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**FROM PIONEER MERCANTILE STATE TO ORDINARY FISCAL STATE:  
PORTUGAL 16th-19th CENTURIES**

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# FROM PIONEER MERCANTILE STATE TO ORDINARY FISCAL STATE: PORTUGAL 16th-19th CENTURIES

## 0 - Introduction

On 6 January 1501, King Manuel I of Portugal went to the village of Restelo in the outskirts of Lisbon, from where Vasco da Gama's fleet had left for its discovery of the Cape of Good Hope route three years before, and laid the first stone of the Church of Saint Mary of Bethlehem, a memorial to that path breaking voyage.<sup>1</sup> The king was certainly upset by the failure of the schemes he had prepared during the previous years to become sovereign of a united Iberia (or at least to ensure such a role to one of his descendants), the results of several deaths in his family.<sup>2</sup> But he was also certainly pleased with the success of Vasco da Gama's voyage of discovery, which seemed to ensure a firm basis for the future prosperity of the kingdom to be ruled by him and his descendants.<sup>3</sup>

How was it that the small kingdom of Portugal had become such a powerful maritime power that it was able to spearhead a permanent link between Europe and India by sea? That is the theme of the first section of this paper, which deals with the fiscal basis of the early Portuguese voyages of discovery. How did the King of Portugal expect to profit from the monopoly of this trade link? That is the

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<sup>1</sup> Several engravings and paintings on the main altar of the church (locally known as the Jerónimos) relate to the feast of Epiphany, evoking the day on which construction of the church began.

<sup>2</sup> The main idea had been for him to marry Isabel, daughter of the King of Aragon, Fernando, and the Queen of Castile, Isabel (1496). Isabel became the heir apparent to the thrones of Aragon and Castile (1497), but died the following year (1498). The same happened with Miguel, the child she bore from King Manuel (1500). The crowns of Castile and Aragon would pass through Juana, the other daughter of the kings, to her son Charles (born in 1500), usually known as the Fifth.

<sup>3</sup> As a sign of his confidence he had taken the title of Lord of Trade, Navigation and Conquest of Ethiopia, Arabia, Persia and India, on the return of Vasco da Gama's fleet.

theme of the second section of this paper, which deals with a model of the ideal mercantile state. How did the exceptional position of Portugal in the trade between Europe and India collapse and force Portugal to become gradually an ordinary fiscal state, a transition it concluded during the 19th century? That is the theme of the remaining sections of this paper, which deal with the Brazilian empire and its collapse, and the hard transition of Portugal to a typical fiscal liberal state and its first false start at modern economic growth.

### 1. The fiscal roots of a world power

In 1400 (one century before King Manuel's inauguration of Jerónimos), the kings of Portugal and Castile signed a truce that put an end to three decades of protracted, although intermittent, warfare between the two countries (1369-1371, 1372-1373, 1381-1382, 1383-1387, 1396-1400). Repeated and ineffectual attempts at mutual interference in the internal affairs of the neighbouring country had convinced both governments that ground for political gains had to be found elsewhere.<sup>4</sup>

The choice of the Portuguese kings was expansion in Morocco. Three reasons supported this choice. First, the infidel status of the country sanctified the military endeavour there as a holy war. Second, Moroccan towns were the points of arrival of trans-Saharan gold caravans, which promised good business. Third, the country had been as badly hurt as the rest of the Mediterranean world by the demographic crisis of the 14th century, so it might prove easy to win. Alas, only the first proposition proved correct. The Portuguese found in Morocco a harder time than expected. Ceuta (1415) was a good start, but further advance had to

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<sup>4</sup> These wars had, however, a positive consequence from a fiscal point of view for Portugal. In 1385, the *Cortes* (an assembly of representatives of the ecclesiastical, noble and popular orders of the population) voted the payment of a tax on transactions, the *sisas*. This tax became thereafter the main fiscal basis of the Portuguese Crown. Curiously, the name of a similar Castilian tax *alcavalas* became synonym of tax hindrance to trade in the Portuguese language. It is fair to conclude that this extension of the fiscal rights of the Crown beyond the traditional tariffs was rather unpopular. However, as the main Portuguese chronicler of these wars, Fernão Lopes, wrote, referring to the increased taxation and inflation (because of coin debasement) they brought, "it is better for the Kingdom to suffer, than to be lost".

wait until the third quarter of the century, and was intermingled with some bitter defeats. Worse still, as Portuguese possessions remained isolated fortresses in a hostile country, their economic prosperity dwindled as a consequence of Christian conquest, because profitable trade looked for alternative outlets.<sup>5</sup>

