

The life annuity loans of the French monarchy

*Dr Alexander Ressos, TEP
Attorney-at-Law (Switzerland), Solicitor (Hong Kong),
Solicitor (England & Wales)*

In the eighteenth century, the French monarchy regularly issued life annuities to finance its deficits. These loans met with great success among investors, because they offered high rates, often well above those of perpetual annuities. Their peculiarity, which would make the fortune of the Genevan capitalists, lay in their pricing: in many issues, the rate offered did not vary, or varied little, according to the age of the life.¹ An investor could therefore obtain the same rate by choosing a life aged five or a life aged sixty.

This uniform pricing was a considerable economic error. An annuity constituted on the life of a healthy child will probably be paid for several decades, whereas an annuity constituted on the life of an old man will be paid for only a few years. By offering the same rate, the state granted investors who chose young lives a considerable advantage, for which it would pay for decades. Several reasons explain this error: the urgency of the financial need, which pushed the state to make its loans attractive; the weakness of actuarial knowledge within the administration, despite the work of the mathematicians of the day; the desire to simplify the issues; and perhaps an underestimate of the investors' capacity to exploit the flaw.

Jacques Necker, Director of Finances from 1776, made massive use of life annuity loans to finance French participation in the American War of Independence. These loans made it possible to raise considerable sums without creating new taxes. Since their terms were generous, Genevan investors, well informed and close to Necker, subscribed in large numbers.² Necker's critics would accuse him of having increased the future burden on the state through badly priced loans, of which the Genevans were among the principal beneficiaries.

To assess the cost of these loans, one must compare the rate offered with the rate that would have been fair given the age of the lives. The economic historians who have reconstructed these calculations estimate that life

annuities constituted on young lives cost the state appreciably more than its perpetual annuities.³ The pricing error thus translated into a considerable transfer of wealth from the state to astute investors.

Caution. The success of a loan among investors does not prove that it is advantageous for the borrower. A badly priced loan may attract subscribers precisely because it offers them an undue advantage, for which the issuer will pay for decades. The actuarial and financial analysis of long-term commitments is a requirement of sound public management.

1 Notes

1. François R. Velde and David R. Weir, “The Financial Market and Government Debt Policy in France, 1746-1793”, *Journal of Economic History*, vol. 52, no. 1, March 1992, pp. 29-30: after the Seven Years’ War, the monarchy abandoned age-based pricing (loan of November 1757); of fourteen major life annuity loans from 1757 to 1787, only three included a gradation by age; at a single nominal rate of 10%, the internal yield varies from about 7% for a life aged 7 to 6% for a life aged 50 (fig. 5). ↩
2. François R. Velde and David R. Weir, “The Financial Market and Government Debt Policy in France, 1746-1793”, *Journal of Economic History*, vol. 52, no. 1, March 1992, p. 26 and table 3 (p. 28): “Necker’s borrowing was primarily in life annuities”; 197 million livres raised in life annuities in the 1770s against 643 million in the 1780s; p. 32: the Genevan schemes “probably accounted for a majority of flat-rate life annuity subscriptions in the 1780s”. ↩
3. François R. Velde and David R. Weir, “The Financial Market and Government Debt Policy in France, 1746-1793”, *Journal of Economic History*, vol. 52, no. 1, March 1992, table 2 (p. 20) and fig. 5 (p. 29): nominal rates on Necker’s life annuity loans of 5.2 to 9%, with internal yields varying widely according to the age of the lives because of the uniform pricing. ↩

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