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Historical Turning Points in Spanish Economic Growth and Development, 1808–2008

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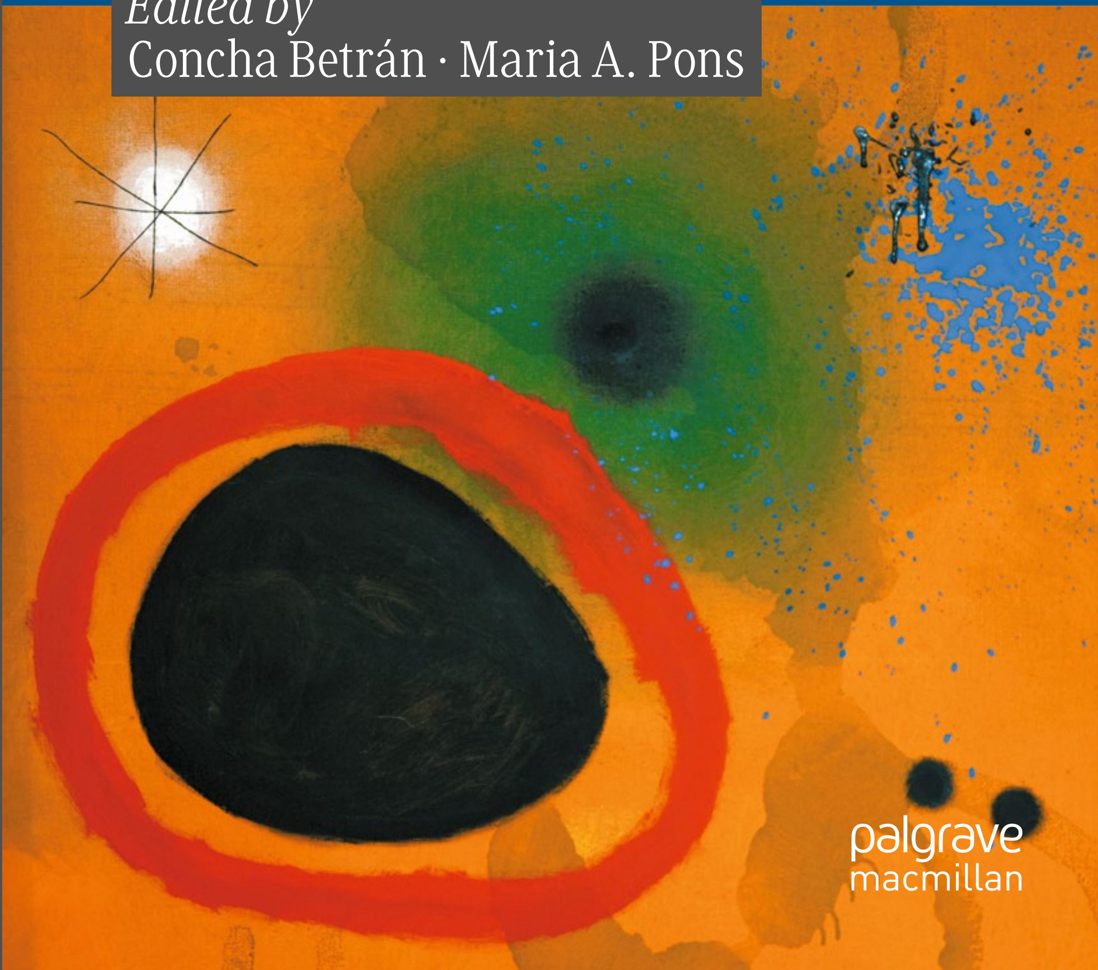
Concha Betrán · Maria A. Pons



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Introduction

Concha Betrán and María A. Pons

Turning points in history alter the basic rules, institutions and attitudes upon which a country's past has been founded. Wars, revolutions, radical political regime changes, lasting economic crises and even natural disasters provoke ruptures and mark new departure points for the future of a country as a whole. When a turning point occurs, the previous circumstances do not vanish, they simply melt down into the new in a path-dependence dynamic, conditioning how countries face the next challenges.

In modern times, there have been some important watersheds, such as the French Revolution, the American War of Independence, the First World War, the Russian Revolution, the Great Depression, the Second World War, the Chinese Civil War or the financial crises that began in 2007–2008. For example, the French Revolution ended the feudal society of the Ancien Régime and brought about radical political, social and

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economic changes that marked the beginning of a new era. The Great Depression can also be considered a turning point: a severe, protracted economic crisis, which led to the fragmentation of the world economy, the emergence of totalitarian political regimes, the sinking of democracy in many nations, the rise of the State as a major economic agent and the implementation of new economic policies. Lastly, the recent financial crisis that began in 2007–2008 was the first economic crisis of the twenty-first century; this so-called Great Recession has entailed profound changes and challenges. All these events represent a sharp break with the past and launching pads into the future.

The aim of this book is to study the main turning points in the Spanish economy and the related challenges it faced; in so doing, we examine the country's long-run economic development over more than 200 years. We concentrate on six turning points that changed the direction of the Spanish economy, although most of them also took place in the world economy. For this reason, the book also compares the Spanish trajectory with the international one. We explore the macroeconomic context in which these turning points happened, as well as the external and internal constraints on domestic political choices for a small country like Spain in the different periods. This is an interesting and innovative perspective since most of the turning points in economic history (the fall of an Ancien Régime or the Great Depression, for instance), as well as their long-term positive and negative consequences, are generally studied from the viewpoint of core countries such as the UK, the US or Germany.

Firstly, we explain why the chosen events marked a turning point in the Spanish economy. We also identify the economic, social or political origin of these watersheds and determine whether they were triggered by a domestic or an external shock. Secondly, we focus on how Spain faced up to each turning point, the reforms that were implemented, the differences between the Spanish response and that of other countries, the results of the policies enacted and what problems were *not* tackled. We explore what ultimately changed, and what did not, considering both international differences and the problems that Spain had in common with other countries, as well as differences and similarities in terms of their policies and resolutions. We consider the changes in different aspects such as growth and structural change, the international sector and trade policy (openness or protectionism), the role of the State and distributive issues, including human capital. In addition to the economic changes, we also reflect on institutional aspects: the quality of institutions and the shift towards either more inclusive or more extractive institutions following a turning point. To sum up, this book takes a historical approach to analyse the main changes that Spain underwent and the challenges it faced at some specific points in the period 1808–2008. The ultimate objective is to learn useful lessons from Spanish economic history in order to better face future turning points.

We have selected the following turning points: 1808, 1898, 1936, 1959, 1977 and 2008. The perspective adopted in this book assumes that countries face turning points or shocks that cause economic challenges; the way countries respond to these challenges depends on the international context as well as international and domestic restrictions, which in turn are conditioned by the size of the country and its level of development. Finally, these challenges spark conflicts due to competing interests and ideas on how to tackle them; the resolution of these conflicts could lead to either continuity or change, and to failure or success.

Some research papers have dealt with how core countries such as the UK or the US have faced specific critical situations, including the First World War, the Great Depression or the oil crises of the 1970s. It is sometimes assumed that the general patterns derived from the experiences of these core countries could be extrapolated to the rest of the world. However, as we show in this book, the dynamics of the "core" and the "periphery" differ widely, even in the case of European periphery countries. For this reason, a deeper understanding is required of how a small, peripheral country such as Spain tackled crucial long-run economic changes. The book argues that Spain, as a peripheral country, faced greater restrictions than core countries when it came to resolving its main challenges. Consequently, the book concentrates on the fundamental vulnerabilities and restrictions that shaped the economic policy responses adopted in each moment and their impact.

Each chapter provides an in-depth analysis of the selected turning point and systematically sets out: (1) why the chosen event was a turning point in the Spanish economy, the origin of this watershed moment, whether it was triggered by a domestic or external shock, and how it related to the international context; (2) how Spain faced up to the situation, the policies adopted in response to the shock, the reforms that were implemented and what challenges were *not* tackled, the differences between the Spanish response and that of other countries, and the restrictions or limitations that determined the adoption of specific measures; (3) the results of the policies enacted, whether the end result represented a step forward in terms of the country's development and modernization or whether it produced an economic setback.

The turning points chosen for analysis in this book are the following:

Chapter 2 is written by Francisco Comín and deals with the events of 1808 and the turning point they represented. The first turning point in modern Spain's economic history was the Napoleonic invasion of the country, followed by the so-called War of Independence and the loss of its colonial empire on the American continent. The invasion sparked an economic disaster and divided the country in two. It was a complex conflict in which the war against the French troops was intertwined with revolutionary movements that challenged the essence of the Ancien Régime. The common people rallied together to drive the invaders out of the Iberian Peninsula, while the political and social elites split apart. The war, however, brought about significant changes: there was an acceleration in the enlightenment reforms, which had begun in the last decades of the eighteenth century, aimed at modernizing the fabric of the country; the first liberal constitution was enacted by the *Cortes* meeting in the city of Cádiz; and the remains of the feudal regime were abolished. However, as the implemented reforms were the result of a pact between liberals and the aristocracy, the institutions were less inclusive than in other countries and this had long-term political and economic consequences. The loss of the American colonies, which had been in possession of the Spanish Crown for more than three centuries, was a severe blow to the economy. Trade flows and Treasury finances were both significantly affected. Moreover, the people's perception of their own country changed: Spain fell from being an imperial nation to a second-rate European power. Finally, the challenges Spain faced centred on how to change institutions to shape a more progressive society and move away from the old institutions which had benefitted the elites of the Ancien Régime.

Chapter 3 is about the 1898 turning point and is written by Pablo Martín-Aceña and Inés Roldán. In 1898, in two short naval battles—one in the Caribbean Sea and the other in the Pacific ocean—the Spanish fleet was destroyed and Spain lost possession of its remaining colonies: Cuba, Puerto Rico and the Philippines. That triggered the start of a political, social and economic crisis that determined events in the following decades. Even today, 1898 is remembered as a watershed moment in Spanish history. The military defeat and the end of what remained of its empire led to an identity crisis, as the nation as a whole became aware of its weakness on the international stage. The Industrial Revolution had failed in Spain and despite some progress, it lagged definitively behind developed western, central and northern Europe. In an attempt to close the gap with the most advanced European nations, a battery of economic reforms was introduced. They included measures in the fiscal and monetary spheres, government investment in infrastructure, legislation to promote and protect strategic industries, and facilities to attract foreign capital. The purpose of the new policies was to "regenerate" the country and modernize its economic fabric. Not all of the reforms and policy measures implemented were successful. Budgetary restrictions on the one hand, and political instability, on the other, affected the results of the "regeneration" programme. Nevertheless, despite the limitations of the regeneration drive, the Spanish economy grew at a faster rate after 1900. Income per capita increased, death rates fell and the population grew, accompanied by a rapid pace of urbanization. Labour started to move from low- to high-productivity sectors, such as the new industries emerging from the second industrial revolution. Foreign investment in utilities and the service sector changed the face of many cities, particularly Barcelona, Bilbao and Madrid. The financial sector expanded. However, despite all this, Spain did not manage to close the gap with the most developed areas of the European continent. A close look at 1898 raises many questions. Were the disastrous military defeats of 1898 a consequence of the underdevelopment of the country? Spain was the only European nation that did not acquire new overseas territories, did not participate in the imperial powers' scramble for Africa and did not play a role in the distribution of the areas of influence in Asia. Quite the contrary, in fact: while almost all European countries, from Portugal to

Russia, gained new colonies, Spain was forced to abandon three rich and strategic territories. Is there an economic explanation for this outcome? Is there any evidence that the 1898 colonial "disaster" was due to economic weakness? What was the economic importance of the lost colonies of Cuba, Puerto Rico and the Philippines? We contemplate the impact of Spain's loss of the colonial market, its control over strategic resources and the financial linkages. Finally, the 1898 Spanish watershed will be connected with turning points in or around that date in other peripheral European countries.

Chapter 4 addresses the 1936 turning point, which has been analysed by Concha Betrán. Taken together, the Great Depression and the Civil War mark another turning point in Spanish political and economic conditions, accompanied by the collapse of the monarchical regime for the second time and the establishment of a modern democracy with the Second Republic in April 1931. Although the Depression was less severe in Spain than in the US or in some European countries (France and Germany for instance), economic growth stopped, unemployment rose and social conflicts intensified. The new Republican regime attempted to implement reforms to meet the challenges: creating new institutions to promote growth and establishing "inclusive" institutions and economic policies to face the international crisis. Their objectives were compelling and sometimes contradictory. Since the country was divided into backwardness and modernity, the reforms were not well accepted by the part of the country that stood to lose out as a result (especially landowners but also rent-seekers). At the same time, these reforms did not go far enough for the other part that expected substantial change (mainly labourers). Meanwhile, the still small new middle class, living in growing cities, was in favour of modernization. All this occurred in an international context in which existing economic policies were being called into question and the new regime had to balance the importance of gaining domestic and international respectability (using orthodox fiscal and monetary policy) with their efforts to shift towards a moderate protectionist policy, and enact land, labour and educational reforms. Although there had been an economic recovery, political and social confrontation was fierce from 1934 to 1936 and ended in a civil war. Similar situations arose in the international context, where different ideologies, including totalitarian ones, threatened the ability to resolve these problems. The connection between the economic crisis and the Civil War is a major issue: for some, the stagnation of the economy and the failure of certain reforms, such as the land reform, are behind the military upheaval of 1936; for others, the causes of the Civil War are to be found in the realm of politics and in the social backwardness of the country. Whatever the causes of the Civil War, the consequences were grim for the Spanish economy: a long-lasting impact in terms of economic growth, with a GDP per capita that did not return to pre-war levels until 1954; autarky and interventionist policies; a huge loss of human capital, poverty and rising inequality; and a 40-year-long dictatorship. Hopes of reform were left unfulfilled, with a severe backlash against social and economic restructuring.

Chapter 5 is dedicated to the 1959 turning point, and is authored by Elena Martínez-Ruiz and Maria A. Pons. After the great blow to economic growth caused by the Civil War, Spain started its recovery in the 1950s. In the 1960s, Spain experienced a process of rapid growth with remarkable structural transformations, a moderate improvement in living standards and profound social change. The 1959 Stabilization Plan facilitated the "economic miracle" of the 1960s and constituted a turning point in Spanish economic history. However, it was only a partial change, which limited the possibilities of growth and development in the medium and long term. The Plan was supported by the International Monetary Fund (IMF), as was the case with other stabilization programmes at that time (the UK in 1957, Turkey in 1958, France in 1958, Argentina in 1958 and Chile in 1959). The main policies were designed to tackle the key economic imbalances, and they also sought a modest improvement in the institutional framework to promote private investment (domestic and foreign) by boosting business confidence. But the Stabilization Plan did not tackle other important reforms such as a new fiscal system to finance increased economic and social expenditure, or a liberalization of the labour market. Moreover, it maintained the high level of interventionism in the domestic market and did not alter the wealth sources of those interest groups that supported the regime. Consequently, no significant advances were made in terms of income and wealth distribution. In the end, Franco ensured continuity through internal stability and took advantage of an international context that provided the Spanish economy, first with support in the form of foreign aid, and subsequently through the absorption of labour (emigration), tourism and direct investment. Despite its limitations, the Stabilization Plan allowed Spain to benefit from the so-called "advantage of backwardness". First, the Plan enabled the introduction of new technologies through the imports of capital goods, direct investments and the acquisitions of patents and registered trademarks, which in turn facilitated a boost in productivity in the industrial and agricultural sectors. Secondly, the Plan exposed Spanish firms to international competition in a favourable international context. Western Europe was a huge market for Spanish goods, and trade openness broadened the narrow internal market. Thirdly, international capital openness increased the availability of external sources of financing used to promote economic growth. Finally, the Plan contributed to the implementation of complementary reforms that facilitated monetary control and helped reduce some macroeconomic imbalances (e.g., by stopping the issue of government debt automatically pledged with the Bank of Spain, or increasing taxes to reduce public deficits). The 1959 Stabilization Plan is a good example of the benefits for an economy of changing from autarky and interventionism to trade liberalization and market regulation. But it is also an example of how political restrictions (the dictatorship) restricted the scope of the reforms and the country's long-term development potential.

Chapter 6 deals with the 1977 turning point, and is written by Joaquim Cuevas and Maria A. Pons. A fourth watershed moment that can be highlighted is the economic and financial crisis of the 1970s due to the oil shocks. It is considered one of the "Big Five" twentieth-century crises and coincided with Spain's political transition from a dictatorship to a full-fledged democratic regime. As in other parts of the world, these were crucial years: the Spanish golden age came to an end; growth slowed down and then stopped; dire difficulties emerged in the banking system; solvency and liquidity problems affected half of the credit institutions and eventually led to their collapse. Uncertainty about the immediate future paralyzed policy makers. Output fell, prices skyrocketed and unemployment reached historical levels. Although the crisis was sparked by an external shock (the oil shock), there are several particular features of the Spanish case that make 1977 a turning point in Spanish economic history. Firstly, the economic crisis was accompanied by political and institutional change. The political transition and the weakness of the new governments shaped responses to the crisis, with key economic decision-making postponed. Secondly, the crisis was more severe in Spain than in other countries. The magnitude of the macroeconomic imbalances accumulated during the Franco period and the delay in the implementation of economic measures contributed to this severity. The main reforms, which were implemented after the 1977 political agreement known as the *Pactos de la Moncloa*, sought to address several key challenges: (a) to reduce the main macroeconomic imbalances (inflation, public deficit); (b) to increase the capacity of the State to implement economic policy (fiscal and monetary policies) and to provide public goods such as health, education or social and physical infrastructure; and (c) to engage in complementary structural reforms such as industrial restructuring, labour market reforms and decentralization of the State. The government prioritized stabilizing macroeconomic measures, meaning the implementation of the structural reforms had to wait until the 1980s. The result was larger imbalances and structural problems; in particular, unemployment rates that were far higher and more persistent than in other European countries. Political instability and resistance from special-interest groups hindered the adoption of other longer-term structural reforms. As a result, some of these reforms were undertaken only in 1982 when the Socialist party (*PSOE*) came to power and there was a broader consensus. Moreover, some reforms were a prerequisite for entry into the European Community in 1986. Ultimately, we have to consider not only the limits of the reforms but also their seminal nature: the reforms implemented from 1977 onwards marked the beginning of the path to modernization, liberalization and international integration on a level with other European countries, a process that was consolidated up to the beginning of the twenty-first century.

Chapter 7 is about the 2008 turning point, and is authored by Jose Ignacio Conde-Ruiz and Elena Martínez-Ruiz. The most recent economic and financial crisis marks another turning point in Spanish economic history. Prior to the crisis, Spain had been one of the economies that had benefitted most from European Economic and Monetary Union (EMU) membership. During the first seven years after the inauguration of the monetary union, Spain's economy enjoyed a phase of sustained growth with notable progress made in terms of real convergence with the core EU member countries. However, the economic growth in the 1999–2007 period was based on foundations that could not be maintained indefinitely. The demand stimulus provided by EMU membership was only partially accommodated by the expansion in domestic output, based on an exceptional increase in the rate of employment. This was not adequately matched by an improvement in productivity. A series of imbalances thus began to emerge which undermined the dynamism of the expansion: inflation differentials, an increasing current account deficit due to a pronounced loss of external competitiveness and rising levels of household and corporate debt. The disequilibria came to light when the international economic atmosphere changed in 2007 with the financial crisis in the US. The crisis did not take long to affect the Spanish economy, although the authorities were slow to recognize it. The Spanish Great Recession has been long and severe, and to some extent has changed the fabric of the country. There are several reasons why the 2008 Great Recession has been a turning point for Spain. Firstly, it has been the most profound of all the Spanish economic crises in the analysed period. The crisis produced a severe recession and a consequent decline in GDP growth, very high unemployment rates, high levels of public debt that reached sovereign debt crisis proportions and damage to Spain's reputation and credibility as it sought assistance from abroad in order to deal with its economic difficulties. Secondly, most of the resulting reforms were targeted at solving the banking crisis, with vulnerable banks being rescued by the government. The counterpart was the implementation of austerity measures with major budget cuts in sectors such as education and health. Thirdly, the economic crisis was also accompanied by a political and institutional crisis. The economic deterioration undermined the public trust in Spanish politicians as well as in other major Spanish institutions such as the Bank of Spain, the judiciary system and the monarchy. Finally, the crisis accentuated territorial tensions (Catalan calls for independence) and social tensions (the 15 M or *indignados* movement).

This chapter provides an analysis of the related policy decisions and the adoption of measures aimed at overcoming the crisis. It also explores essential aspects such as the consequences of making the solution to the banking crisis the top priority, how other European countries faced the crisis and how eurozone membership conditioned these responses.

The book includes an Epilogue written by Concha Betrán and Maria A. Pons, which presents the main conclusions regarding Spain's ability to respond to the key challenges it has faced from 1808 to 2008.

In Spain, real GDP per capita multiplied by more than 20 times between 1808 and 2008. To put this in perspective, if we compare Spanish real GDP per capita with that of other large Western countries (France, Germany, Italy, the UK and the US), we can see that Spain's level of GDP per capita has been consistently lower[1] (Fig. 1.1). Spain had a lower level of GDP per capita in 1808 than other Western countries, showing that the economic differences started before the beginning of the

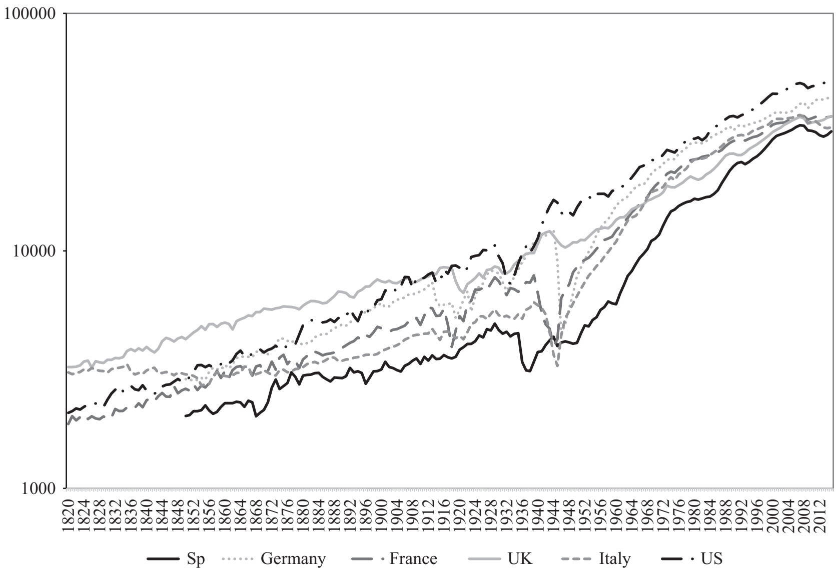

Fig. 1.1 Real GDP per capita in 2011 US$ in logs. (Source: Bolt et al. (2018))

nineteenth century. Around 1800, Spain's real GDP per capita was a long way off that of the leading country (the UK), representing only 48.8 per cent of the real GDP per capita in the UK, and 57.6 per cent of that in Italy. However, it was equivalent to around 80 per cent of German and US real GDP per capita and above 87 per cent of that in France. In 2008, Spain was relatively better positioned in terms of real GDP per capita than in 1800, at 67 per cent of the real GDP per capita in the US (the leading country), nearly 80 per cent of that in Germany and around 91–93 per cent the real GDP in France, the UK and Italy.

As Prados (2017) explains, the improvements in Spain's position in terms of real GDP per capita did not follow a monotonic trend; rather, there were periods of divergence and other periods of catching up. The aim of the book is to analyse the years that marked a watershed in Spanish economic history and examine how they transformed the economy and changed its position relative to other countries.

It can thus be seen that in this period (1808–2008), Spain has evolved into a developed economy and there have been phases of progress and catching up. Despite this, Spain shows some important weaknesses that have their roots in the past. The book studies how Spanish economic problems are related to the (domestic and international) economic conditions and examines the responses to the challenges adopted at key moments; moreover, it tries to understand the reasons for these specific responses.

Among the factors that have conditioned the main responses and their implementation, the book concentrates on: the economic structure (Spain as a late industrializer), the interaction between the political and economic processes (the late establishment of a democratic regime), the distribution of power and wealth among different interest groups, and their influence on the institutional framework and income distribution (which determined whether or not the country could afford to implement the necessary reforms). We also consider the international context (which in some specific cases limited the country's capacity of reaction but in other cases stimulated growth and development).

Note

1. We have used data on real GDP per capita from Bolt et al. (2018).

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2

1808: The Napoleonic Wars and the Loss of the American Colonies

Francisco Comín

2.1 1808 as a Turning Point

The invasion of Spain by Napoleon's armies marked an international turning point as it formed part of the Napoleonic Wars. In response to this invasion, Spanish patriots declared a War of Independence against Napoleon (also referred to at the time as the "French war" or "English war", as these were the two main warring armies). This moment was a turning point in Spain's history because it brought about decisive changes between 1808 and 1874: successive wars, revolutions and counter-revolutions; repeated regime changes (between absolutist and liberal) and swift changes of government; and the reforms that established the liberal constitutional regime and capitalist institutions. Crucially, those wars and institutional reforms had profound economic repercussions. In the short term, they created a demographic and economic crisis, but the country recovered rapidly and the new institutions enabled greater

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growth than in the eighteenth century. However, growth remained below the European average, and thus did not allow the completion of the process of industrialization initiated by the liberal revolution.

The revolutionary and Napoleonic Wars affected both Europe and America. The French armies invaded vast territories of continental Europe, including Spain, where economic growth was held back by the feudal institutions that still held sway in the eighteenth century: absolute monarchies; feudal, municipal and ecclesiastical properties that could not be sold (entailed lands); peasants who paid feudal dues and taxes to the nobles; and guilds that held a monopoly on trade and industry in the cities. The French Revolution of 1789 had done away with these institutions in France. In 1792, European monarchies led by Austria attacked France in an attempt to crush the revolutionary regime. The French army fought back and conquered vast swathes of foreign territory: Holland, the United Provinces, Switzerland, Germany, Italy, Poland and Spain. The Convention and later Napoleon exported the reforms of the French Revolution to the conquered countries: they overthrew the absolutist monarchies and feudal relations, replacing them with liberal institutions; they stripped the clergy and nobility of their class privileges, establishing the equality of citizens before the law, the rule of law and the separation of powers (checks and balances); and they established capitalist institutions (private property, freedom of trade and industry, the stock exchange, the National Bank) as well as the Napoleonic Code. The Napoleonic Wars introduced the "inclusive institutions" of capitalism to the conquered nations, which paved the way for industrialization. After Napoleon's defeat, the Holy Alliance and the European nobility imposed conservative monarchies—even in France—that left Napoleon's key reforms in place (Acemoglu and Robinson 2012; O'Rourke 2006).

One difference between post-Napoleonic Spain and the rest of Europe was that when Ferdinand VII returned to the throne in 1814, overthrowing the constitutional regime of the Cortes of Cádiz, he did not maintain the liberal reforms. Rather, he attempted to turn back time, reinstating the pre-Napoleonic War institutions (restoration of feudalism, guilds and the privileged estates) and abolishing the measures of the governments both of Joseph Bonaparte and the Cortes of Cádiz. Spain's war against Napoleon was relatively short because it started fairly late. The war began on 2nd May 1808 with the popular uprising against Napoleon because he had forced the royal family to abdicate in favour of the Bonaparte dynasty. It ended in 1814, when Napoleon restored Ferdinand VII to the throne and the French occupation came to a close. In order to move his armies to Northern Europe, Napoleon signed a secret agreement with Ferdinand VII that restored him to the throne of Spain, overturning the constitutional regime. The European powers, including Great Britain, contributed to the fall of the constitutional regime, considering it too revolutionary.

The liberal revolution lasted longer because Ferdinand VII restored the Ancien Régime which prolonged the conflict between liberals and absolutists until 1840, giving rise to coups d'état and civil wars. This state of affairs can be explained by the fact that neither side was militarily capable of prevailing over its enemy. The liberals lacked the strength to impose themselves on the nobility and the Church, who defended the absolutism of Ferdinand VII, and he needed the help of foreign forces to overthrow the liberal governments in 1814 and 1823, when he restored absolutism. But the situation changed after the death of Ferdinand VII in 1833, as the nobility that backed the royal claim of his daughter Isabella was supported by the moderate, Francophile and progressive liberals, who took seven years, until 1840, to defeat the Carlists, despite outside assistance from Great Britain and the Holy Alliance. The agreement between the liberals and the nobility allowed Isabella II to win the dynastic war and to carry out the bourgeois revolution enacted by the liberal regime in Spain. But this agreement moderated the reforms of the liberal revolution, creating less inclusive economic institutions than in the rest of Europe, which hindered industrialization.

Another feature specific to Spain was that Napoleon's invasion triggered the wars of independence by the American colonial viceroyalties, which created the Latin American independent republics from 1821. The Napoleonic Wars put an end to the Spanish Empire, benefitting the industrialized nations that were able to trade with the former Spanish colonies.

The most relevant consequence of the Napoleonic Wars, therefore, was that it unleashed the liberal revolution in Spain on two fronts, since two liberal revolutions took place simultaneously. In the first, Napoleon appointed his brother as king (Joseph I) and, with the support of the Francophiles, established French institutions in the occupied Spanish territories, beginning with the Bayonne Constitution. In the second, the patriot government opened Constituent Cortes in Cádiz, which approved the Constitution of Cádiz in 1812. The restoration of absolutism in 1814 prolonged the cycle of wars and coups d'état, revolutions and counter-revolutions until 1868, when a military coup brought an end to the First Spanish Republic (1873), restoring the Bourbon monarchy (1874). This political instability delayed the success of liberal reforms until the Democratic Sexennial (1868–1874).

