

# How the East was Lost: Institutions and Culture in 16<sup>th</sup> Century Portuguese Empire

Bernardo Mueller  
Dept. of Economics  
Universidade de Brasilia

João Gabriel Ayello  
Dept. of Economics  
Universidade de Brasilia

“... we can learn as much from the dead-end path pursued by Spain and Portugal, with respect to institutional evolution, as we can from the successful paths to evolving more efficient institutions pursued by the Netherlands and England.”

(Douglass North, 1990, p. 36)

## 1. Introduction

During the 15<sup>th</sup> century the towns of the Levant were the meeting ground of European and Asian market institutions. Steensgaard (1974, p. 42) describes these as “peddling markets, i.e. predominantly characterized by many entrepreneurs and the numerous purchases and sales in small lots.” The caravans that ferried high-value goods such as pepper, cloves, cinnamon, musk, silk, and others, from the different production areas to the Levant, were small and independent groups that nevertheless used fairly sophisticated commercial instruments, such as bills of exchange. Although this was a competitive market it was characterized by non-transparency and high volatility. One might expect that due to the great distances between Asian sources and European markets, transport costs would be the major determinant of final prices. But because the caravans had to pass through numerous areas controlled by local sovereigns, princes, sultans and other authorities that charged duties, taxes, tolls, rights of transit, and plain robbery, protection costs were actually the major expense in the caravans’ business (Steensgaard, 1974). The uncertainty and risk that resulted from these protection costs made the market for Asian goods in the Levant towns erratic and unpredictable.

When the Portuguese managed to find the sea route to Asia in 1498 they were in a position to outcompete and severely disrupt, if not completely eliminate, the caravans’ trade.

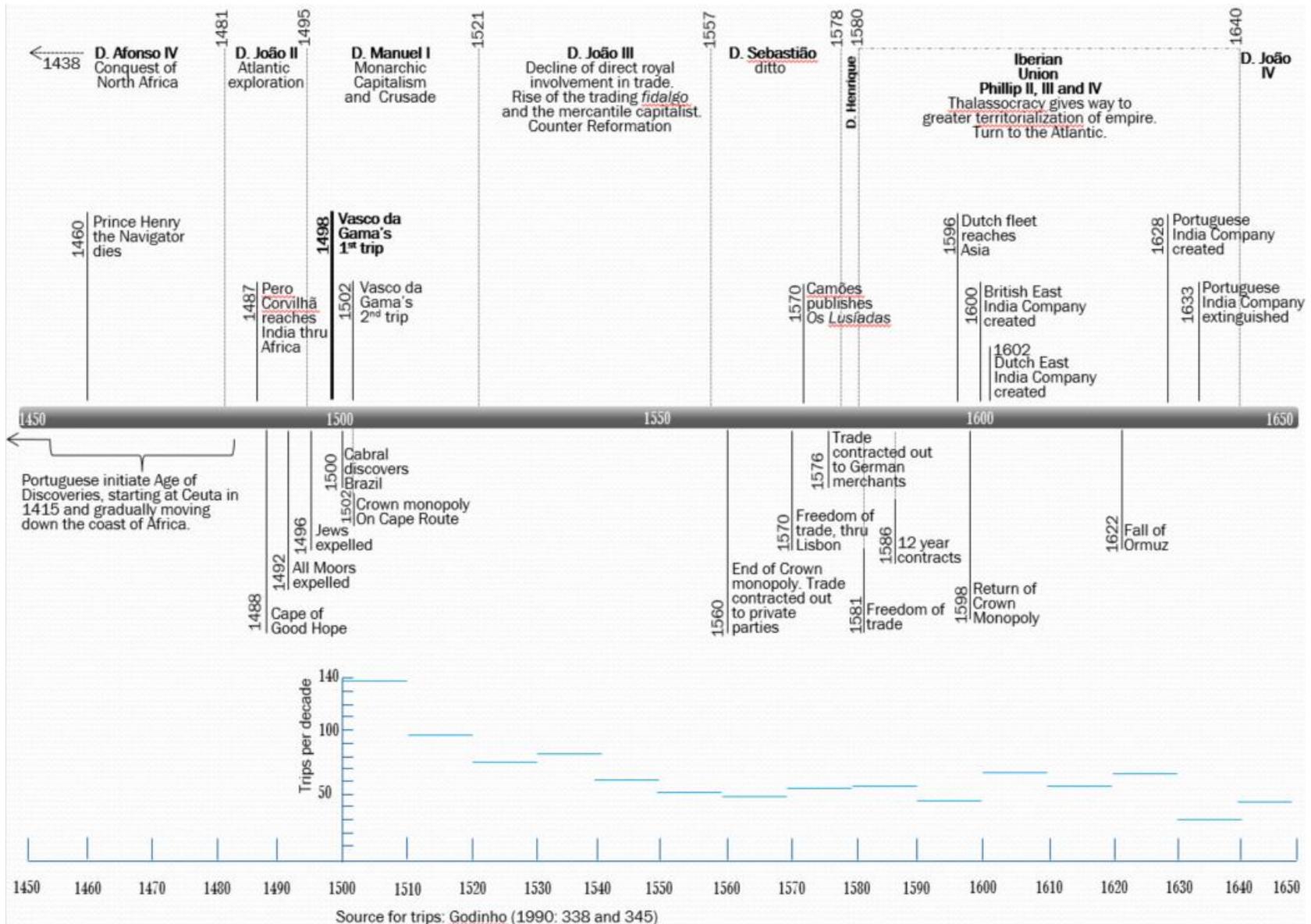
This was not because of the nature of transport costs, which surprisingly were not much different when the goods were taken to Europe by ship (Steensgaard, 1974). It was instead in the internalization of the protection costs that lay the great advantage that could have allowed the Portuguese to dominate the trade in Asian goods. The sea-borne empire and network of *feitorias* (trading posts) which they quickly established with the use of their superior naval power, would have allowed the Portuguese to largely circumvent the multitude of tolls, tax-gatherers, robbers and thieves. This safe conduct would, in principle, make it possible for them to undercut the prices charged by Venetian and other intermediaries in Europe, making Lisbon the major distribution center for spices, silk and other Asian products.

But this did not happen. The Portuguese opted not to divert the trade to their own ships, but rather to allow the flux of goods to continue as before through the caravans, and instead to take over much of the protection racket, especially that which passed along the Indian Ocean and Arabian Sea. By strategically controlling straits, ports and islands they diverted local sea-borne trade to the areas they controlled, charging *cartazes* (safe conducts) from all non-Portuguese ships, as well as customs, duties and much pillaging. As a result, though they remained the only European power in the region for nearly a century, they “did not introduce a single new element into the commerce of southern Asia” (van Leur, 1955, p. 118). True discontinuity and the ‘rise of capitalism’ was not introduced by the *Estado da India* – the Portuguese empire in Asia – but by the Dutch and English Companies much later in the 17<sup>th</sup> century.

Not until the arrival of [the joint-stock companies] does an institutional innovation take place [in the early global economy]. Simplifying greatly, one might say that here the relationship between ‘profit’ and ‘power’ is reversed. *Estado da India* was a re-distributive enterprise which traded in order [to obtain for itself] the full benefit of its use of violence, whereas the Companies were associations of merchants which themselves used violence and thereby internalized the protection costs. (Steensgaard, 1973, p. 114, cited in Wilson (2008, p. 182))

Figure 1 provides a timeline from 1450 to 1650 that chronologically places the main events related to the rise and fall of the Portuguese Asian Empire. The figure shows the duration of each king’s reign, the main landmarks, and the number of trips from Lisbon to Asia per decade. Note that the Portuguese had exclusivity of the sea route until 1596 when the Dutch finally managed the passage around the Cape of Good Hope, followed by the British in 1600. Yet, even before then the Portuguese Crown struggled to control its own agents in Asia and was systematically dismayed at the whole enterprise’s underperformance (as we describe below).

Figure 1. Timeline of the rise and fall of the Portuguese Empire in Asia



A large literature has tried to explain why the Portuguese choose to use their significant technological and territorial head-start over the other European nations in such a way that in retrospect proved to be so disastrous (Boxer, 1961, 1969; Disney, 2009; Pearson, 1988; Steensgaard, 1973, 1974; Subrahmanyam, 1990; Tracy, 1991; Wake, 1979). The choice of violence over commerce yielded quick short-term gains in the first few decades of the 16<sup>th</sup> century, but already by 1650, almost half a century before the Companies arrived, the whole enterprise had initiated a process of decadence that the Portuguese Crown was never able to revert. Even when the *Estado da India* showed a profit, “there is nothing to indicate that such a profit should ever have been transferred from *Estado*, to the parent state” (Steensgaard, 1974, p. 86). The Companies’ subsequent success by focusing on commerce over violence suggests that a switch in strategy by the Portuguese would have been, in principle, a possibility. Yet, even the attempt of creating a Portuguese East India Company in 1628 was short-lived and ineffective, and the Portuguese not only never regained their hegemony, but remained very marginal players in the trade in Asian goods thereafter.

