

Sovereign debt and private credit in Portugal (1668-1797)

PTDC/ HARHIS/28809/2017

1 - The project's main purpose

This is a three-year project to collect the information comprised in all perpetuities issued by the Portuguese crown between 1640 and 1800 funded by the Portuguese Foundation for Science and Technology (FCT) under the designation (PTDC/ HARHIS/28809/2017).

It aims to construct a complete series on Portugal's public debt in the early modern era, focusing on the period in which the country took part in major European wars after regaining political autonomy in 1640.

The project provides data to study the interaction of sovereign debt, private credit market and colonial rents. It puts forward the hypothesis that the creditworthiness of the sovereign borrower depended on the buoyant colonial revenues earmarked for debt service in the 18th century, which may have impacted the crowding out of private funds.

The test of the hypothesis requires two sets of data:

- a) The first set is related to several variables that allow studying the annual fiscal position of Portugal in a long-term approach, namely: a) the debt stock, b) the structure of maturities; c) the debt service; d) the evolution of interest rates; e) the assessment of tax revenues earmarked for debt service; f) the institutional and the gender characteristics of creditors;
- b) The second set of data series is based on account records of major players both in the public and private credit markets. The lay brotherhood of *Misericórdia* is the selected player as it has well-preserved account books covering three centuries of participation in credit transactions. The data are used to test whether the state serviced the debt regularly or whether covert forms of default affected the institution's income streams. It also tests the hypothesis that public credit crowded out the private market.

The project's motivation rests on the current notion that Portugal's record in public debt was flawless from 1560 to 1828 (Reinhart and Rogoff 2011), which is a positive contrast to other monarchies known for their repeated defaults (France and Spain). Most studies on fiscal history

have put forward the hypothesis that representative institutions solved the state's commitment problem. In this strand of literature, the north-western European models of government (Britain after the Glorious Revolution and the Netherlands) and the Italian republican regimes in the city-states perform better than the so-called absolutist monarchies. The study of Portuguese credit markets in the mirror of European countries brings to light an uncharted historical case that helps to corroborate or refute the current state of scholarship based on the conventional cases of success (England and Holland) or failure (Spain, Sweden or France) of the main territorial states.

To better understand the dynamics of public debt during the period under study, it is thought relevant to have a comparative landmark taking the beginnings of the consolidated debt in Portugal. To this end, all the information on consolidated debt between 1529 and 1557 was collected.

2 - Public debt in early modern Portugal: the state of the art

The project fills a gap in current knowledge about the evolution of Portuguese public debt in the early modern period. Conventional wisdom held that the Portuguese monarchy was no different from other monarchies, where debt was the means of financing war and colonial ventures, whereas social unrest was prevented by not resorting to higher taxes. The notion of Portugal's high debt level relied on a study published in 1883 by José da Costa Gomes, *Collecção de Leis de Dívida Pública Portuguesa*. A few years after its publication, the state's default on international lenders barred Portugal's access to international markets until the First World War. This work was thus carried out during the critical years of the country's financial history. Gomes' commitment to one of the political parties in the government prompted the search for evidence of Portugal's historically high levels of indebtedness, illustrating the political capital of his historical narrative.

The book compiles important legal texts from the 16th to the late 18th centuries that provide information about interest rates at issuance in specific periods. The quantitative information available in this work refers to the redemption of the debt inherited by the liberal state in 1837 (Gomes 1883, p. 88). Despite the lack of a quantitative approach, the *Collecção de Leis de Dívida Pública Portuguesa* has been the only reference for scholars interested in the evolution of public credit in Portugal, illustrating the urgent need for research focused on primary sources.

3 - The archival sources

- a) *Royal Chancery books*, a collection kept at the Portuguese National Archive (*Torre do Tombo*) in Lisbon, where information on perpetuities is stored. The data series comprises:

Chancery of King João [John] IV, books 1-5, 7-9, 12;

Chancery of King Afonso VI, books 1-3, 5-15, 17-18, 46, 49-50, 53, 58;

Chancery of King Pedro [Peter] II, books 1-5, 7-16, 54;

Chancery of King João [John] V, books 1-27;

Chancery of King José [Joseph] I, books 15-23, 38-41, 58-61, 71-73, 83, 91-92, 96;

Chancery of Queen Maria [Mary] I, books 5, 8-10, 25, 31, 35, 42.