The Napoleonic Wars had various different consequences in Spain. In the first place, the plunder and destruction of the war had short-term repercussions on population, agriculture, industry, finance and trade, although the Spanish economy soon recovered from these immediate effects. On the other hand, more lasting effects of the war came from the issuance of large amounts of public debt to finance it, as well as the loss of the continental American colonies; these two events led to the bankruptcy of the public Treasury and shaped the economic policy decisions of the Spanish governments well into the latter half of the nineteenth century. Lastly, the longest-term effects of Napoleon's invasion were the institutional reforms introduced by the liberal revolution, initiated by the government of Joseph Bonaparte (Bayonne Constitution) and by the patriot governments (Constitution of Cádiz): the War of Independence sparked the liberal revolution and the formation of the liberal State, which established the institutions of capitalism, which in turn were conducive to industrialization in Spain (Llopis 2002; Pro 2019).

This chapter evaluates the impact of the Napoleonic Wars, the institutional reforms and their effects on growth, economic structure and wealth distribution in Spain. Particular attention is paid to the persistence of Old Regime political and economic institutions and behaviours that distorted the practical application of the new laws, which were formally similar to those of other European nations. Section 2.2 examines the short-term effects of the Napoleonic invasion: death, destruction, seizures, and agricultural and industrial crises. Section 2.3 studies the institutional impact of the Napoleonic Wars and the absolutist and constitutional regimes that followed between 1808 and 1874, focusing on the structural reforms of the liberal revolution. Section 2.4 examines the effects of political and institutional changes on economic growth and the industrial revolution by analysing the agricultural, industrial, public, foreign trade and banking sectors. Lastly, some interpretative conclusions are drawn about the relative failure of the industrial revolution in nineteenth-century Spain.

2.2 The Immediate Effects of the Napoleonic Invasion: Wars, Destruction, Loss of the Colonies and the Liberal Revolution

Without Napoleon's invasion, the liberal revolution of 1808 would not have been possible. In fact, following the French Revolution, the enlightened governments halted their timid reforms and established a cordon sanitaire to prevent the contagion of revolutionary ideas in Spain. The liberal revolution was the main consequence of the French invasion, since the Spanish liberals did not have the strength to either initiate it or to see it through (Martorell 2018). The liberal governments and the Constitution of Cádiz of 1812 were a result of the popular uprising against Napoleon and the liberal regime that he had installed under the reign of Joseph Bonaparte, as well as the French institutions that, with the support of the Francophiles, he established in the occupied Spanish territories. Napoleon was also responsible for the return of absolutism in 1814: Ferdinand VII overturned all the reforms of the two constitutional regimes (Bayonne and Cádiz) and persecuted all Spanish liberals, regardless of whether they were Francophiles or patriots. The disagreeable personality of Ferdinand VII and the vested interests among his court of advisors, contractors and financiers had a delaying effect on the liberal (and industrial) revolution that lasted beyond the death of the king. He had named his daughter, Isabella, as his successor in 1833, a decision opposed by the so-called *carlists.*[1] Out of the pact between the nobility and the bourgeoisie, a liberal State emerged in 1840. It was conservative and favourable to the interests of landowners and financiers. The wars and military coups between 1808 and 1876 can thus be interpreted as an unresolved civil war started by Napoleon.[2] As stated earlier, the liberals were not able to impose themselves on the absolutists of Ferdinand VII, but nor was the king able to defeat the liberals without the support of the Holy Alliance and Britain. The European powers continued to back Isabella II, who had to accept the support of the liberals to hold the throne. Spain became a nation subject to European powers, as it was a political protectorate and an economic colony. Along with the international support, the alliance of the liberals (progressives) with the landed nobility (moderates) can explain the economic policy pursued by the liberal monarchy, which fostered a model of economic growth without industrialization.

As has been pointed out, the Napoleonic Wars caused Spain to lose its American colonies, and it fell from being an imperial nation to a second-tier country with little military and international power. The creation of a liberal regime in the metropole prompted insurgent movements in Latin America, arising out of the power vacuum left by the government of Madrid, and by the desire of the establishment that ruled in Spanish America (viceroys, military governors and other colonial positions) to prevent a liberal revolution and maintain the Ancien Régime. Having gained their independence in the early 1820s, the American colonies became new sovereign republics sharing a common institutional heritage with Spain as well as permanent political instability, which hobbled their economic growth in the nineteenth century (Acemoglu and Robinson 2012).

The Napoleonic Wars increased the scale of military operations (battles of 500,000 combatants): they consumed a larger share of the national budget and entailed greater physical destruction and loss of human life (five million deaths across Europe). France secured huge financial resources from the conquests, as “Napoleon’s France raised the practice of pillage to a fine art”, but it did not improve its fiscal organization or military logistics. The large number of Russian army troops, financial resources from the UK and the local guerrillas’ resistance to the French invader in the occupied continental territories all played a part in Napoleon’s defeat. In Spain, Napoleon faced a British Army with more resources and better logistics, which was also supported by the Spanish guerrillas.[3] The aftermath of the Napoleonic Wars had an impact on

Spain, contributing to a backward economy and social conflicts. Since 1790, Spain had suffered from stagnating agricultural production, because the vast area of land in mortmain (lands belonging to the Church, municipalities, entailed estates, Mesta pastures[4]) prevented any increase in tilled land. The criticisms levelled at these institutions and the Treasury crisis prompted the minister Godoy to approve the confiscation of Church property, the seizure of the tithes of the Church and other measures in opposition to the Church. The hike in basic commodity prices and poor harvests sparked riots and generated resistance among the peasantry to paying tithes and feudal rents. By 1808, Spain had still not recovered from the crises caused by basic commodity shortages (known as the *crisis de subsistencias*) of 1803–1805, the main causes of which were poor harvests and its effects were famine, epidemics and mortality. These economic crises exacerbated the problems of the Treasury due to the resistance to paying taxes, and created a social and political crisis that had already started to undermine the institutions of the Ancien Régime before 1808. This explains the fragmentation of political factions in the face of Napoleon's invasion and the "profound political, economic and social changes" caused by the French invasion (Llopis 2002; Comín and Hernández 2013).

The War of Independence led to a decline in Spanish GDP per capita, though the drop was smaller than that caused by the food crisis in the period 1803–1805. The severity of the economic crisis of 1808–1814 was due to the adverse impact on Spanish wealth and means of production caused by the negative effects of the war: high numbers of war dead; destruction of factories and crops; and looting of artistic works, jewels, precious metals, food and livestock. Spanish public and private wealth was plundered by the two armies (Napoleonic and British), which were financed through theft, taxes and confiscations from the land (crops and livestock). This theft of artworks remains evident in the Wellington Collection, composed of the stolen paintings (200 in total) that the British general found (and then appropriated) in a carriage abandoned by Joseph Bonaparte in his hasty escape.

First of all, the War of Independence severely impacted the Spanish population, which was already in a weakened state in 1808 due to the earlier food and mortality crisis. The demographic crises during the war against Napoleon were caused by factors related to the war. On the one hand, the battles and the siege of cities during the war resulted in a loss of human lives in both the Spanish army and the civilian population; on the other hand, the war itself and the displacement of the troops had a greater indirect impact on mortality by setting in motion the traditional mechanisms that caused shortages, famines and epidemics. The most serious demographic crises occurred in 1809, 1812 and 1813–1814. The "Napoleonic cycle of the Spanish population" covers the first 15 years of the nineteenth century and was characterized by an estimated negative balance in potential population growth (due to increased mortality and falling birth rates) of 800,000 people. In the six years of the War of Independence, the magnitude of this loss of potential population was similar to that produced by the Civil War (560,000 deaths between 1936 and 1942) (Pérez Moreda 2010: 327–329).

The second consequence concerns the major change in the agrarian structure generated by the War of Independence, namely, the halving of the transhumant sheep population. Official exports of merino sheep to France did not exceed 200,000 head (less than 5% of the four million head of sheep in the transhumant population). The main causes of the drop in the transhumant sheep population were theft, requisitioning by troops, the illegal extraction of herds sold by their owners and the confiscation of this property. The church-owned flocks were disentailed and their flocks of sheep were purchased by many buyers who kept the merino sheep as local grazing. A key factor in the decline of transhumant sheep herding was the loss of international markets for the lowest-quality Spanish merino wool and competition from the wool produced by merino sheep exported and acclimatized to Northern Europe. After the war, most of the Spanish merino wool went to the Catalan wool industry. The abolition of the Mesta in 1836 was a liberal measure that was not difficult to enact as the transhumant sheep farming was no longer profitable (García Sanz 2010: 390–396).

Thirdly, the legal and ideological ruptures as well as the changes in the practices of political and economic agents (nobles, merchants, urban oligarchies, peasants) caused by the Napoleonic Wars led to vast areas of land being put under the plough and the non-payment of feudal rents, tithes and other taxes by peasants. On the one hand, the creditors of the

State used their government bonds to purchase disentailed municipal property; on the other, in response to the vacuum of authority left by the central government, the urban oligarchies also engaged in illegal tilling of land. The legislation of the two opposing governments in the War of Independence brought down the feudal institutions of the Ancien Régime: tithing, feudal dues and municipal ordinances on the cultivation of the land and other communal practices. The war prevented governments from enforcing the laws in both the new regime and the Ancien Régime. The peasants understood that the tithe, feudal rents and taxes paid to the king were neither divinely ordained nor always had to be paid, since the governments had abolished them.[5] Therefore, the War of Independence led to the bankruptcy of the Ancien Régime and gave rise to the liberal revolution, altering the distribution of property and agrarian income. After the war, there was a reduction in the inequality in the distribution of income in Spain as the land factor became cheaper (due to the drop in the demand for land caused by municipal property going under the plough) and the labour factor rose in value (due to the increase in mortality rates and the recruitment of troops into armies and to fight as guerrillas, as well as the increased demand for labour resulting from the expansion of cropland, and the decline in animals for draught and transport). This change in the distribution in favour of the peasants lasted until 1840 (Llopis 2004: 43–44).

Fourthly, the War of Independence also had catastrophic effects on the agricultural and industrial activity. These were caused by the destruction of crops, animals for draught and loading, and production equipment; the requisitioning of food and products, and limited access to production inputs; increased fiscal pressure; and exposure to foreign competition, in terms of both the large-scale smuggling of food and industrial goods and abundant imports of products by the government of Joseph I and the British troops in Spain. In addition, smuggling increased as the coasts were left entirely unguarded.[6] The war had a greater effect on the royal factories. The French army destroyed the arms, munitions and steel factories in northern Spain for strategic reasons, while the Royal Porcelain Factory in Madrid was razed by the British troops. Many of the royal factories were shut down because employees' wages were not being paid. Ravaged factories were not rebuilt and the others were abandoned or privatized, due to the liberals' opposition to State-owned companies. Only the royal factories that were fiscal monopolies (tobacco and mines) were restored (Comín 1991). Generally speaking, there was limited destruction of private factories, both because they were not a military target and because the industries lacked large investments in fixed capital. In spite of this, the War of Independence did directly reduce industrial activity, even resulting in the closure of factories, due to the effects of battles and besieged cities, as well as the contributions, requisitions, levies and accommodations required by troops. In addition, there were indirect effects stemming from the drop in demand, transport difficulties, the loss of colonial markets, the scarcity of raw materials and a reduced labour supply due to the recruitment of troops and demographic crises. Although the manufacturing businessmen were subject to a certain degree of tax pressure and requisitioning, they did not face the levels of pillaging suffered by the peasants. Many craftsmen and manufacturers were ruined and proletarianized, polarizing society between factory owners and proletarians, as happened in agriculture between landlords and day labourers. Finally, the industries received orders from the patriot army but not in the territories occupied by the French, as the orders from the Napoleonic army went to merchants who supplied them with imports of foreign goods. The merchants were the ones who benefitted most from the war, especially those who did business with both governments (Sánchez 2010).

Another significant effect of the war was that the Spanish people had to finance all three armies (the French, the British and the patriot army) as well as the guerrillas who fought in the War of Independence. The Cádiz government established an extraordinary war tax and then in 1813 a direct tax, though it did not manage to collect either. The governments of Cádiz and Madrid did not collect enough tax revenue to feed and equip their regular armies, so the troops had to secure their own supplies on the ground—through theft or requisitioning—as did the guerrillas. Some of Joseph Bonaparte's requisitions were paid for by turning over disentailed land. The British and patriot troops paid for some of their supplies with promissory notes, which were not paid out, although some recipients managed to exchange them for public debt securities in the debt conversion carried out by the minister of finance, Bravo Murillo. In order to meet the tax requirements of the French troops, some municipalities charged new taxes on factories and productive activities.[7] To finance the wars, the government of Cádiz relied on supplies from the people, loans and advances from army contractors and Spanish bankers, as well as international aid. Between 1808 and 1815, British assistance to the patriots' cause totalled 7.8 million pound sterling, which was repaid in cash or in debt securities. The Treasury of Cádiz collected 1.5 billion *reales* in taxes, of which 600 million came from America. The latter total dropped after February 1811 when the insurgencies in the colonies began. Most of the colonial remittances came from donations and loans provided by Mexican business owners (Fontana and Garrabou 1986; Prados de la Escosura and Santiago-Caballero 2018; Moreno 2015; Gárate Ojanguren and de Luxán Meléndez 2012). In sum, the only options open to the government of Cádiz were to go into arrears on payments (more than 6.3 billion *reales*) and to issue public debt (which increased by 60% between 1808 and 1814, reaching 12 billion *reales* in 1815). The invasion of Napoleon thus had a lasting effect on public finances, creating the conditions for the bankruptcy of the absolutist Treasury of Fernando VII, following his restoration as monarch in 1814. This bankruptcy was brought about by the loss of American remittances, the reduction in customs revenue, the decline in domestic taxes collected, political instability and war, as well as increased expenditure due to the war and servicing the debt (Fontana 1971; Comín 1990, 2004).

Lastly, the direct cost to the Spanish economy of the loss of the American colonies was less than 6% of GDP (Prados de la Escosura 1988). The indirect effects were greater, and some were positive. On the one hand, the loss of colonial markets forced the Catalan bourgeoisie to support a liberal revolution that created a national market for its industrial production (Fontana 1971). The 1778 Decree of Free Trade between Spain and the Indies ended the monopoly Cádiz held on trade with the Americas, opening it up to 13 Spanish ports, including the Catalan ports of Tortosa and Barcelona. From that moment on, the Catalan bourgeoisie started to sell its products (spirits and textiles) directly in America, generating an agrarian, commercial and industrial expansion in Catalonia. This explains why Catalonia was one of the regions most affected by the loss of colonial markets; as a result, its bourgeoisie tried to find a domestic market for its products. On discovering the limited size of this market, due to the existence of the institutions of the Ancien Régime, the Catalan bourgeoisie became revolutionary, seeking to abolish those institutions and establish liberal economic ones. Besides, the emancipation of the colonies brought an end to the remittances from America, which had represented a source of income for the State and profits for the merchants. From then on, the Spanish Treasury was financed through mainland Spanish resources, with the exception of the transfers from Cuba (Moreno 2015, 2018). Finally, the loss of the empire transformed foreign trade, as exports to America fell by 60%, transit trade between the colonies and Europe disappeared and the flow of silver from America used to compensate Spain's trade deficit with the other European countries dried up. This deficit led to an increase in the outflow of silver, generating a deflationary process aggravated by Napoleon's monetary war, in which the government of Joseph Bonaparte mandated the use of the French currency as a means of payment, attributing a nominal value equal to the Spanish currency although the latter was worth 10% more on the market. In accordance with Gresham's Law, Spanish coins disappeared from Spain, with the French coins being used until the monetary reform implemented by Figuerola in 1869 (Prados de la Escosura and Santiago-Caballero 2018).

2.3 The Legislative Impact: The Liberal Revolution and the Establishment of Capitalist Institutions

In the long run, the effect of the Napoleonic invasion was positive because it triggered a liberal revolution that established the capitalist rules of the game in Spain, through legal and institutional reforms. During the War of Independence, liberal reforms were implemented in Spain on two fronts. The liberal revolution was initiated by the Bonaparte dynasty, which first established the bourgeois institutions in place in France at that time, beginning with the Bayonne Constitution. A little later, the patriot government of the Cortes of Cádiz introduced similar reforms to those enacted by Bonapartists: constitution, separation of powers, rule of law, national sovereignty, personal freedoms and electoral processes. Both governments replaced the mercantile policies of the Ancien Régime with new liberal institutions and policies. However, the institutional transformation was a chequered process as neither constitutional regime (that of Joseph I or the Cortes of Cádiz) lasted very long, being overthrown by the restoration of the absolutist State by Fernando VII in 1814. Then began the violent alternation between the two political regimes (absolutist and liberal), with a period of wars and military coups that lasted until 1840.[8]

The nobility changed its political position as it saw its feudal rents fall (feudal dues, tithes, profits from the Mesta ranchers, etc.). The secular nobility found it profitable to go along with the revolutionary process, rather than oppose it. This was the case from 1833 on and was consolidated under the government of the progressive Mendizábal (1836–1837), who moderated the revolutionary reforms so that the nobles would retain ownership of the land and receive other compensations from the State budget in exchange for renouncing the feudal dues that the peasants were no longer paying.[9] This alliance with the landed nobility allowed the liberal governments to subdue the carlists, an army which brought together those in favour of maintaining the Ancien Régime; namely, the most reactionary nobility, the Church and the peasantry. The regency of María Cristina was unable to impose moderate institutional reform in 1834–1835, while the revolutionary movement of 1835 brought the progressive liberals into government; they opened Constituent Cortes, dismantled the institutions of the Ancien Régime and approved reforms similar to those passed in the Cortes of Cádiz and the Constitutional Triennium, albeit somewhat more moderate. This moderation was due to the pact made between the liberals and the nobility, to the pressure from the European powers that supported Isabella II, and to the realistic approach adopted by the progressives, who had learnt from previous failures that they lacked the strength to impose a liberal regime without the support of the lay nobles.[10] Once the ecclesiastical disentailment had been completed and the tithe abolished, the liberals sought reconciliation with the Church.[11] The Moderate Party was in power between 1844 and 1854 and imposed its model of the State, which retained some remnants of the Ancien Régime. After the Carlist War, the Spanish bourgeoisie was no longer revolutionary. As elsewhere in Europe, from the 1840s on it was concerned with defending itself from the Progressive Party and from the popular revolutions and riots sparked by the anarchists (Llopis 2002; Comín 2018a, b).

The main measures of the liberal revolution in Spain were similar to those adopted in post-revolutionary France. Notable among the political institutions were the constitutions that established liberal political regimes with separation of powers, the rule of law and the equality of citizens before the law; the Constitution of 1837 and those that followed established a shared sovereignty between the people and the monarch, who retained fundamental powers such as appointing the government. First among the notable economic institutions were those that liberalized private sector activity. This included the creation of the market for factors of production (land, labour and capital), the liberalization of the goods market (abolition of guilds and the grain price rate; declaration of freedom of industry; freedom of domestic trade and liberalization of foreign trade), the establishment of private ownership of land (disentailment, abolition of primogeniture, abolition of feudal lordships), and the establishment of the monetary system and the metric system, as well as business legislation (banking system, public limited companies, commercial code and the stock exchange). Secondly, the public institutions that created the liberal State were established: the liberal tax system, the expenditure budget for the supply of public goods, public officials, public debt reform, the education system and public charity were among the most important reforms (Gutiérrez-Poch 2018; Cuevas 2018; Pro 2019).

On the one hand, the liberal agrarian reform established private ownership of land, with the laws on the dissolution of the feudal lordships, abolition of primogeniture, the disentailment of the lands of the clergy and the municipal councils and the suppression of the tithe. These measures affected the distribution of wealth and income, resulting in growing inequality from 1840 on. The dissolution of the feudal lordships consolidated an unequal distribution of property, since the nobility held onto the land, becoming a landowning bourgeoisie. In the ecclesiastical disentailment carried out by Mendizábal in 1836, the lands of the clergy were bought by mid-sized and large-scale farmers, while urban land and buildings were acquired by the commercial bourgeoisie. The civil disentailment approved in 1855 by Pascual Madoz privatized the lands of the municipal councils. Both disentailment processes increased the size of the landed properties and favoured the mid-sized and large owners. They also increased the supply of land on the market, allowing the expansion of cropland area, thereby fostering agricultural growth until the start of the agricultural crisis in 1882. At the same time, the disentailment created the labour market (wage workers) because it led to the peasants' expulsion from the lands that they had, up to that point, cultivated under long-term contracts (*emphyteusis*)[12] in both lay and ecclesiastical seigneuries. It also deprived them of the free use of common land, which they used for grazing, firewood, hunting and fishing. From 1840, the liberal agrarian reforms and the political pact between the oligarchies (nobility and bourgeoisie), along with the increased demand for land by a growing population, exacerbated the situation of peasants and day labourers, putting an end to the ease with which they accessed farmland and pasture during the political crisis of the Ancien Régime between 1808 and 1836. This affected the distribution of income as land rent rose markedly from 1840, having previously stagnated, adversely affecting peasants' living conditions. This is reflected in the rise in child mortality, a decline in the height of men and the reduction of real wages in agriculture. The period after 1840 saw a return to the dynamics of the eighteenth century, with a growing ratio of land rent to wages, exacerbating the situation of tenants and wage workers while landowners grew richer (Llopis 2004; Pan-Montojo 2018).

On the other hand, the liberals created the liberal State: they liquidated State-owned companies, dispensed with economic interventionism and mercantile prohibition and implemented the fiscal and budgetary reforms proposed by the classical economists (Comín 2010). Constitutional governments abolished feudal taxes and privileges and established liberal tax principles (legality, general applicability, sufficiency and proportional equity). The constitutional tax reforms shed the initial radicalism of the Cortes of Cádiz, opting for pragmatism in the 1845 tax system passed by Alejandro Mon. This system lasted, with minor changes, until 1978.[13] The progressive governments of 1854 and 1868 respected said tax system, except for the excises, which were abolished. However, they failed to establish personal taxes, as occurred with the Figuerola tax reform in

1868. The main taxes of the liberal tax system of 1845 were the land tax, the excises and the customs tariff. Despite their opposition to State-owned companies, the liberals retained some fiscal monopolies (tobacco, salt, the lottery) and some State mines (Almadén, Río Tinto) to supplement public revenues (Fontana 1973, 1977; Comín 1988). However, the tax system allowed landlords and industrialists to commit tax fraud, as they hid their wealth to the Treasury, shifting the tax burden to peasants and urban consumers. Tax fraud was another one of the causes underlying the insufficient tax revenues and the public deficit shown in Fig. 2.1.

The poverty of the Treasury prevented the State from fulfilling the classic public functions: defence, security, public works and education. This fiscal incapacity explains the powerlessness of the Spanish army and the foreign invasions. It can also explain the reduced public investment in social fixed capital stock and human capital, which slowed down the industrialization process. So few public resources were devoted to education that most of the population remained illiterate (70% of the

Fig. 2.1 Public budget deficit on GDP (%). (Source: Comín (2014a))

population in 1870), which contributed to the fact that Spain's Human Development Index at that time was far lower than in the developed European countries (Prados de la Escosura 2003; Viñao 2018). In addition, the large budget deficits required a huge issuance of public debt, resulting in a financial burden that could not be borne by the State, which was bankrupt until 1851 (when the debt was restructured by finance minister Bravo Murillo). As shown in Fig. 2.2, this is evident from the high government bond yields of above 10%, a figure in the region of junk bonds. Financing the wars led to the debt crisis in Spain, which had serious consequences for the economic policy of the Spanish governments. In addition, it drove up the costs of financing the State and private companies, thus limiting industrialization. The hardships of the Treasury played a decisive role in how the disentailment, tariff, banking, railway and mining laws were carried out. The design of these laws to compensate domestic and foreign lenders during the Progressive Biennium and the

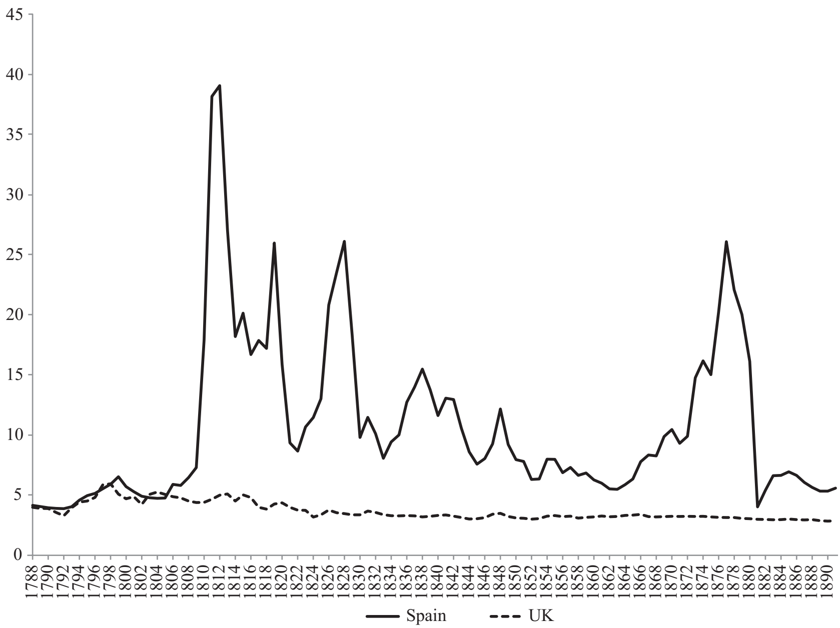

Fig. 2.2 Ten-year Government Bond Yield (%). (Source: Comín (2016))

Democratic Sexennial[14] are issues that have been proposed as explanatory factors for the failure of industrialization (Comín 2018a, b; Gutiérrez-Poch 2018).

2.4 Long-Term Economic Effects: Economic Growth Without Industrial Revolution

The Spanish economy recovered after 1815 because the war had not wreaked major destruction and because actually the institutions and economic practices established by the liberals were kept in place.[15] The capitalist institutions implemented fostered economic growth, with the population and GDP per capita rising simultaneously between 1815 and 1864, except during the Carlist War; in addition, both these variables grew at a faster rate than in the eighteenth century. In 1860, the Spanish population was 50% larger than that in 1787. Nevertheless, the growth in Spain's GDP per capita was less than half that of the European powers, indicating the "relative failure" of Spanish industrialization. Although industrialization began early in Spain, the process failed due to geographical, political and social constraints. Between 1850 and 1890, Spanish GDP grew at 1.7% per year, a lower rate than in other European countries; it was a sign of Spain's backwardness that in 1890 its GDP per capita was half that of Britain and 75% that of France and Germany. Another indication of Spain's lower level of industrialization was the domination of agricultural cycles, with their food crisis; agriculture remained the principal sector of the Spanish economy and its production was highly dependent on the quality of the land, and the dry climate with minimal irrigation. Proof of this can be found in the fact that, between 1840 and 1880, the structure of the active population did not change, with the agricultural population representing 64% of the total (Pascual and Sudrià 2002; Pérez Moreda 2010; Prados de la Escosura and Santiago-Caballero 2018).

The revolutionary measures taken during the War of Independence drove industrial change, but it took two decades to consolidate, and even then growth was slow and the industrialization process remained incomplete. Historians attribute the failure of the industrial revolution to several factors: first, the persistence of some elements of the Ancien Régime; second, political instability and wars; third, the narrowness of the internal market due to the stagnation of agriculture and the geographical environment; fourth, insufficient investment by the State; fifth, the inadequate endowment of agricultural resources; and sixth, the lack of an industrial policy.

In the first place, the vestiges of the Ancien Régime and the country's natural conditions played a role in the relative failure of industrialization. These two factors can explain why the capitalist institutions established by the liberal revolution did not lead to industrialization in Spain. The analysis of the long-term impact of the War of Independence on agriculture and industry underlies the debate on the causes of the failure of the industrial revolution in Spain. While experts in industrial history lay the blame for Spain's backwardness on agriculture, agricultural historians hold industry itself responsible.[16] Spanish agriculture did not remain stagnant, but rather responded positively to both domestic demand (cereal) and foreign demand (wine and citrus fruits). If Spanish agriculture did not achieve greater growth, it was because there was less industrial demand for superior agricultural products, which could have promoted dynamic agriculture, and for labour, which could have driven migration from the countryside to industrial districts. The latter would have solved the problem of agrarian underemployment and unemployment, and pushed up wages, which would have required greater investment from the agrarian owners (Pujol et al. 2001). On the other hand, this perspective denies that institutional issues (the changes in the liberal reform and the legacy of the Ancien Régime) played a prominent role in the evolution of agriculture in the nineteenth century. In any case—bearing in mind the inadequate resources available to Spanish agriculture—the form that the liberal revolution took place and the features inherited from the Ancien Régime made it impossible to resolve some of the traditional problems afflicting Spanish agriculture. Among these problems, it is worth highlighting the concentration of land ownership and the prevalence of smallholdings (minifundios). This situation created rural unemployment and underemployment, and low wages, and dissuaded landowners, as well as settlers and tenants, from making investments in the crops (Llopis 2004: 44–46). The reforms of the liberal revolution (disentailment and abolition of the feudal lordships) reinforced the structure of land ownership, since the purchases of disentailed land by the bourgeoisie and the peasantry sustained the concentration of land ownership. Moreover, the forms of extensive farming and land transfer (short-term leasing and sharecropping) remained the same after the liberal revolution. As such, smallholder farmers, who lacked the resources to invest in their farms, still predominated. Likewise, landowners continued to show little propensity for agricultural investment.

