1 Fiscal Capacity and the Colonial State: Lessons from a Comparative Perspective

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Introduction

This book examines the comparative development of fiscal capacity in a number of Asian and African colonial states. We situate this study in the context of the changing world order in the long century between 1850 and 1960. The end date signals the termination of colonial rule in most of sub-Saharan Africa, with the exceptions of Portuguese Africa (1975) and the semi-autonomous status granted to the Union of South Africa (1910). The starting date of 1850 is more arbitrary, as colonial control began earlier in some parts of both Asia and Africa. But, broadly speaking, it was only after 1850—and indeed in many of the colonies which are examined in this book, several decades later—that the colonial powers began to develop the fiscal systems of the territories which came under their control.

We define ‘fiscal capacity’ as the ability of the state, or its representative agents, to collect revenues in order to provide public goods and services. In this definition, fiscal capacity refers not just to the power of the state to assess and collect taxes, but also to its ability to extract non-tax revenues from state monopolies, from enterprises such as railways or from foreign aid. Moreover, fiscal capacity also refers to the ability of the state to raise loans to supplement both tax and non-tax revenues, especially for capital works. All the chapters in this book examine the long-term development of colonial fiscal policies, using this definition of fiscal capacity. They also


2 Most Asian colonies obtained independence, or a large measure of self-government, in the years between 1946 and 1957.
explore how different colonial administrations tackled the problem of revenue centralization, and what factors influenced both the revenue mix and changing expenditure policies. The chapters also address wider questions on the use of forced labour, debt creation, the impact of increasing global and local trade, and the development of financial systems.

We will argue in more detail that existing concepts and theories of fiscal development have had little to say about the nature and determinants of fiscal development in a colonial setting. Until now, the historical literature has paid much more attention to the rise of the fiscal state in Europe and its offshoots in the Americas, than to the development of fiscal systems in the former colonies and protectorates in Africa and Asia. Fiscal histories that employ a global comparative outlook have either concentrated on the comparative features of fiscal state formation in Eurasia (Yun-Casalilla & O’Brien 2012, He 2013), or have focused on the North-South divergence in the Americas (Engerman & Sokoloff 1997, North, Summerhill & Weingast 2000, Sokoloff & Zolt 2006, Grafe & Irigoin 2012). While there has been a recent upsurge of studies in the fiscal history of African and Asian colonies (Booth 2007a, Frankema 2011, Gardner 2012, Wahid 2013, Frankema & van Waijenburg 2014, Huillery 2014, Alexopoulou & Juif 2017), the findings of these studies have yet to be synthesized. This volume brings the experiences of colonies in Asia and Africa into a global comparative framework in order to clear the ground for new theories on the relationship between colonial state-building and the development of fiscal capacity.


The fiscal systems analysed in this book all developed during the wave of global imperialism that emerged between the independence wars in the Americas (c. 1776–1830) and the end of colonial rule in Africa. The spread of the Industrial Revolution from Britain to the wider Northern Atlantic basin opened up new possibilities to bring overseas areas under direct control. The heightened pace of technological change, and accumulation and application of scientific knowledge brought solutions to a range of problems, including the treatment and prevention of tropical disease (e.g. quinine to treat malaria, smallpox vaccination), communication over large distances (e.g. telegraph) and the preservation of perishable commodities (e.g. refrigerators). Moreover, the major revolutions in transportation, railways and steam ships, in particular, greatly enhanced global trade and opportunities of colonization (Kuznets 1974, 168,
O’Rourke & Williamson 1999, Williamson 2011, Frankema, Williamson & Woltjer 2018). The colonial states, no matter how weak and understaffed many of them were, occupied a critical place in this compulsory process of globalization (Hopkins 2002, 6–7; see also Burbank & Cooper 2010, chapter 10). Colonial states were responsible for maintaining law and order, and for creating a political space for infrastructure development, trade and capital investment, in order to create profitable export sectors. All these aims required money. The fiscal system, it can be argued, formed the backbone of the colonial state.

