

Around the British Gold Standard: Portugal and Brazil,

Two Satellites?¹

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Resumo

Gerações anteriores consideraram as elites de Portugal e do Brasil como seguidores das idéias britânicas de livre comércio. Um olhar mais atento às finanças públicas desses países revela que, apesar de toda a retórica do livre comércio, os dois países mostraram-se entre os mais protecionistas de seu tempo. As elites conduziram políticas monetárias independentes, muitas vezes fugindo da ortodoxia. Finalmente, as elites de ambos os países aproveitaram as oportunidades oferecidas pelo sistema financeiro internacional.

Palavras-chave: finanças públicas, dívida pública, proteção, câmbio, bancos de emissão

N20;N40;N43, N46

Abstract

Previous generations considered the elites of Portugal and Brazil as dupes of British free trade ideas. A closer look at the public finances of these countries reveals that, for all the free trade rhetoric, both countries proved to be amongst the most protectionist of their time. The elites conducted independent monetary policies, often flying in the face of orthodoxy. Finally, the elites of both countries took advantage of the opportunities provided by the international financial system.

Keywords: public finance, public debt, protection, exchange, banks of issue

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F For those who have lived through military dictatorship and cold war, dependence is an emotional issue. Each period of time must of course be analyzed on its own merits. In the “Age of Imperialism” (1850-1914), subject of this paper, there were various truly imperialist regimes. Britain proved a cruel master to nearby Ireland and far away India. Both countries experienced their worst famines of all time under British rule. And the English were no more enlightened in their treatment of Africans than were the other colonial powers on that continent. Although Brazil and Portugal are customarily included in Britain’s informal empire, British influence upon the elites of these two countries was in fact quite circumscribed.

As the First World War destroyed many things, including the gold standard, 1914 is an obvious break point. 1850 perhaps should be explained. This year, the European elites shook off the shock of the Revolutions of 1848 and began to look at economic growth as a means to avoid social convulsion as well an opportunity to further enrich themselves. The well-read Brazilian elite followed the European revolutions with considerable interest. Brazil’s finance minister in 1848 boasted that his country was safer than Europe.¹ The English and Portuguese elites watched the events of 1848 with considerable apprehension, the Portuguese having suppressed their most important social uprising of the century during the previous year. On a more positive note, England celebrated its famous World Exposition in 1851 which demonstrated its industrial accomplishments. With many of its railroads already in place, the country stood ready to export capital in unprecedented amounts while the recent discoveries of gold in the US and Australia provided the world financial system with unusual liquidity. The year 1850 found England with its tariffs and banking system rear-

ranged. Free trade, envisaged by Adam Smith in 1776, became a reality with the repeal of the corn laws in 1846 while the Bank Charter Act of 1844 made the Bank of England the sole issuer of new banknotes, reaffirmed gold backing for these banknotes, and confirmed the Bank’s de facto lender of last resort functions. Three years later, with a bill of indemnity from the government permitting it to temporarily exceed its issue limits, the Bank successfully acted as a lender of last resort during a major crisis.

Turning to Brazil, 1850 marked a major turning point with the abolition of the slave trade. Aggressive British naval action played a significant part in forcing the elite to end the traffic after over twenty years of unkept promises (Bethell, 1970). Britain’s only physical intervention in the politics of independent Brazil consisted of sending frigates into Guanabara Bay to capture slavers. The end of the slave trade allowed the considerable capital thus employed to migrate to other parts of the economy provoking a boom in urban real estate, government bonds, stocks, foreign exchange, and coffee farms. While slaves represented one third of imports in the five years before the abolition of the trade, the end of the traffic turned Brazil’s commercial deficit into a surplus. The year 1850 witnessed independent Brazil’s first commercial code and first land law. As in the case of England, there were also several critical actions taken during the years prior to 1850. In 1844, Brazil significantly raised import tariffs following the expiration of the commercial treaty with Britain the first emperor signed, under duress, to win English and Portuguese recognition of Independence. Never again did England successfully interfere with Brazilian tariffs. In 1846, the government lowered the official gold content of the Brazilian currency to the level where it had traded for the past 20 years in an attempt to move towards participation in the

gold standard. Last, but certainly not least, the army overcame the final local uprising in 1849. From this point to the fall of the Empire in 1889, Brazil enjoyed internal peace --after almost 30 years of foreign wars, coups, and civil wars.

Like Brazil, Portugal had a difficult time from 1820 to 1850. In fact, Portugal's troubles started in 1807 when Napoleon invaded the country. Conveyed by the Royal Navy, the Portuguese court moved to Brazil where it opened the colony's trade to all friendly shipping. This decision cost continental Portugal a significant portion of its tariff revenues. After Portugal regained its Independence from Napoleon, King João VI remained in Brazil which he raised to the status of equal kingdom. In 1820, a Liberal and military revolt attempted to re-colonize Brazil and forced the king to return to Europe. While provoking Brazilian Independence, this revolt set off a series of coups and civil wars in Portugal that ended with the coup of the Regeneration in 1851. From this moment until the dictatorship installed by King Carlos in 1907, Portugal experienced but one minor coup. Like Brazil, but slightly earlier, 1837-'42, Portugal raised its tariffs after the expiration of its trade treaty with Britain. Finally, 1850 proved important to Portugal due to the abolition of the slave trade in Brazil. Although the Portuguese colonies continued sending slaves to Cuba for another 20 years, Brazil was clearly Angola's and Mozambique's largest market. The negative effects of the abolition of the trade upon Portugal were attenuated by the fact that most of the profits anyway appear to have remained with the slavers resident in Brazil while several former traders returned to Portugal from Brazil after this event bringing their capital home with them.

The paragraphs above demonstrate the similarities in the experiences of Portugal and Brazil as well as the economic links between

the two countries. The first British banks outside Britain's formal empire were established in the future colony of Egypt and then in Brazil, in 1863 (Jones, 1993). The London and Brazilian Bank quickly opened branches in Lisbon and Porto to take advantage of the money flows from immigrant's resident in Brazil. Immigrants' remittances remained a significant income for Portugal throughout this period as well as a considerable debit to Brazil's balance of payments. Portuguese merchants comprised a large share of the commercial community in Brazil, a phenomenon easy to observe but difficult to quantify. As many of the most successful merchants did not return to Portugal, at what point did their contemporaries begin to see them as Brazilians? Inter-marriage with the landholding and political elite was not difficult. Eugene Ridings noted (Ridings, 1994, page 33) that the Portuguese were the most numerous, though not the wealthiest, group of foreigners in the various Commercial Associations in Brazil during the nineteenth century. He gives the number of directors of the Commercial Association of Rio de Janeiro in 1877, when British influence had passed its peak and suffered increasing competition from Germany, France, and the US, as follows: Brazilians 3, British, Portuguese, and French, 2 each, Germans, Americans, Austro-Hungarians, Italians, Spaniards, Belgians, 1 each, and 1 each to be divided between Sweden and Denmark-Norway and Argentina and Uruguay. We still need to quantify how much money flowed from large numbers of less fortunate Portuguese immigrants and how much flowed from the largest Lusitanian merchants.

In 1850, Britain ranked first by a considerable distance as creditor to both countries, ranked first as trading partner with Portugal, and numbered among the two largest trading partners of Brazil.

To evaluate dependence, we propose to consider four areas: physical intervention, trade (tariffs and exchange), credit, and technology. Political obstacles to the transfer of technology existed during the Middle Ages and the Early Modern Period, and these obstacles have returned during the Contemporary Period; during the years under study, technology transfer does not appear to have been an issue. Physical intervention in Brazil by British forces did not exist after the abolition of the slave trade. Although Britain subsequently pressured the Brazilian authorities to recognize the freedom of slaves imported illegally after 1831, a process which culminated in a rupture of diplomatic relations briefly in 1863, the British never contemplated extra-diplomatic measures. In the case of Portugal, Britain intervened in 1847, unwillingly and at the insistence of the Portuguese government, together with France and Spain (Bonifacio, 1993). Britain would have used armed force in Africa in 1890 had the Portuguese government not accepted the British ultimatum. More of this event in its chronological place below. The rest of this paper shall focus on trade and credit.

We shall divide this analysis in two broad periods. The first of these cover years of continued political peace and sustained economic growth beginning in 1850, passing through several world crises, and terminating in Brazil with a political and financial crisis caused by abolition in 1888. In Portugal, a crisis became apparent in 1890 with the British ultimatum mentioned above combined with collapse of immigrants' remittances from Brazil and the embarrassment of Portugal's bankers, Barings. Both countries experienced over a decade of continuous financial/political turmoil. Brazil came out of the crisis in 1901 as it resumed the payment of its international debt while embarking upon another period of intense agricultural and industrial development.

Portugal attenuated its financial crisis by reaching an agreement with its international creditors in 1902 and experienced some growth in the years prior to the First World War. Political peace did not return as the country experienced continuous unrest, a dictatorship in 1907, regicide in 1908, the proclamation of a Republic in 1910, and years of continued turbulence thereafter. We shall focus on the periods of improvement, 1850-1890, and crisis, 1890-1902 with brief mention of the post-crisis period, 1902-1914 as an epilogue.

Brazil, 1850-1888

The Brazilian elite of this period was composed of coffee planters, sugar mill owners, ranchers and planters that supplied the exporting plantations as well as the cities with foodstuffs, merchants, officials, and professionals. All these groups took for granted that the state served them and not the mass of the population and that slavery was essential to the process of production. During the 1850s and 1860s, only the most forward-looking leaders of the elite imagined abolition within 20 years; their opponents thought slavery to be eternal. Another given for the elite was that public income depended on tariffs; coffee and sugar planters even consented to an export tariff on their commodities. Tariffs generally provided 60 to 70% of imperial government revenues during this period. And import tariffs were high by European standards generally averaging at least 30% (Luz, 1961). Historians of an earlier generation accused the elite of blindly accepting free trade and the gold tariff to the detriment of industrial growth (Werneck Sodré, 2004, pages 294-95). This view is incorrect on three levels: first the planters and their allies did what they understood to be in their own best interests and proposed actions that helped them access international markets, so they were no one's dupe, second, their revenue tariffs provided local

industry with substantial protection regardless of speeches in favor of free trade, and third, the Brazilian elite adapted the rules of the gold standard to suit their own convenience.

Although the Portuguese monarchy prohibited manufactures in Brazil during the colony, in fact some industries appeared in Minas to clothe slaves in situations where the cost of transporting imports from the coast proved too expensive. Upon arriving in Brazil, João VI encouraged the establishment of factories granting bounties and other favors. Perhaps we should consider him the father of Brazilian industry. Due to lack of scale as well as British competition, few early industries survived. Authors like Werneck Sodré (Sodré, 2004, page 284) and Caio Prado (Prado, 1956, pages 174-176) recognized that the age of free trade ended with the Alves Branco Tariff of 1844 that generally doubled tariffs to some 30%. The abolition of the slave trade released resources which could have been employed in manufacturing had there existed genuine opportunities. In fact, industrialization really took off only around 1880. Although tariff levels continued at the high levels Alves Branco put in place, scale for textiles, processed foods, beverages, and building materials began during the 1880s caused by the increase of demand from immigrants (Dean, 1969). A secondary stimulant present at this moment was the passage of a law in 1882 that facilitated the establishment of limited liability corporations. (Similar laws passed in Britain in 1858 and in Portugal in 1867, by way of comparison.) To conclude, from the 1850s through the 1870s, Brazil had high revenue tariffs, improving transportation, and increasing local capital, but little industrialization took place for lack of a market. Without a shift in the elite's outlook towards industry, this situation began to change in the 1880s due first to a surge in immigration and then to abolition which incorporated,

albeit at very modest levels, some of the freedmen into the monetary economy.

In her groundbreaking study of fifty years ago, Nícia Vilela Luz (Luz, 1961) demonstrates that the governments of the empire never promoted tariff increases for the sake of protection. Only in the 1880s did machinery imports become significant (Graham, 1972, pages 331-332). This decade saw industrialists achieving some prominence in the commercial associations while attempting, unsuccessfully, to establish an organization of their own (Ridings, 1994, pages 45-46). If we cannot praise the imperial elite for a conscious industrialization policy, we also cannot condemn them for not improving the economy. The 1850s saw the commencement of railroad construction in Brazil. By the early 1870s, rails tied São Paulo's hinterland to its port of Santos and São Paulo city to the imperial capital. Government loan guarantees proved fundamental for rail construction, and the authorities nationalized the Dom Pedro II railway from Rio to São Paulo. Rail construction became highly controversial as many members of the elite thought that several tracks would only lose money. These critics often proved correct. Of course, the lines in São Paulo made healthy returns for their investors. The imperial elite also funded telegraphs and the transatlantic cable.