The persistence of the political and economic practices of the ruling classes of the Ancien Régime also included those related to political corruption and tax avoidance, which had serious consequences for economic growth and social stability (Pan-Montojo 1994). Changing the behaviour of politicians, businessmen and owners was more difficult than changing laws and institutions, the practical results of which depend on the ethics of the people in charge of them. The long process of political transition enabled the establishment of patronage and family relations between the nobility and the new bourgeoisie, which perpetuated the corrupt practices of the Ancien Régime. The result was that, between 1808 and 1876, the dominant pressure groups from the Ancien Régime (the Church, Army, landowners and local political bosses, or *caciques*) held sway in the State capture and control over economic policy. They were joined by new groups which emerged in the late eighteenth century (slave traders, industrialists, bankers, speculators, State contractors and foreign investors represented by Spanish frontmen). The political and matrimonial alliances between the commercial bourgeoisie and the landowners, which included the military and the civil servants, created a State that leaned towards the conservatism of the Moderate Party. This party favoured agrarian interests and those of the Church over the interests of industrialists and exporting farmers. Even the progressive governments undermined the national industrialists with the laws of the Progressive Biennium and Democratic Sexennial (relating to railways, banking and mining), favouring foreign capital and its representatives in Spain. This explains why there was no industrialization policy, with the exception of the one set out in the Figuerola tariff of 1869. The violence of the changes of regime and governments (through wars and coups d'état) has overshadowed the continuity of the economic and political elites and, therefore, of the economic policy implemented by the two regimes (absolutist and liberal). In fact, the institutional changes of liberalism were implemented by both liberal governments (Cortes de Cádiz, Constitutional Triennium, progressive governments) and the absolutist governments of Fernando VII, particularly in the decade 1823–1833, when important Francophile politicians returning from exile joined his government (La Parra 2018; Pro 2019).

The wars, the constitutional ruptures and the coups d'état masked the continuity of the characters, and the government and fiscal practices. The reforms carried out in the War of Independence were radical, but moderated in the following Liberal periods, particularly in the definitive reforms of the period 1833–1845. The governments of Fernando VII enacted liberal institutional reforms (tax reforms, creation of the stock exchange, the code of commerce and the Bank of San Fernando) because in his second restoration the king appointed reformist ministers (Francophiles and Treasury suppliers) who went on to occupy important positions in the liberal governments after 1833. The institutions changed, but they continued to be governed by the same type of characters, who perpetuated the patronage and corrupt behaviour of the Ancien Régime. The liberal State, made up of the progressive governments of 1837 and the moderates from 1844 on, featured many political remnants of absolutism, such as the supremacy of the crown, the clergy and the army. The persistence of corrupt behaviour thus hampered economic growth. Added to the ravages caused by the corruption and pillaging of Napoleon, Joseph I and his generals, were the corrupt practices typical of nineteenth-century monarchs and their courtiers, such as Fernando VII, his wife Maria Cristina and daughter Isabella II. These monarchs survived revolutions and counter-revolutions, surrounding themselves with and bestowing their favour on courtiers and financiers who monopolized business of the public budget through contracts and loans to the government, the leasing of public mines and the slave trade to Cuba, which had been illegal in Spain since 1817. These businesses related to the State budget offered huge profits to the contractors, compared to the more modest profits to be gained from industrial enterprise. The monarchs and the court allied themselves with the moderate and progressive governments to jointly plunder the country's wealth, just as was occurring at that time in the nascent republics of Latin America. The European powers, from Napoleon to the Holy Alliance, maintained these Spanish monarchs, absolutists by birth and upbringing. The UK and its financiers (the Rothschilds) also contributed to supporting these monarchs and bribing politicians. The public corruption explains why institutions that were formally similar to those in France could, in Spain, have results that ran so counter to economic growth (La Parra 2018; Pérez Garzón 2004; Rodrigo y Alharilla and Chaviano 2017; Piqueras 2017; Muñoz Jofre 2016; Comín 2018a, b).

The political instability and wars between 1808 and 1840 have been identified as the second factor explaining the delayed industrialization relative to the rest of Europe. Both circumstances created a high degree of uncertainty and business risk that curtailed investment. After the Napoleonic Wars, Spanish industry underwent a recovery and transformation between 1815 and 1835, due to the upturn in the agricultural sector, which increased the demand for industrial products. Change started to happen after the War of Independence because the dynamic industries (cotton, wool, silk, paper, steel and milling) recovered more strongly by adopting productive innovations, opening up new markets and abandoning guild practices. The advance of these modern industries was made possible by the liberalization of the legislative framework achieved through the bourgeois revolution, which enabled the factories' access to essential inputs (water, wood, minerals), established protectionist tariffs and later tackled contraband. Structural transformations were modest before 1840, but already featured some of the characteristics of nineteenth-century Spanish industrialization, such as the lack of international competitiveness of manufactured goods and their concentration in Catalonia. Although the loss of the colonies negatively affected industrial production (the cost to the economy was less than 5.6% of industrial value-added), the positive effects were more important. The loss forced Catalan employers to focus on the domestic market. They modernized their industrial practices, abandoning exports to America of textiles with low value-added in Catalonia and centring instead on full-cycle technological innovation to colonize the internal market by displacing traditional industries and by competing with contraband foreign products.

However, the industrial recovery after 1815 was slow because business innovations were hampered by the wars and political instability, which generated uncertainty among the industrialists and, moreover, resulted in the destruction of modern industrial capital. To the moderate industrial growth after the War of Independence also contributed the shortfall in demand, the shortage of capital, the deterioration of productive equipment, the breakup of commercial networks and, above all, widespread smuggling, which in 1827 accounted for 79% of all imports of textile products (Sánchez 2010).

A third factor concerns the narrowness of the internal market; this was due to the backwardness of the agricultural sector, which generated little purchasing power for industry. The peasants in the North worked small and almost self-sufficient farms that used few products purchased on the market and invested little in industrial products. The big landowners in the South did not generate industrial demand either because they were faced with an excess of low-wage day labourers and tenants with very smallholdings and short-term leases, which discouraged investment. This situation was not tackled by the landlords, who mandated agricultural growth based on extensive farming with low levels of productivity. The adoption of an agrarian growth model based on expanding the cultivated area while making minimal investment is one reason why agricultural growth came to a halt before 1860. Opting to base agricultural growth on extensive farming and cultivation of cereals can be explained by the climatic and geographical conditions in Spain, which prevented the expansion of more intensively farmed crops. The expansion of modern crops (vine and olive growing) was limited by the low domestic demand and the difficulty that producers in the interior had in gaining access to external markets, given the high costs of land transport. As of 1855, the creation of the railway network fostered the creation of a national market for food and raw materials, and facilitated the export of agricultural products from the interior (Llopis 2004: 43–44, 2010: 364–366).

The fourth explanatory factor for the backwardness of the Spanish industrialization process was the insufficiency of the tax system, which prevented the State from using the national budget to generate a certain level of demand. Indeed, it was not even able to pay for its classic functions (defence and security), nor was it able to invest in social fixed capital stock or human capital, elements indispensable for economic growth (Gutiérrez-Poch 2018; Comín 2010; Comín 2014a, b). Along with this situation, it is worth noting the obstacles placed to industrialization by the natural conditions and energy problems. Coal was an essential raw material and source of energy for the first industrial revolution. Spain had abundant coalfields but they were difficult to mine: the layers of coal were narrow and uneven; in addition, the mines were in mountainous areas with high transport costs. By 1860, Spanish coal was more expensive than British coal in Spanish ports, but high tariffs prevented imports. In 1882, British coal was already competing with Asturian coal because of the decline in freight rates and the reduction of tariff protection in Spain. Therefore, Spanish coal was only consumed in the vicinity of the mines, for smelting iron and other metals. As well as being expensive, Spanish coal was of poor quality, which hindered the industrialization process (Gutiérrez-Poch 2018).

Finally, mention must be made of the lack of an industrial policy, particularly in relation to foreign trade. Initially, prohibition made the smuggling of industrial products more widespread, and the government was unable to control it; the end result was as if there had been a free trade policy in place.[17] The enormous scale of the smuggling was made possible by the backing of some major Spanish traders, the forces that were supposed to be preventing it and trade from industrialized countries to smugglers in Gibraltar, Bayonne and the Portuguese border (Comín 2006). The smuggling that took place dealt not only in agricultural and commercial products, but also slaves. Trade in slaves had been illegal since Fernando VII prohibited it in 1817, but slave smuggling continued until the abolition of slavery in Cuba in 1886 (Piqueras 2017). The trade liberalization implemented by the finance ministers Mon (1849) and Figuerola (1869) put an end to the prohibitions and brought down tariffs. Ultimately, these worked as measures against smuggling, by reducing the premium smugglers stood to gain, and expanding legal foreign trade. This trade liberalization spread the effects of the European industrial revolution throughout Spain, meeting the demand for foodstuffs and raw materials, and providing Spain with capital and industrial equipment (Vallejo 2018). Figure 2.3 shows the negative relationship between the level of protection and the degree of openness.

Fig. 2.3 Protection and Openness rate (%). (Source: Tena (2005))

Indeed, the foreign trade model of the Spanish economy was radically transformed by the War of Independence and the loss of the colonies, since these events prompted the export of primary products (agricultural and mining) and the import of raw materials and equipment, which drove industrial modernization. The institutional reforms fostered the creation of the internal market, which was later further strengthened by the construction of railway networks from 1855 on. This market was characterized by the trade of cereals from the interior for manufactured goods from the periphery. The post-war recovery thus increased agricultural exports to France and Great Britain, which became the largest importers of Spanish products, compensating for the collapse of merino wool exports. Following the Mining Act of 1825, there was a rise in mining exports, which further multiplied after the law of 1869. These exports were made possible by European industrialization, which drove up the demand for food and raw materials, while improving the terms of trade for exported primary products compared to imported industrial products; international prices for industrial products fell as a result of European technological progress, which was reflected in the lower prices. Despite the loss of the continental Latin American markets, the remaining colonies (Cuba, basically) continued to absorb 25% of Spanish exports, as their markets were reserved for Spanish products. Between 1840 and 1880, foreign trade (M+X) grew at 4.5% per year, more than GDP, which was double the rate of increase in foreign openness (Fig. 2.3). The trade deficit also increased due to the growth of imports of goods, financed in part by the large inflows of capital after 1855, in banking, the railways and mining.

The final measures of the liberal revolution were adopted between 1844 and 1874. The end of the wars, the establishment of property rights and the Civil Guard to guarantee them, the political stability achieved by the Moderate Party from 1844, the fiscal reform of 1845, the foreign openness from 1849, Bravo Murillo's restructuring of the debt (1851) and the economic policies of the progressive periods (1855 and 1869) explain the increase in the rate of economic growth after 1845. Particularly notable were the economic reforms of the progressives (railway, banking, disentailment, corporate, monetary, tariff and mining) in the Progressive Biennium and the Democratic Sexennial. The liberalization of the internal and external market attracted direct investment and foreign technology. There was notable industrial growth due to the delay that had built up in the first half of the nineteenth century; imports of new technologies enabled an increase in productivity when the railway and mining policies were reformed. On one hand, the railway and banking laws of 1855–1856 created a railway bubble (1855–1866), which diverted capital from industrial investment towards the construction of the railway (Tortella 1973). It was financed by the 56 banks created between 1854 and 1865 (Martín-Aceña and Nogués-Marco 2013; Sudrià and Blasco 2016).[18] In Spain, unlike in Northern Europe, the railway was not a sufficient condition to drive industrialization. Its construction represented major business for foreign business owners, as they found in Spain a market for the products from their factories and received hefty State subsidies. However, once the construction of the trunk lines had been completed, the rail transport companies started to register accounting losses, as there was not enough traffic of either passengers or goods. This triggered a railway crisis that dragged down the new banks that had provided the financing

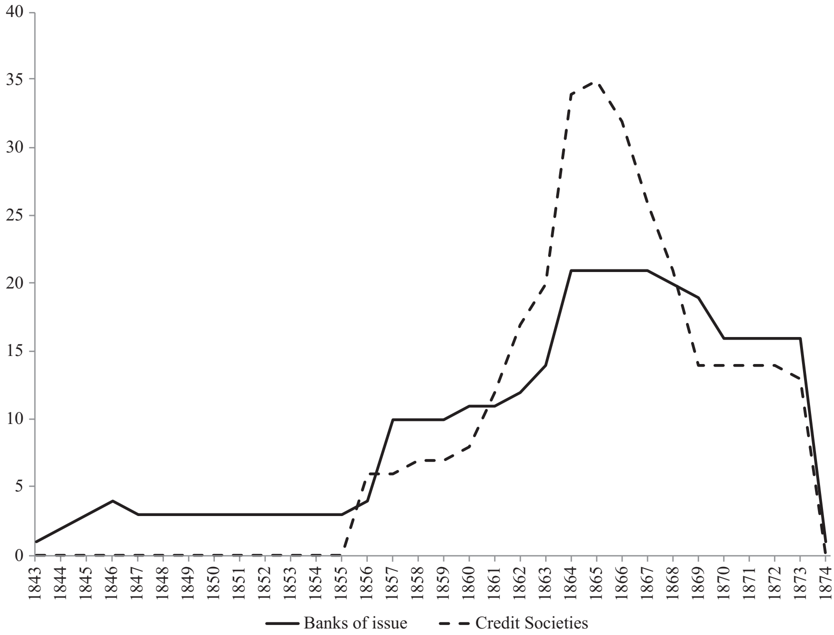

Fig. 2.4 Number of banks of issue and credit societies. (Source: Cuevas (2018))

(Fig. 2.4), many of which went bankrupt (Comín and Cuevas 2017; Cuevas 2018). In addition, the multiplier effect of the investment in the railways went overseas, as the law of 1855 granted railway firms a concession to freely import the necessary material. Consequently, the construction of the railways did not boost the steel sector or the metal industries in Spain, as it only created internal demand for coal, wood and labour for construction (Nadal 1975). Furthermore, the mining law of 1869 allowed the entry of foreign capital, which increased production and productivity in mining. This activity also did nothing to foster industrialization, as the minerals were exported in raw form, preventing the creation of a metallurgy industry. Following the foreign trade liberalization, Spain specialized in the export of primary products with no value-added, such as minerals and wines to Europe (Britain and France accounted for 50% of all exports) and flour to Cuba (which received 15% of exports, although technically they should not be counted as such because the island was a

Spanish province). The imports reveal a certain degree of industrial progress, with a decline in foodstuffs (sugar) and textiles due to the development of domestic production (which imported raw cotton). Exports of wines and minerals along with capital imports brought in foreign currency for the import of raw materials and machinery for industrialization. But trade policy remained strongly protectionist during the period under analysis. The Figuerola tariff of 1869 was moderately protectionist, as the fifth base that stipulated progressive tariff reductions was never applied, after being cancelled at the start of the Restoration (Montañés 2009; Sánchez Picón 2018; Pascual and Sudrià 2002).

2.5 Conclusions

The slower economic growth in Spain can be explained by three overlapping processes: the civil wars that lasted until 1840 and the political instability caused by coups d'état until 1874; the institutions, practices and attitudes from the Ancien Régime persisting into the liberal State; and the ruling elite's self-interested management of the State budget and public debt, which redistributed income in their favour and against the interests of the majority of the population, creating severe social instability that was maintained through the repression of the army. Moreover, in order to gain a more in-depth understanding of the failure of the industrial revolution in Spain, along with the institutions, it is essential to study the actions of the main players in the wars and the liberal revolution; specifically, the generals, politicians, nobles and merchants.

First, the problem of the civil wars and coups d'état from the War of Independence to the First Carlist War was that neither of the two armies (liberal or absolutist) was able to impose itself over the other and clearly establish the liberal revolution or maintain the Old Regime. The liberals' inability to swiftly conclude successive wars and implement the liberal revolution resulted in a protracted process of transition from the absolutist to the liberal State. This situation led to a lengthy period of political instability that slowed down and moderated the economic and institutional reforms, delaying the recovery of trade with the Americas, and exacerbating the bankruptcy of the Treasury (preventing the State from gaining control over smuggling and implementing an industrial policy that fostered economic growth). The long liberal revolution also allowed the privileged groups of the Ancien Régime to become embedded in the liberal regime, creating a Moderate State model that did little to favour industrialists and industrialization. It also allowed the persistence of certain structural problems and adverse practices of the absolute monarchy (profligacy with public funds) that reinforced local clientelism (*caciquismo*) and practices of patronage in the political parties, the army, the public administration, the municipalities and the clergy. In short, the new liberal institutions established after the War of Independence enabled a certain degree of economic growth, but the lack of "good governance" resulted in the failure of industrialization, whether the absolute failure claimed by Nadal (1975) or the relative failure cited by Prados de la Escosura (1988). The explanation for the relative industrial failure, in addition to the poor endowments offered by the Spanish geography, lies in the institutional, political and ethical differences between Spain and Northern Europe, particularly the UK.

Second, the overwhelming presence in the moderate and progressive governments of figures from the former absolutist regimes meant the inheritance of wide-ranging political and economic corruption. On the one hand, this prevented the impeccable liberal laws and capitalist institutions (copied from France) from working properly. On the other hand, the economic policies were detrimental to the modern industries and domestic companies, as they favoured the interests of the landowners, old merchants, contractors and financiers, and the foreign investors that bribed Spanish authorities and parliamentarians (Comín 2018a). These issues arose because the implementation of the liberal revolution in Spain became possible only when the landed nobility came together with the revolutionary bourgeoisie, and when the businessmen that trafficked slaves and held State contracts in the absolutist era joined forces with the liberals, patriots and Francophiles who had been exiled and persecuted under Fernando VII. This political union was enshrined by matrimonial unions of the nobility and the old commercial bourgeoisie with the new industrial and financial bourgeoisie. This alliance of interests between the old and the new elites explains why Spain was the penultimate country to abolish an institution as anti-liberal as slavery, as late as the 1880s. It also explains why its main leaders (including the monarchy) and businessmen continued to engage in the Atlantic slave trade, even though Spanish and international legislation had outlawed this traffic. The old nobility abandoned their defence of the Ancien Régime and joined the side of Isabella only when the progressives agreed to scale back the revolutionary aims of 1812. This led to moderation on the issues of national sovereignty (which would be shared with the monarchy), the laws of disentailment, free trade laws and those that abolished the feudal lordships and primogeniture. The tax reforms and public spending reform were also distorted to compensate the nobility (for the abolition of feudal rents and their share of the tithe) and the clergy. The feudal nobility became the landowning bourgeoisie and the clergy lost their fiscal autonomy, but went on to become financed by the State. As a result, the people most adversely affected by the liberal revolution sparked by the war against Napoleon were the peasants. They lost their rights to use common lands and the long leases of Church and feudal lands, and, moreover, continued to pay disproportionate taxes. Also affected were urban craftsmen and consumers, who paid consumption taxes and heavy tariffs on food imports. From a macroeconomic perspective, Spain lost out and ended up missing the industrialization train.

Lastly, the liberal revolution created marked inequality in the distribution of wealth and income, with a redistribution from the peasantry and consumers to the owners as a result of the liberal laws (disentailment, abolition of feudal lordships) and the effects of the State budget (asymmetric tax system, tax fraud, servicing the debt, favours to political friends through public spending and exemption from taxes and military service for the privileged). These forms of income redistribution were the economic basis for the clientele system (*caciquismo*) that held sway during this period. From 1850, the Spanish State, as a result of the increase in the debt, levied taxes on peasants and urban consumers to finance public spending. Indeed, in peacetime, the main budget item was the payment of interest on the debt. But the unequal distribution of income and the State's abstention on social issues (charity was left to individuals and municipalities, which lacked the funds to finance it) created dangerous social and political instability; those forsaken by the liberal regime adopted desperate (anarchists) strategies that were harshly repressed by the army and the Civil Guard (Martínez Soto 2018; Arenas 2018). Similarly, the tax reform of 1845 also allowed the continued tax evasion by the privileged classes (now economically privileged, as it was the bourgeoisie), which reduced the revenue coming into the Treasury. The Treasury was still afflicted by an addiction to debt, which determined economic policy during the liberal revolution. The resistance of the privileged groups to paying taxes prevented the absolutist State from fulfilling its function of defence, and the liberal State from fulfilling its role of promoting economic growth and tax equity.

The insufficient tax revenue collected by the State caused Spain's decline as a world power in the nineteenth century. After the War of Independence, Spain ceased to be an empire and became a second-tier nation when it was invaded by foreign armies and the American Creole elites gained their independence; later, the liberal governments were challenged by the Carlist forces. Finally, the creditors of the Treasury held the State to ransom and turned it into a debt nation. In addition, tariff, tax, banking, railway and mining policies were implemented that favoured bond holders and large financiers, both domestic and foreign, and were detrimental to farmers and consumers. This economic policy was a major factor in the failure of the industrial revolution in Spain. The enormous volume of public debt in Spain was generated not by the promotion of economic growth, but by wars and misgovernment. Irresponsible debt management hampered economic growth because it had a crowding-out effect on private investment in the era of the liberal revolution, when the monetary system in place was metallism and capital inflows were small, except in the progressive periods after 1855. The high government bond yields offered far greater profits than those earned in industry and legitimate trade, so many private savings were directed towards funding the State or State-subsidized investments such as the railroads. Finally, the insolvency of the public finances was responsible for the higher market interest rates in Spain compared to those in Northern European countries (Fig. 2.2). The higher cost of credit reduced the competitiveness of Spanish industry, as did the high cost of coal. The crowding-out of private investment by public debt, even in the phase of high levels of foreign investment after 1855, was made possible by the existence of bimetallic monetary patterns that prevented the monetization of the budget deficit (Comín 2018a, b).

Notes

1. The *carlists* were the supporters of Carlos Maria Isidro, the brother of the dead king, who wanted to maintain the Ancien Régime. Their opposition to the *isabellines* led to a civil war (the First Carlist War, 1833–1840), which brought about the pact between the nobility and the bourgeoisie to defeat the carlists and establish a liberal regime.
2. Between 1808 and 1876, patriots waged a war against the Francophiles (1808–1814); followed by liberal forces against Ferdinand VII (1814–1833); then liberals against carlists (1833–1840) and, finally, the coups d'état and revolutionary revolts of the Progressive Party against the Moderate Party, which were both liberal.
3. In October 1807, a French army of 28,000 soldiers crossed Spanish territory to invade Portugal, with reinforcements of 350,000 men arriving in July 1811; these forces of Napoleon suffered heavy losses due to the resistance of the Spanish people (Bell 2007).
4. The Mesta was a guild-type institution, created in 1273 to protect transhumant herding.
5. In these extraordinary circumstances, the peasants openly defaulted on the payment of their tithes and feudal dues, and ploughed municipal lands, in violation of the municipal ordinances and the privileges of the Mesta pastures. For their part, the municipalities, the provincial juntas and the regional councils not only legitimized this uncontrolled appropriation of land, but also sold off and distributed common land to raise funds with which to finance extraordinary war expenses.
6. This situation can be related to the loss of the Spanish navy and the ships of the marine guard in 1804, in Trafalgar, to the disorganization of the *resguardos de rentas* (a guard made up of revenue officers) at the borders, and, in general, due to the chaos ensuing from the war. While the political instability continued, smuggling remained commonplace, although levels dropped with the creation of the Civil Guard in 1844, and the reorganization of the *resguardos de rentas* (Comín 1996).

7. In Murcia, in April 1810, the general in command of the French troops demanded that the business owners pay a ransom in advance to prevent the looting of the city.
8. The liberal revolution in Spain experienced both advances and setbacks over a prolonged period of time. This period included two constitutional regimes—the Cortes of Cádiz from 1808 to 1813, and the Constitutional Triennium between 1820 and 1823—which were overthrown by two absolutist restorations of Fernando VII (in 1814 and 1823), before the liberal revolution finally prevailed during the First Carlist War (1833–1840).
9. The financiers and owners backed Mendizábal's disentailment rather than the proposal of Flórez Estrada, which was more favourable to the peasants.
10. From 1835 on, the pact between the progressives and the nobility (later going on to form the Moderate Party) favoured the former feudal lords in the distribution of seigniorial property, and in terms of compensation for the old public debt bonds, for the alienated incomes of the Crown, and for the participation of the laity in the tithes.
11. In an attempt to enlist the support of the Church, in 1841 the Moderate Party approved what was known as the *Presupuesto de Culto y Clero* (the budget for religion and the clergy) to subsidize the clergy. Moreover, in 1844 it even called a halt to the church disentailment.
12. Emphyteusis, one of the most widespread forms of land leasing in Spain before the liberal revolution, established a perpetual lease of the land.
13. This Minister of Finance copied the taxes in force in France, adapting them to the Spanish tax situation.
14. The term Progressive Biennium is used to refer to that established by the progressives between 1854 and 1856, in order to move forward with the reforms that had stalled under the Moderate Party. The Revolutionary or Democratic Sexennial is the name given to the period that started with the revolution of 1868 and lasted until the Bourbon Restoration of 1874. During this period the First Spanish Republic was briefly established (1873–1874).
15. Although Ferdinand VII restored absolutism in 1814 and 1823.
16. The "pro-agrarian" theory holds that agriculture was not responsible for the failure of the industrial revolution and the slow economic growth in Spain, as farmers responded to the increase and changes in demand and contributed to the growth of agricultural production, within the limits

of the insuperable environmental constraints imposed by the Spanish geography (see Pujol et al. 2001).

17. From 1820 on, the liberals of the Constitutional Triennium endorsed the prohibition model of mercantilism, although it was ineffective because the Spanish State was unable to stop the flow of contraband. The wars had destroyed the ships of the navy and the marine guards, which, just as with the terrestrial guards, lacked personnel and were not fully operational. In addition to the poverty of the Treasury, which handicapped the State in its fight against smuggling, the absolutist and liberal governments showed no interest in pursuing the matter and were unsuccessful in doing so. Furthermore, the smuggling was fuelled by prohibition itself and by banditry. A rise in banditry was caused by the guerrillas during the War of Independence, and by the poverty in the areas where contraband was traditionally rife—poverty which was exacerbated by the agrarian reforms of the liberal revolution that created so many unemployed day labourers.
18. The railway and banking bubble burst and triggered an economic (1864–1868) and political crisis (the Glorious Revolution of 1868) that led to Queen Isabella II being deposed.

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3

1898: The "Fin de Siècle" Crisis

Pablo Martín-Aceña and Inés Roldán de Montaud

3.1 1898: A Spanish Turning Point

Spain lost its Empire twice over. In the early nineteenth century it lost its colonies on mainland America after protracted wars of independence. And again, at the end of the century, when in two short naval battles against the United States—one in the Caribbean seas and the other in the Pacific oceans—the Spanish fleet was destroyed and it lost its remaining colonies: Cuba, Puerto Rico and the Philippines (Balfour 1996). The military defeat of 1898 and the end of the nation's Imperial status had a profound impact on the political, social and economic fabric of the country. It led to a general crisis with significant short- and long-term

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consequences. The year 1898—the year of the *disaster*, as it became known by contemporaries—marked a turning point in Spanish history and has left a lasting memory in the country's collective consciousness that lingers to the present day (Pan-Montojo 1998; Maluquer de Motes 1999a).

The *disaster* exposed as a terrible delusion the belief that Spain was anything more than a middle-ranking power. The loss of the last remnants of the Empire provoked a post-imperial crisis. Spain's political system, its national character and Spanish nationhood itself began to be widely questioned (Álvarez Junco 1998). The public perception of the defeat in the 1898 Spanish-American War was that of a profound and far-reaching failure. It was interpreted as proof of the inferiority of the Spanish character. No one was prepared for the debacle, and a mood of shame and dishonour spread throughout the whole nation (Balfour 1995).

The historiography on the *disaster* shows a consensus on the deep profound that losing the colonies represented, and on the pessimism it induced about Spain's economic conditions. Politicians, intellectuals, writers, journalists and the military were engulfed by an atmosphere of frustration that had no previous equivalent, even when the country had lost the bulk of its four-centuries-old Empire 80 years before. While losing the mainland colonies in the 1820s was perceived as "a loss of the King's territories", the loss of 1898—a mere 2% of what had been the large Spanish territory—was taken as a collective failure. Particularly, the islands of Cuba and Puerto Rico were considered an extension of Spanish territory (Balfour 1995). The crisis was all the more acute because it occurred at the peak of the age of Empire, when the possession of colonies was seen as the benchmark of a nation's fitness to survive. Spain was the only European nation that did not acquire new overseas territories, did not participate in the imperial powers' scramble for Africa and did not play a role in the distribution of areas of influence in Asia. Quite the contrary, while most of Europe's nations, from Portugal to Russia, gained new colonies, Spain was forced to abandon its three strategic territories, one of which—Cuba—was even richer than the metropole.

The wars and the end of the Empire in 1898 led to an identity crisis, with a general awareness that the country was militarily and politically weak, and economically backward. The Industrial Revolution had failed, and despite some progress, Spain lagged definitively behind developed countries of western, central and northern Europe.[1] The independence conflict that had been going on in Cuba since 1895 and the fight against the rebels in the Philippines since 1897, and later the war against the United States, stretched the financial resources of the country: public expenditure increased, government indebtedness rose, inflation soared and the peseta depreciated sharply. Losing Cuba, Puerto Rico and the Philippines implied the loss of a strategic reserve market for essential Spanish agrarian (flour, wine) and industrial (cotton textiles) exports. After 1898, sales to the former colonies collapsed and that impinged on total foreign trade.