The expansion of formal and informal empire was led by a handful of Western European powers, but was not an exclusively European undertaking. The United States annexed the Philippines, and replaced its Spanish government in 1900. Threatened by Western incursions in the mid-nineteenth century, Japan decided that an empire was necessary if it was to be taken seriously by the other global powers. In the late nineteenth century, Meiji Japan became an imperial power by adapting foreign production technologies and by engaging in rapid military capacity building.

Although the physical distance from metropolitan centres provided the colonial state with some degree of policy autonomy, improved transportation and communication technologies also meant that metropolitan supervision was more effective than it had been in the early modern era. Both internal and external factors caused changes in colonial policy, including fiscal reforms. In Indonesia, pressures from within the colony and in the Netherlands brought an end to the cultivation system and a transition to the so-called liberal era in the 1860s and 1870s (Fasseur 1991). In India, the rebellion against British East India Company rule in 1857–8 induced a reorganization of the colonial army as well as the government administration and the financial administration (Prakash 2004). The Meiji reforms in Japan involved a reorganization of the fiscal apparatus, which in turn influenced later Japanese imperialism. The discovery of diamonds in 1867 had an enormous impact on subsequent economic and political development of South Africa, including revenue and expenditure policies (Feinstein 2005, 108–9, Gwaindepi & Siebrits, Chapter 9, this volume).

While major investments in fiscal development in sub-Saharan Africa were made only after the scramble of the 1880s and 1890s, many African societies experienced major changes in the relations with their trading partners, both African and European, during the middle decades of the

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3 When they are not supposed to cause much confusion, we will use anachronistic geographic denotations throughout this volume.
nineteenth century. Even though the shift from slave exports to commodity exports occurred at different points in time, this ‘commercial transition’ coincided with improving terms of trade for African commodity exports and rapidly expanding export volumes. The expansion of ‘legitimate commerce’ across the nineteenth century, in turn, created new opportunities for financing the colonial state (Law 1995, Frankema & van Waijenburg 2014, Frankema et al. 2018).

By the end of the nineteenth century, when the scramble for Africa had largely been completed, European empires reached the territorial size that they would retain until the 1940s. In this period, the growth of colonial populations, output and trade accelerated, despite the problems caused by the First World War and the Great Depression. While the transport and communication revolution transformed the logistics of empire-building, innovations in military technologies, including improved naval vessels and machine guns, enhanced the superiority of the metropolitan ‘cores’ over the colonial ‘peripheries’. Investments in railways, roads and harbours opened up the more promising hinterlands to increasing numbers of European merchants, engineers and occasional settlers. Their activities concentrated mainly on export production, but food production for domestic consumption also became a policy concern as populations expanded (especially in parts of Asia) or to supply major mining areas (especially in parts of Central and Southern Africa). The gradual and radical shifts in the global division of labour associated with ‘modern imperialism’ also provoked new flows of migrants, capital and commodities within and across both continents. It is in this context of a changing world order, characterized by sharply increasing flows of cross-continental trade and investment capital, that colonial administrations attempted to strengthen and consolidate the fiscal capacity of the colonial state.

**Fiscal Capacity Building in a Colonial Context**

In most of the colonies of Africa and Asia there was little scope for an ‘organic’ evolution of government structures and fiscal systems, as had occurred in the metropolitan countries over a span of centuries. Until the early decades of the nineteenth century, European colonial control over Asia and Africa had been largely confined to coastal and island settlements, which often functioned as little more than trading posts. Officials charged with running these settlements had neither the resources nor the need to develop new fiscal instruments.

With the expansion of imperialism in the course of the nineteenth century, the costs of maintaining colonies rose. The reluctance of home
governments to place much of the financial burden of imperial expansion on the backs of metropolitan taxpayers pressed colonial governments to expand their revenue base as quickly as possible and become fiscally self-supporting. In fact, in several cases they were asked to make contributions to the metropolitan economy, and to this end new fiscal duties were often imposed upon the local population. Colonial administrators could rely to varying extents on revenue institutions that were already in place, but these were often imperfectly understood, and local elites had good reasons for hiding the extent to which they were taxing their people. Therefore, it was not unusual for local people to be confronted with additional revenue demands from colonial officials while at the same time continuing to pay pre-colonial imposts to local rulers. This was especially the case when colonial governments adopted ‘indirect rule’ and left local power structures largely in place.