With a total of 5,629 registers.

The origins:

Chancery of King João [John] III, books 5-7, 15, 19, 21, 24-26, 31, 33, 38-40, 42, 44, 47-50, 53-55, 57-61, 63, 65-68, 70-71;

Chancery of King Sebastião [Sebastian] and *King Henrique [Henry]*, books, 1-2, 9.

Information on the issuance and management of public debt is found in the Royal Chancery books. As elsewhere in early modern Europe, the consolidated debt in Portugal was based on the issuance of perpetuities, called *padrões de juro*. These were long-term bonds without redemption date, paying interest indefinitely and earmarked to a specific revenue stream. This instrument was fully transferable and negotiable in secondary markets, as a whole or in fractions. Each *padrão de juro* contains information on the principal, the interest rate at issuance, the tax stream assigned to the payment of interest, and the identity of the owner. The transferability of the instrument required a new register at the royal chancery.

The regular issuance of *padrões de juro* in Portugal started in 1529. Considering the timetable of a three-year project, the mass of available documents advised opening the systematic collection of data with the records from 1641 and ending in 1800, which defines a coherent period of the country's political and financial history. It covers the Dynasty of Braganza, beginning with the Restoration War (1641-1668) and the country's participation in other major conflicts of the 18th

century (the War of Spanish Succession and the Seven Year's war). The data collection stops in 1800, regarding the changed context of the Napoleonic threat and the new type of debt instruments that the state had resorted to since 1797. At that time, bonds with small denominations were issued and served as a compulsory currency. From that point onwards, the state chose not to issue perpetuities. The redemption of the stock in perpetuities took place under the rule of the liberal state.

The monarchy rewarded services with payment of pensions called *tenças de juro* or *padrões de tenças de juro*. It is important to note that these instruments are not included in the series offered. The fundament for the issuance of these instruments was not a credit contract, which provided for the delivery of cash to the royal treasury. They compensated the holder for royal services or could be the state's means of paying for the expropriation of property.

It is also worth noting that life annuities in Portugal were also called *tenças (tenças a retro)*. They were issued during the Iberian Union and from 1640 to 1656. There is no evidence that the monarchy resorted to selling life annuities again until the end of the *Ancien Régime*. Probate inventories and other types of property records in the hands of prominent groups that supplied funds to the monarchy through *padrões de juro* contain no evidence of the ownership of life annuities (Pedreira 1995; Monteiro 2003; Salvado 2009). Moreover, the liberal state repaid the stock of debt issued during the Ancient Regime and there is no record of the repayment of debt financed through life annuities (Gomes 1883). Given the demonstrably diminishing issuance of this instrument and the fact that it is not possible to distinguish life annuities (*tenças*) from pensions (*tenças*) in the Portuguese catalogues of the Chancery books, the project excluded the items identified as *tenças*. According to a budget dating from 1641 (Dias 1985), the state expenditure for servicing life annuities was 2.5% of the total payments on *juros* and *tenças*. Therefore, the estimated debt stock from 1640 to 1700 is only slightly undervalued since the project datasets strictly comprise information on *padrões de juro* as a long-term credit instrument.

Since the project was designed to analyse public debt from 1641 onwards, it started from an estimate of the debt stock according to a state budget dating from 1641 and published by Dias (Dias 1985). The computation of the stock in that year considers the amount spent on the service of *juros* and accounts for the interest rate reductions from 1641 to 1800 on the *juros* issued before 1641. The share of annuities whose interest was reduced led to estimate the stock based on 33.3% paying 6.25% and the remainder paying 5%.

The origins

Although the project covers the public debt in Portugal from 1640 to 1800, it considers, as a residual reference, the issues and debt service in the early phase of perpetuities in territorial monarchies. This series makes it possible to assess the health of public credit at a time when *padrões de juro* had just begun their history in the reign of John III. They were a credible financial instrument and accounted for the overwhelming share of assets traded on the capital market in the second half of the 16th century.