Fortunately, Portugal had other cards to play. Not only were there fishermen and traders ready to try to find fresh ground for maritime endeavours, but also, as would be expected in a feudal society, ecclesiastical and aristocratic lords were ready to give formal backing to these endeavours. They were used to providing public goods, such as justice and defence, and to collecting fiscal revenue as a compensation for them.<sup>6</sup> Particularly active were the Knights of Christ, a religious military order issued from the Portuguese branch of the Templars when the order was suppressed, which was led by a member of the royal family who came to be known as Henry the Navigator. Although he hardly set foot on a ship himself, he promoted seaborne activities, and was rewarded with the control of Madeira (late 1410s), the Azores (1430s) and the trade with the Western coast of Africa (1430s), which eventually provided a direct link to Trans-Saharan gold trade, bypassing Muslim interlopers, besides direct trade in ivory and slaves<sup>7</sup> Slowly but steadily, these maritime endeavours began to bring profits to their promoters and to provide a basis for further explorations. Mention should be made of the economic organisation of the colonisation of Madeira and the Azores, because of their importance as early experiments of schemes that would become very important in the colonisation of the New World. Madeira was the first example of a plantation economy, as soon as the Portuguese colonists

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<sup>5</sup> Godinho, *L'économie de l'empire portugais Os Descobrimentos e a economia mundial* - Editorial Presença, Lisboa, 1963-1971.

<sup>6</sup> The feudal character of the Portuguese (and Iberian) medieval society has been the subject of much debate. On the Portuguese side of the question see José Mattoso, *A identificação de uma país*, The tithes represented a general ecclesiastical tax paid by all Portuguese subjects. Local taxes called *foros* formed the feudal tax system, which, according to places, benefited local ecclesiastical or aristocratic lords, vassals to the King, or the King himself, if he happened to be the direct local lord.

discovered its suitability for the production of sugar. Slave workforce brought from the Canary Islands and the West coast of Africa was the backbone of this first epoch of Madeira's economy, which ended during the 16th century, as American plantations developed.<sup>8</sup> The Azores was the first example of a settlement economy, where European peasants tried to reproduce small-scale production of typical European crops. At the same time, the gold, ivory and slave trade of the West coast of Africa also prospered.

Moreover, for a while (during the 1460s) the eastward orientation of the northern coast of the Gulf of Guinea engendered hopes of a Southeast route to the Indian Ocean near at hand. As these hopes were dashed by the southward turn of the African coast in the region of Cameroon, consolidation of the first Portuguese colonial empire meant, for the first time, concentration of the whole business in the hands of the Crown. Credit for this concentration is usually given to King John II, who also became the crucial figure in the Portuguese version of the process of centralisation of royal power against the traditional prerogatives of ecclesiastical and feudal lords typical of late medieval and early modern Europe. (Of course, such a centralisation of royal power did not mean suppression of the plurality of providers of public goods and fiscal systems, which survived until the early nineteenth century). There followed expeditions aimed at discovering the Southeast passage to the Indian Ocean, which succeeded in 1488 (Bartolomeu Dias' voyage). The fact that a further decade was needed to transform this discovery into a practical Cape of Good Hope route by Vasco da Gama's voyage of 1497-1499 clearly illustrates the technological and financial difficulties of the project.

## **2. The first world system: A pioneer mercantile state**

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<sup>7</sup> It is impossible to go here into the very interesting technical details of seafaring improvements needed for these activities, which formed an important innovation cluster, including regular high-seas voyages, astronomic determination of latitudes, etc.

<sup>8</sup> The second trump card of Madeira's economy would be the vineyard, developed mainly during the 17th century.

In the beginning of the sixteenth century the Portuguese mercantile empire was comprised of two elements.

One was the splendid success of the “Cape (sea) route” to India monopolised by Portugal, and within Portugal by the Crown. This success was due to the possibility of bringing exotic Asian goods to European markets with low transportation costs.<sup>9</sup> Merchants were often authorised to do private business, but had to pay lump sums and custom duties for the privilege. Core European states were too busy building their own central states and for some time no other European country was interested in applying economic resources to an uncertain business. The premature Portuguese central state enjoyed monopolistic conditions as long as possible.

The other element of the Portuguese mercantile empire was the Atlantic and Brazilian trade, under the partitioned hegemony provided by the Tordesilhas Treaty with Castile. (The treaty was signed in 1494, roughly mid way between the two pioneering ocean voyages that opened the world: Columbus’ discovery in 1492 and da Gama’s voyage to India in 1498). Foreign competitors soon appeared and private business was the rule, although the obligation to use Portuguese ports for intermediation of colonial trade (the main rule of the Colonial Pact) was soon introduced.

The Cape route was particularly relevant and successful, as it could afford high profits on the goods brought from Asia into Lisbon, before they were re-exported from there to the rest of Europe. Foreign trade became a splendid source of fiscal revenues, particularly because of the monopolistic conditions in this trade for a long time. Revenues from duties on imports and exports were multiplied seventeen fold, from 1496 to 1593, at the Lisbon customs.<sup>10</sup> They may be considered as a 'rent' provided by the exploitation of monopolistic conditions. While some core European countries were involved in wars, the smallest of the Iberian countries ruled the waves of the first world system.<sup>11</sup>

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<sup>9</sup> Godinho, Vitorino Magalhães, *L'économie de l'empire portugais, Os Descobrimentos e a economia mundial* - Editorial Presença, Lisboa, 1963-1971.

<sup>10</sup> Godinho, Vitorino Magalhães - 'Finanças públicas e estrutura do Estado' - Ensaios II - Livraria Sá da Costa Editora, 1978.p. 56.