Subrahmanyam (1993, p. 271) argued in 1993 that “... the key interpretation that dominates studies on the Portuguese in early modern Asia is still a Weberian one,” that views Portugal closer to Asia in terms of its institutions and mentalities than to northern Protestant Europe. In this view the triumph of the ‘modern’ over the ‘medieval’ is explained not by circumstances and endowments but rather by culture and mentality.<sup>1</sup> In his book “The Wealth and Poverty of Nations: Why some are so rich and some so poor,” neo-Weberian historian David Landes includes a short chapter on the Portuguese empire that associates its ultimate fall with a mismatch between Portuguese culture and the exigencies of emerging capitalism:

[The Portuguese should] have continued on this sensible path, minding their own business and trading their natural produce for the manufactures of other lands. Instead, they jumped the traces of rationality and turned their land into a platform for empire. ...The Portuguese expansion is particularly surprising, for Portugal had neither people nor means. Its population was too small to send large numbers abroad. Its material resource, specifically its ability to build and arm oceangoing vessels, were limited. ...Their one emotional outlay was piety. The Portuguese took priests with them on every vessel, for their own safety and salvation. ... These men of God legitimated and sanctified greed. ...Religious commitment

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<sup>1</sup> Other pieces along these lines are Jones (1981) and Hall (1985).

entailed a serious commercial disadvantage: it introduced an element of irreconcilability into what might have been an easier, more profitable encounter. (Landes, 1998, p. 125)

An alternative view, however, emphasizes the role of institutions over culture, geography or other determinants of economic growth and development, as proposed initially by North and Thomas (1973) and developed further in North (1990). There are not many recent detailed analyzes of the Portuguese empire in Asia, but Acemoglu, Johnson, and Robinson (2005) address the question of why the Portuguese and Spanish failed where the English and Dutch succeeded. They hypothesize that the colonial and expansionist experiences of European countries had differential impacts on countries with different endowments and inherited Medieval political institutions. Western Europe, which had direct access to the Atlantic, was better place to take advantage of the opportunities that were opening up than did Eastern Europe and Mediterranean traders. But access to trade was not sufficient for these opportunities to translate into sustained growth. These authors suggest that only those countries that had inherited relatively non-absolutist initial institutions, in particular Britain and the Netherlands truly benefited from these opportunities. Countries such as Portugal, with highly absolutist monarchies, failed to make the most out of their access to the colonial trade. The proposed mechanism through which institutions affected growth is not a direct link between the gains from international trade and economic development. They claim that this direct effect was marginal. Instead, the main impact was through the empowerment of a merchant class that would then be in a position to demand further political institutions that constrained the power of the monarchy, thus laying the foundation for long-term growth and innovation (North & Weingast, 1989). Where the king had the power to control the nation's international trade effort and appropriate most of the gains, no social transformation took place that would promote institutions placing limits on the state and securing property rights, thus failing to produce an institutional environment where investment and innovation would be fostered. Figure 2 reproduces a graph from Acemoglu et al. (2005) which supports this hypothesis using urbanization as a proxy for GDP. The Atlantic traders are initially below the other Western European nations, but once international trade became possible *circa* 1500, they start growing comparatively faster. They then provide econometric evidence that among the Atlantic traders it is those where initial political institutions are more non-absolutist that grow disproportionately in the long term.

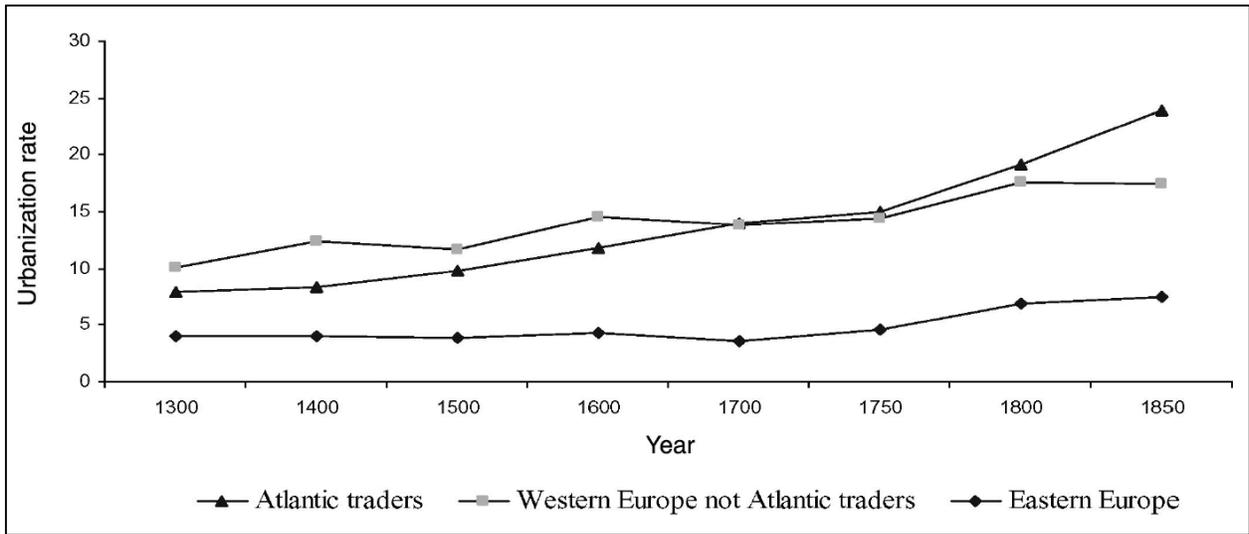
A different but related paper by the same authors (Acemoglu, Johnson, & Robinson, 2002) documents the phenomenon of a reversal of fortune among the countries colonized by European powers since 1500. They document that, as a rule, those colonies that were relatively wealthier in the early periods became relatively poorer today. Figure 3 replicates a graph they present to illustrate this reversal using population density in 1500 as a proxy of past GDP.<sup>2</sup> Here once again the authors' explanation is based on the role of institutions (and is very similar to the main thesis in (Sokoloff & Engerman, 2000)). Where the colonizers encountered more prosperous and populous societies, the existence of precious metals, or environments that comported tropical commodities such as sugar, they opted, independent of colonial origin, for labor coercion, slavery, wealth and land concentration and other extractive policies. These early institutions determined subsequent policies (educational, immigration, land distribution, franchise, etc.) thus creating a path dependence that locked in extractive institutions. These institutions, in turn, generated societies that were not conducive to investment and innovation that are the basis of long term growth, which was especially felt when new technologies and forms of organization arose in the industrial revolution. In contrast, the less prosperous colonies in the early period did not present opportunities for labor coercion, slavery or plantations, and there the disappointed colonizers replicated the more inclusive (or less extractive) institutions from home. Here too the initial institutions persisted over time and centuries later allowed the countries that emerged from those colonies to take advantage of the opportunity to industrialize and prosper.

The history of international trade in the 16<sup>th</sup> century can also be interpreted as the stage of a reversal of fortune. The Portuguese were well ahead of the Dutch, English and other European countries in terms of navigation, expansion and global trade. A 100-year head start in Asian trade should have given the Portuguese a massive advantage in the eventual competition with the other European nations, and yet they were almost immediately displaced once the Dutch and English arrived, and became secondary players thereafter (despite their Atlantic turn towards Brazil). These events afford a test of whether this reversal of fortune can be primarily ascribed to institutions as in Acemoglu et al. (2002) or to culture as per the traditional literature.

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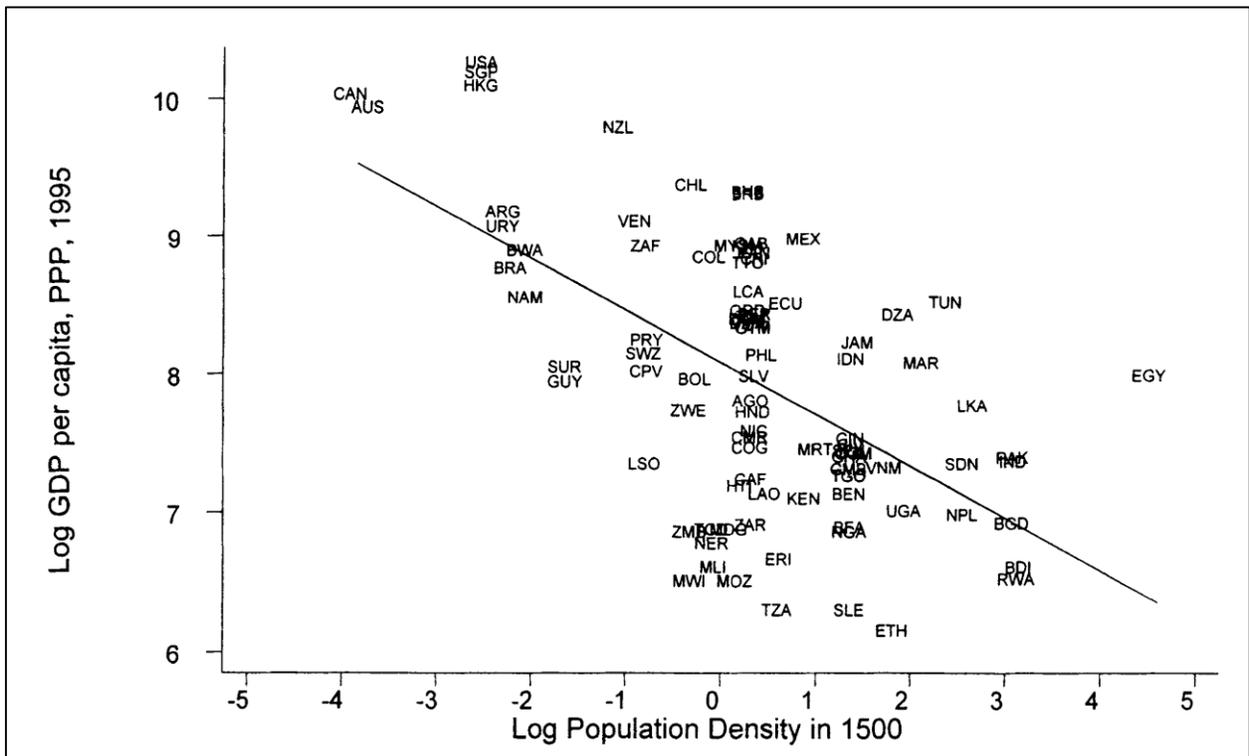
<sup>2</sup> A similar reversal obtains when urbanization in 1500 is used instead of population density.

