须将大钱分两量为变通，庶可节省 [铜铅]。拟将当十大钱改铸三钱四分，当五大钱改铸一钱七分。臣更有请者，改铸八分制钱." 陕甘总督乐斌折，咸丰八年五月二十九日，*Grand Council Memorial Copies*, Box 679, No. 1697-700. See various copper contents in mintage in *Zhongguo jindai huobishi ziliao (shangce)*, pp. 252-9.

convertibility of the issued paper notes. Instead, it divided copper notes into notes redeemable in Beijing and notes redeemable in the provinces. The former (*jingchao*, also known as *changhao* in the market) could be used across provinces but were redeemable only in Beijing. The latter bore the stamp of a provincial treasury (*shengchao*, also known as *duanhao* in the market), and that particular provincial government was responsible for ensuring their convertibility.[716]

In Beijing, the Board of Revenue entrusted the five Official Money Bureaus managed by private merchants, Yuqian, Yufeng, Yusheng, Yuheng, and Yutai, to handle the issue of both notes. In addition to government spending, the Board of Revenue also hoped that merchants would buy provincial notes in Beijing and sell them in their respective provinces. Yet when businessmen carried these notes back to Beijing, the five Money Bureaus refused to redeem them in copper cash. Officials of the Board of Revenue justified this by the insufficient cash reserves in Beijing and blamed provincial governments for not managing copper notes properly.[717] Both the Director-General of the Grand Canal (江南河道总督) Geng Chang (庚长) and the Director-General of the Grand Canal [of Shandong and Henan] (河东河道总督) Li Jun noted that this badly

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716 "长号钞专由京师取钱，短号钞应由外省备本，界限本极分明." 怡亲王载垣会同户部折, 咸丰十年三月十一日, *Grand Council Memorial Copies*, Box 679, No. 2554-7.

717 "臣部颁发外省宝钞，令其开设官号发钱，并准搭收地丁。嗣又奏准将五宇发交外省，盖用司印，仍解京师。原欲使商贩在京购买，运至各该省，卖与民间，以便搭交钱粮，是暗移外省搭成钱粮于买钞时交在部中接济京师急需也。初行之时，尚有买钞出京者，曾收过银三万两。其后外省截留及奏请颁发宝钞有五宇戳记者共一千二百余万吊之多。今则纷纷来京取钱，可见外省并无官号发钱，又不肯搭收钱粮，反为州县抵换实银之计。而京师经费支绌，岂能当此巨款开发." 户部片, 咸丰七年十一月二十六日, *Grand Council Memorial Copies*, Box 679, No. 1448-50.

damaged the creditworthiness of copper notes that they received from the center among businessmen who used to accept copper notes disbursed to them at discount.[718] In response, the Board of Revenue requested two bureaus to set up Official Money Bureaus to safeguard the convertibility of copper notes that they received as expenditures for river works.[719] The switch to copper notes thus did not force the Board of Revenue to centralize tax collection to ensure their convertibility. Instead, the center and provincial governments had to deal with the problem of copper notes on their own terms in their respective socio-economic circumstances.

In Beijing, the Board of Revenue did not have enough reserves of copper cash to back the issued copper notes. It thus had the five Official Money Bureaus, whose names all started with Yu, take these notes as capital and then used the notes issued by the five bureaus to pay the wages of banner soldiers. The central government did not have much tax revenue to collect in Beijing, and it could not receive the necessary raw copper or copper cash from other regions. Government copper notes could only be exchanged with notes issued by the Official Money Bureaus in collaboration with the Board of Revenue. Yet these Official Money Bureaus did not have reserves of cash to guarantee the

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[718] “南河宝钞较之官票易行者，缘掣字宝钞，商贾京外贸易可以持赴官号取钱。故颁发以来，每千售钱二三百文，工员承领犹能敷衍办理，市肆亦尚流通。前于数月间骤然壅滞，竟无收票之人，问系户部出世外省宝钞不准赴京师五宇字号取钱之故。[sic] 所有南河积存掣字宝钞及续发未掣字空钞，势必回归无用.” 江南河道总督庚长折, 咸丰七年十二月十二日; “黄河工需搭用宝钞 [sic] 自上冬五宇号停止取钱，捐铜局停止收捐，各钞蜂拥外行，以致每千仅易钱二百余文 ... 势将成为废纸.” 河东河道总督李钧折, 咸丰八年三月十二日. Both in *Grand Council Memorial Copies*, Box 679, No. 1512-6 and No. 1643-5.

[719] “查旧钞向无钞本 ... 增设五宇官号，准兵民持钞易票，此专为京饷起见，非令行钞省分批向五宇取钱也。[sic] 应请敕下东河总督及河南巡抚... 筹款开设官钱铺.” 户部议复李钧折, 咸丰八年三月二十八日, *Grand Council Memorial Copies*, Box 679, No. 1646-9.

convertibility of their issued notes.[720] Nor did they have the ability to turn the copper notes they received as capital for long-distance trade with merchants in other regions, particularly when Beijing remained isolated from the economic core areas in this period.[721]

The mismanagement and poor performance of the five Official Money Bureaus forced the Board of Revenue in January 1859 to mobilize 50 private money exchangers in Beijing to circulate government copper notes. Beijing's fiscal and economical isolation meant these private financiers did not have the necessary capital and business networks to circulate the copper notes that the Board of Revenue lent to them, and this policy was abandoned in 1860. The accumulation of copper notes in Beijing thus led to great discount rates, and in 1860 a copper note of 1,000 *wen* could not be exchanged even for 100 *wen* cash in the market. The Board of Revenue on 1 March, 1860 decided to stop the issue of new notes. Lack of confidence in the issued notes and the conflicts with the allied forces of Britain and France in Beijing caused a big financial panic in the capital as people rushed to the remaining nine Official Money Bureaus to exchange notes for copper cash. The government had little cash reserves to back up the notes in Beijing,

[720] "即如宝钞一项 ... 其民间持钞到局，并不取现钱而专取官号钱票." 惠亲王绵愉等折, *Zhongguo jindai huobishi ziliao (shangce)*, p. 412.

[721] When the Board of Punishment handled the liabilities of the two Official Money Bureaus, Yufeng and Yuqian, officials noticed that their debts were mainly caused by the inability of the businessmen and financiers to pay back their loans from the two Official Money Bureaus. "[宇谦、宇丰官号商人亏短民欠，各有一百零五万吊和八十万八千吊] 仿照向来办理钱铺章程，勒限两个月完缴。[sic] 惟究其所以亏短之由，实因与民铺川换兑换，被各户拖欠所致，似难置之不问，应请展限." 刑部折, 咸丰九年三月初三日, *Grand Council Memorial Copies*, Box 679, No. 1863-7.

which amounted to more than 10 million *diao*.[722] By September 1861, copper notes were not accepted in market transactions in Beijing.[723]

Lack of cash reserves also led to plummeting creditability of copper notes in some provinces. The Fujian provincial government had depended on silver and copper notes issued by the Yongfeng Official Money Bureaus to meet its spending needs. Yet in 1858, copper notes of 1,000 *wen* were worth only 50 *wen* of copper cash in the market. The Fujian provincial government in 1860 decided to use silver to exchange the various notes that it had previously issued, which amounted to 391,600,000 *chuan* and close the Official Money Bureaus.[724] In Shandong, the falling price of silver in 1857 pushed the provincial government to collect taxes in silver and not to accept copper notes.[725] The center was unable to transport the necessary amount of copper cash to the two Bureaus of River Works in Jiangsu and Shandong to back up the huge volume of copper notes that they received. When the neighboring provincial governments did not accept the copper notes assigned for river works in collecting taxes, they became worthless in the market.[726]

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722 "九官号历年代发兵饷，长开钞票一千余万吊，散布城市，并无票本。现在纷纷向官号取钱，情形佥见吃紧." 户部折, 咸丰十年九月十四日, *Grand Council Memorial Copies*, Box 679, No. 2949-50.

723 Peng Zeyi, *Shijiu shiji houbanqi de Zhongguo caizheng yu jingji* [The Economy and Public Finance in China in the Second Half of the Nineteenth Century], pp. 95-6.

724 闽浙总督王懿德，福州将军东纯，福建巡抚庆端折, 咸丰九年二月初二日, *Grand Council Memorial Copies*, Box 679, No., 1873-77.

725 山东巡抚崇恩折，咸丰七年三月十二日，*Grand Council Memorial Copies*, Box 679, No. 1055-7.

726 "现在东省司库征解钱粮停止搭收 [宝钞], 以致 [河工] 宝钞不能行使，已成废纸." 河东河道总督李钧, 咸丰八年二月十九日; "臣部所发全系省钞，江南藩关运库虽经奏奉谕旨，仍未能照章搭收，南河宝钞愈积愈多，有放无收，竟同废纸." 兼署漕运总督、江南河道总督庚长, 咸丰九年五月二十二日. Both in *Grand Council Memorial Copies*, Box 679, No. 1623-5 and No. 1953-5.

Not all Official Money Bureaus experienced such disasters. For example, up to 1862 the Tongyuan Official Money Bureau established by the Xuzhou military supply station in Jiangsu province managed to ensure the convertibility of its issued copper notes by the receipts from the *lijin* duties. These notes were used to pay the wages of soldiers stationed in Xuzhou and could circulate in the adjacent areas. Encouraged by this experience, the Director-General of Grain Transport (漕运总督) Wu Tang planned to raise more funds to establish the Tongyuan General Money Bureau in Huai'an with branches in Shaobo and Qingtao, so as to issue more copper notes to pay the soldiers stationed in these areas.[727] Likewise, the Shanxi governor Yingqi also reported that the copper notes issued by the Official Money Bureau in Xi'an were accepted by local people and asked the center to allow its continuance.[728] However, these cases of local success in circulating copper notes did not yield general lessons for the Board of Revenue to design or implement institutional arrangements to back up the value of copper notes.

Meanwhile, falling silver prices in many regions after 1857 made it possible for the Qing government to return to its previous dependence upon silver in its public finance.[729] For example, when the market exchange rates of silver vis-à-vis copper cash fell to 1,200 and

[727] "徐州粮台设有通源官钱局…仿照市肆行使钱票，近数年来如宿州、徐属一带俱能通行。上年徐饷久缺，籍此隅资周转，迄今尚有三万余吊钱未经到局取钱，此流通之明证也。臣现在筹划票本，于淮城开设通源总局，并于邵伯、清桃等处添设分局，一律付钱，以示简便… 以接济清淮兵勇口粮." 吴棠片, 同治元年三月十四日, *Grand Council Memorial Copies*, Box 679, No. 3199.

[728] "官铺钱票行用已久，兵民相信，流通在外者约有三十余万串." 陕西巡抚英启折, 同治元年三月十九日, *Grand Council Memorial Copies*, Box 679, No. 3224-5.

[729] Peng Xinwei, *Zhongguo huobishi* [A History of Currency in China], p. 832; Wang Hongbin, "Lun guangxu shiqi yinjia xialuo yu bizhi gaige [On the falling value of silver and monetary reform during the reign of Guangxu]," *Shixue yuekan*, No. 5 (1988): 47-53.

1,700 *wen* in 1857 in Shandong, the provincial government of Shandong decided to use only silver in both tax collection and government expenditures.[730] Likewise, the people in Zhili preferred to use silver to pay taxes when silver prices were lower than the official level.[731] In 1862, the Board of Revenue ordered provincial governments to substitute paper notes with silver in their tax revenue to Beijing and redeem the issued notes. The use of paper notes in public finance was completely abandoned by 1867.

Nonetheless, the economic circumstances which had obstructed institutional developments needed to safeguard the value of official paper notes began to change. The Qing armies dispelled the Taiping forces from the Hankou area in 1856. The Tianjin Treaty signed in 1858 opened the areas of middle and lower Yangzi River to foreign trade. Hankou, Jiujiang, Nanjing, and Zhenjiang became new treaty ports in 1862. Provincial governments of Jiangsu, Fujian, and Guangdong also raised short-term loans from foreign banks in China.[732] The Imperial Maritime Customs, which was first established in Shanghai in 1854, quickly expanded to all treaty ports. Under efficient management by foreign officials in the employ of the Qing government, it became a reliable source of revenue for the center, even though the level of tariff duty was fixed at 5 percent.

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[730] "今年银价大减，每两仅值制钱一千三四百文，至多不过一千五六百文。而官票每两合制钱二千文。请自八年上忙为始，凡征收新旧钱粮临清关税及地丁项下统征各解之河银漕食，概用实银解兑，其官员兵丁养廉俸饷亦以实银支发."（硃批：另有旨）山东巡抚崇恩折，咸丰七年十二月初七日，*Grand Council Memorial Copies*, Box 679, No. 1498-500.

[731] "现时天津、大名、正定各府，银价悉在 [官价] 四串以下，民愿完银而不愿完钱，殊难相强." 御前大臣、军机大臣会同谭廷襄折，咸丰七年五月初十日，*Grand Council Memorial Copies*, Box 679, No. 1161-70.

[732] The total amount of the 12 loans between 1861 and 1865 came to 1.88 million *tael* silver, and the annual interest rates ranged from 8 percent to 15 percent.

At the same time, a new form of collaboration between private financiers and the government began to emerge when the Qing army fought its major battle against the Taiping rebels in the Lower Yangzi River in the period between 1860 and 1864. In 1860, the Zhejiang governor Wang Youling not only entrusted supplies of grain and ammunition to the private banker Hu Guangyong but also deposited official funds in Hu's bank. Hu continued these services to the succeeding Zhejiang governor Zuo Zongtang. Like his counterparts in England and Japan, Hu fully utilized his connections with government to establish himself in the financial markets, and his Fukang Bank became one of the biggest native banks in China in the 1870s.[733]

With the gradual recovery of the remittance networks in the late 1850s, there occurred some cases of remitting part of assigned revenues to Beijing through private financiers and particularly Shanxi bankers. The earliest remittance was in 1859 when the Customs of Fuzhou (*minhaiguan*) requested a private merchant to remit two items, each worth 50,000 *tael* of silver, to Beijing within a year.[734] In 1862 and 1863, the Customs of Guangdong, Fujian, and Shanghai (粤海关，闽海关，江海关), and the provincial governments of Guangdong, Sichuan, Zhejiang, Hubei, Hunan, and Jiangxi began to appeal to Shanxi bankers to remit funds to Beijing while it still remained slow and risky

[733] For the rise of Hu Guangyong and his connections with the Zhejiang government, see C. John Stanley, *Late Ch'ing Finance: Hu Kuang-yung as an Innovator* (Cambridge, MA.: The East Asian Research Center of Harvard University, 1961), pp. 9-12.

[734] "查上年二次解京银两，曾因江南匪气不靖，系交付赴京便商汇兑，颇为妥速…此次惟有查照上年，设法汇兑。现已将此项京饷银五万两，招得赴京殷实商人发交承领，饬令汇兑." 闽浙总督庆端，福建巡抚瑞瑸折, 咸丰十年二月十六日, *Grand Council Memorial Copies*, Box 679, No. 2734-7.

to transport silver bullion to Beijing. Although the amount of each remittance did not exceed 50,000 *tael*, the routes of remittance showed that Shanxi bankers had re-established their financial networks. These connected Beijing with not only coastal cities such as Shanghai, Guangzhou, Fuzhou, and Ningbo, but also interior cities such as Chengdu, Hankou, Nanchang, and Changsha.[735] This marked the beginning of the Shanxi bankers' extensive involvement in the remittance of tax revenue to Beijing. Moreover, it seems that provincial governments had collaborated with Shanxi bankers in remitting official funds before.[736]

IV. Conclusion

The failure of the Qing government to use financial means to overcome its fiscal crisis in the 1850s illustrates the importance of socio-economic circumstances to the building of new institutions to connect state tax revenue and the state's involvement in the financial market. In the initial stage of this interactive process, the probability of making mistakes was high because the state had not yet established the necessary institutional arrangements to back up the creditworthiness of its new credit instruments. In this light, the lack of trust in the paper notes that the Qing government issued and their devaluation in the market were unavoidable. We also observe similar phenomenon in England and Japan in the early stages of issuing short-term credit bills or paper notes.

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735 *Shanxi piaohao shiliao* (zengdingban) [Historical Materials of Shanxi Banks] (Taiyuan: Shanxi jingji chubanshe, 2002), pp. 75-80.

736 When the governor of Jiangxi Shen Baozhen 沈葆祯 was concerned about the reliability of entrusting *50,000* tael to Xintaihou Bank to remit to Beijing, his subordinates told him that this bank had a good reputation in Jiangxi in remitting both official and commercial funds. [臣督同司道访诸舆论，佥谓该号在江开设多年，为官商往来汇兑从无贻误]. 江西巡抚沈葆祯折，同治二年二月二十五日, cited from *Shanxi piaohao shiliao* (zengdingban), p. 80.

Nonetheless, we observe a mutually reinforcing process in the transformation toward a modern fiscal state in both England and Japan. In other words, the excessive dependence of the state on fictitious instruments forced the state to centralize the collection and management of its tax revenue, and fiscal centralization then raised the state's available income to safeguard the creditworthiness of its credit instruments in the markets. The ensuing trust in the state's credit instruments in the markets motivated the state to strengthen this centralization and further enhance its creditworthiness in the financial markets. The socio-economic circumstances in China in the 1850s were mainly responsible for the failure of a similar, mutually-reinforcing process to emerge.