In the European context, scholars have analysed the rise of the ‘fiscal-military’ state, where the ability of countries to wage war was predicated on growing flows of both tax and non-tax revenues. These imposts were often accepted by the population as temporary demands to meet legitimate defence needs, although in many cases the new taxes became permanent (Tilly 1990, Bonney 1999, Hoffman 2015). In most Asian and African colonies, external threats were largely eliminated by the late nineteenth century, and the revenues raised by the colonial state were not primarily intended to fight off external powers. The First World War (1914–18) had some fiscal impact on many colonies, especially through the contraction in world trade which affected revenues. Those colonies which provided significant numbers of troops to the metropolitan country, such as India, shouldered most of the costs of their upkeep (Roy, Chapter 3, this volume). Yet, on the whole, colonial revenues were first and foremost needed to secure internal order. Colonial control often required considerable investments in local armies and police forces, as well as roads, railways and ports. Moreover, revenues were needed to pay the salaries of government officials who administered the government departments. Without the trust and commitment involved in the defence of a ‘nation’, raising revenues on behalf of a foreign government, which often had little legitimacy in the eyes of local people, required a more intensive combination of coercion and co-option. In many colonies across Asia and Africa, officials found this combination difficult, if not impossible, to implement.

One of the ideas advanced by the bellicist theory of fiscal development in Europe, is that constant interstate warfare resulted in an imagined ‘social contract’ between citizens and the state. Gradually, this would become an increasingly important marker of ‘national’ identity, solidarity and unity.
in the face of the violence perpetrated by outsiders. Indeed, nationalism was one of the major social-political forces in Europe both before and during the period of our study (c. 1850–1960). But on whose behalf did colonial governments collect revenue and provide public services? Many subject populations were ethnically heterogeneous, if not fragmented, and did not share a common identity. Moreover, co-optation of specific ethnic groups, social classes or elite factions hampered the idea of a state working in the public interest. The legitimacy problem of the colonial state was aggravated by the importation of labour from India and China into parts of East Africa and Southeast Asia, as well as from Korea into the Japanese colony of Manchuria. This gave rise to economies where small- and medium-scale businesses were owned by people who were neither locals nor from the metropolitan country. To the extent that national identities were sharpened during colonial occupation, it was generally in response to perceived oppression from the colonial power, and to the migrant workers from other parts of the world, who were either regarded as tools of colonial exploitation (e.g. coolies) or as colonial middlemen (e.g. tax farmers, entrepreneurs). Rather than underpinning colonial state formation and fiscal capacity expansion, nationalist ideologies promoted by independence movements thus became a major destabilizing factor of existing political-fiscal arrangements.

Fiscal Extraction and the Costs and Benefits of Empire

The national historiographies which have developed on the colonial experience of particular metropoles, not just in European countries but also in the United States and Japan, reveal great variation in their assessment of the costs and benefits of empire. In Dutch, Belgian and Portuguese historiography the consensus view is that the possessions in Asia and Africa were, on the whole, beneficial to the development of the metropolitan economy. Assessing the contribution of empire to Portuguese economic growth in the early-modern era, Costa, Palma and Reis (2015, 1) concluded that “eliminating the economic links to empire would have reduced Portugal’s per capita income by at least a fifth”. For the modern era, Lains (1998) has argued that the net benefits of Portuguese Africa to the Portuguese economy between 1885 and 1975 were also substantial.

4 It has also been widely acknowledged that silver receipts from Spanish America kept the Spanish-Habsburg war machinery in Europe going for centuries and also supported the survival of the Spanish American empire in the face of British and French encroachment (Marichal 2007).
The net contribution of the Netherlands Indies to the Dutch treasury was also considerable. At the peak of the *cultuurstelsel* (cultivation system) in the mid-nineteenth century, it has been estimated at 52 per cent of the total metropolitan budget (Fasseur 1991, van Zanden & van Riel 2000, 223). The Dutch experiment (c. 1830–60) inspired the Belgian king Leopold II to set up a similar system in the Congo Free State (Frankema & Buelens 2013). Although the rates of extraction were less clear after 1870 (van der Eng 1998, Gordon 2010), private sector remittances remained substantial, especially from the plantation and mining sectors in both Indonesia and the Congo (Booth 1998, 210–14; Buelens & Frankema 2016). Scholars have pointed to the exceptional profitability of Belgian investments in Congolese mining and plantation sectors during the 1920s to 1950s (Buelens & Marysse 2009, Vanthemsche 2010).

