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FROM COLONIES TO NATIONS:

MONEY, TAXES AND FINANCE (18th and 19th Centuries)

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Introduction

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The wars of independence in Spanish America marked not only the demise of the most ancient and far-flung European overseas empire but also the end to what was probably the largest monetary union then in existence. For three centuries the Spanish Crown had maintained a common silver and gold currency in the metropolis, in the vast territories of Spanish America and in the Philippines. Moreover the silver peso (*peso de plata*) – had become the most universally used coin in the world, circulating in China, South Asia and Europe as well as throughout the Americas.

The end of the colonial regime also marked the end to what was the most extensive fiscal structure of the ancient regime in the Atlantic world. Adam Smith in his classic work on The Wealth of Nations (1776) emphasized the fact that the tax administration of the Spanish crown in the Americas was a much more efficient extractive machine than that of Great Britain in its colonies. Nonetheless, the Spanish American empire eventually collapsed as a result of the succession of international conflicts which took place in the Age of Revolution, beginning with the wars of independence of the United States (1775-1783) and concluding with those of the Latin American nations (1810-1825).

The fiscal and financial transition from colonies to nations proved extraordinarily problematic in most of Spanish America as well as in Brazil, a fact which has frequently been adduced by historians to colonial legacies.[1] Recent historical research, however, has raised serious doubts about what has long been presupposed to be the negative inheritance of the *entire* colonial experience.[2] In fact, analysis of the unified and stable monetary, fiscal and financial regimes of the colonial era suggests that from the perspective of institutional stability, clarity of norms and rational expectations, there is much to debate with regard to the costs of Latin American independence. In contrast to the United States, where independence did not impede but rather favored financial development and a fiscal system that worked well, in Latin America the reverse was true.

With independence, each new state in the subcontinent sought to affirm its political and financial sovereignty. Among the most serious obstacles to the construction of stable and solvent governments were monetary fragmentation and difficulties in carrying out fiscal reforms, both of which had negative consequences for the public and private economy, particularly in regard to transaction costs. The transition from the well-organized if exploitative colonial tax system to the mixture

[1] A recent reaffirmation of this overly negative view of colonial rule can be found in the introduction by John Coatsworth, ed. Latin America and the World Economy since 1800, Cambridge, Mass., Harvard University Press, 2000. In this text colonial institutional constraints and practice are held largely accountable for underdevelopment in Spanish America.

[2] For instance an expert on Peruvian financial history has affirmed that it is incorrect to argue that the weakness of the 19th century financial system in Peru was due to its colonial legacy, for in fact 18th century financial institutions were quite strong. See Alfonso Quiroz, “Consecuencias financieras y económicas del proceso de independencia en Perú, 1820-1850” in S. Amaral and L. Prados de la Escosura, eds., *La independencia americana: consecuencias económicas*, Madrid, Alianza, 1993, pp.124-156.

of centralist and federalist tax regimes prevalent in most of Latin America after 1825 proved extremely difficult. The destruction of a large part of the Bourbon administrative system led to a weak and inefficient public sector for decades. In addition, after 1820, monetary problems began to plague many of the newly independent Latin American states, which adopted a considerable variety of monetary standards: pure silver standard in old, silver mining economies like Mexico, Peru, Bolivia and Chile, inconvertible paper money standards in Brazil and Argentina, and so forth. Weak monies and/or inflation, public deficits and capital flight causes by the wars destabilized post/independence economies and undermined the reconstruction of domestic financial markets.

In sum, while liberal political reforms and institutions were ratified throughout Latin America on a widespread scale from the 1820s, their practical effect was quite different from that in the United States. Economic development was virtually stagnant until the 1850s, with a handful of regional exceptions. Foreign trade was one of the few relatively important engines of growth, but was not accompanied by sufficient advances in domestic economies. In this regard, it is our argument that fiscal, monetary and financial obstacles exercised a major role in slow economic development in this era.[3] We base this hypothesis on the recent and relatively abundant literature that has explored these issues for several of the larger Latin

[3] A recent paper that so argues is Maria Alejandra Irigoin, "Macroeconomic Aspects of Independence in Spanish America: The effects of fiscal and monetary fragmentation, 1800s-1860s", 63rd Congress of the American Economic History Association, Tennessee, September, 2003.

American nations, in particular Argentina, Brazil, Chile, Colombia, Mexico and Peru, as can be seen in our bibliographic essay.

A second thesis of the present essay is that while the economic recession of the first decades after independence was deep, recovery in Latin America actually began from mid-century. It was in the period 1850-1873 that a series of export booms began to allow for relatively, sustained economic growth in the more dynamic nations of the region. This period also witnessed marked improvements in the fiscal situation of many states accompanied by an early and powerful international inflow of foreign capital (mostly in the form of government loans). These years were also the time of the birth of banking in Latin America. Hence financial factors played an important part in this early phase of takeoff of economic development in the region which, in spite of being uneven, allowed for high growth rates in a number of regions.

The present chapter provides an overview of the diverse and, at same time, parallel trajectories of the fiscal and financial history of the Latin American nations in their transition from the colonial empires of the eighteenth century to the independent states of the nineteenth century. Particular emphasis is placed on the fact that the process of nation-building in both political and economic terms was protracted and often discontinuous.

The four sections that make up this chapter deal successively with the following subjects: (a) the colonial monetary, fiscal and financial regimes; (b) the tax reforms of the early independent era and the emergence of chronic public deficits; (c) the gradual establishment of tax states with a more consistent capacity to generate revenue; (d) the debt cycles of the Latin American states in the nineteenth century and the changing priorities of public expenditures. These are large questions, all of which relate to the central theme of the difficult transition from colonies to nations. Hence, our opening question which is: What happens to the economy as a result of the bankruptcy and fragmentation of an imperial state?

To answer we must first review the nature of the colonial monetary, fiscal and financial system and then address the issue of the impact of the wars of independence.

I) The Colonial Monetary and Fiscal Order: Spanish America and Portuguese Brazil

To attempt to understand the monetary, fiscal and financial legacy of three centuries of colonial government in Spanish America and Brazil it is essential to keep in mind institutional contexts. Metropolitan models were fundamental but colonial adaption was considerable. For instance, it is well known that the monetary regimes of colonial Brazil and Spanish America were molded, respectively, by the monetary systems and standards of the Portuguese and Spanish monarchies. Nonetheless, in each of the colonies some aspects of the nature of monetary circulation was distinct, especially with regard to local fractional currency, much of which was based on tokens and commodities that served as money.

Similarly, the fiscal regimes in America were in part the result of the transposition of a number of taxes which already had a long history in the respective metropole. But there were also innovations as a large number of new, local taxes were established in the colonies which were entirely different: for example, the taxes on silver production and Indian tribute in Spanish America, or the exactions based on brazilwood, sugar production and the sale of slaves in Brazil. Furthermore, if we analyze the credit regimes of the colonial societies, it must be emphasized that while the basic credit norms and loan instruments were essentially those of the Catholic European ancient regime- being controlled largely by ecclesiastical and mercantile corporations- the actual functioning of financial markets in the colonies was quite different in some instances from the societies of Portugal and Spain. It is to these problems- the monetary, fiscal and credit regimes of Spanish America and Brazil- that we now wish to direct the attention of the reader.

Colonial monetary regimes

From the 16th century to the 19th century, Spanish America, and later Brazil, provided the bulk of silver and gold essential to the functioning of metallic monetary systems around the globe.[4] Given these mining riches, it might be presumed that the colonies themselves would have enjoyed a widespread circulation of silver and

[4] For a recent overview see Marichal (2001) "El peso o real de a ocho: moneda universal de España y América, siglos XVI-XVIII", in Banco de España, El camino hacia al euro (2002), pp. 25-38.

gold currency, and that this would have served to buttress a dynamic credit system with a presumably beneficial impact upon all social and economic sectors. In fact, however, the actual circulation of metallic currency within both Spanish America and Brazil was fairly limited, a fact so paradoxical that it has provoked considerable debate among historians, hard put to explain the scarcity of cash in circulation within what were eminently silver and gold-producing economies.