Figure 2 – “The Rise of Europe”.



Source: (Acemoglu et al., 2005, p. 548). Urbanization data from (Bairoch, 1988). Urbanization rates weighted by population. Population data from (McEvedy & Jones, 1978).

Figure 3 – “The Reversal of Fortune”.



Source: (Acemoglu et al., 2002, p. 1234). Log GDP per capita PPP against Log Population in 1500. GDP per capita from (World Bank, 1999); log population density in 1500 from (McEvedy & Jones, 1978).

The discussion in Acemoglu et al. (2005) supporting their econometric evidence for the institutional hypothesis is highly focused on the ‘successful’ cases, to the detriment of those where growth-enhancing institutions did not materialize. They dedicate 1,901 words to the British case, 1,375 to the Dutch, and only 474 words to Portugal, Spain and France combined. We have found this to be true of much of the economic history literature, despite Douglas North’s epigraph in this paper. By revisiting the 16<sup>th</sup> Portuguese case in greater detail we contribute in this paper with a more fine-grained analysis of the determinant of long-term growth and prosperity. The next section structures this analysis by posing and answering five key questions that span the rise and fall of the Portuguese involvement in European-Asian trade in the 16<sup>th</sup> and early 17<sup>th</sup> century. We address each of the five questions by considering whether it can be better accounted for by the institutional hypothesis or the traditional cultural view that has dominated the historical literature on early modern Portugal. We then complement this analysis with an econometric exercise that tries to measure the separate impacts of institutions and culture on different countries’ global trade success by using as a measure of the relevant political institutions an index created by Acemoglu et al. (2005) that captures the level of constraints on the executive.

## **2. The Rise and Fall of the Portuguese Empire in Asia**

### *2.1. Choices, caravans, caravels and companies*

We structure the discussion of the role of culture and institutions in the rise and fall of the Portuguese empire of the 16<sup>th</sup> century around the following five questions.

- 1) Why did the Portuguese succeed in finding the sea route to Asia nearly 100 years before any other European nation managed to do the same?
- 2) Why did the Portuguese choose to exploit this privileged position through violence instead of commerce?
- 3) What were the causes of the downfall of the *Estado da India*?
- 4) What’s behind the success of the English and Dutch companies?
- 5) Why didn’t the Portuguese change their approach to revert their fall, perhaps emulating the Dutch and English formats?

### *2.2. Why the Portuguese?*

How did a small and underpopulated kingdom (see Landes’ quote above) move so far ahead of its competitors in global trade and expansion in the 15<sup>th</sup> and 16<sup>th</sup> century? Angus

Maddison suggests three advantages of the Portuguese that help us to understand this prominence (Maddison, 2006, p. 59). The first is the strategic benefit of being located at the exit of the Mediterranean. Econometric evidence by Acemoglu et al. (2005), referred to above, has shown that this is in fact an important consideration, though not exclusive to the Portuguese. The second is the Crown's sponsorship of Atlantic exploration through "research on navigation technology, training of pilots, and documentation of maritime experience in the form of route maps with compass bearings (rutters) and cartography" (Maddison, 2006, p. 59). Rei (2011) shows that the Portuguese kingdom of the 15<sup>th</sup> century was uniquely placed financially to sponsor these developments and the subsequent exploration, first in northern Africa, then south along the African coast and eventually in Asia. She argues that because the early expansion of 1415 - 1498 yielded high rates of return, the crown was able to organize the subsequent phase as its own monopoly. This contrasts with the organization of the British East India Company and the Dutch VOC, both founded as their nations finally gained sea access to Asian trade *circa* 1600. Rei (2011) argues that both of these nations' maritime enterprises were private as opposed to royal endeavors not because of culture or ideology, but because both crowns found themselves under financial stress at the time due to previous wars and other circumstances. The direct involvement of the Portuguese crown is best illustrated by Prince Henry's (the Navigator) leadership, obtaining financing, setting up the center for explorers at Sagres, and in promoting expeditions and exploration. The third advantage was Portugal's history as a crossroads for different peoples and ideas, thus bring together "Catalan sea captains, Jewish cartographers, Arab astronomers, and Portuguese knights as well" (Karsten, 2012, p. 57).

Prince Henry encouraged his mariners to draw on the most advanced mathematical thinking and map-making of the time. The son of Jewish map-maker Abraham Crespes found sanctuary in Portugal when he was driven out of Aragon. Iberian Jewish astronomers and mathematicians were conversant with the achievements of Muslim scientists, and extended the application of trigonometry to navigation. ... While trigonometry and the astrolabe had been used to establish the direction of Mecca by Muslim savants, and celestial calculations used by Jewish savants to confirm the date of the Passover, the Portuguese princes encouraged the application of these techniques to celestial navigation and map-making. (Blackburn, 2010, p. 100)

Ominously, the crowing feat of finding the sea route to Asia that this *mélange* of cultures and ideas had made possible occurred just a few years after the 1496 decreed expulsion of Jews

and Muslim from Portugal. Though many converted, continued inquisitions and prosecution led to extended suffering and oppression over time. It is somewhat contradictory that the motivation for acquiring the new technology and knowledge derived both from the desire for crusades and for commerce in North Africa. We will see next that this fundamental contradiction between aristocrat and merchant, or between violence and commerce, extends to the way the Portuguese choose to set up *Estado da India*, their enterprise in Asia.

### 2.3. Why Violence over Commerce?

According to the journal of Álvaro Duarte, the main historical source from the first trip by Vasco da Gama to Asia in 1498, the Portuguese were received in Calicute (southern India) with the question, (to their surprise in Castilian): “What the devil brought you here?” To which they answered: “We have come for Christians and spices.”

This reply highlights the two motivations which were at the root of the Portuguese aspirations for conquering the route to Asia. The first was a straightforward extension of the religious war against the Moors, which had been a central part of Portuguese culture, in which the nobility played the central role, personally leading the wars and crusades. Dom Manuel I (1495-1521, see figure 1) was particularly pious and zealous of this objective. One of his goals was to find the legendary Christian kingdom of Prester John in Asia, with whom they would join forces to defeat the Muslim heretics. The second motivation was to establish a blockade of the movement of spices and other Asian goods through the Red Sea, thus diverting that commerce to Portuguese caravels to make Lisbon the new European *entrepôt* for these goods.

These two objectives were not necessarily contradictory. A pioneering scout sent to Asia by the regular trade routes some years before Gama’s first trip had already informed the Portuguese of the possibility of sailing in the Indian Ocean and had identified Calicute as a Christian land where spices abounded. The idea was thus to ally with the locals in commerce and in the fight against the Moors. Vasco da Gama had taken with him a letter to the Zamorim (monarch) of Calicute, highlighting the absolute value of the Christian faith and the intention of proceeding with the evangelization of the local people. In addition, the Portuguese expressed the interest in establishing a permanent factory to purchase and trade the local produce. As it turned out, Calicute was not Christian but Hindu, and the local economy depended crucially on Muslim traders and on a large fraction of the population which was Muslim. Because of this, Godinho (1965, pp. Vol. II, pg 170) interprets that the fallout that quickly took place between the

Zamorim and Vasco da Gama after the first veneer of cordiality dissipated, as the inevitable outcome of the arrival of the Portuguese in Asia. The Portuguese represented not only a religious threat to the Muslim merchants but ruinous competition in the spice trade. Due to boycotting and lobbying by the Muslim in cahoots with local merchants, the Portuguese failed to establish a factory and left behind mutual suspicion and animosity.

Despite the disappointment in Calicute, the balance of the first voyage along the Cape was highly encouraging as the fleet returned to Lisbon in 1499. Only samples of Asian goods had been brought back, but with the information that the first trip had uncovered, they foretold of extraordinary possibilities for subsequent expeditions. In 1500 Pedro Alvares Cabral set off for the second trip to Asia with a much larger and better-armed fleet, this time taking a large assortment of goods to trade. On the way they (supposedly) accidentally discovered Brazil, but quickly set off once again to where the promise of riches was much higher. The history of this trip confirmed the resistance of local traders to the Portuguese intrusion, although the imposing fleet diffused much resistance along the way. Once again the Portuguese were cordially received by the Zamorim in Calicute and were allowed to establish a factory. But nothing had really changed in the political economy of this kingdom and very soon the factory was attacked with many Portuguese killed. Cabral avenged these aggressions by looting and burning many Muslim vessels and by bombarding the city. Subsequently he set up relations and factories in two minor kingdoms, Cananor and Cochim, that were happy to ally themselves with the Portuguese against a common enemy. Vasco da Gama returned in 1502 and using extreme violence and cruelty attacked Calicute and Muslim targets to avenge his and Cabral's earlier upsets (Subrahmanyam, 1997). He also sought to further expand Portuguese commercial interests, strengthening ties to allies and undermining their competitor's trade.