<sup>11</sup> Charles V's empire mainly opposed France (1521-1556) and Turkey (1569-1580). On the Portuguese efforts to preserve monopoly conditions for navigation and trade against piracy see Godinho, Vitorino Magalhães, 'As incidências da pirataria e da concorrência na economia marítima portuguesa no século XVI' - in Ensaios II, Lisboa, Sá da Costa, 1978.

A main question is to decide if it was the high central state revenues that helped to build a large trade empire or if it was the large Portuguese trade-empire of the sixteenth century that helped to build the central state.<sup>12</sup> (Although Portugal could not rule and administrate vast territories in Asia, a control over a network of strategic commercial centres through military fortresses and a superior naval power over local navies were enough to rule Asian trade.)<sup>13</sup>

In an abstract model, the ideal mercantile state has the monopoly of the connections between two important markets. From the foreign market (Asia) come the cargoes of an important commodity (at first chiefly pepper, later other 'drugs' such as cinnamon, cloves, nutmeg, coffee, etc, cotton and silk textiles, sophisticated pottery, etc.).<sup>14</sup>

The ideal mercantile state buys this (or these) commodity (commodities) and brings it (them) to the home market (Europe) to be sold to (hopefully) eager and wealthy consumers. The profit of the operation (P) is, of course, the product of the quantity bought, transported and sold (Q), by the unit profit, which is the difference between the selling price (S), and the sum of the buying price (B) and the transport price (T):<sup>15</sup>

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<sup>12</sup> As it seems to have happened in England, according to Martin Daunton's paper.

<sup>13</sup> This system of ruling vast regions with minimal costs was invented by Afonso de Albuquerque (and Francisco de Almeida).

<sup>14</sup> As the poet puts it:

*"Leva a pimenta ardente que comprara;  
A seca flor de Banda não ficou;  
A noz e o negro cravo, que faz clara  
A nova ilha de Moluco, com a canela  
Com que Ceilão é rica, ilustre e bela"*

(Camões, *Lusíadas*, IX, 14)

He carries burning Peper, which he brought;  
Nutmegs(the which their own dry'de flow'rs up trim)  
From Banda; the black Clove(for which is sought  
Maluco's Isle) and Cinnamon, through which  
Ceylan is noble, beautiful, and rich

(Camões, *Lusíadas*, IX, 14)

<sup>15</sup> Of course, what is called here "transport price" must include not only the transport price in the strict sense (which corresponds to the freight that would be paid to a provider of

$$P = Q (S - B - T)$$

The short-term strategic variable to be manipulated by the ideal mercantile state is, of course, the quantity of commodity to be bought, transported and sold. To maximise total profit  $P$ , the ideal mercantile state must buy, transport and sell a quantity  $Q^*$  of commodity such that

$$Q^* = - (S - B - T) / (dS/dQ - dB/dQ - dT/dQ)$$

Which makes  $dP/dQ = 0$ .

As  $dS/dQ < 0$  (to increase the quantity sold, the price must be lowered) and  $dB/dQ > 0$  (to increase the quantity bought, the price must be raised), and it is possible to assume without much trouble that  $dT/dQ = 0$  (there are no economies or diseconomies of scale in transportation), we may be confident that  $Q^*$  is positive.

If we assume that  $d^2S/dQ^2 = 0$  and  $d^2B/dQ^2 = 0$ , we may also be confident that  $d^2P/dQ^2 = 2 (dS/dQ - dB/dQ)$  is negative, what ensures that  $Q^*$  is really a maximum.

In practice, the ruler of the ideal mercantile state must find a middle ground between the absence of connection between the two markets, which ensures a maximum difference between the selling and buying prices, but provides no profit, because there is no trade, and the full connection between the two markets, which reduces the difference between the selling and buying prices to the level of the transportation prices, and, therefore, provides also no profit.

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transportation services), but also the losses of cargo in shipwrecks (which corresponds to the premium that would be paid to a provider of insurance services) and the protection costs against predators of the business (mainly European and Maghrebin pirates in North Atlantic waters between the Azores and the Portuguese Mainland). Of course, the ideal mercantile state provides the transportation and the protection and seldom makes insurance contracts.

The short-term problem is to find the best mid way that maximises total profits. The long-term problem is to preserve the monopoly of the connection, quite a familiar problem of barriers to entrance. The big trouble in the case of sixteenth century Portugal is that the monopoly rested on the exclusivity of the technology and geographical knowledge needed to sail the Cape of Good Hope route, something that was impossible to preserve in the long run, either because of information leaks, or because potential competitors could imitate the Portuguese by trial and error (and it was impossible for the Portuguese to ensure full control of the 'closed' sea they claimed in the South Atlantic and South Indian Oceans). By the late sixteenth century Portuguese monopoly of the Cape route collapsed under the efforts of Dutch, English and French merchants. Portugal tried to resist throughout most of the seventeenth century, but by the 1660s it already had only a minor share of the Cape route trade.

