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Polish and Swedish Fiscal Policy in the Years 1772-1792. A Short-Run Analysis

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Abstract
This paper compares Poland and Sweden in the second half of eighteenth century, as two, poorly developed, agrarian countries. Sweden secured its existence, but Poland did not manage to break out of a political dependency and ultimately vanished from the map. We would like to discuss the causes of these different outcomes. Contemporary interpretations underline the role of reasonable fiscal policy. We argue that in this particular case this explanation is insufficient. Contrary to that, our analysis shows that in the context of short term political risks, expansive fiscal policy which led to unpayable debt may be more justifiable than policy of balanced budget.

Keywords: economic history, Poland, Sweden, public debt, fiscal revenues, fiscal expenditures, military spending, 18th Century.
JEL Code: N13, N23, N43.

Introduction

Fiscal policies of Poland and Sweden, between 1772-1792 are objects of the following analysis. Both countries were subjects to a political turmoil as a result of their position within contemporary political landscape. In XVIII century Poland and Sweden both experienced a prolonged political and economic crisis. It led

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to a loss of their prominent position within the region and brought on Russian supremacy. In the second half of XVIII century both states embarked on a mission to bolster their position in the region, mainly against dominating Russia. In recent years, historians specializing in the economic history point out to a fundamental importance of the state's policy for country's economic progress or, in a broader perspective, to laying foundations to a long term economic growth (e.g. North, Thomas 1973; North 1981; Acemoglu, Robinson 2012). Researchers mostly emphasize the importance of government initiated institutional determinants to build a continuing economic prosperity. Protecting proprietary laws and introducing institutions that enable market economy are considered major factors in the process (North 1990, North, Weingast 1989, Greif 2006). Fencing properties in Sweden, starting in the second half of XVII century, is a good illustration of measures mentioned above. Fencing private land resulted in an agrarian revolution in Sweden in XIX century and in proclaiming of May 3rd Constitution in Poland, which fundamentally transformed Poland's political system. In a short term perspective tax related initiatives and equally the nature of expenses were more important elements of Poland's and Sweden's policies in the second half of XVIII century. Both countries decided to go about it in a different way. Poland run a balanced fiscal policy, where the spending was offset by the income (within the researched time frame). Sweden's policy was by far more expansive as its expenditures exceeded the revenue and were covered by credits or foreign subsidies.

Modern interpretations stress out the importance of the state's balanced fiscal policy, pointing out to a threat of excessive liabilities. In their important work Reinhardt and Rogoff (2009) demonstrate the risks of an increasing state debt. A standard economic explanation stresses out that countries which for various reasons carry on an expansive fiscal policy, resulting in a high debt, run into a deep crisis leading to an economic destabilization. In extreme cases it ends with a bankruptcy. Following this approach, Poland's policy was much more in line with basic goals of securing the state stability and the prosperity growth. This interpretation ignores however specific conditions of a pre modern state and also economic and noneconomic short term risks, mostly generated by current political circumstances.

The researchers analyzing a formation of a modern national state point out to the key role of war efforts in the process (e.g. Tilly 1985, 1992, Levy 1988). As Charles Tilly pointed: „War made the state and the state made the war" (1992). The efforts of pre modern states were mostly directed at providing sufficient revenues for the army and wartime demands. It led to a foundation of an adequately efficient administrative structure and fiscal system (Giddens 1985, Glete 2002, Gennaioli, Voth 2011). "For roughly four centuries after 1453 […] no European state recognized a responsibility for the economic growth with a social welfare as anything other than a contingent" (O'Brien 2008, p. 1). Due to these findings an efficiency of a fiscal policy in analyzed countries should be viewed in terms of a capacity to finance war efforts and maintain an army capable of protecting the state.

Nevertheless short term risks that may result in a collapse of enterprises built to reform existing institutions, become essential factors affecting the state's fiscal policy rating. In cases analyzed, it is crucial to consider the importance of political risks related to Russia's aggressive politics against both states. In our opinion that particular danger jeopardized the success of any planned internal policy including fiscal ones .

We are going to show, based on Poland's and Sweden's cases, that in pre modern states a short term, expansive fiscal policy, even leading to a deep financial crisis of the state, could be more effective than a strategy of balancing revenue and spending. It may be opposite to Reinhardt and Rogoff's conclusions. We will show that the process of evaluating state's fiscal policy should include not only economic factors like a danger of excessive debt and a risk of bankruptcy – but also noneconomic threats (e.g. military). In this context we are going to prove that, counter to Reinhardt and Rogoff's findings, Sweden's fiscal strategy leading to a paramount state debt was better suited to the demands of a contemporary state than Poland's policy of balanced budget.

We will compare the fiscal policy with the actual fiscal performance of Poland and Sweden in the second half of the eighteenth century. In particular we are going to show growth dynamics of fiscal revenues in both countries. In this research we use published data of Swedish and Polish state revenues in the second half of the eighteenth century (Fregert and Gustafsson 2008, Drozdowski 1972, Rybarski 1937, Wyczański 2003, 2006). Additionally, we use existing estimates of historical GDP per capita, population and urbanization rates in the eighteenth century (Schön and Krantz 2012, Malanima 2010, van Zanden 2009, Kuklo 2009, Gieysztor 1997, Heckscher 1954) to describe briefly the economic situation of both countries.

Our analysis begins with a brief description of the economy and the population of Poland and Sweden in the eighteenth century. In the second section we are going to present our analysis of fiscal capacity and state revenues. In the third part we will discuss the rationality of a particular fiscal policy, its implementation in both states and we will analyze its efficiency in view of different types of risks – economic and political.

