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The Making of Credit and Debt in Pre-Industrial France

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Introduction

In 2008, the American housing bubble unexpectedly burst sending property values plummeting. Thousands of American families had ceased refinancing their household loans. Their adjustable-rate mortgages far outpaced the value of their homes, causing a wave of foreclosures across the country. An estimated nine million households lost their homes because the subprime loans they had subscribed to were subject to speculation on the stock market and to predatory lending, making them incredibly toxic.[2] In the meantime, banks and insurance companies, which had neither anticipated the bubble nor the high number of failed payments, faced huge difficulties. Real estate is not only the largest single form of wealth, it is also the most important form of collateral for borrowing.[3] Lehman Brothers Holdings in the United States, one of the most infamous investment banks, and one of the most important, could not avoid bankruptcy. Other banking institutions had to be bailed out at the expense of the American taxpayer simply to avoid a crash of the world's financial system. Yet, the 2008 financial crisis, which led to the eviction of millions of people, decimated stocks and hard-earned family savings, and shut down business was the result of human action. It is perhaps one of the worst self-inflicted economic disasters. Highly complex, sophisticated and heavily intermediated financial mechanisms, coupled with moral hazard and deregulation in this sector, contributed to this situation and to the ensuing worldwide financial and social crisis in the following years. How did we end up there? My current research project and the topic of a forthcoming book proposes to rewind the course of history and look at the world before banks.

In early modern Europe, and in France in particular, the allocation and deployment of financial funds was mainly assured by private lenders via peer-to-peer transactions. There was no bank, no credit score and no algorithms to determine who was eligible to a loan. While there existed early forms of banking in premodern Europe – such as the Medici bank for example – they were reserved for a tiny fraction of the population, the wealthy and privileged.[4] Commercial banks as we know them today only emerged in the 1820s.

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[2] Noelle Stout, *Dispossessed: How Predatory Bureaucracy Foreclosed on the American Middle Class* (Oakland, California: University of California Press, 2019), 4.
[3] Adam Tooze, *Crashed: How a Decade of Financial Crises Changed the World* (New York: Viking, 2018), 43.
[4] Raymond De Roover, *The Rise and Decline of the Medici Bank, 1397-1494* (Beard Books, 1999).

My research on pre-industrial credit has shown that moral norms prevailed in peer-to-peer lending within tight-knit societies before the advent of commercial banks. Loans were flexible and could be renegotiated. Norms of cooperation, solidarity and fairness prevailed. And predatory lending remained rare.

1. What was Peer-to-Peer Lending?

In early modern Europe, credit and debt were the two most essential features of economic exchange. Warding off temporary shortages in the cycle of agrarian economic activity constituted the primary function of credit in traditional societies. But in the early modern period, economic development, characterized by substantial growth – notably thanks to improvements emerging in a period of proto-industrialization and boosts in agricultural output – also required more capital and financial exchange for further investments, engendering growing indebtedness. Credit was therefore an essential financial tool for millions of Europeans, either to sustain their investments or to make ends meet.

Before the advent of banks, the allocation and deployment of financial funds was mainly ensured by private lenders. Throughout Europe, women and men borrowed and lent from each other, often at the local level, in tight-knit networks.[5]

Peer-to-peer lending networks were in fact extensive networks of personal relations. These networks often formed at the local and even hyperlocal level. These chains of credit were deeply embedded in the social fabric of the community. Creditors and borrowers often knew each other, and they had good reason to extend loans to one another. Because actors in early financial networks knew each other, were linked by strong ties, they had incentives to cooperate and act fairly towards one another.[6]

Early financial markets were characterized by exchanges that were autonomous from the state. Before the second half of the eighteenth century, most private loan transactions took place without much institutional involvement or intercession. State institutions did provide some facilities for the conclusion of contracts (notaries in France, Spain, and Italy for instance) and their enforcement (courts, in most Western regions), but regulation was otherwise largely absent.

2. Contracting

There were multiple different types of credit instruments and various channels from which to obtain a loan/credit. Throughout France, pre-industrial credit markets were indeed characterized by their diversity. Credit transactions ran the gamut from daily exchanges to shop

[5] See for instance Elise M. Dermineur, "Rethinking Debt: The Evolution of Private Credit Markets in Preindustrial France," *Social Science History* 42, no. 2 (2018): 317–42; Craig Muldrew, *The Economy of Obligation: The Culture of Credit and Social Relations in Early Modern England* (New York: Palgrave Macmillan, 1998); Philip T. Hoffman, Gilles Postel-Vinay, and Jean-Laurent Rosenthal, *Priceless Markets: The Political Economy of Credit in Paris, 1660-1870* (Chicago: University of Chicago Press, 2001); John F. Padgett and Paul D. McLean, "Economic Credit in Renaissance Florence," *The Journal of Modern History* 83, no. 1 (2011): 1–47; Chris Briggs, *Credit and Village: Society in Fourteenth-Century England* (Oxford: Oxford University Press, USA, 2009).

[6] See for instance Laurence Fontaine, *L'économie morale: pauvreté, crédit et confiance dans l'Europe préindustrielle* (Paris: Editions Gallimard, 2008).

for groceries at the local market, notarial contracts to purchase land, to promissory notes for the domestic servants' wages. Therefore, a wide range of credit contracts existed; either contracts sanctioned by an official seal or non-official – written or verbal – agreements. Contrary to our modern experience with banking loans, the credit experience of French people was marked by both lender's and borrower's high input and expectations.