The Brazilian elite closely followed economic developments in Europe and the United States. Many members of this elite demonstrated considerable economic nationalism and conducted well informed debates on how to develop their economy. Politicians recognized that industrialization had not only benefits but also costs in terms of higher prices and lower quality. The participants recognized that heavy industry could not acquire scale in Brazil while not even every light industry could expect to do so. As Luz demonstrates (Luz, 1961, pages 34-35), the

viscounts of Itaboraí and Souza Franco, leading spokesmen, from the late 1840s to their deaths in the early 1870s, respectively, of the conservative Saquaremas and the liberal current of the elite, both acknowledged the need for industrializing over time, both recognized the primacy of agriculture, and both saw revenue tariffs as necessary for financing the state. In short, Souza Franco proved somewhat, although only somewhat, more pro-industry than Itaboraí.

While few members of the elite became industrialists prior to abolition, the elite divided between a group devoted to the preservation of slave agriculture and another who envisaged a growing economy paced by the immigration of Europeans, the expansion of both small farms and large plantations, the development of railroads and other infrastructure, the encouragement of a banking system spread all over the provinces, and to a lesser degree, to the growth of industry and education. From 1848 to 1862, with one brief interruption, the Saquarema slavocrats controlled the government. In fairness, they abolished the slave trade (under duress), created the first land law (to favor large landowners), and the first (restrictive) commercial code. Their hardest fight against the more progressive forces took place on the issue of banking regulations.

After the world crisis of 1837, which had a traumatic, if short, impact upon the merchants of Rio de Janeiro, a group of the larger traders established Brazil's first bank since the demise of the Banco do Brasil in 1829. This Banco Comercial do Rio de Janeiro suffered relatively little government influence and could not issue banknotes although it issued "vales", a short-term debt instrument. During the next decade, one bank opened each in Belem, São Luís, Recife, and Salvador. In 1851, during the boom following the abolition of the slave trade, the future viscount of Mauá, already one of Brazil's leading business-

men, opened the second Banco do Brasil. Capitalized at twice the size of the Banco Comercial do Rio de Janeiro, the new bank competed directly with the older one. The Saquaremas, led by the finance minister viscount of Itaboraí, did not approve of independent banks. A year after the organization of Mauá's bank, the finance minister ordered the merger of the Banco Comercial with the Banco do Brasil and effectively placed the new entity under government control by nominating the president and vice president. Although the surviving Banco do Brasil continued privately owned, the government effectively dominated the decision-making process. An extreme centralist, Itaboraí forced the other four regional banks to become branches of the Banco do Brasil. Brazil then had but one bank. Anyone hostile to the government would have difficulty obtaining a bank loan anywhere in Brazil.

Itaboraí considered himself an orthodox follower of the gold standard. He wanted to retire the paper money the government had outstanding (originally placed in circulation to replace the banknotes of the first Banco do Brasil that failed in 1829) and substitute these with gold-backed banknotes issued by the new Banco do Brasil. A well-informed man, he knew that the Bank Charter Act of 1844 required the Bank of England to issue banknotes 100% backed by gold (above the original £14,000,000 of notes backed by the government debt). He also knew that the British commercial banks tried to maintain cash and funds at call equal to one third of their liabilities including deposits. Combining the two notions, he granted the new Banco do Brasil the right first to issue banknotes equal to the double of its capital (paid into the bank in the form of gold and government paper money) and then enhanced this privilege to the triple. A contemporary English banker would have considered this practice as wildly inflationary yet

Itaboraí maintained his reputation for soundness. When Itaboraí left the ministry of finance in 1853, his successor appointed him president of the Banco do Brasil. By 1857, his bank had doubled the circulating medium of Brazil while the exchange hovered around par.

In May of 1857, the emperor decided to call a more progressive government for the first time since 1848. The new finance minister, the future viscount of Souza Franco, represented the sector of the elite that favored decentralization, including regional banks of issue, immigration of Europeans, gradual emancipation, railroad construction, and with less enthusiasm, industry and education (Schulz, 2013a). Souza Franco participated in the organization of Brazil's first four railroads and issued Brazil's first international railroad bond to finance the Dom Pedro II from the capital to São Paulo. His other immediate initiative was to permit the organization of five new banks of issue, one each in Rio, Porto Alegre, Salvador, Recife, and São Luís, and the transformation of an existing bank in Rio into a bank of issue. These banks had more stringent limits for banknote issue than those set by Itaboraí for the Banco do Brasil; they could issue up to one time their capital backed 100% by government debt or certain other securities. Souza Franco sought to maintain the milreis at parity but did not oblige these banks to redeem their notes in gold. He allowed redemption in paper money. In the meantime, Mauá, who had set up an unincorporated banking house after being pushed out of the management of the Banco do Brasil by Itaboraí, received from Souza Franco the privilege of converting this entity into a limited partnership (*sociedade em comandita*). The limited partnership emerged during the middle ages as an institution that gave limited partners (*sócios comanditários*) limited liability as long as they did not participate in the management of

their partnership. Only the general partners (*sócios ostensivos*) faced unlimited liability. Souza Franco justified this structure by reference to a French law of the previous year, 1856, in spite of the medieval origin of the limited liability partnership.

During Souza Franco's tenure, these six banks issued a total of 14,000 contos of banknotes as opposed to 40,000 contos issued by the Banco do Brasil since 1853. As luck would have it, six months after assuming office, and when the new banks had just begun to issue banknotes, an international crisis hit Brazil. This crisis began, as did most others in the nineteenth century, in the United States. The US economy suffered from over-investment in railroads as well as speculation in other assets. Without having a central bank at this time, the American banks had to abandon the gold standard for two months. Britain, America's greatest creditor, suffered in turn, curtailing lending in its other markets like Brazil. This reduction in credit proved a double stroke against the Rio business community as the US constituted Brazil's largest export market and diminished its purchases during moments of stress. In London, the Bank of England again acted as lender of last resort, saving the local market from a wave of bankruptcies. The Bank appeared set to go over its limit for banknote issue and obtained an indemnity from the government, which it happily did not have to use. In Brazil, Souza Franco permitted the Banco do Brasil to issue over three times its capital. The four-year-old bank thereafter did an excellent job as lender of last resort. Given the demand for gold by foreign merchants anxious to discharge their debts, the Brazilian currency fell from par, 27d, to 22.5d very rapidly. During the worst of the crisis, the government guaranteed the foreign exchange positions of the Banco do Brasil which sold sterling to raise the milreis. Once the worst had pas-

sed, the directors of the bank no longer wanted to participate in this business and declined the minister's request to continue, a rare act of lack of cooperation.

Souza Franco turned to Mauá to sell sterling and maintain the milreis. This banker readily agreed and invested his own money in this project rather than relying solely on the government's guarantee as the directors of the Banco do Brasil had. Mauá and Souza Franco properly assessed the market that quickly rebounded after the crisis, making a large profit for the banker and restoring parity for the minister. During this period, Souza Franco came under intense attack from Itaboraí and his followers who blamed the incumbent for provoking the crisis with his banknote issue. In vain, Souza Franco pointed out that Itaboraí's bank had issued far more banknotes than his banks had, that the crisis originated outside Brazil, and that anyway, the milreis had returned to par. Itaboraí insisted that banknote issues be restricted to avoid future crises. Although a not inconsiderable part of the imperial elite shared Souza Franco's views of the Brazilian economy, at the end of the day, the Saquaremas still had a majority of this elite in 1858 and managed to have the emperor replace Souza Franco with a series of ministers who concurred with Itaboraí. By 1860, these men had the parliament pass the Law of Obstacles which made it impossible for the banks of issue to continue. By this law, they were forced to redeem in gold banknotes originally issued against paper. Any fall from parity resulted in a loss for the issuing banks so they surrendered their issue rights. Until its partial repeal in 1882, the Law of Obstacles applied a break to all types of corporations which required acts of parliament to obtain limited liability.

After the banks of issue relinquished their issues, money in circulation contracted in

Brazil compromising the liquidity of the markets. A major domestically induced crisis almost took place in 1862 and did occur in 1864. Excessive lending by banking houses through factors to Rio province coffee planters, that began to feel the effects of age and exhaustion of their trees, provoked this crisis. Once again, the Banco do Brasil acted as lender of last resort and had its issue limit suspended. Despite rapid and energetic action taken by the viscount of Caravelas, finance minister at the time, a good deal of wealth disappeared as major unincorporated banking houses collapsed. By the time the smoke cleared from this crisis, the country found itself at war with Paraguay in what turned out to be a long and expensive struggle.

In 1866, the government named a commission of three former finance ministers, precisely Itaboraí, Souza Franco, and Caravelas, to re-organize the Banco do Brasil. The needs of war forced the three men into agreement. They decided that the Banco do Brasil would surrender all its gold to the government so that the latter could meet its obligations in hard currency. No one hoped for a gold standard as long as the war continued. The three former ministers also resolved that the bank could no longer issue new notes but that its existing notes would enjoy legal tender status. Finally, they agreed to convert a large share of the bank's loan book into a mortgage portfolio. In fact, this last measure converted past due short-term loans into long term mortgages that in practice might not be received in the future.

After the passage of this reform, the war proceeded slowly while the government, encouraged quietly by the emperor, discussed a time table for emancipation for the first time. In a dramatic moment which foreshadowed the coup d'état of 1889, the Saquaremas utilized a threat to resign by the duke of Caxias, the Brazilian

commander in chief, to oust this progressive ministry replacing it with one presided by Itaboraí. After silencing all talk of abolition, Itaboraí saw the war to a victorious conclusion while having to endure the lowest exchange of the whole empire, 17d.

Once the war ended, Emperor Pedro II relieved Itaboraí of office. The monarch forged a coalition that passed the Law of the Free Womb, in 1871, which declared all children of slaves born after this date as free. This legislation has been viewed by some as a major concession by the slave owners acknowledging that servitude would come to an end while others see it as a cynical maneuver to preserve slavery for another generation. The truth must be somewhere in the middle, a compromise possible at that moment. With peace and with prosperity in the world, Brazil appeared to recover quickly from the war as the milreis returned to parity. While at war, the world crisis of 1866 had barely affected Brazil, and when a new international crisis began in May of 1873, this one too seemed to pass Brazil by. In September, the crisis, that began in Central Europe, reached the United States, Brazil's largest market, and still no impact on Brazil. Finally, in May of 1875, a week after the death of his friend and defender, Senator and Councilor of State Souza Franco, Mauá suspended payments. Prime minister and finance minister viscount of Rio Branco reacted energetically to this new crisis. As the Banco do Brasil had been prohibited by the law of 1866 from issuing new banknotes, Rio Branco supplied liquidity by lending the bank the paper money the government had on hand. This action once again made the Banco do Brasil into a lender of last resort that saved many firms from going under, although Mauá and three incorporated banks eventually went into liquidation.

1875 proved to be the empire's last fi-

nancial panic, but it inaugurated a decade of recession in the coffee market forcing the milreis down from its parity of 27d to 20d, almost as low as during the Paraguayan War. During the coffee recession, São Paulo and southern Minas continued to increase their production while that of Rio province accelerated its decline. In 1880, a vigorous abolitionist campaign began supported by residents of the cities. In 1884, seeing the handwriting on the wall, the Banco do Brasil refused to accept slaves as collateral for loans. In the future, planters would have to offer in guarantee either their land, which often was difficult due to unclear titles, or crops on the trees. The depreciation of the Brazilian currency served well the planters who followed the Saquarema leadership. With the decline of the milreis, they received more local currency for their coffee exports. When coffee exports and the exchange recovered in 1887, finance minister Francisco Belisario Soares de Souza, nephew of Itaboraí's Saquarema colleague, the viscount of Uruguai, suggested lowering parity so the coffee planters would not lose their income in local currency.² The Saquarema dedication to gold went only so far. By 1887, the world of the Saquaremas was turning upside down. Through death and manumission, the number of slaves had declined to the point that servile labor could no longer man the expanding coffee plantations of São Paulo. Drought in the Northeast, making free labor cheaper than slaves, combined with the sale of slaves to São Paulo to undermine the Northeastern commitment to slavery. That year, leaders from São Paulo and the Northeast abandoned the last slaveocrat ministry, that of the baron of Cotegipe where Belisario continued as finance minister. Months later, Cotegipe was out and abolition passed in parliament. With coffee prices at cyclical highs, the milreis at parity, and immigrants swarming in, the fears generated among the elite by abolition disappeared. Except for the coffee

planters of Rio, with their old, uncompetitive trees, the remainder of the elite, including the planters of São Paulo and Minas, reached a state of euphoria. But the coffee planters of Rio could still make themselves heard. Although the government denied the Rio planters an indemnity for the loss of their slaves, the last two monarchist ministries tried to provide them with debt relief through easy loans.