The political regime, whose pillars dated back to the 1876 Constitution, survived another 25 years, but the shock of 1898 was followed by continuous government changes. To start with, the Liberal government of Mateo Sagasta—the man who officiated over the surrender with Washington and in the month of December signed the Treaty of Paris, through which Spain lost Cuba and Puerto Rico and was forced to sell the archipelago of the Philippines to the United States for 20 million dollars—was duly replaced by a Conservative government headed by Francisco Silvela in February 1899. Two years later, Sagasta was back in power with a team of ministers closely associated with the war period. Similar changes occurred frequently and it was not considered in any way remarkable. True, the regime resisted, but the period that followed the *disaster* was marked by unrelenting political instability (Varela 1997; Martorell Linares 2000, 2002). Government volatility became the feature of the period up to the First World War. The forces behind the instability were the new actors: the socialist party in Parliament, trade unions demanding radical changes in working conditions, the voice of the regions—Catalonia and the Basque Country—asking for autonomy, and a society undergoing a rapid process of modernization with new aspirations. In the period 1900–1913, Spain suffered from a dizzying succession of governments, which brought about a seemingly endless series of ministers of finance, with hardly any time to approve and implement meaningful reforms.

Moreover, the military defeat in the wars did not lead to a collapse of the economy or to the financial bankruptcy of the State. Contrary to predictions that the loss of the colonies would be followed by ruin, the Spanish economy did not plunge into an immediate crisis. In the years 1899–1900, an orthodox programme of financial reconstruction—fiscal and monetary measures to stabilize the economy—was successfully introduced. Military expenses were cut, government debt payments were reduced and the budget deficit eliminated, inflation was brought under control and the peseta appreciated. While there was a fall in the level of exports, it was not as severe as the loss of the protected market would suggest. Many industries depended on trade with Europe rather than with the territories. Thus, while exports to the colonies decreased, the loss was more than compensated by sales to other countries.

In fact, 1898 was followed by a strong reaction, a so-called regeneration drive. In the economic area, it materialized in an array of financial measures and reforms with the aim of straightening out a directionless economy and promoting industrialization (Maluquer de Motes 1999a; Velarde Fuertes 1999). In an attempt to close the gap with the most advanced European nations, a battery of economic reforms were implemented in the first years after the *disaster*. They included measures in the fiscal and monetary sphere, government investment in infrastructure, legislation to promote and protect strategic industries, and facilities to attract foreign capital. The purpose of the new policies was to "regenerate" the country and modernize its economic fabric. Not all the reforms and policy actions implemented were successful. Budgetary restrictions, on the one hand, and political instability, on the other, conditioned the results of the regeneration programme.

Nevertheless, and despite the limitations of the regeneration effort, the Spanish economy grew faster after 1900, and the gap between Spain and the most developed regions of the European continent did not widen as it had in the second half of the nineteenth century. Income per capital rose, death rates fell and the population grew, accompanied by a rapid rate of urbanization. Labour moved from low- to high-productivity sectors such as the new industries of the Second Industrial Revolution. Foreign investments in utilities and the service sector changed the face of many cities, particularly Barcelona, Bilbao and Madrid. The financial sector expanded with the establishment of new and larger banks and savings banks. New industrial and services companies were founded in successive waves with foreign capital, as well as with capital repatriated from the colonies (especially from Cuba). The 1898 shock and the ongoing process of world trade globalization forced the Spanish economy to adjust to the new financial and economic environment. However, the adaptation and integration into the international economy was incomplete, hindered by the permanent political instability which frustrated some of the reforms, and by the nationalist ideology that swept the country after the military catastrophe and the colonial loss.

In short, the year 1898 was indeed a watershed for the Spanish economy. Not only because of the financial impact and the loss of protected strategic markets, but also because of the awareness of the country's economic backwardness and the sense of failure, a regeneration impulse was set in motion. This involved an array of reforms to remedy *los males de la patria* (the malaise of the mother country), in the words of a central figure of the regeneration movement (Mallada 1898).

The chapter is organized as follows. Section 3.2 examines the impact of the loss of the last colonial markets on the Spanish economy. The costs of the Cuban war in 1895 and the US war three years later, together with the problems in how they were financed, are analysed in Sect. 3.3. Section 3.4 evaluates the programme of economic and social reforms undertaken at the end of the conflicts and after the loss of the colonies to regenerate the country. Section 3.5 includes some final remarks.

3.2 The Loss of the Colonial Markets

Although by the mid-nineteenth century the largest customers of Spain's exports were the most developed economies of Europe (accounting for 66% of the total), the share of what still remained of the Empire was not insignificant, totalling 8.0% of the export trade. There is no lack of contemporary testimonies, particularly with regard to Cuba, that confirm its importance for both agrarian goods and industrial products (Maluquer de Motes 1974). As early as 1871, the Centro Hispano-Ultramarino de Madrid stated that:

> When all nations, rich in their agricultural products, in their trade and in their manufactures, seek and secure markets for their fruits and artifacts, we cannot allow inertia to segregate or snatch the markets that we have formed in America, in that world that our ancestors uprooted from the dark, that we populate, and that owes to us their religion, culture and prosperity. If we let them get lost in their homeland, we lose the elements of the future Spanish renaissance; we will condemn our nascent industrialists, when not to death, to the languor that leads to agony.

Another text from the same period, looking at the crucial role of the colonial market, claims that:

> The Antilles … are … the market for our grains, our flours, our wines; they are the main force behind our merchant navy and our military navy; they are the source of our domestic economy and the place to where our people emigrate each year. With our help and our support, the colonies progress and enrich themselves, enriching the country and enriching their families.

Similar arguments of the relevance of the Caribbean market can be found in an article published in 1878 (Sudrià 1983), when the first war ended in Cuba:

> Taking advantage, then, of the peace that we fortunately enjoy, it is our ruler's duty to also seek all kinds of protection for the Peninsula, since so many sacrifices have been imposed on us to reach the desired end of such a bloody and costly struggle; and, in this case, the way to compensate us in part, is that our products be placed in the West Indies without hindrance or encumbrances of any kind.

From these and similar testimonies, it becomes clear that the colonial trade was seen as a significant force in promoting the economic growth of the country. A force that, it was argued, would contribute to the prosperity of the nation.

After 1880, with the introduction of protective legislation, the colonial market became even more relevant. The Commercial Relations Act of 1882 considered, for customs purposes, the overseas provinces a part of the Spanish mainland. It was a first step towards reserving the colonial market for the metropole's agrarian and industrial products. The act regulated the import regime applied to the islands, and established gradual reductions in tariffs so that by 1891 the commercial traffic between the mainland ports and colonial ports enjoyed the status of "coasting trade", with all the advantages that entailed. While this measure facilitated the free entry of Spanish goods into Cuba, Puerto Rico and the Philippines, a second regulation, the budget act of 1890–1891, implemented a 20% raise across the board in customs duties for foreign products. Soon after, the tariff act of 1892 confirmed this increase, and opened the way to further increases. By the end of the decade, all three colonial territories, particularly Cuba, had become a market entirely reserved for Spanish producers. Foreign goods, which faced high protective barriers, had been almost entirely excluded (Alzola y Minondo 1895; Zanetti Lecuona 1998).

There was no commercial reciprocity between the mainland and the colonies. Exports from the latter did not enjoy the same privileges as the peninsular products entering the colonial territories. Customs duties at Spanish borders remained high, and colonial goods also bore two specific loading taxes, the same as imports coming from elsewhere in the world. Pro-free trade Cuban planters and merchants, many of whom were of Spanish origin, complained bitterly of this unjust treatment. Industrial companies in the United States also protested against the discriminatory trade policy: Cuban and Puerto Rican markets were open to Spanish goods but closed to those of other nations. In retaliation, the US Congress approved in 1890 the Commercial Relations Act, better known as the McKinley Bill, which imposed heavy duties on imports shipped from the Spanish Antilles to the US market. The damage to Cuban sugar and tobacco producers was so acute that the Spanish government was forced to open negotiations with Washington to reach a *modus vivendi*, by which US manufacturers could enter the Cuban market at lower rates than the general tariff. In exchange, sugar and other primary products from the Spanish Antilles regained access to the huge US consumer market.

The rekindling of the independence conflict in Cuba after 1895 and the revolts in the Philippines constituted another factor that contributed to the expansion of colonial trade, especially textiles, shoes and foodstuffs, in order to supply the troops deployed in increasing numbers in both territories. And a third factor that contributed to the expansion of sales to the overseas colonies was the sharp depreciation of the peseta against the dollar and the major European gold standard currencies. From an exchange rate at parity in 1880 of one pound sterling to 25 pesetas, the value of the pound rose to 39 pesetas in 1898. This drop in the peseta-sterling exchange rate increased the competitiveness of Spanish exports and acted as an additional barrier for foreign imports.

Table 3.1 shows the share of the colonial market in total Spanish exports in different periods. In the quinquennium 1890–1894, exports to the Antilles represented 19.5% of total Spanish exports (Cuba 14.7% and Puerto Rico 2.8%), while trade with the Philippines accounted for 2.3%. Compared with the colonial trade of the Netherlands (4.5%), France (10.5%) or Portugal (13.8%), Spain's trade flows to its colonial territories were larger. In the following five-year period, from 1895 to 1899, the share of the overseas territories, stimulated by the aforementioned factors, increased to 24%; that is to say, the colonies absorbed almost a quarter of the total mainland foreign trade, with Cuba clearly leading the group. For the two islands of the Antilles, exports more than doubled before independence, while goods shipped to the Philippines multiplied by a factor of five.

It is also worth looking at the composition of both exports and imports in order to understand the impact of the loss of the overseas territories at a sectoral level. Until 1880, sales to Cuba consisted of two main products, flour and wines, which made up two-thirds of all colonial exports. Thereafter, Spanish wines found new markets in Continental Europe as a consequence of the French wine crisis caused by a phylloxera outbreak. Rice and olive oil were also exported to Cuba. But after the legislation of 1882, shoes and cotton textiles became leading exports to the colonial market, while flour exports expanded to meet the demand derived from

Table 3.1 Share of the colonial market in total Spanish exports. (In percentages)

	1890–1894	1895–1899	1900–1904	1910–1913
Cuba	14.7	16.8	6.1	5.3
Puerto Rico	2.8	3.2	0.6	0.3
Philippines	2.3	4.0	1.7	0.7
Total	19.8	24.0	8.4	6.3

Source: Estadísticas Históricas de España, vol. II, table 8.7

the war. The same can be said for Puerto Rico, where the main products sold were flour, grains, legumes, wine and olive oil. Shoes and cotton textiles were added in increasing quantities. At the end of the 1890s, flour and cotton textiles accounted for almost a third of total exports. Spanish imports from Cuba and Puerto Rico were the typical tropical and plantation commodities: sugar, tobacco and coffee (Maluquer de Motes 1974; Fraile and Escribano 1998).[2]

For the Catalan textile industry, the market of the colonies took on a strategic relevance (Harrison 1974). From 1885 to 1891, the proportion of exports jumped from 3% to 13%, and kept growing thereafter. In the most prosperous years, 1893–1897, cotton textile exports from Catalonia reached levels of almost 10,000 metric tons annually, of which 45% went to Cuba, 17% to Puerto Rico and 33% to the Philippines. This item became the leading product among Spanish exports to the Antilles, and by 1898, exports to Cuba and Puerto Rico alone accounted for 20% of the total production of the cotton industry (Sudrià 1983).

According to the figures of the *Estadísticas del Comercio Exterior de España* (Spanish Foreign Trade Statistics), the trade balance between Spain and Cuba was consistently favourable to Spain both before and after 1882. For instance, in that year, exports were three times greater than imports. The difference increased the following year, and in 1897 exports to Cuba were valued at 123.4 million pesetas while imports amounted to 19.0 million, that is, 6.5 times more exports than imports. A similar conclusion can be reached looking at the trade with Puerto Rico. Spanish sales to the small Antilles island always exceeded its purchases, such that the trade balance was always positive. The balance of 43.1 million pesetas in 1889–1891 increased to 96.4 million in 1892–1894, and then rose to a maximum of 151.6 million in 1895–1897. In fact, the surplus balance of the colonial trade contributed to the overall trade surplus and in some years it even offset Spain's trade deficits with the rest of the world.

With the military defeat in both Caribbean and Pacific waters, colonial trade figure plummeted immediately after the end of Spain's sovereignty over the islands. According to the Spanish Foreign Trade Statistics, the total colonial export trade of 286.0 million pesetas fell to 81.4 million. Overall, the average volume of exports to the former colonies shortly before the Great War represented only 6% of the total, a long way off the figure from before 1898. Exports to Cuba, which reached a peak in 1897 of 252.9 million pesetas, dropped to 67.4 million in 1898. By the beginning of the century, 1900–1904, peninsular sales to the former colonies as a share of total exports were 6.1% in Cuba and 1.7% in the Philippines, while for Puerto Rico they had almost disappeared entirely (0.6%). These percentages continued to decrease: in 1910–1913, they were 5.3% for Cuba. 0.3% for Puerto Rico and 0.7% for the Philippines. These shares were far below those recorded before the *déblâcle*.

For the cotton industry, the defeat and decolonization had very serious consequences, at least in the short term. The loss of the Antilles and the Philippines meant a notable reduction in the volume of cotton manufactures placed in the colonial market. In Cuba, sales volumes declined from an annual average of 4500 tons in the five-year period before 1898 to 1800 in the years that followed the *disaster*. In the case of the Philippines, the decline was even more abrupt: from 2500 to 800 tons per year. The most notable damage was, however, in Puerto Rico, where the export total fell to merely symbolic figures. Overall, shipments of cotton to overseas colonies dropped by 70%, from 8500 to 2600 tons per year (Sudrià 1983, 1999).

The impact of the collapse of the share of colonial trade in total exports can be observed in Fig. 3.1. Total exports also fell from a high of 1345 million pesetas in 1898 to a low of 1138 million in 1902, a non-negligible drop of 15%. The substantial commercial balance of 488 million pesetas in 1898 sank to a much lower figure of 15 million in 1901. Undoubtedly contributing to this decline was the deterioration in the balance of trade with the colonies: from 151.6 million in 1895–1897 to 52.1 million in 1901–1903. These figures subsequently recovered, but slowly, and did not return to the 1898 level until 1911, with 1396 million. Factors contributing to this aggregate decrease included not only the closing of the colonial market, but also the revaluation of the exchange rate of the peseta after the stabilization plan discussed in the next section. In sum, the loss of the Antillean (Cuba and Puerto Rico) and Philippine colonial markets was a blow to the Spanish economy (Maluquer de Motes 1974; Sudrià 1983).

Fig. 3.1 Foreign trade: exports and the trade balance, 1880–1913. (Source: *Estadísticas del Comercio Exterior de España*)

The fall in foreign trade would have been even larger if it had not been for certain forces that partially offset the loss. A substantial share of the volume of total exports was redirected to alternative areas in Latin America and Europe, although these exports remained limited until 1914, when Spain's neutrality boosted all its exports (Fraile and Escribano 1998). For instance, the share of trade with developed European countries increased somewhat, albeit no more than three percentage points, from 67% in 1895–1899 to 70% in the four-year period 1910–1913. Exports to the United States grew slightly: from representing 1.3% of the total at the end of the century to 5.8% in the years before the Great War. And in the Latin American republics, the foreign sales that had represented 6% of total exports between 1895 and 1899 rose to 8.7% in the years 1910–1913.

Nevertheless, for Castilian growers and flour millers, neither Europe nor Latin America served to compensate the loss of the protected colonial markets; their sales to the three territories practically disappeared due to the competition of foreign suppliers. The Catalan industrialists fared somewhat better. Exports of cotton fabrics to the American republics totalled 715 tons in 1898, rising to 1874 tons in 1913; the main destinations were Argentina and Mexico, which had previously been fairly small markets. In the case of Europe (especially France, Italy, the United Kingdom and Germany) the figure of 706.0 tons (12%) in 1898 increased to a maximum of 1615.2 tons in 1909 (19% of the total). After this date, there was a notable reduction until the First World War. The lack of competitiveness was the main difficulty affecting the external placement of Spanish cotton manufactures, as their prices exceeded those of foreign producers by as much as 30%.

There was however a positive aspect of the loss of the colonies, which has been emphasized by the economic literature: the end of Spanish sovereignty prompted a repatriation of capital, particularly from wealthy Spanish entrepreneurs in Cuba and from Cuban citizens of Spanish origin. The total figure has been estimated at between 1000 and 2500 million pesetas,[3] a not insubstantial amount. The flow continued during the first decade after the loss of the colonies, and the resources were invested in all sectors of the economy. The *indianos*, the term used to describe the wealthy Spaniards returning from America, bought property and built houses for their families in places where they were born or had sentimental ties. Also, part of the capital was channelled to financial institutions, either transforming small firms into joint-stock companies or creating new banks, some of which became leaders in the sector. Repatriated funds were also invested in modern industrial concerns, such as metallurgy, electricity, cement and chemicals.

There is no lack of qualitative evidence. For instance, accounts of Spanish entrepreneurs that established businesses in the three overseas territories (most of them in Cuba) and biographies of *indianos* have traced their economic activities (Bahamonde and Cayuela 1992). Moreover, the influx of repatriated capital, and foreign capital, in an even larger volume foreign capital, is reflected in the number of banks established between 1900 and 1910, and in the balance sheets of banks and other credit institution. From the 36 banks registered in 1900, by 1910 the official statistics list 60. Bank deposits, including those in all credit institutions, increased from 533 million pesetas in 1900 to 945 million in 1913. The number and size of companies created or listed on the stock exchanges of Madrid, Barcelona and Bilbao is also proof of the availability of fresh capital, either *indiano* or foreign (British, French, German, Belgian and Swiss). By 1900, the number of joint-stock companies was 944 and it increased to 1291 in 1913. In short, after 1898 the foreign trade balance suffered, while the capital account exhibited better health.

3.3 War and Finances

The outbreak of a new rebellion in Cuba in 1895 forced Spain to engage in a costly three-year war. A few months later in the same year, a second independence movement surged in the Philippines. In addition, in the spring of 1898, with the intervention of the United States in both territories, and also in Puerto Rico, the conflicts acquired an international dimension. The financing of the wars became an essential issue; indeed, this was the second way in which the turn-of-the-century events impinged on the Spanish economy. How to pay for the war became a central concern for the ministers of finance and foreign affairs, as well as for the presidents of the government; first, for the conservative Antonio Cánovas del Castillo and later for the liberal Mateo Sagasta.

The metropole wanted the treasuries of each of the colonies to be responsible for the war expenses, without them affecting the general State budget. This implied that the funds used to pay for the wars had to come out of the local budgets, whether through tax increases, by issuing debt or by arranging credits with local or foreign financial entities. Nevertheless, as the armed conflicts lasted longer than expected and became complicated by the intervention of the United States, the costs exceeded the financial capacity of the colonies and eventually the governments of Madrid had no choice but to get involved in their financing (Maluquer de Motes 1996, 1999b; Roldán de Montaud 1997).

When the uprising broke out in Cuba, the island's finances were already in difficulty. The Ten Years' War of 1868–1878 had cost more than half a million pesos (2500 million pesetas) and left the Cuban Treasury with an outstanding debt of 125 million pesos (625 million pesetas). During the following years, the metropolitan government tried to strengthen the accounts of the island. It introduced cuts in public spending and reformed several taxes to increase revenues. Moreover, two debt conversions were undertaken in 1886 and 1890 to extend its amortization period and reduce its financial burden, which in the mid-1880s absorbed between 40% and 50% of the colony's revenue. To continue operations, new debt securities were created, *Obligaciones hipotecarias de la Isla de Cuba* (Mortgage obligations of the island of Cuba), known by the popular name of *cubas*. Although the sales of the *Obligaciones* served to cover part of the annual deficit, the truth is that the budget remained unbalanced throughout (Roldán de Montaud 1997; 1999b).

When the news of the uprising reached Madrid in the month of February, the war minister announced that 6000 men would be sent to the conflict and an additional contingent of 20,000 would be prepared (by the end of the conflict Spain had sent more than 180,000 officers and soldiers). In parallel, the foreign affairs minister requested an extraordinary war loan. He argued that if the ordinary resources of the island were insufficient, the uncovered expenses could be financed with the issue of new *cubas*. In this way, the Spanish Congress approved 650 million pesetas, thought to be sufficient to sustain a short conflict. Later developments would mean that the quantity fell short of what was needed, as the war against those in favour of independence dragged on.

Part of the securities were placed directly on the market: a total of 167 million. The rest was used as collateral to negotiate a loan with the Banque de Paris et Pays Bas (Paribas), the sole credit operation that it was possible to obtain abroad. The Bank of Spain also allowed *Obligaciones hipotecarias de la Isla de Cuba* as collateral for loans and advances to the minister of the colonies. The first operation between the Treasury and the Bank concluded in April 1895, for a total of 25 million pesetas. Further advances followed, and at the end of the year, operations totalling 135 million had been carried out. This same policy continued during the following years. By the end of 1898, the credit provided by the Bank to the central Treasury amounted to 1238 million pesetas, more than 60% of the total portfolio of the issuing institution. In fact, the Bank of Spain became the financial institution that provided the largest share of the resources consumed during the war.

In 1896, the war continued with the money obtained through the sale of *Obligaciones hipotecarias*, that is, with the Cuban Treasury's own resources. However, once the supply of securities had been exhausted, subsequent credit operations had to be guaranteed by the metropolitan Treasury. In the 1896–1897 budget, it was explicitly acknowledged that local budget revenue no longer served as a basis or guarantee for any credit operation of the Cuban Treasury. For the first time in the financial relations between the metropole and the colony, there was a reversal in the policy that made the Cuban Treasury responsible for the debt contracted to finance the war. New loans and advances needed to be guaranteed by metropolitan income. Cuba had lost its credit.

The first time that peninsular income was used to guarantee an operation in favour of the Cuban Treasury was in July 1896. It consisted in the issue of *Obligaciones hipotecarias* to the value of 400 million pesetas, backed by income out of the central budget, particularly customs revenue. The product of the issue was delivered, as an advance, to the Cuban Treasury, which would be obliged to settle the operation at a future date.

At the end of 1896, the political situation worsened. In December, the American president, Grover Cleveland, sent a worrying message to the Spanish government. He argued that even if the White House did not yet recognize the belligerent status of the Cuban rebels, the United States could not remain indifferent to a situation that affected its economic interests. If Spain could not pacify its colony, it would jeopardize its national sovereignty. Shortly thereafter, that warning materialized in a serious threat: on 20 May, the American Senate approved the recognition of belligerency of the Cuban insurgents. Worse, on 21 September 1897, the United States issued an ultimatum demanding that the government of Madrid find a solution to the conflict in Cuba, either by accepting the mediation of the United States or by pacifying the situation by its own means. It was clearly a warning that the United States would eventually intervene.

At the time, Spain was facing a turbulent political situation. Cánovas del Castillo was assassinated in August 1897 and the conservative government fell from power. On 4 October 1897, a liberal government headed by Sagasta took office. The new administration assumed that it was impossible for the conflict to last much longer. However, as long as it lasted and until an agreement was reached, more money was needed, since the coffers were completely empty. The Madrid authorities tried to obtain external financing, but the price of public debt on the stock exchange hit the floor and the growing tension with Washington, which would eventually lead to war, made any foreign credit operation impracticable.

As the money from the loans of 1896 had all been used and the Cuban Treasury did not have securities that could be used as collateral for advances from the Bank of Spain, the peninsular Treasury was forced to make a new issue of short-term bills, amounting to 200 million pesetas. As in the previous case, the product would be delivered to the Cuban Treasury as an advance. And in December 1897, the Government decided on a new (third) issue, of 200 million pesetas backed by customs duties. All in all, the Treasury bills already on the market totalled 800 million pesetas.

The Caribbean island was not the only zone in conflict. The political and military situation in the Philippines worsened after the Balintawak cry for independence in the suburbs of Manila. As in the case of Cuba, the Government of Madrid decided that the war expenses should be borne by the local Treasury. That is, the expenses derived from the fight against the insurrection would be the exclusive responsibility of the Treasury of the archipelago.

As of March 1897, the war had become more intense and additional troops had to be sent. This meant higher expenses. In an attempt to obtain funds, the Government negotiated with foreign and national bankers, but had no luck with either. Without the contribution of private capital, the Government urgently prepared a project to ensure the placement of a loan with a general guarantee from the nation. Given the pressing circumstances, Parliament approved the project without discussion. This time, the issue—mortgage bonds of the Philippine Treasury known as *filipinas*—amounted to 200 million pesetas, with the double guarantee of the islands' customs revenues and Spain's general incomes. The debt was divided into two series. Series A was offered to peninsular subscribers and to ensure its success, its placement was negotiated with a group of Spanish financial institutions. The B series, placed in Manila for Philippine investors, encountered many difficulties. It was an operation that had never been attempted before in the colony, which did not even have a stock exchange.

The explosion of the US battleship *Maine* in the waters of Havana on 15 February 1898 made war with the United States inevitable. On 11 April, President William McKinley requested authorization from Congress to intervene in Cuba. The joint resolution of the House of Representatives and the Senate demanding the immediate independence of Cuba and empowering the president to send troops to Cuba was in fact a declaration of war. This sent shockwaves through the credit market: on 20 April, the stock market price of Spanish redeemable debt, which in March had been trading at 86.7 below its nominal quotation, fell to 55.0. On 23 April, the minister of finance gathered a prominent group of bankers in Madrid and asked them for support to end the stock market panic. The fear was also that the shaky situation would affect the Bank of Spain and the convertibility of its notes. There were rumours of a possible decree imposing the *corso forzoso*.

In early May, events accelerated. The Philippines' independence uprising in Cavite against the sovereignty of Spain's rule was the prelude to the destruction of the Spanish fleet by the American navy in Manila Bay. The impact on the quoted price of the Spanish public debt was immediate; it fell to a low of 45% of its nominal value. The decline was transmitted to the market value of the *cubas* and the *Filipinas*. Both securities dropped 20 points in less than 24 hours. The finance minister, in need of urgent funds to meet the challenge of the American invasion, requested more advances from the Bank, which in turn demanded to raise the legal issue limit of 1500 million pesetas set in 1891 to 2500 million. Finally, in a desperate move, in May 1898 Parliament approved an extraordinary act that opened all feasible channels for the Government to obtain whatever means were at hand: the issuance of State and Treasury debt in all its forms—perpetual, redeemable and floating (Roldán de Montaud 1997; 1999a).

Figures on the cost of the war vary according to the source (official public administrators or private researchers), ranging from a minimum of 2000 million pesetas to a maximum of 5000 million. The most accurate estimate is that of the *Cuenta General de las Campañas de Cuba y Filipinas* (General Account of the Campaigns of Cuba and the Philippines),

Table 3.2 The cost of the colonial wars. (In thousands of pesos (pesetas in parentheses))

Years	General account of the expenses in Cuba	General account of the expenses in the Philippines	Total
1895–1896	63,802		63,802
1896	45,000		45,000
1897	118,462		118,462
1898	167,535	45,520	213,055
1899–1900	184,386	8765	193,151
Total	579,185	54,285	633,470
	(2,895,925)	(271,425)	(3,167,350)

Source: Roldán de Montaud (1997)

prepared by the Ministry of Foreign Affairs, a summary of which is exhibited in Table 3.2. According to this exceptional document that covers the period 1895–1902, the cost of the war in Cuba was 2896 million pesetas, while the Philippines campaign cost 271 million. In total 3167 million was spent; this was a huge amount, four times greater than the government budget revenue, and equivalent to one-third of the country's gross national product. Obviously, the Cuban conflict absorbed the bulk of the funds mobilized to pay for the wars. The conflict in the Philippines was also expensive, but much less so. In the Puerto Rican case, as the war lasted only a few weeks, its impact on the country's overall finances was insignificant.

The total of 3167 million pesetas had been mainly financed with credit, that is, by issuing all sorts of short- and long-term Treasury and State debt, guaranteed with revenue from either the colonial or the metropolitan budgets. As can be seen in Table 3.5 (next section), the outstanding volume of Treasury bills multiplied by a factor of three, and the total public debt jumped from 7400 million pesetas in 1895 to 10,596 million by the end of 1898, or a 30% increase. Only a relatively small amount, around 50 million, was obtained through ordinary taxes. Table 3.3 shows the variety of securities issued in millions of pesos and pesetas. Part of the debt was placed on the market and taken by private companies and individual investors. The largest portion went to the portfolio of the Bank of Spain in exchange for money advances. Government assets on the Bank's balance sheet amounted to 789 million pesetas in

Table 3.3 Debt issues in Spain and in the colonies to finance the wars

	Million pesetas	Million pesos
Mortgage bills (1886 issue)	35.3	7.1
Mortgage bills (1890 issue)	582.9	116.6
Obligations guarantee with customs revenue	800.0	160.0
The Philippines loan	200.0	40.0
Miscellaneous credit accounts	250.0	50.0
Non-redeemable public debt issues	2000.0	400.0
Total	3868.2	773.6

Source: Roldán de Montaud (1997)

1895, while by 1898 this figure had increased to 1811 million, or more than 90% of its portfolio and 70% of its total balance sheet. From these figures, it is apparent that the Treasury was heavily indebted to the Bank, and the survival of the latter depended on the repayment of the credits (Tedde de Lorca and Anes 1976).

The changes on the asset side of the Bank's balance sheet involved a rapid expansion of the volume of banknotes in circulation, which in turn led to a significant rise in the stock of money (Martín-Aceña 1994). The consequences were inflation and an uncontrolled depreciation of the peseta, as can be observed in Fig. 3.2. Prices that had remained stable since 1880 began an upward trend in 1895, and from that year on the drift accelerated. Simultaneously, the price of the gold standard currencies rose. For instance, the pound sterling rate of 26.3 pesetas in 1890 was 28.9 in 1895 and reached a peak of 39.2 in 1898. The financing of the war brought not only budget deficits and indebtedness, but also rampant inflation and currency devaluation.