Several explanations have been advanced to explain the relative scarcity of metallic currency in daily circulation. To begin with, historians have studied the voluminous and constant export of precious metals to Spain and Portugal from the earliest days of colonization of the Americas: in fact, these remittances increased over time, reaching their peak in the eighteenth century. Moreover, within the colonies themselves, most of the silver and gold (in bars and coin) did not long remain in circulation but was soon retired from local markets. This was the consequence of the fact that heavy silver and gold stocks were held for long periods by the State as well as corporations and rich individuals, although not mainly for the purpose of hoarding. Rather, the nature of the colonial economy and polity explain this behaviour of accumulation of large stocks of silver and gold.

In the first place, it is important to note that all colonial tax administrations in the principal mining regions retired a significant portion of metallic currency from circulation in order to reserve it because they had instructions to send important sums to the metropolis: they wished to assure that when the warships sent from Seville or Lisbon arrived, there would be little delay in loading them with the precious metals. Additionally, silver had to be saved in order to meet the annual remittances for colonial outposts with insufficient revenues to cover their local, military and administrative expenses.

In the second place, private actors also accumulated huge stocks of precious metals and coin. From the sixteenth century until the end of the eighteenth century, the oligarchies of wealthy merchants in Mexico, Lima, Cartagena, Havana, Bahía and Rio de Janeiro made it a point of concentrating large silver and gold stocks in their firms, which they reserved for months in order to have sufficient funds to buy practically all the imported products sold at the great, annual fairs held in each colony after the arrival of the convoy of ships (*flotas*) from Spain or Portugal. Finally, the powerful ecclesiastical institutions in all of Spanish America and Brazil extracted large amounts of silver through tithe collection and other ecclesiastical taxes and, hence, accumulated important stocks of silver, which were used in part to assure both future expenditures as well as to assure the continuous flow of credit operations that ecclesiastical organizations realized on behalf of large property-owners.

The fact that much silver and gold was exported and/or held outside of consumer markets for long periods helps to explain the relative stability of colonial prices over the long run. Despite high production of precious metals, there was not much abundance of coin in domestic circulation. Therefore prices rose only slowly, except at times of agrarian and commercial crises. Nonetheless, recent research on markets in late Bourbon Mexico indicates a fairly sustained price rise of basic agricultural commodities at the end of eighteenth century.

Another striking feature of the colonial monetary regimes was the extraordinary stability of the standards and units of account of the metallic monetary system over a period of three centuries. Silver and gold coins were the most important instruments of that system in Spanish America and Brazil, although, as we shall note later, small-scale transactions required the development of alternative fractional currencies and a set of complex credit mechanisms linked to both consumption and salaries. In Spanish America, as Cortes Conde notes: “The most common silver coins were the real and its multiples: the real of two (later the peseta) real of four (half peso) and real of eight (the peso, an ounce of silver). Fluctuating over time, between 16 and 17 silver pesos were equivalent to one gold peso (one ounce of gold).” [5] Quite quickly, the silver pesos became the most widely circulating currency in the world. Indeed, already from the late sixteenth century, the silver peso had found a fundamental niche in the monetary vocabulary in most nations. In his monumental study of the worldwide circulation of American silver and gold in the seventeenth and eighteenth centuries, Michel Morineau points out that among the most common terms used in different languages to describe the silver peso were *pieces of eight*,

[5] Roberto Cortés Conde and George T. McCandless, “Argentina: From Colony to Nation. Fiscal and Monetary Experiences of the Eighteenth and Nineteenth Centuries”, in Bordo and Cortes Conde *Transferring Wealth and Power* (Cambridge University Press, 2001), p. 384.

stuken van achten, *pieces de huit réaux*, *pesos fuertes*, *piastres fortes*, *piastres* and *patacones*. [6]

It is important to recognize, however, that for a long time, monetary policy and practice in the colonies was not closely regulated by state. In the same way that it farmed out taxes, during the seventeenth century the Spanish Crown extended concessions to a small group of silver bankers who took charge of the minting of money. The leading silver merchants established close alliances with large silver miners, but their power was challenged after the 1730s as a result of new monetary policies of the Bourbon monarchy. Hence, much closer state regulation and control was established over monetary affairs. This became especially clear in New Spain when complete control of the Casa de Moneda de México (the only mint in the viceroyalty) was taken by the viceregal government in 1733. Important technical advances were introduced, and the quality of the silver coins improved notably, reinforcing the vast, international demand for Mexican silver pesos. The importance of this mint for world economic history was registered by Humboldt on his visit there in 1803:

"It is impossible to visit this building...without recalling that from it have come *more than two billion pesos* over the course of less than 300 years... and without

[6] Michel Morineau, *Incroyables Gazettes,* (Cambridge University Press/Maison de Sciences de l´Homme, 1985), p. 51.

reflecting on the powerful influence that these treasures have had on the destiny of the peoples of Europe." [7]

In contrast to Mexico and Peru, which were the great silver producers of the ancient regime, Brazil became the main source of gold for the world economy from the late seventeenth century, although the real Brazilian gold boom took place in the first two thirds of the eighteenth century. Brazil thus became the greatest producer and exporter of gold in the 18th century, much of it ending up in England which subsequently adopted the gold standard, in contrast to Spain, France and Italy which remained on bimetallic standards until the last third of the 19th century. In short, colonial legacies clearly have had considerable importance for international monetary history.

Colombia and Chile were also gold producers in the eighteenth century but paradoxically they also suffered from relative scarcity of metallic currency since the bulk of the gold was exported to Spain due to its high price. In any case, gold coins were never much used much for local trade. The silver peso and silver real were the most widely used monetary instruments for all wholesale and a fair amount of retail transactions throughout Spanish America and southern Brazil.

Despite their extraordinary silver and gold riches, historians have insisted once and again that it is necessary to explain the monetary paradox of these

[7] Alexander Humboldt, *Ensayo político de la Nueva España* (México, UNAM, reedición de 1991), p.

colonial societies. As Ruggiero Romano and other specialists have argued, the metallic monetary system in Spanish America was basically controlled by elites. Hence, monetary stocks (and wealth in general) were highly concentrated. Popular sectors suffered the consequences for they had considerable difficulty in obtaining the silver coin which they required both for payment of taxes and for mercantile transactions. Nonetheless, numerous ways were found to circumvent the shortages of fractional currency: A parallel monetary system developed which was based on non-metallic monetary instruments: among these were a great variety of coin tokens issued by merchants in cities, towns and haciendas: these were generally known in Peru as *moneda de la tierra* and in Mexico as *tlacos*.

The result was that there developed a *dual monetary system* which reflected the existence of a highly stratified economy and society On the one hand, there stood small but powerful elites which included mineowners, great merchants and large landowners, all highly monetized. The wealthy corporations such as the Church and Consulado that represented these elite held, or had access, to enormous metallic monetary stocks. There was some spillover to other social sectors but it was quite limited: medium sized merchants, mine workers and state functionaries received salaries in silver but most of the rest of society lived on the fringes of the monetary economy. Indian peasants who formed the bulk of the rural population in the viceroyalties of Mexico and Peru participated in the monetary economy but also frequently carried on barter. Slaves in Brazil and throughout

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Spanish America had occasional access to metallic currency but on a very small scale. Not surprisingly, the result of such a stratified society and economy was that the mass of population tended to suffer from both lack of metallic currency as well as other fractional currency instruments, and this clearly made for low levels of individual savings.

The dual monetary system also contributed to the existence of a *dual credit regime*. Substantial sources of credit existed for the wealthy and for powerful corporate institutions: much less credit was available for the rest of society, although, as we shall see, there were some important institutional instruments that can be identified as popular savings organizations. With regard to the private credit system for the elites, it is important to recognize that in Spanish America and in Brazil, the institutional framework of financial transactions was defined by the norms of what European historians (particularly of Catholic Europe) have denominated as the “ancient regime”. Most credit transactions, for example, were governed by a complex and highly codified set of rules established by the Catholic Church, the one hand, and by mercantile corporations (such as the “Consulados”), on the other. A review of the ecclesiastical and mercantile codes used in New Spain (Mexico) in the eighteenth century demonstrates that there were great similarities with the equivalent norms utilized in Bourbon Spain. In other words, despite the manifest, social and ethnic differences between colonial and metropolitan society, the parallels in rules of economic behavior were striking.

In the colonial societies, credit for artisans, mine workers and peasants was often linked to coercive instruments. For instance, shops in towns and cities throughout Spanish America extended credits for daily consumption that often led to excess charges. Similarly, merchants with establishments on large haciendas and mining sites, advanced commodities at high prices against the future salaries of laborers. As a result, many workers became permanently indebted, with the result that they were reduced to a semi-servile status.