When considering the choice of violence over commerce, it is important to consider the message that these initial trips sent to the Portuguese rulers. Despite all the setbacks Cabral encountered, his venture generated up to fifty times the invested capital and da Gama's subsequent trip profited 15 times what Cabral had made.<sup>3</sup> In 1496, before da Gama's first trip the King's Council had been divided in two groups that stood on different sides regarding whether to push forward with the discoveries towards India. One group of advisors was reticent about the

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<sup>3</sup> Godinho (1965, p. Vol II: 173 and 176)

costs and perils of venturing into the unknown. The other was lured by religion and spices. After the return of Gama in 1501 the first group had become in favor of a strategy of peaceful commerce. They argued that the imposition of military conflict at such a distance from home would be too costly and would be counterproductive for the goal of evangelization. The other group, however, argued that the financial success of the first trips had shown that the profits from the traffic in spices would be enough to pay for the costs of war. In the end this logic was inescapable and the trips continued very much imbued in the combined strategy of force and commerce. In the face of continued resistance, the Portuguese realized that they would have to establish a permanent presence and proceeded in establishing a network of fortresses and local allies. This presence would become the *Estado da India*, which we discuss in the next section. This second phase of establishing empire was led with an iron fist by Alfonso de Albuquerque, who became the second governor of Portuguese India. By this time, it had become clear that it was not realistic to imagine eliminating the Muslim or finding Christian Indians, and the religious motivation was displaced to the background.

How do these early events in the history of the Portuguese Empire in Asia inform the question of why the Portuguese chose violence over commerce? It is tempting to ascribe the violence and aggression in that enterprise to medieval Portuguese culture that viewed commerce as undignified and conquest as the noblest trait of the titled and privileged aristocracy. The contrast with the English and Dutch companies, that take a definitively more mercantile approach once they manage to cross the Cape of Good Hope, suggests that the determining factor behind these choices must be related to Iberian and Catholic versus northern and Protestant origins. Godinho (1965) tries to get at this issue at length in his three volume analysis of the Portuguese discoveries. He examines not only Portuguese history, but also art, architecture, poetry, and many other sources in order to understand the motivating forces throughout this period of Portuguese history. Although he does conclude that the distinctive nature of Portuguese culture was in fact a major determinant of many of the outcomes that we analyze in this paper, his analysis is more nuanced than a simple merchant versus aristocrat dichotomy. Instead he sees the 15<sup>th</sup> and 16<sup>th</sup> centuries as a period of shifting culture (beliefs, values and preferences) as new opportunities opened up by the explorations impose new outlooks. Portuguese expansionism in the 15<sup>th</sup> century was strongly motivated by the notion of crusades and enrichment through war and pillage. This was a highly stratified society where ascension was achieved through birth and

enhanced through arms and violence. The *fidalgos* (aristocrats) and *cavaleiros* (warriors) looked down on commerce, manual labor, and the notion of living within one's means. But the very expansionism that was propelled by this view of the world, opened up opportunities for commerce and trade that required very different values and outlooks. Godinho argues that the Portuguese empire was underscored by an incomplete transition from the old to the new structure of society, generating contradictory values that failed to promote the behavior and choices that were essential for the new capitalist order:

The State mercantilized, but did not organize itself as a commercial enterprise. The aristocrat was tempted by greed, but did not know how to become a merchant, and found his ruin in excessive expenditures. The merchant wanted to become, or saw himself forced to become a warrior (*cavaleiro*), and the hypertrophy of the merchant-State hindered the development of a strong mercantile and industrial bourgeoisie. The need for savings was discovered but it was diverted to real estate, without fomenting investment. (Godinho, 1965, pp. Vol I, pg. 62)

We do not deny the importance of beliefs in the determination of history. But the choice of violence over commerce in the early stages of the Portuguese empire are more likely an imposition of the situation encountered than a consequence of an antiquated worldview. As we discussed above, the Portuguese were rightly seen from the start as interlopers in a long established commerce, and conflict was in many ways inevitable. We prefer to see these events through the framework used by Sokoloff and Engerman (2000) to analyze the development of the New World Economies. In their analysis all colonial powers, irrespective of their origin/culture/religion, sought to make the most profit possible from their overseas discoveries. What made different strategies be adopted, i.e. more inclusive versus more extractive institutions, was not the colonial origin, but instead the colonies' factor endowments, that is, the possibilities for enrichment presented by the specific situation. Where there were precious metals produced by the natives, these were stolen and the natives' labor appropriated. Where it was profitable to import slaves and produce tropical goods, this was done. Where the only option was to settle the land with your own population in family farms, this was the chosen path.

In this view, the Portuguese in the early 16<sup>th</sup> century encountered a set of factor endowments and possibilities that held the potential for great gain, but also a very adversarial environment and bellicose competitors. It is doubtful that the Dutch or the English would have taken a much different strategy had they reached the Indian Ocean at that time. When they did

finally get there by 1600, the set of factor endowments and opportunities was much different than that faced by the Portuguese when they first arrived. The passage of 100 years had generated a very different set of knowledge and relations among all the peoples involved. The whole global commercial network was a very different game and therefore presented very different choices.

Subrahmanyam and Thomaz (1997, p. 300) describe three distinct models of imperial organization used by the Portuguese as they expanded overseas. This characterization suggests that what determined their choice of strategy and method was highly dependent on the specific conditions and situations encountered in each case, as proposed by Sokoloff and Engerman (2000)'s factor endowment theory. Before 1498 the Portuguese style of colonization was violent and bellicose in North Africa, commercial and peaceful trade in Guinea, and land-based production in the Atlantic islands. Similarly, after 1498 and now in Asia, their style of colonization was violent and bellicose in the Western Indian Ocean, commercial and peaceful east of Melaka and dominated by private Portuguese traders in the Bay of Bengal. Whatever the role that culture may have been playing, it seems that the cost and benefits presented by the realities on the ground had a preponderant influence.

Furthermore, the Dutch and British were not simply hardwired to automatically pursue a forward-looking and capitalistic style of action. Despite their ultimate organization as a true trading company, the Dutch VOC nevertheless made prolific use of violence and tactics very similar to those of the Portuguese, suggesting that in a different context violence might have been even more central to their *modus operandi* (Meilink-Roelofs, 1969). Duncan (1975) argues that the distinction between the Portuguese and the Dutch was never as stark as portrayed by authors such as Steensgaard.

Portuguese merchants resident in Amsterdam did business in exactly the same ways as their Dutch partners and competitors, and probably owned stock in the Dutch East India Company. Dutch merchants in Lisbon showed no qualitative advance in commercial method over their Portuguese colleagues, with whom they entered into many partnerships. ... Like the Portuguese, the Dutch sold protection, levied tariffs, and issued safe-conducts (*cartazes*) for Asian shipping. Like the Portuguese, the Dutch were brigands as well as merchants, but the "organized violence" of the Dutch was more destructive, because more thoroughgoing, than that of the Portuguese. Nor did Dutch monopolies always contribute to a rationalization of markets. Their cloves and nutmeg

monopoly in the Moluccas had the deleterious consequences usually associated with monopoly structures, including the ruination of competitors and a reduction in the volume of total commercial transactions. (Duncan, 1975, p. 517)

If use of violence and force by the Portuguese in setting up their empire can be argued to be more an imposition of the facts than a predetermined style of being, the choice of protection over trade cannot be so easily rationalized. Steensgaard (1974) argues that the arrival of the Portuguese did not really change the structure of the market in Asian goods. They simply displaced the previous tax-collectors and bandits taking those roles for themselves, so that until the arrival of the Dutch and English companies around 1600, nothing fundamental had changed with the way these goods were distributed within Asia and to Europe. The move towards capitalism would only be made once these companies entered the market and almost fully displaced the caravan trades to their ships and the sea route back to Europe. In the next subsection we consider why the Portuguese adopted this ultimately fated strategy, and in the subsequent subsection why they did not change once it became clear that protection was not working.

#### *2.4. Why Protection over Commerce? The principal-agent problem.*

*Estado da India*, the Portuguese enterprise in Asia, was composed of a network of fortresses, factories, ships and all the offices, ranks and personnel charged with implementing and managing the Crown's affairs. It was founded in 1505 when the first Viceroy was appointed, and was only extinguished in 1961. Initially it was based Cochim, but was changed to Goa in 1530. Steensgaard (1974, p. 85) (following Godinho) describes *Estado da India* as a "social system in which ambitions are archaic although the situation is dynamic." His influential thesis about the Portuguese empire emphasizes the *Estado da India*'s choice of selling protection instead of trade, making it "one of the purest examples in history of constitutionally determined corruption" (pg. 93) and concludes that "the Portuguese choice was integrated within a complete normative system, a whole culture" (pg. 85). That is, he ascribes the failure of the Portuguese to use their technological innovation to introduce new capitalistic relations into the global trading system in the early modern period to their archaic ambitions, in other words, to culture.