### **3. The second world system: A first step into a fiscal state profile.**

Profitable activities attracted new partners into business. Before the 1560s, the main danger was piracy. As six large ships per year were enough to bring the annual cargoes, piracy was very attractive. From the 1560s on, European countries developed efforts to manage sea voyages into Asia under new naval abilities, putting an end to the Portuguese monopoly of Asian goods' trade that lasted for almost one hundred years.<sup>16</sup> As European countries began trading in the Indian Ocean and conquering strategic seaports from 1620 to 1660, competition became the rule in the market under the action of the British and Dutch Companies for Trade.<sup>17</sup> Due to the development of more efficient economic and financial institutions by those countries, Portugal lagged behind.<sup>18</sup>

However, the number of rival European states engaging in geopolitical and mercantilist competition for trade colonisation and colonial empires was limited. Historical global conditions were much closer to the conditions of the oligopoly

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<sup>16</sup> Fluyts and other new ships were quicker and easily manoeuvrable. See Monteiro, Saturnino – *Batalhas e combates da Marinha Portuguesa*, Lisboa, Sá da Costa, 1990-93.

<sup>17</sup> Godinho refers to 1580 as a turning point: Godinho, Vitorino Magalhães - '1580 e a Restauração' - *Ensaio II* - Livraria Sá da Costa Editora, 1978.

<sup>18</sup> This interpretation follows North, Douglass – 'Institutions, transaction costs, and the rise of merchant empires' in *The political economy of merchant empires, 1350-1750* N. York, Cambridge University Press, 1991.

game with a succession of leading powers in the world market and followers. In this second world system Portugal could no longer perform the sixteenth century leading role it had had in the world, and behaved as a follower.<sup>19</sup> The trade of tropical commodities from the American continent was organised as an informal cartel – oligopoly with separated production areas, monopolised selling areas in part of Europe and competition in other selling areas. Wars amongst mercantilist states may be compared to redistribution processes within this cartel.<sup>20</sup>

For Portugal, the most favourable production area for trade in the new second world system was Brazil. From the 1580s on, the main origin of tropical goods traded in Lisbon moved towards Brazilian coasts. Several tropical goods were appreciated in European markets and could be produced in this Portuguese colony, still providing high revenue. Brazilian sugar was cultivated by African slave labour force and dominated Brazilian exports. However, dye-producing wood and tobacco were also attractive, providing large exports to Lisbon.<sup>21</sup> Not only did European countries manage to cultivate sugar in other South American possessions from 1650 on, but also free business conditions were available for Portuguese merchants and private businesses. The decreasing prices of tropical goods (particularly of sugar) in European markets were due to competition between Brazil and other producers (such as Dutch, French, English and Spanish cultivation of sugar), as the provision of European markets by all these producers left to each of them smaller shares in the cargoes and lower prices.

The eventual reduction of tax revenues from Brazilian trade and increases of expenditure because of the wars (against the United Provinces, England and France to preserve the overseas possessions, and against the Western Hapsburg Empire to restore Portuguese autonomy) forced the Portuguese exchequer to introduce new taxes on consumption<sup>22</sup> and income (royal tithe in

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<sup>19</sup> Modelsky and Thompson also refer to the 1580s as the turning point from the first to the second world system: See Modelsky, George; Thompson, William – *Seapower in global politics 1494-1993* – Seattle, University of Washington Press, 1988. See also Modelsky, George (editor) – *Documenting global leadership* – Seattle and London, University of Washington Press, 1988.

<sup>20</sup> For the move of the core of Portuguese colonial empire from Asia to Brazil, see Godinho, Vitorino Magalhães - 'Portugal, as frotas do açúcar e as frotas do ouro, (1670-1770)' - *Ensaio II* – Lisbon, Livraria Sá da Costa Editora, 1978.

<sup>21</sup> See Serrão, José Vicente – *O quadro económico: Configurações estruturais e tendências de evolução* ' in Mattoso, José - *História de Portugal* – Lisbon: Círculo de Leitores, 1992-94.

<sup>22</sup> *Real d'água*, a tax on the consumption of wine and meat, was created in the 1630s.

the 1640s). Thus, the Portuguese state began to change toward a more fiscal and less mercantile profile.<sup>23</sup>

Peaceful periods came afterwards, but the royal tithe was never abolished and took a permanent place alongside excises and consumption taxes. These taxes were the main basis for the future Portuguese State fiscal system. Even so, duties could provide high revenues and the Portuguese central state could go on feeding its budget, as colonisation in Brazil still provided a mercantile profile to the Portuguese exchequer. The high weight of customs in overall taxation resulted not only from the greater volume of trade, but also from the ease of taxing imports. At Lisbon, the main Portuguese port-city and capital of the empire, a modest number of officers were enough to collect huge amounts of revenue.<sup>24</sup>

In the 1680s gold mines were discovered in *Minas Gerais* in Brazil. A tax amounting to 1/5 of gold inflows from Brazil provided huge amounts of gold for coinage and supported public expenditure in the first half of the eighteenth century (from 1695 to about 1754). Because of the large quantities of gold available, this was a second significant role for Portugal in the world system and a glorious support for a leading position in the world market. Brazilian-Portuguese gold fuel the trade with Great Britain, the Baltic trade and provided access to silver for trade in Asia. This new model was short-lived, however. Brazilian gold was almost exhausted by the middle of the eighteenth century.<sup>25</sup>

The Portuguese central state needed to satisfy permanent financial expenditures with domestic fiscal revenues, as did European states. The Brazilian gold boom coincided with an elevated role for domestic taxes for two reasons. Firstly, the eighteenth century Portuguese kings inherited fairly old domestic taxes (created in times of foreign threat, as explained above) from their ancestors. Secondly, the Portuguese economy saw a period of short-term prosperity (rooted mainly in wine exports), but long-term development did not

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<sup>23</sup> War periods always obliged the creation of new taxes to support military expenditures. Defence was a first rank priority and severe foreign tension gave way to increasing tax burden. See Macedo, Jorge Braga; Silva, Álvaro Ferreira; Sousa, Rita Martins – War, taxes and gold: the inheritance of the real – Working-paper nº 318, FEUNL, March 1998.