1. Poland and Sweden – a brief look at a population, a society and an economy

The population of Polish Lithuanian Commonwealth was about 12 million before the first partition (1772) (Gieysztor 1997). As a result of the partition the number of inhabitants decreased to 7.7 million. According to these estimates in 1790 population of Poland and Lithuania together increased to 8.6 million (Kuklo 2009). In 1771 population density in the Commonwealth was 17 persons per sq.

kilometer. After the partition it dropped to 15 persons per sq. kilometer. During next two decades it raised again to 16.5 inhabitants per sq. kilometer. In the middle of the eighteenth century, the population of Swedish monarchy (Sweden and Finland) was 2.2 million. In the beginning of 1770 it increased to 2.6 million, and then raised again to 2.9 million in the beginning of the 1790s (Edvinsson 2009, The Population of Finland, 1975). An average population density in Sweden and Finland was much lower than in the Commonwealth. In the beginning of 1770 it was about 3 persons per sq. kilometer and in the end of the eighteenth century it increased to 4 inhabitants per sq. kilometer.

One of the major indicators, used to qualify the level of social and economic development in a pre-industrial world, is urbanization. As many researchers point out, the bigger share of urban population makes for the higher level of economic development, which in turn leads to the higher productivity of cities' inhabitants and to the development of market economy (cf. e.g. Broadberry, Gupta 2006, de Vries 1994).

Table 1. The level of the urbanization in Poland, Scandinavia, Germany and England in the eighteenth century (cities above 10,000 inhabitants).

	1700	1750	1800
Poland	3.8	3.4	4.1
Scandinavia	4.3	4.6	4.8
England	13.2	16.4	22.1

Source: Melanima (2010).

Levels of urbanization in the Commonwealth and Swedish monarchy in the eighteenth century were rather low, typical for pre-industrial states. According to Paolo Melanima (2010) in the case of Poland the amount of people living in the cities was about 4% of the whole population, and in the middle of the century it fell to about 3.5%. In Scandinavia the level of urbanization was slightly higher and reached about 4.5%. We can safely assume that the urbanization of both countries was almost equal or equal. There were no large cities in both countries except Warsaw (about 100,000 inhabitants),Gdańsk (about 40,000) and Stockholm (about 70,000).

The level of urbanization indicates the type of social structure of both countries – a traditional rural society. In the end of the eighteenth century the share of peasants in Poland and Lithuania was about 75% of the entire population. According to Kuklo, town population reached about 15%, but that group included inhabitants of very small towns, often the size of a large village. When comparing Kuklo estimates to Melanima's numbers, which include only cities larger than 10,000, about 70% of "burghers" lived in small towns. The number of noblemen in the Commonwealth in the last decades of the eighteenth century is estimated to be about 7,5% of the whole population (Rostworowski 1987). About 20% of that group were magnates and rich noblemen, the rest were small noblemen, often without any property (Kuklo 2009).

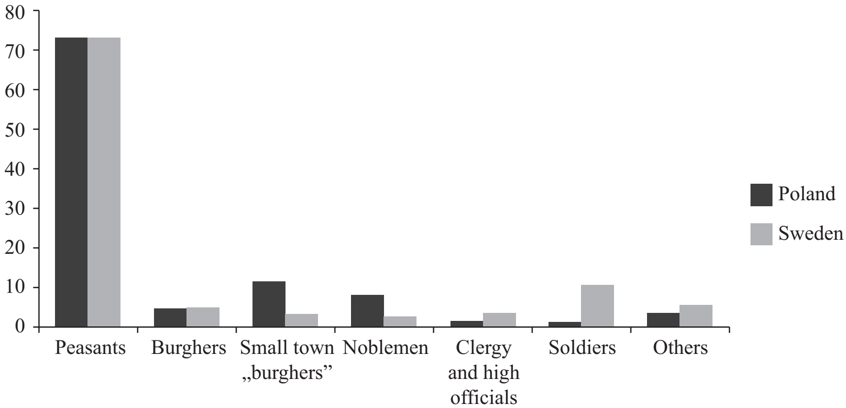

Figure 1. A social structure of Poland and Sweden in the late eighteenth century. Source: Kuklo (2009) for the Commonwealth (1790), Heckscher (1954) for Sweden (1760).

In Swedish monarchy, as well as in the Commonwealth, peasants were the most numerous social group, in Poland reaching about 75% of population (Heckscher 1954). The number of burghers was about 6-7% of Swedish and Finnish populations. It meant that probably 2-3% of the entire population lived in very small towns. The number of noblemen – rich and poor – is estimated to be about 2% of the population, though Heckscher also included clergy and higher officials in the highest strata of the society. In his opinion that group reached 5% of the entire population. Soldiers, demobilized and in service (about 10%), constituted a very important share of the society.

In the eighteenth century social structures of Poland and Sweden were quite similar, dominated by the rural population, first of all peasants. Although distinctive features, unique for each country existed. In case of the Commonwealth it was a huge number of noblemen, much higher than in Sweden. In Sweden it was a very large number of soldiers (about 10%), considered to be a separate group, much bigger than in Poland.