In contrast to London, which was the center of England's domestic and foreign trade and yielded some 70-80 percent of customs revenues in England, Beijing in the 1850s remained isolated from the economically developed regions in China. As Beijing was cut off from tax revenue and long-distance trade, the central government could hardly mobilize big merchants or financiers to promote its financial experiment. Meanwhile, the major wars that the English state fought in its transformation to a modern fiscal state were either at sea or in Continental Europe. In this situation, it was natural for the central government to centralize its tax revenues in London to supply its troops and navy. In comparison, the civil wars in China further fragmented an already decentralized fiscal system, even though the total recorded amount of money that the Qing government spent to repress domestic rebellion in the period between 1850 and 1868 was as high as 300 million *tael* of silver.[737]

The Qing government's experiment with paper notes in the 1850s also differed from that of Meiji Japan, even though inconvertibility was a concern in both cases at the beginning. The Meiji government at the time did not have to confront a competing regime, and it was thus better able to impose its paper notes as the only legal currency in domestic transactions and public finance. In so doing, it removed the possibility for officials who collected taxes to buy discounted paper notes and use them at their face value in transferring the collected taxes to the government. Meanwhile, the Meiji government's attempt to circulate paper notes was sustained by the expanded domestic economy and exports, particularly the financial networks established by private financiers. Financiers who cooperated with the state could utilize the regular tax revenues to enhance their credibility in the financial markets. The government for its part benefited from the speedy transfer of its collected revenue and the financiers' conversion of taxes paid in rice into money in economically backward regions.

In contrast, the civil wars in China during the 1850s not only prevented the collected revenue from being transported to the center but also destroyed existing nation-wide financial networks. As a result, it was difficult for the Qing government to find powerful financiers with interregional networks to circulate its silver notes. The provincial institutions to issue silver notes could not appeal to interregional long distance networks

[737] This included the spending to repress the Taiping and Nian rebellions, and other rebellions in Southwest and Guangdong and Fujian. Calculated from Peng Zeyi, *Shijiu shiji houbanqi de Zhongguo caizheng yu jingji* [The Economy and Public Finance in China in the Second Half of the Nineteenth Century], p. 136.

to link their financial businesses together. In the absence of financial intermediaries to float silver notes, the Qing government was forced to deal directly with peasants and small retailers by relying upon the copper notes. The nature of copper cash, which was suitable for local transactions only, further reduced the possibility of mobilizing big merchants to circulate copper notes issued by the state.

Once these constraints in the socio-economic circumstances were reduced by the recovery of normal business conditions and central control of public finance in the post-war period, why did Qing China not develop into a modern fiscal state? The Chinese case illustrates that a vibrant domestic economy with extensive financial networks and the potential to collect elastic indirect revenues a necessary, but not sufficient, condition to support the interactive process of building the institutions of a modern fiscal state. In the next chapter, I will elaborate this point by studying the interactions between the state and economy in China in the period between 1870s and 1890s.

Chapter 7 Persistence of the Traditional Fiscal State and the Potential for Fiscal Centralization in China: 1864-1911

I. Introduction

The socio-economic conditions in China in the period from 1864 to 1894 were quite different from that of the 1850s. Domestic trade was recovered following the end of civil wars in economically core areas by 1864. More importantly, the high value of silver, which had greatly troubled both economy and public finance, began to fall after 1858. As major western powers went on the gold standard in the mid-1870s, the price of silver fell in the international market. A massive influx of silver into East Asia began. The low value of silver further stimulated Chinese exports to the west. In this situation, the problem caused by the nature of the Chinese monetary system, which used silver by weight rather than token silver currency as the standard currency, were not as severe as in the deflationary period from the 1820s to the mid-1850s. With the expansion of both domestic and foreign trade, Shanxi bankers and their newly emerged big bankers in Zhejiang and Shanghai quickly re-established nation-wide financial networks to transfer money across regions.

New patterns also emerged in the interactions between the state and private financiers. Provincial governments increasingly cooperated with well-established private financiers to remit both tax revenues to Beijing and to transfer funds among themselves. To meet the urgent military expenditures, such as for the suppression of the Muslim rebellions in the northwest of China and the re-conquest of Xinjiang between 1866 and 1884, the Qing government borrowed huge amounts of money from foreign banks operating in China. It also became willing to pay interest rates to borrow from Chinese merchants, which represented a big change in the government's attitude toward domestic borrowing. As contact with Europe and America increased, government officials acquired more information about the handling of financial issues such as state bonds and central banking.

In regard to the composition of government income, significant alterations also occurred after the 1860s. The receipts from the indirect customs and *lijin* duties exceeded the revenue collected from land taxes. Under the supervision of western officials, the Imperial Maritime Customs quickly became the most efficient bureaucracy in the Qing government. Receipts from the customs steadily rose even though the tariff level was fixed at 5 percent by western powers. Management of the collection of the customs in treaty ports was highly centralized.[738] The central government was impressed, and Qing officials often consulted Robert Hart, the inspector-general of the Imperial Maritime Customs, over important financial issues.

Nonetheless, the Qing government did not extend such centralized approaches of to the collection of domestic taxes, particularly the *lijin* duties which were levied upon transactions of domestic consumer goods. Nor did centralization of the customs alter the decentralization of broader fiscal operations. Even in the case of customs revenue, the Board of Revenue only received 40 percent into its own coffers, while it assigned the rest to be transferred directly from places of collection to the areas where it would be spent.

[738] Stanley F. Wright, *Hart and the Chinese Customs* (Belfast: M. Mullan, 1950), chapters X and XI.

For *lijin* duties, both collection and allocation remained decentralized. This remained true even as annual government income rose from 40 million *tael* silver in the 1840s to 80 million in the 1880s. Why were the decentralized institutions of public finance so sticky in China even under new socio-economic circumstances? Particularly since the Qing government in the 1870s decided to modernize its army and navy, construct railways, and build arsenals and shipyards, why did not it try to centralize its tax revenue to mobilize more financial resources for these major projects?

In this chapter, I argue that the persistence of a traditional fiscal state in China did not a result from political conservatism on the part of Qing government.[739] Instead, it should be viewed as the outcome of interactions between the existing fiscal institutions and socio-economic circumstances of the late nineteenth century. This process significantly affected state actors' efforts to perceive and search for alternative institutions in public finance. In particular, the failure in the 1850s to develop the necessary financial institutions to float paper notes forced the central government to return to the use of silver and copper cash in the postwar reconstruction of public finance. As the center did not possess the financial means to speedily allocate expenditures to meet spending needs across China, the decentralized assignment fiscal system which allocated tax revenue from provinces of collection directly to destinations of spending was superior.

[739] See the discussion of political conservatism during the Tongzhi Restoration between 1862 and 1874 as leading to following decline of the Qing dynasty in the classic study by Mary C. Wright, *The Last Strand of Chinese Conservatism: The T'ung-Chih Restoration, 1862-1874* (Stanford: Stanford University Press, 1957).

The reliance of the center upon administrative methods to coordinate inter-provincial transfer of revenue and expenditures via decentralized fiscal institutions was self-reinforcing. Without the institutional ability to move fund rapidly, the central government had to give considerable autonomy to provincial governments so that they could better respond to local circumstances and emergencies in governing the large territory of China. It could hardly obtain accurate information about tax collection and necessary spending needs at the local level, a fact which further increased the bargaining power of provincial governments vis-à-vis the center in fiscal issues. Meanwhile, the Board of Revenue could still rely upon the decentralized fiscal institutions to meet urgent speeding needs. Under such circumstances, state actors did not actively search for alternative institutions in public finance.

Centralization in public finance required the center to use speedy credit instruments such as paper notes or bills of exchange to transfer revenue and expenditure between the center and provinces. However, advocates of adopting these means in public finance at the time had to confront the suspicion and even hostility of government officials who still had fresh memories of the paper notes fiasco of the 1850s. Without an equally severe fiscal crisis, the Qing government had no motivation to risk a repeat, even with their growing knowledge of western models of public finance. Yet without the use of credit instruments, the center simply could not centralize its public finance. Officials who were unfamiliar with financial issues such as paper notes or state bank could still hold important posts in the Board of Revenue. Instead of overhauling the fiscal institutions, officials of public finance were more concerned with the scarcity of copper cash which greatly affected the domestic economy beginning in the 1880s.

The persistence of a traditional fiscal state thus illustrates the outcome of socio-economic circumstances being ready to support institutional development toward a modern fiscal state yet no factor such as a credit crisis existing to push state actors move toward that direction. This implies a counterfactual argument, i.e., had a credit crisis occurred, a process of institutional learning toward centralized institutions in public finance would have happened and China would have become a modern fiscal state. In order to show that this is reasonable, I use the indemnities to Japan in 1895 as a proxy to the credit crisis and examine whether we subsequently see discernible features of institutional learning similar to those fund in the initial stage of the transformation to a modern fiscal state in England and Japan.

In section II, I describe how the political authority of the center allowed it to continue its reliance upon the decentralized assignment system to meet new challenges between 1864 and 1894. Then I examine the obstacles to fiscal centralization and the debates among government officials over proposals to issue state bonds and establish a state bank. In section III, I discuss the institutional arrangements for collecting the indirect *lijin* duties and examine the potential of and limits to fiscal centralization in China. Finally, I discuss the implications of the institutional development after 1895 for the formation of a modern fiscal state in China. Section IV speculates a possible outcome of a modern fiscal state.

II. Central power, fiscal decentralization, and persistence of a traditional fiscal state

After the suppression of the Taiping rebellion in 1864, the central government began to reduce the autonomy of provincial governors in fiscal and military matters which the center had been forced to grant during the time of war.[740] For example, between 1853 and 1864, provincial governments could borrow from foreign merchants before receiving approval from the center. After 1864, they had to receive formal approval from the center prior to foreign borrowing.[741] The assertion of central authority over foreign borrowing was further strengthened by the centralized management of the Imperial Maritime Customs. Without the agreement of the inspector-general of the Imperial Maritime Customs, no provincial government could assign the collected customs revenue as security for a foreign loan.[742] Central control also freed foreign banks from the risk of default by provincial governments. As normal information flows were restored in peace time, no provincial government could hide the fact of large foreign loans from the center.

The Board of Revenue began to regain its lost control over fiscal operations. This was particularly the case in the collection of *lijin* duties as provincial governors had been

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[740] The historian Liu Kwang-ching has pointed out that the central government after 1864 exerted unambiguous political control over the nomination and tenure of provincial governors and firmly controlled the allocation of military expenditures. See Liu Kwang-ching, "Wanqing dufu quanli wenti shangque [A reexamination of the power of provincial governors during the late Qing]," in Liu Kwang-ching, *Jingshi sixiang yu xinxing qiye* [The Statecraft Approach and the New Enterprises] (Taipei: Lianjing chuban shiye gongsi, 1990), pp. 243-97. Hosomi Kazuhiro also noted out the Board of Revenue after 1885 could assert the central authority by controlling the allocation of naval expenditures. Hosomi Kazuhiro, "Ri Kōshō to kobu [Li Hongzhang and the Board of Revenue]," *Tōyōshi kenkyū*, Vol. LVI, No. 4 (March 1998): 811-38.

[741] On the assertion of central authority in foreign loans and the coordination of inter-provincial revenue for interest payments after 1864 in Ma Linghe, *Wanqing waizaishi yanjiu* [A Study of the History of Foreign Loans in the Late Qing] (Shanghai: Fudan daxue chubanshe, 2005), p. 43 and p. 53.

[742] "[赫德]称此后如有借银之举，若无总税务司准扎，各口税务司均不得印押等语." Cited from the memorial of Prince Gong, 同治六年十二月二十八日, *Grand Council Memorial Copies*, Box 679, No. 3489-92; Zhongguo renmin yinhang canshishi, ed., *Zhongguo qingdai waizhaishi ziliao: 1853-1911* [Historical Materials of Foreign Debts in the Qing Dynasty] (Beijing: Zhongguo jinrong chubanshe, 1991), p. 34.

granted full autonomy over collection and spending. Nonetheless, the Board of Revenue in 1861 began to strengthen its supervision of *lijin* duties. It required provincial governors to regularly report the amounts of collected *lijin*, the number and location of each *lijin* collecting station, and the names of personnel. In 1872, the Board further standardized the form of *lijin* accounts reported to the center. By 1874, most provincial governments sent the required accounts to the Board of Revenue, twice a year from provinces in the economic core areas and once a year from more remote provinces. Based upon these reported accounts, the Board of Revenue decided how to allocate the receipts from *lijin* duties for various purposes across regions. In this sense, the amount of *lijin* which provincial governors reported to the center was subjected to the reallocation of the Board of Revenue and thus should not be considered local or provincial taxes.[743]

Nonetheless, the restoration of central supervision over the fiscal system in the post-war period had to come to terms with the increasing expenditures in provinces which the Board of Revenue could not satisfy in its allocation of funds. The center thus had to give a certain degree of fiscal autonomy to provincial governments, as they bore the brunt of responsibilities in reconstruction of local infrastructure, maintenance of local order and defense, provision of social welfare, and so on. With the emergence of this provincial fiscal operation independent from central supervision (*waixiao*), a new fiscal division of labor appeared between the center and provinces.[744] However, this did not represent the

[743] See Susan Mann, *Local Merchants and the Chinese Bureaucracy*, pp. 103-4.
[744] See Zhou Yumin, *Wanqing caizheng yu shehui bianqian* [Public Finance and Social Change in the Late Qing], p. 242.

rise of regionalism or the collapse of central authority in public finance.[745] Although provincial governments constantly bargained with the center over the distribution of tax revenue, they shared the same fundamental concern for the state interest. As the state interest included both national defense and maintenance of domestic order and welfare, provincial governors could openly reject the center's attempt to extract more revenue by emphasizing their responsibilities in local governance.

For example, when the conflict with France forced the Qing government to increase spending on seaborne defense in 1884, the Board of Revenue ordered the provincial government of Shaanxi to hand over to the center the 10-20 percent of the collected *lijin* duties which had previously been retained locally. In response, Bian Baoquan, the provincial governor of Shaanxi, pointed out that it was a normal practice for provincial governments to retain such a proportion for local expenditures. Bian argued that this was by no means embezzlement as the retained *lijin* revenue was used for public purposes within provinces. Bian thence refused to obey the order of the Board of Revenue. In his view, the Board of Revenue simply did not have the means to allocate sufficient funds punctually to meet all sorts of local, extraordinary expenditures. Moreover, Bian argued that domestic governance was as important as national defense in terms of the state interest and therefore the center should not use defense as an excuse to extract revenue

[745] The collapse of the centralized fiscal system in the late Qing is a claim made by many Chinese historians. In fact, this refers to the collapse of the fiscal system that had formed by the mid-nineteenth century, but does not necessarily entail a lack of central authority in fiscal matters in the post-Taiping period. For examples of this claim, see Wei Guangqi, "Qingdai houqi zhongyang jiquan caizheng tizhi de wajie [The collapse of the centralized fiscal system in the late Qing]," *Jindaishi yanjiu*, Vol. 31, No. 1 (1986):207-30; Chen Feng, "Qingdai zhongyang caizheng yu difang caizheng de tiaozheng [The adjustment of the relationship between the center and local governments in public finance]," *Lishi yanjiu*, No. 5 (1997), pp. 111-4; He Lie, *Lijin zhidu xintan* [A New Exploration of the Institution of Lijin] (Taipei: Shangwu yinshuguan, 1972), pp. 157-160.

and sacrifice the necessary expenditures for provincial governance.[746] The center could hardly refute such an eloquently justified argument; the Board of Revenue had to concede and only required Bian to send in item-by-item accounts of this particular expenditure. Bian rejected this request by pointing out that it made no sense for the Board of Revenue to check the specific accounts of provincial expenditures.[747] Other provinces also considered it impractical for the Board of Revenue to supervise expenditures for provincial purposes.[748]

As this new fiscal division of labor emerged, no provincial governor attempted to challenge the central authority in public finance. What was at issue was how the central government managed the revenue that provincial governors had agreed to pass to the center. Even with the same amount of revenue, a centralized institution could improve the efficiency of fiscal management and enhance the fiscal capacity of the center. Because the Qing government had large territories under its administration, a necessary condition for centralization of public finance was the means to disburse expenditures

[746] "查酌提厘税留外办公，各省皆然，不独陕省。[sic] 此等留外之款，抚藩两署均有案牍可稽；遇有提用，藩司随时秉商，按款呈报，层层钤束，上下周知其为不能侵欺朦混，固不待辩而明者也。陕省度支匮乏… 遇有要需，全赖此等留外款项挪垫通融，得以无误。至于地方应办诸务，事机各有缓急，情势各有重轻，要在因地因时，熟筹妥办，既非部臣所能遥度，亦非部臣所能代谋。如事无巨细，概行咨部请示；款无多寡，一律报部覈消。绳之以文法，稽之以岁时，贻误地方，谁执其咎。故外销款项，实各省所必不能无，但当论其为公为私，不当论其报部不报部。[若因海防吃紧，库储罗掘一空]疆吏则束手坐困，设遇缓急，何以应之." 陕西巡抚边宝泉折, 光绪十年十二月二十六日, *Palace Memorials*, Box 32, No. 695-9.

[747] "[此等款目] 数目琐碎，头绪繁杂，往返咨查，徒费公牍，似于实政无裨." (军机大臣奉硃批：户部知道) 陕西巡抚边宝泉折, 光绪十一年七月初三日, *Palace Memorials*, Box 32, No. 722-4.

[748] For the example of Jiangsu, see Iwai Shigeki, *Chūgoku kinsei zaiseishi no kenkyū* [A Study of the Fiscal History of Early Modern China] (Kyoto: Kyoto Daigaku Shuppankai, 2004), p. 136.

speedily. However, the Board of Revenue at the time of post-war reconstruction did not have such necessary financial means.