In this subsection we put forth a different interpretation of the rise and fall of the *Estado da India* in the 16<sup>th</sup> century, in which the ambitions of the actors, rather than being assumed archaic, are taken to be the standard ambitions of pursuing one's own self-interest, but where, at

the same time, the choices made in pursuit of those interests were shaped by the incentives and constraints that were to a large extent determined by institutions. The argument is that because of the circumstances in which the *Estado da India* was created, there was a principal-agent problem between the Crown and those agents tasked with representing the Crown in Asia. This problem arose because of the information asymmetry inherent to any colonial enterprise, where the metropole has to be represented across the world by its agents, whose interest do not perfectly align with those of their principals.<sup>4</sup> The standard ‘solution’ of the principal-agent problem is that the agent is able to extract an informational rent proportional to the level of his informational advantage, be it through compensation by the principal to act according to contract, or through direct shirking relative to the behavior where there is no information asymmetry. In the period we are concerned with, the information asymmetry was particularly severe given the primitive state of communication and transport at that time.<sup>5</sup> As we show below, the magnitude of the resulting informational rent received by the participants in *Estado da India* is commensurate to this informational unbalance. We argue that the decadence of *Estado da India* in the 16<sup>th</sup> century is due, not to culture, but to the resulting inefficiencies caused by this form of relationship between the Crown and its representatives.<sup>6</sup>

The starting point to understand the principal-agent problem between the Portuguese Crown and *Estado da India* is to recall that from the start the enterprise was monopolized by the Crown, even if private merchants were allowed to take part at different times. We noted earlier that this form of organization is not due to centralizing tendencies rooted in culture, but due to the fact that the Portuguese Crown happened to have the financial capacity during the late 15<sup>th</sup> century to keep the enterprise largely in its own hands (Rei, 2011). As we have also already noted above, once in Asia it quickly became clear to the Portuguese that they would have to

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<sup>4</sup> For example, de Figueiredo, Rakove, and Weingast (2006, p. 411) describe how the principal-agent problem between the English Crown and the American colonists in the 18<sup>th</sup> century shaped the organization of that enterprise: “Even though the King appointed most colonial executives, he was dependent in important ways on the colonial legislatures. This dependence reflected another economic necessity: given the costliness of rule, such decentralization was the only viable alternative. For the metropole to have assumed more control would simply have been so expensive as to be ineffective.”

<sup>5</sup> Steensgaard (1974, p. 81) notes that for the Portuguese Crown “to rule over a kingdom in which the sun never sets involves not only almost insurmountable problems of communication, but also so widespread interest that any policy followed could only with difficulty avoid being paradoxical.

<sup>6</sup> When the English and Dutch companies made it to Asia, almost 100 years after the Portuguese, they also faced a principal-agent problem. But, as we discuss in subsection 2.6, their novel form of organization mitigated the problems created by the informational asymmetries and thus resulted in less inefficiencies compared to *Estado da India*.

maintain a permanent presence with a widespread network of fortresses, factories, harbors and ships, given the level of economic and political competition which they encountered. As a fleet commander in 1504, and as the second governor from 1509 to 1515 (only the first was called a viceroy), Alfonso Albuquerque played a key role in establishing *Estado da India* as the representative of the Portuguese Crown in Asia. This early effort required the use of force and violence so as to overcome the resistance of those who were being displaced, and Albuquerque was particularly skillful at military affairs. He sought to keep power centralized in his own hands, as the King's representative, restraining the ambitions of individual *fidalgos* (aristocrats) and Crown factors that took part in *Estado da India*. Nevertheless, what we see again and again in almost all studies or accounts of *Estado da India* is the Crown's interest taking second place to the interest of the agents who were supposedly charged with implementing and managing the Crown's affairs.

The early trips had already made it clear to everybody that though taking part in *Estado da India* might be a risky affair, given shipwrecks, combat and disease, it was also a unique opportunity to acquire wealth. Godinho (1965, p. Vol. II pg. 159) tells us that although Vasco da Gama's first trip brought only samples of Asian goods, the sailors and other participants were rewarded with sufficient pepper and spices to "show largesse in presents to all their acquaintances." The captain, in particular, was granted 10 *quintais* of pepper as well as other spices.<sup>7</sup> From the outset the pattern ensued where the private interest of the agents and that of the Crown would be in constant tension. This is particularly true of the fleet captains who often made fortunes through their own trading within the Indian Ocean. The violence and pillaging of the early years was necessary to overcome resistance, gain ground and impose a presence. One can imagine the scope for individual self interest in the confusion and uncertainty of battle.

Godinho (1965, p. Vol III pg. 13) states the Vasco da Gama's second trip in 1502

... inaugurated the grand era of commandeering and looting, that lasted, as we know, for over ten years, until 1512 approximately. There are, unfortunately, no statistics. The amounts, however, must have been considerable, but only a small part went into the State's coffers: it was the private interests that got rich. (*our translation*)

Given the opportunities for enrichment from participating in *Estado da India* there was an excess demand among the Portuguese male population to enlist. In order to deal with this

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<sup>7</sup> One *quintal* in the Portuguese empire was approximately 60 kilograms.

excess demand, the rule emerged that deployment in Asia of participants in *Estado da India* would be strictly for three years. Supposedly this rule was rigidly observed, both for the lower rank of soldiers as for those seeking higher offices and captaincies. It is easy to visualize that when faced with such an end-game, especially in an environment of high information asymmetry, the incentives were to make the most of the limited time in office.

The institutionalization of private interests within the structure of *Estado da India* can be perceived, for example, in the *quintaladas* (individual cargo space) that the members were granted, especially on the return trips. This space was an extremely scarce and valuable asset as the transport of pepper, spices and other Asian goods, back to Europe could signify a sizeable windfall. The *quintaladas* were in addition to salary, and once again they can be interpreted as an additional inducement given by the crown in the early years to incentivize the establishment of Portuguese dominance. In the grappling game to ration the cargo spaces among the different ranks, from captain to the lowest soldier, it often happened that the Crown's own cargo would be the first to cede space (Godinho, 1965, pp. Vol. III, pg. 50). There was even a market for sale or renting of cargo space, supplied by sailors who had not managed to acquire the goods to take home, or by others who could influence the boarding procedure. The Crown tried to discipline the process many times, for example by appointing inspectors (*vedor*) or by increasing the penalties for contraband. In 1510 the system of *quintaladas* was limited to only higher officials and in 1517 they were abolished for good. Nevertheless, contraband and other ways around the rules persisted. In another attempt to regain control the Crown started auctioning off the three-year posts instead of simply granting them. This suggests a recognition that since it could not control or restrain its agents from stealing, it could at least try to capitalize ex-ante on the opportunities represented by a post in *Estado da India*. These events highlight the fact that in principal-agent problems it is not enough to simply decree away the inefficiencies without addressing the essence of the matter, that is, the information asymmetry. In this regard, Steensgaard (1974, p. 95) suggests that "a clean-up of the constitutionally determined corruption would have torn asunder the bonds that held *Estado da India* together."

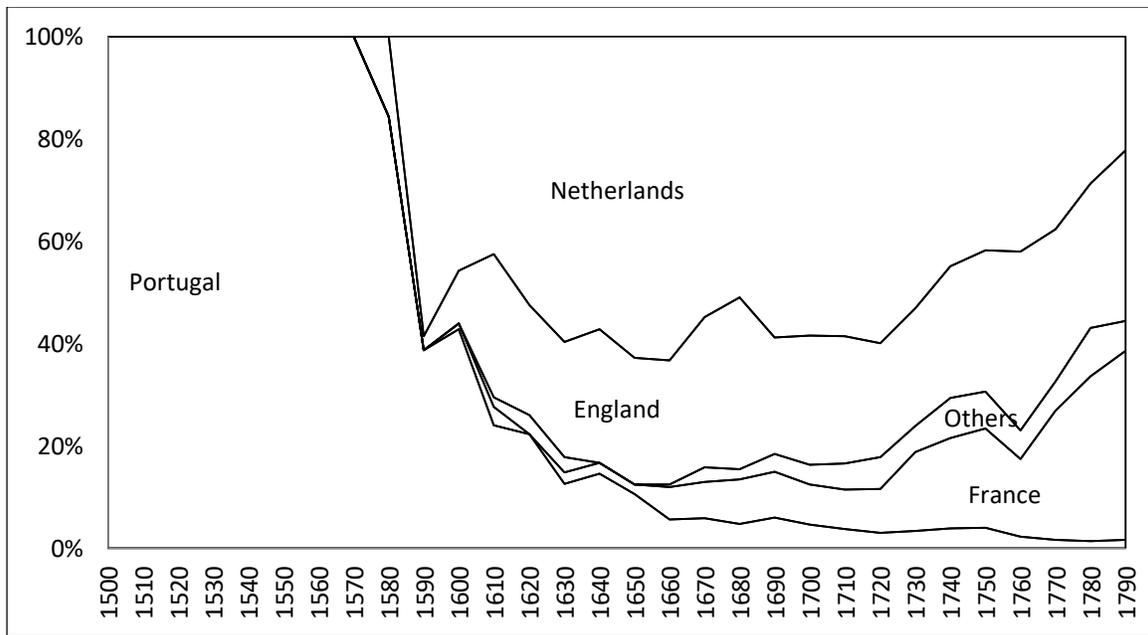
Another example of the shirking of *Estado da India* agents involves the *cartaz* system instituted by the Portuguese in 1502. A *cartaz* was a license to navigate, enforced by the superiority of Portuguese naval technologies. Ships accosted by the Portuguese and found to be without a *cartaz* could have their cargo confiscated and could also be sunk or burned. The intent

of this policy was initially to block the passage of goods through the Red Sea and thus impose a Portuguese monopoly of pepper and other goods in Europe. But the receipts from the sale of the licenses proved to be a more direct and immediate way to make a profit, especially for the officials charged with the blockade. So although the Portuguese effectively had control over navigation in the Indian Ocean and the Red Sea, Asian goods nevertheless continued to flow through to the Levant cities to be sold to Europe. The *Estado da India* had simply assumed the place of the tax-collectors they had displaced. And while the profits from this form of organization belonged by right to the Crown, its agent in the front line were able to appropriate a large share. Ferreira (2015, p. 151) notes that piracy by Portuguese ships gone rouge undermined the *cartaz* system since then “there was no advantage for those ships who willingly called into the Portuguese controlled ports and paid their taxes to the king.”