One last question needs to be addressed in order to understand why the State was forced to take on the debt left by the war, and how it was eventually solved after 1899. As explained above, the financing of the wars was borne by the colonial treasuries, and left very few traces in the metropolitan budget. Even the amortization expenses of the Cuban and Philippine mortgage notes were allocated to the local budgets (Tedde de Lorca 1981; Roldán de Montaud 1997).

The Treaty of Paris, which ended Spanish sovereignty over the three territories, was mute with regard to the financial legacy of the conflicts.

Fig. 3.2 Prices and the peseta exchange rate. (Source: Martín-Aceña and Pons (2005))

Spain tried to make the United States, or Cuba and the Philippines themselves, responsible for the debt payments, as generally established in international law. The attempt did not get far. Much of the debt had been issued with the guarantee of the nation's credit, and the fact that a large proportion of it was in the portfolio of the Bank of Spain meant that the Spanish authorities were obliged to return the loans. In other words, Spain was compelled to accept the subrogation of all the colonial debt. Therefore, the budget for 1899 included a chapter under the heading *Deudas procedentes de las colonias* (Debts from the colonies) for an amount of 1175 million pesetas that had been guaranteed by each of the colonial treasures, and another 1520 million that had the direct guarantee of the central Treasury. Adding up the two gives a figure of 2695 million pesetas. The amount required annually to service the debt, in terms of amortization and interest payments, was 197 million (the total, however, was even higher because there were a few more unpaid colonial expenses added to this amount that had to be included in the central budget). Since the annual bill to service all the public debt of the central government (7103 million pesetas) was 332 million pesetas, the pressing problem was how to pay 529 million pesetas all together to service these debts when the estimated revenue in the Spanish budget was only 750 million pesetas.

In order to face this critical problem and thereby avoid an unwanted and catastrophic default, the only viable solution was to undertake radical debt restructuring and a far-reaching fiscal reform accompanied by cuts in ordinary expenditures. This was in fact what was done after the signing of the Treaty of Paris (Roldán de Montaud 1997).

3.4 Reaction, Regeneration, Reforms

The bitter defeat of 1898 meant that Spanish society was faced with an unpleasant political and economic reality. There was near-consensus among social agents that the liberal regime born with the Constitution of 1876 had worn itself out, that it did not function as expected. Spain was a weak nation: it had lost its Empire because its economy was underdeveloped and uncompetitive, and poverty was widespread throughout all its regions. Action was needed to remedy the shortcomings of the country. It was necessary to modernize its economic structure. Spain urgently needed to be regenerated from top to bottom, starting with the economy.[4]

Regeneration meant implementing reforms to increase the population's standard of living, to provide the country with basic infrastructure, and to build a solid transport network connecting the inland regions with the Mediterranean and Atlantic ports, from which exports were sent to the rest of the world. It was also necessary to eradicate the illiteracy that was still widespread in large sections of rural areas, to open public schools in all villages, to reduce mortality rates, especially infant mortality, and to promote a better distribution of income and wealth. The State had to mobilize all its resources and use the instruments it had at hand. It had to intervene directly and indirectly in the economy. The government was obliged to design and apply a battery of policy measures to promote investment and production. It also had to defend agrarian and industrial producers from foreign competition through higher tariffs and with all sorts of protective mechanisms.

The most urgent priority was to put an end to the financial chaos left by the wars of independence and the war against the United States. Before undertaking any reform, it was necessary to implement a "stabilization plan" to end the budget deficit, reduce the indebtedness of the State, cut monetary expansion, curb the depreciation of the peseta and adopt the gold standard in order to join the international monetary system. There was no time to lose, and so the task was immediately assumed by the so-called National Regeneration Government, constituted by Francisco Silvela in March 1899. The man in charge of the stability programme was the Minister of Finance, Raimundo Fernández Villaverde. On his shoulders fell the responsibility of rescuing the exchequer from its near-bankruptcy and of restoring the fiscal and monetary equilibrium of the nation (Harrison 1980).

The first goal was to balance the budget. As the minister declared in a discourse in the Senate in the month of November,

> the heart of the problem… may be summed up in what abroad is called balancing the budget … a policy which causes the state to live off its own income, where the budget is in equilibrium, strong enough to support itself, with normal resources, without recourse to the use, or rather the misuse, of credit.

To balance the budget, the most essential measure was to reduce the debt burden; with the amortization and interest payments, and including the colonial debts, it accounted for 40% of total expenditure, or almost half of the total resources of the budget revenues. There were three elements to the debt reform: first, the consolidation of the floating Treasury debt into redeemable titles, with a maturity term of 50 years; second, the reduction of the net annual cost (payment) of all outstanding debts with the establishment of a 20% tax on the interests received by the debt holders; and third, the conversion of the redeemable debt into perpetual debt. The first two elements were approved immediately by the law of August 1899 and the third by the law of March 1900 (Comín 1999a, b). The finance minister also imposed an austerity policy with the aim of containing current expenses, which hardly increased at all in the following ten years (Table 3.4).

Balancing the budget also required an increase in the ordinary revenue of the State, necessitating a fiscal reform to create new taxes and reinforce existing ones. The changes in this area were less radical, despite three attempts to reform the entire tax system: one in 1909 and the others in 1912 (Martorell Linares 2002). Hence, there was no innovation, but rather a restructuring of the tax table. The idea was not to increase fiscal pressure but to modernize the tax structure. The rates of some indirect taxes, in particular the consumption tax, were eliminated or reduced, while the direct ones on capital and labour were reinforced. The minister's proposed tax reforms were contained in 54 separate bills, not all of which were approved. As mentioned above, they covered a number of areas, among them production, consumption, personal taxation and inheritance. The most far-reaching of these reforms in the long-term was the *ley de contribución de utilidades* of 27 March 1900, which aimed to tax

Table 3.4 Central government budget, 1900–1913. (Million pesetas)

Years	Revenue	Expenditures	Surplus/deficit
1900	964	929	+35
1901	1021	983	+38
1902	1024	953	+71
1903	1037	1014	+23
1904	1037	983	+53
1905	1041	969	+72
1906	1105	1002	+103
1907	1097	1031	+66
1908	1079	1023	+56
1909	1065	1116	−51
1910	1128	1133	−6
1911	1181	1175	+7
1912	1196	1259	−63
1913	1371	1442	−71

Source: Comín (1988)

Table 3.5 Public debt in circulation. (Million pesetas)

Year	Government debt	Treasury bonds	Total public debt
1895	6409	818	7400
1896	6492	1391	7977
1897	6443	1842	8378
1898	7399	3109	10,596
1899	8422	2943	11,449
1900	9618	3026	12,729
1901	11,051	2222	13,363
1902	11,101	2149	13,337
1903	11,505	1152	12,744
1904	11,498	1052	12,638
1905	11,488	936	12,523
1906	11,488	937	12,533
1907	11,666	690	12,475
1908	11,678	589	12,390
1909	11,851	456	12,471
1910	9851	452	10,480
1911	9787	443	10,420
1912	9782	361	10,350
1913	9793	356	10,372

Source: Comín and Diaz (2005)

personal income and the profits of industrial companies. Another important tax reform addressed the official stamp duty, through which the finance minister managed to double the income from this source. To compensate for the loss of revenue from the import duties on sugarcane from the Antilles, a new tax on sugar was introduced (Solé Villalonga 1967; Martorell Linares 2002).

In the area of monetary policy, the stabilization programme sought to deflate prices and stop the depreciation of the currency. To achieve these two goals, it was crucial to reduce the amount of Bank of Spain banknotes in circulation, which was still the main component of the Spanish money supply in 1899. To that end, the first measure was to lower the legal issue limit, from 2500 to 2000 million pesetas. At the same time, the interest rate on loans from the Bank to the Treasury was cut. And in 1902, a law partially reformed the Bank, forcing it to sell its portfolio of public funds to reduce its balance and to strengthen its gold metal reserve with a view to implementing, in the immediate future, the much-desired gold standard system to give stability to the peseta (Martín-Aceña 1994, 2000; Sabaté Sort and Serrano Sanz 1999).

The stabilization programme was an undeniable success, and the debt conversion was widely acclaimed. When Villaverde left office in July 1900, the burden of the debt interests, which accounted for approximately two-fifths of the budgetary expenses, had been reduced by more than 2200 million pesetas. The effect of the conversion on the budget for 1899–1900 was impressive. The annual burden of interest on the debt which had previously stood at 464.5 million pesetas was reduced to 287.7 million, a net saving of 176.7 million. Table 3.5 tracks the evolution of the debt in circulation. Initially, in 1899–1901, the conversion and consolidation policies increased the outstanding volume, but after 1902 the downward trend is obvious: from its highest level of 13,363 to 10,372 million pesetas by the end of the period. The most remarkable feature was the drastic drop in the quantity of Treasury bonds, falling from a peak of 3026 million pesetas to only 356 million by 1913.

Although the fiscal reform did not turn the whole system around, some advances were made. Fiscal pressure did not increase because finance ministers wanted to promote investments to boost the national economy. They also sought to introduce a near–income tax and suppress unpopular indirect taxation, such as the consumption tax, without compromising total revenue. Both goals were accomplished. More importantly, as can be seen in Table 3.4, between 1900 and 1908, the budget resulted in a surplus. True, the budget returned to deficit in 1909. However, until 1913 it was a controlled deficit; in fact, the fiscal year of 1911 closed once again in surplus.

The deflationary policy introduced by the government was more than effective. The quantity of banknotes in circulation fell by more than 100 million pesetas, and this translated into a reduction of the total money stock of nearly 300 million. The drastic process of sales of government assets held by the Bank in its portfolio also yielded results: from a maximum of 1811 million pesetas in 1898, they fell to 730 million in 1905 and then to 456 million in 1913. That is, as a proportion, they went from 70% of total assets to a mere 17%. On the contrary, the gold reserve on the Bank's balance sheet increased substantially, from 342 million in 1898 to 674 million in 1913. The purchases were aimed, in part, at preparing the institution for the adoption of the gold standard (Martín-Aceña 2000).

Prices were stabilized and within a few years there was a convergence towards international levels, thereby narrowing the difference between Spanish domestic prices and international prices. The exchange rate immediately mirrored what had happened to prices, to the budget balance and the reinforcement of the gold reserves. The appreciation was as quick and spectacular as its previous decline. In the 13 years between 1900 and 1913, the peseta managed to recover almost all of its lost value, reaching a rate of 27 pesetas to the pound, a mere 5% below its official parity when it first was defined in 1868. These developments led the authorities to consider the possible adoption of the gold standard, although eventually no definite decision was taken.

The stabilization programme was followed by reforms in different fields: economic, social and administrative. In the Public Administration area, the aim was to professionalize the career of civil servants. An Act approved by the Ministry of Finance in 1904 increased the number of its technical staff, modified the hiring procedures and provided greater stability to the employees. The example was followed in other ministerial departments that approved similar standards.

A significant new initiative was the creation of the Ministry of Public Instruction in 1900, through which the State assumed responsibility for the payment of teachers' salaries in primary education, opened new schools and hired more personnel. In secondary education, an act of 1901 introduced the teaching model used in French schools, which was deemed to be more modern and efficient. At the level of university education, the innovations included the establishment of specialized research organizations, such as the *Junta para la Ampliación de Estudios*, the *Centro de Estudios Hispánicos*, and new scientific research centres, such as the *Instituto de Material Científico*.

In 1905, the Ministry of Agriculture, Industry and Commerce was renamed Ministry of *Fomento* (Development). It was reorganized with specialized departments and staffing quality was improved by hiring engineers, architects, economists and technical officials in various fields. The most remarkable initiative was the creation of seven river basin authorities hydraulic divisions, which were the forerunners of the *Confederaciones*

Hidrográficas. Besides, in 1907 a Production Council was established to coordinate the works and projects of the Ministry.

The intervention of the State in the economy became even more visible with the Plan of Hydraulic Works of 1902, through which the State took charge of the construction of a network of dams, reservoirs and irrigation channels to foster agrarian productivity. It also began projects to improve the water supply to major cities. In its early stages, little progress was made but there was a significant jump in investment with a specific Law of Hydraulic Works enacted in 1911. Equally successful was the Agronomic Service created in 1907 to organize the intervention of the State in the field. The aims of this service were to establish a clear legal framework for rural development and create instruments to help farmers introduce new production methods, mechanized plots and fertilizers, and to facilitate the sale of the harvests. Another goal was to solve the lack of rural credit, a crucial factor needed to modernize the primary sector. Also in 1907, a law on colonization and repopulation was passed, and timid steps were taken to implement agrarian reform, distributing public lands that were poorly cultivated or uncultivated.

Another pillar of government action was through the use of indirect measures to promote production. In 1906, the government approved protective tariffs, with high import duties to shield national industrial producers from foreign competition. One year later, a specific Industrial Protection Act established that all contracts and purchases made by any public administration body should be "national". It meant that only Spanish companies could make contracts with the State, the provinces or the municipalities to develop investment projects and receive subsidies or tax exemption, and also that domestic producers had priority over foreign firms to supply goods and services to those same administrative units. To ensure compliance, the *Comisión Protectora de la Producción Nacional* (National Production Protection Commission) was set up, a body that would have a significant role to play in the policy to support and protect domestic manufacturing. In 1907, another initiative was approved: the Naval Programme to reconstruct the navy, which contained substantial direct financial aid to the shipyards and, hence, served to promote the activities of related firms. In addition, in order to develop the merchant navy, the Maritime and Communications Act of 1909 established several aid mechanisms, including subsidies and money bonuses.

The State intervention in the field of social assistance was also considerable. A key piece of the welfare policy was the creation in 1903 of the *Instituto de Reforma Social* (Institute of Social Reforms), which implemented extensive measures to regulate working conditions in industry, the working day for women and children, safety and hygiene in factories, and protection from workplace accidents. Another field of action was the push to construct low-cost housing for workers and find ways to facilitate their access to banking credit. In 1906, the Labour Inspection Service began to operate, and in 1908 the *Instituto Nacional de Previsión* (National Institute of Welfare) was set up. These two instruments laid the foundations for the presence of the Public Administration in the area of social assistance and welfare.

Some of these abovementioned changes were reflected in the budget. Debt amortization and interest payment expenditures fell. Expenditures first dropped and then held steady after 1900, which implied that the governments—both conservative and liberal—were able to stick to the stringent austerity policy launched with the stabilization programme. As a result, and along with the savings in debt servicing, there was room to increase public spending in other areas. Defence expenditures rose due to the financial aid channelled to the reconstruction of the navy. Public investment also increased as a consequence of the government's programmes to improve the transport network and to finance the hydroelectric initiatives. The State taking on the expenses of primary education is also an example, as is the moderate percentage increases in welfare and health expenditures in the total budget (Tedde de Lorca 1981).

3.5 Final Remarks: The Performance of the Economy, 1900–1914

The year 1898 was, and still is, a memorable turning point in Spanish political and economic history. Two external shocks—the war against the United States and the loss of what remained of Spain's former huge colonial Empire—shook the country's collective consciousness, and the fundamental pillars on which its political system was based. Both events were seen and felt as a national tragedy, as a catastrophe that revealed the nation's weakness and its shortcomings. Francisco Silvela himself denounced Spain as a country "without a pulse", and Lord Salisbury, in his oft-quoted speech in May 1898, had implicitly referred to Spain as a "dying nation". It was certainly a nation whose future was in doubt. The country, from its political body down to the common people, fell into a profound identity crisis.

The unexpected military defeat against the United States—an adversary that was not a European power, did not have historical respectability and was effectively unknown to many, but that had risen to become the world's top-ranking industrial nation—was taken as an unmitigated humiliation (Balfour 1995, 1996). The defeat had taken just a few weeks, with the navy destroyed in both the harbours of Santiago and Manila. Moreover, the army deployed in Cuba and the Philippines after years of heavy fighting had been unable to prevail over the non-professional rebel groups of fighters, who eventually put an end to three centuries of Spanish sovereignty over the islands. The *disaster* was seen as a consequence of an exhausted and decadent political regime dominated by two parties—the Conservatives and the Liberals—that replaced one another in government. The regime was thought to have already run its course. The 1898 catastrophe was also perceived as sign of economic backwardness and poor management of the public resources.

Surprisingly enough and contrary to all expectations, 1898 was not followed by either political disintegration or economic breakdown. Both the constitutional regime of 1876 and the economy resisted the shocks, and despite the high cost of the wars in terms of both human lives and money, the State survived. On the contrary, the end of the conflicts and the loss of the colonies set in motion a wide-ranging programme of economic and social reforms, the ultimate aim of which was to regenerate a country that was thought moribund (Maluquer de Motes 1999b; Tedde de Lorca 1997; Pan-Montojo 1998).

The macroeconomic statistics for the first years of the new century reveal progress in income and investment dynamism. The financial reconstruction successfully reduced the volume of public debt in circulation, balanced the budget, put an end to inflation and reversed the fall in the peseta's external value. Consumers and entrepreneurs reversed their expectations. Foreign capital flowed into new industries and repatriated wealth from the colonies permitted the incorporation of the Spanish economy into the expansionist wave of prosperity that characterized the world economy for nearly the first decade and a half of the twentieth century, up to the outbreak of the Great War in 1914.

Spain's economic performance between 1900 and 1913 stands up well in comparison with previous periods. Gross domestic product (GDP) growth in constant terms for the last two decades of the nineteenth century, 1880–1899, was about 0.8%, while after the *disaster* and up to 1913 it rose to 1.8%, which is not an insignificant difference. The population grew from 18.6 million in 1900 to 19.9 million in 1910. Overall mortality fell from 29 to 22 per thousand between 1900 and 1913. Industrial output grew at the moderate rate of 1.7%, but the sector diversified and benefitted from the innovations associated with the Second Industrial Revolution. Markets became more integrated and the level of financial intermediation increased.

All combined, the end of the wars, the financial stabilization, the arrival of repatriated capital, the entry of foreign capital and the reforms generated an atmosphere of optimism that changed business expectations. There was a revival of private investment and a reawakening of entrepreneurial activity. The reforms initiatives spread across all sectors.

The energy industry was one of the most dynamic, particularly in the production and distribution of electricity. A handful of firms were created to take advantage of river flows. Two giants were founded: one in 1901, Hidroeléctrica Ibérica; and a second in 1907, Hidroeléctrica Española. New and old credit institutions were behind the promotion of both companies. There were significant changes in the iron and steel industry due to a process of concentration, especially with the establishment of new companies such as Altos Hornos de Vizcaya, another huge enterprise. In metallurgy and machinery, similar movements took place; well-known names at the time included Metalúrgica Duro-Felguera, Nueva Montaña Quijano and Sociedad Española de Construcciones Metálicas. In the shipbuilding industry, the leaders included the Sociedad Española de Construcción Naval and the shipyard Euskalduna. The first automotive manufacturing plant was opened in Spain in 1904, the

Hispano Suiza. There was also frenetic activity in the chemical industry, with the foundation of two modern companies, Cros in 1904 and Unión Española de Explosivos; and in the food industry, where in 1903 the Sociedad General Azucarera was born.

Entrepreneurship in banking resumed its past progress after two decades of stagnation. Two of the largest credit institutions were founded in Madrid: el Banco Hispano Americano (with Spanish-Mexican capital) in 1900, and the Banco Español de Crédito (out of the nationalization of the Spanish Credit Mobilier with domestic money) in 1902. Two other powerful institutions were founded in Bilbao: the Banco de Vizcaya and the Crédito de la Unión Minera en 1901.

The available quantitative evidence on GDP indicates that following the relatively good performance during the first part of the 1890s, figures for the last five years were negative. GDP fell by 1.1 points and GDP per capita by almost three points. Beginning in 1899, the recovery was strong, particularly in the early years of the century, with remarkably positive percentage variations. The upswing continued thereafter; as such, it can be said that the Spanish economy enjoyed an uninterrupted "golden period" for more than a decade.

There are a number of different driving forces behind these economic "good times". First, there is the stability framework generated by the financial reconstruction undertaken immediately after the Treaty of Paris. Second, the large amounts of private capital (foreign and domestic) channelled to the new sectors of the Second Industrial Revolution, complemented with the State's investment efforts in infrastructure, and in the transportation network. Third, the protection provided to the agricultural and industrial sectors by the tariff act introduced in 1906. Fourth, a change in the expectations of both consumers and entrepreneurs, as the conclusion of the conflicts brought an end to a long period of uncertainty. It seems that the *disaster* was no longer a topic of discussion in the boards of directors of the main companies. The end of the war expenses, the balancing of the budget and the appreciation of the peseta came as a relief, prompting families and firms to reconsider their consumption and investment plans for the future. Besides, nominal and real wages that fell after 1895, albeit slightly, improved at the turn of the century: in 1913, they were 11% and 7% higher, respectively, than in 1898 (Maluquer de

Motes 1999a). Though minor, the improvement may have been enough for workers to sense that their purchasing power had increased.

A significant factor was the economic wave of globalization that characterized the world economy from 1875 on and continued into the first decade and a half of the twentieth century. The new technologies in maritime transportation (the adoption of steam in transoceanic shipping) and the extension and improvements in the railway systems reduced the cost of freight and fares. Not only were more people moving from one continent to another, but the volume of foreign trade also increased. Protectionism decreased thanks to reductions in tariffs and trade policy removed mercantilist restrictions on economic activity. Free trade advanced throughout, although after 1890 some European countries and the United States raised duties on imports to defend nascent industries and to protect farmers from cheap foreign foodstuffs and raw materials. Technical progress in a large number of industrial sectors, such as chemicals, steel, equipment, and energy (electricity and oil), and in communications (the telegraph and the telephone) caused world prices of finished and semi-finished products to decline. Real wages grew and the standard of living rose, particularly in the most developed nations of Europe and America. The gold standard system became universal, bringing general stability to foreign exchange markets. The multilateral payment network that emerged in the last decades of the nineteenth century deepened and facilitated the movements of goods, services and capital. International investment enjoyed a "golden age", and capital moved almost freely from London, Paris and Berlin to the rest of the world. The establishment and growth of specialized financial institutions in both lending and borrowing countries, such as commercial banks and investment houses, made foreign investment easier and less risky. Trade and migration also enjoyed exceptional years.

Undoubtedly, the economy of Spain, despite its nationalistic bias and its lean towards protectionism, did not remain untouched by this phase of globalization. As has been mentioned, foreign capital poured into the country to complement domestic savings, and was eventually invested in new industrial and banking companies. As the borders were kept open, Spanish emigration peaked and workers and entrepreneurs settled and thrived in their host countries, in particular in the South American subcontinent. There was even a rise in the exports of a more diversified economy, in spite of the loss of the colonial market. Globalization was therefore another factor that contributed to the growth of Spain's economy after 1900.

Although there was obvious progress, it is also true that compared with the most developed economies of Europe, the picture is less rosy. The Spanish GDP growth rate did not match that of its major trading partners, Germany (2.7%), France (2.4%) or Italy (2.6%), all of which were better placed to take advantage of the globalization drive that swept the world from 1870. Rather Spain's rate was closer to that of climacteric Great Britain (1.6%). Hence convergence, not only with Western Europe but also with the rest of the world, had to wait till the 1920s. This means that the reforms undertaken after 1900 took time to materialize. Moreover, since the fiscal changes were limited, the State remained financially weak, with insufficient resources to carry out all its modernizing programmes, as occurred in the education sphere. On the other hand, protectionism may have been excessive, reducing the necessary incentives to entrepreneurs to increase competitiveness and search for foreign markets. It has been argued that the interventionist and nationalist nature of the economic policy implemented after 1900 could have been somehow detrimental. The political instability of the period may also have frustrated some reforms and impinged on the performance of the economy.

The year 1898 was a defining moment in Spanish economic history. First, because the vast and ancient Empire of the Monarchy, which dated back to the sixteenth century came to an end. The loss of Cuba, Puerto Rico and the Philippines meant that the country was no longer an imperial power, but merely a middle-ranking nation. The loss of the three colonies critically affected Spain's foreign trade and the financing of the wars against the independence groups in Cuba and the Philippines, and against the United States caused financial distress leading to inflation and currency depreciation. The reaction after the collapse forms part of the 1898 turning point. What happened in 1898 set in motion an array of economic reforms to "regenerate" the country's structure and changed business expectations. The mood of economic agents shifted from pessimism to optimism almost overnight. Under the umbrella of this new atmosphere and the influence of an increasingly globalized international economy, Spain rapidly recovered from the shocks and made solid progress in the first decade of the twentieth century.

Notes

1. For the evolution and trends of the Spanish economy in the nineteenth century, see Prados de la Escosura (1988).
2. Tobacco was a state monopoly and was subject to special trade conditions (Roldán de Montaud 2002).
3. Maluquer de Motes (1999a), who has studied the issue in some detail, suggests an even large figure. See also Broder (1976) and García López (1992).
4. The term *regenerationism* became widely used after 1898 to designate the need for reforms to change the course of the country. Two widely mentioned writings of the time were Macías Picavea (1899) and Costa (1924), and, more recently, Harrison (1979).

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4

1936. Frustrated Hopes: The Great Depression, the Second Republic and the Civil War

Concha Betrán

4.1 1936 Turning Point in the Spanish Economy

Contrary to general trends in many other economies in the interwar period, the Great Depression in Spain coincided with the collapse of the monarchical regime for a second time and the establishment of a modern democracy with the Second Republic on 14th April 1931. While many countries turned towards totalitarian regimes during the period, Spain changed from a dictatorial monarchy to a republic with a full, modern democracy.[1] However, in the context of economic depression, the new regime faced remarkable challenges due to the growing demands. As a democracy, the Republic had to meet the demands of diverse competing groups, especially those from an emerging middle class, who had been left behind during the dictatorship.

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The economic growth of the 1920s produced major advances in new sectors. At that time, manufacturing overtook agriculture in the economy, accounting for 28% of GDP. Although the share of agriculture in total employment was around 50%, this represented a reduction from the previously high figure of 65% of total employment. There was a decline in traditional industries, such as food and textiles, in favour of a more diversified industrial structure, with the rise of the electricity industries, and industries of primary metal processing, building materials, equipment goods and metal transformation. Manufacturing was also geographically distributed, triggering urbanization and the expansion of cities (Madrid, Barcelona, Valencia, Sevilla and Saragossa). Consequently, this also was a period of internal migration: the growing industries attracted migrants to the industrial and service centres, as labour was driven out of agricultural areas towards these expanding regions.[2]

Changes were also taking place in the countryside. Although the fact that wheat production was protected by tariffs meant this crop represented a large share of agricultural production, there was a significant shift in Spanish agriculture towards new crops: olive trees, fruits (citrus, tomatoes, dried fruits) and vegetables, with growing success in the international export markets during the period. The growth of cities and highly productive agricultural regions stood in contrast to the traditional, backward rural areas, some of which were home to landless peasants. All these changes were accompanied by the geographical dispersion of the economic activity in manufacturing and agriculture.

In the period before the Great Depression, inequality narrowed as a consequence of economic growth, capital accumulation and structural change. Inequality indicators such as the Gini index and the ratio of wages to GDP per capita both peaked during World War I and decreased during the 1920s. But, at the same time, as a consequence of the economic growth of the 1920s, the ratio of profits or capital income to GDP increased (Tafunell 2005) as did the skill premium, the ratio between the wages of skilled and unskilled workers (Betrán and Pons 2004). Moreover, there was a dispersion of economic activity; regional income inequality reached its highest level in 1920 before falling until 1930 (Rosés et al. 2010). These changes in income and regional distribution can be considered as indicative of a more diversified and complex economy and society, in which the demand for major reforms intensified (Comín 2002).

These new demands arose in the midst of an international shock, namely the Great Depression, making economic policy a huge challenge. Foreign markets dried up, agricultural prices fell abruptly and Spain's major exports, which were agricultural and raw materials, faced serious difficulties. For example, wine, which had represented the bulk of Spanish exports in the second half of the nineteenth century, had many problems in accessing its traditional markets due to protectionist policies (in France, the US and Argentina). Similarly, orange exports were damaged by the British Imperial Preference, with Valencia citrus growers losing their privileged market to imports from Palestine and South Africa. International migrations from Spain that started in the late nineteenth century were still significant in the 1920s, but ended with the Great Depression. Capital flows fled the market as a consequence of the crisis and because of the uncertainties associated with the new political regime. Meanwhile, the trade deficit increased in the 1920s, supported by capital inflows; however, in the new context of economic depression, the currency underwent a major devaluation from 1928 to 1932. The international environment constituted an external constraint for a small, southern European, middle-income country such as Spain.

The Republic embodied a government coalition that gave a voice to those who had been marginalized by the preceding dictatorship. These interests represented the advance of fruit growers, urban manufacturers and the new demands from workers and landless peasants. During the interwar years, social unrest and public grievances were common in Spain,[3] as in many other countries. In the case of Spain, the King allowed dictatorial governments (Primo de Rivera and later Berenguer) from 1923 to 1930 in an attempt to put a stop to social unrest and other social and political claims. However, Spanish society's demands for political changes were manifested in the first municipal elections held after the fall of the dictatorship. Monarchic parties were defeated by republican ones, and King Alfonso XIII renounced the throne and left the country, going to Rome. The Republic was peacefully established. While other countries turned to dictatorships during the period (Portugal, Italy and Germany), Spain shifted towards a modern democratic republic, a democracy with an ambitious programme of reforms. However, this was an extraordinary challenge amid the international economic crisis, given the severe external constraints on this small country that had lost its empire while others were on the ascendency with an expansion of colonial and trade relationships from the end of the nineteenth century onwards.