The failure of the financial experiments in the 1850s discredited government paper notes. Although two officials in 1860 proposed using paper notes to cover the deficit of the central government, the Board of Revenue instead decided to return to the use of silver and copper cash.[749] As peace returned to the economic core, the Board of Revenue was able to order provincial governments to send revenue in silver to the center; annual submissions rose from 8 million *tael* in the 1860s to 13 million in the 1880s. Meanwhile, in order to mitigate the severe scarcity of copper cash in the capital, the Board of Revenue in 1867 ordered provincial governments in Hubei, Hunan, Jiangsu, Jiangxi, Zhejiang, and Guangdong to transport copper cash to Beijing. Despite the inherent difficulty in transporting bulky copper cash, these provincial governments still managed to send in a total of 1.37 million *chuan* of copper cash by 1869 (1 *chuan* = 1,000 *wen*).[750] In 1887, the censor Xie Zuyuan proposed re-establishing the Official Money Bureaus to issue copper notes to relieve the tight credit in Beijing at the time. The Board of Revenue cited the fiasco of recruiting private financiers to circulate copper notes in the 1850s in rejecting this proposal.[751]

[749] The two proposals were made by the censors Meng Chuanjin and Zhou Hengqi in 同治元年十一月. See *Zhongguo jindai huobishi ziliao (xiace)*, pp. 627-32.
[750] Calculated from the numbers in *Zhongguo jindai huobishi ziliao (xiace)*, p. 515. The number for Hunan is cited from the memorial of the Hunan governor Liu Kun, 同治七年四月二十日, *Grand Council Memorial Copies*, Box 679, No. 3510.
[751] The memorial of Xie and the reply from the Board of Revenue are in *Grand Council Memorial Copies*, Box 680, No. 565-7 and No. 572-4 respectively.

In contrast to the center's non-involvement in the financial markets, provincial governments from the 1862 onward increasingly collaborated with private bankers to store and remit government funds. With the recovery of domestic long-distance trade and the expansion of China's exports, the number of cities that were connected by the nation-wide financial networks under Shanxi bankers rose from 27 in the 1840s to 54 in the 1880s. The new, large-scale banks in Zhejiang and Shanghai such as the Fukang bank and the Yuanfengrun bank also established their own webs of inter-regional remittance.[752] In addition to receiving deposits and providing credit to merchants, the major banks began to get involved in public finance. Imperial Maritime Customs offices in cities such as Shanghai, Ningbo, Hankou, and Fuzhou and *lijin* collection stations often designated particular private banks to deposit the collected revenue and remit it to destinations of spending upon government orders.[753] Meanwhile, these private financial networks began to remit revenues from provincial governments to Beijing and handle the funds that the center assigned for transfer between provincial governments. The amount of remitted revenue from provincial governments to Beijing rose from 19 million *tael* in the period from 1862 to 1874 to 63 million in the period from 1875 and 1893.[754]

This linkage between official funds and private financial networks had great potential. As the tax revenue from the provinces to Beijing and government expenditures allocated from Beijing to provinces represented two opposite directions in the flow of silver, the center's use of remittance to allocate expenditures to provinces could greatly reduce the

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[752] Huang Jianhui, *Shanxi piaohaoshi* [A History of Shanxi Bankers], revised version, p. 203 and p. 208.
[753] Song Hui-zhong, "Piaoshang yu wanqing caizheng [Shanxi Bankers and Public Finance in the Late Qing]," in *Caizheng yu Jindaishi Lunwenji* (shangce) [Collected Papers on Public Finance and the Early Modern History] (Taipei: Academic Sinica, 1999), pp. 424-5.
[754] Huang Jianhui, *Shanxi piaohaoshi* [A History of Shanxi Bankers], revised version, p. 240.

need to transport silver across regions. The collaboration between the government and private bankers was mutually beneficial. The speed of government funds transfer was much faster and more predictable than the transportation of silver bullion. Private banks which remitted government funds could profit from the time interval (ranging from one month to three months) during which they held these monies interest-free before turning them over to the government. The possession of regular government funds also increased their creditworthiness in the financial markets. Meanwhile, the government could, if it chose, extend these domestic financial networks by entrusting private banks with the remittance of government revenue in provinces such as Anhui, Shanxi, and Shandong, which still used the transportation of silver to send revenue to Beijing before 1894. More importantly, such collaboration provided an opportunity for the center to mobilize the nation-wide financial networks to circulate government paper notes in the economy, an option not available in the 1850s. However, these potential benefits were far from self-evident to the Board of Revenue.

As the central government at the time used silver and copper cash to disburse annual expenditures of more than 3 million *tael* in Beijing and the surrounding area, it thus needed to receive revenue from provinces in silver instead of in bills of exchange issued by private bankers. It did not occur to officials of the Board of Revenue that they could collaborate with the same group of private bankers who had already remitted large amounts of tax revenue from the provinces to Beijing to disburse the expenditures that the central government allocated to provinces. In fact, the Board of Revenue had never used the method of remittance to allocate its expenditures to provinces. In consequence, the banks that remitted revenue from the provinces had to convert the received bills of exchange into silver in Beijing and then hand the bullion over to the Board of Revenue. The full benefit of remitting government funds between Beijing and the provincial governments was thus not realized. As a result, when silver prices were high in Beijing, the Board of Revenue often forbade private remittance and insisted that provincial governments send revenue in silver, even though they were aware of the convenience and speed of remittance.[755]

Meanwhile, the remittance of government revenue was subjected to the conditions of the financial markets. For example, when the financial markets were quite tight in Beijing during the Sino-Japanese war in 1895, the time needed to remitted silver from Jiangxi to Beijing rose from the usual 40 days to 60 days and the remittance charges almost doubled. Although the Board of Revenue urged the provincial government of Jiangxi to remit some 230,000 *tael* to Beijing, De Xin, the Jiangxi governor, reported to the Board of Revenue that it was even faster to transport silver to Beijing directly.[756] Instead of being able to use financial policy to mitigate tight credit in the financial markets, the Qing government's fiscal operation itself was constrained by their fluctuations, particularly when private bankers had to hand over silver to the Board of Revenue.[757] The method of partial remittance from provinces to Beijing co-existed with transportation

[755] Huang Jianhui, *Shanxi piaohaoshi* [A History of Shanxi Bankers], revised version, pp. 266-72.

[756] "[接户部电令，速汇二十三万五千余两解部] 与各号商商办，兹据覆称，因京师银根太紧，必须六十天始能汇交，而汇费又较前倍增，似不如遴员管解较为直捷迅速." 江西巡抚德馨片, 光绪二十一年五月二十日, *Grand Council Memorial Copies*, Box 680, No. 1156.

[757] This may explain the extremely small amount of remitted revenue to Beijing in 1878 and 1884, when there were two major financial panics in China. For the variation in the amount of remittance to Beijing see Song Hui-zhong, "Piaoshang yu wanqing caizheng [Shanxi Bankers and Public Finance in the Late Qing]," p. 199.

of silver and did bring about fundamental institutional changes in the operation of public finance.

The use of silver instead of credit instruments significantly affected the attitude of the Board of Revenue toward the financial markets and the risk of depositing government fund in private banks. For example, the Fukang bank established in the 1860s had become the biggest native bank in China by the 1880s. When it went bankrupt in December of 1883 due to its excessive investment in the export of raw silk, it owed more than 1.59 million *tael* to both the provincial and central governments.[758] Instead of using regulations to better supervise the private banks that held large amounts of tax revenue and official funds, the Board of Revenue simply prohibited the private remittance of government monies. This policy was futile as the remittance of revenue to Beijing was resumed when the financial panic ended in 1885. Nonetheless, this attempt showed the disposition of the Board of Revenue to separate tax revenue and private financial markets, even at the cost of sacrificing the speed of transfer.

The unwillingness of the Board of Revenue to become involved in the financial markets is also apparent in its rejection of a proposal to establish a joint-stock state bank in China. This idea was put forward in the summer of 1885 by William Keswick and 密克, two British businessmen of the Jardine, Matheson & Co, one of the largest foreign merchant houses in China. It was modeled on the Bank of England and was to deposit the collected

[758] The number is cited from the memorial of Zhejiang governor Liu Bingzhang, 光绪十二年二月十五日, *Grand Council Memorial Copies*, Box 680, No. 443-5.

customs revenue, issue banknotes that could be used to pay taxes, and manage the reception of revenue and disbursement of expenditure on behalf of the Board of Revenue. The initial capital of 10 million *tael* would be raised through stock subscription in China.[759] Li Hongzhang, the governor-general of Zhili and one of the most important officials of the time, supported this plan. The Empress Dowager Cixi was in favor of it too.[760] Yet the Board of Revenue fiercely objected. The foreign presence in this plan also instigated strong opposition among officials in Beijing, who even called for the impeachment of Li Hongzhang.[761]

Nonetheless, the Board of Revenue could still have accepted the scheme of a state bank, which could greatly enhance the spending capacity, while disallowing the participation of foreign capital. Such an approach would have helped the Board of Revenue meet rising military expenditures. The Qing government spent a total of some 80 million *tael* for its military campaigns to re-annex Xinjiang in the period from 1875 to 1884. The Sino-French War between December 1883 and June 1885 cost it about 30 million *tael*.[762]

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[759] "该洋商原禀内称，国家库存现银交存行内，毋庸收发现款，凡进出各项，皆由银行经办，以银纸成交。又交纳部库、协济邻省银款，一纸汇拨。又章程内开银行益处，各省关收发官项亦可代理。又交帑纳税皆可以银票上兑."户部折附件, 光绪十一年九月十七日, *Grand Council Memorial Copies*, Box 680, No. 409-410.

[760] Aware of the opposition of the Board of Revenue to Li's proposal, the Empress Dowager Cixi asked officials of the Board of Revenue to "carefully deliberate this proposal as Li Hongzhang held that such an official bank could offer great benefits ([懿旨] 李鸿章言官银号大有利益，汝等详细思之等因，钦此)." Cited from the memorial of the Board of Revenue, 光绪十一年九月十七日, *Grand Council Memorial Copies*, Box 680, No. 389-94.

[761] See Li Hu, *Zhongguo jingjishi conggao* [Collected Essays in the Economic History of China] (Changsha: Hunan renmin chubanshe, 1986), pp. 242-44; Wang Jingyu, "Luelun Zhongguo tongshang yinhang chengli de lishi tiaojian jiqi zai duiwai guanxi fangmian de tezheng [On the historical conditions of the establishment of the Imperial Bank of China and its characteristics in foreign relations]," *Zhongguo jingjishi yanjiu*, No. 3 (1988), pp. 95-7.

[762] The numbers are from Zhou Yumin, *Wanqing caizheng yu shehui bianqian* [Public Finance and Social Change in the Late Qing], p. 267 and p. 271.

Given these circumstances, why did the Board of Revenue not try to mobilize capital from Chinese merchants or financiers to create a state bank? It is therefore important to examine the specific reasons other than hostility to westerners that the officials of the Board of Revenue used to reject the proposal of a state bank.[763]

In their review of the proposed state bank, officials in the Board of Revenue conflated the concept of a state bank with private banks and often cited the bankruptcy of two major private banks, the Fukang in 1883 and the Oriental in Shanghai in 1884, to illustrate the dangers of depositing state funds in banks. Meanwhile, they revealed a deep suspicion of the credit instrument of banknotes and their role in public finance. They did not realize that the substitution of silver bullion by banknotes could greatly change the operation of public finance and lay the basis on which to build centralized institutions. Nor did they consider the possibility that such a state bank in Beijing could complement the private remittance infrastructure upon which several provincial governments relied to send revenue to Beijing. Instead, they were worried about the danger of using banknotes in public finance, and they often referred to cases of devaluation of paper notes in the US and Russia and their failure in 1850s China.[764] In their view, it would be a huge disaster for the state if these banknotes lost creditworthiness in emergent situations.[765] Even Prince Chun, who agreed to set up a state bank to raise loans for the state, refused to give

[763] The major officials in the Board of Revenue in 1885 were 大学士管理户部事务额勒和布，户部尚书阎敬铭，户部尚书崇绮.

[764] 户部折附件, 光绪十一年九月十七日, *Grand Council Memorial Copies*, Box 680, No. 414 and No. 420.

[765] "况实银皆入银行，银纸遍布民间，凡公家一切征收款项，举无实银。设有缓急，银纸无人行用，其害终归于国." The memorial of the Board of Revenue, 光绪十一年九月十七日, *Grand Council Memorial Copies*, Box 680, No. 389-94.

it the privilege of managing public finance. He particularly insisted that the bank should hand over silver to the Board of Revenue if it was to conduct remittance of revenue to Beijing in future.[766]

This rejection was to a large extent the result of a lack of financial knowledge among the officials of the Board of Revenue. However, there were also powerful officials such as Li Hongzhang who understood the importance of having a state bank to both the economy and the state. In his report to the Board of Revenue in regard to the proposal of the two British merchants, Li Hongzhang pointed out that the depression which followed the financial panic in 1883-4 was not in the interest of the government. Li urged imitation of the western experience, where establishment of state banks stimulated the circulation of currency in the markets. Li wanted the proposed state bank to be a fractional note-issuing bank with a cash reserve ratio of one-third and with western machines to print high quality banknotes.[767] Sheng Xuanhuai, who came from a family of wealthy native bankers and was an important official who promoted modern enterprises such telegraph, railway, and mining, was well-known for his knowledge of western affairs and financial matters. As early as 1882, he had proposed to Li

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[766] "迨臣屡次与李鸿章面讲函商，始将该洋商奢望删除殆尽。如所称请准利权各节，已改为：户部交银生息与否从户部便；各省关税由该行汇兑与否从各省便，如由该行汇交部库，不准以洋钱洋票充抵，仍照例以实银上兑." The memorial of Prince Chun, 光绪十一年九月十七日, *Grand Council Memorial Copies*, Box 680, No. 386-7.

[767] "[阜康银号倒闭之后] 近来中外货币无可流通，商市萧索，殊非公家之利，亟应仿照西法为穷变通久之计。[sic] 创设国家有限银行…于国家利益实多。[银行所出银票] 但有常存三分之一之现银足资周转." 直隶总督李鸿章拟设官银号节略，光绪十一年 (month unknown), in Zhongguo diyi lishi danganguan, eds., *Guangxuchao zhupi zouzhe* [Imperially rescripted palace memorials of the Guangxu reign] 光绪硃批奏折-财政-货币金融, volume 91, p. 675.

Hongzhang the creation of a big bank to remit official funds by telegraph.[768] In 1887, Li Hongzhang sent three officials, Sheng Xuanhuai, Zhou Fu, and Ma Jianzhong, to negotiate a bank plan with the American merchant E. S. K. de Mitkiewicz who represented the Philadelphia Syndicate and the Silver Ring in the US. This was not designed as a state bank, yet it planned to raise low-interest rate loans when needed by the Qing government.[769] This plan was also aborted due to the strong opposition of the Board of Revenue.

The Court accepted the decision of the Board of Revenue, yet it also protected the advocates of a state bank from attacks by censors. Prince Chun particularly pointed out that they were mainly concerned with how to overcome the fiscal difficulties caused by the huge military spending and foreign loans in the Sino-French War of 1884. In his view, state bank proponents shared with officials of the Board of Revenue the "same idea of serving the state, even though their ways differed."[770] After rejecting the proposal to use financial means to enhance the spending capacity of the state, the Board of Revenue

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768 Wang Erh-min, "Sheng Xuanhuai yu Zhongguo shiye liquan zhi weihu [Sheng Xuanhuai and the protection of the interests of Chinese enterprises]," *Zhongyang yanjiuyuan jindaishisuo jikan*, No. 27 (June 1997), p. 26.

769 According to Li Hongzhang, the American merchants were trying to find a better investment opportunity for American silver when the US went on the gold standard. "密建威复称该国富商各有银矿，因本国通用金洋钱，无可生发。彼见各口英法德各银行，每以重利盘剥中国官商，心甚不服，求准在通商口岸与华商殷富者集股伙开银行，如国家有公事借用，可仿照欧美各大邦国债之例，每年仅取息三、四厘." 直隶总督李鸿章折, 光绪十三年八月二十二日, *Grand Council Memorial Copies*, Box 680, No. 670-3.

770 "自去岁海疆多事，用款骤增，不得已始借洋款，彼按西国通例，归本有期。遂致一时济急，耗帑无穷。李鸿章身任艰巨，目击心伤，故有官银行之请。部臣职司出纳，虑远思深，是以辩驳甚力。虽迹似不同，其为谋国则一." 醇亲王片, 光绪十一年十二月, *Grand Council Memorial Copies*, Box 507, No. 2034-5.

turned its attention to how to extract more tax revenues (*kaiyuan*) and cut unnecessary expenditures (*jieliu*), the fiscal creed of the traditional fiscal state.

Typical explanations of this episode in the literature have used the conservatism of the Board of Revenue in financial issues to explain the failure to establish a state bank in China. But given the presence of a range of ideas about public finance, it is more important to ask how officials who knew little about banking could still occupy the important posts on the Board. Why did the Court not promote officials such as Sheng Xuanhuai to take charge of public finance? To answer these questions, we need to examine how officials of the Board of Revenue at the time used decentralized fiscal institutions to meet rising speeding needs.