The structures of both economies were also similar. We can reconstruct the structure of Polish economy in the late eighteenth century using the local data related to employment. According to Topolski (1969), in the late eighteenth century in Wielkopolska, about ¾ of the population worked in agriculture, 17% were craftsmen[1] and 5% were tradesmen and 3,7% were of other occupations. This

[1] The number of craftsmen in Wielkopolska was probably much higher than in other parts of Poland, because of a well-developed textile industry in this region.

data confirms the domination of agriculture in Polish pre-industrial economy. In the second half of the eighteenth century agriculture dominated also in Sweden and Finland, where about 75% of the people – as pointed by Heckscher (1954) – we reemployed in the rural economy. About 5% of Swedish population worked as craftsmen both in villages and in towns, and about 3% were employed in the iron and copper mining and in metallurgy.

The structure of both economies was underdeveloped compared to England and Holland. The agriculture in Poland and Sweden was traditional, and agricultural innovations had only limited influence on the rural performance (Kula 1983, Grigg 1980, Magnusson 2000)[2]. The industry played marginal role in both economies, producing only for the local market. In the second half of the eighteenth century Poland and Sweden were quite similar, peripheral countries. Social and economic structures and urbanization levels are the evidence of those similarities.

Table 2. GDP per capita of Poland, Sweden and United Kingdom (GDP per capita of UK in 1820 = 100)

	1700	1750	1820
Poland	38	34	41
Sweden	65	47	43
Great Britain	69	84	100

Source: for England and Sweden – Bolt and van Zanden (2013), Swedish data based on Schön and Krantz (2012), for Poland - Van Zanden (2009).

The estimates of GDP per capita confirm these observations. Both countries were more or less on the same level of development, very much behind when compared to leaders: England or Holland. Polish GDP per capita in the eighteenth century was estimated by Jan Luiten Van Zanden (2009), who assessed it as 30-40% of British GDP per capita in 1820. In the first half of the eighteenth century Polish GDP decreased. It was a result of extremely destructive wars and their consequences, such as plagues and devastations. In the second half of the eighteenth century Polish economy recovered, but it did not reach the level of prosperity observed in the first half of seventeenth century (Van Zanden 2009). In first decades of the eighteenth century Swedish GDP per capita also rapidly decreased, as a consequence of Great Northern War. From 1730s the level of production tended to stabilize, but was much lower than in 1700s. In the eighteenth century Swedish GDP per capita decreased to about 33% and was a little bit more than 40% of British level according to Schön and Krantz (2012).

[2] An agrarian revolution in Sweden (including the process of enclosures), which started in the second half of the eighteen century, had a very limited impact on Swedish economy in the late eighteen century, its results were only seen in the next century.

2. Poland and Sweden. Revenues and expenses of the State – a comparative analysis

The results of the analysis of Poland's and Sweden's fiscal data during the last quarter of the eighteenth century are quite surprising.

The level of revenues[3] of both states, shown on Figure 2 below, was similar. Moreover dynamics of revenue growth were much higher in Poland than in Sweden in the analyzed period, as lines of trend indicate[4].

What made Swedish short-term situation better was the scale of special funds i.e. mainly external subsidies for Sweden, granted by France (and periodically by England). Those special funds were the effects of political decisions, to a large extent, exogenous, in the researched period.

In turn, the level of expenses was significantly different, as shown on Figure 3. The long-term trend shows, that dynamic of growth of Swedish expenses was much faster than that of Polish state. It was also much faster than the growth of revenues. In Poland, revenues exceeded expenditures during almost an entire period of time (see Figure 4). Only Polish-Russian War (1792), Confederation of Targowica (1792-3) and the collapse of the state changed that situation (Wąsicki 1952). Main sources of revenues of Polish state were various taxes and duties. Taxes were paid by peasants and gentry, townsmen and Jews. Nobility was excluded from some of those payments. The budget was projected for every two years, based on anticipated tax revenues. In turn, Swedish expenses exceeded revenues during almost entire analyzed period (see Figure 5). That situation resulted not only in the permanent fiscal deficit, but also in the rapidly growing public debt.

The picture sketched above shows results of reforms, launched in both countries in early 1770's, after a long period of institutional crisis. Outcomes of those fiscal reforms were different. In Poland they resulted in balancing of the state budget and improving the efficiency of tax collecting (according to some estimates, in 1750. ca. 20% were collected, while in late 1770s, more than 90%). The level of taxation remained low in accordance with Polish gentry expectations and –most probably – also with its financial capabilities. Those capabilities were limited due to previous wars and the economic crisis. The level of expenses of the state also remained low. Military expenses constituted the most important position in spending (ca. 50% of budget, sharp growth noted in 1790 was related to Polish-Russian War; see Figure 6).

According to our position, there is no clear evidence of state finance crisis in Poland during final decades of independence. What is more important, there

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[3] Revenues and expenses of Polish king, excluded from state finances, are not included in the analysis.

[4] Trend separated with Hodrick-Prescott filter (λ=50) for the period 1786-1788 (we excluded years of war).