Expectations concerning the new government were high but the times were turbulent. The new democratic Republican regime attempted to implement reforms to meet the challenges, creating new institutions to promote growth, establishing "inclusive" institutions through social policies and implementing economic policies to face the international crisis. The Republic's hope was to have the chance to shape the country into a more modern one, with democratic and inclusive institutions and free from the pressure of the old elites or traditional interest groups. The Azaña government, a coalition of liberal and socialist reformers, rapidly implemented a wide-ranging political and social package, including the separation of Church and State, army reform, land reform, an ambitious public education project, labour reform, divorce law, women's suffrage and the prospect of autonomy for the regions (Malefakis 1970; Preston 1978). However, this produced a domestic shock as the political change also generated political instability and depressed business expectations. Besides, the new social policies came up against the constraint of the balance of payments. The higher unit costs caused by the new labour laws had made competing imports more attractive and profits fell. In the countryside, wheat and other agricultural prices were falling, and the partial land reform contributed to the deteriorating economic conditions.

In addition, cultural and social changes, such as the secularism of the society and the concessions to workers, were not well accepted by a part of the emerging middle class, a conservative bourgeoisie.[4] Nor was the working class free from internal tensions. The division and conflict between the two most important unions (CNT and UGT, the anarcho-syndicalism National Confederation of Labour, and the socialist General Workers' Union, respectively) was also a looming problem at the start of the Republic.[5] Early on, the CNT supported political turmoil, with several strikes and three insurrections (18th January 1932, 8th January 1933 and 8th December 1933), specifically in Catalonia and Andalusia.

The economic crisis intensely affected this young regime due to the fall in the agrarian exports and increasing chronic unemployment in agriculture and manufacturing. Business stoppages, tariff barriers, trade restrictions and quota policies were a shock to the Spanish economy (Azaña 1986: 26–28). The aims of economic policy had to be changed to involve more interventionism from the State, following a more accommodative approach.[6] However, from the very beginning of the new regime, there was constant scheming against the Republic.[7] The opposition and critics found a wide audience in the newspapers and journals (Jackson 1965), making the challenges tougher for this democratic constituent regime. In 1933, CEDA, a coalition of right-wing parties (including the Radical Republicans), ascended to power and tried to paralyze part of the reforms, particularly in 1935. In February 1936, a government with a majority of republican and socialist parties won the elections, a new coalition of left-wing parties called the Popular Front. In spite of this, the republican bourgeoisie (centre-left) was in power (without representation of the labour parties), implementing a moderate programme announced and agreed before the elections (Azaña 1986: 30). Azaña's second spell in power lasted until 1939, when his side was defeated in the Civil War. Conflict and polarization increased during this period: there was an attempted military coup on 10th August 1932 (by General Sanjurjo) backed by the far right and a general strike and miners' revolt in 1934 (October) organized by the far left. Tensions rose notably after 1934; accordingly, the goal of Azaña's new government was pacification. However, Juliá (2008) argues that this approach had the opposite result, resulting in more conflict. The reason he gives is that the socialists (Largo Caballero's radical part) and the unions used confrontation as a way to weaken the government so that the socialists could later gain power for themselves.

Support for the new regime declined during the period. On the one hand, opposition to the reforms came from the elites (landowners and capitalists), with the landowners especially opposed to the land reform (Malefakis 1970), given that policy had been dominated by agricultural elites and long-standing interests in textile manufacturing and iron and steel well into the 1920s. On the other hand, the central and northern Spain's conservative middle class (professionals, merchants and bureaucrats and mid-size landowners) were also opposed. This had much to do with the Church and secularization reforms (Graham 2005), as well as the social reforms (Jackson 1965).

The consequences were fatal: a military coup on 18th July 1936 that—unlike the successful coup in 1923 that led to rapid regime change with the Primo de Rivera dictatorship, and the next in 1932 that was defeated—met with resistance from big cities and republican supporters, leading to a civil war (Juliá 2008: 175–76). The Civil War lasted three years and was immediately followed by World War II. The consequence was a historical turning point in terms of Spanish economic growth and development: an economic autarky lasting until at least 1951, and an interventionist economy until 1959, a huge loss of human capital, and a 40-year political dictatorship. This turning point was a sad time for Spaniards; the economic and political consequences were long-lasting and can still be felt even today.

The chapter is organized as follows. First, we explain the Great Depression in Spain and the policies enacted, describing the characteristics of the financial crisis and how Spain dealt with this shock. Second, we address the reforms implemented in the Second Republic and the economic and political implications. Third, we discuss the interwar period, which in Spain ended in 1936 with the Civil War (1936–1939), and its implications. In the final section, we conclude that hopes of reform were left unfulfilled, with a severe backlash against social and economic restructuring.

4.2 The Great Depression in Spain: Impact and Policies

In terms of GDP per capita, the impact of the Great Depression in Spain was milder than in the US but similar in intensity to the rest of Western Europe on average. For instance, the effects were less severe than in France and Germany but similar to those experienced by Italy and Belgium. The drop in per capita income in the Spanish economy was around 12% between 1929 and 1933, a lesser fall than in the US (31%) but higher than the UK which registered a smaller decline (4%) over the same period, as shown in Fig. 4.1 based on the latest estimations by Bolt et al. (2018).

Regarding the different effects by sector, according to the estimates provided by Prados de la Escosura (2017), Fig. 4.2 shows that the fall in agricultural GDP was initially greater than that of industry; however, a good harvest in 1932 increased production that year, and again in 1934. A drop in agriculture exports is observed until 1933, followed by an increase. Industrial GDP dropped between 1931 and 1932, and then registered a slight increase from 1933 on. Services remained stable during the period, while construction suffered the greatest decline until 1932.

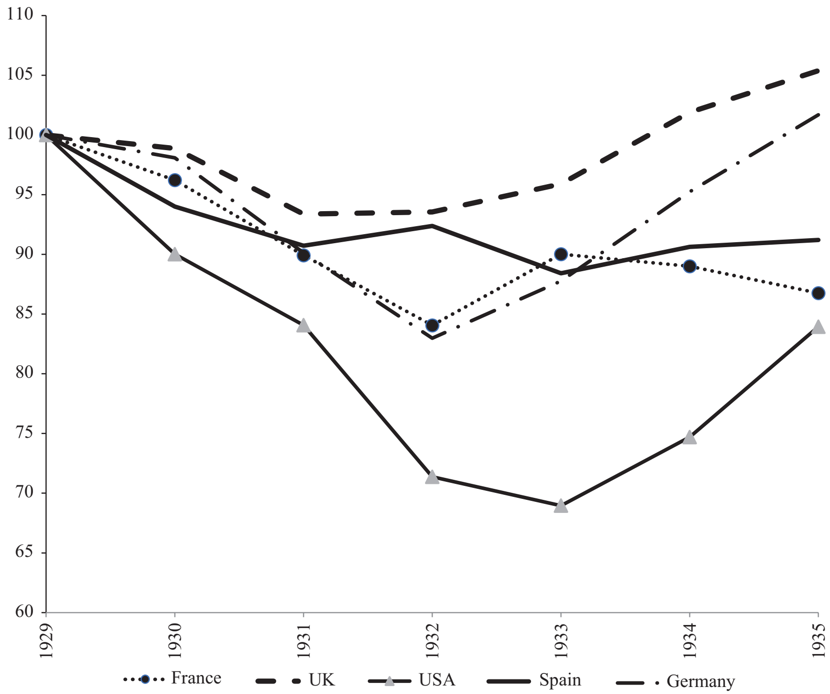

Fig. 4.1 Spain's real GDP per capita compared with the US, the UK, France and Germany, 1929–1935. 1929=100. (Note: Own calculations from Maddison Project Database (2018), real GDP per capita in 2011 US$ (rgdpnapc), 1929=100. Source: Maddison Project Database, version 2018, in Bolt et al. (2018))

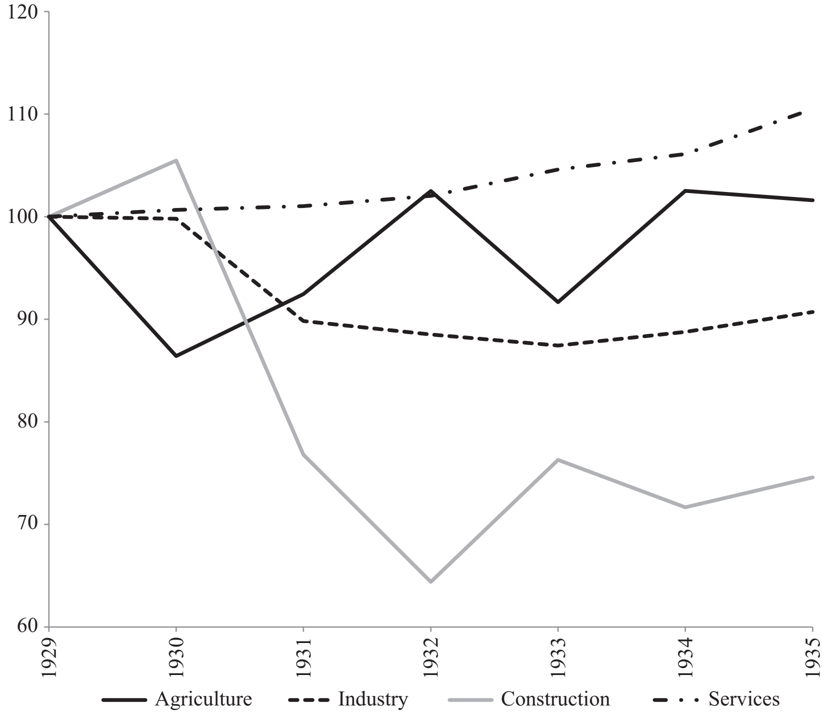

Fig. 4.2 Trend in Spain's industrial, agricultural, construction and services GDPs, 1929–1935. (Note: GDP for Agriculture, Industry, Construction and Services, volume indices of gross value added, 1929=100. Source: Prados de la Escosura (2017))

The 1929 US stock market crash dragged down European stock markets, including Spain's, whose index decreased by around 65% from 1928 to 1934. The main transmission channel for the international crisis was the fall in exports, linked to the contraction of international demand and the rise in protectionism. However, Spain had come off the gold standard and had a flexible exchange rate during that period. The depreciation of the peseta allowed for an improvement in external competitiveness in the early years; this helped to reduce current account imbalances and to avoid international deflation. In the early 1920s, the peseta floated around official parity (established in 1868), but from 1927 its value dropped. The nominal exchange rate between 1927 and 1931 fell by 34.76% with respect to the pound, and more than 50% with respect to the franc and the dollar. Initially, the Bank of Spain refused the use of gold reserves to stabilize the exchange rate, but later on there were some attempts to intervene to guarantee the value of the peseta, with a resulting loss of gold reserves (Martínez-Ruiz and Nogues-Marco 2014). Despite these efforts, the peseta continued its depreciating trend until 1932, as we can see in Fig. 4.3. The peseta then appreciated with the devaluation of the pound sterling and dollar until 1933, and subsequently stabilized (Fig. 4.3). Some countries used exchange rates as a trade policy instrument; for example, the UK and the US abandoned gold and devalued their currencies. Others, however, remained on gold, such as Belgium, France, the Netherlands and Switzerland, and used tariff protection and quantitative restrictions as alternative protective policies.

Regarding the banking crisis, this downward trend triggered by internal (regime change) and external shocks stemmed from an economic recession that generated banking difficulties and capital outflows (Ventosa

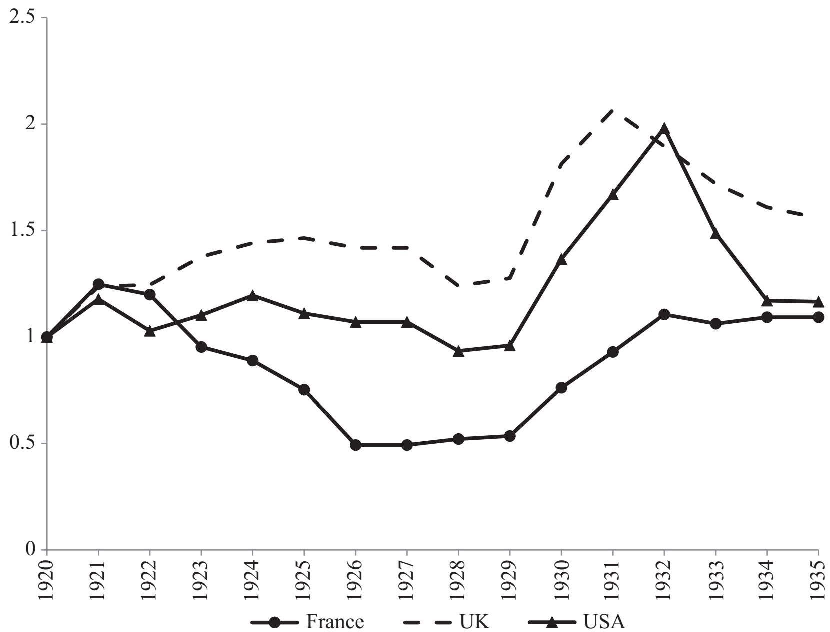

Fig. 4.3 Exchange rates in relation to the dollar, pound sterling and franc. (Note: The peseta value of each currency, 1920=1. Source: Martín-Aceña and Pons (2005))

i Calvell 1932). The deposits-to-currency ratio, which is used to measure panic withdrawals, decreased by 23% between 1930 and 1931, but by only 9% from 1929 to 1933.[8] The end result was that seven banks disappeared (three in 1930 and four between 1934 and 1935), but this was a small banking crisis in comparison to other countries.[9] It was not particularly harsh because the Bank of Spain provided banks with all the cash they needed to convert deposits into currency; as a result, monetary contraction was lower than in other countries, except in 1931. Since the crisis coincided with a flight from the peseta, the government also authorized a rise in interest rates to stop the outflow of capital. However, this restrictive monetary policy had less of an effect on Spanish banks than it did on those in other countries, as they were loaded with gilt-edged securities and they pledged their unused portion of government paper to obtain cash (Martín-Aceña 2013).

Moreover, Spain did not have external debt nominated in gold as other European countries in the period (such as Germany) did. Spain's neutrality in World War I allowed it to have a trade surplus. In addition, given its adverse experience with sovereign defaults in the nineteenth century, it paid off all its foreign debts and increased its official reserves, becoming the country with the fourth largest gold reserves in the world. This gold position was considered important as it offered the possibility of joining the gold standard system or being close to the 1868 gold parity after World War I; there was even a commission for studying the adoption of the gold standard in 1929. Therefore, the Republican government did not want to lose gold reserves and saw them as an important asset for the Spanish economy in turbulent times.

4.2.1 External Constraints and International Context

Like many economies in Southern Europe and the New World, Spain was reliant on export markets for its agricultural goods and raw materials, the demand for which was falling. The major trade collapse imposed restrictions on Spanish exports. It is not clear that industrial countries suffered more harm during the Great Depression than has been conventionally understood. The Spanish case posed a warning regarding external restrictions on agrarian economies during the Great Depression. Also, market access was restricted as a consequence of the trade policies applied by Spain's most important trading partners. In 1932, the UK introduced the Imperial Preference agreement and diverted trade to colonies and dominions or Commonwealth countries. France stayed on the gold standard and used tariffs and quotas to protect its market, while Germany intervened in foreign markets with the establishment of exchange controls.

In addition, return migration from urban centres reached critical levels, and so rural unemployment surged. At the same time, capital inflows were drying up, which in turn affected the current account balance and consequently the exchange rate. To be clear, the external constraints were enormous for the Spanish economy and also produced a turning point in trade policy that affected economic growth and made an important contribution to deteriorating economic conditions. It also contributed to higher unit costs as a consequence of the new labour laws that made competing imports more attractive and Spanish exports less competitive. In the case of agricultural exports, the land reform—especially due to its failures and partial implementation—additionally damaged the competitiveness of agriculture. In addition, most of the new and more coordinated demands made of the new regime came specifically from regions depending on international trade, such as Andalusia and the Basque Country. Prices for Spanish agricultural goods dropped and the iron and steel industry collapsed. The trade channel played a more important role in spreading the crisis than has previously been argued for Spain and in general in studies on the Great Depression. Figure 4.4 shows that exports declined by around 20–30% in constant values (38% in current values and 54% in gold-pesetas, and 20% in volumes). However, imports fell at a slower rate. Hence, the trade deficit increased during the period, especially from 1933 on. Besides, a high share of total exports were from the agricultural sector, representing around 60–70%, which explained most of the export trend and collapse.

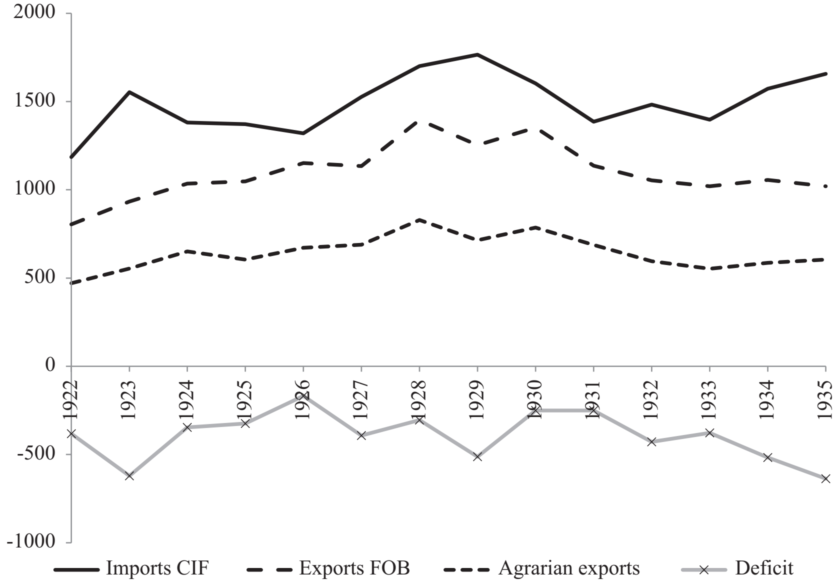

Fig. 4.4 Imports, exports and agrarian exports and trade balance. (Notes: All values in millions of 1913 pesetas. Trade is special trade. Source: Tena (2005) and Barciela et al. (2005))

4.2.2 Monetary and Fiscal Policy

The Republic, wanting to secure its international reputation, sought to maintain an orthodox monetary and fiscal policy, even if the peseta had not been on the gold standard since 1883. Regarding monetary policy, the interest rate increased from 1927 to 1931 in order to hold the exchange rate. Indalecio Prieto, the finance minister until December 1931, passed a banking law (26 November 1931) mandating government participation in the central bank with three representatives on the board of directors.[10] This policy was seen as State interference in the economy. The government argued that its monetary policy was to defend public interests instead of the Bank of Spain's. Prieto, as a consequence of the sharp capital flight, increased interest rates to defend the peseta,[11] without success. This intervention was criticized by the Bank of Spain and business interests[12] and it was the reason behind the creation of a research service (*Servicio de Estudios*) in the Bank of Spain, in order to analyse and advise on monetary policy.[13] Subsequently, the new minister Carner, in charge from December 1931 to 1933, did not intervene to maintain the peseta. At any rate, this was not necessary due to the UK abandoning the gold standard in 1931 and the US in 1933. Still, interest rates decreased only moderately from 1932 to 1935 because this policy was not supported by the Bank of Spain and the Bank of Spain's research service (Martín-Aceña 1984); rather, the decrease was due to the pressure on the government from business and industrial lobbies and the requirements produced by the crisis.

Another new target was to reduce the public budget deficit; both Carner and Azaña were worried about the commitment to fiscal stabilization[14] (Azaña 1976; Comín and Martín-Aceña 1984). The finance minister took steps towards implementing an income tax in 1932 (22nd December) with a complementary tax to be applied only to the top incomes[15] as a fiscal and also redistributive reform. But in the end he adopted a more expansionary fiscal policy, especially in 1933 and 1934.[16] However, the public sector at that time represented a small share of the total economy and there were no major changes in public spending or the budget deficit-to-GDP ratio during the Second Republic in relation to the preceding period, which remained in the range of 10–13% of GDP. Thus, fiscal policy was not substantially altered, generating neither a general contraction in the economy nor helping to combat the crisis (Comín and Martín-Aceña 1984).

The main potential difference was more social public spending and higher labour-intensive public investment than in the previous dictatorship regime, such as road infrastructure, irrigation works, housing and education.[17] But the critical conditions stemming from the Great Depression and international context prompted the government to make a practical adaptation to the circumstances, and in the end an accommodative monetary and fiscal policy was adopted. In sum, with the exception of the early years, these policies were not restrictive.

Figure 4.5 shows the evolution of discount interest rates applied by the central banks of major economies compared with those applied by the Bank of Spain. According to Fig. 4.5, in the first year monetary policy was restrictive, and the UK and the US raised the interest rate to defend

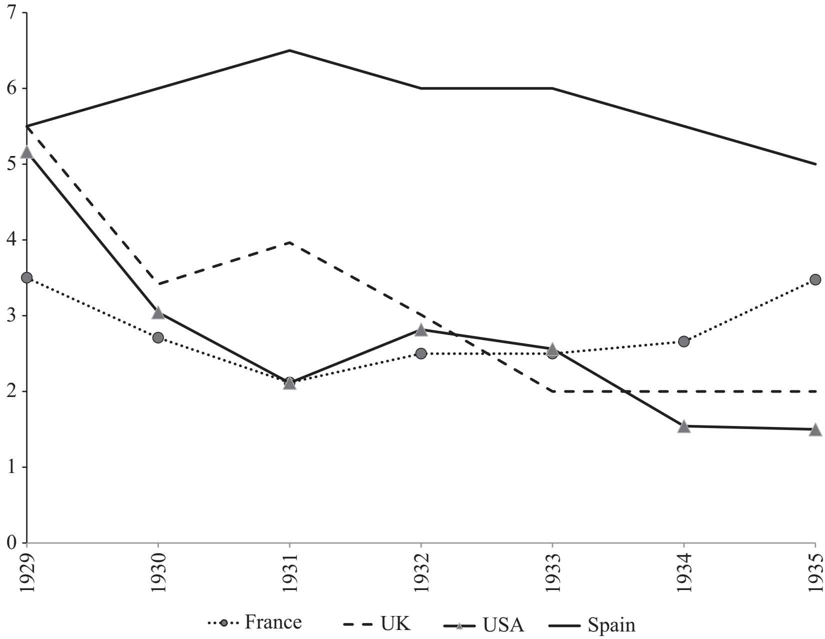

Fig. 4.5 Spain's central bank discount interest rates compared with the US, the UK and France. (Source: For the UK and France, Forero-Laverde (2018); for Spain, Comín and Martín-Aceña (1984); for the US, the Federal Reserve Bank of St. Louis, Economic Data)

their currencies in 1930–1931 and 1931–1932, respectively; however, this was no longer necessary when they abandoned the gold standard in 1931 and 1933, respectively. In the 1930s, countries remaining on the gold standard could not follow expansionary monetary policies. France was on the gold standard until 1936 and kept a restrictive monetary policy of increasing interest rates during the period. Spain, however, increased interest rates until 1931 but cut them thereafter. Although discount interest rates applied by the central bank were higher than in other countries, deflation in Spain was much lower.

Regarding fiscal policy, Fig. 4.6 depicts the public budget-to-GDP ratio: all the countries ran sizable public budget deficits, mainly as a consequence of the declining fiscal revenues due to the crisis in 1932. Countries which suffered from a severe crisis, such as the US and France, had a greater budget deficit than countries such as the UK and Spain, although

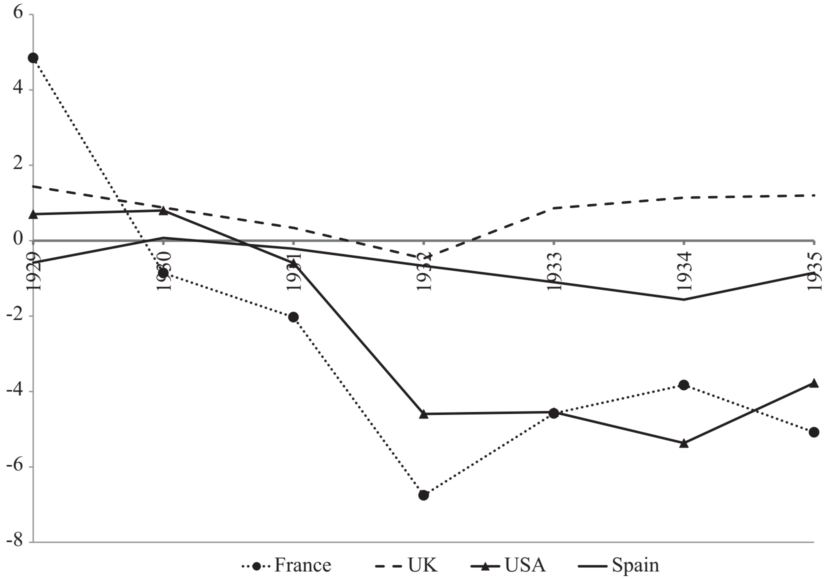

Fig. 4.6 Spain's public budget-to-GDP ratio (%) compared with the US, the UK and France. (Source: Jordà, Schularick and Taylor (2017), datasetR4 (Release 4, May 2019))

the deficit was relatively small in relation to present standards and, consequently, to have an important economic impact. In addition, economies were reluctant to apply fiscal stimuli since this could lead to an increase in the trade deficit and the loss of gold reserves. Spain, as commented above, increased its budget deficit from 1931 but not significantly so.

In conclusion, monetary and fiscal policies were accommodative, given the orthodox rules of the period. And as a consequence they were not particularly expansionary, but nor were they aggressively contractionary, as in the case of France.

4.2.3 Trade Policy

A protectionist trade tariff was enacted in 1922 after World War I. The structure of this tariff remained unchanged[18] throughout the whole interwar period (the dictatorship and the Republic). When the 1929 international panic occurred, the US and France responded by raising tariffs and, in the case of France, also by establishing discriminatory policies. The Spanish government retaliated, adopting the so-called Wais Tariff, passed in July 1930; it was the last change in tariffs before the establishment of the Republic.[19] The Republic initially wanted to change the influence of interest groups on trade policy and to eliminate the so-called "integral protectionism" that fundamentally benefitted wheat, sugar, coal, cotton textiles and the iron and steel industry. At the beginning, the new government authorized quotas as France was applying them to Spanish exports (December 1931). But they were not used until November 1933 and even then very little.[20]

However, Spain's policy choices were limited. France and the UK diverted trade to colonies, protectorates and possessions. Spain was not a member of a trade bloc. Indeed, the Republic's foreign policy was actively in favour of the League of Nations postulates.[21] The Republic abandoned retaliatory trade relations for a more conciliatory and forward-looking policy. Trade policy essentially consisted of leaving the existent tariff system in place, and negotiating and approving reciprocal bilateral trade treaties, using different instruments depending on the country: tariffs, MFN clauses and quotas by goods in exchange for Spain's access to export markets for agricultural goods. This also meant concessions for industrial goods. The political goal was to exchange access to the domestic market for markets abroad. The main motivation for this was to reduce the increasing trade imbalances caused by the higher fall in exports in relation to imports and the resulting increase in external debt. As a result, bilateral commercial agreements allowed Spain to maintain its gold reserves. We can consider this policy as a moderate protectionism and a non-retaliatory policy. The reasons behind it were an attempt to address the large fall in Spanish agricultural exports and its harmful effects on the Spanish economy, and to follow the proposals of international economists and the League of Nations. The problem was that these principles were not followed by the majority of countries and the consequences were damaging for the Spanish economy. Again, the Republic aimed to respect international rules and stick to economic conventions.

4.3 Reforms Under Democracy

The Republican regime attempted to implement reforms to meet the challenges it faced. These included creating new institutions to promote growth and establishing "inclusive" institutions. One item on its political agenda was to tackle the still-pending reforms from the liberal regimes of the nineteenth century with the objective of modernizing the country.[22] On the one hand, the agricultural sector was very backward and there was an unequal distribution of land: concentrated in large estates, *latifundios*, in the south-eastern Spain and in small estates in the north, especially north-western Spain, *minifundios*. These two extremes in land concentration produced low investment and reduced labour and land productivity. On the other hand, wages were low and working conditions were miserable, especially in the countryside; and although wages had increased during the 1920s, wage inequality rose, thus worsening economic conditions for labourers. Moreover, education levels were very low in relation to international standards. Therefore, the new regime wanted to intervene by introducing inclusive institutions to promote equal opportunities and improve income distribution.

4.3.1 Land Reform

Land reform was the pivotal reform of the Second Republic. Agriculture was the main economic sector but productivity was low. The unequal structure of land ownership was considered one of the factors explaining this situation. In 1934, the Catastro, a landownership census on which agricultural land tax payments were based, indicated that 1.25% of taxpayers possessed 40% of all the land, and this concentration was especially high in Andalusia, Extremadura and Castille-la Mancha (Malefakis 1970). Moreover, there was structural agricultural unemployment, forced unemployment and widespread poverty, which were aggravated by the economic crisis. It was thought that land reform could improve this situation. Robledo and González (2016) suggest that the principal realm of land reform was agriculture's social problem and peasant unemployment. Prior to the land reform in 1932, the government had enacted a number of different decrees to combat unemployment and prevent landowners from leaving land uncultivated (the decrees of compulsory tillage in 1931 and intensification of cultivation in 1932) and oblige employers to hire workers in the same neighbourhood or town (municipal district decrees in May and September 1931).