Nominally, the Qing fiscal system was highly centralized as the Board of Revenue directly supervised all the collected tax revenue and expenditures of local governments. The Board of Revenue appealed to two main methods to simplify its fiscal administration. First, it set fixed quotas for tax collection and expenditures for prefectural governments, which helped discipline the performance of prefectural magistrates when it was difficult for the center to accurately assess its tax base and monitor local governments.[771] Second, the Board of Revenue relied upon an account-reporting procedure to determine the allocation of the annual revenue remaining after deducting the quotas for prefectural governments. In the winter season, each provincial

[771] Although Edgar Kiser and Xiaoxi Tong rightly points out the difficulty of the center to monitor local government in public finance in late imperial China, they neglect the importance of fix quotas to reducing the information cost in bureaucratic management. See Edgar Kiser and Xiaoxi Tong, "Determinants of the Amount and Type of Corruption in State Fiscal Bureaucracies: An Analysis of Late Imperial China," *Comparative Political Studies*, Vol. 25, No. 3 (October 1992): 300-31.

government was required to send its next year's estimated expenditure (*donggu*) to the Board of Revenue. Upon approval, the Board assigned the expenditures to provincial governments for the next year, with one disbursal in the spring and the other in autumn (*chunqiubo*). Provincial governments also needed to send their accounts of annual expenditures to the Board of Revenue for an item-by-item audit (*zouxiao*).[772]

Practice, however, was highly decentralized. In absence of a nation-wide financial network in eighteen-century China, the actual transfer of government revenue and expenditures was conducted by transportation of silver bullion, which was extremely time-consuming in a pre-modern society. In this situation, the central government did not aggregate all its annual income to Beijing but retained a large proportion in treasuries at provincial level or even in prefectural governments in strategic locations. In this way, the Board of Revenue could save the cost and time of transporting silver by assigning the stored revenue directly to destinations of spending.[773] By the mid-nineteenth century, this fiscal operation had become dysfunctional as it could not respond properly to the rising extraordinary expenditures of local governments and tax arrears caused by the rising value of silver.[774] However, what the Board of Revenue restored after 1860s was such a decentralized fiscal system.

[772] Madeleine Zelin, *The Magistrate's Tael: Rationalizing Fiscal Reforms in Eighteenth-Century Ch'ing China* (Berkeley: University of California Press, 1992), pp. 15-8.
[773] Peng Yuxin, "Qingdai tianfu qiyun cunliu zhidu de yanjin [The development of the system to retain and transportation of land taxes in the Qing dynasty]," *Zhongguo jingjishi yanjiu*, No. 4 (1992): 124-33;
[774] Iwai Shigeki, "Shindai kokka zaisei ni okeru chūō to chihō [The center-local relationship in the fiscal system of the Qing dynasty]," *Tōyōshi kenkyū*, Vol. XLII, No. 2 (September 1983), pp. 338-40.

In regard to the total annual income of some 80 million *tael*, which the Board of Revenue received regular accounts of collection from provincial governments, only 15 percent or so were actually sent to Beijing. For the rest, the Board of Revenue allocated their expenditures according to various needs across regions. Some were spent within the province of collection, some were assigned for purposes in other provinces, and the rest were stored in various treasuries waiting for future assignments from the Board of Revenue. The fixed quotas in both tax collection and ordinary expenditures thus greatly reduced the administrative difficulty involved. Board of Revenue officials thus did not necessarily require extensive financial experience to fulfill their ordinary duties.

To deal with extraordinary expenditures, for which the Board of Revenue could no assign quotas in advance, two conditions had to be met. First, the Board of Revenue needed to know the exact amount of funds stored in treasuries scattered across the provinces after disbursing all the ordinary expenses. Second, when the Board of Revenue ordered the transfer of particular items of fund stored in specific local treasuries, the assigned money had to still be available. In the new circumstances after the 1860s, these two prerequisites were not always satisfied.

In the 1860s, the Qing government set about reducing the supplementary levies and official quotas of land taxes in the provinces of Hunan, Hubei, Jiangsu, Jiangxi, Zhejiang, and Anhui.[775] In addition to a paternalist concern for local welfare in the aftermath of

[775] Liu Kexiang, "Shijiu shiji wushi zhi jiushi niandai qingzhengfu de jianfu he qingfu yundong [The efforts of the Qing government to reduce land taxes and settle land taxes in the late 19th century]," *Zhongguo shehui kexueyuan jingji yanjiusuo jikan*, volume 7 (Beijing: Zhongguo shehui kexue chubanshe, 1984), pp. 315-21.

war, it was important for the Board of Revenue to set realistic quotas which prefectural magistrates could meet when collecting land taxes. But the Board of Revenue could not anticipate the fluctuations in the yields of land taxes caused by nature. Moreover, the revenue from *lijin* duties levied upon commercial transactions varied year by year according to the changing conditions in the markets, which were beyond the control of the government.[776] In regard to government spending, provincial governments had to confront all sorts of these extraordinary expenditures in local governance which the Board of Revenue could hardly address in its annual allocation of expenditures.

Variations in tax collection and spending by local governments thus eroded the ability of the Board of Revenue to operate effectively. Considering the number of items of specific tax revenue, treasuries to store official funds, and purposes of disbursements, the Board of Revenue, which did not have computer and real-time telecommunications, quickly lost track of available revenues in this complicated decentralized fiscal operation.[777] Fiscal chaos resulted as the state tried to link specific items of revenue to meet particular purposes of spending across regions. In contrast, a centralized fiscal institution would have enabled financial officials to allocate expenditures from a sum of income aggregated from various sources of revenue, thus avoiding the unnecessary trouble of matching particular items of income to specific purposes of spending.

[776] Luo Yudong, *Zhongguo lijinshi* [A History of *Lijin* in China] (Shanghai: Shangwu Yinshuguan, 1936), pp. 29-33.
[777] This phenomenon is well-known to fiscal historians. See the discussion in He Lie, *Qing xiantong shiqi de caizheng* [The Public Finance of the Qing Government in Reigns of Xianfeng and Tongzhi] (Taipei: Guoli bianyiguan, 1981), pp. 402-4.

While this decentralized fiscal system functioned poorly, it still worked well enough. The center did not completely lose its control over public finance. The fiscal muddle described above was not sufficiently pressing to force the center to search for alternative institutions. When there were emergent needs, such as military spending or return of foreign loans, the Board of Revenue could still order provincial governors to send the assigned amount of revenue to destinations of spending. Provincial governors might then have to remove revenue from sources other than those designated by the Board of Revenue to meet these demands. Both the provincial governments and the offices of the Imperial Maritime Customs in Guangdong and Fujian provinces often borrowed from domestic banks.[778] In consequence, the Qing government could afford its Xinjiang campaigns, fight an expensive war with France, and build a modern navy strong enough to contain conflict with Japan in the 1880s.

However, the assignment of ordinary expenditures in this decentralized fiscal system was quite a different story. Provincial governors often delayed the shipment, reduced the amount, or even ignored the assignment from the Board of Revenue. For example, for the total of 8 million *tael* of revenue designated to Beijing in 1886, the Board of Revenue only received 4 million *tael* on time, and some 2.8 million *tael* were in arrears.[779] Of the annual ordinary expenditure of 4 million *tael* for the navy which the Board in 1880 assigned from the *lijin* revenues from Jiangsu, Zhejiang, and Jiangxi and the customs revenue from Shanghai, Ningbo, Fuzhou, and Guangzhou, the amount of money that the

[778] Huang Jianhui, *Shanxi piaohaoshi* [A History of Shanxi Bankers], revised version, p. 244.
[779] The memorial of the Board of Revenue in 光绪十二年十一月十五日, Cited from ibid., p. 252.

navy actually received every year never exceeded 3 million.[780] Because the decentralization of fiscal operations deprived the Board of Revenue of the ability to possess the accurate information about revenue and available silver stocks, the central government could do little to improve this situation.

During the three decades between 1864 and 1894, the decentralized assignment fiscal institution in China did not encounter any crisis which it could not handle. Given the geographic location of Beijing and the territory of China, military campaigns in frontier regions did not motivate the Board of Revenue to centralize tax revenue as it could still assign revenue from collecting provinces directly to the troops. Neither did foreign borrowing change matter. The Board of Revenue could simply assign revenues from provinces directly to treaty ports such as Shanghai to make interest payments to foreign banks.

Since a fiscally decentralized system lacked elasticity in yielding more financial resources, the central government avoided to fight prolonged and expensive wars, as shown in the Sino-French war in 1884. The main purpose for the Qing government to build a western-style navy in 1874 and to upgrade it in the 1880s was to contain Japan, and it rejected proposals to attack Japan in 1885 by emphasizing the huge cost of a naval war. After 1888, there was an informal alliance between China and Japan. Japan did not challenge China's dominance over Korea, while China accepted Japan's annexation of Ryukyu (today's Okinawa) and supported Japan's efforts to revise unequal treaties and

[780] Zhou Yumin, *Wanqing caizheng yu shehui bianqian* [Public Finance and Social Change in the Late Qing], pp. 269-70.

resume sovereignty in its customs.[781] The threat of Russia to Manchuria in 1890 was still far from a crisis which would force state actors to search for new fiscal institutions.

The decentralized fiscal institution was thus quite stable in the current international circumstances. When the flooding in Zhengzhou in 1887 forced the center to spent extraordinary funds of 12 million *tael* over four years for river work and disaster relief, the Board of Revenue in 1887 decided to stop purchasing warships and weapons from the west.[782] The extravagance of the Empress Dowager Cixi caused great annoyance to the officials on the Board of Revenue, yet it was by no means the cause of fiscal decentralization. The thrifty of the ruler would have had little impact on the operations of public finance when considering the stickiness of the decentralized fiscal institution at the time.

The Board of Revenue was not against financial or monetary innovations in general. In the 1880s, it permitted provincial governments in Guangdong, Hubei, and Jilin to use western technology to mint token silver currency (*yinyuan*). In response to a nation-wide dearth of copper cash, it also let provincial governors use steam-powered machines to mint a new style of copper cash (*tongyuan*). Moreover, the Board of Revenue permitted provincial governors in Jiangsu and Henan to re-establish Official Money Bureaus to

[781] Nishizato Kiyuki, "Rei Shoshō [Li Shuchang] no tainichi gaikō ronsaku to sono shūhen [Issues surrounding the strategy toward Japan proposed by Li Shuchang]," *Tōyōshi kenkyū*, Vol. LIII, No. 3 (December 1994): 443-79.
[782] This amount was mainly disbursed from the silver stocks held by the Board of Revenue and the revenue originally designated from the provinces to Beijing.

issue copper notes to alleviate the scarcity of copper cash in local markets.[783] Nonetheless, without a severe fiscal crisis, the Board of Revenue had little motivation to re-introduce paper notes in public finance. Moreover, the devaluation of paper notes and its social consequences in Japan, which the Chinese embassy reported to the center, may have further strengthened the bias against paper notes. However, without the use of credit instruments in public finance, it made no sense to even conceive of centralization.

The persistence of the traditional fiscal state in China under the new socio-economic circumstances in the period between 1864 and 1894 thus attests to the stickiness of decentralized fiscal institutions. We do not know what kind of institutional development might have occurred if there were a credit crisis during this time. Several questions remain. What was the potential of the Chinese economy at the time to yield more tax revenue if the Qing government faced greater spending demands? To what extent could the Qing government rely upon its administrative institutions to realize this potential? Was it possible for the Qing government to achieve fiscal centralization and to build a modern fiscal state if it were subjected to a huge credit crisis?

III. Potential and limit in fiscal centralization and the beginning of an institutional learning process after 1895

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[783] The Tongyuan Official Money Bureau was re-established in 1881 in the city of Qingjiang in Jiangsu province to issue copper notes to mitigate a dearth of copper cash. 黎培敬片, 光绪七年七月十一日, *Grand Council Memorial Copies*, Box 680, No. 311. The provincial government in Henan set up the Yuli Official Money Bureau in 1888 to issue copper notes for the use of river work in Zhengzhou. 倪文蔚片, 光绪十四年二月十四日, *Grand Council Memorial Copies*, Box 680, No. 749.

In the period between 1864 and 1894, the annual income of the Qing government mainly came from land taxes, the customs revenue, and *lijin* duties.[784] After the suppression of the Taiping, the Qing government tried to extract more revenue from land taxes by conducting nation-wide land surveys. However, the information problem was insurmountable as local gentry and clerks in prefectural governments had little incentive to reveal the accurate information of landed wealth to the center.[785] As a result, the annual yield from land taxes stood at the level of 30 million *tael* when the quota system for collecting land taxes was decided. We observe similar inelasticity in collecting land taxes in England and Japan during their transformation into modern fiscal states.

From the 1870s onward, the Qing government had realized that it could only depend upon the customs and *lijin* duties to meet rising expenditures. The Board of Revenue was particular impressed by the efficiency and reliability of the Imperial Maritime Customs. Yet the 5 percent tariff duty fixed by western powers severely restricted the potential of the customs in yielding more revenue. However, like the Meiji government, the Qing state was independent from foreign intervention in the collection of indirect taxes levied upon consumer goods, *lijin* duties. After 1860, foreign merchants could pay a supplementary tariff duty of 2.5 percent at treaty ports (*zikoushui*) and were thence exempted from the payment of *lijin* duties within China. Yet the Qing government had full autonomy in regard to the rate or the method of *lijin* collection over domestic consumer goods.

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[784] The selling of official ranks was only an exigent fiscal measure and its actual yield was far below the anticipated amount.
[785] For information and administrative cost in land survey between 1860s and 1890s, see Liu Kexiang, "Shijiu shiji wushi zhi jiushi niandai qingzhengfu de jianfu he qingfu yundong [The efforts of the Qing government to reduce and settle land taxes in the late 19th century]," pp. 348-9.

As did the excise in England, *lijin* duties started as exigent fiscal measures in the civil wars. In the post-war era, their collection was continued as they were indispensable to both central and provincial governments in meeting the increasing military and domestic expenditures.[786] Imposition of *lijin* was justified by the principle of equity in taxation as it was levied upon commercial sectors which had been lightly taxed before. Government officials also appealed to the Confucian creed of treating agriculture as the fundamental basis of society to legitimate the collection of *lijin*, noting that it reduced the burden of land taxes upon peasants.[787] The rates of *lijin* usually ranged between 2 and 10 percent. As *lijin* became formal taxes, the collection offices in each province became specialized official institutions, which were independent from prefectural magistrates and were subject to the supervision of the governor and the provincial treasurer. The structural conditions of the Chinese economy significantly affected the development of these, particularly the degree of efficiency and centralization attainable.

There were three kinds of *lijin* duties: *lijin* levied upon production, transit *lijin*, and landed *lijin* or *lijin* collected from retailers.[788] The administrative difficulty involved varied greatly. As commodities in the market in China at the time were produced by numerous small-scale producers, the cost to collect *lijin* duties upon production was formidably high. Collection of *lijin* duties from small retailers had the same problem. Therefore, provincial governments mostly targeted big wholesalers or guilds that were involved in inter-regional trade. Both the information and administrative cost of

[786] Luo Yudong, *Zhongguo lijinshi* [A History of *Lijin* in China], p. 37.
[787] Susan Mann, *Local Merchants and the Chinese Bureaucracy, 1750-1950*, pp. 100-1.
[788] Luo Yudong, *Zhongguo lijinshi* [A History of *Lijin* in China], pp. 55-7.

assessing market value and collecting transit *lijin* were low in the following three cases: 1), when a large amount of a given commodity was packaged and ready for transportation; 2), when the package passed certain pivotal nodes in the transportation networks; and 3), when the package arrived in a new market before it was dispatched to small retailers.

Thus in 1867, the Fujian provincial government repealed *lijin* duties upon smaller retailers and only focused upon major consumer goods, particularly tea and opium.[789] Likewise, small businesses in Shanghai were exempted from *lijin* in 1857 and in Shanxi in 1862.[790] In order to facilitate the collection of lijin on tobacco, which was difficult to collect from small peasants and businessmen, the Gansu provincial government asked merchants to form three tobacco guilds in Lanzhou and Jingyuan, two major areas of local tobacco cultivation.[791] For the big wholesalers, it was difficult to hide commodities from government inspection and the cost of avoiding the key places in transportation could be unnecessarily high. Yet they could pass the burden of *lijin* duties to retailers by raising prices. In this light, the collection of *lijin* upon wholesalers reduced the tension

789 "将百货厘金减抽二成，渔网杂捐，肩挑小贩，概行停抽，并将偏僻地方无碍大局之小卡酌量裁撤." 闽浙总督吴棠折, 同治六年六月初九日, *Palace Memorials*, Box 32, No. 297-8.

790 In Shanghai, "[厘捐] 小者过于苛碎，故名目虽多，徒招怨恨 [sic] 将零星经纪删除二十余项，小本利微各业亦一概免捐." 两江总督何桂清、江苏巡抚赵德辙折, 咸丰七年七月初一日, *Palace Memorials*, Box 31, No. 2736-40. In Shanxi, "坐贾内另有售卖药膏各户 … 多系小本经营，籍以糊口，按户收厘，事涉烦扰，随即出示停止." 山西巡抚英桂折, 同治元年八月十三日, *Palace Memorials*, Box 32, No. 75-77.

791 "[司员等称] 甘省出售水烟，向无专行 … 若任其散漫，殊难稽查。必须先立烟行，方有专责。该员等谕令议立行首，请领牙帖，输纳税银，责令按货捐厘。[sic] 统计常年覈算约可收银似四、五万两." 陕甘总督乐斌折, 咸丰八年四月二十八日, *Palace Memorials*, Box 31, No. 2800-3.

between collecting officials and ordinary consumers or small retailers.[792] Meanwhile, big wholesalers and guilds were often organized and thus more powerful than individual small businessman. They often had both informal and formal channels to interact with governors and financial officials at the provincial level. For example, tea merchants could petition governors to reduce the *lijin* duties imposed on tea by referring to the competition from the Japanese and Indian tea in the international markets.[793] In this sense, big wholesalers were less vulnerable to extortion by collecting officials.