<sup>24</sup> According to Sideri, Sandro – Trade and power - in 1641 and 1681 Lisbon customs represented 88% and 79% of total customs revenue, respectively.

<sup>25</sup> See Macedo, Jorge Borges de – A situação económica no tempo de Pombal – Alguns aspectos – Morais, Lisboa, 1982.

follow. The Portuguese case does not fit neatly into the European central state profile. As the country was much poorer, customs and rents from monopolies still provided a much higher support. Average data for the period 1762-1777 serves to illustrate that situation:<sup>26</sup>

|                                |                              |
|--------------------------------|------------------------------|
| Customs (domestic and foreign) | 24.15%                       |
| Tobacco                        | 17.00%                       |
| 1/5 on Gold                    | 11.75%                       |
| Diamonds                       | 4.95%                        |
| Royal tithe                    | 10.35%                       |
| Sundry revenues                | 6.7%                         |
| Excise                         | 6.25%                        |
| Overseas revenues              | 5.35%                        |
| Brazil wood                    | 2.35%                        |
| -----                          |                              |
| TOTAL                          | 100% (=5 253 <i>contos</i> ) |

Moreover, the society of the Ancient Regime allowed great discrepancies in taxation according to social status, birth condition and local tradition. Only three taxes applied to everybody: Two of them had been created in the past under foreign threat; A local tax on consumption of goods, particularly on meat and wine, was absorbed by the central state in the seventeenth century and applied across the board to all subjects and territories. As in other European countries, the late eighteenth century brought political centralisation to Portugal and broader functions to the central state. Under a pressing need to move towards safer collection, the government created a tax on the leading agricultural export staple: wine.<sup>27</sup> In order to increase the state's efficiency in the process of assessment and collection of revenue, Pombal's illuminated government also created (in 1761) centralised accounting in the Royal Exchequer (*Erario Regio*). Functions

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<sup>26</sup> Source: Tomaz, Fernando – “As finanças do estado Pombalino, 1762-1776” – in Estudos e ensaios em homenagem a Vitorino Magalhães Godinho – Sá da Costa Editora, Lisboa, 1988, p. 362-363.

<sup>27</sup> It was applied to support the University of *Coimbra*. Because of the association of this tax with higher education, it received the special name of 'literary subsidy' (*subsídio literário*).

included defence, justice, administration over the national territory, and primary matters regarding education.<sup>28</sup>

This was only a first step toward a fiscal profile.

#### **4. A second step into the fiscal profile.**

Wars against revolutionary and imperial France (1793-1795, 1801) called for new taxes: a stamp tax and a conspicuous consumption tax. Furthermore, French occupations (1807-1808, 1809, 1810-1812) forced the royal family to take refuge in Brazil and to open its ports to direct foreign trade. Brazilian independence soon followed (1822) and put an end to all remnants of the old mercantile state. As the Indian and Brazilian colonial empires were gone forever, and a new (African) colonial empire would not be created until the “scrambling for Africa” in the last decades of the 19<sup>th</sup> century, a clear fiscal profile was imposed on the Portuguese state.<sup>29</sup>

The pattern presents similarities with most of the European countries under the Liberal framework.<sup>30</sup> Late eighteenth century Romantic ideas on freedom, equality and fraternity were widespread and brought new ideals of justice and equity. The concept of each man as a citizen aided the fiscal character of central states. The solution to the fiscal problem, in Portugal, as in other countries, was to endorse liberal ideas to frame new institutional arrangements – to abolish Church and feudal fiscal systems and to increase State fiscal revenue to encompass the revenue of the others. This was a slow and painful process. In Portugal it involved a civil war to impose a Constitutional Monarchy (1828-1834) and further decades of civil unrest (1830s and 1840s). Military expenditure to restore peaceful conditions was supported through foreign borrowing. This cost of the liberal victory meant a legitimisation of the central state as the only institution to collect taxes from citizens.<sup>31</sup> The idea was to fill the gap left by the

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<sup>28</sup> In such an illiterate country, literacy became a concern and university teaching even demanded the creation of the *subsídio literario*, as explained above.

<sup>29</sup>This new (African) colonial empire created after the Berlin Conference was too poor to afford the same mercantile success as had the previous empires. On this see Smith, Gervase Clarence - [The third Portuguese colonial empire](#) -

<sup>30</sup> See Comín, Francisco - *Historia de la Hacienda Publica - Europa - Nuevos Instrumentos Universitarios*, Barcelona, Critica, 1996, p. 169-236.