The majority of Spanish agriculture has a Mediterranean climate, which means rainfall is irregular and scarce. Vineyards and olive groves adapt better to these environmental conditions while cereal crops, although adapted, had extremely low yields per hectare. During the first third of the twentieth century, agricultural productivity improved, in terms of yield per land and in labour productivity. The consumption of fertilizers grew sharply, albeit starting from a low level, with their use quadrupling between 1907 and 1935 (Gallego 1986). Agricultural mechanization finally took off when, after World War I, real wages began to increase and to incentivize the substitution of labour with capital investment. Nevertheless, irrigation, to compensate for the scarcity of rainfall, and intensive cultivation techniques required considerable investments (Simpson 1996: 217). Agricultural exports accounted for 60% of exports before the crisis. Exports of citrus crops and olives increased in the 1920s, offsetting the decline in wine shipments, which had peaked before the war (Pinilla and Ayuda 2002, 2010; Ramón-Muñoz 2000). By 1930, nearly 60% of the fruit crop was exported. Spain was the world's largest exporter of olive oil in the first third of the century (Simpson 1996). Valencian oranges were in high demand in the UK, far outperforming other sources (Simpson 1996). In the 1930s, the decline in demand and increasing protectionism of the main trading partners harmed these exports. The agriculture crisis worsened and the already chronic unemployment in agriculture increased, especially for landless peasants.

Land reform had been called for since it was highlighted in 1795 by Jovellanos, who decried the land held in mortmain and advocated land reform. In the mid-nineteenth century, the privatization of land belonging to the Church and municipal and communal land, and its sale by public auction took place in the successive disentailment processes. But the result was not the desired; the property structure did not change and land concentration even increased. There was consensus by reformers that land inequality was an inconvenience hindering agricultural change

(Flores de Lemus, Pascual Carrión and others). The Republic's land reform in September 1932 consisted of land expropriation by compensation, with the exception of those lands owned by the high nobility (the *grandeza*), large estates (*latifundios*) of more than 250 hectares, land cultivated systematically by tenants and poorly cultivated land. Not all regions were included for expropriation, only central and southern Spain (Andalusia and Extremadura and in the provinces of Ciudad Real, Toledo, Albacete and Salamanca). Still, it was promised that landless labourers would be settled by means of the compulsory land purchase by the Agrarian Reform Institute (IRA), a State institution. There were failures in the reform, and difficulties relating to the State's capacity to implement the reform. The most important weaknesses were the protracted parliamentary discussion, long-standing legal conflicts, the lack of budget, especially to buy land to settle landless peasants, and an uneven application in different parts of the countryside.[23] As a consequence, land redeployment was slow in 1932–1933, and the right-wing ascent to power in 1934 stopped part of the reform. Finally, in 1936, with the more leftist government coming to power, there was a rapid implementation. There were restrictions on government action; moreover, the compensation required also entailed high costs for reimbursing expropriated landowners.

This partial and slow implementation land reform was due to the difficulties in a democracy of ensuring a rapid implementation, and the end result was more conflict and disagreement.[24] Not only the large estate owners—as had been expected—but also the medium-sized and small landowners were against the reform. The main reasons for this were that the reforms sometimes failed to account for their particular situations, especially those deriving from agricultural labour regulations, and also threatened insecure property rights. Conversely, there was also an increase in rural conflict and strikes (Domenech 2013). Domenech and Herreros (2017) argue that these conflicts had more to do with the incompleteness of the land reform (slow and partial) than with the land reform itself. For example, the intensification of cultivation was uneven, predominantly occurring in Extremadura but very little in Andalusia (Cordoba, Jaen). Furthermore, these conflicts were worse in municipalities with no previous history of land reform, unlike other types of conflicts in the period (land invasions, temporary occupations in protest). Moreover, peasants with higher expectations of land reform protested more.

Land reform was considered a revolutionary law that was one of the reasons for the Civil War (Malefakis 1970; Casanova 2010). But also, as Domenech and Herreros (2017) show, the slow process of land reform under democracy had destabilizing effects, such as protest and revolution in Andalusia, which increased social and political polarization. In contrast, Carmona et al. (2019) questioned the opportunity offered by the reform. They found that before the Great Depression, access to land increased in terms of agrarian wages in relation to land prices, and the percentage of landless workers decreased, according to census data. In addition, rural migration was an important factor in reducing agrarian unemployment. Nevertheless, after the crisis and its strong impact on the agricultural sector, the Republic decided that the backwardness of agriculture had to be resolved.

4.3.2 Labour, Education and Other Reforms

The Republic enacted redistribution measures with the land reform and also made improvements in labour conditions and wages. The Labour laws consisted of increasing nominal wages, with the establishment of a minimum wage and a 44-hour working week. These reforms also affected the agricultural sector where an eight-hour day was introduced for the first time. Reforms in the industrial sector began in 1919, along with most of the member countries of the International Labour Organization (ILO). Moreover, in the agricultural sector, municipal labour decrees stipulated the hiring of labourers from the same municipality.

The most important law was the one that created the *Jurados Mixtos*, which were boards of arbitration and conciliation with representation of workers and employers from all sectors, including manufacturing, agriculture and services. The establishment of these boards increased workers' bargaining power. However, Domenech (2011) considers that these changes were an extension of the previous labour laws to new groups and a continuation of the State interventionism of the dictatorship.

There were also changes in social insurance and the unionization of workers was allowed, giving them more power in the collective bargaining of wages and working conditions. Unions, especially CNT and UGT, were a permanent source of conflict, competing to gain supporters among urban and rural workers, since they had been illegal during the dictatorship. However, the Republic did not introduce unemployment insurance.

The consequences were favourable in terms of income distribution. Inequality decreased during the Republic: the Gini index dropped from 0.45 in 1931 to 0.37 in 1936 and the ratio of wages to GDP per capita fell from 1.56 to 1.19 for the same years, due to increasing wages (Prados de la Escosura 2008). However, on the other hand, in a context of decreasing demand and declining labour productivity, the reforms also meant increasing labour costs and worsening competitiveness. This became particularly serious when the peseta appreciated in 1932, contributing to the decline in exports and increasing the competitiveness of imports. The profits-to-GDP ratio decreased from 77% to 61% at the beginning of the crisis, between 1930 and 1931, and fell further to 55% in 1934 and 45% in 1936.[25] But rising wages also produced a higher demand for consumer or final goods, contributing to increased imports of these types of goods and boosting trade imbalances.

4.3.3 Educational Reform and Other Reforms

Spain's educational level was low when measured by illiteracy rate and the school-enrolment ratio, although there had been an improvement in the previous period. The illiteracy rate was around 50% in 1910 and was reduced to 32.5% in 1930,[26] and primary school enrolment rates were 44.2% in 1910 and rose to 58.8% in 1930. The educational budget increased by 50% during the Republic period. From 1909 to 1931, the number of schools built totalled 11,128, around 500 per year; however, in only one year, the first year of the Republic, the completion of 9600 schools was announced and a five-year plan was drawn up to reach 27,000 schools. That said, the programme slowed down after 1933 due to a budget shortfall.[27] In addition, the number of new teachers increased by 7000 and the teaching salary improved by about 15% between 1931 and 1933

(Jackson 1965: 63). Moreover, religious orders were excluded from education, as part of the larger objective to secularize society. In the Republic period, school enrolment reached 69% in 1934, rising by around ten percentage points in only four years. Secondary school enrolment (10–19 years old), although low, increased sharply from 1.82% in 1930 to 2.79% in 1934.[28]

Regarding social and political reforms, the aspiration was to establish more inclusive political institutions to reduce the power of the traditional elites and special interest groups, such as landowners and traditional industrial and financial elites. Thus, the secularization of the country diminished the Church's power by means of the separation of Church and State, and was achieved through measures such as the withdrawal of State financing of the Church, and the secularization of education. The power of the army in the State and its influence in political affairs were reduced through an army reform intended to modernize it but also to gain adherents to the Republic inside the army.

4.4 The Civil War and Its Consequences

Although an economic recovery had been underway since 1934, there was fierce political and social confrontation from 1934 to 1936, which ended in a civil war. Similar situations arose in the international context, where different ideologies, including totalitarian ones, threatened the ability to resolve these problems. The connection between the economic crisis and the Civil War is a major issue. The stagnation of the economy and the failure of certain reforms, such as the shortcomings of land reform, are considered to be behind the military upheaval of 1936 (Malefakis 1970). Moreover, some authors (such as Domenech 2013; Carmona et al. 2019) believe the limitations in terms of executive power and a weak state to be factors in the failure of the Republic. For others, the main reasons are to be found in the realm of politics and the social and ideological conflicts occurring during the interwar period (for example Juliá 2008; Casanova 2010; Graham 2005).

Nevertheless, there is also a combination of external and internal forces that may have played a role in the demise of the Second Republic. The international restrictions due to the economic crisis and protectionist policies enacted by other countries was one of the major components. On the one hand, the main sectors affected were the export sectors, the dynamic agricultural sector, and the iron and steel industry, among others. On the other hand, the ambitious reforms were difficult to carry out in this context and in a democratic regime in which new interests had to be taken into account. The demands came from diverse competing groups that had been left behind during the dictatorship, and belonged to an emerging middle class. In the new regime, these groups had political instruments for organizing their claims (general elections, parliamentary debate, and protests and strikes). Moreover, there were public budget restrictions due to the low fiscal capacity and the orthodox fiscal policies still applied at that time.

These constraints and limitations in the reforms gave rise to polarization, diminishing the support from the still small emerging middle class. As commented above, there was a drop in the support from central and northern Spain's conservative middle class, which contained professionals, merchants and bureaucrats and also middle-size landowners threatened by the land reform. At the bottom of the distribution, these reforms did not go far enough for those that had expected substantial change and improved economic conditions, mainly labourers and landless peasants. However, according to the estimates of inequality and extreme poverty provided by Prados de la Escosura (2008), inequality and poverty were not rising before the civil war. However, these changes negatively affected the part of the country that lost out as a result of the social and economic reforms, especially large landowners, traditional sectors and rent-seekers, as there was a rise in wages in relation to property incomes. The fall in inequality was due to the reduction in the gap between returns to property and labour, and this gap was greater than the increase in wage inequality that also occurred during the period. Moreover, as in other countries, the Great Depression had a negative effect on the top income shares.

Internal factors included the limitations of monetary and fiscal policies to maintain the conventional policy, as happened with trade policy. These limitations, in terms of a moderate expansionary monetary and fiscal policy and moderate protectionist policy, were due to the regime's attempt to consolidate its reputation, and were considered fundamental for Spain's independence and autonomy in international policy. The Republic needed to guarantee the democratic order, even though it ran counter to some interests and had the potential to increase conflict. This situation, when other countries were applying beggar-thy-neighbour policies, went against the Republic's planned objectives. As a result, the ambitious objectives in this negative context created greater division and polarization.

In the case of trade policy in the interwar period, O'Rourke (2018) states that the international trade conflict, with its heightened protectionism, was not politically resolved, leading to World War II. Similarly, international trade policy and the moderate protectionist policy applied in order for the Second Republic to gain market access for Spanish exports had certain implications in the economic confrontation between different economic interest groups. On the agriculture side, this involved traditional landowners, landless labourers and highly productive agricultural exporters; on the industrial side, modern and traditional industrial sectors, and conflicts between entrepreneurs and workers. Trade conflicts and other conflicts of interest may have contributed to the instability that led to the Civil War in Spain. But they also affected the differences in how countries coped with the interwar conflicts. Democratic European countries were indecisive (France) or indifferent (the UK) in terms of their trade agreements with Spain. And this external policy continued when the Civil War started; the so-called policy of appeasement was adopted by democratic countries to prevent a second world war, which eventually took place anyway. Conversely, authoritarian governments acted rapidly with respect to both trade and external policy, evading their League of Nations agreements and commitments. The policy approach followed by these countries also affected Spain's Republic, with German and Italian aid being a determining factor in its defeat in the Civil War.

Factors in the realm of politics include the class struggle, while political reasons relate to the increase in conflict and social unrest, rather than simply economic reasons (Silvestre 2003). In the case of agriculture, the bad harvests, poverty and inequality in the 1930s did not explain the strikes and social unrest that increased in this sector during this period. However, gains in rural labourers' bargaining power, a more organized propaganda and ideology opposed to State intervention could be among the explanatory factors of rural conflicts (Domenech 2013). Both the anarchists (CNT) and the socialists (UGT) competed, in political terms, to organize the urban and the rural proletariat.

Moreover, the social and political changes such as the army reform, the secularization of society in confrontation with the Church and some modern social transformations (divorce, women's suffrage) generated increasing opposition, especially from Catholics, who made up most of Spanish population. Likewise, there was opposition to the regional autonomy that was given to Catalonia in 1932 and finally to the Basque Country in October 1936, as well as the autonomy projected for other regions such as Galicia. In a general pre-war international context, different ideologies (fascist and communist) came into violent confrontation in an attempt to impose their solutions. Such was the case with the general strike and miners' uprising in October 1934, and in the military coup in July 1936.

The Civil War produced the greatest macroeconomic contraction in Spanish history: −0.33 for the period 1935–1939, computing the annual peak-to-trough decline in GDP (calculated from Prados de la Escosura's data). This loss is approximately equivalent to the GDP for 1935, while the cost of the war was between 25% and 30% of GDP for the same year (Martín-Aceña 2006: 48–9).[29]

It also had a long-lasting impact in terms of economic growth: GDP per capita did not return to pre-war levels until 1954. There was also a backward step in terms of structural change: while agricultural employment represented 47% of the total in 1929, in 1940 it increased to 50% and did not return to the pre-war level until 1951.

The most important impact was on the population. Population loss was around 4% of the total, a huge figure in comparison with the losses in France and Italy as a consequence of World War II (3% and 2%, respectively). Fatalities during the war, starvation and the repression of the following years accounted for around 550,000 deaths in total, which resulted in an additional deficit of more than half a million births (Ortega and Silvestre 2006). Another important loss was due to exile, which affected 200,000 people, and the incarcerations of nearly 300,000 people. These last two sources of population loss had a severe impact on human capital (republican politicians, trade unionists, high-level civil servants, intellectuals, university professors, teachers and workers) producing a long-lasting effect on the economy and society. Moreover, in terms of social capital, the lack of trust and collaboration in society, out of fear of repression, also affected the economy.

In addition, there was a major impact on the educational attainment level. The war and post-war period meant that part of the population could not access education, with the result that the percentage of the population without schooling in the 1936 generation was similar to that in the 1922 generation. This low level of education persisted until 1955, with nearly a third of the population having no education. In short, the educational level of Spaniards in 1955 was slightly lower than in 1922 (Nuñez 2005). However, at the same time, there was a decrease in the percentage of the population with primary education and an increase in those with secondary and tertiary education. It meant an increase in education inequality, since a third of the population had no access to education while a growing number had a secondary or tertiary education; as a result, there was a reduction in equal opportunities for the whole population relative to the previous period.

Regarding material losses, equipment goods were not strongly affected. The most important losses were in railways and roads, infrastructure and transport materials, such as railroad materials (locomotives and wagons), which registered a 40% reduction, 70% in automobiles and around 30% in the merchant navy (Catalan 1995).

Another important impact hit the trade and openness of the economy. According to the estimates reported by Martínez-Ruiz (2003), during the conflict exports fell by 42% and imports by 27% in relation to those before the war. During the war, imports (excluding military armaments) dropped by 40% and exports by 50%. The recovery took a long time. Before the 1929 economic crisis, the openness ratio, measured by the trade-to-GDP ratio, was 17%. After the war, the openness ratio declined from 10.3% in 1935 to 4.1% in 1940, and the declining trend continued until 1942, when it hit 3%. The 1935 openness ratio was not reached again until 1951 (10.9%) and the pre-crisis ratio until 1962 (17.4%).

In view of the turbulent times in international trade and the experience of the Spanish economy, Spain opted for autarky. Autarky was considered a way to avoid dependence on other countries. International trade and foreign investments were fully regulated. Exchange rates were fixed at a value higher than in an equivalent market, reducing Spanish export competitiveness. Autarky led to a scarcity of inputs and equipment goods, thus affecting investment and economic growth. Moreover, interventionist regulatory systems replaced markets as a way of allocating resources. In the agricultural sector, land was given to the previous landowners, the State intervened in markets for most products and prices were administratively fixed, producing scarcity and black markets. In the industrial sector, an industrial institute (INI) was set up as a public holding company, copying the Italian model to promote industrialization, and interventionist regulation was similarly applied. In the finance sector, the State intervened to allocate resources to privileged sectors and finance the public deficit, part of which was monetized creating inflation. Also, given the labour conflicts of the interwar period, unions were forbidden and the labour market was regulated to guarantee employment and maintain low wages and discipline. As a result, wage compression occurred, increasing inequality between property and labour income, producing a rising income inequality. Indeed, inequality and poverty were higher than in the World War I period (Prados de la Escosura 2008). Poverty and malnutrition due to food scarcity reduced living standards and affected the height of an entire generation.

In sum, all these policies produced scarcity, low economic growth, a protracted recovery that was not completed until 1954 and a loss of opportunity to grow and achieve a higher GDP per capita and better living standards for the entire population. As is to be expected, there were also social and political consequences; a backlash against social reforms and civil rights with the establishment of a dictatorship in which the dictator Franco ruled the country for 40 years until his death.

4.5 Conclusions

In 1936, hopes of modernizing the country and establishing inclusive institutions to promote equal opportunities and economic growth were frustrated. The international environment represented an external constraint for this small, southern European, middle-income country, due to the reduction in agrarian and raw material exports to its main trading partners, without alternative markets opening up, which depressed the economy. In addition, there were domestic shocks stemming from the change of regime towards a democracy with an ambitious programme of reforms. These reforms under democracy constituted another source of conflicts, given the diverse interests arising from the new and greater demands in this international context. The reforms implemented enabled an increase in education levels and wages and improved labour conditions for the whole population. But there were also failures, including the partial land reform, which polarized landowners and labourers, and the increasing labour costs during the crisis, which also divided business-owners and workers, amplifying the balance of payment restrictions.

In short, the external shocks and constraints were so great and the domestic plans so ambitious that the end result was fatal, culminating in a civil war in 1936. As a result, hopes of reform were left unfulfilled, with a severe backlash against social and economic restructuring, and a long-lasting impact on the economy, living standards and society. The consequences included the establishment of an authoritarian regime that recoiled against the previous policies enacted. Besides, the economic autarky that lasted until 1951 and the interventionism that continued until 1959 delayed the post-war recovery.

Notes

1. This was not the first time in Spain's history; it had also happened in 1873–1874, which is why this was called the Second Republic. In 1874, the monarchy was restored, bringing back elitist liberalism. However, from 1890 there was universal male suffrage.
2. The poorest and most remote regions, farthest away from the industrial centres in Andalusia and the north, had the fewest internal migrants (Silvestre 2005).
3. The periods with the most strikes were 1917–1922 and the first years of the Second Republic, occurring mainly in the industrial sector and also in agriculture in the latter period. The number of strikes diminished in the Primo Rivera dictatorship (Silvestre 2003).

4. Azaña (1986: 24–25) addressed these issues in his writings on the causes of the Civil War.
5. Azaña (1976) explained it in his diaries.
6. Azaña (1986: 26–28) mentioned that the "traditional liberalism" policy was impossible when it came to economic questions, as the most important difficulties came from the international crisis. The State had to intervene and these interventions were considered as a threat of impending statism.
7. This was how Juliá (2008) interpreted the period. In Azaña opinion's, the start of the Civil War was not a desperate solution on 14th July 1936 from a part of the country opposed to a precarious situation (Azaña 1976: vol. I, II and 1986: 27).
8. These figures contrast with the 53% decrease in deposits in the US in the same period (data for the US from *The Federal Reserve Bank of St. Louis, Economic Data*).
9. The banking crisis mainly affected the Banco de Cataluña, Banco de Reus and Banco de Tortosa. With the exception of the *Banco de Cataluña*, which held 25% of all deposits in Catalonia, the rest were small banks. Therefore, the banking crisis did not have major repercussions on the Spanish financial structure.
10. The representatives were Flores de Lemus and his disciples Agustín Viñales and Gabriel Franco. Flores de Lemus was against the exchange rate intervention; this became clear in 1929 when he was director of a government-commissioned report to a group of prestigious economists, *Dictamen de la Comisión de Patrón Oro*. He believed that relative prices between the Spanish and international economies and the current account deficit prevented Spain from being on the gold standard. However, as Flores de Lemus was a government representative in the Bank of Spain he upheld the government's policy.
11. *El Financiero* (24 April 1931); this intervention was justified due to the regime change and the need for political stability.
12. *Servicio de Estudios* del *Banco de España* and *El Financiero*; the latter journal represented business interests.
13. The most prominent economists during the period 1931–1936 were José Larraz, Olegario Fernández Baños and Germán Bernacer.
14. According to Palafox (1991: 224), over this whole period but particularly at the outset, the Republicans wanted to differentiate themselves from the dictatorship's budgetary dislocation, which created fiscally

autonomous bodies, and this policy aggravated the continuing downward trend.

15. This process of income tax implementation started in 1900 with a new tax called the *Contribución de Utilidades* (a profit tax), which was transformed substantially in 1920 and 1927 to convert it into a tax on income and profits. The architect of the new income tax was Flores de Lemus, who collaborated with the Finance Ministry from 1906 to 1936 and was also involved in the previous tax reforms during the 1920s.
16. Carner explained in an article titled "The Economy of the Republic" in *Economia Nacional*, num. 1, January 1933, pp. 5–10, how the economy of the Republic should be, the need for intervention and the importance of making Spain's economy more competitive and reducing production costs in a difficult international context.
17. Palafox (1991) argues that this was a shift away from spending on railways and economic services, affecting certain sectors more deeply.
18. The tariff on iron and steel, heavy industry, textiles, horses, and olive oil, among other products, increased in 1926–1927.
19. Additional tariffs on aluminium and aluminium goods in 1928, and in 1930 on cars, and films, among other items, as a retaliation against the US.
20. Viñas et al. (1979) and Serrano Sanz (1987) summarize trade policies during the period.
21. For the importance of following the League of Nations rules, Saz (1985), Azaña (1986).
22. The Republicans followed the republic French model of 1789 in which reforms in land distribution, education, the State-Church relationship, and the army were essential part of the new constituent regime (Graham 2005).
23. Given the expected consequences, the commission that studied and prepared the reform had wanted a quick implementation ordered by decree without parliamentary discussion. But again the Republican government sought the most legal and democratic process of implementation.
24. One example of the difficulties and unrest was the forceable land occupation in Casas Viejas (Cadiz) in January 1933, where, during an anarchist uprising, the Civil Guard took action against the peasants, resulting in fatalities and a serious political crisis.
25. Own calculation using data from Tafunell (2005).

26. However, in 1930 this figure was 4.3% in the US, and in the UK, France and Germany it was 3%, 5.3% and 1.5%, respectively. However, Italy registered high rates of illiteracy: 23.1% in 1930 (Betrán and Pons 2013).
27. A long-term loan of 400 million pesetas to municipalities was approved to finance school construction in 1932 (Jackson 1965).
28. From 2.86% to 4.72% in 1930 and 1934, respectively, considering students between 14 and 19 years old. School enrolment data taken from Nuñez (2005).
29. In comparison with other civil wars, the cost in terms of destruction and population loss was higher than in the Mexican Civil War but lower than in the Russian one. Although the American Civil War had an intermediate impact as great as in Spain, its destruction was higher (Martín-Aceña 2006).

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5

1959: The Stabilization Plan and the End of Autarky

Elena Martínez-Ruiz and María A. Pons

5.1 Why 1959 Was a Turning Point

The Franco regime was an institutional break in the history of Spain that had major economic consequences. In addition to political and social repression, the Francoist ideology imposed serious restrictions in the economic field. Market forces were replaced by controls and regulations that impeded competition and efficiency, and isolated the economy from foreign markets. Spanish firms adapted to the situation, seeking to make the most of the opportunities offered by the Francoist regulations and trying to avoid the harm they caused. Spanish economic activity was characterized by lack of competition, inefficiency, rent-seeking and corruption. As

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a consequence, Spain stagnated for more than a decade, and the process of industrialization was stifled. Slow growth was also accompanied by large imbalances. By contrast, in the 1960s, Spain experienced rapid growth with remarkable structural transformations and profound social change. The aim of this chapter is to explain how the 1959 *Plan de Estabilización* (Stabilization Plan) facilitated the "economic miracle" of the 1960s and constituted a turning point in Spanish economic history.

In the collective mind of the Spanish people, the so-called Stabilization Plan is viewed as the starting point of industrial growth following the Civil War. However, the Spanish economy had already began to grow at a good pace in the early 1950s. Further, while the Plan was a package of economic policy measures theoretically aimed at replacing the isolationist and interventionist policy with a market-regulated and open economy, its main objective was in fact to correct the serious macroeconomic imbalances that put the Spanish economy on the verge of bankruptcy and threatened to cut short the incipient growth process. Indeed, the measures adopted were limited to the minimum necessary to avoid the collapse of the Spanish economy and were not so different to those implemented in other stabilization plans in the same period in other countries. Therefore, it is pertinent to examine why 1959 was a turning point in the Spanish economy and what role was played by the Stabilization Plan.

In this chapter, we will argue that 1959 is a defining moment in Spanish economic history because it had long-term effects by altering basic economic and institutional rules, shifting the existing balance from state intervention towards market mechanisms. These changes were largely brought about by the Plan, which tore down key pillars of the autarkic model adopted during the two decades after the Civil War and, in doing so, put in motion a profound transformation of the Spanish productive structure, accelerating the transition from an agricultural to an industrial economy. In turn, these changes in economic policy modified the behaviour of private agents and increased business confidence (Martín-Aceña 2004), promoting domestic and foreign investment as they improved the institutional framework.

Although the process of liberalization had started before the Plan as the result of the failure of the autarkic policy, and the Plan was not the only reason for the economic expansion of the 1960s, it effectively improved general economic conditions by stabilizing the economy and accelerating the process of dismantling controls and creating better external economic relations. However, it is impossible to know with any certainty if the liberalization measures would have had the same scope without the Plan, given the severe difficulties the regime faced in maintaining a self-sufficient economy, and considering that the incipient process of European integration was prompting the Francoist regime to set its sights on Europe.

Regardless of how successful they may have been, most of the measures in the Plan were far from bold. This lack of audacity reflected the absence of agreement within the Franco regime on the right course of action to be taken, so that some measures were reversed as soon as the most serious problems had been overcome. Moreover, certain reforms considered essential for launching a process of sustained and balanced growth were never adopted; indeed, the 1959 Plan was an economic reform without a political reform. That meant the Francoist regime altered its approach only to some of the essential economic issues, leaving untouched those that could affect the stability of the regime or jeopardize Franco's personal hold on power. Hence, the only measures adopted were those allowing Spain to obtain foreign aid and helping to promote international acceptance of the Francoist regime; nothing was undertaken that might be at odds with the substance or ideological bases and interests of the regime, such as tax or labour reform.

Chapter 5 is organized as follows. In Sect. 5.2, the changes prior to the 1959 Stabilization Plan are explained. During the 1950s, some timid liberalization measures improved economic growth relative to the previous decade. However, the autarkic model was not abandoned, and the result was the accumulation of sharp imbalances at the end of the decade. Section 5.3 examines the 1959 Stabilization Plan and compares it with other stabilization plans applied in other countries in the same period. Section 5.4 evaluates the contribution of the Plan to growth in the 1960s and the economic benefits of reducing isolationism and controls, while Sect. 5.5 explain the limits of the economic reforms in a dictatorial regime. Section 5.6 summarizes the main conclusions.

5.2 Autarkic Growth and Imbalances

Although the process accelerated in 1959, the 1950s began with a timid attempt to change the economic policy relating to the economic and political changes in the international context, which would have a substantial influence on the evolution of the Spanish economy. The tentative process of liberalization of the Spanish economy was also necessitated by the critical situation of the balance of payments. The 1940s were characterized by low growth (with an annual rate of real GDP growth from 1940 to 1949 of around 1%) and the setback in industrialization (in 1950 the industrial sector represented around 27% of total GDP whereas in 1930 it had been above 32%). Slow growth was also accompanied by major imbalances. Inflation and external imbalances were the result of the limitations of isolationism and interventionism. Inflation was linked to scarcity but also to the permissive monetary policy and the inflationary mechanism used to finance public investments. High inflationary rates also impacted external imbalances by negatively affecting exports. Moreover, Spain maintained a very complex system of exchange control, with multiple exchange rates and an overvalued peseta that hindered exports and stimulated imports. The year 1947 was especially difficult for the Spanish foreign sector. The shortage of international means of payment was so alarming that the monetary authorities warned of the possibility of having to suspend payments.

However, the outbreak of the Cold War brought about a shift in US foreign policy towards the containment of Soviet expansionism. With communism as the enemy to beat, the international rehabilitation of Franco's regime was only a matter of time. The gradual acceptance of Franco's Spain as a member of the anti-communist bloc from 1948 on had important economic repercussions. In 1949, the change in attitude of the US administration led to the granting of the first American credits. Between 1949 and 1953, some $70 million arrived from the US, allowing the Spanish economy to avoid the impending collapse, although those funds covered only 3% of foreign purchases. In fact, the Spanish economy found other sources of currencies that served to alleviate the shortage of means of payment (Martínez-Ruiz 2003). The outbreak of the first armed conflict of the Cold War, the Korean War, marked a rapid rise in international demand for raw materials, which directly benefitted Spanish exports. In addition, the rapid expansion of European economies, fostered by the liberalization and cooperation movements launched by the Marshall Plan, revived trade flows with traditional European partners. For two years, 1950 and 1951, the trade balance shifted in Spain's favour, thanks to the sharp rise in exports.