Creditors and borrowers often knew each other and were bound either by family ties or by geographical or social propinquity, if not all three. Parties had information available on each other, such as the standing of an individual's reputation, a critical factor in establishing creditworthiness. A good reputation for honesty and reliability in obligations was of great social importance. In the absence of a credit score or any other form of screening mechanism, reputation and social capital (who you know and who knows you) played a critical role in a debtor's eligibility to negotiate a loan. Strong bonds between villagers equated strong social norms and a high level of trust.[7]

How important was this peer-to-peer lending system in premodern Europe? A simple look at probate inventories suffices to fully understand credit's economic significance. Most descendants left liabilities behind, evidence of the prevalence of credit and debt. In Paris, at the beginning of the eighteenth century, 65% of day laborers died with debt. Towards the end of the Old Regime, 80% did so.[8] In Alsace, 80% of the deceased bequeathed debts to their heirs,[9] and only a third of households left a positive balance on their deaths.[10] In fact, before the ascent of banks, the volume of mortgage debt was equal to at least 10% of GDP in 1807, a percentage highlighting the vitality of early financial markets.[11] This figure, however, is only the tip of the iceberg, largely because the calculation is based solely on transactions extracted from notarial records and does not include unregistered and/or verbal loan agreements. If one adds up these shadow transactions, then the significance and ubiquity of credit in the early modern economy is stunning. And its importance even increased throughout the early modern period.

3.Flexibility

The basis of peer-to-peer exchange was the possibility to negotiate and renegotiate. Most of the credit agreements were very flexible by modern standards, in at least three ways. First, parties could negotiate the terms of their agreement and could skirt around the legally-imposed interest rate limit. Interest could be concealed in the loan itself.[12] Even in notarized contracts. After all, there was no, or little, coercive authority, and almost no control over private agreements. Second, despite the fact that most deeds specified a short-term deadline, it took

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[7] Elise M Dermineur, "Trust, Norms of Cooperation and the Rural Credit Market in Eighteenth-Century France," *Journal of Interdisciplinary History* 55, no. 4 (2015): 1–22.
[8] Rebecca L. Spang, *Stuff and Money in the Time of the French Revolution* (Cambridge, Massachusetts: Harvard University Press, 2015), 45.
[9] Jean-Michel Boehler, *Une société rurale en milieu rhénan: la paysannerie de la plaine d'Alsace (1648-1789)* (Strasbourg: Presses universitaires de Strasbourg, 1995), 1180.
[10] Elise M. Dermineur, "Peer-to-Peer Lending in Pre-Industrial France," *Financial History Review* 26, no. 3 (December 2019): 365.
[11] Philip T. Hoffman, Gilles Postel-Vinay, and Jean-Laurent Rosenthal, "Entry, Information, and Financial Development: A Century of Competition between French Banks and Notaries," *Explorations in Economic History* 55 (2012): 39–57.
[12] See for instance James E. Shaw, "The Informal Economy of Credit in Early Modern Venice," *The Historical Journal* 61, no. 3 (2018): 623–42.

longer for borrowers to repay – therefore the initial length specified in the contract mattered very little. It took longer to repay because most people had an irregular income. As a result, some loans were renewed either informally or formally. But most agreements were simply "rolled over"; as long as the interest was paid, both parties found themselves satisfied. And finally, a degree of flexibility existed regarding the guarantees backing loans and the function of such guarantees. For example, borrowers could offer the payment of interest in kind via the land they pledged if needed.

4. What happened in case of default?

Despite the norms of solidarity, cooperation and fairness that characterized pre-industrial society, breach of agreement did occur. When lenders and debtors had exhausted all the informal possibilities available to settle their disagreement, taking the matter to court was often the last resort.

In cases of dispute, the local judge summoned the parties to appear at court, assessed the validity of the contract and requested its terms be enforced.

But the judge had more of an arbitration role than a coercive role. A lot of these disputes had to do with accounting. People had a hard time keeping track of payments and repayments. Reciprocity made exchange more complex and therefore more difficult to untangle.

However, if the debtor fell short of resources and could not meet the terms of payment, the judge ordered foreclosure and an auction of the debtor's assets. But in fact, many lawsuits stopped after the first hearing at court and parties preferred to resume talks and negotiations privately. People could acquire a summons from the court system but then did not choose to pursue them aggressively. A summons to court sent a signal to other members of the community regarding the state of one's affairs. On the one hand, a debtor's reputation was at stake in an age when information remained scarce and when a credit score system did not yet exist. For a debtor, a summons to court, being in the public eye, meant a stain on her reputation.[13] Some debtors ran the risk of seeing other debts being suddenly recalled. On the other hand, taking an insolvent debtor to court mattered also to the creditor's reputation.

A summons to court for the first hearing was a means to publicly shame bad debtors. It acted as a tool to publicize a bad debtor. Summoning an insolvent debtor to court in the public eye acted as a credit score system.

Concluding remarks:

Today, and especially since the 2008 crisis, there is little trust left in the banking system. In the United States, in 2019 when Donald Trump was still president, there was more confidence in the presidency and the police than in the banks. In Sweden, there is more confidence in Systembolaget, the government owned chains of liquor stores, than in banks. I am not suggesting that we should go back to early modern peer-to-peer lending but there is perhaps something to borrow from these early financial markets in order to reintroduce flexibility and facilitate access to funds for the most disadvantaged. Adjustments and alternative choices based

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[13] Daniel Lord Smail, *The Consumption of Justice: Emotions, Publicity, and Legal Culture in Marseille, 1264-1423* (Cornell University Press, 2003).

on past experiences can be (re)implemented for a fairer society and economy. Early financial markets offered human-oriented features, as the book highlights, features we have lost.

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