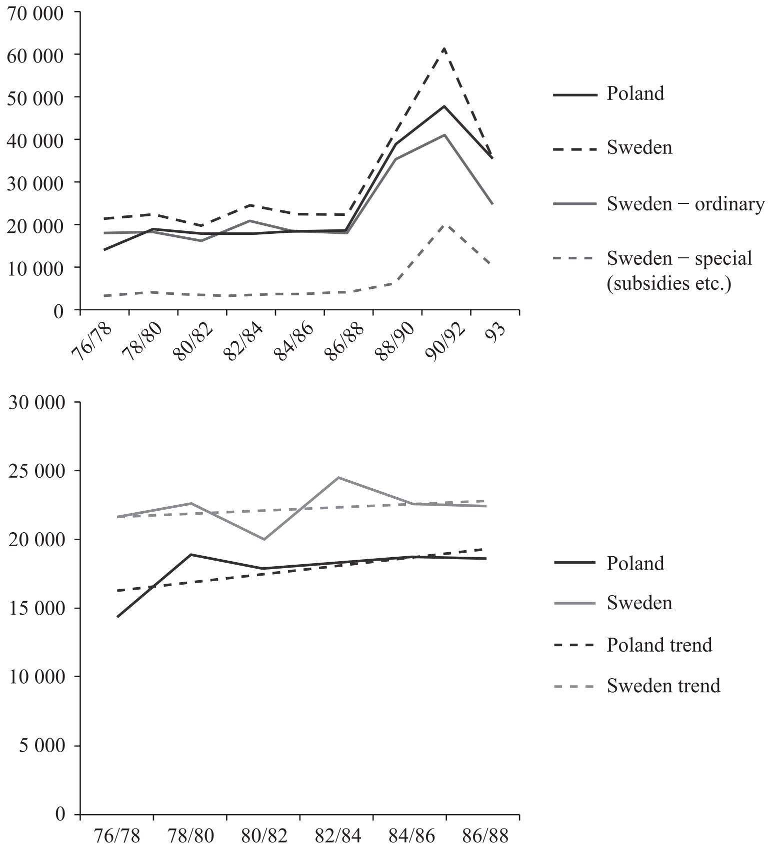

Figure 2. Revenues of Poland and Sweden, 1776-1793. Average for 2-year periods (in Polish złotys).
Source: Rybarski (1937), Wyczański et al (2006), Fregert and Gustafsson (2008).
Note: Exchange rates as published in Edvinsson, Jacobson,Waldenstroem 2010. Polish budget (a plan of expenses) was made for 2-year period. For the sake of comparability, the whole analysis of revenues and expenses is made in 2-year period, i.e. Polish and Swedish revenues, as well as Swedish expenses are recalculated.

is evidence, that Polish state had the capacity to raise fiscal revenues even in the last months of its existence. Dynamics of growth of fiscal revenues are shown on Figure 7. Until 1790 taxes and duties covered almost 100% of fiscal revenues of the state[5]. Despite the gentry reluctance to a strong and omnipotent state, territorial and demographic losses and deteriorating trade conditions, tax revenues slowly grew during the whole period. Due to mentioned factors, the growth of tax revenues per capita was even faster. What is more impressing, Polish state relied on internal and external creditors in very limited measures (cf. Rybarski 1937).

[5] Revenues from a domain were assigned as Kings' treasure.

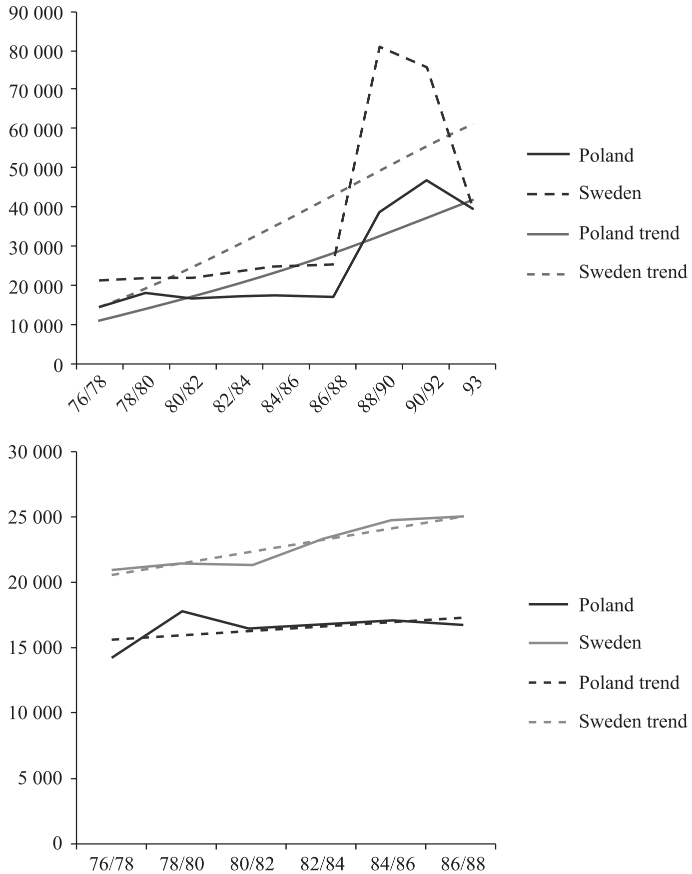

Figure 3. Expenses of Poland and Sweden, 1776-1793 (in Polish złotys).
Source: Rybarski (1937), Wyczański et al (2006), Fregert and Gustafsson (2008).

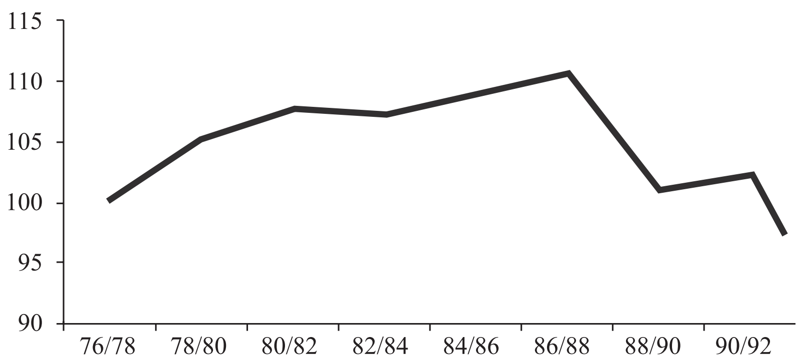

Figure 4. Balance of finances of Polish state. Revenues as a fraction of expenses (in %), 1776-1793.
Source: Rybarski (1937), Wyczański et al. (2006).