The collection of *lijin* duties in provinces was typically handled by a hierarchical bureaucracy staffed by salaried expectant officials, who acquired their title either through civil examination or purchase. The collection of *lijin* in Hunan is well-known for its dependence upon members of the local gentry rather than expectant officials. The historian Lu Yudong in his study of *lijin* argues that the Hunan approach reduced corruption as the gentry often came from wealthy families and cared about their local reputation.[794] Nonetheless, the gentry-collectors in Hunan province were in fact salaried staff of the *lijin* office, and the Hunan governor Bian Baodi considered it important to pay them well so as to avoid abuses.[795] Entrusting the collection of *lijin* duties to merchant

[792] This might explain why the observed anti-*lijin* riots mostly occurred in the late 1850s and early 1860s when small retailers and producers were directly taxed, while collection between 1875 and 1895 was generally without incident. On the early anti-*lijin* riots, see He Lie, *Lijin zhidu xintan* [A New Exploration of the Institution of *Lijin*], pp. 118-9.

[793] For such examples in Hubei, Anhui and Jiangxi, see 署湖广总督湖南巡抚卞宝第、湖北巡抚彭祖贤折, 光绪十一年二月二十八日, *Palace Memorials*, Box 32, No. 700-4; 两江总督曾国荃片, 光绪十四年五月初二日, *Grand Council Memorial Copies*, Box 489, No. 245-6; 护理江西巡抚布政使方汝翼折, 光绪十九年三月二十七日, *Grand Council Memorial Copies*, Box 489, No. 2276-8.

[794] Luo Yudong, *Zhongguo lijinshi* [A History of *Lijin* in China], p. 87.

[795] "所有卡局需用之费，在事官绅薪水之需，稍令宽余，俾得洁己奉公，无虞拮据。亦以养其廉耻，杜绝侵欺." 湖南巡抚卞宝第折, 光绪十三年五月二十四日, *Palace Memorials*, Box 32, No. 854-6.

guilds, which was attempted in some areas, led to under-taxation. When Li Hongzhang, the governor-general of Zhili appointed officials to replace the gentry-merchant collection in 1880 in the city of Tianjin, annual receipt rose from 20,000 to 60,000 *tael*.[796]

Due to the importance of *lijin* revenue, provincial governments had a strong incentive to oversee the performance of collecting officials. The monthly accounts of collecting stations or offices had been sent to their supervising offices twice a month, along with the collected revenue. After aggregating these accounts, the supervising offices sent the accounts to headquarters in the following month for inspection.[797] Still, as the volume and routes of trade in localities varied year by year, it was difficult for headquarters to evaluate collecting performance. To provide incentives to collecting officials, provincial governments often reported to the center the names of those who had above average receipt in collection and awarded them with promotion of official rank and priority to hold official tenure (优先录用). Meanwhile, collecting officials could only stay in their posts for three years, and thus their accounts were subject to check of subsequent office holders. If fraud was discovered, the preceding official was held accountable.[798] The collecting official was also responsible even if the shortage was caused by collusion

[796] 直隶总督李鸿章折, 光绪六年四月十三日, *Grand Council Memorial Copies*, Box 488, No. 954-6.
[797] Luo Yudong, *Zhongguo lijinshi* [A History of *Lijin* in China], pp. 93-8.
[798] By this method, the *lijin* office in Jiangxi in 1863 found that the managing official Wang Yongxu under -reported revenue, retained fines, and manipulated the exchange rates between silver and copper cash in reports for personal profit. Wang was deprived of his official title and had to pay back the money. Memorial of unknown official, 同治三年, *Palace Memorials*, Box 32, No. 206-7.

between his subordinates and merchants.[799] If the yields of *lijin* fell, yet market transactions in a given area were prosperous, that office became the target of inspection.[800] As the value of a commodity was assessed by different stations and collecting offices, purposeful under-assessment by one station could be reported by others.[801]

When the yields of direct collection were poor, provincial governors sometimes involved merchants in collection. One method was to assign a fixed amount to the guild in a particular sector, say raw silk, the guild then divided the payment among its members. As the commodity was free from other transit *lijin* duties after paying this fixed amount, merchants in coastal areas who exported their goods abroad found it attractive..[802] The other method was to farm *lijin* collection out to merchant-farmers who could retain up to 32 percent of receipts as their income.[803] Professional *lijin* farmers thus had an incentive

[799] Ding Yong, the collecting official in the Houli *lijin* station in Guangdong province was stripped of his office and had to make compensation of two thousand tael when a shortfall of that amount resulted from collusion between his inspector and merchants. Only after repaying the money could he recover his official title. 两广总督张之洞折, 光绪十三年六月十四日, *Palace Memorials*, Box 32, No. 868.

[800] In a good year for the tea market, the provincial governor of Yunnan became suspicious about the falling *lijin* revenue from the office responsible for Simao and Pu'er, two major tea-producing areas. The inspecting officials then found a discrepancy between the revenue that the collecting official remitted through the Guangyufeng bank and the amount of money that he actually handed over to headquarters. 云贵总督岑毓英折, 光绪九年五月二十二日, *Grand Council Memorial Copies*, Box 488, No. 1849-50.

[801] "[广东] 西、北两江，局卡林立，皆有稽查之责，势难概行勾通。上下厂岂肯为人受过，不行举发." 两江总督李瀚章折, 光绪十六年八月二十二日, *Palace Memorials*, Box 32, No. 1327-31. For example, officials in the *lijin* station at Huang Caoba in Guizhou province found that a large volume of Yunnan opium coming from Luo Ping that did not have receipts of paying *lijin* duties. According this report, the Yunnan provincial government traced out that the collecting official at the *lijin* station in Luo Ping colluded with businessmen and under-assessed the value of their goods. The memorial of the Yunnan governor Lin Shaonian, 光绪二十九年七月二十一日, *Grand Council Memorial Copies*, Box 490, No. 1997.

[802] Luo Yudong, *Zhongguo lijinshi* [A History of *Lijin* in China], p. 114.

[803] By 1886, the collection of *lijin* levied upon imported opium in Hankou and Jiujiang followed the example of Zhenjiang and switched from direct collection to this kind of merchant farming. 江西巡抚德馨

to collect more efficiently. Despite efforts to collect *lijin*, the total *lijin* revenue collected from commodities other rather than opium accounted for only 5 percent in the total commodity value of grains, tea, cotton, and silk cocoons.[804]

Government officials were aware that high duties of *lijin* were counterproductive as they simply encouraged countless forms of evasion.[805] For example, Chinese merchants could pay the supplementary customs duties (*zikoushui*) under the name of foreigners so as to avoid paying domestic *lijin* duties. As the revenue from this supplementary customs tariff was under the control of the center, provincial governments had to keep duties low to attract Chinese merchants to pay *lijin* duties, of which governors could retain in their hands at least 10 to 20 percent.[806] Competition for *lijin* revenue among neighboring provinces through which merchants could chose different routes of trade further contained the rise of *lijin* duties.[807]

折, 光绪十二年三月二十八日; 湖广总督裕禄、湖北巡抚谭钟培折, 光绪十二年十月初六. Both in *Grand Council Memorial Copies*, Box 488, No. 2633-8 and No. 2811-7. In the case of Hankou, monthly receipts more than doubled.

804 The receipt of this *lijin* revenue (*baihuo lijin*) in 1894 was around 16 million *tael*. Assuming that provincial governors retained 30 percent of the collected *lijin*, the total revenue collected is 16 million/0.7, which is 22.86 million *tael*. The total estimated commodity value of grain, tea, cotton, and silk cocoons is cited from Xu Dixin and Wu Chengming, *Zhongguo zibenzhuyi fazhanshi* [A History of the Development of Capitalism in China], volume 2 (Beijing: Renmin chubanshe, 1990), p. 302.

805 "厘税愈重，偷漏将必愈繁." 陕西巡抚叶伯英折, 光绪十三年二月二十九日, *Palace Memorials*, Box 32, No. 814-6; "若厘税再加，偷漏将防不胜防." 湖广总督裕禄、湖北巡抚奎斌折, 光绪十三年三月十九日, *Palace Memorials*, Box 32, No. 823-5.

806 Dai Yifeng, *Jindai Zhongguo haiguan yu Zhongguo caizheng* [The Customs and Public Finance in Early Modern China] (Xiamen: Xiamen daxue chubanshe, 1997), pp. 136-9.

807 In the collection of *lijin* duties upon opium in Hunan province, the Hunan governor Zhang Xü told the Board of Revenue that high *lijin* duty in Hunan simply made merchants to go through the neighboring Guizhou or Guangxi where duties were low, to reach Jiangxi. 湖南巡抚张煦折, 光绪十七年九月二十八日, *Palace Memorials*, Box 32, No. 1544-7.

Other factors kept *lijin* rates at reasonable levels. The Qing government often reduced or even temporarily repealed the *lijin* duties levied upon the long-distance trade in grain in years of poor harvests and famine.[808] Competition from Japanese and Indian tea forced governors in the tea-producing provinces to reduce *lijin* duties on tea. For these reasons, the imposition of *lijin* did not necessarily lead to excessive extraction of commercial wealth. Nor did its levy imply an anti-commercial attitude among government officials. Instead, provincial governors well understood that the revenue from *lijin* would rise with an expanding volume of trade. As the Hunan governor Bian Baodi and the Hubei governor Peng Zuxian put it, the yield from *lijin* duties depended upon prosperity in the markets.[809]

The dominance of small producers in the Chinese economy and the levy of *lijin* upon wholesalers significantly restricted the center's ability to supervise the collection of *lijin* in localities. As the Board of Revenue did not possess the necessary institutions to survey the whole economy independent from provincial governments, it could only accept the accounts of collected revenue reported by provincial governors. It had no institutional ability to estimate the potential yield of *lijin* revenue in each province. Provincial governors themselves did not have this ability either. However, the lack of

[808] When famine struck in Shanxi, Shaanxi, and Henan in 1877, the Board of Revenue repealed the *lijin* duties on grain for one year. Cited from the memorial of the Anhui governor Yu Lu, 光绪四年三月十一日, *Grand Council Memorial Copies*, Box 488, No. 475-6. When poor harvest drove up grain prices in Hubei in 1885, the Hubei provincial government temporarily halted the *lijin* on the grain trade to attract merchants to ship grain in from other provinces. See the memorial of the Hubei governor Tan Junpei, 光绪十一年 (month unknown), *Palace Memorials*, Box 32, No. 732. The provincial government of Jiangsu adopted a similar measure in 1888. See the memorial of the governor-general of Jiangsu and Jiangxi Zeng Guoquan, 光绪十四年 (month unknown), *Palace Memorials*, Box 32, No. 1078-9.

[809] "裕课首在恤商，必使商有赢余，斯市面方能起色，税厘可望旺收." 署湖广总督湖南巡抚卞宝第、湖北巡抚彭祖贤折, 光绪十一年二月二十八日, *Palace Memorials*, Box 32, No. 700-4.

institutional ability to extract maximum *lijin* duties from the economy does not necessarily imply that the central and provincial governments had lost control over the *collected* revenue. As the *lijin* collection in provinces was highly institutionalized and hundreds of collecting and supervising officials were involved, it is unlikely that provincial governments could effectively collected *lijin* duties yet only give a small proportion to the center. The oversight of collecting officials was also institutionalized, particularly in the inter-personal check of accounts. It is thus unlikely that a large proportion of the *lijin* revenue could have been embezzled by collecting officials, even though there were definitely many cases of misconduct and corruption. In order to understand how the conditions of the Chinese economy limited the rise of *lijin* revenue, we shall examine the efforts made by the Qing government after 1884 when it was troubled by growing expenditures in defense and river works.

The obvious target for increasing *lijin* revenue was opium, the biggest consumer good in China at the time. Through difficult negotiations, the Qing government in 1877 finally made the British government to agree to an imposition of an additional consumption duty (*yangyao lijin*) of 80 *tael* on every 100 *jin* of imported opium. A number of Guangdong merchants petitioned the center to let them form a company in Hong Kong to monopolize the import of Indian opium into China. Li Hongzhang, the governor-general of Zhili, supported this plan as it greatly facilitated the collection of the additional and substantial duty on imported opium.[810] Although this plan was impractical given the opposition of

[810] In Li Hongzhang's view, such a company could not only effectively collect the heavy duties on imported opium but also save the huge costs to collect duties after the imported opium was dispatched across China. 直隶总督李鸿章片, 光绪七年六月十八日, *Grand Council Memorial Copies*, Box 488, No. 1327-9.

foreign opium merchants, it showed that government officials understood clearly that it would be most effective to collect *lijin* duties from big warehouses before the goods had been dispatched. As Yang Changjun, the governor-general of Fujian and Zhejiang, pointed out to the center, that it was easier to collect the additional consumption duty on imported opium when it passed the Customs as a whole, and it was hard to prevent evasion once it became scattered after entering China.[811] For this reason, the center decided in February1887 to have the Imperial Maritime Customs, rather than provincial governments, collect this additional duty on imported opium.[812]

The Qing government also attempted to raise receipts from the *lijin* duties levied upon domestic opium. On 2 June 1890, the center consulted provincial governors about the feasibility of increasing this duty from the current 30 *tael* per *dan* on opium transported by land and 40 *tael* upon opium transported by river to 110 *tael* per 100 *dan* as Robert Hart suggested. The center also asked them to come up with methods for improving the yields from domestic opium in their provinces and ordered them to send separate quarterly accounts of the *lijin* revenue collected from domestic opium to the Board of Revenue.

In response, provincial governors, particularly in provinces where there was no opium cultivation, opposed this measure. In their view, a heavy *lijin* duty on domestic opium

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[811] "洋药关税收之于轮船进口之时，其数整；华税厘金收之于洋行分售之后，其数散。故偷漏关税较难，偷漏厘税则易." 闽浙总督杨昌濬折, 光绪十三年三月初四日, *Grand Council Memorial Copies*, Box 488, No. 3005-7.

[812] The historian Dai Yifeng is right to point out that this case illustrates the central authority in fiscal issues, yet he neglects the common concern to prevent tax evasion that is shared by both the center and provinces. See Dai Yifeng, "Wanqing zhongyang yu difang caizheng guanxi [The fiscal relationship between the center and provinces in the late Qing]," *Zhongguo jingjishi yanjiu*, No. 4 (2000), pp. 53-4.

was impractical as it would simply be undermined by illegal traffic in opium, which was a high-value, light, and easy-to-hide commodity. In addition, governors of provinces with significant opium cultivation such as Yunnan and Sichuan pointed out that it was almost impossible to collect high opium taxes from small peasants.[813] Nonetheless, some governors did put forward methods about how to increase the receipts from domestic opium. For example, the Hubei provincial government established a specialized office in the Yichang prefecture to manage the collection of *lijin* duties on Sichuan opium, much of which passed through Yichang to enter Hubei.[814] Liu Bingzhang, the governor-general of Sichuan, proposed converting various transit *lijin* levied upon domestic opium by offices or stations scattered in various regions into one uniform tax levied on major wholesalers in major opium-producing provinces. After paying this single tax, merchants were free from paying transit *lijin* on opium in any other province. As Liu pointed out explicitly, this collection method could help the center to manage the collection of opium taxes.[815]

This scheme represented an important step toward centralization in collecting *lijin* duties on domestic opium. The center then let the Jiangsu provincial government, which had made a similar proposal, to experiment with this new method of collection (*tuyao*

[813] Lin Man-houng, "Wanqing de yapianshui [Opium taxes in the late Qing]," *Si yu yan*, Volume 16, No. 5 (1979):

[814] "川土入鄂，南路以宜昌施南一带为水陆要隘，大邦皆出于此 ... 现于宜昌府设立土药专局，檄委湖北候补道吴廷华总办局务." 湖广总督张之洞、湖北巡抚谭继洵折, 光绪十六年八月二十四日, *Palace Memorials*, Box 32, No. 1335-41. The Hubei provincial governments also reported the special accounts of collecting domestic opium to the Board of Revenue. Lu Yudong is wrong to say that provincial governors always hide the accounts of domestic opium from the center.

[815] "[土药税厘] 如部议必欲加抽，亦须统筹全局... 议定划一章程，免致各省任意自为，既有碍民生转无裨于国计。抑或仿照洋土办法，径由出产省分全数抽收一次，粘贴印花。此后所过省分不再抽收." 四川总督刘秉璋折, 光绪十六年十月初四日, *Palace Memorials*, Box 32, No. 1407-8.

tongjuan). A special collecting office (*tuyao tongjuanju*) was established in Xuzhou, one major area of opium cultivation. It issued licenses to opium merchants and levied a uniform opium duty upon them. After paying this in Xuzhou, these merchants were not liable for any other transit duties in Jiangsu province, including the major *lijin* collection offices in Nanjing, Suzhou, and Shanghai. The center even asked the troops stationed in Xuzhou to protect the transportation of opium by the licensed merchants.[816]

In the collection of *lijin* duties upon domestic opium, the center and provincial governments thus understood the importance of economies of scale to tax collection, i.e., the bigger the scale, the more difficult to evade taxes, and the easier for the government to extract more tax revenue. We observe the same consideration in the collection of beer excises in England and the sake taxes in Japan, where the emergence of big merchants in the respective goods greatly reduced the cost of central collection and supervision. However, the result of the experiment in Xuzhou was not very encouraging. The annual revenue actually collected was some 200,000 *tael*, lower than the originally anticipated 300,000 *tael*; and accounted for only 2 percent of the total value of opium produced in Xuzhou.[817] As opium cultivation was scattered among small peasants, it was impossible to prevent the illegal traffic of opium among non-licensed merchants. The difficulty of forming a monopoly for domestic trade of opium in China was thus mainly caused by the nature of opium trade and production. In 1894, the total tax revenue collected from domestic opium was 2.2 million *tael* silver, accounted to only 2.3 percent of the

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[816] 总理衙门会同户部折, 光绪十七年三月二十三日, *Palace Memorials*, Box 32, No. 1454-60.