From the currency reform of 1846 to abolition, Brazil had the gold standard as an ideal. For years, the milreis hovered around parity and even traded above this level during periods of high coffee prices. On the other hand, during the Paraguayan War and again during the late seventies and early eighties, the milreis moved well below parity only to recover once more around abolition. Not being on the gold standard benefitted planters. Being close to the gold standard helped pay the international debt, to which we turn next.

Brazil's international debt began in 1825 when Emperor Pedro I assumed part of the Portuguese debt to Britain as the price for the recognition of Independence by Portugal and Britain. During the difficult years that followed, Brazil had to borrow to pay interest but always serviced its debt.

After 1850, as we have seen, the country's fortunes improved. The Rothschilds, who participated in several of the earlier issues, consolidated their position as Brazil's lead bankers with the loan of 1852 and their appointment as exclusive agent in 1855. This house underwrote all the facilities for the central government until 1906. In addition to direct loans, the government guaranteed funds taken by railroad companies. The railroad loans were contingent liabilities; when rail profits generated dividends of, usually, 7%, the government did

not have to pay. Many of the lines failed to produce profits while the São Paulo Railway always did. By the end of the Empire, annual disbursements of railroad guarantees came to L800,000 compared to interest on international government debt of L1,900,000 and immigrants' remittances of L3,000,000.

Local debt, called apólices, payable in milreis rather than sterling, modelled itself on the British consols. As such, these instruments, by 1850, had evolved into perpetuums yielding interest, generally 6% per annum, but no amortization. Apólices immediately became popular with a wide cross-section of the elite including planters, merchants, officials, and professionals as well as their spouses and widows. When the decline of the milreis during the Paraguayan War made foreign debt more onerous and less forthcoming, the government accelerated the issue of apólices. To make these instruments more attractive, the government issued special national loans with interest paid in gold, at 5% rather than the customary 6% in milreis (Summerhill, 2015).

After the war, international borrowing became progressively less expensive while internal demand for apólices grew. Indebted planters complained that potential creditors preferred apólices to loans. As apólices traded consistently over par, the government proved able, in 1886, to reduce the interest rate to 5% by threatening to prepay existing apólices. The conversion economized funds for the treasury but did not increase credit for the Rio coffee planters because potential lenders considered them an unsatisfactory credit risk. The cries of the Rio planters also induced the Saquarema ministry of Cotejipe, 1885-1888, to substitute domestic debt for foreign in a move to diminish the supply of apólices. The recovery of the coffee market after 1885, allied with the country's excellent

payment record, led to a great improvement of terms: Cotegipe and Belisario took an international loan of L6,000,000 for 38 years at a coupon of 5% and a discount of only 5%, a cost which compared favorably with those of many European states.

Contemporaries sensed what we would call “crowding out” by the government of the private sector, in this case the Rio coffee planters. Successive governments took the twin measures of reducing the interest on apólices and issuing more foreign debt to avoid crowding. Back in 1866, with the support of both Itaboraí and Souza Franco, the government created a mortgage portfolio in the Banco do Brasil that, in theory, would make it easier for planters to borrow long term at reasonable rates. On that occasion, the directors formed this portfolio by exchanging largely past due advances, originally made to the banking houses that collapsed during the crisis of 1864, into mortgages on the properties of the planters who were the ultimate recipients of these credits, often through their factors (comissários). In the following years, the bank’s collection experiences turned out to be unfavorable, and in 1887, it terminated this portfolio. The mortgage law itself did not properly defend creditors as it stipulated that loans could not exceed half of the hypothecated property. As a result, there were cases of debtors suing their creditors to take their properties against payment to the debtors of the other half! Although the declining Rio planters obtained a terrible reputation as deadbeats, more prosperous planters in other regions like São Paulo and the south of Minas Gerais provided their creditors with a more satisfactory experience. Recent research by Rita Almico (Almico, 2015), Renato Marcondes (Marcondes, 1998), and Anderson Pires (Pires, 2009), among others, covering the rising areas of São Paulo and Minas, has caused

a major reappraisal in the role of the mortgage as a credit instrument during the late nineteenth and early twentieth centuries. Often the creditors were local capitalists lending in their own names. Formal bank credit took time to reach the interior of the country, but credit by private individuals, relying on mortgages, and credit by factors on the security of future coffee sales, went a long way to satisfying the needs of those planters that managed viable properties.

To conclude, Brazil achieved abolition, an event that many had thought impossible a generation before, without major violence or disruption of the economy. The availability of European and potential oriental immigrants played a major role in the timing of abolition, but external pressure, even of the moral sort, proved to be of minor importance (Rocha, 2008) in the passage of emancipation. Throughout the period from the abolition of the slave trade to abolition, the Brazilian elite had maintained prudent financial administration that gave the state ample access to both international and domestic credit markets as well as an exchange rate that had periodically returned to parity. High revenue tariffs provided local industry with a degree of protection while the emergence of a domestic market comprised of salaried immigrants and, to a lesser extent, freedmen, had produced by 1888 the beginnings of national light industry. The independence of the Brazilian elite during this period appears clear.

In order to placate the declining Rio coffee planters, the last two prime ministers of the Empire and especially the first governments of the Republic abandoned this prudence with dire results. Before discussing this departure from prudent finance, let us turn to the Portuguese experience.

Portugal, 1851-1890

The current consensus among Portuguese historians (Reis, 1993, Lains, 1995) is that Portugal found itself further behind the most advanced economies in 1914 than it had been in 1850. Stephen Haber (Haber, 1997) suggests the same for Brazil. In one sense, Haber is correct in that the United States growth exceeded that of Brazil at that time. On the other hand, if we take the dynamic Central and Southern parts of Brazil by themselves, we may find a rate of expansion like that of the United States, while of course the economy of the Northeast failed to grow or even shrank. In the case of the dynamic areas of Brazil, especially São Paulo, Rio city, Southern Minas, and Rio Grande do Sul, contemporaries sensed a great expansion throughout this entire period. There were moments of euphoria, during the 1850s, after abolition, and again during the first decade of the twentieth century. To overlook this optimism would make it difficult to understand the “age of improvements”. For its part, all of Europe, in a wave going from northwest to southeast, became enthralled with this age of improvements. Despite not being able to participate in the material progress to the same degree as other small economies did, Portugal still experienced a feeling of exhilaration with the opening of its railroads, bridges, ports, and telephone service. Although the period 1890-1914 proved particularly difficult for Portugal, this country did benefit visibly from the improvements of the age up to 1890. For all its shortcomings, the “*Regeneração*” was precisely a regeneration.

Turning to industry in Portugal, today there exists a consensus that protection during this period was high, in fact even higher than in the United States, the quintessential high tariff country (Reis, 1993, page 16). The Portuguese elite, like its Brazilian equivalent, was not a

dupe of the free trade arguments made by British economists. If anything, Portuguese development may have been retarded by excessive tariffs that removed the incentives for Portuguese firms to modernize themselves³. For the public finances, import tariffs turned out to be slightly less important than their Brazilian equivalents, amounting to slightly less than half of state revenues compared to a range of 60 to 70% for Brazil. In any case, the tariffs constituted a major source of state income although the state did use the tariffs to protect industry and, unlike Brazil, to protect agriculture as well.

As Portugal had an industry in the eighteenth century (Madureira, 1997), industrial interest groups already functioned in Portugal in 1850. State protection for industry had a tradition in this country beginning with the count of Ericeira, an almost contemporary of Colbert in the seventeenth century, running through the marquis of Pombal in the eighteenth, to various governments of the nineteenth century, including the Setembrists of 1837, who imposed the first protective tariff after the British occupation. In fact, protective tariffs proved a constant after 1837, free trade rhetoric to the contrary notwithstanding. Due to adequate protection, the restoration of peace, and a favorable world economy, Portuguese industry began to grow in the decade before 1850 and continued at a respectable if not spectacular pace until the First World War (Lains, 1995, page 60).

While both Portugal and Brazil depended upon England as their chief supplier of external funds, Portugal saw Britain as her principal market for wine while Brazil had a different buyer for coffee: The United States. One must remember that the United States remained a large debtor economy until the very end of the nineteenth century, competing with Brazil and Portugal for British loans until the Boer War,

1899-1902, when J P Morgan appeared as a creditor to Britain. While Brazil “effortlessly” diversified its markets as new areas like Germany, Austria-Hungary, and Italy became major consumers of coffee at the end of the century, Portugal had more difficulty in identifying its market for wine as England imported more from the competition. Clearly England used its importance as a customer to negotiate the best possible trade treaty with Portugal; Britain did not have this position of strength in bargaining with Brazil.

As Portugal practiced protection while several of its leaders praised free trade, this country’s elite also demonstrated independence in its exchange policies and in its debt repayment practices. Let us turn first to Portugal’s experience with the metal backing for its currency. The war against France forced even England off the metallic standard in 1797. Banknotes, especially of the Bank of England, circulated at that time while gold went to an 80% premium over paper at the worst moments of the Napoleonic War (Clapham, 1945, II, page 78). When England returned to convertibility in 1821, sterling had the same metallic value as it had had in 1797. The lowering of prices from the 80% premium caused commercial failures, salary reductions, depression, and social conflict. As many members of parliament were creditors of the state, they thought these inconveniences worth the benefits of the state paying its creditors the full amount owed them in metal. Borrowers, many merchants, and the unemployed would have disagreed. Portugal, without a state bank, issued paper money beginning in 1797 sending gold to a premium. Political instability and civil war delayed Portugal’s return to convertibility until 1854. Worthy of note is that Portugal became the first state to follow Britain on the gold as opposed to the bi-metallic standard. Prior

to suspending convertibility in 1797, England had reduced the legal tender status of silver to transactions no greater than L25. In 1821, only gold became legal tender thus commencing the era of the gold standard. Even more remarkable, in my opinion, is that Portugal returned to convertibility at a rate only slightly lower than the level of 1797: a milreis of 55d as compared to 63d in 1797. Brazil, which of course had a common currency with Portugal until 1822, adopted a milreis of 27d in 1846 and rarely achieved convertibility at that rate.

Between 1797 and 1854, Portugal suffered the War of the Oranges with Spain, repeated French invasions, British occupation, civil war between absolutists and constitutionalists, several coups, and finally another major civil conflict. The decision to go on gold at 55d must have gratified the domestic creditors, many of whom held seats in the legislature. Unfortunately for the creditors, the same government, whose moving spirit was Fontes Pereira de Melo, in 1852 had unilaterally lowered the interest on both external and internal debt to 3% p.a. as well as terminating amortization, turning all the Portuguese debt into non-amortizing consols or perpetuals. As new debts could only be sold at over double this 3% yield, the “renegotiation” represented a major capital loss for the creditors. Brazil treated both its external and internal creditors in a much more favorable manner. In the case of external debt denominated in pounds sterling, the exchange rate did not matter to the creditors who received in gold. External creditors suffered no loss lending to Brazil until World War I disrupted the market. As the de facto Brazilian exchange rate fell during the 1820s to what would become the parity of 27d, domestic creditors who purchased apólices after this time, would have lost nothing by Brazil officially going on a 27d parity, which

continued through 1889. (After 1889, holders of domestic Brazilian debt suffered from the devaluation; in 1914, the Brazilian currency stood at 16d). While the holders of Portuguese debt lost half of their investments in real terms when the interest rate dropped to 3%, Brazil's creditors never suffered an involuntary conversion and came out whole. What is most interesting is that, after Fontes personally went to London in 1855 to negotiate with Barings, both external and internal creditors purchased ever increasing amounts of Portuguese debt at ever more advantageous terms, even after sustaining this severe "hair cut".