<sup>31</sup> Central state monopoly in taxation allowed an expansion of state revenues all over Europe.

abolition of other fiscal systems by expanding public tax collection, profiting from the citizen's ability to pay. Despite the fact that many could afford to pay, resistance could exist. Resistance was common. Fiscal pressure often brought mob uprisings and social unrest. Although the liberal ideology and the Parliament surveillance on public finance were established in the Constitution and were commonly accepted, riots occurred during difficult economic periods.<sup>32</sup> This social reaction may be interpreted as “a loss of consent” from taxpayers. Moreover, tax evasion was a common reaction, particularly in a small, poor country where extraordinary custom duties had, in earlier times, relieved taxpayers of the tax burden by providing excellent inflows to the Exchequer from previous colonial empires (first Asia, and then Brazil).

The question was how to expand fiscal exaction. The solution was to divide the traditional royal tithe into different taxes according to the revenues to be taxed (land revenues, industrial revenues, or interests) in order to increase the collection throughout the 1850s and 60s. However, customs went on providing the lion's share to the Exchequer. Table 1 shows comparative European data.

Table 1 - Ratio of customs' revenues on fiscal revenue (%)

| Year | UK | Italy | France | Germany | Spain | Portugal  |
|------|----|-------|--------|---------|-------|-----------|
| 1850 | 23 | -     | 9      | 22      | 13    | 41 (1852) |
| 1860 | 37 | 16    | 7      | 16      | 11    | 44        |
| 1870 | 35 | 10    | 6      | 56      | 11    | 33        |
| 1880 | 29 | 12    | 9      | 56      | 15    | 39        |
| 1890 | 28 | 19    | 14     | 56      | 17    | 43        |
| 1900 | 23 | 19    | 12     | 53      | 18    | 33        |
| 1910 | 28 | 21    | 15     | 44      | 15    | 31        |

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<sup>32</sup>The so-called *Maria-da-Fonte* popular revolt in the 1840s and the so-called *Janeirinha* in Lisbon and Oporto in 1868 were the most acute moments of resistance against two attempts to increase tax payments. See Mata, Maria Eugénia - “A actividade revolucionária no Portugal contemporâneo – uma perspectiva de longa duração – *Análise Social*, vol XXVI, (112-113), 1991, p. 755-769.

Sources: Comín, 1996, p. 219; Mata, 1993, p. 129, 136.

Excepting Germany, no other country matched the role of customs' duties on fiscal revenues in the selected sample of European countries of Table 1. The weight of customs in Portugal was greater than in the UK. This fact may result from the small size and openness of the Portuguese economy, but it is surely linked to three centuries of imperial customs tradition. Other explanations may reside in the lower exaction cost of customs revenue and the lower political cost compared with internal indirect and (especially) direct taxes.

Improving tax collection efficiency meant improving public administration and extending the state staff throughout the country in order to develop a true fiscal network over the entire nation. This was a priority for the central state from the 1840s on, in order to administrate and control the whole territory, which lasted until the First World War.<sup>33</sup> Worries about transportation and communication facilities such as roads, railways, and telegraph and, later, telephones were presented in Portugal as main issues for economic growth and modernisation. In Portugal the ideal of state efficiency included the provision of these public goods by the central state, because of market mechanism failure.

In this way, Portuguese politicians from the 1850s to the 1890s equated progress with material infrastructures and the provision of public goods.<sup>34</sup> Such a framework for social welfare meant subsidising private companies, or public provision in the case of a failure of private supply. These new social functions of the central state required more revenue.<sup>35</sup> Smuggling and tax evasion were, however, rampant. No available studies can identify the most tax resistant classes in Portugal. However, privileged traditional upper-society groups seem to have been the most evasive of Portuguese nineteenth-century taxpayers. It is known that landowners sought to hide land revenues, avoiding the inclusion of

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<sup>33</sup> High transportation and information costs to put Lisbon (the central state capital) in touch with every part of the country were real problems to overcome. This was true for the European territory of the kingdom because private initiative to build transportation facilities was usual all over Europe, but weak in Portugal. It was particularly true for the administration and taxation in the Atlantic islands of *Azores* and *Madeira*.

<sup>34</sup> Mata, Maria Eugénia – *As três fases do Fontismo: Projectos e realizações* – in *Estudos e ensaios em homenagem a Vitorino Magalhães Godinho* – Sá da Costa Editora, Lisboa, 1988.

<sup>35</sup> New functions included the support to transportation and communications facilities, as well as health and more education.

their properties in national land *cadastre*.<sup>36</sup> Newly created luxury taxes based on external indicators of consumption, such as domestic waiters, carriages, coats of arms and transportation horses produced low revenues.<sup>37</sup>

As Francisco Comín puts it, tax evasion is a common attitude in Latin countries.<sup>38</sup> Tax evasion coupled with enlarged expenditure meant high public deficits, which were supported by public debt. Under globalisation borrowing was easy at the leading European Stock Exchanges and the government planned an indebtedness cycle for Portuguese public finance. According to government blueprints, the foreign debt would be paid in the future, but in the early 1890s there was a partial bankruptcy. The inefficiency of government and central state cannot be disguised.