[817] 两江总督刘坤一折, 光绪十九年七月二十一日, *Palace Memorials*, Box 32, No. 1843-6.

estimated total value of domestic opium (94 million *tael*).[818] In comparison, the Qing government received 5.2 million *tael* from collecting the *lijin* duty upon imported opium from the Customs, which amounted to 14 percent of the total value of 37 million *tael* of imported opium.[819] As both provincial and central governments had made great efforts to raise the receipts from *lijin* duties, we can safely exclude the possibility that there were consumer goods other than opium which were produced on a large scale or participated in inter-regional trade yet evaded the attention of government officials.

Given the socio-economic circumstances in China in 1894, would it have been possible for the Qing government to centralize its tax collection and mobilize more financial resources? It is difficult to answer this counterfactual question. Nonetheless, the indemnity of 230 million *tael* that the Qing government owed to Japan and which it decided to return within three years serves a proxy to a severe credit crisis upon the central government. Neither the Qing nor the Japanese government could have anticipated the outbreak of this major conflict, which lasted less than two years. Although the military spending of the Qing government rose sharply during the war, the Chinese economy was not severely disrupted, in contrast to the civil war of the 1850s. In fact, there was a boom of private investment in modern industry in Shanghai right after the end of the war. It was thus a crisis that primarily affected the central government.

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[818] The estimated total value of domestic opium in 1894 is cited from Xu Dixin and Wu Chengming, *Zhongguo zibenzhuyi fazhanshi* [A History of the Development of Capitalism in China], volume 2, p. 302.
[819] Tang Xianglong, *Zhongguo jindai haiguan shuishou he fenpei tongji* [Statistics of the Customs Revenues and Their Dispense in Early Modern China] (Beijing: Zhonghua shuju, 1992), p. 120 and Hsiao Liang-lin, *China's Foreign Trade Statistics, 1864-1949* (Cambridge: East Asian Research Center of Harvard University, 1974), p. 52.

The rapidly rising military spending after the outbreak of the Sino-Japanese war quickly exhausted the silver reserves of the Qing government. In addition to curtailment of other expenditures and extraction of more revenue, the Board of Revenue first borrowed 1 million *tael* from merchants in Beijing, and the center soon ordered provincial governors to borrow from Chinese merchants two-year loans at 7 percent. Meanwhile, the central government in September 1894 had the Hongkong and Shanghai Banking Corporation (*huifeng yinhang*) issue stocks in London to raise two loans on behalf of the Chinese state (*Zhongguo guojia*), with customs revenue assigned as security.[820] The Qing government received the first loan of 10 million *tael* on January 10, 1895. In contrast to previous foreign loans which were negotiated by provincial governments with the approval of the center, this was the first time that the central government directly negotiated on its own behalf.

Provincial governments experimented with various ways to attract domestic loans. In Zhili, Governor-general Li Hongzhang extended the term of borrowing from two years to six years with the aim of reducing the burden of interest payments. Meanwhile, the Customs Office in Tianjin issued stocks to creditors, the value of each stock being 600 *tael*.[821] The lenders in Suzhou and Nanjing received similar stocks of 250 *tael* issued by

[820] 总理各国事务衙门会同户部，代中国国家向汇丰银行商借银款... 准汇丰银行权为中国国家经手人，代中国国家借 ... 库平足色纹银一千万两." 总理衙门折, 光绪二十一年正月十二日, *Grand Council Memorial Copies*, Box 680, No. 1067-88.
[821] The Custom Offices in Shanghai and Guangzhou seem to have adopted the same method as Li Hongzhang reported that he followed their precedents in Tianjin. 直隶总督李鸿章折, 光绪二十年十二月二十三日, *Grand Council Memorial Copies*, Box 680, No. 1055-9.

the Customs Office in Shanghai.[822] Provincial governments in Zhili, Jiangxi, and Fujian entrusted guilds or wealthy merchants rather than government offices with handling borrowing and interest payments to creditors.[823] This kind of collaboration with Chinese merchants to raise loans for the state was used by Hu Guangyong, the founder of the Fukang Bank. In September 1878, he organized a company named Qiantai, which specialized in raising money from merchants in Shanghai, Hangzhou, and Suzhou for lending to the government at 12.5 percent to fund the military campaigns in Xinjiang. This company raised 1.75 million *tael* from Chinese merchants; the face value of each stock was as high as 50,000 *tael*.[824] In comparison, the value of stocks of credit that the provincial governments issued to attract lending from Chinese merchants in 1895 ranged from 100 to 1,500 *tael*, which helped attract investment by small creditors. Many provincial governors emphasized the importance of securing confidence in the initial stage of domestic borrowing as they were aware that many merchants who had idle capital were observing whether the Qing government could return punctually. In the view of the Hubei governor Tan Jixun, if the government demonstrated its ability to

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[822] 署理两江总督、湖广总督张之洞折, 光绪二十一年十二月二十一日, *Grand Council Memorial Copies*, Box 680, No. 1304-7.

[823] In Fujian, "[福建息借商民] 第尚有稍为变通者，省城当设一总局，请二、三正绅为商民所信服者，经理其事，集款交官，领息付民，必有汇总之地，府州亦然." 闽浙总督谭钟麟折, 光绪二十年九月十三日, *Grand Council Memorial Copies*, Box 680, No. 1029-30. In Tianjin, "交银还银概由通纲公所各总商经手，不准吏胥留难滋弊." 直隶总督李鸿章折, 光绪二十年十二月二十三日, *Grand Council Memorial Copies*, Box 680, No. 1050-4. In Jiangxi, "选择殷实商号经理银钱收放等事，概既不经由藩库，亦不假手胥吏." 江西巡抚德馨折, 光绪二十一年二月二十一日, *Grand Council Memorial Copies*, Box 680, No. 1124-7.

[824] Xu Yisheng, *Zhongguo jindai waizaishi tongji ziliao* [Statistical materials on Foreign Loans in Early Modern China] (Beijing: Zhonghua shuju, 1962), p. 3.

assign revenue to return the principal and interest punctually, wealthy merchants would "rise to lend" in future.[825]

The attempt at domestic borrowing in 1894 did not immediately prompt institutional development toward fiscal centralization. Provincial governments borrowed from merchants separately. This kind of decentralized borrowing could not realize the potential of raising domestic loans because the merchants who could afford to lend to the state were mostly concentrated in coastal cities, particularly Shanghai, the financial and commercial center of China at the time. It was difficult for governors in less developed provinces such as Shandong and Hunan to find merchants who were able to lend to the government. The foreign loans by the central government did not necessarily lead to fiscal centralization as long as the Board of Revenue continued to assign revenue from provinces of collection to Shanghai to make interest payments to the Hongkong and Shanghai Bank. With China's defeat and the signing of the Treaty of Shimonoseki Treaty in April 1895, the Qing government ordered provincial governments to stop domestic borrowing as it had to give priority to paying off the huge indemnity to Japan. We therefore cannot tell what kind of institutional development that domestic borrowing would have produced if the Sino-Japanese war had lasted longer.

As it was, the indemnity of 230 million *tael* forced the Board of Revenue to search for new institutions to raise income. In June of 1895, the censor Guan Shixiang claimed that

[825] "惟是官商银钱往来，全在示人以信。此项息借银两，必须豫筹有著的款，届期本利全还，毫无挂欠，俾名商闻而兴起." 兼护湖广总督、湖北巡抚谭继洵折, 光绪二十一年二月二十七日, *Grand Council Memorial Copies*, Box 680, No. 1133-5.

there was no need to fundamentally reform the established institutions (*zuzong chengfa*); he advocated reducing government spending to the level of the in mid-eighteenth century and using the surplus to pay the indemnity.[826] In response, officials of the Board of Revenue argued that it was important to reform established institutions according to the changing times.[827] This was particularly true when retrenchment could not meet the needs of indemnity payments, defense, and important projects such as railways, telegraph, and arsenals. It is clear from their responses that the huge post-war indemnity and concomitant military expenditures, which could not be handled by the existing institutions of public finance, constituted a common problem for state actors in China. The principles of reforms were explicit in the imperial edict of 19 July 1895 which called for proposals for reform and self-strengthening, i.e., the urgent thing was to raise revenue for the military and the fundamental means were to encourage commerce and industry.[828] The indemnity thus provides an opportunity for us to observe the institutional changes in public finance implemented to meet this challenge and to evaluate whether they represent the early stage of an institutional learning process toward a modern fiscal state sustainable by the socio-economic circumstances in China at the time.

In regard to financial reform, there were three proposals between April 1895 and January 1896 to establish a state bank, which was to manage the collected revenue and

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[826] "居今日而理财，不在开源也亦在截流而已；亦不必变法也，亦法祖宗而已." 御史管式献折. Cited from the memorial of the Board of Revenue, August 8, 1895, *Grand Council Memorial Copies*, Box 680, No. 1170-7.

[827] "祖宗成法所当万世遵守者也。然时势异宜则斟酌损益，法亦因之而变洪." The memorial of the Board of Revenue, August 8, 1895, *Grand Council Memorial Copies*, Box 680, No. 1170-7.

[828] "大约以筹饷练兵为急务，以恤商惠工为本源." 上谕-令各省筹拟变法自强办法, 19 July, 1895. Cited from *Zhongguo jindai huobishi ziliao (xiace)*, p. 636.

government expenditures at both central and provincial levels, to issue banknotes, and to raise loans for the state.[829] The princes and officials who were in charge of military and financial issues also considered a state bank the necessary basis for commercial and industrial development to protect the interests of China against foreigners. They planned to establish state banks in Beijing and Shanghai first and gradually open branches in provincial capitals and major market towns.[830] Nonetheless, officials of the Board of Revenue still did not know how precisely to establish such a state bank. For example, they wondered how it could deposit official funds in both the center and provinces as these funds all had specific purposes and thus could not stay in the bank for too long.[831] They thus considered it vital to examine banks in Europe and the US, the contribution of banking to Japan's rise, and the methods used by the Shanxi bankers. Only then would it be possible to make the regulations for the official bank of China.[832]

In September 1896, Zhang Zhidong and Wang Wenshao, two powerful governors-general recommended Sheng Xuanhuai, a major advocate of establishing a state bank, to the center. On 27 May 1897, the Imperial Bank of China (*Zhongguo tongshang yinhang*) was founded as a joint-stock bank with a nominal capital of 5 million *tael* and a paid-in capital of 2.5 million *tael*. Among its twelve directors, eight were powerful bankers and

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829 See *Zhongguo jindai huobishi ziliao (xiace)*, pp. 635-6, p. 637, and pp. 640-1.
830 "一切工商之业，类皆抵敌洋商，自保利权之道，诚不可不认真讲求而不能漫无条理。俟银行根基稳定，次第推广." 督办军务王大臣会同户部折, 23 February, 1896. *Grand Council Memorial Copies*, Box 680, No. 1285-94.
831 "臣等窃维各直省官项存付银行者，非解部专款，则邻封协饷，银行难以久储；若以各直省库款付之银行，则必库款有余存而不动，设旋付旋提，究于银行何补也？" 督办军务王大臣会同户部折, 23 February, 1896, *Zhongguo jindai huobishi ziliao (xiace)*, p. 642.
832 "如蒙特简大臣承办，当于承办之先，博考西俗银行之例，详稽中国票号之法；近察日本折阅复兴之故，远徵欧美颠扑不破之章，参互考证，融会贯通，拟定中国银行办法." Ibid., p. 642.

merchants, including Yan Xinhou, Zhu Baosan, and Ye Chenzhong. By May of 1898, it had opened branches in Beijing, Tianjin, Hankou, Guangzhou, Shantou, Yantai, and Zhenjiang.[833] The Board of Revenue clearly used the Imperial Bank of China as a pilot project to see whether it was practical to establish a note-issuing state bank. The Shengjing general, 依克唐阿 (equivalent to the governor of Fengtian province) in January 1898 suggested that the Board of Revenue raise capital to establish a central bank to issue paper notes. In his view, under the current pressing need to raise government income, there was no speedy method available other than the issue of paper notes; and without the establishment of a state bank, there was no way to secure the creditworthiness of paper notes.[834] In response, the Board of Revenue pointed out that Sheng Xuanhuai had implemented the proposed plan in Shanghai. The Board of Revenue needed to see whether it would work out in practice.

In regard to issue of paper notes, officials of the Board of Revenue argued that adequate cash reserves were vital to their successful issue. Yet the government at the time was severely short of revenue, as it had to make the interest payment of 23 million *tael* every year. In this situation, they wondered whether it was feasible to let the state bank float paper notes. In particular, they pointed out that the devaluation of paper notes was the

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[833] For the early history of the Imperial Bank of China, see Albert Feuerwerker, *China's Early Industrialization: Sheng Hsuan-Huai (1844-1916) and Mandarin Enterprise* (Cambridge, MA.: Harvard University Press, 1958), see 225-241.

[834] "方今事势急迫 … 此时仓猝聚亿万之财，收亿万之利，舍钞法万无良图；欲行钞法，舍银行无以取信。[sic] 诚能于此时由户部筹款在京师设立总银行，外省提用库银于省垣设分银行，各处口岸则由关道筹款设立通商银行，仍由部印造钞票 … 凡完纳租赋税厘及一切报效上输之款，准其银钞兼收。文武官员廉俸，旗绿各营防营兵饷以及薪工役食，俱以银钞发放." 盛京将军依克唐阿折, February 15, 1896, *Grand Council Memorial Copies*, Box 680, No. 1696-703.

cause of the biggest samurai rebellion in Japan in 1877.[835] Opponents of a note-issuing state bank also used the failure of paper notes in the 1850s to make their case. Even Sheng Xuanhuai admitted that this most recent failure in floating paper notes was a lesson that should be taken seriously.[836] As late as January 1899, officials on the Board of Revenue, including the Minister Wang Wenshao, who had supported Sheng Xuanhuai's effort to establish a state bank, still considered it impractical for the government to issue paper notes. In their view, paper notes issued by the Board of Revenue could not circulate in the economy, as attested by the experience of the 1850s. Moreover, they were concerned that their use in public finance would drive silver out of China, leaving the government holding worthless paper notes.[837] Banknotes were thus viewed as a purely private credit instrument with which the state should not get involved.

The deep-seated caution of the Board of Revenue toward banknotes significantly restricted the performance of the Imperial Bank of China. Designed as a state bank, it was subjected to the restrictions of a central bank, as it could not invest its capital in industrial enterprises and real estate. Yet it did not have a monopoly on the issue of

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835 "惟是欲行钞票，必先宽筹成本。刻值洋债困于外，饷粮耗于内，出入相抵，不敷甚巨。何从筹大宗的款为钞票成本之用？若成本少而钞票多，则强轻为重，强虚为实，无智愚者知其不可。即如该将军声称，日本俄罗斯皆籍行钞以致富强。然日本西乡之乱，纸银一元不敌铜钱二百；俄国岁计亦载银罗般一易纸罗般十，可为成本不足不能流通之明证，此行钞票之难也." 户部折, March 23, 1898, *Grand Council Memorial Copies*, Box 680, No. 1735-9.

836 Sheng Xuanhuai, "Memorial note on the establishment of an official bank," 31 October, 1896. Cited from Xia Dongyuan ed., *Sheng Xuanhuai nianpu changbian (xiace)* [Autobiographical Materials of Sheng Xuanhuai] (Shanghai: Shanghai jiaotong daxue chubanshe, 2004), p. 541.

837 "[如由] 户部造票，使各省通行，并准其完粮赋、完税厘，是直以票为银，非仅以票取银，正与钞票无异。无论民间不肯相信，即勉强行用，而受之公家仍还之公家，库帑所储多系空纸，情形亦极可虑。[sic] 而目前正患银贱钱贵，再加以盈千累万之银票，银愈贱而钱愈贵，市价又何由而平." 户部折, January 27, 1899. *Grand Council Memorial Copies*, Box 680, No. 2012-20.

banknotes, which was the most profitable business for the Bank of Japan and Bank of England before they established their dominance in the domestic financial markets. Even in the remittance of official funds, the Imperial Bank of China had to compete with private banks which remitted money for provincial governments and customs offices. Moreover, it had to hand over silver to the Board of Revenue in its remittance to Beijing. As the Imperial Bank of China did not have many profitable projects to attract more subscribers to enlarge its capital stocks, it could only issue limited amounts of banknotes.

In contrast to its reluctance to float state banknotes in both public finance and the economy, the Board of Revenue was very interested in issuing state bonds to raise domestic loans. Shortly after the establishment of the Imperial Bank of China, the Zongli Yamen inquired whether it could provide low-interest loans to the government, as the Bank of England did for the British government. In reply, Sheng Xuanhuai pointed out that state loans in the west were raised by the bank on behalf of the state through selling state bonds in the markets not by using the bank's capital as security.[838] In January 1898, Huang Siyong, a metropolitan official, proposed adopting this method to borrow from Chinese merchants. In his proposal, he made it clear that such state bonds should be assignable in the markets and could be inherited as property. Moreover, the subscription of state bonds and the interest payment should be entrusted to private banks. In Huang's view, bonds secured by the state were more trustworthy than stocks issued by private companies.