We do not know who really held either the Brazilian or the Portuguese external and internal debts. One may imagine that a number of individuals held both. Foreign, including Portuguese, merchants held a good deal of the Brazilian internal debt (Summerhill, 2015). Brazilian landowners, politicians, and professionals held the rest. Foreign merchants resident in Brazil, along with wealthy Brazilians, purchased the external debt. Coupons could be presented in England or Brazil for payment so that clients of the British banks in Portugal would find no difficulties in receiving coupons through their banks. One may assume that many large investors in Brazil's external obligations were successful Portuguese merchants who returned home. By the same token, Brazilians and Portuguese resident in Brazil held Portuguese debt. How much Portuguese and Brazilian external debt was held by British investors not commercially linked to these two countries is an interesting question waiting for future research. A first hypothesis is that more not commercially linked foreigners held Portuguese debt than held Brazilian debt. The Brazilian state had a harder time even partially repudiating its debt because these obligations were held by local people who

counted politically.

The banking system of Portugal developed at the same time as that of Brazil, with the advantage for Portugal for allowing regional banks of issue. Portugal's first bank began later than that of Brazil. João VI organized a privately owned, but government controlled, Banco do Brasil in 1809, almost as soon as he arrived in Rio de Janeiro. This bank enjoyed a monopoly of banknote issues, financed the government thereby, and collapsed in 1829 due to the government's inability to repay. When the king returned to Portugal in 1821, he took as much of the Banco do Brasil's gold as he could and presided over the foundation of the Banco de Lisboa. This bank also was privately owned, enjoyed a monopoly of banknote issues in the capital, and financed the government. The Banco de Lisboa suffered from its inception under the difficulties of Portugal's unstable political situation. In 1846, during the civil war, the government merged it with another troubled institution and created thereby the Banco de Portugal. This new institution, like the Bank of England, and the soon-to-be-formed second Banco do Brasil, was privately owned, enjoyed a monopoly of banknote issue in the capital, acted as lender of last resort, and assisted the government whenever necessary.

In 1835, the Banco Commercial do Porto was established in that city with the privilege of issuing banknotes. When Portugal returned to convertibility in 1854, the banknotes of the Banco de Portugal and the Banco Commercial had to be exchanged for gold at sight at these banks. After 1854, several private note issuing banks established themselves in various towns of the Northwest of Portugal.

Convertibility proceeded normally for these banks until Portugal abandoned the gold

standard in 1891. Unlike Brazil, Portugal only had one major financial crisis, that of 1876, in the entire period from 1854 to 1891. Of the major world financial crises of the nineteenth century, the United States was at the middle of the following: 1837, 1857, 1873, and 1893, and was certainly involved to a lesser but important extent in those of 1825, 1847, and 1866. Regarding Brazil, we have noted above that the crises of 1837, 1857, and 1873 (this last crisis with a delayed effect) all upset the local financial markets. As Brazil depended upon the United States for purchasing its coffee, the contagion seems evident. Although Portugal did not export to the United States directly, it did export to England which felt the effects of the US immediately. A first hypothesis for these crises not spreading to Portugal is that the Portuguese economy appeared less dependent on the outside world.

The Portuguese crisis of 1876 occurred in August, thus 15 months after the suspension of the Banco Mauá and the Brazilian crisis of 1875, 35 months after the collapse of J Cooke in the United States, and 39 months after the Krach on the Berlin Stock Exchange which set off the world crisis of 1873 in the first place. Brazil might have something to do with the Portuguese crisis. Since the abolition of the slave trade, the volume of remittances from Brazil had become a significant component of the Portuguese balance of payments. During the Paraguayan War, 1864-1870, the Brazilian currency fluctuated reaching a low of 17d. Remittances became more expensive, so the volume sent to Portugal contracted and the Portuguese economy felt this loss. When the war terminated, the Brazilian currency rebounded towards parity and remittances increased in tandem. The Brazilian crisis of 1875 affected the exchange rate and created a pessimistic mood in the country which would have continued as the

prices of coffee proceeded downward. All over the world, deflation appeared to have settled in as contemporaries experienced the “Great Depression”, ultimately from 1873 to 1896. The United States in 1876 had not yet returned to the metallic standard that it abandoned in 1861 at the onset of its civil war. By 1876, the government was moving to return to convertibility, which happened in 1879, only into gold. The demonetization of silver as a currency caused a major political battle that ultimately was resolved only with the discovery of gold in Alaska and the end of the deflation after 1896. To return to convertibility without lowering the gold content of the dollar, the US authorities exacerbated the deflation creating bankruptcies, labor strife, and resentment from debtors of all types, especially the still numerous farmers. With this conflicted background, coffee prices fell and remained low for another decade. Portuguese residents of Brazil in 1876 could have foreseen a difficult patch ahead and decreased remittances thereby also creating an expectation of lower remittances in the future.

Portugal’s banking bubble accompanied that of Germany with a lag. Germany’s began with the victory over Austria in 1866 that resulted in a virtual unification of the country under Prussian leadership. Many new banks were organized, including the Deutsche Bank, which continue through today. Other institutions lacked real capital and lived on promises rather than resources. The boom received more fuel with victory over France in 1870, the annexation of Alsace-Lorraine, the French indemnity, and the proclamation of the German Empire. By 1873, many companies had their stock values bid up to impossible levels, and the inevitable Krach occurred. Portugal’s bubble started around 1870. By 1873, there were 13 banks, perhaps an adequate number for an economy the size of

Portugal's. By 1876, the number had quadrupled to 52. The crisis was quickly overcome with the Banco de Portugal acting as the lender of last resort. Several banks failed outright while others merged. Although the Banco de Portugal obtained a law giving it a monopoly of banknotes all over the country, opposition from the other banks of issue prevented this monopoly from going into effect. In 1887, a second law affirmed this monopoly, again without success. As Portugal remained on the gold standard, all the banks of issue had to deliver gold when customers presented their notes. In terms of banknote issue, Portugal stimulated economic growth outside the capital. This was the situation when the great crisis of 1890 struck.

During the 1880s, three events appeared that would affect Portugal's future: the occupation of Africa, the exhaustion of the *Regeneração* and with it of the monarchy, and the wine glut. Until this decade, Africa represented nothing more to Portugal than a source of slaves to export. At the time of Brazil's independence, the Portuguese elite feared that the Angolan elite would desire to form a union with Brazil. When the Portuguese demonstrated that, despite British pressure, they would not interfere with the slave trade, Angola remained a colony. The abolition of the Brazilian slave trade in 1850 eliminated the African colonies' major export although both Angola and Mozambique continued to supply Cuba with slaves for a further 20 years. As early as 1825, writers suggested that Angola could become a new Brazil by planting the same tropical crops, especially coffee, sugar, and cotton, that Brazil did. While the period 1825 to 1880 witnessed Brazil's takeover of the world coffee market as well as its continuation in the sugar and cotton businesses and its emergence as a supplier of cocoa, Angola and Mozambique languished, perhaps because the Portuguese could not enslave

ve Africans on their homeland (Gervase-Smith, 1985).

By 1880, England had established firm control over the English-speaking areas of South Africa but only nominal power over the Dutch speaking provinces of Transvaal and Orange. Awareness of the mineral wealth of South Africa made the English anxious to secure the use of Lourenço Marques harbor in case of a conflict with the Boers. That year, they made a treaty with Portugal to assure the use of this port, and in so doing, provoked a strong reaction in Lisbon, that led to the fall of the Portuguese government.

Also by 1880, other European powers began to take note of Africa's potential. That decade, due to the failure of Egypt and Tunisia to pay their external debts, England and France, respectively, established protectorates over these north African states. In the southern and central parts of the continent, England, France, Germany, Belgium, and Italy all became interested in acquiring colonies. Although the German victory over France in 1870 had established this country as the most feared force on the European mainland, England viewed France as an almost equal danger to the island empire's balance of power strategy. England preferred Portuguese settlement to that of potential rivals and, at first, defended the Portuguese claim to control the Congo River against Belgium. When, in 1884, it became apparent that King Leopold of the Belgians had effectively occupied the north bank of the river, England withdrew its support of Portugal. The loss of the northern side of the Congo galvanized the Portuguese government into an attempt to occupy as much of the territory between the coasts of Angola and Mozambique as possible. Here, Portugal's aspirations clashed with those of her oldest ally which sought to consolidate its dominium from newly occupied Cairo to the Cape of Good Hope. For Britain to maintain control from

Cape to Cairo, Portugal could not hold Luanda to Beira. At this time, Germany became a colonial power annexing Tanganyika, just north of Mozambique, Namibia, on the southern border of Angola, as well as several areas of central western Africa. Although of all the colonies mentioned, only Egypt and South Africa generated serious income for their owner, the European states believed that the several African areas would prove valuable. As the decade of the 1880s came to a close, Portugal found itself in potential conflict both with England and with Germany but without a revenue stream from its colonies. As early as 1871, Eça de Queiroz suggested selling all or part of the African colonies to repay the national debt, that he felt was becoming unsustainable (Monica, 2009, page 124).

Eça was far from the only observer to be worried about the size of the national debt. Prior to the 1880s, Spain, Greece, and Italy had serious debt problems while even Hungary, then part of the Austro-Hungarian Empire, came close to a moratorium in 1873. Portugal's debt service, almost exclusively interest, absorbed half of the budget, and many contemporaries, including the Economist expressed skepticism during the 1880s regarding Portugal's ability to pay. The optimism of Fontes Pereira de Melo helped maintain the value of Portuguese securities, but his death in 1887 removed one of the mainstays of growth. After Fontes's passing, the whole idea of the Regeneração came to be questioned. Yes, Portugal had railroads, but the elite began to feel deceived as prosperity had not come along with transport, and the country felt that it had lost ground relative to other European states. With the disillusion over the Regeneração came also a questioning of the monarchy. France, Portugal's Latin model, became a Republic in 1870 inspiring the formation of a Portuguese Republican Party in 1876. Though the incumbent

monarchist leaders could still easily control the outcome of parliamentary elections, the vocal republican party, attacking the current regime as corrupt, made the successive royal governments uncomfortable. An articulate, if small, Socialist Party, promoted Portugal's first strikes and competed with the Republican Party in the two cities. The fall of King Carlos' Brazilian cousin, Emperor Pedro II, in November 1889, added tension to the air.

The bright spot in Portugal's 1880s was wine exports. A disease attacked French vines making France a major market for Portuguese wines, both for consumption and for re-export in French bottles. As British consumption of Portuguese wines declined, the French market became providential. Unfortunately, in 1887, the exports to France began to decline as the French vineyards recovered while imports from France's colony of Algeria expanded.

Let us now return to the difficulties faced by the Bragança monarchy in Brazil.

Brazil, 1888-1901

Immediately after abolition, the planters of Rio demanded indemnity for their loss of slaves. Although the Conservative government led by João Alfredo Correa de Oliveira denied this appeal, the prime minister knew he would have to do something to placate this still important group. The month of abolition, João Alfredo summoned a bi-partisan committee, led by the Conservative viscount of Cruzeiro and the Liberal viscount of Ouro Preto, to draft a banking reform that would permit the issue of banknotes. While this committee prepared its bill, João Alfredo signed agreements with two existing institutions, the Banco do Brasil and the Banco da Bahia, to on lend to planters the 4,300 contos Cotegepe had left unused in the emancipation fund. The banks received these funds interest free and

agreed to provide an equal amount from their own resources in order to lend the double long term at 6%. In fact, the banks appear to have lent only the funds received from the government.

In November of 1888, the *Cruzeiro-Ouro Preto* proposal became law, and in January 1889, João Alfredo regulated this statute. This measure appeared to look backwards to the 1850s as it provided for banknotes with two types of backing: government debt and gold. With government debt, *apólices* or national loans, as backing, the new banks of issue could issue banknotes up to two thirds of their capital. This fraction compares conservatively with the contemporary United States law permitting 90% of capital, and Sousa Franco's rules of 1857 which permitted issues up to 100% of capital. The regulation on gold backing allowed issues as high as three times capital backed by and convertible into gold. Three times capital is extremely inflationary, even if mitigated by the need to convert the banknotes to gold on demand. In fact, during João Alfredo's government, no bank found issues, as regulated in January, to be an interesting proposition.