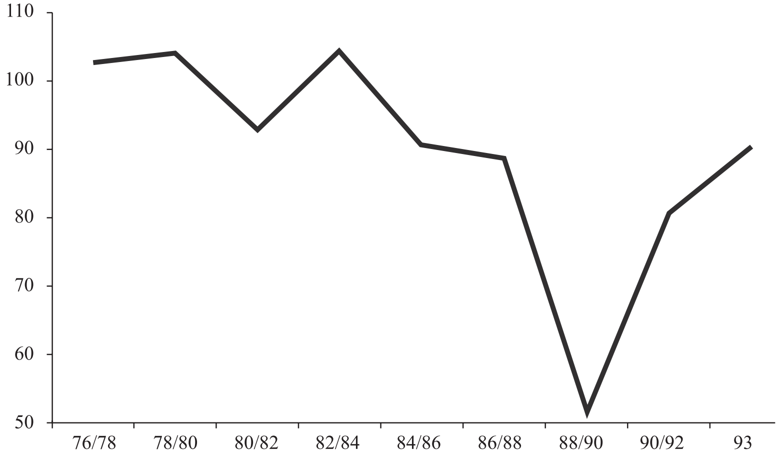

Figure 5. Balance of finances of Swedish state. Revenues as a fraction of expenses (in %), 1776-1793.
Source: Fregert and Gustafsson (2008).

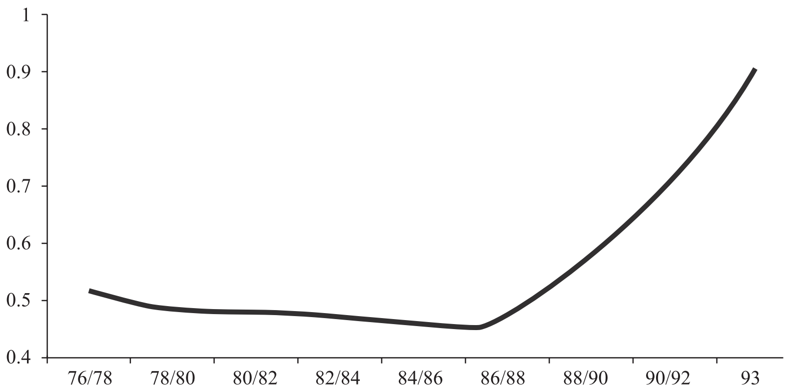

Figure 6. Polish military expenses as a share of state expenses, 1776-1793.
Source: Rybarski (1937), Wyczański et al. (2006).

During Polish-Russian War, expenses almost tripled, but were still covered mostly by growing tax revenues (Rybarski 1937, Drozdowski 1972, Wyczański et al 2003, 2006).

It should be emphasized, that in a short analyzed period, the fiscal consolidation and the increase in fiscal revenues of Poland are clearly visible, particularly when compared to Sweden. That trend could be observed in an ascending line on the chart illustrating fiscal revenue levels (a pronounced fiscal capacity growth in

Poland, as opposite to Sweden) and state expenditures (huge raise in dynamics of expenditures in Sweden, mostly due to an uncontrollable increase of debt operating costs). It affected not only the time of wars with Russia in both countries, but also earlier periods. A consolidation and budget stabilization together with state's growing efficiency in collecting taxes could be perceived, in Poland's case, as

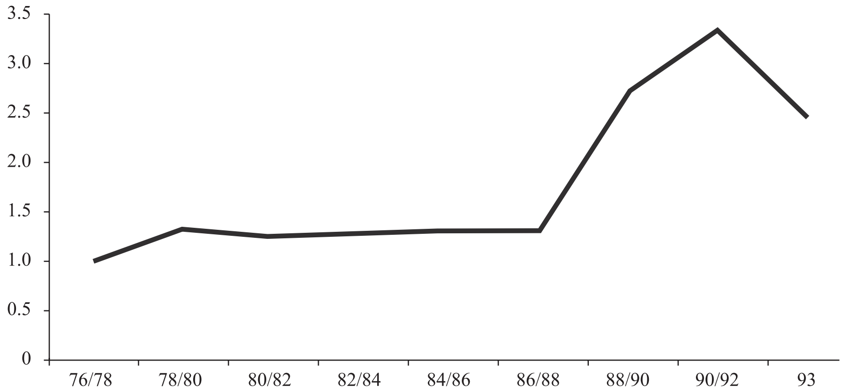

Figure 7. Dynamics of tax revenues, Poland 1776-1793 (1776/78=1).
Source: Rybarski (1937), Wyczański et al. (2006).

correlated with a growing capacity of the state. Hence, there are strong arguments supporting a thesis, that fiscal consolidation was a visible symptom of successful institutional adjustments in Poland.

The situation in Sweden was different. Due to a construction of the political system, the state budget was – to certain extent naturally – unbalanced (see: Fregert 2009). It was an effect of the political games within the parliament (Riksdaag) itself and between the parliament and the king. Gustav III individually set the level of expenses, while the level of revenues relied on the decision of the parliament. In effect, the fiscal crisis of Swedish fiscal-military state was almost unavoidable. Since Great Northern War, Swedish state lost the capacity to finance wars (and – to some extent –also self-finance its own military forces, see: Glete 2006, Glete 2012, Rattanen 2009, Roberts 1986). The stability of the state was based on a growing debt and a permanent influx of external subsidies. One can assume that Swedish debt in early 1790s was impossible to repay caeteris paribus. Actually, the problem was resolved in the early nineteenth century, due to very fortunate circumstances[6].