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[838] Sheng Xuanhuai, "Reply to the inquiry of Zongli Yamen," 12 April, 1897. Cited from Xia Dongyuan ed., *Sheng Xuanhuai nianpu changbian (xiace)* [Autobiographical Materials of Sheng Xuanhuai], p. 572.

The Board of Revenue immediately approved this plan. In January 1898, it decided to issue state bonds of 100 million *tael* (named *zhaoxin*, meaning "great trust") in China. The value of each bond was 100 *tael*, bearing an annual interest rate of 5 percent. The term was 20 years. These bonds could be freely traded in the markets. However, the Board of Revenue did not entrust the subscription of these bonds to private banks, nor did it let private banks manage the interest payments. It did not even seek help from the newly founded Imperial Bank of China in Shanghai. Instead, the Board of Revenue replied upon administrative institutions to distribute these bonds among provinces. The responsibility of returning interest payments was thus passed to government treasuries scattered in Beijing and provinces. Although 10 million *tael* were raised through both voluntary and forced subscription, many of them were stored separately in treasuries of provinces and waited for the Board of Revenue's future assignments.

Considering the highly decentralized nature of Qing fiscal institutions, it was difficult for the Board of Revenue to take the responsibility of making interest payments for this domestic borrowing. But by decentralizing management of this domestic borrowing, they made it extremely difficult to discipline provincial governments to make punctual interest payments to creditors scattered in various provinces. Moreover, provincial governments had to give priority to meet their assigned quotas in making annual installment of 12 million *tael* after 1896 (plus an additional 5 million *tael* after the second loan from Britain and Germany in 1898) to return the loans which China borrowed from Britain, Germany, France, and Russia to pay the indemnity to Japan. In this situation, it was hard for provincial governors to safeguard the interest payments to the domestic subscribers of the *zhaoxin* bonds. The resulting chaotic interest payments greatly damaged the creditworthiness of the Qing government in the markets.

Although the customs revenue was the main security for the foreign loans, the Board of Revenue divided the annual installment of 12 million *tael* (17 million *tael* after 1898) among provincial governments and offices of the Imperial Maritime Customs.[839] The political authority of the center and the administrative ability of provincial governments are clearly illustrated by the punctual arrival of installments of annual interest payments to the Customs Office in Shanghai. The installments for the French and Russian loans had to arrive in Shanghai at the end of the third and ninth month every year; and those for the British and German loans at the end of the second, fifth, eighth, and eleventh months. The Board of Revenue ordered the Customs Office in Shanghai to send separate accounts on the received quotas from provincial governments, and to report to the Board by telegraph as soon as the assigned funds arrived in Shanghai. The Board also used telegraph to press provincial governments if there were arrears in sending the assigned installments.[840] According to the reports of the Customs Office in Shanghai, more than 95 percent arrived on time between 1896 and 1899.[841] These punctual interest payments suggest that the Qing government had the ability to raise long-term loans or to support its state bank, even if this was not realized.

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[839] Luo Yudong, "Guangxu chao pujiu caizheng zhi fangan [Methods to cover public finance in the reign of the Guangxu emperor]," in Zhou Kangxie, ed., *Zhongguo jindai shehui jingjishi lunji (xiace)* [Collected Essays in the Socio-Economic History of Early Modern China] (Hong Kang: Zhongwen shudian, 1971), p. 245.

[840] The memorial of the Board of Revenue, 光绪二十二年八月十七日, *Grand Council Memorial Copies*, Box 507, No. 2428-30.

[841] 两江总督刘坤一折, "江海关经理四国还款收支各数," June 8, 1899, *Grand Council Memorial Copies*, Box 507, No. 2796-8; September 21, 1900, *Grand Council Memorial Copies*, Box 507, No. 3087-9.

The return of the foreign loans constituted a pressing problem which forced both provincial and central governments to enlarge tax base and improve efficiency in tax collection. However, it was difficult for the government to extract more from the transit *lijin* levied on interregional trade. The major items in long-distance trade were all agricultural goods, particularly tea, grains, and cotton, whose consumption did not have the inelasticity of addictive consumption goods such as liquor and beer. The competition of Japanese and Indian tea in the international market made it impossible to raise *lijin* duties on the Chinese tea. Meanwhile, the Treaty of Shimonoseki not only opened more treaty ports in China but also allowed foreigners to set up enterprises in the treaty ports areas. In this situation, Chinese merchants increasingly chose to pay the additional tariff (*zikoushui*) at treaty ports rather than the transit *lijin* duties. Foreign businessmen who manufactured goods in China also pressured the Qing government to repeal the transit *lijin*.

The Qing government consequently began to search for alternative methods to collect indirect taxes. One option was to raise the tariff duties and thus repeal domestic lijin duties. Officials in the Board of Revenue and the Zongli Yamen had discussed this method in 1896. But its implementation had to be approved by the western powers. The collection of *lijin* duties upon immobile producers was constrained by the small scale of production of major consumption goods in China. Only Zhili, Sichuan, Jilin, and

Fengtian managed to collect taxes from liquor producers, and the annual receipts did not exceed 1 million *tael* in one province.[842]

As mentioned earlier, the tax levied upon domestic opium was an early target for centralized collection. After 1895, the Board of Revenue attempted to extend this method from Xuzhou to major provinces of opium production and trade and to collect uniform opium duties upon congregated volumes of opium. The center promoted officials who had demonstrated ability in collecting *lijin* duties, such as Ke Fengshi in Guangxi and Chen Yiluo in Jiangsu, to take charge of collection. Branch offices sent their monthly accounts to supervising offices in the province, which then sent account reports to the center every three months.[843] The total revenue collected from domestic opium rose from 2.2 million *tael* in 1894 to 9.3 million *tael* in 1907, of which the center retained 3.7 million *tael* and the rest was assigned to provincial governments.[844] Yet both illegal traffic and nation-wide movement against opium smoking in the 1900s checked the further rise of revenue from domestic opium.

IV. A modern fiscal state as a possible outcome

The institutional changes caused by the payment of indemnity to Japan after 1895 thus allow us to speculate about the two scenarios of China's possible transformation into a

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842 The annual receipts of liquor taxes were 630,000 *tael* in Sichuan in1906, and 800,000 *tael* Zhili in 1902, and 500,000 *tael* in Fengtian. See He Hanwei, "Qingmo fushui jizhun de kuoda jiqi juxian [The expansion of and limits to tax collection in the late Qing]," *Zhongyang yanjiuyuan jindaishi yanjiusuo jikan*, No. 17 (xiace) (December 1988): 69-98.
843 For the discussion of this process toward centralization, which was sped up by the Boxer indemnity of 1900, see He Hanwei, "Qingji guochang yapian de tongjuan yu tongshui [Centralization in collecting opium taxes in the late Qing]," in *Xinhuoji: chuangtong yu jindai bianqianzhong de zhongguo jingji* (Taipei: Daoxiang chubanshe, 2001), pp. 560-70.
844 Ibid., p. 570.

modern fiscal state. The fiasco with the issue of paper notes in 1850s compromised the path of floating paper notes in the economy. Foreign models were not convincing, both because historical memory of the earlier fiasco were especially strong in Beijing and because the examples of other countries offered negative as well as positive experiences with issuing paper notes.

The Board of Revenue was more willing to accept the token silver currency minted by machine than the "empty" paper notes. It allowed provincial governments in Guangdong and Hubei to experiment with this coinage. As the minted silver currency smoothly circulated in the markets, the Board of Revenue in November 1889 considered it to be "the badly needed thing for China" and ordered its expansion in Guangdong.[845] Its acceptance in both market transactions and government finance in Hubei and Guangdong encouraged the center to recommend its adoption to all coastal provinces in July 1894. In 28 March 1896, the Qing government declared counterfeiting silver currency a capital crime, ending its long-standing laissez-faire attitude toward silver currency.[846] In February 1900, Zhang Zhidong, the governor-general of Hubei and Hunan, sent officials of the Hubei Mint to Beijing to help set up the capital Mint. In the mintage of copper cash, the center also let provincial governments experiment first. Only when profit from the mintage of copper cash led to excessive mintage did the center begin to attempt to take control. In both cases, modern technology provided the means for the Qing

[845] "臣等伏思，兴铸银钱，实为中国现在应办之事." 户部折, 27 November, 1889. *Zhongguo jindai huobishi ziliao (xiace)*, p. 678.
[846] The memorial of the Board of Revenue, 28 March, 1896. *Zhongguo jindai huobishi ziliao (xiace)*, pp. 684-5.

government to achieve conformity in the mintage of silver and copper currency at both central and local levels.

In contrast to the reluctance to float paper notes, government officials at the time understood the importance of using its tax revenue to mobilize more financial resources through borrowing. Like the Meiji government in the same period, the Qing government only took out foreign loans in urgent situations. Unlike the Meiji government, the Qing government before 1894 did not have much pressure to try long-term domestic borrowing. The foreign loans undertaken to fund the military campaigns in the northwest and Xinjiang between 1866 and 1883 did not trigger any institutional development which introduced the use of credit instruments into public finance. The borrowed money was sent to troops on the frontiers in the form of either bullion or supplies. Meanwhile, the Qing government could rely upon its decentralized institutions to return these loans.

Nonetheless, the economic conditions needed to transform the Qing into a modern fiscal state along the English path were available in China after the 1880s. Firstly, a stock market had emerged in Shanghai between 1862 and 1872, and a specialized stock exchange company (*Shanghai gupiao pingzhun gongsi*) was founded in October 1882 to facilitate the transactions of stocks.[847] In the period from 1872 to 1883, modern enterprises in transportation and mining raised total capital of 6.64 million *tael* through selling stocks in Shanghai.[848] Secondly, there was a large amount of idle capital seeking investment opportunities in Shanghai and the coastal regions. By 1894, the estimated

[847] Tian Yongxiu, "1862-1883 nian Zhongguo de gupiao shichang [The stock market in China: 1862-1883]," *Zhongguo jingjishi yanjiu*, No. 2 (1995), pp. 58-9.
[848] Ibid., p. 64.

total wealth of some 10,000 compradors that was ready for investment was as high as 200 million *tael*.[849] Yet the interest rates on deposits in both native and foreign banks were low; for example, the interest rate of a one-year timed deposit in foreign banks in Shanghai was around 5 percent.

In this situation, the Qing government could have raised more financial resources by issuing state bonds in Shanghai. In their efforts to borrow from domestic merchants in 1894, government officials knew the importance of entrusting private financial intermediaries to manage the subscription and interest payments of credit bills for state borrowing. More importantly, the Qing government had demonstrated its ability to ensure punctual arrivals of the assigned revenues from the provinces to Shanghai. Punctual interest payments would make its bonds very attractive to investors in Shanghai and coastal regions. Nonetheless, considering the geographic distance between Shanghai and Beijing, the Board of Revenue had to be pushed to try to mobilize the financial markets in Shanghai for its purposes. Moreover, such pressure needed to last long enough to realize the mutually reinforcing effects between the punctual interest payments and the increasing confidence of investors in the bonds of the state. Had the Qing government used 5 percent of its annual income of 80 million *tael* in the late 1880s to serve a perpetual state borrowing at 6 percent, it could have raised 67 million *tael*. This amount of money could have supported its original plan to build two more fleets at the scale of the Beiyang fleet, a plan not realized due to the lack of funds.

[849] Xu Dixin and Wu Chengming eds., *Zhongguo zibenzhuyi fazhanshi* [A History of the Development of Capitalism in China], volume 2, p. 175.

Chapter 8 Conclusion: Actor, Institution, and Socio-Economic Conditions in the Rise of the Modern Fiscal State

The emergence and consolidation of new institutions, like other socio-political developments, is a temporal process requiring decades or even longer. This temporal dimension implies that there is a considerable time interval between the independent variables and the final observed institutional outcome that we want to explain. What kind of causal mechanisms can carry the causal effects across this time span between independent variables and a dependent variable? How do we locate the origin of such a temporal causal mechanism? These questions are important ones for the study of historical causation in the social sciences which use factors prior to the final outcome to explain it.

Take the building of a house as a metaphor for institutional development. Theories based upon the independent variables that are too close to the final outcome add little explanatory value, just like the putting of the last brick tells us nothing about how the house is designed and how its base was laid down. Causal indeterminacy simply rises exponentially the farther away that our independent variables are from the final outcome. The further we go back in time, we find that not only the design of the house but also the site of the building is open to debate among actors. In extreme cases, even the decision not to build can be possible if actors simply cannot resolve their differences. In explaining socio-political development, the vital thing is to identify a mechanism which can avoid deterministic explanations that "over-explain" and pure narratives that "under-explain" the final outcome of institutional development.

In this dissertation, I take the emergence and consolidation of the institutions of the modern fiscal state as a specific case of fundamental institutional innovation to address the general issue of how new institutions come into being, an important issue in institutional dynamics. The rise of the modern fiscal state results from actors' conscious efforts to try to bring together different kinds of institutional blocks – both old and new – into a new system of public finance. Nonetheless, this is only part of the story. Disagreements among actors over the design of new institutions involve not only their distributional impact but also their feasibility in practice. Is it possible for the state to live with its perpetual liabilities, either long-term borrowing or paper notes? Who is going to shoulder the major burden of taxation? Who is going to benefit from such perpetual liabilities? Socio-economic conditions significantly constrain different plans of institutional development. Not every place is suitable to build the same house.

The institutional learning model that I construct based upon detailed historical examination of the successful cases of England and Japan and the unsuccessful instance of China attempts to integrate various factors into one temporal causal mechanism. These included the ideas, cognitive capacities, and interest concerns of actors, their experiments with various institutional blocks, and the prevailing socio-economic conditions which they cannot easily manipulate to fit their preferred institutional designs. This model takes seriously the multiplicity of possible outcomes that are caused by the interactions among these factors. It then seeks to explain how the observed outcome arose from the pool of multiple possibilities inherent in the process of institutional development.

Existing theories regarding the rise of new institutions have done a poor job of addressing this multiplicity of possible outcomes. In neo-institutionalist models, actors' strategic calculations of interest determine their institutional preference. Politically powerful actors intentionally choose the institutional arrangements which will maximize their interests. In this light, the rise of new actors, such as the merchant class, becomes crucial to explain the establishment of new institutions. However, this approach has difficulty accounting for the creation of centralized institutions which efficiently extract revenue from indirect sources, particularly from domestic consumption. Based upon interest-calculation, traditional political elites whose wealth comes mainly from land should not oppose such institutions. The asymmetry of power implied in the collective action problem undermines the ability of ordinary consumers to organize politically to safeguard their interests. In this situation, neo-institutionalist models cannot explain the timing of the establishment of centralized fiscal institutions to collect taxes upon domestic consumption. Why does it take *decades* for political elites, including both the monied and landed classes, to find these institutions which are favorable to their interests? The problem with the neo-institutionalist account of institutional development is that it is *ahistorical*, i.e., it improperly assumes that actors have perfect information about the functions and distributional effects of institutions yet to be created.

As emphasized by the theory of punctuated equilibrium, fundamental institutional innovation often originates from the breakdown of old institutions which have exhausted their ability to handle new problems. Their collapse also means a lack of guidance or any kind of roadmap for actors, who therefore have to search for alternative institutions under the constraint of huge uncertainties. Neither the rational capacities of actors nor ideational factors are able to dispel the dense opacity in the early stages of searching for new institutions. For example, in the initial period of experimenting with new fiscal or financial institutions, in addition to different interests, ideas, and political agendas, actors have very different understandings of the intricacies of the financial market and its relationship with public finance. Their technical competence in regard to the operation of the financial markets also varies greatly. In an early modern state, even among officials in public finance, only a few could grasp the operation of credit instruments such as bills of exchange, banknotes, or paper notes. Moreover, private finance is different in nature from public finance. The attempt to connect tax revenue permanently with the state's liabilities in the financial markets, which were dominated by private financers, of course aroused suspicion, opposition, and even hostility among the majority of government officials.

Under these circumstances, strategic calculations based upon the interest concerns of actors are unable to determine the direction of institutional development. When the distributional effects of the nascent institutional arrangements remain uncertain, actors may oppose institutions that are in fact in their long-term interest, or embrace others that turn out ultimately to not be in their favor. In this light, the breakdown of old institutions opens up a space for innovation, yet it does not imply any specific direction of subsequent development. The early stages of fundamental institutional innovation are thus open-ended. There are competing plans or policy options, each of which implies different directions of institutional development. Agency matters, yet actors' intentions and willingness to search for new institutions to replace the discredited ones do not suffice to guarantee that they will look in the right direction. Power struggles among actors in the highly political process of institutional development further complicates the story. When the political cost of failure remains high, actors become risk-averse in experimenting with new institutional arrangements in public finance. Meanwhile, the lessons that could have learned from a pioneer's failures may be ignored by successors who have completely different institutional designs. This situation is highly unfavorable to attain a "collective learning" among the trials of different institutional arrangements, as we observe in innovations in science and technology.

The uncertainty inherent in the initial stage of institutional development and the multiplicity of possible outcomes it entails also causes trouble for the theories of institutional change found in historical institutionalism. The emergence of new institutions often has a sequential order. Nonetheless, the unique sequence leading to the observed institutional outcome is often one seen only in hindsight. When actors are groping for new institutions in the darkness, they have to face multiple possible sequences. Sequence analysis of institutional change begs the question of why it is this particular sequence, rather than the others, that explains the final result. Theories based upon self-reinforcing effects among the constituent elements of a new institutional system provide a powerful means to understand the consolidation of institutions. However, they encounter a similar problem of timing when we ask how a self-reinforcing mechanism began.