#### *2.5. Why did the English and Dutch companies succeed where the Portuguese failed?*

The arrival of the English and Dutch companies in Asia quickly brought about a collapse in the caravan trade in spices. Figure 4 shows how quickly the relative number of Portuguese ships parting for Asia fell once the Dutch and English entered the game. By pursuing a strategy primarily based on commerce rather than violence the companies outcompeted the Levant towns and their Mediterranean counterparts, in particular the Venetian. Already in the first decade of the 17<sup>th</sup> century the direction of trade reversed for pepper and spices, as they started being imported by Levant towns from Europe (Steensgaard, 1974, p. 173). The success of the early companies and their role in ushering new organizational forms that would evolve into the modern listed company has been analyzed extensively by the economic history literature (Carlos, 1992; Carlos & Nicholas, 1990; Chaudhuri, 1981; Ekelund & Tollison, 1997; Lipton, 2009; Neal, 1991; Shikida, 2007). Even Adam Smith in *The Wealth of Nations* addresses the issue (though he criticizes them for their monopolistic power) (Anderson & Tollison, 1982).

Figure 4 – Relative participation in number of ships parting for Asia



Source: Data from Vries (2003).

This literature recognizes three key characteristics of the joint-stock companies that helped them succeed in making a profit where the Portuguese had failed. The company format provided a particularly effective means to raise capital from dispersed sources to finance its fleets and expeditions. The attractiveness to investors included not only limited liability, but also greater transparency and participation in the company's decision-making process. Financing had been a perpetual constraint for the Portuguese enterprise, frequently limiting the number of fleets sent to Asia. At first each of the North European expeditions involved a new subscription and the company was disbanded at the end of the trip as profits were distributed. But eventually the notion of permanent capital emerged and the capital would automatically remain invested at the end of each trip. For an investor to opt out it was not necessary for the company to be disbanded, but rather shares could be sold in a 'secondary market'. An important consequence of this format was to reduce the myopia of those setting the company's strategies, in particular the choice of violence versus commerce. This is so because the price of the shares reflected the discounted expected flow of returns from the company's business. Even if one did not expect to still own the shares in the future, decisions made today would instantly be capitalized into the share price, thus making the decision-makers internalize the consequences of their choices on the company's future earnings. Furthermore, because there were many owners and even the participants in the

trips were often shareholders, there were more principals to monitor the agents' behavior, thus helping to mitigate the principal agent problem that similarly afflicted the English and Dutch Companies. Contrast this to the short-sighted incentives faced by the Portuguese Crown and especially by the captains and other agents in *Estado da India* whose time in office was limited by design.

It is tempting to ascribe the emergence of the company format in England and the Netherlands and its absence in Portugal and Spain, to cultural predispositions towards capitalistic forms of organization. We have argued, however, that these differences are better understood by the circumstances that determined the context in which each country first engaged in the sea route to Asia. The Portuguese enterprise was a State-led effort because the State had the financial means to retain control since its inception. The English and Dutch companies were monopolies chartered by the king but not under his direct control, because when they were created "the funds the crown was able to raise not only had more pressing employment (war), but were also insufficient to bear the cost of the voyages" (Rei, 2011, p. 118). Furthermore, the stage into which the English and Dutch entered in the 1600's was very different from that faced by the Portuguese in the early 1500. It was decidedly a more global world by then, with greater knowledge and understanding and very different technology. Not only were the Portuguese – a declared enemy - already there, but local interests were wise to the threat and opportunity which the new European represented. The temptation to dominate the market for protection which the Portuguese had found irresistible, was as not as alluring by the time the English and Dutch made it to the Indian Ocean. By then the sale of protection had already run into diminishing returns while the perspective of trade, where profits could be reinvested in a growing business, held the promise of increasing returns.

#### 2.6. *Why were the Portuguese unable to reform?*

We argued that a principal-agent problem between the Crown and *Estado da India* was responsible for the inefficiencies of the Portuguese enterprise in Asia. By taking over the sale of protection, the market for pepper, spices and other Asian goods continued to overwhelmingly flow through Asia to the cities in the Levant. These markets continued to be marked by uncertainty, non-transparency and volatility. Over the long term this strategy and form of organization did not prove beneficial to the Portuguese Crown. Godinho (1965) describes how the king was time and again disappointed with the bounty brought by returning fleets. Why then

not reform the system to reduce information asymmetries, change incentives and mitigate the losses and rent dissipation?

We suggested that allowing the agents to participate heavily in the spoils of conquest in the early periods can be understood as a means to incentivize the agents to assert Portuguese dominance in a hostile environment. But once this path had been taken, there was no going back. Gradually, the need for military might and resolve decreased and the possibilities of peaceful commerce made a mercantile approach more attractive. But by then the interests of the diverse set of agents that made up the *Estado da India*, from the captains, to the bureaucrats, including priests, missionaries, sailors, *casados* (Portuguese who married and settled in Asia), and many others, was already engrained in the system. The Crown was naturally aware of that it was being despoiled by its own agents and it systematically tried to reform the system. But these attempts were generally ill-fated, not the least because in the end they had to be implemented by the very people who were the beneficiaries of the status quo. In order to illustrate the inexorable grip of the path dependence that subverted the Crown's attempts to switch from the inefficient organization of *Estado da India* to some other less wasteful and perhaps more capitalistic forms, we briefly describe in this subsection three instances in which a reform of the system was tried but ultimately failed. In all three of these examples the failure to modernize is a consequence of political economy and not of culture. That is, it is the principal-agent problem that generated, and the path dependence that perpetuated, a system based on redistribution rather than gains from trade, as the parties that would be harmed by the more efficient system were in a position to block those reforms.<sup>8</sup>

The first example involves the trade in goods from Malaca (pepper, drugs, silk, porcelain) in current Indonesia, that the Portuguese colonized in 1511. Because of the position of Malaca as the eastern-most Portuguese outpost, these goods were shipped first to Cochim or Goa on the western Indian coast, and then on another trip to Lisbon. This two-step journey was maintained until 1578 when Francisco Lobo made the first direct trip from Malaca to Lisbon, reducing transportation costs and travel time significantly. One might expect that this economically superior strategy would be quickly adopted as the norm for transporting these goods to Europe. Yet the establishment of a regular direct route only took place in 1581 and lasted for only 12 years, during which a surprising number of failed trips and shipwrecks put an end to the effort.

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<sup>8</sup> This is the fundamental reason proposed by Acemoglu and Robinson (2012) for why nations fail.

The failure was not due to reasons of navigation, but rather to the interests of the various agents in Malaca, Cochim and Goa who had for over 75 years been the intermediaries in this market, many of them *casados* who had settled in definite in these regions. Godinho (1965, pp. Vol III, pg. 36) argues that “the direct route would shake the foundations of the empire, as it was not only made up of a set of factories whose personnel was always changing and anxious to go back to the metropole, but also a web of settlements.” This example illustrates the maintenance of inferior modes of organization despite the existence of better alternatives, which pervaded much of *Estado da India* and together were the reason of its downfall.

The second example involves a series of attempts by the Crown to change the nature of *Estado da India* and how goods from Asia were brought back to Portugal. In 1570 the Crown lifted its monopoly as the sole purchaser of pepper and other goods in Asia and sole seller in Lisbon. Freedom to trade was open to all private interests with the restriction that the goods should enter through Lisbon where they would pay a duty. The preamble to the law that opened the market makes it clear that the reason for this change was that the previous restrictions on trade were already ‘judicial fiction’ as the law was constantly violated and penalties rarely imposed. What the reform did was to set the law in accordance with reality, as much of the pepper that was brought to Europe did not come through the Crown’s monopoly, but rather through the caravans and through contraband in *Estado da India*. Steensgaard (1974, p. 98) argues that “it is probable that wastage and corruption have in practice reduced the profits of the Crown: this would be the most obvious explanation for the radical reorganization of the pepper carried out in 1570”. But this change did little to increase the Crown’s profit as smuggling and dealing by both large and small private interests within *Estado da India* continued unabated throughout the entire period. Already since 1520 there had been a law that ships making stops on-route back to Portugal were only allowed to have one person go on land to see about supplies and other business, with stiff penalties to those who disobeyed as well as for the receptor of the merchandise on land and for the captain and first mate. Similar care existed for when the ships finally arrived in the Tejo in Portugal. Apparently these restrictions were less than effective as in 1601 the Crown went as far as hiring Castilian inspectors to oversee the unloading of ships. This went against an oath to never nominate foreigners to posts in the public administration in Portugal, and probably arose from the distrust by the Crown of its own regular agents (Godinho, 1965, p. Vol III pg 69).