The debates in Britain and France have been less conclusive and often more politicized (e.g. Gann & Duignan 1967, Ferguson 2002, Lefeuvre 2006). Davis and Huttenback (1988) argued that empire-building not only brought about a redistribution of resources between the United Kingdom and its colonial dependencies, but also transferred resources within British society from the general British taxpayer to a select class of merchants, entrepreneurs and investors who greatly benefitted from the ‘free’ naval and military protection of their overseas activities (O’Brien & Prados de la Escosura 1998, Offer 1993, Edelstein 1994, 213–14). More recently, scholars have explored the extent to which British colonies benefitted from access to metropolitan capital markets and favourable conditions for government loans (Ferguson & Schularick 2006, Gardner 2017).

Marseille (1984) and Lefeuvre (2006) have argued that French colonies received substantial net inflows of funds to the detriment of French taxpayers, especially in the decades after 1930. Marseille (1984) has also pointed out that in the interwar years in particular, uncompetitive traditional industries were sustained by captive colonial markets after the loss of European markets, with adverse effects on the competitiveness of French industries. Following earlier incomplete attempts by Bobrie (1976), Coquery-Vidrovitch (1982) and Marseille (1984) to calculate the net transfers between France and its colonies, Huillery (2014, 1) estimated that the net payments to French West Africa (the AOF) were negligible, on average 0.29 per cent of total metropolitan public expenses, while the burden on African subjects was high. This view finds support in the work by van Waijenburg (2018), who has shown that the implicit tax burden of forced labour in French West Africa was extremely severe, particularly up to the 1920s.  

5 Although the literature on the costs and benefits of empire to the metropole is dominated by European scholars, Asian and African scholars have taken up the issue as well. As Roy
The Japanese case is also important, not least because many students of comparative colonialism, following the influential work of Myers and Peattie (1984), have tended to accept that Japanese policies in Taiwan, Korea and Manchuria were more ‘developmental’ compared with the extractive or exploitative policies pursued by the European powers. In fact the evidence is mixed. In Taiwan, the Japanese government transferred funds to the colonial budget in the early years of colonial occupation, but, after 1909, surpluses from the colony were used to fund transfers on both government and private account to metropolitan Japan (Booth & Deng 2017, 94). But both Korea and Manchuria maintained large balance of payments deficits, funded by inflows from Japan. An American study of the Japanese economy came to the conclusion that, at the end of the 1920s, from a fiscal point of view the colonies were a liability rather than an asset (Moulton 1931, 180). Large capital inflows to both Manchuria and Korea persisted until the 1940s.

Fiscal Development and Economic Growth

The debates on the costs and benefits of empire for European metropoles are closely connected to the debates on the (long-term) consequences of colonial extraction for colonial societies. An influential strand of literature stresses the intimate link between colonial repression, fiscal extraction and institutions designed to exploit colonial populations (Jamal 1978, Young 1994, Acemoglu, Johnson & Robinson 2001). Other studies, especially on sub-Saharan Africa, have argued that colonial state budgets were small and, if anything, led to understaffed bureaucracies and under-investment in public services rather than high tax burdens (Kirk-Greene 1980, Frankema 2011, Gardner 2012). In the context of Asian colonies, the impact of the cultivation system on living standards in Java and the role of the colonial state in the Indian famines of the late nineteenth century have been extensively debated (see for Java: Elson 1984, chapter 11; see for India: Roy 2012). The scanty evidence we have suggests that colonial economies did grow over extended periods of time, mostly in the order of an annual 0.5 to 1.0 per cent per capita (see for Africa 1870–1950: Prados de la Escosura 2012; see for Asia 1870–1950: Maddison 2010). This growth was largely driven by the expansion of export sectors and related infrastructural investment. Rapid growth was realized in times of mineral or cash-crop
export booms, but these usually tapered off after one or two decades at best. Structural change and economic diversification, and in particular the development of competitive manufacturing industries, remained weak. The biggest exception among the cases studied in this book is South Africa, where greater political autonomy after 1910 facilitated the adoption of import substitution policies in the industrial sector from 1924. Along with systematic labour repression, these policies resulted in a manufacturing share of 20 per cent in GDP by 1960, in addition to 13 per cent for mining (Feinstein 2005, 144, Austin, Frankema & Jerven 2017, 356). Yet, pervasive racial discrimination meant that little of the growth translated into improvements in living standards for the indigenous African majority (Feinstein 2005, 67–71).