In the case of state long-term borrowing serviced by reliable revenue collected from indirect consumption taxes, why did state actors not realize a wonderful self-reinforcing mechanism between the efficiency in tax collection and the increasing amount of long-term credit they could obtain from the markets? This problem is more serious when we consider the multiple possible self-reinforcing processes inherent in a process of institutional development. For example, instead of a self-reinforcing process between efficient tax collection and increasing confidence of investors in state long-term borrowing, it is equally possible at the initial stage that unreliable or insufficient tax revenues undermine the confidence of creditors in government's long-term borrowing. The consequent difficulty in raising long-term credits in turn removes the pressure on the government to reform its institutions of tax collection.

Likewise, the use of credit instruments in the fiscal operation of the state is vital to centralize the government's fiscal management. The increasing centralization in fiscal operation then consolidates government officials' confidence in using credit instruments to transfer revenue and official funds. However, difficulties in stabilizing the value of credit instruments in public finance may lead government officials to abandon them and to rely instead upon a decentralized fiscal operation which assigns revenue from sites of collection directly to destinations of spending. This situation further reduces the necessity of introducing speedy credit instruments into state fiscal operations. A self-reinforcing process can be either a virtuous or a vicious cycle, leading to quite divergent institutional outcomes.

The problems that historical institutionalists have in explaining the emergence of new institutions are caused by their inadequate historical examinations of the *actual* process of institutional development. As a result, they often neglect the other possible sequences and outcomes and implicitly take the observed outcome as given. They then retrospectively find a particular sequence or self-reinforcing mechanism to "explain" it. The price to pay for doing so is an *ex post facto* interpretation of institutional development, which is in essence equivalent to the mistake of selection bias.

The causal indeterminacy and the openness to multiple possible outcomes in the process of institutional development are illustrated in the three episodes of institutional transformation that I examine in this dissertation. In the case of England, the nascent centralization in tax collection and the state dependence upon short-term credit bills to meet its spending in the 1650s did not automatically lead to a self-reinforcing process toward long-term credit. The fiscal decentralization and dependence upon big tax farmers for credit and collection of taxes between 1660 and 1667 had a strong "lock-in" tendency. The establishment of efficient and centralized Excise Department in the late 1680s did not necessarily lead to effort to build institutions of long-term borrowing. In the case of Japan, the need to "learn from the west" and centralize the fiscal system was by no means an object of consensus among major political actors between 1868 and

1871. Even when the new central government was established in 1871, there were still deep divergences over the tempo of institution building. Similarly, in the 1860s it was still too early to predict China's failure to centralize its fiscal system as important changes did occurred in its public finance in the 1870s and 1880s. The revenue from the indirect customs and *lijin* duties replace that from land taxes as the pillar of public finance. Provincial governments increasingly collaborated with private financiers to remit revenue and official funds. The center did not lose its political control in financial matters and had the necessary authority to mobilize funds to fight international wars. Seen in this light, a temporal mechanism needs to explain not only the observed institutional outcome, the modern fiscal states in England and Japan and its failure to occur in China, but also the non-occurrence of other possible outcomes in the process of institutional development in each case.

The institutional learning model that I propose in this dissertation provides a temporal causal mechanism to overcome the causal indeterminacy in the initial stages of institutional development and account for the observed institutional outcome. This model hinges on a conjunction of the necessary socio-economic conditions and a credit crisis of the state. In each case, a credit crisis originated from the unintended consequences of actors' desperate dependence upon the massively issued fictitious credit bills to meet government spending, such as short-term bills unfunded by tax revenue or non-convertible paper notes. It did not result from intentional efforts of actors to build new institutions and it was therefore exogenous to subsequent institutional development in public finance. The origin of this credit crisis thus rules out explanations that are based upon actors' intentional designs of new institutions.

Nonetheless, the credit crisis constituted a common problem which threatened the very survival of the state. As the available tools of public finance were unable to deal with the emergency, it forced state actors to venture beyond the "lock-in" condition of existing institutions. The nature of the credit crisis also provided an opportunity for officials with some grasp of the financial world to play important roles in building new institutions in public finance. Meanwhile, the special nature and the magnitude of the credit crisis tested the effectiveness of new institutional arrangements which actors implemented. Therefore, it not only forced state actors to innovate but also facilitated a continuous accumulation of effective institutional arrangements, practical knowledge among government officials, and competent financial officials. This remained true in spite of power struggles among government officials who had quite different political ideas, agendas, and institutional preferences. When this accumulation reached a self-reinforcing stage where effective and centralized tax collection secured the creditworthiness of the state's perpetual liabilities in the markets, either in the form of perpetual annuities or convertible paper notes, the process of institutional development moved irreversibly toward consolidation of the modern fiscal state. However, we must not take this continuous accumulation of institutional learning process for granted. It is unlikely to occur in absence of the credit crisis, given the existence of alternative directions of institutional development, such as the lock-in situation of fiscal decentralization or the rejection of paper notes based upon previous failures in floating them.

Socio-economic conditions, which actors could not manipulate to facilitate the implementation of their favored institutional arrangements, significantly affected the unfolding of the institutional learning process triggered by the credit crisis. For example, the scale of production and wholesaling determined in important ways the effectiveness of attempts to centralize the collection of indirect consumption taxes. The degree of the development of domestic financial networks and inter-regional trade greatly influenced the viability of the credit instruments that the state introduced to the markets and shaped the specific means to build up long-term liabilities of the state. For example, the existence of resourceful financiers in the economy who are able to hold government's short-term credit bills longer for future returns is one vital condition for the state to convert its massive short-term debt into long-term borrowing. Likewise, the smooth floating of government paper notes throughout the domestic economy depends crucially upon interregional economic transactions and financial networks which generate necessary demands for a uniform and convenient medium to reduce transactions costs.

Nonetheless, socio-economic conditions did not determine the direction of institutional development. The direction toward fiscal centralization, particularly in the collection of elastic consumption taxes, and long-term liabilities funded by tax revenue, was an outcome of the institutional learning process. But socio-economic conditions do constrain the possibility of an institutional learning process. In the extreme situation, unfavorable socio-economic conditions may simply prevent it from happening. The small and dispersed production of consumer goods can greatly hinder the state's efforts to establish a centralized direct collection of taxes upon domestic consumption. A domestic economy torn apart by civil war is also highly unfavorable for the state to introduce its paper notes as the standard medium of exchange. Socio-economic conditions do not simply allow an institutional learning process to take place but may also effectively shape its specific path. For example, the overwhelming concentration of financial networks and wealth in London and its surrounding environs in early eighteenth-century England significantly tilted the path of institutional learning process toward the direction of perpetual annuities rather than that of floating the banknotes issued by the Bank of England.

In each case of England and Japan, a credit crisis resulted from particular events which themselves did not dictate the direction of subsequent institutional development in public finance. Yet it triggered an institutional learning process which ended up with the institutions of the modern fiscal state. The credit crisis in England was mainly caused by the excessive issue of the unfunded short-term bills that the English government adopted as exigent fiscal measures. The problem of how to redeem the massive amount of fictitious Treasury Orders between 1667 and 1672 directly led to fiscal reforms toward more centralized management of the ordinary revenue. Meanwhile, as the royal government bore the full risk of redeeming these credit instruments that the state created in the markets, its contractual relationship with tax farmers increasingly leaned toward a wage contract, which paved the way for government direct collection of the customs and excise. The massive short-term credit bills between 1688 and 1693 constituted another credit crisis which forced the English government to begin experiments with various means of long-term borrowing thereafter. The sheer magnitude of government debt in 1713 basically defined the direction of problem-solving in the direction of prolonging the terms of debt and reducing annual interest payments.

The steady expansion of the English domestic economy and of foreign trade was necessary to yielding an increasing return effect in the process to centralize the collection of the customs and excise: rising receipts consolidated the royal government's confidence in the direct collection of the customs and excise. Likewise, the recovery of the domestic economy and the take-off of England's foreign trade after the disruptions of the Nine Years War provided two requisite conditions for the self-reinforcing process in the 1720s, which led to the successful conversion of the English government debts into low-interest perpetual annuities. Increasing domestic consumption and the appearance of the mass production of beer brewing in 1720 was favorable to the effective and centralized collection of the ever-rising excises. Reliable interest payments then enhanced investors' confidence in the government bonds of perpetual annuities, even though their annual interest rates were reduced to 3 percent. The increasing dependence upon indirect consumption taxes, particularly excises, to service the burden of interest payments of the government's perpetual annuities greatly reduced the conflict of interests between land owners and the government.

The nature of the credit crisis in Meiji Japan was quite different. It started as *de facto* long-term state liabilities, i.e., non-convertible paper notes issued by the Meiji government to fund its war to topple the Bakufu in 1868. The establishment of the Meiji regime prior to the building of necessary institutions to collect taxes forced the Meiji government to continue its reliance upon non-convertible paper notes. The decision to adopt the gold standard in 1870 had one serious, unintended consequence, which was to greatly exacerbate the credit crisis of paper notes denominated in gold when the value of gold in the international markets began to rise considerably after 1873. This credit crisis provided an opportunity for westernizing officials to dominate the search for necessary financial institutions to safeguard the value of government paper notes, regardless of the power struggles among different factions. The difficulties involved in handling the non-convertible paper notes in the domestic economy also shielded them from being purged by the politically powerful conservatives, even when they made many policy mistakes in early Meiji. The rise and fall of specific officials responsible for managing government finance did not affect the continuous accumulation of the institutional arrangements which contributed to centralization in both tax collection and management of government finance. These institutional developments paved the way for establishing the Bank of Japan to monopolize the supply of banknotes as the legal tender in the domestic economy in the late 1880s.

The growing Japanese economy following the opening to the west and the development of domestic financial and trading networks were the crucially important to sustaining the circulation of government paper notes even though they were *de facto* non-convertible.

Meanwhile, increasing domestic consumption, particularly the consumption of liquor, constituted an importance source of revenue for the government to tap. The formation of a national market in sake not only encouraged sake brewing but also facilitated the central government's efforts to build up a centralized bureaucracy to assess and collect the duties levied upon sake brewers after 1872. Nonetheless, as the credit crisis in Japan was caused by the floating of paper notes throughout the domestic economy, policy mistakes in handling the issue of paper notes had nation-wide distributional effects. These in turn stimulated increasing demands for a representative polity. The political stability of the institutions of the modern fiscal state in Japan in the 1890s was largely due to the huge indemnity from China in 1895, which greatly increased the financial resources of the central government vis-à-vis localities.

In comparison to the rise of the modern fiscal states in England and Japan, the failure to attain a similar transformation in nineteenth-century China illustrates the importance of a conjunction of necessary socio-economic conditions and a credit crisis to the unfolding of the institutional learning process. When the Taiping Rebellion forced the Qing government to issue paper notes to cover its deficits, the conditions in the domestic economy were highly unfavorable to the government's financial experiments. The civil wars cut off Beijing's connections with the economic core areas, disrupting both the transportation of tax revenue to Beijing and the private long-distance trade through the capital. Moreover, they disrupted the nation-wide financial networks that the Shanxi bankers had established by 1840 and greatly reduced the volume of long-distance trade.

As a result, the Qing government could not float short-term bills in anticipation of its incoming tax revenue. Meanwhile, its fiscal operation became more decentralized as tax revenues were sent from sites of collection directly to its troops on the battlefields. As the falling volume of large-scale commercial transactions reduced the demand for silver, the Qing government in 1855 decided to switch from silver to copper cash notes in its experiment with paper notes. Its original purpose was to satisfy the increasing demands of the war economy and thus facilitate the circulation of copper cash notes in the economy. However, the difficulty of transporting bulky and low-valued copper cash across regions made it impossible for copper notes to become the uniform currency in the domestic economy. The issue of paper notes denominated in copper cash thus failed to stimulate the development of fiscal centralization.

The situation in China between the 1870s and 1890s was just opposite to that between the 1850s and 1860s. The post-war economic expansion provided a stable base for the state to extract revenues from the customs and domestic consumption taxes, which became the major pillar of public finance. The revival and development of domestic financial networks enabled provincial governments to increasingly collaborate with private bankers to remit tax revenue to Beijing. Under these conditions, there was no pressure to force the central government to re-experiment with the issue of its own credit instruments, particularly when the memory of the fiasco of paper notes was so fresh among political actors. Without credit instruments to speedily transmit government funds to localities, the central government could only continue to rely upon the traditional assignment system to designate the direct transfer of monies from sites of collection to places of spending. The ability of the decentralized assignment fiscal operation to support – albeit with some difficulties – the expensive and prolonged military campaigns in the northwest and Xinjiang between 1866 and 1882, not to mention the building of a modern navy, further reduced the need to seek alternative institutions. Thus fiscal decentralization and the center's lack of credit instruments mutually reinforced each other. This lock-in situation continued until the huge indemnity to Japan after 1895 forced the Qing government to resume the search for new institutions, such as the state bank and the centralized collection of opium taxes.

The relatively small scale of production of major consumer goods in nineteenth-century China severely restricted the Qing government's ability to centralize the collection of indirect taxes levied upon domestic consumption. This contrasted sharply with the elastic revenues that the English and Japanese governments could extract from the large-scale production of beer and sake respectively. Meanwhile, the lack of a uniform standard in the silver currency made it difficult for the state to float silver notes throughout the domestic economy. Nonetheless, the necessary conditions for the central government to raise long-term loans were available in late nineteenth-century China. Although the economy did not allow the establishment of a highly centralized bureaucracy to collect indirect taxes from major consumer goods, the Qing government did have the institutional ability to centralize the collection of the customs. More importantly, the Qing state exhibited the ability to ensure punctual arrival of the annual installments of some 12 million *tael* in tax revenue from various provinces to Shanghai so as to pay the indemnity to Japan.

As we have seen in the case of England, this ability was vital to encourage investors' confidence in the state's long-term borrowing. Meanwhile, the necessary conditions for the state to build up the system of market-based long-term borrowings were satisfied in China at the time: the stock markets in Shanghai, the practice of issuing short-term bills of borrowing which could be freely traded in the markets, and a community of investors who were looking for secure opportunities of investment. Considering the close connections between the major government officials and big financiers in nineteenth-century China, it is not far-fetched to suppose that a financial institution similar to the Bank of England could have emerged in Shanghai in the late 1890s. It could have managed the subscription and interest payments of the government's long-term borrowing raised from the markets. Such an institution could have secured political supporters in Beijing by attracting princes and officials to invest in state bonds. It could have won the favor of the officials of the Board of Revenue by sending them annual "gifts," as the Bank of England did to the officials of the Treasury in the eighteenth century. However, in the absence of an institutional learning process, these elements remained disconnected and could not form a self-reinforcing process toward the institutions of state long-term borrowing.

The institutional learning model thus provides a common mechanism to explain different routes and sequences of developing the institutions of the modern fiscal state in England and Japan, as well as the failure to do so in China. Moreover, for each case, it explains why other *possible* outcomes are not the observed one. Furthermore, it not only takes into account exogenous factors in institutional development but also has a built-in endogenous mechanism to explain the timing of the appearance (or not) of a specific institutional outcome, i.e., the rise of the modern fiscal state. It explains in detail the path-dependent processes of the emergence (or not) of the modern fiscal state. In comparison, conventional theories about the functions and distributional effects of existing institutions cannot explain the establishment of these new institutions, even though they are important to understanding their stability.

At the same time, the contribution of the institutions of the modern fiscal state to enhancing state capacity and stimulating financial development, particularly the development of the securities markets, casts new light on the role of the state in economic development in general, and late development in particular. The existing literature of late development often assumes that in eighteenth-century England, economic development in general and financial development in particular resulted from the operation of a free market economy. The state is perceived as playing only a negative role of protecting property rights. As we have seen, however, the ability of the English state to effectively collect indirect taxes to service the interest payments of its perpetual annuities was vital to the development of the contemporary securities markets. Likewise, the Bank of Japan, which was backed by state tax revenue, was able to encourage long-term investments in railway building through discounting the bills of banks which accepted stocks of major railway companies as security. This method of promoting long-term industrial investment was different from both the state's direct industrial investment and the practice of universal banking, the two usual policies to stimulate long-term industrial investment in the theory of late development.

In contrast, the regular tax revenue of the Qing government remained separate from the stock markets in late nineteenth-century Shanghai. As a result, there were no securities such as state bonds to stimulate the steady development of the stock market. Instead, the dominance of stocks of joint-stock companies whose values varied frequently in the markets led to fluctuations, which further enticed speculative investments. The functions of the modern fiscal state in a market economy suggest the institutional causes which led to the lack of long-term industrial investment in late nineteenth-century China.

Finally, the modern fiscal state possesses a significantly greater ability to affect the economy and welfare of the whole society through its fiscal and financial policies. It is therefore not surprising to find that the institutions of public finance become a major focus to contest for fairness and justice in the making of tax and financial policies. The regressive nature of public finance greatly agitated social reformers in England in the late eighteenth and early nineteenth centuries. Likewise, the purpose of the newly established institutions of the modern fiscal state was bitterly debated in the Japanese Diet in the early 1890s. Clearly, the path-dependent nature of the process of institutional change does not imply an end of politics when the path moves irreversibly toward a particular institutional outcome. Instead, new institutions provide different platforms for politics.

Archival Sources:

Unless otherwise noted, all box numbers refer to the catalogue number of each microfilm box preserved in the No. 1 Historical Archives, Beijing.

Palace Memorials Concerning Money and Finance (宫中硃批奏折- 货币金融项):
Boxes: No. 60, No. 61, No. 62, No. 63, No. 64

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Concerning Commercial Taxes (from the Daoguang to Guangxu reign) 杂税类 (道光朝至光绪朝):
No. 487, No. 488, No. 489, No. 490, No. 491

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