The regime of freedom to trade did not last very long as the price of pepper was still set by the supplies that entered through the Levant and in 1576 a new scheme was tried that sharecropped the pepper business between the Crown and a German contractor called Konrad Rott who would have exclusivity to purchase pepper in Asia and transport it back to Portugal. The idea was that half of the pepper would belong to the Crown, but would automatically be purchased by Rott so as to avoid competition between both parties from bringing prices down. These new arrangements also did not resist falling pepper prices as the caravans continued to supply much of European demand, an indication that *Estado da India's* supposed intent to block Asian goods through that route was ineffective. The reason, once again, had a lot to do with the myriad interests within *Estado da India* that took part in the grand protection racket it actually was. When the enterprise was once again reorganized in 1586, this time rented out to contractors who had to sell the pepper they brought over to the Crown at a fix predetermined price, there was “popular outcry and indignation letting us sense the extent of the contraband done mainly by the small agents ... (as) the big and powerful obtained frequent waivers and liberties” (Godinho, 1965, p. Vol III pg. 69). This author also notes that contractors paid more for the rights to bring the pepper than the Crown made in previous years from the business, which he interprets as an indication that the smuggling – which the contractors hoped to stop - was probably more than 25% of that value.

Several other rearrangements were tried until 1597 when the Crown once again reasserted its monopoly. These constant changes were due both to the Crown's dissatisfaction with the profits it received from its Asian business and to the difficulties encountered by many of the contractors that had to compete with supplies entering through the Mediterranean (Prakash, 2006). In 1591, for example, no ships arrived in Portugal from India. By the end of the century the Dutch had managed to sail the Cape of Good Hope and the British were about to do the same so that future prospects for profits were even worse.

The third example of a failed attempt to reform and adapt the Portuguese enterprise to the new changing environment is the creation of the Portuguese India Company in 1628. At this point the Portuguese monopoly had already been broken by the English and Dutch companies and the number of ships leaving Portugal for Asia each year, as well as the volume of commerce, had fallen dramatically. All Portuguese centers in Asia, except possibly Macau, were undergoing financial difficulties and the whole enterprise yielded a deficit, as Lisbon had to send more

resources than it received (Disney, 1978). The idea to emulate the Dutch and British companies was natural given the success these organizations were producing in their commerce in the East, despite their lack of experience with the region. Yet, since before its inception the Portuguese company was more subject to political than to commercial interests and was consequently very different than those companies in important aspects. The creation of the East India Company (EIC) in England was undertaken by members of the merchant class, and although the Crown did concede a monopoly, diplomatic assistance and support from the English navy, the company was never subject to the government. The Dutch East India Company (*Vereenigde Oost-Indische Compagnie – VOC*) was partly owned by the Estates-General and the municipal governments had the power to indicate the company's directors, however the power of the merchant class was such that it was more likely that the VOC controlled the government than the other way round (Acemoglu et al., 2005, p. 566). These ownership structures gave the companies considerable autonomy to pursue their commercial interests in a professional manner, whereas the drag due to web of interests in *Estado da India* may have been a bigger challenge to the Portuguese Company than the threat posed by its new competitors.

Disney (1978) shows that although the Portuguese Company was not officially subject to the Portuguese government, in practice the Portuguese Crown and the bureaucracy in India systematically send instructions and requests to the Company.<sup>9</sup> In the first election to set up the company the Crown nominated all of the directors. Except for one, all were noblemen and none of them had any capital invested in the company. According to Disney (1978) all of them were “old, sick, or both.” The Crown determined the policy for the purchase of pepper in India and even interfered in such minor details as the supply of bunk beds on board. The Crown also indicated how many ships it expected the Company to send each year, though the lack of resources by the Company often frustrated this expectation. In Asia similar governmental interference in the Company's business took place. The Viceroy in Goa, for example, used the Company's vessels in his own and the government's interest, despite this being prohibited.

In large part due to this lack of separation between the private and royal nature of the Portuguese Company, it never managed to attract any significant private investment, despite the

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<sup>9</sup> From 1580 to 1640 Portugal had been taken over by Spain due to the lack of heirs in the royal family's lineage. Throughout this period, however, Spain granted Portugal extensive freedom to manage its colonial interests. The Portuguese Company was required to file reports with the Commerce Council in Madrid.

Crown's pressure for this to happen, including the offer of titles of nobility contingent on the quantity invested. New Christian businessmen (converted Jews), who dominated much of Portuguese commerce and capital, were the major potential source of investment. Yet, the fact that the Company's statutes allowed for the possibility of confiscation of the subscribed capital in the case of heresy by the investor, created a very different business environment than that faced by English and Dutch counterparts. In the end the Portuguese Crown was responsible for over 75% of the subscribed capital, different municipalities participated with 23%, and less than 0.1% came from private investors. In 1633 the Portuguese Crown decreed that due to the Company's failure to attract private capital, its main *raison d'être*, it would no longer continue to fund the trips. Only five years after its creation, the Company was extinguished.

The short history of the Portuguese India Company, like the two preceding examples, illustrates the effect of absolutist political institutions and the ability of those threatened by change to block reforms and innovations that can enhance efficiency and general welfare. In all three cases the Portuguese enterprise was faced with secular decadence and stagnation and yet failed to adopt promising changes. Although the new organizational forms portended greater economic performance, they also had redistributive consequences. As a result, the reforms were either blocked or distorted, never encountering the environment where they could truly flourish. The sad demise of the Portuguese Empire in Asia is thus not so much a story about failure due to cultural inheritance, but rather one of ill-suited political institutions.

### **3. Empirical evidence of link between institutions and trade with Asia**

In the preceding sections we argued that the demise of the Portuguese enterprise in Asia over the 16<sup>th</sup> century was not fundamentally determined by cultural traits of the Portuguese that would have lead them to eschew commerce in favor of violence, as defended by much of the historical literature (Subrahmanyam, 1993, p. 271), but rather by the country's institutions which in turn were shaped and interacted with factor endowments, circumstance and context (Acemoglu et al., 2005; North & Thomas, 1973; Sokoloff & Engerman, 2000). In order to provide some empirical evidence to complement this argument, this section estimates the relative impact of institutions and culture on the intensity of European countries' activities over the sea route to Asia. Poor data availability for the period precludes us from achieving the levels of

internal consistency that we would like in the estimation, so the results are presented as complementary evidence for the preceding historical discussion.<sup>10</sup>

The data is structured by decade for 1500 to 1850 and covers nine countries (Portugal, Holland, England, France, Denmark, Belgium, Sweden, Spain and Austria). The proxy for the quality of institutions is an index of control over the executive used in Acemoglu et al. (2002, 2005) and created following the methodology in Polity IV. The evolution of this index for Portugal, Holland and England is shown in Figure 5. Note that although all three countries improve over time, Portugal at the end of the period is at the level England was at the start.

The dependent variable is a measure of the performance of each country's Asian enterprise over the sea route. This is captured in two ways; the number of trips leaving Europe to Asia, and the total dead weight of those ships.<sup>11</sup> Culture is controlled for through a dummy that indicates catholic countries (Portugal, Spain, France, Austria-Belgium), and a separate dummy for Iberian countries (Portugal, Spain). In order to control for other factors that affected the performance of country's Asian enterprises, we use the countries' population and total GDP. Finally, a measure of the population of Asia (sum of China, India and Japan) is used to control for circumstances in Asia that might hinder or facilitate the European countries' activities. The number of trips leaving for Asia over time for each country – one of the dependent variables - is shown in Figure 6.

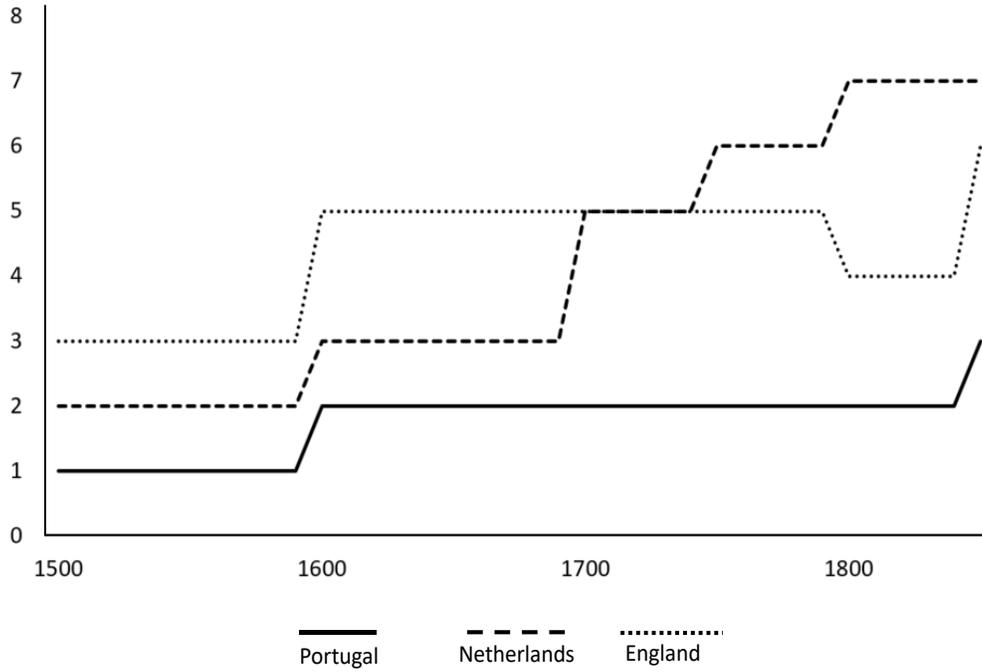
Table 1 shows the result of the estimation of several different specifications. Each specification is run first with the number of trips per decade as the dependent variable and then with the total weight. The first two pairs of columns have the institutional variable on the left-hand side together with one of the cultural variables, Iberian and Catholic. In both cases the greater the level of control over the executive, the higher the number and weights of trips per decade, at a high level of statistical significance. The Iberian dummy coefficient is negative and marginally significant when the dependent variable is the number of trips. The catholic dummy is negative and significant (p-value 0.06) when the dependent variable is weight. However, once the control variables are added, both of the cultural variables lose their statistical significance

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<sup>10</sup> Leite (2015) estimates the impact of institutions on the number and weight of trips from Europe using a measure of proselytism (measured as number of priests and clergy on the ships) as an instrument for institutions. In this paper we do not want to go into the discussion over exclusion restrictions that this instrument naturally gives rise to, which detracts from the main theme of the paper, so we use instead the least square estimates as complementary evidence.