It is also true, however, that a number of more equitable, corporate forms of credit also existed for some non-elite sectors. Within artisanal guilds in the cities as well as in the Indian towns, known as *repúblicas de indios,* there were numerous, religious lay brotherhoods (*cofradías*) which served as primitive savings institutions that extended credit. Nonetheless, it should be noted that these archaic credit forms did not imply that there existed a truly efficient credit system. As is well-known, the relative volume of credit depends markedly upon volume of circulating money but also upon velocity. The velocity of circulation of money was slow in the colonial economies, a fact which tended to reflect the skewed distribution of metallic money stocks.

The tax machines of colonial administrations

Similar in complexity to the monetary and credit regimes of colonial economies were the fiscal structure and dynamics in Spanish America and Brazil. Both the Spanish and Portuguese monarchies had long reaped substantial fiscal benefits from their overseas colonies. In the first place, the taxation regimes established in the 16th century were based on the principle that the colonial societies would pay their way by raising local taxes which would cover virtually all local government expenditures. In the second place, the most productive colonial treasuries (particularly those with high income from mining taxes) were expected to pay for administrative and military expenses of those administrative units which had little tax income. These intra-american tax transfers, known as “situados” in the Spanish Empire included regular payments from the treasury of Mexico to the colonial administrations iof the Spanish islands in the Caribbean as well as to the Philippines; similarly, the viceroy of Peru assured a regular stream of remittances of silver revenues from Lima and Potosí to maintain the military administrations in far-off Buenos Aires and Santiago de Chile.

Under the Spanish and Portuguese regimes, the colonies were also expected to provide fiscal surpluses to the metropolis. However, such transfers were highly cyclical during the sixteenth and seventeenth centuries. For instance, during the Thirty Years Wars in Europe (1618-1648), the Spanish Crown obliged the American colonies to provide extraordinary sums, a portion in taxes and the rest in the shape of forced loans as well as interest-paying loans. During this epoch, the shipments of Peruvian silver to Spain and, hence to Spanish armies in Italy, Germany and Flanders, was truly extraordinary. Subsequently, however, the remittances of American taxes in silver and gold diminished notably, a fact which some historians have linked to the so-called *long depression* of 1650-1700.

Another explanation for the cyclical nature of fiscal transfers can be attributed to the fact that, before the eighteenth century, colonial governments throughout Spanish America as well as Brazil did not have sufficiently large and professional tax-collecting corps to effectively manage their extensive and multilayered fiscal systems. Tax farming was a common solution- in similar fashion to the fiscal administrations of the states of Catholic Europe- but this method tended to reduce efficiency of revenue collection.

From the early eighteenth century, however, increasing military and administrative expenditures obliged the imperial governments of both Spain and Portugal to press for an increase in the efficiency of the tax administration through adoption of a number of administrative and fiscal reforms. Tax faming of the most productive tax branches was eliminated: for example, mints in Mexico and Peru were transferred from private merchant bankers to the crown; simultaneously, the collection of sales taxes (*alcabalas*) was taken out of the hands of the mercantile guilds and made the responsibility of the growing staffs of professional tax collectors and accountants of the royal administration. Likewise, in Brazil the colonial administration took over a more direct role in the collection of taxes on gold and sugar production. In both Spanish America and Brazil, royal monopolies- on tobacco, mercury, powder and diamond production were established and began to produce substantial increases in revenues.

These measures, known as the Bourbon reforms in Spanish America, gained particular force from mid-century during the regime of Charles III in Spain

(1759-1788). In the case of Portugal and Brazil, a similar set of fiscal, administrative and military innovations came to be known as the Pombaline reforms in honor of Sebastian de Pombal, the forceful prime minister of the monarch, Joseph I of Portugal (1750-1777). In both cases, the result was a notable increase in fiscal collection which would allow for the transfer of rising amounts of tax surpluses to the respective metropole.

Recent historical research on Spanish America, in particular, has accumulated vast amounts of evidence on the rise in tax revenues particularly in Spanish America. The quantitative studies initiated by historians John Te Paske and Herbert Klein, who reconstructed the accounts of the treasuries New Spain, Peru and Buenos Aires, opened the way to a new evaluation of the imperial tax machine of the Bourbon regime. The large size of the fiscal surpluses remitted to Spain in the eighteenth century are testimony to the fact, as may be observed in Graph 1.

The results of these and many subsequent historical studies have confirmed the argument espoused by the great economic theorist Adam Smith in his famous work The Wealth of Nations (1776) to the effect that the Spanish and Portuguese empires in the Americas produced very substantial fiscal surpluses for the mother countries. The distinguished Scottish economist argued that these transfers to the Iberian Peninsula stood in stark contrast to England and France which always had to pay more in fiscal terms for the maintenance of their American colonies than what they received.

Research on the colonial tax administration in Spanish America raises important questions for modern theories on the long-term evolution of tax systems. For instance, historian Richard Bonney and his colleagues who have worked on the history of European tax systems between the 14th and 18th centuries have underscored the shift from *patrimonial states* which collect taxes to cover expenses of the Crown to *tax states* which devote most of their revenues for autonomous civil and military administration. [8] Clearly, the Spanish administration in the Americas was something more complex than the Weberian patrimonial state, but one must ask exactly what kind of tax state was it? This, in turn, raises a large number of questions on the varied characteristics of imperial states in the eighteenth century.

The historical geography of the Spanish fiscal administration in the Americas indicates that there were major shifts in the relative productivity of the different colonial treasuries. From the late sixteenth century until the early eighteenth century, the viceroyalty of Peru was the jewel of the Spanish crown, largely because of the productivity of the great silver mines in the Andes, among which Potosí stood out above all others. The tax revenues derived from silver production were quite extraordinary, but from the mid-seventeenth century decline was evident. Moreover, Peru would soon be replaced by the viceroyalty of New Spain (Mexico) as the premier tax machine of Spanish America.

[8] Richard Bonney, ed., *Economic Systems and State Finance*, European Science Foundation, Clarendon Press, Oxford, 1995.

In the eighteenth century, Bourbon Mexico produced a large and growing fiscal surplus which was used to buttress not only Spain but also its imperial administration in the Caribbean islands. This was of strategic importance following the brief British occupation of Havana (1762) which threatened Spanish control of its American empire. The building of fortifications throughout the Caribbean as well as the buildup of land and naval forces in the last decades of the century required formidable financial resources. The large sixe of the Mexican contributions can be seen in Graph 2, which analyses both the fiscal transfers to other colonies, known as *Situados*, as well as the direct tax remittances to Spain.

But where did this great volume of funds come from? A review of the tax regime in Bourbon Mexico in the late eighteenth century provides a clear illustration of the major sources of revenue of the colonial administration in Spanish America. The most archaic and "sui generis" of the colonial fiscal exactions was the tribute tax (*"tributo"*) levied on all heads of households in the Indian towns (the so-called Indian republics or communities).[9] The rate was of approximately two silver pesos (two dollars) to be paid yearly by every "*tributario*", being charged uniformly on Indian peasants who lived and cultivated their own land but only occasionally on peasants who worked on haciendas or plantations. As can be seen from Table 1, the annual income generated from this source was slightly over 1 million pesos, making up approximately 7,6% of net income of the viceregal government in the 1790s.

[9] This tax was derived from the tribute paid to the Aztec emperors by all subject peoples and therefore

A second traditional revenue source for the colonial administration was made up by a collection of mining taxes, the most important being the *diezmo minero*, a 10% duty levied on all silver produced. This tax was charged at the royal mints where all silver from the viceroyalty was brought to be coined. (Include Map of mints in Spanish America and Brazil).

While the direct tax on mine production was the single most important item among the varied list of exactions which fell upon Mexican and Peruvian silver, a close runner-up was income derived from seignoriage, as data on minting revenues indicates *(amonedación de oro y plata*). Additional income was derived from the sale of the products of the state-owned mercury monopoly, an essential ingredient for colonial silver refining processes, but the bulk of the income thus generated was used to buy more mercury and shipped off to Spain. The net revenues obtained in Bourbon Mexico from mining taxes- directly and indirectly- was close to 4 million pesos in the 1790s, approximately 26% of total *net income* of the viceregal government.