According to a general pattern, there are three main phases for public indebtedness (which were planned by the Portuguese government in the 1850s).<sup>39</sup>

In a first phase, a central state may seek loans and borrow from the market in order to finance public expenditures devoted to investment. The justification of this may include the failures of the market, the need for providing satisfaction of needs to present generations, the role of public goods to stimulate economic growth and welfare and the long-term character of consumption provided by

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<sup>36</sup> Mata, Maria Eugénia - A contribuição predial, contribuição de repartição ou contribuição por quota – Revista de História Económica e Social, 1988.

<sup>37</sup> A Deputy commented in 1880 on the low number of taxpayers in a very ironical way: In Portugal taxes are not paid according to individual property, but inversely to political influence; (...)

I will recall, as a simple example among so many others, an article of the luxury tax: only 33 persons pay tax for using coats of arms on their carriages!

In Portugal, where aristocracy so much abounds, where the class decorated with honorific titles is so large, where aristocracy has grown in a fantastic way, which may not be but extremely nice for the nation, that in this way becomes more considered in the world; in Portugal where there are so many aristocrats, that their number even surpasses the non-aristocrats, it is strange that only 33 tax payers pay for the use of arms on their carriages - Deputy José Rodrigues de Freitas, *'Diário das Sessões da Câmara dos Deputados'*, session of 14th May 1880, Parliament Archive, DSD114, p. 2087.

<sup>38</sup> Comín, Francisco - *Historia de la Hacienda Publica - Europa* - Nuevos Instrumentos Universitarios, Madrid, 1996, p. 227-232.

<sup>39</sup> For a Brazilian analysis see Abreu, Marcelo de Paiva - *A dívida pública externa do Brasil 1824-1931* - Working-paper nº 83 - Department of Economics, PUC, Rio de Janeiro.

material infrastructures, which lasts for several generations.<sup>40</sup> As future generations would also use the service of public investment, it should only be fair that present and future generations would finance their building together. Public debt left from present generations to future generations represents their participation in this collective effort. This phase is characterised by net government borrowing.

In a second phase, the government stops borrowing, society benefits from the public goods, previous investment matures, improving Gross Domestic Product and Exports. Government supports the debt service (basically the interest), as economic growth improves.

In a third phase, previous public investment generates multiplier effects and not only does society benefit from increased welfare, but the government can, as well, collect higher taxes on expanded economic activities in order to pay the debt.

Let

Y represent GDP

D be the net amount of (foreign) borrowing ( $D > 0$  if the state is borrowing and  $D < 0$  if the state is repaying the debt),

$\Delta D$  is the variation of the debt and

d the average annual accumulated rate of growth of the public debt

S be the service of the foreign public debt,  $\Delta S$  the growth of this service and s its average annual growth rate

T be the amount of taxes and

t its average annual accumulated rate of growth.

This means that

In the initial state  $D=0$   $G=T$  and  $T=f(Y)$   $dT/dY > 0$

In the first phase  $\Delta D > 0$   $G > T$  and  $G-T$  is supposed to be investment

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<sup>40</sup> In a model for total public debt GDP may be used as a proxy for capacity to pay (and in a model for public foreign debt Exports should be the proxy).

In the second phase  $\Delta D > 0$   $G = T$  because to attain this phase it is enough to decide to stop investment to be financed by borrowing.  $G$  now includes interest repayment.

In the third phase  $\Delta D < 0$   $G = T$  and this is possible because  $Y$  has increased as a result of public investment. To attain this third phase it is necessary that

$\Delta T/T > \Delta S/S$  or, more precisely, that  $t > d$ , if we consider total public debt

or

$\Delta X/X > \Delta D/D$  or, more precisely, that  $x > d$ , if we consider only foreign public debt

What went wrong in Portugal?

In the initial state  $D > 0$  because of debt incurred to impose the liberal regime. Domestic and foreign borrowing went on from the 1850s to the end of the 1880s: leading European stock exchanges provided significant loans to the Portuguese government. As industrialisation faced several difficulties, borrowing outstripped economic growth ( $\Delta D/D > \Delta Y/Y$  and  $d > y$ ). Borrowing also grew faster than tax revenues. With the exception of the 1870s,  $\Delta D/D > \Delta T/T$  and  $d > t$ . The second and third phases were never reached. Table 2 provides the data.