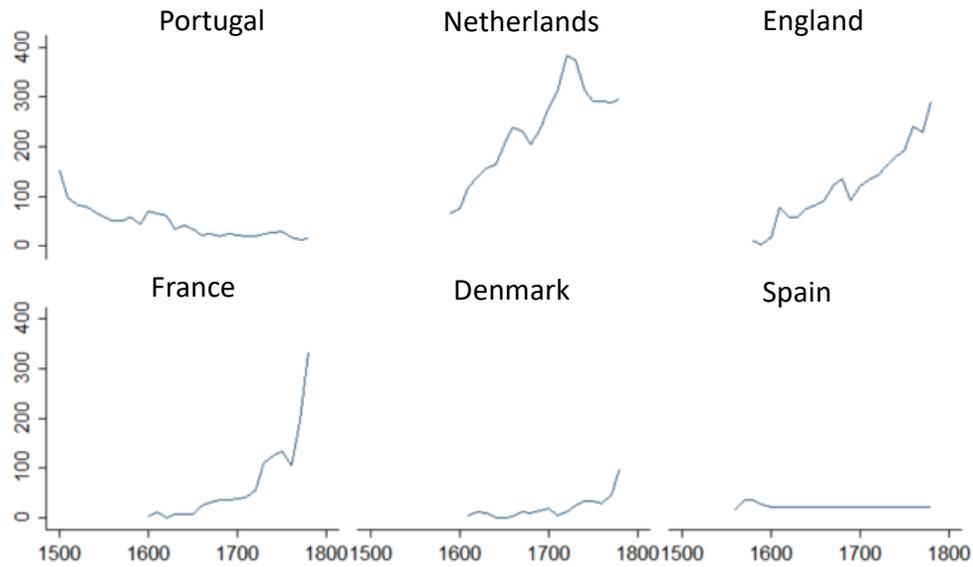
<sup>11</sup> Data from (Vries, 2003).

Figure 5 – Control over the Executive



Source: Data from (Acemoglu et al., 2005).

Figure 6 – Number of trips leaving for Asia



Source: Data from Vries (2003).

while the institutional variable remains positive and significant with a slight drop in magnitude. Of the controls, higher populations have a negative effect on the number and weight of trips, and GDP has a positive effect, both statistically significant in all cases. The size of Asian population is only statistically significant when the dependent variable is the number of trips. Greater Asian populations are correlated with fewer trips.

Clearly the variables in this exercise are only rudimentary measures of the features they seek to measure, in particular institutions and culture. Furthermore, the estimation by ordinary least squares may not deal properly with a potential endogeneity of both institutions and culture, or with the possibility of omitted variables that might simultaneously influence each country's success and its institutions and culture. For these reasons the estimation results should be viewed with caution and considered merely as ancillary evidence that does not refute the historical evidence presented earlier. Nevertheless, they corroborate the argument in this paper that political institutions related to the relation between the central states and the private interests involved in each country's Asian enterprise were more important to the outcomes observed than cultural characteristics.

#### **4. Conclusions**

In the first volume of his trilogy on the Portuguese age of discovery, Vitorino Godinho (1965) provides vivid evidence about the changes undergone by Portuguese society. He compares the drawings that ornate a medieval text from the 14<sup>th</sup> century with those of a text from the early 16<sup>th</sup> century, when the transition to the early modern was already underway. The early text is the *Crónica Geral da Espanha* written in 1344 by Pedro Afonso the son of the king of Portugal. It is one of the most important historiographical chronicles of Portuguese history of that time. The later text is the *Ordenações Manuelinas* which is a compilation of Portuguese legislation published in 1513. The illustrations in the first text are in the margins and in between the columns of text. Godinho (1965, Vol I: 60) highlights the figures in page 155, which show a king, a bishop, knights, shepherds, regular folk, houses and an ox. This is a picture of medieval society, composed of *oratores*, *bellatores* and *laboratores* (those who pray, those who fight, and those who work) with no sign of those who do commerce and trade. In the later text there are five different prints, one for each tome. In common these five prints have the king D. Manuel at the center holding the royal scepter, the symbol of justice, on which unfolds the banner *Deo in celo tibi autem in mundo* (God in the heavens and in the world). In each of the prints the king is

surrounded by a different group of people, jurists and the military nobility in the first, clergy and farmers in the second, administrators and actuaries in the third, merchants in the fourth, and prisoners being tried by the king in the fifth. His point is that the comparison shows that in the intervening period between the publications, a new element had emerged in Portuguese society. Merchants were absent from the first but were given prominence in the second. He does not claim that the transition to this new society had been consolidated by then, on the contrary. The argument throughout his long analysis of Portuguese history is that the transition had been partial and incomplete, with the old society hanging on and resisting the new ways, leading ultimately to the demise of the Portuguese enterprise in Asia.

Although we do not negate the importance of cultural imprints on historical events, in this paper we have advanced the argument that the troubled trajectory of Portuguese endeavors in Asia is best understood as determined by the opportunities and constraints that arose from the interaction of institutional factors with context and circumstance. The Portuguese Crown monopolized trade with Asia, not because of culture, but because it was in a position to do so. Protection was chosen over commerce because at the time and in those circumstances, that was a good choice for the Crown and for its agents. *Estado da India* foundered not because of cultural traits inimical to commerce, but because of a severe principal agent problem between the Crown and its agents. The inability to break free from the perverse structures that *Estado da India* had become, was not a cultural shortcoming, but a standard case of interest groups invested in the status quo blocking reform. Similarly, the successful innovations that allowed the English and Dutch to ultimately predominate, were not so much due to cultural traits as they were to the specific relations of the merchant classes to the crowns in these countries.

So when Godinho (1965, Vol I, 65) argues that the problem was that “the State mercantilized, but did not organize itself as a commercial enterprise”, we see this failure not as a consequence of Portuguese culture, but rather primarily of the institutions that mediated that process.

Table 1 – Trips to Asia, Institutions and Culture.

Dependent variables: Number (Qty) or Weight (Ton) of Ships leaving Europe for Asia in each decade from 1500 to 1850.

	Qtd.	Ton.	Qtd.	Ton.	Qtd.	Ton.	Qtd.	Ton.	Qtd.	Ton.	Qtd.	Ton.	Qtd.	Ton.	Qtd.	Ton.
Control over the Executive	38,59	40.566	45,34	47.165	45,99	43.711	43,46	38.903	41,78	36.315	34,02	22.483	35,3	24.590	34,8	24.454
	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]
Iberian	-19,38	1.073									1,8	302			-19,61	-23.814
	[0,102]	[0,945]									[0,870]	[0,981]			[0,320]	[0,300]
Catholic			18,93	33.733									11,89	11.712	32,18	35.690
			[0,184]	[0,063]									[0,387]	[0,460]	[0,192]	[0,204]
Population					0,0035	3,51					-0,019	-14,4	-0,02	-14,71	-0,022	-16,09
					[0,000]	[0,000]					[0,001]	[0,000]	[0,001]	[0,000]	[0,000]	[0,000]
GDP							0,000003	0,004			0,00002	0,01	0,00002	0,013	0,00002	0,014
							[0,000]	[0,000]			[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]
Asia									-0,00004	0,2	-0,0003	-0,03	-0,0003	-0,039	-0,0003	-0,025
									[0,500]	[0,500]	[0,000]	[0,614]	[0,000]	[0,549]	[0,000]	[0,716]
R <sup>2</sup>	0,53	0,39	0,52	0,41	0,57	0,44	0,58	0,52	0,52	0,42	0,64	0,63	0,64	0,63	0,64	0,63
N	149	154	149	154	149	154	149	154	149	154	149	154	149	154	149	154

Qtd. = number of ships leaving Europe for Asia per decade (de Vries, 2003)

Ton. = dead weight of ships leaving Europe for Asia per decade in tons (de Vries, 2003).

Iberian = dummy for Iberian countries (Spain and Portugal)

Catholic = dummy for Catholic countries (Belgium, Spain, France and Portugal)

Population = population (1000 people) (McEvedy e Jones, 1978, apud Acemoglu, et. al, 2005).

GDP = estimate of GDP in 1000 US\$ of 1990 (Maddison, 2001)

Asia = population of China, India (McEvedy e Jones, 1978, apud Acemoglu et al. 2005) and Japan (ClioInfra)

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