Peter Ericsson, Uppsala University
Patrik Winton, Örebro University

## Financial Intermediation in Stockholm, 1720–1760

In this paper, we analyze how the financial market in Stockholm functioned by focusing on financial intermediation between actors. Since the market was so large, it was impossible for participants in the market only to rely on their existing social networks to receive information about prices and availability of credit. Many also needed help with organizing transactions. This demand for financial services created opportunities for actors, such as government civil servants, merchants, brokers and shipping agents, to provide assistance, but also to profit from information asymmetries. We use ledgers created by the government's Debt Office (*Riksens ständers kontor*), to track how financial intermediation developed over time and to investigate the different strategies actors utilized in the market. This rich source material has not been used before by research.

Financial markets are crucial to any advanced economy as they function as meeting places for savers to link up with borrowers. A well-functioning market increases available capital and provides means of payment. It also reduces risk and time lags and makes it easy for creditors to sell their claims to others. However, markets are not perfect. Their imperfections take the form of transaction costs, such as information asymmetries and lack of trust. Today such hurdles are reduced by the banking system. But before banks existed, transactions had to be organized in other ways in order to overcome obstacles.

In the early modern period intermediaries were crucial in structuring financial transactions and in bridging geographical distances. Their know-how enabled them to make a profit on imperfect markets, at the same time as they made the markets a little less imperfect (Neal 2000, Neal & Quinn 2003, Flandreau 2009). Although we know that intermediaries existed, our knowledge how their activities were organized in Sweden during the 18th century is very limited.

The market for government debt that emerged in the 1710s and 1720s reached all parts of Sweden and all sectors of society. It was the first time that virtually all subjects owned financial instruments that could be traded in all parts of the realm. In order for transactions to take place it became necessary for intermediaries to provide assistance. The challenges were many: Sweden was sparsely populated with large geographic distances; with mostly localized credit markets; and with limited information about the creditworthiness of people in other parts of the realm. By examining the activities of intermediaries in Stockholm, which was the largest town and financial center in the Swedish realm, we are able to gain a new understanding of how such activities functioned.

As we are dealing with a financial market that is not very established, and where the level of specialization is low, we use the concept of intermediary in a wide sense. Financial intermediation is a response to obstacles associated with financial transactions and the well-functioning of financial markets. The role of an intermediary is to aid in a transaction between two parties, such as a debtor and a creditor. Some intermediaries are mere matchmakers, while others take an active part by investing their own money in the transactions. Either way, intermediaries add value by conveying trust and legitimacy. They are able to provide their services because they know how the market operates. They also have access to crucial information, which is not always freely available. Intermediaries thus manage and distribute asymmetric information, but they are also imbued with trust. Trust is necessary in order to collect the information needed, but it is also vital for their ability to act on behalf of multiple parties with conflicting interests. Without information they would be redundant. Intermediaries can therefore be characterized as hubs of information (Lamoreaux 1994, Neal & Quinn 2001, Neal & Quinn 2003, Levy 2012, Bochove 2013).

Beside information and trust, financial intermediation is also affected by geography and density. Long distances and lack of communication create opportunities for individuals who can bridge that gap, not only between remote rural areas and commercial centers, but also between cities and towns. Density is also important to the creation of markets and thereby in the rise of intermediaries. As manufacturing and trade were concentrated in towns, the demand for financial services was most dynamic there. The risk associated with overseas shipping, for example, had a strong influence on the development of insurance mechanisms and intermediaries. Furthermore, people of a certain community will determine the type and extent of services that they require. Demand will increase not only because of population growth, but also because personal networks become more diffuse and information asymmetries will arise as the population increases and people grow less familiar with each other. Thus, the more complex a community is, the greater the demand for intermediaries (Masahisa, Krugman & Venables 1999, Flandreau 2009).

Financial transaction costs in the early modern period had several interdependent causes, such as distrust; geographic distance; lack of information; problems of enforcement; and time lags. Previous research has noticed three basic means to overcome such obstacles and reduce transaction costs. The first solution was to deal with people you knew, such as family members, friends and neighbors. The social network strategy depended on ties between the individuals involved, and the transactions were handled without involving a third party. Such transactions have been described as informal and based on trust and personal obligations. Various social groups could employ this strategy. Scholars have identified noblemen, merchants, craftsmen and peasants using this strategy. It has been emphasized that such transactions took place in both rural and urban settings, and within various legal and political frameworks (e.g. Muldrew 1998, Müller 1998, Lindgren 2002, Perlinge 2005, Fontaine 2014, Dermineur 2015, Lindgren 2017).