Unsatisfied by João Alfredo, just over a year after abolition, the Rio planters joined with their Liberal opponents in parliament to overthrow him. Emperor Pedro II summoned the Liberal viscount of Ouro Preto to form a government at a moment when the Republican sentiment of many in the elite became apparent not to say vociferous. Limited by the emperor in terms of the political concessions he could make, particularly in regards to federalism, Ouro Preto concentrated his energies on financial measures with four major initiatives. He converted most of the external debt from 5% coupons into 4% for 55 years, demonstrating Brazil's standing in the international market, while issuing a large domestic national loan to have cash on hand to help provide liquidity to the coffee planters.

He expanded João Alfredo's loans to the banks for on lending to agriculture; whereas João Alfredo had contracted to provide 16,000 contos and actually lent 4,300, Ouro Preto contracted 172,000 (almost the size of the circulating medium) and actually advanced 26,000 contos to no fewer than 17 banks, some which appear to have been organized exclusively to receive the state's funds.⁴ The banks on lent the government money and came back for further resources without releasing any funds of their own as they had contracted to do. Ouro Preto's third initiative removed João Alfredo's limits to the issue of gold-backed banknotes. When these new rules failed to elicit issues, Ouro Preto launched a fourth measure, the creation of the *Banco Nacional*. This new institution, which included the French *Banque de Paris et de Pays Bas* as a major shareholder, had 90,000 contos of authorized capital and the privilege of issuing three times this amount backed by and convertible into gold. With the milreis at par, Ouro Preto thus attempted to go on the gold standard, giving the appearance of highly conservative finances. In fact, an issue of three times capital, a sum larger than the entire circulating medium, would have been highly inflationary and would have the immediate impact of preventing the milreis trading over par thus guaranteeing planters more local currency for their exports. In the longer run, this convertibility had no chance of success as a fall in coffee exports would have quickly ended the possibility of redeeming banknotes in gold. Ouro Preto, however, focused on winning support for the monarchy in the short run.

Ouro Preto's energetic measures started a bubble which affected the prices of stocks and other assets, called the *Encilhamento*. Like other bubbles, this one had real underpinnings in the sense of a positive coffee market combined with the successful abolition of slavery and the crea-

tion of a national market of immigrants and freedmen. Ouro Preto's financial measures won him much support from some members of the commercial community of Rio as well as criticism from others for his use of public funds to bail out the Rio planters.⁵ As it turned out, the Rio planters abandoned the monarchy while a coalition ostensibly led by the military staged a successful coup against Pedro II on November 15, 1889. We have no signs of British or other foreign influence leading to this coup. On the contrary, the Rothschilds suspended new transactions for Brazil until the Republic conducted elections while the British government also denied recognition to the Republic until the new regime proved its legitimacy. The Banque de Paris et de Pay Bas immediately cut its lines to its affiliate, the Banco Nacional.

Foreign merchants, including the substantial Portuguese community, as well as wealthy Brazilians, sent large amounts of money out of the country during the weeks that followed the coup, forcing the milreis down from par of 27d to 24d in one month. The stock market boom of the Ouro Preto months came to a halt, while the coffee planters continued to clamor for more loans. The first finance minister of the Republic, Ruy Barbosa, has been among the most admired and most attacked figures in Brazilian history. The stint in the finance ministry, from November 1889 to January 1891, constituted his only experience in executive office. Hailed as a protector of Brazilian industry, one of his initial acts was to cancel a tariff increase promulgated by Ouro Preto. In December, he tried to force the banks of issue that had signed contracts with his predecessor to effect these issues. Reasonably the banks refused to issue notes at 24d that the ambiguous legislation might oblige them to redeem at 27d. In January, with the stock market paralyzed, the exchange declining, and the plan-

ters complaining, Barbosa decided to abandon the conservative practices of his predecessors, going even further than Ouro Preto had on the path to recklessness. On his authority and that of the president, Marshal Deodoro da Fonseca, without advising his colleagues in the cabinet, Barbosa issued a decree giving a bank to be organized by Francisco Mayrink, principal shareholder of several other institutions, the privilege of issuing banknotes up to 200,000 contos, the entire circulating medium of the country at that time. This issue was to be backed by government bonds. The idea of bond backing as practiced in the contemporary United States and by Souza Franco's banks of issue made a good deal of sense. What bothered many within the elite was the astronomic size of this issue which permitted the 200,000 contos for the central part of Brazil while authorizing another bank, yet to be established in Barbosa's home town of Salvador, to issue a further 150,000 contos for the Northeast and North of Brazil and a third institution to cover Rio Grande do Sul with an issue limit of 100,000 contos. A public outburst within two weeks reduced the authorized limit of Mayrink's bank's issue to 100,000, and a second protest caused the three banks to be further reduced in March to 50,000 each. As it turned out, by September, Mayrink's bank had issued 50,000 in banknotes while the entire volume of apólices negotiated on the secondary market was 33,000 contos in 12 months (Franco, 1983, page 107). Apparently, no one inspected Mayrink's books to see if he had purchased the 50,000 contos of apólices necessary to back his issue.

Three of the ministers in the provisional government numbered among the banks' most outspoken critics: the war minister General Benjamin Constant Botelho de Magalhães, the justice minister Manuel Ferraz de Campos Sales, and the agriculture minister Demetrio Ribeiro.

All three offered their resignations. Benjamin Constant remained in the provisional government when Marshal Deodoro appealed to him in the name of the unity of the armed forces. Campos Sales withdrew his resignation after Barbosa promised to allow the establishment of a bank of issue in São Paulo that Campos Sales' party, the PRP, could control (Abranches, 1954, page 91). Ribeiro left the government.

The privileged banks of the monarchy, the Banco do Brasil and the Banco Nacional, did not remain out in the cold. In March, as Mayrink's issue limit was reduced to 50,000 contos, these two banks received the same issue limits under even more favorable circumstances. They could issue each these 50,000 contos backed 50% by gold but not convertible into gold until the exchange returned to par and remained there for one year, an extremely unlikely event. An unconvertible gold backed note is nonsense; these banks received the right to print money. Together with Mayrink's Banco dos Estados Unidos do Brasil, with its 50,000 of bond backed notes, where no one inspected the bonds, the three institutions could in effect almost double the circulating medium. Two noteworthy events occurred in August: Barbosa permitted Mayrink to issue 50,000 contos of gold backed but unconvertible banknotes, like the two former monarchist institutions could issue, taking his total limit back up to 100,000 contos, and Mayrink gave Barbosa a mansion in Rio.⁶ By September, the circulating medium had risen from 210,000 contos in January to 280,000 contos, after years of stability.

Once these banks began to issue, the stock market boom returned while the milreis continued its decline despite excellent coffee exports. In May, Barbosa discontinued Ouro Preto's loans to agriculture after disbursing an additional 14,000 contos to pet banks. That same month, he

began collecting 20% of the import tariffs in gold to compensate for the loss of revenue due to the devaluation. In October, he decided to collect 100% of the tariffs in gold forcing up the cost of living. That same month of October, Barbosa took steps to curb the most egregious practices of the stock market, receiving praise from his loudest critics.⁷ Within two months, the leaders of the Encilhamento discovered ways around the new rules, and the abuses began again. This month, December of 1890, Barbosa gave Mayrink a final present: the minister authorized the merger of the Banco dos Estados Unidos and the Banco Nacional to form the Banco da Republica. The surviving bank received the issue rights of the two merging banks as well as those of the Banco do Brasil which sold these to Mayrink. The banker's dream came true as he could issue 150,000 of unconvertible gold backed notes plus 50,000 backed by bonds no one inspected. He could finally double the circulating medium at the beginning of the Republic. Increased issues, facilitating and encouraging capital flight, forced the exchange down to 20d, a level seen at the trough of the previous coffee cycle during the early 1880s.

While Barbosa prepared his final gift to Mayrink, two important events transpired, one outside and one inside Brazil. Barings, the second most powerful merchant bank after Rothschilds, became insolvent due to excessive exposure to Argentina and had to be bailed out by a group of banks led by the Bank of England and Rothschilds. Investor appetite for Latin America fell off as Argentina had been the most active market in the region, followed precisely by Brazil, now experiencing a financial bubble of its own. Inside Brazil, the provisional government successfully conducted legislative elections in September convening congress on November 15, the first anniversary of the proclamation of

the Republic.

Already at the beginning of the legislative session, the PRP, the Republican Party of São Paulo, elected Prudente de Moraes as the president of the senate. São Paulo emerged as the richest state in the new Republic exporting twice as much as Rio de Janeiro. The PRP expected Prudente to be elected president by the constituents as soon as they passed the new constitution. As so often happens after military coups, the officers acquired a taste for political power, and Deodoro presented his candidacy as an alternative to that of Prudente. Campos Sales, representative of the PRP in the provisional government, as well as several colleagues, supported Prudente and had themselves elected to congress. At the end of January, the entire provisional government resigned. Barbosa had by this time lost the confidence of Deodoro due to the low exchange and had not won the confidence of the PRP which generally disapproved of the Encilhamento in Rio. He therefore left the ministry of finance to take up his seat as senator from Bahia. Deodoro replaced the provisional ministers with former monarchists mostly from the Northeast. The baron of Lucena, occupied first the ministry of agriculture and then the ministry of finance and acted as if he were the prime minister. He took over Barbosa's friendships with Mayrink and the other leaders of the Encilhamento. Described as a plunderer by the British minister (Schulz, 2008, page 91) when he assumed office, Lucena went on to prove the minister correct.

On February 24, 1891, the constitution went into effect. The following day, congress elected a president and vice president to serve until November 15, 1894. By threats and bribery, Deodoro won the election. His second minister of war, Marshal Floriano Peixoto, endorsed both by Deodoro and by Prudente, became the vice president. The PRP started a ferocious opposition

while Lucena continued to encourage the bubble. By the second quarter, although Mayrink issued ever increasing amounts of notes, prices on the stock exchange began to fall. By the third quarter, the milreis sank to 14d, lower than it had ever been, even during the worst moments of the Paraguayan War. Coffee prices remained high demonstrating that excessive issues caused this currency collapse, as contemporaries perceived. By September of 1891, eight months after Lucena took office, the Banco da Republica had 300,000 contos of notes in circulation, an immense amount, without considering paper money or other banknotes, equal to 150% of the circulating medium at the proclamation of the Republic 22 months before. Lucena now proposed to congress to double this limit to 600,000 contos. He lacked the votes to do so. Partially in response to opposition in congress, Deodoro and Lucena staged the "stock market coup", closing the legislature by force on November 3. Immediately, the PRP, in control of São Paulo, began to conspire with the navy and with vice president Floriano Peixoto. A strike of railroad workers, their standard of living compromised by the inflation that accompanied the devaluation, isolated the capital by land while the navy severed sea communications. Realizing that he could not even count on the garrison of Rio and not wishing to start a civil war, the first president of the Republic resigned on November 23, only 20 days after the coup.

Vice President Floriano Peixoto assumed power with the desire to end the Encilhamento and return to the prudent finances of the monarchy. He also wished to consolidate the Republic while providing protection for national industry. These three goals conflicted with one another as he pursued all three in tandem. The PRP had hoped that Floriano would follow the letter of the constitution and hold new presidential elections

as Deodoro's term still had more than two years to run. Floriano argued that the transitory articles of the constitution provided that the first president and vice president should serve until November 15, 1894, and he always referred to himself as vice president. The PRP accepted this interpretation in exchange for control of São Paulo and the selection of one of their own, Francisco de Paula Rodrigues Alves, as minister of finance.

Rodrigues Alves took office with the milreis at a new low of 12d. The cost of living in Rio, highly dependent on imports, became intolerable for those on fixed salaries while industrialists who had ordered foreign machinery now had to pay twice as many milreis for these. The first six months of government proved chaotic. While the senate resisted Rodrigues Alves' campaign to prohibit further banknote issue, Floriano concentrated his energies on deposing all the governors who had accepted Deodoro's coup. In fact, only one governor, Lauro Sodré de Pará, repudiated the coup and another, Julio de Castilhos of Rio Grande do Sul, was ousted even before Deodoro fell in Rio. All the other governors were removed by force by March of 1892. It looked as though the country would fall apart. The leaders of the Encilhamento organized several unsuccessful coups culminating in a major conspiracy to depose Floriano in April. When soldiers purportedly bribed by a leading railroad owner failed to appear, Floriano counter attacked capturing and deporting to the Amazon some 40 figures including politicians, bankers, journalists, and military officers.