To what extent has fiscal development stimulated or limited colonial economic growth? In the absence of a historical counterfactual it is hard to formulate even a tentative answer to this question. The few countries that, at least in name, remained independent (e.g. Liberia, Ethiopia, Thailand) did not fare any better than their colonial neighbours, but it remains questionable to what extent this tells us anything about the relationship between fiscal development and economic growth. Some have argued that the access of colonial states to metropolitan capital markets has enhanced their possibilities to borrow and invest cheaply, in contrast to poor countries that remained independent (Ferguson & Schularick 2006; see for a critique: Accominotti et al. 2010). However, colonial powers in general tended to be rather conservative in the supply of colonial loans and could have done much more if they had wanted to. Only after 1945, were substantial grants-in-aid provided for investment in colonial development programmes. Moreover, in many African colonies, marketing boards were syphoning off export sector surpluses that remained unutilized for capital investments or expansion of local banking.

Investments in health and education received low priority, although there was considerable variation across colonies and metropolitan powers. For instance, the United States channelled much more resources into the education system of the Philippines than the Dutch did in Indonesia under the so-called ‘ethical policy’ (Frankema 2013). Whereas school enrolment rates in British Africa rose faster than in French Africa before 1940, the British relied much more on private funds supplied by missionary organizations to finance mass education, while the French emphasized the role of public educational investment by the colonial government (Frankema 2012, Cogneau & Moradi 2014).

Any evaluation of the relationship between fiscal development and colonial economic growth will have to consider the transition that colonial states made from a ‘night-watchman state’ with minimal resources
towards a more ‘developmental state’ (Booth 2007b, 67–8), with small but growing investments in health, education and infrastructure. This transition was supported by increasing opportunities for borrowing in metropolitan capital markets, increasing grants in aid, and some degree of tax diversification towards ‘modern’ personal and corporate income taxes and general sales taxes. All these developments reflected the ambition to ‘modernize’ the colonial state, but the effect of these reforms has remained limited in the majority of cases.

This brings us to one of the key insights of this book: colonial economies and societies were difficult to engineer and the solution to the revenue problem thus varied enormously both across and within empires. Since local economic, political and social conditions were crucial in shaping the opportunities and constraints to fiscal capacity building, the economic legacy of the colonial ‘fiscal state’ may be best considered as unique to each colony and often even each region. Specific blends of political, legal and commercial institutions evolved which, in most cases, required significant modification to support a process of ‘modern’ economic growth.

**Fiscal Capacity and the Colonial State:**
*a Theoretical Vacuum*

We now return to the issue of fiscal capacity, and its relation to state capacity. The existing literature accepts that state capacity includes fiscal capacity, but they are not synonymous concepts. State capacity also involves the ability to protect subjects of the state against the threat of internal or external violence, expropriation and other offences; to effectively implement government policies; and to run a state bureaucracy. State capacity also includes the concept of ‘legal capacity’, which Besley and Persson (2009) define as the capacity of the state to support markets with appropriate institutions. In this book, we use the term ‘colonial state’ to refer to a governance system imposed on indigenous people in a distinct territory by a foreign power for a prolonged period of time, whereby the central government ultimately relies on the military, administrative and technological backup of the metropole to secure internal order.

The colonial state thus defined made use of foreign agents to run key positions in the administration, the army and, in most cases, the major export sectors of the local economy. Almost all colonial states analysed in this book were states where local or indigenous inhabitants comprised a large majority of the population; the main exception was British Malaya, where large-scale in-migration from China and India had