The second strategy was to use a third party to oversee and coordinate transactions. Here, the role of notaries as intermediaries between debtors and creditors has been emphasized. Notaries could facilitate transactions by bringing together people unknown to each other and by monitoring their actions to ensure that they followed contracts. Instead of trust between debtor and creditor, the system was built on the parties' trust in the office of the notary and his ability to intervene if one party failed to recognize its obligations. Notaries were especially important in France, the Holy Roman Empire, Spain and the Dutch Republic, but in Britain and Scandinavia they played a much more limited role (Hoffman, Postel-Vinay & Rosenthal 2000, Levy 2012, Bochove 2013).

The third strategy was to utilize widely trusted payment institutions, such as bills of exchange drawn on established merchant houses in major economic centers. Such financial instruments facilitated payments over long-distances and reduced the risk of currency depreciation. There was also an established procedure to deal with non-compliance. The bills of exchange existed throughout Europe; they were traded on an open market; and there were brokers in the major towns who could help actors acquire and sell them. (Samuelsson 1955, Müller 1998, Neal 2000, Flandreau 2009, Andersson 2011).

Swedish historians have recognized the important role social networks and personal relationships in financial transactions played during the early modern period. They have also dealt with bills of exchange in international trade. Especially the export of bar iron was dependent on the availability of internationally recognized bills. Such transactions have mainly been studied by using source material from the iron works sector and the major merchants, and by analyzing probate inventories. The importance of intermediation for well-functioning financial markets has been recognized, but there are no studies on how intermediation actually worked in Sweden before the emergence of a banking system.

By examining the market for government debt, it will be possible to fill this crucial gap, and to relate the workings of the Swedish system to broader European developments. In an international context, the Swedish case can illuminate how intermediation functioned in markets where notaries played a very limited role.

The debt market in the early eighteenth century consisted of vast numbers of prospective sellers and a much smaller group of wholesale merchants that were the potential buyers. The emergence of the market was driven by the king's need to finance a continued war effort. From 1715 to 1718, bonds were issued to a total value of about 2.5 million silver daler (dsm.) In 1715, military officers and civil servants were paid in salary bills, to a total worth of around 1.2 million dsm. Their value, however, was dwarfed by the output of fiat coins. The light copper coins had a denomination of 1 dsm, but their copper content was very low, and they could not be exchanged for any precious metal. In conjunction with them, paper bills were initially issued, but they never reached the same volumes. At the end of 1718, an unpreceded amount of around 20 million dsm. in fiat money was circulating. After the death of Charles XII, the new regime partially defaulted on the fiat money. All fiat money should be exchanged for so called insurance notes, for a little less than 50 per cent of their nominal value. The insurance notes could only be redeemed as payment for a new customs duty on international trade, the *licent*, which was administrated by a new government agency, *Riksens ständers kontor*, which can be characterized as a Debt Office (Ericsson & Winton 2019, 2020).

In June 1719, around 200,000 transactions took place in which over 20 million dsm. worth of fiat money was exchanged for insurance notes. Money was thus transformed into securities to a new nominal value of 9.1 million dsm. Moreover, since all households held fiat money, virtually all households initially held such securities. In order to liquidate their assets, it was necessary for the holders to sell their notes to merchants who could either use them to pay the licent or resell them to other merchants. Thus, several transactions stretching over several years could take place before the bills and notes were liquidated. For this market to emerge, it was crucial for the prices on the secondary market to be considerably lower than the nominal value. It was only when paying the licent that a holder received the nominal value. At other times, holders had to accept to sell their notes at a discount that could be as high as 80–90 percent.

We have studied two categories of intermediaries who were very active on the market for government liabilities, namely brokers and shipping agents, none of which have received any attention from previous research. A royal ordinance, dating from 1720, which set out to regulate their activities can provide some information of their operations. Brokers were appointed by the magistrate and had to take an oath. They were prohibited to conduct any trade of their own, as not to jeopardize their impartiality. They mediated in a variety of business activities; real estate, ship's cargoes or any type of commodity exchange between merchants. They would also mediate loans or means of payment, typically bills of exchange, and they were engaged in currency exchange. Moreover, and crucial to this study, they would trade in government liabilities and provide their customers with the securities needed to pay the *licent.* The latter activity, however, was not explicitly regulated in the ordinance of 1720.