[6] Reinhard and Rogoff (2011) suggest that English pre-Napoleon debts were impossible to pay in a similar way. Those debts were finally paid only due to fortunate military circumstances.

The fiscal crisis and inefficient political model resulted in a state of permanent deficit. It was also a symptom of more serious, institutional crisis. A deteriorating fiscal system was a part of that crisis as shown in Figures 2 and 8: revenues of Swedish state remained constant between 1776 and 1788. Still, the debt grew, GDP per person remained quite stable, the currency was slowly losing its value[7] and the population rose. That meant, that most probably, real tax revenues per capita rapidly declined.

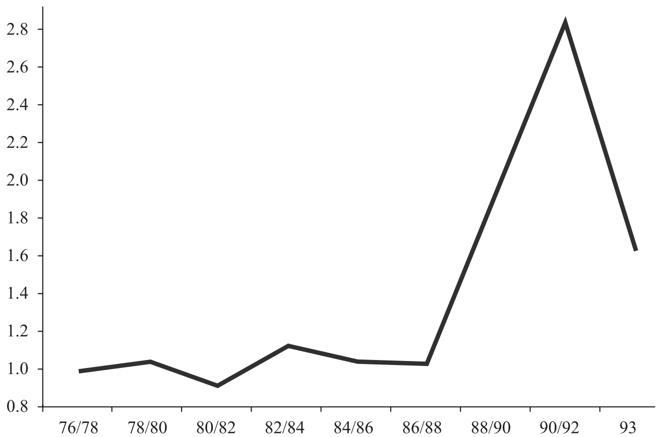

Figure 8. Dynamics of the revenues of the Swedish state, 1776-1793 (1776/8=1).
Source: Fregert and Gustafsson (2008).

Similarly to Poland, military expenses remained a major part of the state budget (see Figure 9). What is noteworthy, the share of military expenses in the budget tended to decline until 1792 (excluding the period of preparing to war with Russia) from 40% to 20-30%. The sharp growth in 1793 was an effect of the sharp decline of the state expenses. The diminishing share of military expenses was mostly linked to growing interest rates burdening state finances (up to ¼ of budget expenses, or even more, according to Rattanen 2009). Consequently, Swedish ability to fight wars was slowly vanishing. In effect, 15 years later, in 1809, Sweden was absolutely incapable of preparing for the war with Russia, and lost Finland.

Figures 10, 11 and 12 additionally illustrate the scale of a fiscal crisis in Sweden. In late 1780s, the growth of military expenses was covered by a sky high

[7] Between 1776 and 1790 Swedish Dalar lost 30% of its value in relation to Pound Sterling. In 1776 1Swedish Dalar silver mint (dsm) was briefly equal to 1 Polish złoty in 1776. Then, there is no data concerning exchange rates, but probably it was similarly devaluated. In the whole analysis we assume a constant exchange rate: 1 dsm=1 złoty.

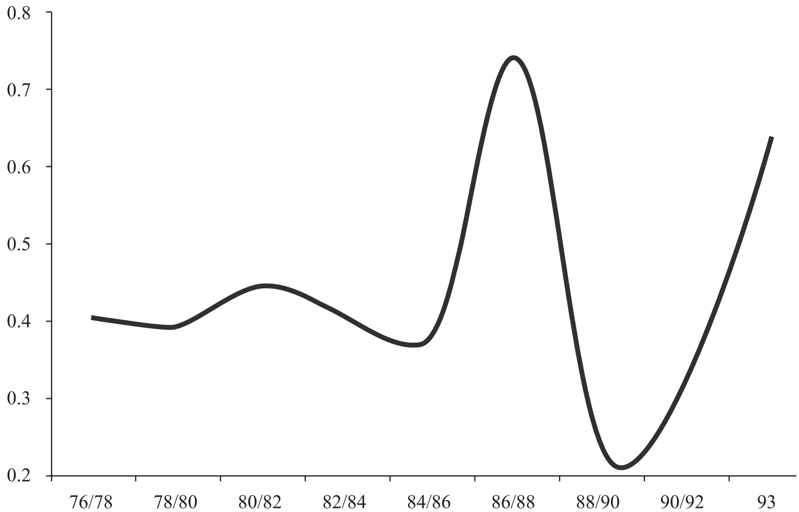

Figure 9. Swedish military expenses as a share of state expenses, 1776-1793. Source: Fregert and Gustafsson (2008).

deficit and a sharp growth of debt. The tax rate, which was one of the highest in Europe, and massive foreign subsidies were not sufficient to cover growing expenses. Figure 10 shows the scale of the deficit (black line) and the deficit excluding subsidies (gray line). Gradually the situation was getting out of control.

Figure 10. Swedish government deficit as a percent of GDP, 1777-1793. Source: Fregert and Gustafsson (2008).

Figures 11 and 12 show this process more thoroughly. The first one presents a sharp rise of debt which doubled between 1779 and 1788, and then almost quadrupled in the following six years. Next one shows debts of the state as a share of estimated GDP. Here, the growth of an indebtedness is even more striking: from 10 to almost 50% of GDP in one decade.