Table 2 – Comparing Portuguese total indebtedness growth with GDP growth

| Year | D   | $\Delta D/D$ | d    | Y   | $\Delta Y/Y$ | y    | T  | $\Delta T/T$ | t    | S    | $\Delta S/S$ | s    | X    | $\Delta X/X$ | x   |
|------|-----|--------------|------|-----|--------------|------|----|--------------|------|------|--------------|------|------|--------------|-----|
| 1851 | 83  |              |      | 255 |              |      | 9  |              |      | 4.7  |              |      | ?    |              |     |
|      |     | .64          | 4.7% |     | .44          | 3.7% |    | .22          | 2.0% |      | .72          | 5.6% |      | ?            | ?   |
| 1861 | 136 |              |      | 366 |              |      | 11 |              |      | 8.1  |              |      | 14.3 |              |     |
|      |     | 3.24         | 8.5% |     | .28          | 2.5% |    | .36          | 3.2% |      | .84          | 6.3% |      | .56          | 4.6 |
| 1871 | 308 |              |      | 469 |              |      | 15 |              |      | 15.0 |              |      | 22.4 |              |     |
|      |     | .63          | 3.1% |     | .35          | 3.1% |    | .53          | 4.4% |      | .33          | 2.9% |      | .14          | 1.3 |
| 1881 | 417 |              |      | 634 |              |      | 23 |              |      | 19.9 |              |      | 25.5 |              |     |
|      |     | 1.523        | 3.4% |     | .28          | 2.5% |    | .30          | 2.7% |      | .49          | 4.1% |      | .23          | 2.1 |
| 1891 | 583 |              |      | 811 |              |      | 30 |              |      | 29.6 |              |      | 31.4 |              |     |

Sources: Mata, 1993, p. 255.

Unit: D, Y, S and T in thousands of *contos*.

The 1850s and 60s correspond to the first phase. Borrowing did not stop in the following decades (1870s and 1880s). Borrowed revenues were used not only for public investment but also for current expenditure, investment did not increase the GDP enough to collect taxes to support the entire public debt service. Exports grew at a slower rate than foreign public debt service. The ideal model did not work. Before the third phase was attained, state bankruptcy was unavoidable.<sup>41</sup> The main conclusion is state inefficiency. As Comín says, "when the government is unable to fulfil the payment of public debt interest, bankruptcy shall be declared, openly or disguisedly".<sup>42</sup> Portuguese partial bankruptcy in 1892 consisted of a forced decrease of interest to 1% and a suspension of amortisation. It was declared by a government decree on the 13th of June 1892 in the wake of the Baring crisis. This bank was a traditional lender to the Portuguese government. Short-run loans that were usually received as floating debt were no longer to be had because of the South American crisis. The payment of interest and amortisation could not be achieved. In a geopolitical perspective, by the end of the nineteenth century the earlier sixteenth-century leader of Discoveries was an underdeveloped indebted country. Political, literary and philosophical discussion on decadency themes was at the fore.

The bankruptcy may be considered as an attempt to decrease  $\Delta D/D$  through a decrease of the interest rate in order to reduce it to values close to the rate of GDP growth. The outflow of capital for debt service, coupled with a trade deficit, had brought on a shortage of metal in Portuguese banks in the year before. A rush on the banks led to a suspension of convertibility that could not be overcome. As convertibility was a pillar of the gold-standard regime, which had been adopted since 1854, the abandonment of the gold standard in 1891 deprived Portugal of international trust. In the next year foreign lenders

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<sup>41</sup> Mata, Maria Eugénia – *As três fases do Fontismo: Projectos e realizações* – in *Estudos e ensaios em homenagem a Vitorino Magalhães Godinho* – Sá da Costa Editora, Lisboa, 1988.

<sup>42</sup> Quoting Hoffman and Norberg - *Historia de la Hacienda Publica - Europa - Nuevos Instrumentos Universitarios*, Barcelona, Critica, 1996, p. 23.

considered the bankruptcy default as something intolerable, as the Portuguese government failed to meet its obligations with lenders at the international stock exchange markets. From then on no more foreign borrowing was available.<sup>43</sup> This financial disaster was laid at the feet of the political regime and especially the monarchy, leading to the victorious Republican revolution that cast off the royal family and the monarchist regime in 1910.

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<sup>43</sup> Difficult negotiations with lenders for a conversion of the foreign debt would last until 1902.

Table 2 – Comparing Portuguese total indebtedness growth with GDP growth

| Year | D     | $\Delta D/D$ d | Y   | $\Delta Y/Y$ y | T   | $\Delta T/T$ t | S   | $\Delta S/S$ s | X   | $\Delta X/X$ x |
|------|-------|----------------|-----|----------------|-----|----------------|-----|----------------|-----|----------------|
| 1851 | 83    |                |     | 255            |     | 9              |     | 4.7            |     | ?              |
|      | .64   | 4.7%           | .44 | 3.7%           | .22 | 2.0%           | .72 | 5.6%           | ?   | ?              |
| 1861 | 136   |                |     | 366            |     | 11             |     | 8.1            |     | 14.3           |
|      | 3.24  | 8.5%           | .28 | 2.5%           | .36 | 3.2%           | .84 | 6.3%           | .56 | 4.6            |
| 1871 | 308   |                |     | 469            |     | 15             |     | 15.0           |     | 22.4           |
|      | .63   | 3.1%           | .35 | 3.1%           | .53 | 4.4%           | .33 | 2.9%           | .14 | 1.3            |
| 1881 | 417   |                |     | 634            |     | 23             |     | 19.9           |     | 25.5           |
|      | 1.523 | 3.4%           | .28 | 2.5%           | .30 | 2.7%           | .49 | 4.1%           | .23 | 2.1            |
| 1891 | 583   |                |     | 811            |     | 30             |     | 29.6           |     | 31.4           |

Sources: Mata, 1993, p. 255.

Unit: D, Y, T, S and X in thousands of *contos*.