A third branch of income was that derived from taxes on trade, most of which were duties on internal commerce ("*alcabalas*") and on native alcoholic beverages ("*pulques*"), producing 24% of net receipts. The products of internal trade taxes increased systematically until the 1790s in part because of increased commercialization but also as a result of the increasing pressure exerted by collectors. It should be noted that the *alcabalas* were a European fiscal instrument

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can be considered to be an "American" tax and not a European legacy.

introduced to Spanish America, operating in identical form to the sales taxes in Spain and France.

Another European and, more specifically Bourbon tax innovation, was the tobacco monopoly, established in New Spain in 1767. By the end of the colonial period, it had become the single largest source of public revenues, providing almost 30% of the government's net income. The state-owned tobacco factory in Mexico City employed over 8,000 workers by 1800, but this was only a part of the total number of people who depended on the monopoly for their livelihood: there were also some two thousand administrative and commercial employees as well as several thousand tobacco farmers. But this great organization was not autonomous as it maintained close financial, commercial and productive links to the tobacco monopolies in Cuba, Louisiana and Spain. Indeed, this far-flung, state-owned firm was a vast multiregional enterprise, perhaps the largest of its kind in the eighteenth century world.

The state monopolies also produced a great *proportion* of revenues of the viceroyalty of New Granada (modern-day Colombia). As a recent study conducted by Colombian historians has shown, the outstanding characteristic of royal income in this viceroyalty in the last decades of the colonial period was the role of state monopolies, especially on liquor and tobacco. These monopolies accounted for almost 60 percent of the total revenues of New Granada in the 1780s and hence were much more important than the ordinary taxes of the local government.

Additional fiscal contributions to the colonial administrations in Spanish America included a varied group of branches, some of them relatively independent from the state treasuries. For instance, there were several categories of Church income that were collected by ecclesiastical functionaries and then transferred to the state. In summary, recent research has demonstrated the tax machinery in Spanish America was a well-organized money-extraction mechanism which provided growing streams of income to local administrations and to the Spanish Crown.

Although there existed significant parallels between the tax regime of Spanish America and that of Brazil, the contrasts are equally striking. The initial revenues from Brazil in the early sixteenth century originated from the Crown monopoly contracts for the exploitation of brazilwood. Subsequently, between 1580 and 1680 when Brazil was the world´s largest producer and exporter of sugar, the most important tax was the *dízimo*, the tenth of the harvest of each sugar producer. Later, in the eighteenth century the taxes on gold production became central to the colonial treasury but evasion was enormous. Unfortunately, it is difficult to evaluate the relative importance of such evasion because there are extremely few published studies on the fiscal system of this great Portuguese colony, which became the world´s leading gold producer in the eighteenth century. The urgency of knowing more about the Brazilian colonial fiscal and monetary system is underlined by a recent study which notes the considerable continuity of the fiscal regime from the early decades of the nineteenth century:

> "By the second decade of the nineteenth century, when the Brazilian colony was elevated to the status of United Kingdom with Portugal (1816), the main existing taxes in Brazil were the *dízimo*; export duties

> differentiated by ports; import duties; transit taxes between captaincies; the royal quinto on gold production; the royal or national subsidy, levied on meat, hides, sugar cane, brandy and rough woolens manufactured in the country...a tax on each sugar mill or distillery; a tenth of urban rented property; the meiasisa levied on the sale of sales with a profession..."[10]

The authors mention a long list of additional exactions, which indicates that local colonists were obliged to comply with almost as many exactions as the inhabitants of the Spanish colonies in the Americas. Inevitably, after independence there was a strong pressure for fiscal reform and the abolition of a large number of the much-disliked colonial exactions.

Metropolitan exactions and forced debts

Analysis of the allocation of funds received by the colonial administrations as well as expenditures requires a methodological approach which is somewhat at variance with studies on eighteenth century European tax systems that focus mainly on the gradual construction of a "national" tax administration. In particular, it is necessary to emphasize that the viceroyalties and captaincy-generals of Spanish America were all part of a *well-integrated transatlantic fiscal machine*. Each part of the tax administration of the Spanish empire was connected to the other parts, to a greater or lesser degree. In this case, the imperial logic went much beyond a more restricted "national" logic of fiscal and financial administration.

[10] Marcelo de Paiva Abreu and Luiz A. Correa do Lago, "Property Rights and the Fiscal and Financial Systems in Brazil: Colonial Heritage and the Imperial Period", in Michael Bordo and

In this regard, it would appear that the recent, detailed research on the finances of the Spanish empire suggests that a profound revision is necessary of the relatively simple scheme of metropole-colony to explain the fiscal dynamics of empires. More attention must be devoted in the case of the Spanish *universal monarchy* of the *ancient regime* to the complex functioning of its <u>three-tiered</u> system of management of imperial finance.

This system can be observed in the operation of basic principles which determined the disbursement of public monies and explain the logic of expenditures of the multiple treasuries of the empire and of the viceroyalty. A first, basic and secular principle (applied since the sixteenth century) was that the largest number of expenses should be covered *in situ* with local tax income, collected on a regional level and accumulated in a local *caja real* (treasury). However, when a local treasury office produced a fiscal surplus, these would normally transferred to another regional *caja* which had a deficit. But these remittances were not necessarily limited to the viceroyalty; they were also shipped abroad to different points of the empire, to other colonial administrations which had insufficient funds to maintain themselves or, to the metropolis, itself. (See Graph 2.)

Metropolitan exactions increased over time and reached their peak at the end of the eighteenth century as the Spanish Crown became involved in successive international wars against its great rivals, Great Britain (1763-1767, 1779-1783, 1796-

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Cortes Conde eds., *Transferring Wealth and Power* (Cambridge University Press, 2001), p.338.

1803), and France (1793-1795, 1808-1814). As a result, the demands of the Madrid treasury augmented, and colonial administrators were instructed to remit as much fiscal surplus as possible. A recent study has demonstrated that Bourbon Mexico alone was forced to send 250 million silver pesos of net fiscal surplus to Spain between 1760 and 1810.[11] At an annual average of 5 million pesos this sum was equivalent to close to extracting 2% of colonial Mexico´s gross product each year. Considering that the ancient regime economies normally grew by no more than 1% or 2% of gross product per year these fiscal extractions reduced most possibilities of growth. This is the conclusion of Richard Garner´s careful quantitative analysis of the Mexican eighteenth century economy which demonstrates that there was little growth in productivity or investment.[12]

Beyond the extraction of important portions of fiscal revenues, by the end of the eighteenth century, the Spanish Crown also required loans from its colonies to cover its phenomenal public deficits in the 1790s and just after the turn of the century. Historical research has revealed that more than 30 million pesos of were raised by means of forced loans and interest-paying loans in Mexico in these years and transferred to the metropolis. On the one hand, these extractions wiped out a significant portion of the investment capital available in the viceroyalty; on the other, they constituted an extremely burdensome legacy after independence as holders of

[11] Carlos Marichal, *La bancarrota del virreinato, 1780-1810* (Fondo de Cultura Económica, 1999) analyzes these remittances in detail.
[12] Richard Garner, *Economic Growth and Change in Eighteenth Century Mexico*, (University of Florida, Press, 1993).

these debts demanded post-independent governments to reimburse them for the sums advanced. This situation was similar throughout Spanish America as is confirmed by historical studies on the Peruvian and Bolivian colonial debts, which weighed for decades on exchequers with little possibility of liquidation.

II.) **Independence: Monetary Fragmentation and Public Deficits, 1820-1850**

To understand the complexity of the transition from colonial to independent regime it is indispensable to explore the long-term economic impacts of the wars of independence. While this subject is discussed in a subsequent chapter in this volume, it should be noted that the specific *fiscal and monetary* impacts of independence differed from nation to nation.[13] In the short-run, it is clear that those nations which experienced the most prolonged conflicts also tended to suffer greater disruption of public and private finance. In the long-run, other factors, including trade trends, monetary policies as well as domestic political conflicts were fundamental in determining whether a given state was able to achieve fiscal stability or was ravaged by chronic public deficits.