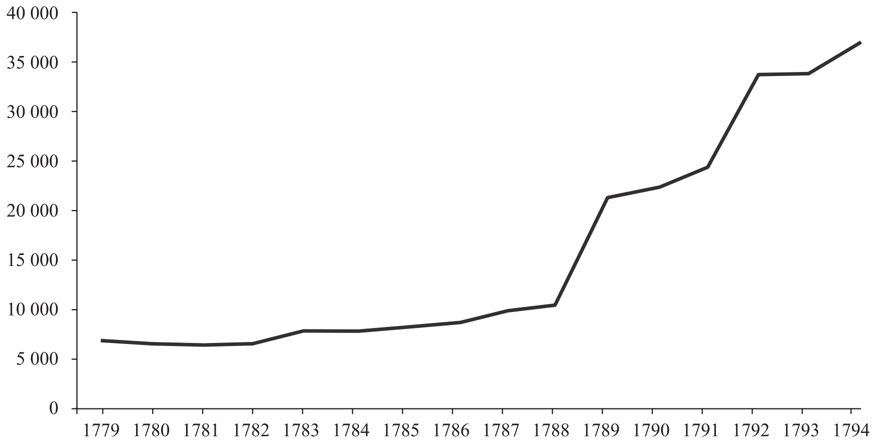

Figure 11. Debt of Swedish state in millions of dsm (dalar silver mark), 1777-1793.
Source: Fregert and Gustafsson (2008).
Note: 1 DSM briefly equals 1 Polish złoty.

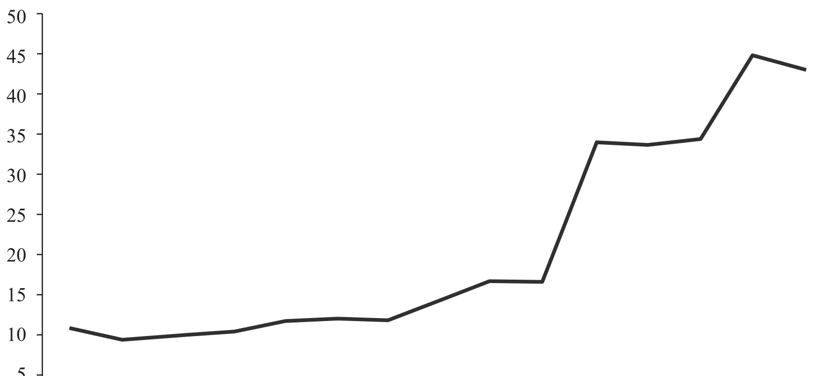

Figure 12. Debt of Swedish state as a percent of GDP, 1777-1793.
Source: Fregert and Gustafsson (2008).

Today a total debt of 50% of GDP is not perceived as dangerously high (see: Reinhart, Rogoff 2009). However, taking into account the size of Swedish state budget, dynamics of growth in pre-modern times and the cost of interest, the risk of default grew rapidly since early 1780s. Total debt was two times bigger than state revenues in 1780s, and ca. 8 times bigger in 1790s. And in fact not long after, in 1812, following a disastrous war lost to Russia, Sweden went bankrupt. But in current European political landscape new circumstances did not allow to wipe Sweden off the map.

By 1790s all symptoms pointed out to an ongoing process of successful institutional reforms in Poland. The next stage included changes to a May 3rd Constitution leading to a total overhaul of the political system, and for the most part also of the social system. It all evolved in a controlled way, unlike the revolution in France. An attempt at institutional reconstruction was possible thanks to stable finances. The foundation for prosperity had been laid. Sweden represented an opposite situation – the collapse of the state financial system appeared at the same time as the institutional crisis. Reform options were limited in the wake of falling state capacity. But finally it was Sweden that managed to successfully mobilize its resources and survive while Poland ceased to exist.

3. Reasonability of fiscal policies in Poland and Sweden: short- and long-run factors

Reinhard and Rogoff (2009) when recalling historical examples, emphasize the importance of balanced fiscal policy, avoiding the excessive deficit and state debt accumulation. According to these researchers an overly expansive state policy leads to an economic crisis and, in extreme cases, to a bankruptcy. Sweden in the second half of XVIII century conforms to circumstances listed above. As a result of the enduring deficit in state finances Sweden recorded extremely high debts that led in the end to a bankruptcy declaration in 1812.

The fiscal policies of the Commonwealth in its last years should be evaluated in a dramatically different way. Expenditures were almost completely covered by the revenue. Parliament looked after balancing the budget and there was no bankruptcy threat to the state treasury. Reforms of Great Assembly, including fiscal ones, were considered highly innovative and guaranteeing prosperous state advancement. But Poland did not survive the crisis of the state in the XVIII century and introduced reforms turned out to be insufficient. We can find the explanation for such outcome in long term circumstances (which are not an object of this paper) but also in short term conditions. Explanations offered by Reinhardt and Rogoff in regards to Swedish and Polish contemporary situations seem inadequate in our opinion. The researchers ignore the issue of a short term risks management related to the current political situation of discussed countries in the second half of XVIII century including international situation (in this particular case a growing threat of Russia). Those risks, compromising state sovereignty, should be considered equally significant as economic threats caused by an overly expansive fiscal policy contributing to debt and bankruptcy.

In researched cases of Poland and Sweden, the short term fiscal policy could be interpreted as following. Poland contrary to Sweden followed a balanced budget policy to avoid economic risks of growing state debt. Nevertheless due to limits placed on state expenditures (along with a low tax level) the country became exposed to increasing risks of the international political situation. Balanced budget policy (together with low level tax revenues) proved inefficient, disregarding political risks affecting short term fiscal policy.