Floriano and Rodrigues Alves had little time to savor this victory. On the one hand, a group of economic nationalists organized a campaign to bail out those industries suffering from the collapse of the exchange. Here Rodrigues Alves began to part company with Floriano and his minister of industry, Colonel Serzedello Correa.

Floriano and Serzedello felt the need for Brazil to be self-sufficient at least regarding light industry and threw their weight behind the industrialists, even if this meant delaying the balancing of the budget, another major goal of theirs. The campaign for industry proved a free for all with the profiteers of the Encilhamento favoring the bail out together with the young military officers around Floriano and against the PRP. To finally complicate an already difficult situation, in June, Floriano restored Julio de Castilhos to the governorship of Rio Grande do Sul from which he had been deposed in November precisely for supporting Deodoro's coup. Floriano felt that Castilhos was the only republican capable of maintaining the state against the old monarchist politicians.

That same month of June one of Floriano's followers proposed issuing 100,000 contos of internal bonds to finance the industries through the banking system. The Rothschilds wired their disapproval of this inflationary measure. Simultaneously, Rodrigues Alves, who also disliked the aid to industry, negotiated a nine, twelve, and fifteen-month loan with the Rothschilds, the first external borrowing of the Republic.

Two months later, the finance minister resigned, largely against aid to industry which he considered inflationary as well as inefficient, and Floriano replaced him with Serzedello. Serzedello believed both in the gold standard and in protecting industry. His varied political, military, and business career was crowned with his election in 1904 as the first president of the Centro Industrial do Brasil. Unable to reorganize the financial system through a congress still highly influenced by the leaders of the Encilhamento, Floriano and Serzedello waited until parliamentary recess. In December they merged the Banco da Republica with the Banco do Brasil, placing the president of the latter institution, former Liberal prime minister Manuel Pinto de Souza

Dantas, as president of the surviving entity with the senator from São Paulo, Rangel Pestana, as vice president. The government authorized the surviving entity to issue 100,000 contos of 5% 30-year bonds to finance its bail out of industry. At the same time, the president and his minister raised the tariffs on textiles, the first time in Brazilian history where protection counted for more than revenue. Not until over a generation later would Brazil again have such an avowedly pro-industry government in office.

The Rothschilds applauded the merger and the termination of further banknote issues although, of course, they did not like the industrial bonds. In any case, they approved first of Rodrigues Alves and now of Serzedello to the point of underwriting a term loan on behalf of the Oeste de Minas railway (which delivered the proceeds of the loan in gold to the government in return for paper money in Brazil). The exchange market showed its contentment with Serzedello by rising to 13d in early 1893 while the external bond market also recovered.

Unfortunately, in April, Serzedello resigned in protest against what he considered an erroneous policy pursued by Floriano in Rio Grande do Sul. The previous June, the vice president restored Julio de Castilhos as governor. In February, the state suffered an invasion by forces, both monarchist and republican, hostile to the governor. Rather than attempt a mediation, Floriano gave all his support to Castilhos while deaths, especially by throat slitting, rose. Navy minister Admiral Custodio de Melo resigned with Serzedello against the Rio Grande policy. From this point, Floriano and his new finance minister, Felisbello Freire, attempted no further reforms while struggling to find means to pursue the civil war.

In September Admiral Custodio led the

fleet into rebellion, expecting to repeat the quick overthrow of Deodoro. This time, things went differently; the army staid loyal to Floriano who held the capital. The naval revolt added a new dimension to the civil war and placed the vice president in the hands of the PRP. To suppress the rebellion, he agreed to allow the election of Prudente as president, which occurred in March 1894. Floriano appealed to the foreign powers with warships in Guanabara Bay to prevent the rebellious fleet from bombarding the city. At the same time, his partisans accused the British of aiding the monarchists in Rio Grande do Sul. Floriano purchased a new fleet in the United States and had it sail down to Brazil (Topik, 1996). Presumably the United States favored the Republic. In fact, the participation of the foreign states proved limited, with Portugal ultimately playing a leading role. When the rebels in Guanabara Bay scuttled their ships in March of 1894, they were received onboard two Portuguese warships, an act that provoked a public outcry against the Lusitanians. As the Portuguese bakers were always the scapegoats for the high price of bread, several suffered harassments or worse after the escape of the rebels. Floriano broke off diplomatic relations with Portugal, which were only restored the following year by the Marshal's successor.

Floriano's recapture of Guanabara Bay, followed by victories over the rebels in Parana and Santa Catarina, led observers to wonder if he would in fact turn power over to the oligarchy in the person of Prudente. Floriano ungracefully declined to attend Prudente's inauguration but did not interfere with the proceedings. With the war still active in Rio Grande do Sul, Prudente took over a country with severe financial difficulties. He summoned Rodrigues Alves back to the ministry of finance with a conservative agenda. Their top priority was to reduce the cir-

culating medium, now 708,000 contos, or triple its size at the beginning of the Republic. In consequence of Floriano's printing paper money to finance the war in the South, the milreis had descended to 10d, just over a third of its parity, tending to confirm believers in the quantity theory of money. The most pressing economy measure was to negotiate an end to the fighting, achieved in July of 1895, not coincidentally a month after the death of Floriano. In their first two years in office, Prudente and Rodrigues Alves succeeded in reducing the circulating medium to 678,000 contos.

Unfortunately for Prudente, the coffee trees planted during the euphoria of the Encilhamento began to bear fruit just as he took office. As Brazil produced most of the world's coffee, prices fell drastically. Now Prudente faced the demands of his allies in São Paulo for easier money. Attempting a contractionary monetary policy during a commodity down turn proved to be an extremely difficult task. The consensus, both inside Brazil and outside, thought the government should seek to restore the parity of 27d, in effect since 1846 and loosely maintained under the monarchy. On the other hand, one of Prudente's advisers, the Englishman J. P. Wileman, suggested the president defend the current 10d without attempting to return to parity. Wileman argued that rising exchange had negative effects just as great as declining currency. When currency fell, salaries lagged so the poor earned less. When currency rose, employers quickly reduced salaries or made workers redundant. Any variation in exchange made it difficult for businessmen to calculate their costs. Countering the argument that devaluation constituted an expropriation of creditors who placed their faith in the state, Wileman stated that apolices had changed hands since their issue so that an appreciation of the milreis would benefit unduly those who ac-

quired these instruments along the way. History tended to agree with Wileman especially after the British government's disastrous return to parity in 1925.

Prudente did not follow Wileman's advice and sought to strengthen the milreis. The local market believed that, at least, the period of devaluation had come to a close, so Rodrigues Alves proved successfully placed a large issue of apólices. The Rothschilds also believed in the PRP government and underwrote an international bond issue. The devaluation had decreased the cost of servicing the local debt in relative terms while increasing the portion of the budget necessary to cover the international debt. A portion of the proceeds of the new international bond surely went to pay interest on previous issues.

In addition to balancing the budget and contracting the circulating medium, Prudente wished to nationalize the former banks of issue as well as their banknotes which had become paper currency in fact. During his first two years in office, he proved unable to win legislative approval for this measure. In fact, he did not control congress at all. In November of 1896, in the middle of his four-year term, Prudente took a leave of absence for health reasons. His vice president, Manuel Vitorino Pereira, changed the entire cabinet when he took office, and many believed that Prudente would never return. Although the president and the vice president had become enemies, they agreed on the necessity of nationalizing the banks of issue which Vitorino executed shortly after coming into power. Given the debt of the Banco da Republica and the others to the state, the government saw no reason to pay compensation to the former shareholders. As Prudente had desired, the banknotes became government paper money while the state took the gold and bonds backing these issues, even if this backing proved considerably less than the volume of

notes outstanding. The experiment with private banknotes, begun under the monarchy in 1888, had come to an end. Although privately-issued banknotes continued until well into the twentieth century in countries like the United States and Australia, Brazil never tried them again.

In March of 1897, Prudente recovered to the point where he could resume office. While coffee prices continued downward, he had to fund a costly military campaign against a millenarian movement in the Northeast. After victory over these rebels in October, Prudente survived an assassination plot the next month that killed his minister of war. The president seized the opportunity to crush the conspirators and win control over congress. For better or worse, the presidents who followed Prudente through the end of the First Republic in 1930, all enjoyed immense power during their terms. As a sign of his force, the incumbent had no difficulty in making a fellow Paulista, former justice minister Campos Sales, his successor. On the economic front, Prudente had less success during his final two years and found himself obliged to expand the circulating medium as a consequence of the military expenses as well as the decline of tariff revenues. The milreis duly fell to 7d, its lowest level prior to World War I.

Faced with difficulties in meeting his external debt payments, Prudente arranged a two-year external loan in November of 1897 as a stopgap. It became clear to both the government and the Rothschilds that a more comprehensive renegotiation must take place. Both parties acted with a long-term perspective, and both parties did well because of their farsightedness. The indebted government sent the president-elect to London to negotiate, an unusual gesture which highlighted its commitment to honoring its obligations. The bankers, for their part, agreed to go three years without interest payment in cash, as

they received new bonds therefore, and thirteen years without principal payments. The country won time while the creditors received payments as agreed from 1901 until the First World War stopped all gold remittances

The Rothschilds based their decision to support Prudente and Campos Sales largely on Brazil's good payments record. During the Empire, the external debt, consumed less than 10% of exports. Even under the Republic, debt payments to exports, known as the debt service ratio in financial circles, generally stood only slightly over 10%. This ratio was considered quite conservative. During the Empire, Brazil's external and internal debt payments each ranged from just over 10% to just under 20% of the national budget. Devaluation during the Republic caused the service of the internal debt to fall below 10% while the external service reached 25% which precipitated the renegotiation (Schulz, 2013, page 251). Brazil's debt figures compared favorably to those of many European countries.

Campos Sales took office in November of 1898 with the Funding Loan in place and with the discovery of additional gold reserves in South Africa and Alaska. Coffee prices remained stable while the volume of exports boomed bringing Brazil much needed gold. Together with his finance minister, Joaquim Murinho, Campos Sales increased revenues while diminishing expenditures. He raised income by levying Brazil's first excise, on alcohol and tobacco, and by charging a quarter of the import tariffs in gold. The president and his minister lowered expenses on the army and navy. They succeeded in reducing the circulating medium, which had reached 733,000 contos at the end of Prudente's term, down to 675,000 by the end of their term. As gold flowed in and fewer milreis circulated, the value of the milreis rose from 7d at their inauguration to 14d two years later. Campos Sales

also ignored Wileman's advice which suggested adopting a new, lower parity. Even with the exchange doubling, Campos Sales not only failed to announce a new parity but he and his minister spoke of regaining 27d.

In March of 1900, Murtinho made an agreement with the shareholders of the Banco da Republica to give them back the right to elect their two top officers that Serzedelo's decree had assigned to the government in 1892. Murtinho also negotiated a partial forgiveness of the official loans to the bank in return for a schedule for the repayment of the rest of the government's extensive loans to the bank. Like many of the other banks in Rio, the Banco da Republica took positions in gold and the milreis. The directors had speculated on the milreis when it hit 14d in July before receding to 10d the next month. With the decline of the milreis, the public began withdrawals at the bank which appealed to the government for help. Although displeased with having to make loans instead of receiving repayment as negotiated earlier in the year, Murtinho did offer loans in sterling. In September, the directors ran out of cash and suspended, provoking the worst financial crisis in Brazil's history thus far. No fewer than eight banks suspended, and many had to be liquidated. Contemporaries called this crisis the liquidation of the Encilhamento.