The leading broker of the 1730s, -40s, and 50s was Matthias Lafransen. His activities give an idea of the scope and depth of the market of government liabilities. Like hundreds of others, mainly merchants, but also a variety of subjects and institutions, he held an account with *Riksens ständers kontor* from 1723 to his death in 1757, where many of his transactions were registered. Over the 35 years that he was active, Lafransen deposited or bought liabilities to a nominal value of close to 830,000 dsm. in slightly more than 1,100 separate transactions. He redeemed liabilities as *licent* payments or sold to other actors for a nominal value of about 805,000 dsm. in more than 1,800 separate transactions. What sets his dealings apart was not their frequency but the high value of the individual transactions. Typically, he was buying and selling liabilities in bulk with even denominations to and from leading merchants, a strategy that characterizes a wholesale actor on the market. Not only that, Lafransen conducted a fair amount of his business with government liabilities outside his account at *Riksens ständers kontor*. The sheer numbers and the geographic distribution of origin of the liabilities would have made it impossible for him to collect them on his own. Instead, he relied on a network of business contacts, 'his men' he called them, to acquire the various bills and notes and to sell them on to him. These transactions were based on credit, and the sellers were not paid until Lafransen redeemed the bills as *licent* payments or sold them on to others. It was most likely in this segment of the market that more substantial profits could be made. As for his social standing, his probate inventory reveals that Lafransen died a very wealthy man. His assets included two houses in Stockholm, and large 'secure claims' on a number of merchants. This sets him on par with the wholesale merchants of Stockholm.

Shipping agents were also very active on the market for government liabilities. A royal ordinance from 1748 set out to regulate their operations, which was probably a codification of their previous practices. The main function of shipping agents was to facilitate trading and to assist merchants and seafarers in their dealings with local authorities. Just as the brokers, they were appointed by the magistrates and required to take an oath in order to guarantee honesty and impartiality in their dealings. At the arrival of a merchant ship, the shipping agent was to meet up with the captain; inspect the ship and ensure that passports and other necessary documents were presented at the customs duty office. As the ships were ready to depart, the shipping agent should see to that the required warrants and passports were issued and delivered; that receipts and other documents were in order; and that pilots were contracted. The fee for their services depended on the size of the ship and on whether it was domestic or foreign owned.

Shipping agents offered to provide merchants with the liabilities needed to pay the *licent*, or to pay it on their behalf. As a result, they were among the most active on the market for government liabilities, and in the 1740s and 1750s the most active among the shipping agents was the firm of Frisch & Knaak. In the sixteen years from 1740 to 1755 they deposited or bought liabilities to a nominal value of around 745,000 dsm. in more than 4,500 separate transactions. During the same period, they redeemed liabilities as *licent* payments or sold to other actors for a nominal value of 740,000 dsm. in 1,950 separate transactions. The two shipping agents Diedrich Frisch and Anthoni Knaak were active both before and after their joint venture, but during these years their activities peaked. Compared to the broker Lafransen, the shipping agents dealt in smaller amounts, and the amounts were often denominated in uneven sums. On the other hand, Frisch & Knaak conducted more individual transactions than Lafransen did, and so did a few other shipping agents that we have examined. As for the transactions in liabilities conducted outside *Riksens ständers kontor*, the activities of the shipping agents are difficult to access. They did, however, purchase a substantial amount of their holding of bills and notes from sellers that did not have an account of their own, which indicates that they could have done their business in ways similar to that of Lafransen's. Probate inventories reveal that shipping agents were rather prosperous burghers, who owned houses in Stockholm. But they were not part of the elite, and the value of their property could not be compared to that of Lafransen's.

The cases of Lafransen and Frisch & Knaak show that financial intermediation was a bustling business in Stockholm during the eighteenth century. The business was driven by an expansion in international trade, but also by the demand for assistance when dealing with government liabilities. Thus, there were inseparable connections between the mercantile activities and the workings of the Swedish fiscal-military state. The activities of brokers and shipping agents show that the credit market in Stockholm included so many actors that it was impossible for social networks to coordinate and monitor the behavior of the market participants. The results of this study therefore leads to a questioning of the existing narrative in the literature that focuses on the informal character of early modern credit in Sweden. The results also show that the number of transactions that the brokers and shipping agents in Stockholm were involved in were at par with leading notaries in the Dutch Republic. Thus, although the number of actors was more limited in Stockholm than in Amsterdam, the leading intermediaries in the Swedish capital offered a wide range of financial services that helped merchants to bring different parts of the Swedish realm together at the same time as the services assisted merchants to participate in the global economy.