The situation in Sweden was different. Gustav III's monarchy run an extremely expansive fiscal policy, exposing the state to an increasing economic risk as a result of growing debt ultimately caused the state bankruptcy in 1812. Still in a short term this policy allowed to limit political hazards of contemporary political circumstances. Despite territorial losses (losing Finland to Russia in 1809) Sweden managed to survive until the nature of political (geopolitical) conditions changed during Napoleon wars. Sweden kept its sovereignty and a favorable international landscape after Napoleon wars (a low political risk) and institutional alterations initiated in the second half of XVIII century and consolidated in a second decade of the XIX century enabled Scandinavian monarchy to rebuild its economic capabilities followed by the fast progress in the second half of XIX century.

A higher short term rationality of Swedish policy could also be explained with unique state features in an observed time period. As many pre industrial state researchers point out foundations of a success or failure lied in a capability to build and maintain an efficient army, effectively protecting country's borders and capable of possible expansion (e.g. Tilly 1985, 1992; Levy 1988, Gennaioli, Voth 2011). In that context Polish strategy was less efficient than Swedish, even with balanced expenditures and revenues. Incurring debts allowed Swedish king to support a relatively large armed force, although - as Glete (2006) claims – by far inferior to the army at the beginning of the XVIII century. Due to those circumstances Sweden, despite territorial losses, was able to survive the fiscal and the military state crisis in XVIII century and carried on profound reforms in the early years of the XIX century. The stability of institutions shaped in late middle ages could have played a major role as it provided the limited stability in a deep crisis situation and guaranteed a certain level of confidence outside.

On the contrary Poland, leading a balanced fiscal policy, with a very low expenditure level, was not able to accumulate enough means to build a capable and an adequately large army to protect its sovereignty. Even final – and late – attempts to raise revenues did not allow to follow through with a plan to have 100 000 soldiers army. As a consequence Poland surrendered to a partition and a fall of the independent state. Poland suffered from implications of its political heritage and from low confidence level of the creditors as the state had not been present on the international financial market.

The question arises why Poland did not conduct a different fiscal policy, allowing it to avoid dangers related to high political risk? The problem could probably be explained in a reference to long term conditions, mainly following a very popular, modern economic history concept - an institutional approach (North 1980, 1991, Acemoglu, Robinson 2012). In this work we do not claim to conduct a comprehensive analysis of XVIII century institutional conditions of Polish policy. Nevertheless we would like to attempt to present number of hypotheses explaining reasons and limitations behind it.

Contemporary comparative studies of political institutions initiated by North and Weingast (1989) emphasize the state capacity more and more. It is defined as a state's, a modern state's in particular, capability to put forth its resources and maintain an effective legal system. In these terms the Commonwealth remained a weak state for an extended time. The state required institutional reforms to strengthen its capacity. Changes, due to particular system features, could not happen in a short period of time, they had to be conducted gradually. Hence the initial goal of enhancing the fiscal capacity followed later with the political system restructuring without compromising gentry, parliament and the king - major political forces. Within frail institutions existing before Great Assembly reforms the reinforced army could lead to an uncontrollable enhancement of king's authority. Due to these circumstances building the military power of the state – to preserve an internal equilibrium – had to be preceded by institutional reforms limiting that very possibility. Building a strong army capable of altering geopolitical balance's tipping point in the region, protecting the Commonwealth's interests were possible only at the next stage. Altogether the time frame for the changes turned out to be too long and there was no alternative to that particular sequence of events within existing institutional constraints.

On the contrary Sweden had been the military and fiscal state for a long time and despite a half age long crisis, its institutions had been consistently strong. Hence outside entities'–creditors'– higher level of confidence and also a bigger capacity for mobilization. As much as Swedish fiscal capacity turned out to be limited which led to the rapidly growing debt, the state proficiency inherited from earlier times and foreign powers' confidence were enough to protect the state's equilibrium for following years. Territory losses to Russia took place only as late as 1809.

Conclusions

Conducted analysis leads to a number of essential conclusions. First of all, as we have tried to prove, a balanced fiscal policy does not have to be a reasonable solution in high political risk circumstances. Although as a consequence of further reforms Poland's fiscal and state capacities as a whole increased, due to a growing external threat (a political risk) that policy turned out to be inadequate and long overdue. This leaves us with a question to investigate: if a different policy was possible at all in the existing external (Russia's domination) and internal circumstances (contemporary political and social systems).

On the other hand, in Swedish case, expansive fiscal policy allowed the state to persevere until international conditions changed (lower political risk), even at the expense of losing state's financial liquidity. It does not mean that the risk of carrying on with an excessively expansive fiscal policy does not present an important hazard. Due to that policy a slow deterioration of Swedish institutions occurred, leading to almost complete dissolution of Swedish fiscal and military state. Swedish case indicates that a state capacity factor could not be considered as a parameter associated with any particular political or social system. Incapability to carry on a defensive war against Russia at the beginning of XIX century and state's bankruptcy are a testimony to this theory. In reality preserving Swedish institutions was possible thanks to an unpredictable change in political conditions after Napoelon's defeat. Swedish sovereignty was established as a result of Great Britain's intervention – the actual debt reduction and adding Norway at Denmark's expense.

These two analyzed cases show that research of preindustrial states should consider, to a higher degree, factors different than only economic ones and include state institutions durability (or even the state existence itself). We would like to agree with the researchers pointing to the importance of an army in preindustrial states. Hence an evaluation of state's readiness and ability to finance war efforts, to collect taxes, also the level of foreign confidence, the local political situation and long term institutional circumstances should be considered key elements when studying state and fiscal capacities. At the same time, the research of financial policy should not ignore current political conditions – internal and external alike – and risks following, which should be considered endogenous.

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