Analysis of the difficult transition from colonies to nations in Latin America can allow for a particularly interesting contrast with the less traumatic experience of the thirteen angloamerican colonies which became the United States. The latter were successfully able to resolve the fiscal and financial challenges posed by

[13] See the essay by Leandro Prados de la Escosura in the present volume.

independence and the creation of a new federal state. As Richard Sylla has convincingly argued, the tax, monetary and financial reforms designed by Alexander Hamilton offered the new republic a solid foundation for its incipient public finances. [14] Indeed, a number of the constitutional and fiscal reforms established by the early United States were adopted by the elites of different Latin American nations in the 1820s but this did not guarantee similar results. The legal ratification of worthy fiscal and financial institutions did not ensure efficient or successful application, a fact which reveals the complex and often contradictory interface between institutions and practice. However, much additional research needs to be done to explicate this conundrum. Therefore our brief summary merely offers a sample of some of the intriguing questions that historians have begun to explore in this terrain. In this regard, it should be suggested that the history of the widely diverging fiscal and monetary experience of the new Latin America states offers a particularly rich, laboratory for future comparative studies.

State formation and new monetary regimes

Traditionally, the historiography of the wars of independence emphasized the impact of military and political conflict on trade and the traditional silver mining sector. But equally important were the widespread fiscal and monetary effects. To being with, the independence of the Latin American states between 1810 and 1825 broke the back of the vast monetary unions of the Spanish and Portuguese

[14] See the essay by Richard Sylla in *Cambridge Economic History of the United States* (Cambridge

empires. Each of the new governments in the region sought to affirm its monetary sovereignty and, not surprisingly, the outcomes differed markedly from nation to nation and even from region to region. The costs of the fragmentation of the colonial monetary order are difficult to evaluate and pose a major challenge to future analysis by economic historians. However, it may be suggested that the study of this problem should be high on the research agenda since the legacy of relatively weak and/or unstable monetary regimes has been one of the most important and debilitating factors in the evolution of all Latin American economies from independence to the present day.

Generally speaking, after 1820, those countries with greatest silver mineral wealth continued on a metallic monetary standard, using the classic silver peso (peso fuerte) or some relatively close variation. Mexico, Peru, Chile and Bolivia continued to mint silver pesos on a large scale throughout the nineteenth century. On the other hand, countries such as Brazil, Colombia or Guatemala which had important gold (but not silver) deposits, found it difficult to increase production and therefore sought alternative monetary solutions: Brazil, for instance, began to experiment with a paper money standard in the early nineteenth century. Simultaneously, in the Argentine Confederation a dual monetary system developed; while the provinces of the interior continued to depend largely on silver currency (mostly Bolivian pesos), the dynamic state of Buenos Aires began a long and complex experiment with a paper money regime.

University Press, 1999).

In most nations, the wars of independence had themselves caused radical changes in the old monetary systems. In the first place, mining production and therefore the minting of silver and gold coins declined dramatically. In the second place, a large number of new coins (either debased silver or copper coins) and other monetary instruments (promissory notes known as *vales*) were circulated by insurgent armies. As a result, after the wars there emerged a set of diverse monetary systems with multiple mediums of exchange: old silver and gold coins from the colonial era, debased coins minted during the years of insurgency, considerable amounts of government promissory notes and an increasing inflow of foreign coins (mainly European) as a result of the introduction of free trade.

The monetary changes wrought by war posed great problems for the new states and their political leaders. A secular experience of monetary stability had not prepared local elites for the reform or adoption of new monetary standards. Generally speaking, debates in the 1820s in the young Latin American legislatures on changing monetary regimes and policies were as yet not well-informed. Post-independence monetary experiments with paper money and the issue of copper coin for fractional currency were common but were generally failures in these early years. Nonetheless, several representative examples are well worthwhile reviewing in the light of the region´s subsequent monetary history.

Among the most important of the old silver mining economies, the case of Mexico merits special attention. It would continue to be the major supplier of silver coin to the world economy during the first three quarters of the nineteenth century: in fact, until the 1880s, silver consistently represented close to 80% of total Mexican exports. Not surprisingly, the silver peso remained the basic medium of monetary exchange within the domestic economy. However, in contrast to the colonial era, the secular monopoly position of the Mexico City mint was broken during the wars of independence and several regional mints began operating, the most important being those of Chihuahua, Durango, Guadalajara, Zacatecas and Guanajuato.

These regional mints subsequently served to finance regional caudillos and therefore fuelled federalism. A striking example was that of Zacatecas where the abundance of mining production and its flourishing mint contributed to the financing of a regional militia which successfully confronted the central army of the republic until 1835. Monetary disarticulation thus contributed to political fragmentation reflected in weak national administrations, which suffered an appalling turnover of presidents and ministers.

An additional problem that confronted the governments of many nations in the 1830s and 1840s was the relative scarcity of silver coin in circulation (most of it being exported to pay for imports and for contraband). As a result, finance ministers were often tempted to mint considerable quantities of copper currency, alleging, in general, that it was required to cover the demands of fractional currency by both consumers and shopkeers. Not surprisingly, the excess circulation of copper currency had the effect of further accentuating the scarcity of silver, since- according to Gresham´s law- the baser currency inevitably tends to expel the higher quality money from circulation. To counter this trend, experiments were instituted in various countries to retire the considerable amounts of copper coin in circulation. In Mexico these policies led the central government to the creation of Banco Nacional de Amortización del Cobre in 1837, which managed to retire much of the copper after strenuous efforts and considerable expense.

Another and, in some regards, more successful case of experimentation with metallic currency was that of Bolivia, the other great silver producer of the Americas during the decades spanning 1830-1870. In 1829, the new head of state, general Andrés de Santa Cruz (1829-1839), decided to modify the new nation´s monetary standard by authorizing the mints to combine production of high-quality silver pesos with a complement of debased coins known as *febles*, which had only 75% silver content, the rest being copper and nickel. The silver pesos were exported to pay for European imports while the *febles* were used both to cover state and army expenditures as well as to serve commercial transactions in a very broad set of economic regions which overlapped various countries: Bolivia, southern Peru, northern Argentina and Chile. In essence, as historian Antonio Mitre has demonstrated, the circulation of the feble constituted a fairly successful attempt to sustain the mercantile circuits between these regions that had been operative for over two centuries during the colonial era.

While silver-rich Mexico and the Andean countries continued on metallic currency standards, several dynamic economies on the Atlantic seaboard (which suffered from scarcity of silver and gold) began to experiment with paper money standards from early in the nineteenth century. The Empire of Brazil (established formally in 1822) inherited an official bank- the Banco do Brazil, founded by the Portuguese monarch in Rio de Janeiro in 1808- that issued considerable quantities of paper currency. The early history of this early banking institution has been studied by several historians: there would appear to be a consensus that its failure in 1829 was closely linked to the expenditures derived from the Argentine-Brazilian war of 1826-1829, which consumed most of the resources of the government and its bank.

A more complex paper money story was that of the government of Buenos Aires between 1822 and 1854. The earliest banking institution established was the Banco de Descuentos de Buenos Aires (1822-1825), being promoted by a local consortium of wealthy domestic and British merchants who obtained government approval for the initiative. In addition to its original capital, the state authorities helped the bank by depositing the proceeds of the first Argentine foreign loan of 1824 in the coffers of this private firm. With large metallic reserves, the bank officers were able to successfully issue convertible paper money for four years, contributing to a short-lived mercantile boom in Buenos Aires.

Subsequently, however, this private bank was forced to provide heavy advances to the Argentine government for its military expenses with the result that convertibility was abandoned. The state authorities nationalized the bank- now named Banco Nacional (1826-1835)- but it became essentially an adjunct of the public treasury. In 1835 with the consolidation of the government of Juan Manuel de Rosas in the state of Buenos Aires, the bank was formally closed and the authority to print paper money was transferred to the old mint, the *Casa de Moneda*, which became the first government institution in Latin America to issue paper currency on a systematic basis in these years. Most of the paper money issued was used to cover the considerable deficits suffered by the Rosas administration, particularly during the years of naval blockades by French and British warships, which provoked sharp drops in import tax revenues. Despite the inflationary nature of the paper money regime, it survived and actually allowed for the financing of an expanding regional economy. This surprising monetary experiment has been analyzed by economic historians Samuel Amaral, Roberto Cortes Conde and Alejandra Irigoin. As the latter affirms:

> "During this period (1835-1854) the state – in the province of Buenos Aires – was financed by the so-called inflationary tax. Inconvertible paper money became an actual fiduciary currency, and the means of payment for domestic transactions in the province. Bullion did not entirely disappear though, it was currency standard in neighboring economies...This bi-monetary (non bimetallic) system was an extraordinary phenomenon in contemporary monetary history."[15]

Finally, it is worthwhile noting the rather singular trajectory of public finance in the autonomous state of Buenos Aires, before its union with the other provincial governments of Argentina in 1862. During several decades, following independence, occasional, large deficits were caused by military conflict and several foreign naval interventions, but the Buenos Aires administrations used novel credit and monetary instruments to cover expenditures. We have already mentioned some of the monetary experiments which merit attention; as Graph 3 indicates, the increasing prevalence of public deficits can be clearly identified.

