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‘Indulgent creditors of kings: Dealing with sovereign default in eighteenth-century Portugal’

This paper addresses sovereign debt in early modern economies and aims to assess how ordinary lenders often dealt with sovereign debtors in arrears. It takes Portugal as a case study and asks two fundamental questions: Is the lack of evidence on sovereign defaults itself the evidence of the sovereign’s immunity in an absolutist regime? Which institutional solutions could creditors resort to find financial redress in case of sovereign default?

Theoretical and historical views on public credit delve upon the “sovereign debt puzzle”. The conundrum’s fundamental principle is that lending money to governments can be riskier than any other investment because governments are hard to sue to make them repay a debt. An important strand of literature in economic history has addressed this puzzle following North and Weingast’s (1989) argument. The assumption that political constitutions affected the creditor’s perception of risk is now received wisdom. The Spanish and France distressed debt, or the sound financial system of the English and the Dutch parliamentary regimes are representative cases in this literature. While much of the research up to now focuses on the institutional framework that constrained the sovereign to a credible commitment, the investors’ perception of the sovereign defaults remains mostly unexplored.

This paper contributes to the literature on early modern public credit by drawing attention to the management of sovereign debt in countries not subject to distressed debt. The research we conduct assumes that the best-studied cases were the tips of an iceberg. No track-record of serial defaults or no evidence of great episodes reforming the financial system may indicate also representative cases of early modern financial history. Public credit could smoothly evolve according to ordinary lenders’ expectations and ad hoc solutions to overcome arrears. We claim that further understanding of the public credit’s functioning should consider ordinary investors’ standpoint and ask whether income was affected by the sovereign’s unreliable commitment.

The paper uses evidence from lay brotherhoods in Portugal – the Misericórdias -, which were also one of the leading suppliers of both private and public long-term credit. Drawing on different archival sources (account books and documents from the royal chancery), it assembles a new dataset on investment in perpetuities, which allows tracing the pace of the government’s payment of interests between 1700 and 1826. Data show that despite Portugal’s deployment of financial resources to sustain a colonial empire, there is no evidence of distress debt until 1826. However, the Misericórdias’ accounting books reveal that: 1) there were, indeed, disguised forms of default affecting the income of this institution; 2) the fragmentation of the fiscal system in different tax administrations allowed the sovereign to default on perpetuities collateralized by particular fiscal streams without challenging the whole system of interest payments. This paper argues that fragmented tax administration favored both creditor and sovereign borrower by releasing the service of the sovereign debt from critical disturbances, albeit it also imposed a cap on the volume of debt.