- b) Notarial and account books in the archives of the lay brotherhood of the *Misericórdia of Porto*.

The series constructed with these archive sources illustrates the undertakings of a major market player in the public and private credit markets. It informs the institution's annual returns from investments in public credit and displays the pace of the state's debt service.

4 - The datasets: The Excel sheets

A - DEBT

Sheet 1 – Stock variation

- a) The value of the stock in 1641 is an estimation based on debt service in that year, as explained above (section 3a):
- b) The values of long-term debt stock report to the value at the end of the year t1;
- c) The outstanding short-term debt is a construction based on the *juros* that consolidated the floating debt. It should be taken as a lower bound estimate because there is no information on short-term maturities that were eventually repaid and not consolidated;
- d) Italics indicate that there is no information available in Chancery books;
- e) The annual net value of issuances considers redemptions and refinancing *juros* at lower interest rates. Negative numbers indicate that redemptions were higher than issuances.

Sheet 2 - Debt service

- a) The base year 1641 is taken from a published source that gives the debt service in that year (section 3a);
- b) The interest rate is the ratio of the debt service in year t_1 to the stock at the end of the year t_0 .

Sheet 3 – The origins of the public debt

This series is a primary reference for assessing the health of public credit at a time when *padrões de juro* had just begun their history as a credible financial instrument and accounted for the overwhelming share of assets traded on the capital market in the second half of the 16th century.

B – FISCAL COFFERS ASSIGNED TO DEBT SERVICING

This database provides an evolving overview of the fiscal resources that served the debt. The evolution is presented in four periods of 40 years each. Despite being arranged in homogeneous chronological periods, these periods cover historical events that assure their coherence at other levels:

The first period: 1641-1681 corresponds to the years of the restoration of Portugal's political independence and the instability, ranging from the Restoration War to the enthronement of the regent prince as King Pedro II.

The second period: 1682-1721 comprises a long-lasting period of political stability but a significant financial effort due to Portugal's involvement in the War of the Spanish Succession.

The third period: 1722- 1761 includes a major operation to consolidate the short-term debt issued during the war of the Spanish Succession and the noteworthy contribution of the rents directly or indirectly generated in the empire (gold and tobacco) to service public debt.

The fourth period: 1762-1800 comprises a new administration system affecting debt payments. Although it embodied the establishment of a new board that centralised state spending,

interest payments continued to be serviced by the yield of specific taxes assigned to the debt service.

Sheet 1 – Long-term debt (*padrões de juro*) (1640-1800)

- a) Data on fiscal coffers presented in the spreadsheet is the balance of each period;
- b) The negative values indicate that the bond redemptions paid into the coffer had a higher value than the new issues in that period;
- c) The decimal numbers in the column “number of bonds” indicate that there were *padrões de juro* whose interest payment was assigned to more than one coffer;
- d) Zero bonds and a negative variation in the value of the coffer indicate that *juros* paid in the coffer underwent an interest reduction;
- e) A negative number of bonds indicates that redemptions exceeded the number of new issues in the 40 years under analysis.

Sheet 2 – Short-term debt (debenture notes) (1640-1800)

This sheet lists the coffers that serviced short-term loans until their consolidation - (due to consolidation the servicing varies in different coffers, the movement of which has been recorded on sheet 1).

Sheet 3 – Long-term debt (*padrões de juro*): the origins

C – CREDITORS (1641-1682)

This spreadsheet gathers information on creditors in the first issues of *juros* or those who have accepted interest reductions. Creditor identification is available on the *juros*, but cross-referencing with other primary sources was necessary for the sociological study. The social background of bondholders was identified through a targeted investigation into archival funds, available at <https://digitarq.arquivos.pt/>: *Habilitações das Ordens Militares, Familiaturas do Santo Ofício, Leituras de Bacharéis* and *Registo Geral de Mercês*.

D – INTEREST PAYMENTS TO THE MISERICÓRDIA OF PORTO

To be released. Work in progress.

This sheet provides the income flows of Misericórdia originated in interest payments from *padrões de juro*.

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