Tax reforms and public deficits, 1820-1850

While the establishment of monetary sovereignty was part and parcel of the process of construction of new political sovereignties, fiscal reforms were even more important. The ratification of liberal constitutions in the Latin American nations in the 1820s and the early adoption of parliamentary governments and liberal legislation (molded on existing models of Europe or the United States) led to intense debates on the means to transform colonial fiscal structures and create more modern ones. In practice, the transition from colonial to independent tax regimes proved remarkably difficult and was, perhaps, one of the major obstacle to a sustained process of economic growth.

A contradictory aspect of the fiscal reforms of the 1820s in nations such as Mexico, Gran Colombia and Central America was the superimposition of a United States federalist tax model upon colonial Spanish administrations, which had been characterized by a high dose of centralism, tempered by a certain degree of flexibility with respect to distribution of tax funds among the regional treasuries. Paradoxically,

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[15] Alejandra Irigoin, “Inconvertible Paper money...” in JLAS, 2000.

instead of allowing for flexibility, the new tax systems established after independence, proved to be rigid, inefficient and prone to intensify bitter rivalry among federal and state fiscal bureaucrats for the appropriation of revenues.

A second source of conflict arose from the weakening of the old colonial bureaucracy, which despite its faults had been effective in collecting taxes and maintaining accurate accounts on an incredibly complex range of sources of state income. The dilution of the tax administration and increasing subordination of fiscal employees to local military and political caudillos in many countries made revenue collection increasingly anarchic after independence, and accounting methods suffered notably. As a result, neither authorities in the governments or the armies had a real grasp of how much money would be available nor did they have a precise idea of how it was being spent. Indeed, the contrast with the extraordinarily detailed fiscal reports of the late eighteenth century is still a cause for surprise among historians.

A review of the tax reforms in Mexico, which had been the richest Spanish American colony, can perhaps shed some light on the nature of a few of the fiscal problems confronted by the new states . To begin with, two major sources of income of the colonial administration- the indian tribute tax and mining taxes- were abolished. This implied a nominal reduction of potential income of the state by almost 30%- at the levels current in the late colonial period. Other colonial taxes were also lost to the federal government, being transferred to the state governments as part of the political pact among regional elites which led to the ratification of the Mexican Constitution of 1824. The most important of these were the levies on internal trade (*alcabalas* and *pulques*) which became the backbone of most state governments for almost half a century.

In fact, local sales taxes known as *alcabalas* became the basic source of income for half a century for most provincial governments in Latin America, with the exception of Chile and Brazil. Historians have begun to explore fiscal records to attempt to measure the importance of these taxes for local government and, perhaps more important, their impact on domestic trade. Preliminary evidence would seem to suggest that the combination of regional sales taxes and transit taxes known as *peajes* (which were applied throughout Latin America) constituted significant obstacles to inter-state trade. Hence, in contrast to the United States which experienced a strong movement towards the integration of regional markets into a national market in the first half of the nineteenth century, Latin American economies were confronted by marked fiscal obstacles to domestic trade transactions.

In order to compensate for the abolition or transfer of many colonial taxes, the elites of virtually all the new Latin American government approved measures which made customs duties on foreign trade the backbone of the new fiscal systems. Once again, the United States served as model in this key reform but the results were not generally as satisfactory as expected. While customs receipts increased markedly in the years 1822-1825, they subsequently declined and/or stagnated.[16] Prolonged

[16] Victor Bulmer Thomas, An Economic History of Latin America (Cambridge University Press, 1994) has argued that the stagnation of Latin American foreign trade in these years was a major cause of slow economic growth and hence, underdevelopment.

economic recession affected the income of most Latin American states which, in many cases, had to recur to varied forms of emergency finance to cover deficits.

All of the Latin American republics except Brazil and Chile suffered chronic public deficits from the mid 1820s through to the early 1850s. The deficits were caused by the stagnation of tax revenues but also by the continued high expenses of military forces which absorbed on average between 60% and 80% of the public expenditures of most states until well past mid-century. Weak fiscal administrations could not successfully confront demands for increased expenditures by money-voracious military forces and these, in turn, intervened constantly in politics, further weakening governments.

Paul Gootenberg has underlined the complex fiscal dynamics of militarized politics in the case of early republican Peru, but his observations are pertinent for many other countries in the region,

"The general problems of caudillo finance are well known, its solutions are not... Caudillo regimes between 1825 and 1845 across the region were systematically bankrupt, fiscal desperation a constant. Military expenses ran high (more than 70% in primitive budgets), unforeseeable outlays remained the norm (mobilization for new revolts) and concrete rewards on short demand were critical to maintain bloated cadres of officers, clients and bureaucrats; or else, the logic went, risk another revolt and disintegration of the central state. " [17]

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[17] Paul Gootenberg, *Between Silver and Guano: Commercial Policy and the State in Postindependence Peru,* (Princeton University Press, 1989), p. 101.

Thus, there was initiated a vicious cycle in which fiscal deficits led to weak government which, in turn, stimulated frequent challenges to the political or military elite in power. As a result, civil strife proliferated, particularly as national military leaders frequently forged political alliances with disaffected regional elites. The high expenditures of these disjointed, albeit highly militarized states provoked severe deficits which could only be covered with emergency loans from domestic merchant bankers. Inevitably, much of tax revenue was mortgaged to moneylenders and, consequently, even worse fiscal conditions prevailed, provoking even more internal strife.

Mexico, which had been the richest colony, fared the worst among the new Latin American states in the forty years following independence. It not only suffered from a great number of domestic military conflict but also two foreign invasions, which can be attributed in good measure to its fiscal and military weakness. The invasion of Mexico by the United States in 1847 led to the loss of vast territories in the north, including the modern states of California, Nevada, Colorado, Arizona, New Mexico and Texas. Later in 1862 the Anglo-French-Spanish occupation of Veracruz led to full-fledged occupation of the nation by a French army of 30,000 men who remained until their defeat in 1867.

III.) <u>Taxes on Trade and the Building of Nation-States in nineteenth century Latin America</u>

The dark picture which we have drawn of fiscal reform in post-independence Latin America was tempered by several notable success stories. Brazil and Chile, in particular, maintained centralized administrations which were relatively successful in limiting military expenditures and able to obtain sufficient tax revenues (basically from import duties) to avoid the buildup of large deficits. Other countries were not so fortunate in good measure because their foreign trade was sluggish and because of the high prevalence of contraband. Moreover, from the 1820s through the 1840s, protectionism was widespread and discouraged many imports. Generally, speaking, low foreign trade meant low government income since customs taxes were such an important portion of public revenues.

After a quarter century (1826-1849) of stagnation in foreign trade, the decade of the 1850s marked a decisive economic and fiscal inflexion for many nations, as exports expanded rapidly in Brazil, Chile, Peru, Buenos Aires, Colombia and Central America. This first export boom lasted from mid-century until approximately 1873. Brazilian exports which had remained at an average of 6 million pounds sterling during the 1840s, rose to more than £10 million in the 1850s and £ 20 million by the early 1870s. (The quantum leap in physical volume of production was even more marked since coffee prices tended to decline after the mid 1840s). In the same period in Colombia (New Granada) government income rose markedly with the notable expansion of foreign trade between 1850 and 1875 as exports rose from an average of less than 3 million dollars in the late 1840s to an average of close to eight million dollars in the 1850s and 20 million dollars in the early 1870s. In fact, Colombia would not again attain the same level of exports until well into the 2oth century.