The terms of the Funding Loan precluded Murtinho from allowing a bank to issue banknotes as in 1857 and 1864 and limited the government's issue of paper money, as in 1875, to the amount outstanding in 1898. He could therefore lend only 25,000 contos, a moderate amount of paper. He had already lent, in the month prior to suspension, L1,000,000, equivalent to 30,000 contos. To provide liquidity to the Banco da Republica, the minister supplied the bank with 100,000 contos of five-year government bonds with a coupon of 3%. In return for

the bond, the sterling advance, and the loan of paper money, Murtinho obtained from the shareholders the pledge of all their shares as well as the right to appoint the two principal officers that he had relinquished in March. From then on, there was no question that the Banco da Republica was the government's bank. In a few weeks, both the creditors and the shareholders accepted Murtinho's proposal. During the month that it took to print and distribute the bonds, the Rio market remained paralyzed as few merchants had the liquidity to make payments. As soon as the bonds hit the street, they circulated as quasi currency, and the economy began to recover. Both Brazil's international and its domestic debt rose on the secondary market.

Murtinho received criticism from all sides. Merchants complained that he did not do enough to secure liquidity for the market and that many firms could have survived if only he had made available a bit more resources. Foreigners attacked him as overly permissive. In fact, he acted with energy to provide significant liquidity to the market while scrupulously observing the terms of the Funding Loan. Successful tight money policies invite the question of whether they would still have been successful if they had been less tight. What we know is that the Brazilian economy enjoyed 14 years of expansion following the crisis of 1900. On July 1, 1901, Brazil resumed cash payments on its external debt, and shortly thereafter, obtained a large facility from the Rothschilds which Murtinho employed to purchase several loss-making railroads. This purchase saved the large payments of guaranteed interest that the government had been disbursing for years. Murtinho also rented out railroad lines in the government's possession receiving rent instead of losing money. Campos Sales delivered his office to former finance minister Rodrigues Alves with the milreis at 12d

and the economy booming.

Portugal, 1890-1902

Before the term “gay” acquired a new meaning, the 1890s were commonly referred to as the Gay Nineties. The generation that experienced the first world war quite naturally recalled this decade as a wonderful, peaceful, and prosperous time when the rich could revel in the fruits of material progress and the middle class in the United States could enjoy the comforts of indoor plumbing and telephones. In one sense, this was true. In terms of finance, it proved to be a most difficult decade for many states. The Great Depression, which had begun in 1873, persisted. Several countries like Argentina, in 1890, had to suspend the service of their debts while others, like Italy, in 1894, had to abandon the gold standard. The United States, which had already overtaken Britain to become the largest economy in the world, almost had to abandon the gold standard twice, in 1893 and again in 1895. As these events happened at different times, internal factors rather than one acute world crisis must be the causes of their difficulties.

We have seen in the case of Brazil, the crisis dragged on for the whole of the 1890s due to three separate and consecutive factors: first from 1888 to 1891, an attempt to placate the debt-ridden Rio coffee planters by easy money. After the governments that pursued this policy were repudiated and overthrown, a new president, Marshal Floriano Peixoto, tried to return to conservative practices on one hand but became involved in a costly civil war he might have been able to avoid. His successor, in office from 1894 to 1898, achieved peace rapidly but failed to balance his budget due to a collapse of coffee prices. Only with the recovery of coffee did Brazil regain financial stability. Portugal suffered from four problems that occurred simultaneously du-

ring the entire decade. Brazil was Portugal’s first problem. With the slide of the Brazilian currency during the bubble, it became more expensive to send remittances to Portugal, so this major source of revenue shrank. We can recall that remittances from Brazil exceeded that country’s external debt payments. Only with Brazil’s recovery at the end of the decade did remittances return to their level of the 1880s with a positive effect on the value of the Portuguese currency. There was nothing the Portuguese authorities could do to ameliorate this problem except cheapen their own currency which they did in 1891. Mata (Mata, 1987, page 33) demonstrates that by 1896, the volume of remittances returned to the level of 1889. Ironically, the collapse of the Brazilian milreis in 1890 is described by a local journalist as in part caused by merchants, particularly Portuguese, sending money out of the country in the expectation that things would deteriorate further.⁸ Given the decline in Portuguese receipts, this observation begs the question of where the funds went. Probably a fair amount left Brazil by exchange operations at British, Portuguese, or Brazilian banks and went to banks in England. International private banking with England as a jurisdiction of destination appeared during the very end of the seventeenth century and expanded enormously with the receipt of emigrant money during the French Revolution (Healey, 1992). By the 1890s, investors enjoyed a wide choice among banks in England. At this time, wealthy Portuguese taking funds out of Brazil might have found it to be much less risky to park these resources in London rather than bringing them into their own country.

Other than Brazil, Portugal’s three problems were: the decline of wine exports, the dispute over the African colonies, and an unfortunate decision regarding the payment of the public debt. Due to vine diseases in France

during the 1880s, Portugal sold large quantities of wine to that country which both consumed and re-sold the Portuguese beverage to others. As the French production of wine recovered and France imported more from its African colonies, Portuguese wine exports to that country declined significantly beginning in 1887. England, Portugal's traditional wine consumer had been reducing its purchases for several decades due in part to a change in preferences away from fortified wine and in part to accommodate other trading partners. In this case, Portugal had to find new markets for wine and other products. During the 1890s, while France fell to become an entirely marginal market for Portugal, the African colonies, Brazil, and to a lesser extent, Germany and Spain all absorbed greater quantities of Lusitanian exports (Lains, 1995, page 93). Wine represented 50% of Portuguese exports during the 1880s as compared to 43.6% during the following decade (Lains, 1995, pages 92, 106-107).

The problems of foreign relations over Africa and the public debt ran together. By 1890, England held both Egypt and South Africa and wished to connect the two by rail. In the latter country, England ruled directly over English speaking areas but only loosely over Dutch speaking Transvaal and Orange. From the previous decade, one of the goals of British foreign policy had been to assure free use in wartime of Lourenço Marques, now Maputo, and then not yet until 1898 capital of Mozambique; expansionist leader Cecil Rhodes advocated outright annexation.

During the 1880s, as noted previously, the English had not yet decided whether their main potential rival was Germany or France. As England quarreled more with France, precisely over Suez and other parts of Africa, there existed a group within the British elite that looked to

an alliance with Germany. Only after the Boer War, during the first decade of the twentieth century, did it become likely that England would join France and Russia against Germany. After Portugal's failure to gain the north bank of the Congo in 1884, the Portuguese government turned its attention to occupying the territory between its East and West African colonies. Unfortunately, the Lusitanians came too late as the British, moving south from Kenya and north from South Africa had already commenced the occupation of what is today Zimbabwe and Zambia. Both the British and the Portuguese lacked tack. The Portuguese leaders should have bent over backwards to not antagonize their major creditor, major consumer, and shield against a highly acquisitive Germany, looking over Portugal's shoulders from Namibia and Tanganyika. The British for their part should have been careful not to de-stabilize a monarchist regime that held various strategic bits of land in case of hostilities with another great power. In a world of coaling stations, the Azores, Madeira, and the African colonies, especially Lourenço Marques, proved valuable assets.

A recent Portuguese historian (Costa, 1998, page 62) places most of the blame for the confrontation with Britain on the shoulders of the Portuguese foreign minister, Barros Gomes, and his group. Diplomacy did not prevail as the Portuguese government sent troops into areas where the English already had established, if small, bases, and the British reacted by presenting a formal ultimatum to the Portuguese authorities to desist in these disputed areas or face war. Once the ultimatum came, the Portuguese government had no choice and backed down by the next day. The consensus is that the ultimatum cost the monarchy a good deal of support and released great feelings of humiliation among the elite as well as among the lower middle

urban groups. Consumers boycotted English goods while employees left British enterprises. One intellectual apparently committed suicide illustrating the depth of feeling. On the other hand, Eça de Queiroz opined that Portugal's problem was Portugal and not external powers (Monica, 2009, pages 365-366). The economic consequences of the ultimatum were minimal. Portugal retained a territory in Africa beyond its resources to develop. A railroad across from Luanda or Lobito to Lourenço Marques or Beira would not have made much difference to the progress of Portuguese Africa. When the dust settled, England and Portugal made a treaty, within 18 months of the ultimatum, giving access to Lourenço Marques to Britain in case of war and maintaining Portugal's claim to many square miles that it had not yet effectively occupied. The British government also took steps to show its support for the Portuguese monarchy, which, thereby regained part of its lost prestige (Marques, 2009). By this time, however, the ultimatum helped provoke a major financial crisis that would disturb Anglo-Portuguese relations in a different way.

During 1890, as we have seen, remittances from Brazil seem to have plummeted, even though a considerable amount of capital flight from that country occurred. At the same time, wine sales to France almost disappeared placing the government in a gold shortage. Both external and internal borrowing became progressively more difficult as many potential lenders considered Portugal to be what we would call today over-leveraged. In November, Barings, Portugal's principal bankers, had to suspend due to over commitment in Argentina. The Bank of England and Rothschilds rescued Barings but new facilities from this bank were out of the question. Rothschilds had contacts with the Portuguese authorities at this time, but

no loans proved forthcoming from this source. That year, the finance minister muddled through. On January 31, 1891, a major if unsuccessful republican uprising in Porto further jostled an already nervous market. During the beginning of this year, to anticipate revenues, the government rented out the tobacco monopoly, an expedient utilized at various moments in the past. This action constituted a return to tax farming. By May, the Banco de Portugal held too little gold to guarantee conversion of its banknotes. The government accordingly relieved all the issuing banks of converting their banknotes for sixty days. When this sixty-day period proved insufficient, Portugal abandoned the gold standard indefinitely in July. The other issuing banks could also not convert their notes and finally gave up the issue privileges that the authorities had attempted to cancel in 1877 and again in 1887. Circulation would henceforth consist of Banco de Portugal notes and paper money. Leaving the gold standard further effected the self-esteem of the elite. But it was probably a good idea. Brazil and other Latin American countries had benefitted from not being on the gold standard. With a depreciating currency, Portugal's exports would become cheaper while immigrants' remittances would go further in Portugal. Importers and creditors of the internal debt were the two groups who would be negatively impacted.

Off the gold standard, the Portuguese state honored its commitments to both internal and external creditors during 1891. Early in 1892, a new minister, the historian Oliveira Martins, decided that drastic action had to be taken regarding the debt payments which consumed half of the budget. Perhaps, had the Barings house enjoyed a normal situation, the debt negotiation could have been similar to the one Campos Sales was to agree with

the Rothschilds. Unfortunately, there were no serious negotiations, and the Portuguese government unilaterally imposed a settlement which the creditors did not accept. Oliveira Martins may have thought that he was raising taxes, but the creditors certainly considered his actions a default (Costa et al, 2011, pages 358-361). The minister raised the withholding tax on the domestic debt from 3% to 30%. As no other type of income was taxed at this level, this measure could be understood as a partial default. The domestic bonds, since 1852, were consols or perpetual debt without amortizations so that an increase on the tax on the interest reduced the yield by the same percentage.

Treatment of the foreign creditors was even worse. Of the three per cent interest due on the successive international issues since the re-negotiation of 1852, only one per cent would be paid in gold. The other two per cent would be paid in Portuguese currency subject to the 30% tax. Amortizations of principal, on those external loans that had amortizations, were also cancelled (Mata, 1987, page 26). Of the two per cent paid in Portugal, 30% would be taxed. Of the remaining 1.4% after taxes, at the very least, the creditor would sustain a major exchange loss plus associated expenses. It is not clear how negotiable the paper received from the government would be. In practice, the creditor could at the end of the day receive only one third of that which was due on interest and no principal in the foreseeable future. At any period, this act of the Portuguese government comes very close to a unilateral repudiation and must have caused the worst possible impression on the international financial community.

Portugal's balance of payments had caused creditors to worry already in the 1880s. By 1891, the figures had become untenable: exports L 4.4 million, imports L 8.2 million, immigrant

remittances L 2.0 million, and external debt payments L 2.6 million.⁹ External debt payments to exports, the debt service ratio, exceeded 50%, by itself a sign of disaster. Remember, we noted above Brazil's debt service ratio at this time of 11%. Even if we add remittances to exports in the denominator, which is generally not done, the debt service ratio would still be over 40%. Portugal's internal and external debt payments consumed half of the budget compared to Brazil's one quarter to one third. While the numbers show that Portugal could only meet its external obligations by new borrowing, the unilateral repudiation could probably have been avoided.