In Central America, coffee exports expanded rapidly: in Costa Rica they went from less than one million pounds sterling in the early 1850s to more than £ 2 million in the 1860s and close to £ 5 million in the mid 1870s; similar trends are found in the trade statistics of Guatemala and El Salvador. The fiscal result was that the weak Central American states finally began to count upon sufficient tax revenues to attempt modernization. Hector Lindo Fuentes argues:

> “In all Central America at mid-century approximately half of all fiscal revenues were derived from the tobacco and liquor monopolies...As foreign trade increased, customs duties rose in importance.... During this period (after 1855) it is possible to observe a clear increase in the capacity of the State to raise taxes, which suggests that the export expansion allowed for the consolidation of the government. “[18]

From mid-century, therefore, it appeared that liberal reforms and rising trade had finally made it possible to launch relatively efficient *tax states* in Latin America. But how *liberal* were these new tax regimes? A comparative review of the tax structures of leading nations of the North Atlantic world in the nineteenth century leads to the conclusion that there was no specifically "liberal" type of fiscal policy, since fiscal constitutions and structures varied considerably. The centralist governments of Spain and France, for example, relied on tax structures which placed much emphasis on land taxes and state monopolies. In contrast, the federal government of the United States (during the entire century) and in Germany (after 1875), customs taxes were the key to fiscal prosperity. The contrast between liberal states with centralist governments and those with federal administrations appears striking and therefore would seem to offer a key to the question posed. In this respect the great expert on fiscal history, Gabriel Ardant, argues that "the growth of customs income had a particularly striking effect on the financial strength of federalist nations..."[19] But what can be made of the case of Great Britain, which also had a strong central government yet relied on customs duties as the foundation of its fiscal system, at least during the first half of the nineteenth century?

A similar set of questions can prove useful to analyze the building of the tax systems of Liberal states in Latin America during the nineteenth century. Most conformed (from 1820 onwards) to the federal model suggested by Ardant, in which customs taxes constituted the main source of income for national governments. The fact that most of the national governments of Latin America depended on import/export taxes as the main source of revenue for over a century (actually, until 1930) suggests that there were important connections between this

[18] Essay in Samuel Amaral and Leandro Prados de la Escosura, eds., Las consecuencias económicas de la independencia latinoamericana, (Madrid, Alianza, 1993), p. 54.
[19] Gabriel Ardant "Financial Policy and Economic Infrastructure of Modern States and Nations" in Charles Tilly, ed., *The Formation of Nation States in Western Europe* (Princeton University Press, 1974), p.222.

type of fiscal policy and foreign trade policy in this long period during which "liberalism" was, to all intents and purposes, the dominant political ideology among Latin American ruling elites.

The fiscal system in early nineteenth century Brazil has been less studied than that of other nations of Latin America, but its importance should be emphasized because -in contrast to many of its neighbors- it did not suffer a drop in tax or trade income. Much to the contrary, Brazil had the highest volume of exports of all Latin America economies from the 1820s almost until the end of the nineteenth century. The imperial government derived over 60% of all of its income from taxes on imports and exports. Deficits were significant but covered by issue of external and internal debt, which did not become an overwhelming burden as in other nations, such as Mexico or Peru.

Another clear example of reliance (not to say dependence) on trade for government income was Chile where customs revenue was sufficient to finance practically all government expenditure for the first decades after independence without incurring burdensome deficits. This prudent fiscal and financial management was reflected in the fact that in the 1830s the value of the Chilean currency rose relative even to the dollar and pound sterling. During the years 1850-1873, when Chile experienced a boom in copper, silver and wheat exports, imports rose consistently, and continued to provide the government with most of its income. However, from the 1880s there was a notable shift to export taxes as exactions on the great nitrate export trades provided a rapidly growing portion of total revenues.

Another special case which should be mentioned is that of Colombia (New Granada) which despite poor macro-economic performance benefitted from a government which maintained a fairly efficient tax administration after 1830. But the income climbed much higher during the early export boom of 1850-1873 which also contributed to important fiscal changes as the Colombian government was able to reduce its traditional dependence on the liquor and tobacco monopolies and came to rely more fundamentally on duties on imports, in consonance with trends in most other Latin American nations.

The most stunning export boom was that experienced by Peru which benefitted from the expansion of exports of guano, nitrates, sugar and cotton between 1850 and 1875. In particular, the state-owned monopoly of guano allowed for extraordinary fiscal windfalls, transforming the Peruvian government into the richest state in Latin America during two decades. Peru was the only nation in which exports directly provided most of fiscal income. In practically all the other countries import taxes constituted somewhere between 80% and 90% of total trade taxes, although many nations there continued to be some (relatively moderate) taxes on exports. By the end of the century, on the other hand export taxes were generally eliminated.

One of the few, larger countries that did not benefit from this early export boom was Mexico, mainly because of the impact of the two foreign invasions of its territory which further destabilized its already weak economy. Nonetheless, by the early 1880s, recovery was in full swing. The administrations of presidents Manuel González (1880-1884) and Porfirio Díaz (1884-1910) were able to build a strong state on the basis increased tax income, most of it derived from import taxes, although the internal tax known as “timbre” also produced an increasing volume of resources.

Slow development of financial markets and banks

The fragmentation of monetary regimes and chronic public deficits not only delayed the establishment of stable and strong states but also constituted serious obstacles to the formation of modern financial markets throughout Latin America in the first half of the nineteenth century. Economic historians have only begun to explore the fundamental problems raised by the protracted development of financial markets in the region. In order to understand the nature of financial backwardness, it is important to analyze some of the major causes of the late development of banks, the slow growth of capital markets and the difficulties in coordinating public and private finance.

In the first place, attention should be directed to the consequences of the destruction of colonial credit organizations and mechanisms throughout Latin America in the early nineteenth century. The colonial financial markets had been much more sophisticated than traditional historiography supposed. Both the wars of independence and subsequent conflicts provoked substantial capital flight. In addition, the economic decline of the Church- which had been the largest lender in the colonial era- also weakened traditional credit markets and practice.

In the second place, it is necessary to evaluate the institutional limitations caused by the slow shift from colonial legislation to liberal legislation with regards to both credit and other economic activity. In many nations colonial norms remained in practice for decades: indeed, modern civil and commercial codes were not ratified until well after mid-century. The lack of modern financial institutions, the weakness of judicial systems, the prevalence of corruption among public functionaries and the arbitrary exercise of political power generated high levels of risk for most transactions. Uncertainty was the keynote of business for decades. Hence, both commercial credit and mortgage credit suffered.

A third and fundamental obstacle to the development of modern financial markets in the first half of the century was the great difficulty in creating relatively open, domestic market for public securities. During the first half century following independence, interest rates on (sort-term) government loans tended to be extremely high due to political risk (in the case of Mexico fluctuating wildly between 30 and 200%). As a result, most potential investors could not be attracted to long-term investments which offered lower rates. In the majority of countries of the vast region, the unstable debt policies of federal governments stymied the effective development of domestic short-term capital market as well the birth of stable and open markets in long-term public and private securities.

In this regard, it seems worthwhile recalling that the historical experience of advanced economies indicates that the operation of a broad and stable market for public securities was one of the key preconditions for the development of modern financial markets. In Latin America it would not be until the 1850s that governments were able to consolidate domestic debts and to renew service on early foreign loans. With the gradual recovery and stabilization of public finance in the 1850s came the possibility of establishing more modern financial instruments such as private and public banks, which began to appear in a good number of the major cities and ports of the subcontinent from the 1850s and 1860s. These financial innovations were largely predicated on the improvement in the tax revenues of the majority of the Latin American states, a trend that- as we have previously argued- gained strength only after mid-century.

As most Latin American states began to obtain substantially more tax income, they also begin to break out of the debt traps in which they had been ensnared since independence. A key objective of liberal reforms in the 1850s was consolidation of domestic debts. In Peru, guano revenues were used on a large scale to pay off a broad range of lenders to the governments, but as Alfonso Quiroz has demonstrated, the commercial bourgeoisie of Lima was the particular beneficiary. In Mexico and Colombia, a policy of disentitlement and sale of church properties by the state was initiated to consolidate old, internal debts. This Liberal program allowed for the transfer of important amounts of ecclesiastical urban and rural real estate to merchants and landowners who acquired these properties by paying with a combination of cash and domestic debt securities which were accepted at face value, despite the huge price discounts for such paper in financial markets.

Apart from consolidation of debts, perhaps the most frequently used catchword of state policy from these decades was “progreso” (economic development), and special government agencies were established to further this end. Paradoxically, the poverty-stricken Mexican state was one of the first in Latin America to create a public agency specifically aimed at promoting national economic development. The establishment of the Mexican Secretaría de Fomento in 1853 preceded the first economic development ministries of other Latin American nations, most of which came into being in the 1860's or 1870's under a variety of names: Ministerio de Agricultura, Comercio e Obras Públicas (Brazil, 1861), Ministerio de Fomento (Guatemala, 1871 and Venezuela, 1874), Ministerio del Interior (Argentina, 1863). Hence, the role of state as promoter of economic growth began to be important in these early decades, in what one could perhaps describe as Gershenkronian-style development.

Financial modernization and investment were among the most important keys to development. The increase in tax revenues plus consolidation of domestic public debt contributed decisively to the gradual (albeit still limited) modernization of domestic financial markets. Until mid-century, financial backwardness had been a common feature of all Latin American economies: the prime indicators of this situation were the lack of banking institutions, the erratic fluctuations of exorbitant interest rates, the lack of modern commercial and financial legislation and the non-existence of formal stock markets. But from the 1850s and 1860s this situation slowly began to change. These decades were witness to the birth of numerous banks and insurance firms in the more important cities and ports of the subcontinent, as well as of several small stock markets in Rio de Janeiro, Buenos Aires, Lima and Santiago de Chile. Simultaneously, the governments of the larger nations began to collaborate with domestic and foreign entrepreneurs and bankers in the promotion of the first railroad firms, the modernization of ports and other infrastructure projects, including construction of roads, bridges and telegraph lines.

In Argentina, the development-oriented Banco de la Provincia de Buenos Aires (1854) provided loans to the first railroad, the state-owned Ferrocarril Oeste (1857) which became a very profitable enterprise. In Brazil, the first Latin American investment bank, the Banco Mauá, promoted railroad, steamship and other infrastructure projects from the 1850s to the mid 1870s. In Peru almost a dozen banks sprung up in Lima in the 1860s, spurred by the dynamism of the guano boom. Similarly in Santiago de Chile, the 1860s and early 1870s were a time of financial modernization, leading to the establishment of numerous banking establishments as well as a vibrant if small stock market.

I V.) **Early Foreign Debts and Financial Crises**

Special emphasis has been placed in this chapter on the domestic factors (monetary, fiscal and financial) which influenced the uneven evolution of the Latin American economies and states in the nineteenth century. This follows in the footsteps of the recent research of economic historians who have produced excellent studies that require a revision of much of traditional economic history of the region and, particularly, of the traditional dependency interpretations, which tended to focus most attention on the role of external factors in economic development and underdevelopment.

Nonetheless, as has already been suggested in our analysis of the relation between domestic tax dynamics and international trade, it would be unwise to neglect the intersection of the trajectories of the Latin American economies and of international economic trends and forces. For, indeed, the Latin American economies needed international markets and capital. It was precisely in the periods of greatest expansion of the foreign trade of Latin America ([1850-1873] and [1880-1914] that one can observe the most solid advances in modernization of states and economies throughout the region.

That international markets were essential to exports is evident. And so is the fact that foreign trade was one of the most important engines of growth as well as of revenues for governments. On the other hand, less clear is the reason why virtually all Latin American nations turned so heavily to international capital markets, in particular for state loans. Certainly the loans provided important sources of capital but the money was not always wisely spent and, furthermore, the burdens of the debt service were not generally anticipated, leading to frequent debt crises. Yet in spite of the repeated financial debacles, Latin American governments returned once and again to European capital markets for new loans.

The history of Latin American foreign loans can be described in terms of a series of cycles which correspond quite closely to the financial cycles described in the classic economic literature on international business cycles. The first loan boom in Latin America took place in the years 1822-1825, followed by a series of suspension of payments in 1826-1828 and subsequent moratoria which generally lasted until the 1840s or 1850s. A second wave of international loans subscribed by virtually all the Latin American governments took place between the late 1850s and 1873, when a new economic crisis halted capital flows to the new region and led to a traumatic debt crisis. Finally, in the 1880s, a new cycle of loans gained strength with extraordinary rapidity, concluding with financial crises in Argentina and Uruguay in 1890/91, and in the next two years in Brazil and Chile.

The cyclical nature of theses trends are discussed in another chapter in this volume[20], and therefore in our closing section of this essay, we will focus basically on the uses to which the loans monies were put. The aim is to raise the question of whether the funds obtained in European capital markets contributed to economic development in Latin America. In the earliest loan boom of 1822-1825, it can be readily established that the bulk of the funds taken by the new states was invested in military expenditures. This was logical, considering that the process of independence was still in process: the final defeat of the Spanish forces in South America only took place in December, 1824 with the decisive battle of Ayacucho. Moreover, in subsequent years, Spain- with the support of the Holy Alliance- threatened various Latin American nations repeatedly with new attempts at reconquest. The early foreign loans therefore were destined to military purposes and did not directly serve to spur economic growth.

Substantial changes took place during the next loan boom of the 1855-1873 period. Practically all Latin American governments turned to European capital markets for substantial loans in this period, using the monies for three main purposes: refinancing debts, military expenditures and public works development. (See Table 3.)

Close to a third of the new loans were used by governments for refinancing operations. It is undeniably correct to argue that the refinancing of old debts with new loans obtained on better terms (lower interest rates and longer amortization) may prove to be a boon to public finance. Certainly some of the loans obtained in this period did fulfill this objective and allowed the Latin American economies to reenter European financial markets, from which they had been frozen out since the

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[20] See the chapter by Alan Taylor, "Foreign Capital in Latin in the 19th and 20th Centuries" in this

widespread suspensions of debt payments in the late 1820s. But other refinancing loans- such as the Peruvian foreign loans of the 1850s and early 1860s- were simply used to payoff local mercantile elites who pressured for reimbursement of much government short-term debt on their hands.

Other foreign loans were used essentially to finance military expenditures. Examples abound including the nefarious Mexican imperial bonds issued to finance the invasion of Mexico by a French Army which installed the Austrian archduke, Maximilian, as local emperor (1863-1867). Not surprisingly, after the expulsion of the French troops in 1867, the Mexican authorities refused to recognize these securities as legitimate debts. Other loans issued for military expeditions included the very large volume of sterling bonds issued by the Argentine and the Brazilian governments to finance their joint invasion and occupation of neighboring Paraguay (1865-1870). Clearly, such financial operations did not contribute in a constructive way to economic development.

Finally, it is important to keep in mind a set of loans issued for public works, in particular railway construction and port modernization. Argentina, Brazil, Chile, Peru and various Central American republics were particularly active in attracting money for the building of infrastructure which was essential to the promotion of both domestic transport and markets and to export economies in the years 1860-1873. A portion of these funds allowed for important investments which soon had a

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volume.

significant impact on economic growth, particularly in Argentina, Chile and Brazil. On the other hand, the huge railway loans of Peru and the lesser ones of Honduras proved unwise adventures; the lines remained unfinished for decades and much of the money was siphoned off in corruption by bankers, contractors and politicians.

In summary, during the first three quarters of the nineteenth century, the slow and uneven process of financial modernization in the Latin American nations engendered formidable obstacles to economic development. Persistent difficulties in the construction of efficient tax administrations contributed to public deficits and led, in numerous cases, to the adoption of a variety of risky financial policies. Experiments with inflationary monetary instruments proved costly in both political and economic terms, as did the accumulation of an excess volume of short-term domestic debt and long-term foreign loans. Domestic financial markets were undermined by the persistence of inefficient judicial and institutional frameworks which, in turn, contributed to the late emergence of banking and the debility of formal capital markets throughout Latin America. Progress was the catchword of the era but proved remarkably difficult to achieve.

GRAPHS AND TABLES

Graph 1 Tax remittances from Spanish America to Spain (18th century)

Graph 2 Fiscal remittances from Mexico, 1720-1799: Situados to Caribbean and remittances to Spain

Graph 3 Government of Buenos Aires Revenue, Expenditure and Balance, 1820-1860

Graph 4 Tax revenues of the Brazilian government, 1833-1888

Graph 5 Tax revenues of the Chilean government, 1830.-1893

Graph 6 Tax revenue of the Mexican government, 1867-1910

Graph 8 Brazil public debt service, 1824-1888

Table 1 Tax income of Government of New Spain in 1790, by sector

Table 2 Tax income of the Mexican Government, 1826-1831

Table 3 Latin American Foreign Loans, 1850-1875