Oliveira Martins moved in the highest intellectual and social circles including the court. The government in which he participated represented an opportunity for reform at a moment when part of the elite recognized the need for change following national humiliation at the hands of England as well as national bankruptcy. King Carlos, who had spent a good deal of time with Oliveira Martins, gave his full and considerable support. The minister, for his part, wished to enhance the already great powers of the monarchy reversing the example of Victorian Britain where the queen increasingly reigned but did not rule. Oliveira Martins, the king, and many intellectuals such as Eça de Queirós recognized the need to curb corruption while reforming public finances. To his credit, Oliveira Martins attempted to raise taxes and reduce expenses to eliminate the chronic and deteriorating fiscal deficit that accompanied the balance of payments deficit. In various respects, his possibilities for action were limited by the unwillingness of most politicians to change a system that benefitted themselves. The consensus among politicians that prevailed until the death of Fontes in 1887 had, by 1891, broken down resulting in a degree

of paralysis. Regarding the debt itself, Fontes cast the giant shadow: his renegotiation during the 1850s served as Oliveira Martins' example as it included precisely a decrease in interest. But the context was different. While Fontes proved able to negotiate with Barings in 1854, Oliveira Martins could not do so as the bank had its own problems. The anti-English atmosphere of the ultimatum also made an understanding more difficult as the minister had to be seen as standing up to John Bull. As compared to the Brazilian deal obtained from the Rothschilds, which of course was seven years in the future, the Portuguese decision gave the creditors some immediate cash while Brazil provided none. But the negotiated solution pleased the creditors infinitely more. Oliveira Martins would have been far better off paying nothing but negotiating longer than by his unilateral action.

It should be no surprise that it took Portugal ten years to come to an agreement with its creditors. It should also be no surprise that Portugal only received one small loan in England during the period of dispute, in 1896, and only one other small facility after the renegotiation, in 1912 (Mata, 1987, page 26). The loan of 1896 was guaranteed by the tax on tobacco, already alienated to a private syndicate under exceptionally favorable terms, an unusual arrangement for the late nineteenth century (Mata, 2010, page 18). By June of 1892, Portugal came to be considered a deadbeat. From the time Portugal abandoned the gold standard, Cecil Rhodes pressured both the British government and his bankers, the Rothschilds, to purchase what he called Delagoa Bay: Lourenço Marques. The Rothschilds declined to help and told him that the Portuguese did not want to sell the port, and no one would force them to do so. (Ferguson, 1998, page 887). In 1893, the Portuguese did not have the same luck with the Germans who seized

a disputed area in the north of Mozambique.

In 1892, Portugal increased the level of its industrial tariffs to raise revenues as well as to become more self-sufficient. This time the legislators paid particular attention to the colonies giving continental Portuguese industries a privileged position in these markets. Gradually Africa began to become an economic asset and generate revenues for the Portuguese economy.

In two steps, 1889 and 1899, Portugal imposed high duties on wheat to protect domestic producers. As a consequence of the "Law of Hunger", the cost of living of urban workers jumped enhancing their inclination to strike and to join opposition groups such as the Republicans and the Socialists. Portugal was in good company as Bismarck had adopted the same policy of protecting grain for Germany. Agricultural protection has always been even more controversial than industrial protection. Taxes on wheat reduced the volume of imports leading to lower tax collection.

Oliveira Martins' tenure as minister lasted only a few months, but his various successors over the next decade failed to reach an agreement with the creditors due to Portugal's continued balance of payments deficit, the cautious state of the international capital markets, and the political paralysis mentioned above. Throughout the 1890s, as a consequence of Portugal's impasse with its external creditors, interested parties in both England and Germany imagined they would be able to purchase all or part of the Portuguese Empire. If we use the exchange rate as an indicator, the Portuguese situation deteriorated further after the departure of Oliveira Martins; the worst years for Portugal were also the worst years for Brazil, 1897 to 1900. After the latter year, as the Brazilian exchange revived, so did the Portuguese, approaching par

by 1905, the year before Brazil went on the gold standard (Mata, 1987, pages 52-53). During the nadir of the crisis, in 1898, the Germans and the British signed a secret treaty with one another that offered to lend money to Portugal on the guarantee of the African colonies and Timor and by which the two powers agreed which portions of the empire they would receive should Portugal default. In the minds of the negotiators were France's annexation of Tunisia in 1881 for failure to honor its debts as well as the more dramatic Anglo-French occupation of Egypt the following year for the same reason.

In spite of this secret convention, the British authorities, once assured of the use of Lourenço Marques, proved more interested in limiting German expansion than acquiring Portuguese territory. Thus, with covert British assistance, Portugal arranged a bridge loan in France that year avoiding borrowing in either Germany or England and consequently pledging its colonies (Costa, 1998, 88). A year later, as the Boer War loomed, Portugal's bargaining position improved. It reached an agreement with England confirming the use not only of Lourenço Marques but also of other ports in Mozambique by the British military and restored the "oldest alliance". The German emperor's pro-Boer stance, as well as his insistence on building his navy, separated him from England which found it worthwhile to defend Portugal from further German expansion.

With the recovery of the exchange, Portugal thought it expedient to sit down with the creditors. In 1902, the cabinet agreed to increase payments by about one third and won the grudging consent of the primarily British and French lenders (Mata, 1987, page 26). In fact, that year, the Portuguese government negotiated first in Paris with French, Belgian, and Dutch investors, and after the conclusion of this

agreement, the government finally renegotiated with the British creditors led by the recovered Barings. In both cases, the Portuguese pledged their continental customs receipts, as did the Brazilians in 1898. Of great significance, the Portuguese did not have to pledge the receipts of their African colonies or their Atlantic islands. Germany, and to a lesser degree, France, still entertained the hope of acquiring part of the Portuguese empire (Costa, page 122).

We have noted that Brazil's external situation improved dramatically in the years following 1898 mirrored by events in the United States. While America almost departed the gold standard in 1893 and 1895 and nearly elected William Jennings Bryan president in 1896 on a platform of abandoning the gold standard, by 1902, this now booming country had created an overseas empire by defeating Spain in 1898 and had become a creditor to Britain by helping to finance the Boer War. Whereas these countries, and many others, experienced prosperity from 1898 to 1914, Portugal missed this opportunity. In 1902, emigrants' remittances provided room to breathe, but the accompanying growth of exports never took place, aside from a modest expansion of sales to the African colonies. The traditional political parties had not taken advantage of the economic improvement to attempt any significant reforms and refused to share power with a developing lower middle class. After 1902, a reform-minded king became increasingly authoritarian in his frustration with the politicians. A serious republican opposition also appeared at this time to capture the obvious dissatisfaction of elements of the lower middle and the upper middle sectors (Valente, 1976). As late as 1902, neither royal dictatorship nor republican success were foregone conclusions.

Epilogue: Brazil, 1901-1914

The Rodrigues Alves government left

its mark on Brazil's capital as it disposed of the resources to build many impressive official edifices as well as the new main avenue. In 1905, Rodrigues Alves completed the liquidation of the Banco da Republica, which had in fact functioned all of time since Murtinho took it over during the crisis of 1900. Capital in this institution, re-named the Banco do Brasil, was divided among the old shareholders, the state, which received a participation in return for its uncollectible loans, and new shareholders, who contributed cash. Since 1905, the Banco do Brasil has functioned as the state's official commercial bank and fiscal agent. Industry grew, even without protectionist governments, to the point where Brazil had become self-sufficient in several light industries, especially in the textile sector. The milreis rose further, reaching 16d by the end of the Rodrigues Alves administration. Now the coffee planters began to see too much of a good thing. Their exports brought them ever less local currency, and the thought of a milreis at 27d proved entirely distasteful to them. To prevent the milreis from further appreciation, Brazil's leaders resolved to go on the full gold standard. There took place a long discussion on what would be the best rate which President-elect Afonso Pena settled by choosing 15d. In 1906, Brazil went on the gold standard at this parity from which it increased to 16d a few years later. Brazil remained on the gold standard until the First World War (and briefly returned from 1926 to 1930).

By 1906, with a new super-crop of coffee, Brazil threatened to supply more of the beverage than the world could consume. Rather than allow the price to fall, President-elect Pena and the governors of the coffee producing states took advantage of Brazil's strong credit to obtain foreign funding to take the excess off the market. Rothschilds declined

to lend for this purpose, ending their tenure as Brazil's banker. American banks stepped in with glee and provided the funds. The valorization scheme worked in the short run but failed over the longer term. The manipulation provided an incentive for Colombia and other competitors to increase their production. What the valorization demonstrated was that Brazil's elite, rather than depending upon England or any other power, knew how to manipulate the financial system for their perceived benefit.

Epilogue: Portugal, 1902-1914

For much of the world, the years 1902 through 1914 witnessed impressive economic growth lubricated by gold flowing from Alaska and British-controlled South Africa. As Brazil participated in this boom, immigrant remittances to Portugal attained new highs. Thanks to Portugal's collaboration during the Boer War, as well as England's preoccupation with an expansionist Germany, England visibly supported its oldest ally with a state trip by King Edward VII to Lisbon in 1904. Thus, two of the factors which had provoked the crisis in 1890 had been resolved while two remained. By 1902, remittances contributed positively to the balance of payments even if some contemporaries saw the emigration of able bodied males as an obstacle to growth. And although the Ultimatum of 1890 left scars, King Edward's trip went a good way to restoring King Carlos' prestige while the Royal Navy came to be seen more as a guarantee than as a threat to the Portuguese Empire. The other two factors, the need to recover international markets for Portuguese goods and the lack of tax revenue to service the public debt, continued. The successive Portuguese governments' failure to increase the efficiency of tax collection, improve the treatment of creditors, and resolve the country's unfavorable trade balance contributed to Portugal's inability to take advantage of the

global conjuncture.

Politics dominated events in Portugal during this period of mediocre growth. The consensus among the leading political parties to rotate in power appears to have broken down during the crisis and could not be restored during the first decade of the century. Facing increased criticism of the monarchy due the government's inability to provide either economic growth or political reform, King Carlos assumed a progressively more authoritarian position, declaring a dictatorship in 1907. Early the next year, he and the crown prince were assassinated. In a further two years, the monarchy was overthrown. The new republic did not really consolidate itself by the time that World War I started, as it faced the same social, political, and economic difficulties that the monarchy did, often employing many of the same personnel.

Portugal's disappointing performance from 1890 onwards cannot be blamed on dependence. The Portuguese made at least one disastrous and avoidable decision, the one regarding payment of the external and the internal debt. Other policies and practices such as meager investment in education or poor use of the colonies may also have contributed to an unsatisfactory experience. The breakdown of the political process, which no doubt had a major impact on economic growth, came from internal factors not unique to Portugal. In his classic, *The Strange Death of Liberal England*, George Dangerfield shows how even England appeared to be tearing itself to pieces in the years before the first war between the unions, the suffragettes, and the Irish.¹⁰ Portugal appeared unable to find a political consensus, either under the monarchy or under the republic, to include the new groups, especially the urban lower middle classes and the factory workers, that were thrown up by the success of the *Regeneração*.

Final Remarks

To the extent that the elites of Portugal and Brazil did not do everything they wanted, their limitations arose from domestic causes: divisions within the elites or opposition from rising groups outside the elite. Foreign interference had little impact.

Here we have examined Portuguese and Brazilian policies regarding trade, currency, and public debt to demonstrate the limited British influence in these key areas. Only on two instances, using armed force, did Britain make its presence felt: in the 1840s, the Royal Navy invaded Brazilian waters to seize slave ships, and in the 1890s, the same Royal Navy assured English control of Rhodesia while protecting Mozambique from German ambitions. These exceptional actions proved the rule.

Notes

1. Brazilian "Anais da Câmara de Deputados", August 30, 1848.
2. Schulz, 2013, pages 139-143. Generally, where there are various paragraphs without references, this is because I am based on my publications cited here.
3. Lains, 1995, page 36, notes that the Portuguese economy was among the most closed in Europe creating an obstacle to growth that tariffs exacerbated.
4. Figueiredo, 1889, page 75.
5. Rio News, July 1, 1889.
6. Rio News, August 18, 1890.
7. Rio News, October 20, 1890

8. Rio News, June 30, 1890.

9. Mata, 1987, pages 30 to 33 for all figures except for immigrants' remittances which is my estimate.

10. See also Powell, 1996. Rio News, June 30, 1890.

Mata, 1987, pages 30 to 33 for all figures except for immigrants' remittances which is my estimate.

10. See also Powell, 1996.

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