The export growth was supported by the devaluation of the peseta in 1948. However, the correction of one of the most damaging excesses of the regime's economic policy did not mean even a partial abandonment of the autarkic strategy, as the staging of the devaluation clearly shows. The solution chosen by the authorities in 1948 was the application of an intricate system of multiple exchange rates. Given that the import licences remained in force, the introduction of multiple exchange rates was an extra twist in the already over-intervened external sector. However, the measure involved a strong devaluation of the peseta, of approximately 36%, which partially offset differences in the evolution of prices between Spain and other countries; this helped to temporarily boost exports. However, as Martínez-Ruiz (2003) showed, export growth was due more to the expansion of world trade than to the devaluation of the peseta, which was still insufficient.

In addition, from 1951 on, some of the internal controls that prevented the effective allocation of productive resources in Spain were loosened. The administrative distribution of raw materials and energy was abandoned and that of food was considerably reduced. In the agricultural sector, the mandatory quota delivery policy was halted and the regulation of production in all crops was eliminated. On the other hand, the number of goods under price control was reduced, so that most agricultural products became subject to free price formation. Moreover, for the products still subject to intervention, as in the case of some cereals, the setting of a minimum price close to that of the market and the guaranteed purchase of the crop served to give producers some security. The reduction of control over the markets resulted in a resounding increase in supply, partly because production was incentivized and partly because the production that had been traded on the black market went back to the official market when ration cards were eliminated in 1952. Prices reacted to this increase in supply and stabilized after an initial rise. The shortages that had characterized the Spanish markets during the 1940s were beginning to fade. The liberalization policy was accompanied by an agrarian policy that sought to modernize and develop the sector, although this had very uneven results and by the end of the decade the sector still had not significantly modernized (Simpson 1995; Barciela and López 2003).

The final indication of Franco's international rehabilitation came from the signing of the cooperation pact between Spain and the US in September 1953. US aid was granted in exchange for the construction of military bases in Spain. However, there was no economic conditionality, only some general recommendations on the need to correct the main excesses of the autarkic policy, such as the need to devaluate the peseta and unify exchange rates, to eliminate the barriers to foreign investment, to reduce the role and size of public companies (INI) and to sign a new trade agreement with the US. These recommendations were not followed until the implementation of the 1959 Plan.

The process of economic modernization started to accelerate again in 1949, and the intense growth rate meant that in 1955 Spain finally surpassed the 1929 levels of real income per capita (Prados de la Escosura 2017). On the other hand, the structural change of the economy also intensified in the 1950s. The share of agriculture in the national economy dropped to less than 24% of GDP in 1958, while that of industry rose to 36%. The greater availability of foreign exchange made it possible to increase imports, especially machinery and equipment. The foreign sector was one area in which there was a clear change. For example, the significance of trade in goods as a percentage of GDP, which between 1946 and 1950 barely reached 6% on average, rose to 12% five years later. There were also some other modest signs of modernization during the 1950s. Spain had a severe lack of statistical data on economic variables, a situation that began to change in 1954 when the first National Accounts were presented; in 1958, coinciding with Leontief's visit to Spain, the first input-output table was published thanks to the financial aid that the Ministry of Finance gave to the Faculty of Political Science and Economics of the University of Madrid.

However, the Spanish economy failed to recover the ground lost during the Civil War and the 1940s. As a consequence of the conflict, Spanish per capita income fell with respect to that of the main European countries, and in 1938 Spanish GDP per capita was only 40% of the average for France, Great Britain and Germany, a long way off the 68% registered in 1930. Despite the remarkable growth of the 1950s, in 1959 Spanish per capita income barely exceeded 45% of the average income of those countries, meaning that Spaniards' standard of living did not catch up to that of its European neighbours. Further, the merely relative success of the 1950s was marred by the persistent problems that held back the Spanish economy.

Economic imbalances were not only a Spanish problem. The 1950s and 1960s were two decades of global economic prosperity with high rates of growth, a rapid rise in productivity and low unemployment rates, but the flip side to this prosperity was the emergence of certain economic imbalances. In particular, the two major concerns of policymakers and international organizations were the critical role of trade and the need to reduce trade restrictions and inflation pressures. Various editions of the World Economic Survey (United Nations) and International Monetary Fund (IMF) reports published during this period placed the emphasis on these two topics. Yet Spain suffered more seriously from these problems than other Western European countries. The autarkic growth was an unbalanced growth. As industry developed, there was a growing need to increase the flow of raw materials and machinery, which led to an increase in import demand: exactly the opposite of what was intended. As the exchange rate was still heavily overvalued, it was difficult for Spanish exports to compete. Moreover, this growth took place in a heavily protected context, which meant that producers could concentrate on supplying the captive domestic market, without making any effort to reduce costs or increase productivity; this obviously made it impossible for them to compete in international markets. Thus, exports failed to take off and financing the growing imports became even harder.

Spanish current account imbalances were very high in comparative terms (Fig. 5.1). Portugal and Spain were the only two countries in a sample of eight Western countries that had persistent current account deficits from 1950 onwards.[1] Only Portugal was in a worse situation than Spain; the two other countries with higher current account deficits, France and Italy, were able to turn the situation around and achieved

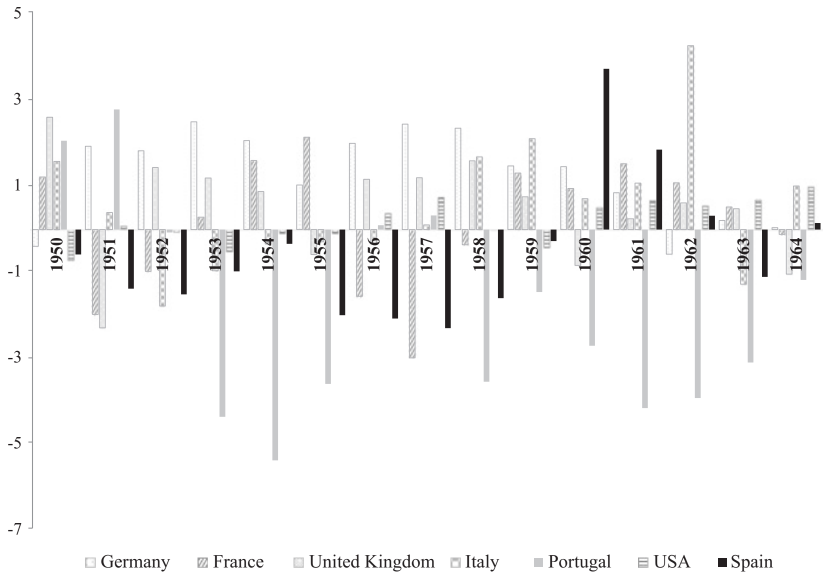

Fig. 5.1 Current account imbalances on GDP (%), 1950–1964. (Source: Spain, Tena (2005); other countries, Jordà, Schularick and Taylor (2017)

current account surpluses before Spain. Limitations on foreign investment—from the prohibition on majority foreign ownership to the difficulties in repatriating profits—depressed private capital inflows, which did not help tackle the growing current account deficits. Indeed, this was the most serious imbalance that the Spanish economy suffered from 1955 on.

The main domestic imbalance was inflation, which was clearly above that of other Western countries (Fig. 5.2).[2] Inflation exacerbated the overvaluation of the peseta and, consequently, the lack of competitiveness of Spanish products in the international markets became more acute and intensified current account deficits. There were three main factors behind the high Spanish inflation rates: (a) the public deficit, not due to its size but rather the way that these deficits and some other extra-budgetary expenditures were financed with public debt, which could be automatically discounted with the Bank of Spain without additional costs, increasing the amount of money in the economy; (b) a rise in wages that

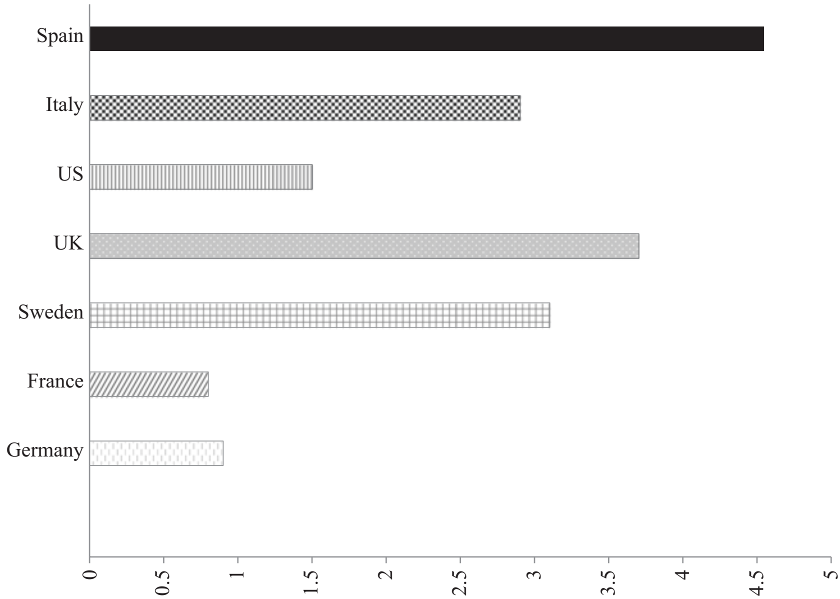

Fig. 5.2 Consumer Price 1952–1957 (Average annual change, %). (Source: Spain, INE; other countries, World Survey data United Nations (1957))

ended up being transferred to prices and that was especially high in 1956 and 1957 and (c) the lack of elasticity of the aggregate supply (González 1979).

Furthermore, the government budget faced growing difficulties. Bizarrely, the over-interventionist autarkic policy was not accompanied by strong participation of the State in economic activity. The weight of the public sector in the Spanish economy declined throughout the 1940s, reaching its lowest level in 1951, when public spending accounted for barely 9% of GDP (Comín 1996). The underlying cause of this small public sector was the unwillingness to undertake a fiscal reform that would have necessarily harmed the groups that supported the Francoist uprising in 1936. The lack of fiscal reform compressed public revenues, which hardly grew at all during the 1940s. The public revenue crisis was further exacerbated by import restrictions, which led to the collapse of import tariff revenues, and the failure to update tax rates in an inflationary context, which also had a very negative effect on income from other fundamental taxes. Fiscal pressure fell from an average of 17% in the first half of the 1940s, to 13% in the second half, and 10% in the first five years of the 1950s. Further, an anachronistic mentality, which gave priority to balancing the budget in a world devoted to Keynesian policies, meant that the public sector remained small and underdeveloped, incapable of assuming the new functions that would become essential in developed countries after World War II. Thus, spending on education, health and infrastructure barely increased during this period, leading to the neglect of fundamental aspects for economic growth (Comín 1996). Therefore, the budget deficits were never high because the expenses were compressed to correspond to the meagre tax revenues. But even if the budget deficit as a percentage of GDP was lower than in other Western countries throughout most this period (France, Italy, Sweden and the US had a higher budget deficit as a percentage of GDP than Spain), the situation deteriorated from 1957.

As mentioned above, the main problem was not the size of the deficits, but the inflationary mechanisms used to finance them. Although the financing needs of the State were never excessively high, the public debt grew rapidly during the 1950s. This debt issuance was aimed at financing autonomous agencies, as well as undertaking numerous extra-budgetary investments (Comín 2016). It was a finalist debt, which did not go through the control of the Ministry of Finance but was issued with the endorsement of the State. This debt would end up on the banks' balance sheets; they accumulated it due to the advantages that the automatic pledge mechanism gave them and the influence of a banking regulation that linked the expansion of the banks to the maintenance of a certain level of public debt as bank assets (Pons 2002; Comín and Cuevas 2017).

Finally, inflation caused a progressive deterioration of the living standards of the Spanish population. In line with the "totalitarian" interpretation of the role of the State in economic development, labour regulation covered all spheres of labour relations from labour conditions to wages. It was an intense, exhaustive, almost suffocating control aimed at maintaining public order by guaranteeing job stability, while in turn ensuring business-owners a cheap, disciplined workforce. In this regard, salary increases were controlled. The distributive struggle that had made consensus impossible in the 1930s was thus resolved through fierce repression. This failure to keep wages up to date in a context of strong inflation led to the collapse of the standard of living of the working population, which caused a fall in private consumption. The share of wages in national income fell from 53% in 1935 to just over 30% in the late 1940s. During the 1950s, it stagnated at around 40% (Muñoz de Bustillo 2007). The loss of purchasing power meant that the population had to devote most of their income to essential goods such as food, clothing and housing. Thus, the demand for mass consumption goods was paralyzed. In response, Spanish industry focused on labour-intensive, technologically less-advanced sectors. Hence, the authoritarian model of labour relations also had dire consequences for economic development.

Consequently, there were outbursts of social unrest. Paradoxically, the first protests appeared in 1951, just when the dictatorship was achieving its first international successes. In that year, there was social unrest caused by workers demonstrating against the fact they had spent more than ten years with low wages, shortages and rationing. The first expression of this protest was a boycott of the trams in Barcelona and later there were protests and strikes in the Basque Country. The effects of the protests were appreciable and may have contributed to the change in Franco's government in 1951 (Ysàs 2008). From 1956, student protests in Madrid and strikes in the north of Spain added to the abovementioned economic difficulties. The protests concentrated on the big firms in Catalonia and the Basque Country, and in addition to repression, there was a rise in wages so that for the first time they reached the pre-Civil War level. However, the increase in wages produced an inflationary spiral and the social unrest did not abate. In 1958, a wave of conflicts arose in Asturias, the Basque Country and Catalonia. The Franco government's response was repression, and it declared a state of emergency that managed to dampen down the social unrest (Soto 2006; Ysàs 2008).

5.3 The 1959 Stabilization Plan

In the end, these imbalances made it impossible to continue with the autarkic strategy and rendered the adoption of the Stabilization Plan in 1959 inevitable. The best explanation for this decision is doubtless the re-emergence of the foreign sector crisis in 1957, but there were other factors that helped set it in motion. With regard to internal factors, mention should be made of the gradual increase in the influence of technicians ("technocrats") in the dictatorship's governments during the so-called Pre-Stabilization Biennium (1957–1959). Regarding the outside world, crucial stimuli came from Europe, with the transition to full convertibility of the main European currencies in 1958 and the involvement of international organizations, the IMF and the World Bank, which, in addition to playing an advisory role, were willing to provide financial assistance to carry out the Stabilization Plan. For the first time, there was clear evidence of a change in perspective, with Spain beginning to look to Europe and the possibilities of integration it offered instead of looking inward.

The very serious imbalances in the balance of payments and the strong inflationary tensions that had been dragging on since 1956 forced a total rethink of the principles that informed economic policy decisions, giving way to a more orthodox approach closer to that prevailing in Western economies. The first steps in this direction were taken at the end of February 1957, when in a government reorganization, people renowned for their liberalizing ideas took over the economic ministries. Some of the members of this new cabinet were advised by economists that supported the price mechanism as a central instrument of the economy and rejected interventionism.[3] Despite this, it cannot be assumed that this new cabinet changed the ideological foundations of the regime. Most of the political ideas that had been imposed after the Civil War remained in force for a long time; in fact, on 17th May 1957, the Law of Fundamental Principles of the Movement was passed to reaffirm some of the Franco political positions.

The first measures taken by these ministers already pointed in the direction of greater rationality and openness, although they were still excessively prudent. Regarding the regulation of the external sector, they attempted to rationalize and simplify the system. Thus, in April 1957, the exchange rate was unified, a measure which was accompanied by a sharp devaluation of the Spanish currency. However, the regime of prior import authorization remained in force. Despite liberalizing intentions, the attempt to introduce rationality into the system was a failure: first, because many of the mechanisms that allowed discriminatory treatments through different exchange rates continued to work; and second, because of the insufficient devaluation of the peseta, which was not enough to encourage exports. The reform was gradually reversed and by the end of 1958 the system of multiple exchange rates had been resurrected.

There was also a minor fiscal reform with the aim of increasing revenues. No new taxes were introduced, although the names were changed, and the collection methods were modified. However, the reform represented a step back with respect to previous attempts to make the system more equitable by generalizing the income tax. The government's stated intention of making the income tax the central tax system was withdrawn. The new collection methods encouraged fraud and limited the State's collection capacity (Comín and Martorell 2013). During the first year, however, the reform managed to increase tax revenues, although this result was misleading as the number of taxpayers and the tax revenues stagnated again from 1959 on (Comín and Vallejo 2012). Finally, some other complementary measures were adopted, such as the unification of the budget with the inclusion of all public expenditures and investments, the rise of the Bank of Spain interest rate and the introduction of limits on rediscount, among other actions. The contradictory character of the tax reform meant these other measures became the core of the reform.

The main contribution of the 1957 changes was the incorporation of Spain into international organizations (the IMF and the World Bank in 1958, and the Organization for European Economic Co-operation (OEEC) in 1959) and some bilateral agreements with France, Germany, the UK and the US. However, the scope of these measures was limited. There was not a real liberalization policy and many contradictory measures were adopted due to the government's reluctance to take clearer steps towards a market-based economy. Moreover, there was marked opposition from part of the government to turning the responsibility for monetary policy over to the Bank of Spain and to pursuing monetary discipline. One of the main difficulties was the fight for the control of the foreign reserves and exchange rate policy that, since the Law of 1939, had been under the jurisdiction of the Ministry of Commerce and the IEME, the organism responsible for managing the exchange control system.

Therefore, the measures associated with the 1957 cabinet reshuffle were not able to solve the Spanish economy's problems. However, there was a certain change in the assessment of the problems and in how to address them: there was a growing consensus that it was necessary to unify the exchange rate, to depreciate the value of the peseta and to promote the entry of foreign investment. These three elements would be central in the Stabilization Plan.

Reforms were also influenced by an international context characterized by an economic order that encouraged liberalization and domestic macroeconomic stabilization. As mentioned, the IMF reports and the World Economic Surveys of the United Nations during the 1950s focused their attention on two aspects. Firstly, the need to increase regional integration by eliminating barriers to trade, adopting more multilateral payment arrangements and restoring currency convertibility as an essential mechanism to reduce persistent current account imbalances. Secondly, to control inflation by using fiscal and monetary policies. Although after World War II considerable progress had been made in the right direction, international organizations in the mid-1950s insisted on the need to go further. As a result of these efforts, for example, the European Economic Community was created at the beginning of 1958 and there was an attempt to restore the convertibility of major European currencies in the same year. It is obvious that the Spanish government looked positively on the prospect of future integration in the European market, and that the restoration of convertibility and international relaxation of trade restrictions increased the cost to Spain of remaining outside the multilateral economic system.

An overarching concern about inflation was also behind the policy action of the main policymakers in countries such as the US or the UK as a way of encouraging short-run stability and long-run growth (Romer and Romer 2002). The 1950s and 1960s were the period of the "stop and go" policies, which were based on Keynesian demand-management theory, and which focused on how to make the following four main objectives compatible: full employment, price stability, a current account surplus and economic growth. The problem for economic management was that after introducing measures to promote growth and employment (the "go" phase), when growth sped up and unemployment was low, balance of payment problems and prices tensions emerged: governments were then forced to respond by increasing taxes, cutting government spending and reducing demand (the "stop" phase) (Middleton 1987). In this context, the IMF advised and supported some stabilization programmes (based on the "stop phase") such as those of the UK in 1957, Turkey in 1958, France in 1958, Argentina in 1958 and Chile in 1959. The Spanish Plan was in line with these programmes.

In addition to their advisory role, the IMF and the World Bank were willing to provide financial assistance to carry out stabilization programmes. This was a key factor in Spain, which was close to bankruptcy. The Franco government committed to the main international institutions that it would make critical economic reforms in exchange for financial aid. By the end of June, the government sent a copy of the report it had prepared to the IMF and the OEEC to obtain technical advice but also as a sign of the real intention of starting a new "era". In the end, despite being against the reforms, Franco agreed to change the economic framework because he controlled the political future of the country (Calvo 1999); however, the Plan was also a way to ensure the continuity of the regime (Anderson 1970; Fuentes Quintana 1984, 1986).

The severity of the economic imbalances in the late 1950s left Spain on the verge of bankruptcy and this factor is behind the approval of the Plan. But foreign pressures were added to these internal difficulties and in the end (notwithstanding Franco's reservations about abandoning much of the regime's programme) the government adopted the Stabilization Plan of 1959. The Plan was developed in the Ministry of Finance (Mariano Navarro and Juan Antonio Ortiz) in close collaboration with the Ministry of Commerce (Aberto Ullastres) and the Bank of Spain (Joan Sardà). The idea was mainly to imitate what neighbouring countries had been doing to promote reconstruction after World War II, to stabilize the economy and to take advantage of the expansion phase of the world economy.

The general objective of the Plan was to achieve economic growth while avoiding inflation and disequilibrium in the balance of payments (the most severe problems afflicting the Spanish economy but also those that were in the spotlight of the international organizations and were central to other stabilization programmes). Two kinds of measures were included: on the one hand, those related to the stabilization of the economy, which were mainly aimed at controlling inflation and solving the current account imbalances and the scarcity of foreign reserves in the short term; on the other hand, some domestic and foreign liberalization measures aimed at introducing market mechanisms and integrating the Spanish economy into the international markets.

The 1959 Plan was not so different from those applied in other countries and supported by the IMF. The only Plan with a wider reach was the Rueff Plan. In the French case, in addition to the typical measures associated with a stabilization plan aimed at correcting imbalances and reducing the level of interventionism, other types of "compensating" measures were introduced to reduce the costs that such a plan imposes on some sectors of the population. In particular, the introduction of a national minimum wage and the reform of the education system reinforcing education in rural areas stand out. Such compensating factors were not included in the Spanish case; nor were they incorporated in the Latin American stabilization programmes. The stabilization plans in Latin America placed the emphasis on containing inflation. They did so by restricting the expansion of credit and money and also by fostering non-inflationary behaviour in the public sector. Limits on credit were introduced and attempts were made to promote multilateral trade, free of restrictions and discrimination, and without multiple exchange rates. Other aspects such as wage control, or public service taxes were also considered but were not compulsory (Marshall et al. 1982).

The common feature between the Spanish plan and those applied in Latin America was that the granting of financial aid was conditional on the reforms. Conditionality was also central in the case of Turkey.[4] In France, although Lynch (2000) maintains that the adoption of the Rueff Plan in 1958 was a political necessity for De Gaulle to secure the future of the EEC and to maintain his leadership in this project, it was also a way to obtain further international loans. The only country that negotiated an arrangement with the IMF officially without economic policy conditionality was the UK.[5]

The 1959 Spanish Plan was, therefore, in line with the rest of above-mentioned programmes, albeit with an important institutional difference: it was the only country with a dictatorship.[6] Another difference was the level of distortion in the external sector, which was clearly higher than in the other countries and, consequently, the potential impact of foreign liberalization was substantial.[7] The Plan included the following measures. Firstly, fiscal and monetary measures to control inflation were passed. There was a minor fiscal reform that increased indirect taxes (on petrol, tobacco and telephone services), introduced new custom duties and established limits on public spending. The government also committed to stop issuing government debt automatically pledged with the Bank of Spain, which up that point had been the main source of money creation. With respect to monetary measures, there was an increase in the Bank of Spain discount rate, and to help regulate liquidity, limits on the growth of banking loans were established, as well as a prior import deposit, limits on the issue of new public debt and some legal ratios. In order to control inflation, there was also a wage freeze. Secondly, some minor measures to reduce domestic interventionism were adopted and some regulated prices were adjusted to market prices (petrol, tobacco, telephone, transport) in order to further depress demand. Finally, an array of measures linked to the foreign sector were passed. The inefficient multiple exchange rate system was eliminated and the peseta was devalued by 42.8% to set a more realistic exchange rate (from 48 to 60 pesetas per dollar). In July 1959, the peseta became convertible with major European currencies and integrated into the Bretton Woods system. A gradual process of liberalization and multilateralization of trade began with the approval of the 1960 Tariff (this was a protectionist tax but replaced the previous more inefficient licence system). The authorities committed to liberalizing at least 50% of imports. Lastly, restrictions on foreign direct investment were relaxed.

The other central aspect of the international organization agreements was the financial aid. Spain received $544 million from the international institutions ($175 million from the IMF, $45 million from the OEEC, $253 million from the US government and $71 million from New York banks). The aid represented around 6% of GDP and 50% of total state revenues (Martín-Aceña 2004). As Table 5.1 shows, in relative terms the amount received by Spain was very substantial and having this huge amount of potential help was crucial for the approval of the Plan, although in the end the success of the adjustment process made these credit facilities redundant (Sardà 1970; Carreras and Tafunell 2003).

Table 5.1 Financial aid as a percentage of GDP

Spain (1959)	6.0
France (1958)	1.9
UK (1957)	2.0
Argentina (1958)	3.6

Source: Spain, Martín-Aceña 2004; France and UK, IMF Reports for the financial aid and Jordà, Schularick and Taylor (2017) for the nominal GDP; Argentina, Marshall et al. (1982) for the financial aid and IEERAL (1986) for nominal GDP. Own elaboration

5.4 The Spanish Golden Age

The literature on the Latin American stabilization programmes holds that in the long run the 1950s plans had minimal impact and that the only real advances were the simplification and rationalization of the exchange rate systems. Results in other areas such as the improvement in public budget balances or the control on credit growth were meagre, and there is certainly a consensus that these programmes did not contribute to better growth conditions, income distribution or financial stability in the medium and long run (Marshall et al. 1982). By contrast, hundreds of papers have considered[8] the Spanish Plan as a turning point in the Spanish economy because it was the beginning of a new era characterized by greater international integration and it had permanent effects on the economy by facilitating structural change, GDP growth and productivity increase. Therefore, the role played by the Plan in the changes of the 1960s must be evaluated.

In the short term, the Stabilization programme was a success because current account deficits disappeared, foreign reserves increased[9] (mainly thanks to an increase in exports, a decrease in imports and the entry of foreign capital), inflation declined and the public budget also registered better figures (thanks to an increase in revenues due to tax reform and a moderation in public spending). The fall in public deficits reduced the pressure on prices and contributed to better inflation performance. On the other hand, the elimination of import licences brought about the disappearance of black markets for raw materials and other mechanisms of corruption arising under the supply constraints. This led to a certain cost reduction, which was evident to contemporaries, although difficult to quantify (Ortínez 1993; Comín 2018).

However, as in other countries such as Chile, Argentina and France, in the short term there was a depression with a rise in unemployment,[10] a decrease in wage income due to the fall in extra working hours and a negative impact on final consumption. The higher costs of the short-term depression were, therefore, borne by the working class and small firms that saw their credit reduced (Rubio 1968). After the implementation of the Plan, taking into account the economic difficulties for the working class, some measures to control prices and food shortages were passed. However, these measures reinforced the idea that the government lacked confidence in the free market and was returning to autarkic measures. There was also an unsuccessful attempt to introduce some social measures, mainly in education (Zaratiegui 2018).

Nevertheless, the recovery was relatively rapid, especially considering the number of measures adopted. Spain took more or less the same time as France to recover (around 12–15 months) even though the size and scope of the stabilization programme was clearly greater in Spain than in France (Rubio 1968). The rapid recovery was also thanks to the emigration of Spanish workers to other European countries that were similarly in a period of economic expansion, the migrant remittances and the growth in tourism (tourism revenues rose by 15% in 1959 and 57% in 1960, and the number of tourists multiplied by 5 between 1960 and 1967 and by 75 between 1959 and 1973).

But the 1959 Stabilization Plan was a turning point in the Spanish economy due to its long-term effects. After a short downturn, the Spanish economy began to grow at a more-than-remarkable rate, both in historical terms and in relation to other countries. What definitively changed? The most important changes were those associated with liberalization and the dismantling or relaxation of controls in the foreign sector.[11] The protectionist measures from 1959 were less interventionist than previous ones,[12] and although Spain did not cease to be a protectionist country,[13] part of the change in terms of liberalization was irreversible (Viñas 1982). This greater liberalization allowed the introduction of new technologies through the imports of capital goods, direct investments and the acquisitions of patents and registered trademarks, which in turn facilitated a boost in productivity in the industrial and agricultural sectors. For the first time since the Civil War, Spanish firms had access to the technology and the procedures in use in the most advanced countries. The unlimited possibility of importing capital goods and the arrival of a large volume of foreign direct investment introduced more productive technologies (both incorporated and unincorporated) into the Spanish economy, which enabled a rapid catching-up process. Indeed, the catching-up process is undoubtedly one of the keys to the "Spanish miracle" of the 1960s (Martín-Aceña and Martínez-Ruiz 2007). In addition, the Plan exposed Spanish firms to international competition in a favourable international context. Western Europe was a huge market for Spanish goods, and trade openness broadened the narrow internal market. The increased competition faced by the Spanish economy forced greater specialization, in line with the comparative advantages of the country, which meant a strong reallocation of resources.

Table 5.2 shows the radical change in the composition of exports (with a decrease in agricultural exports and a substantial increase in manufactured exports) and the increase in the openness rate from 1959 to 1973. Despite this, in 1973 the Spanish trade openness ratio (23.3%) was still a long way off that of other European countries such as the UK (34.2%), Germany (34%) or Italy (35.2%). In a country that was traditionally capital-scarce, the international capital openness increased the availability of external sources of financing used to promote economic growth. There was an impressive increase in foreign capital inflows after 1959, mainly from the US, followed by Germany, and this foreign investment was critical for some specific sectors such as the automobile, chemical and electric materials sectors, among others (Puig and Álvaro 2015). Therefore,

Table 5.2 Foreign sector, 1959–1973

	1959	1967	1973
Composition of Spanish exports (in percentages)			
Primary products	79.4	62.3	35.9
Semi-manufactured products	10.8	12.5	18.3
Manufactured products	9.8	25.2	45.8
Openness ratio (%)	10.5	18	23.3
Foreign capital inflows (million pesetas)	9,559	50,100	207,500

Source: Tena (2005)

the measures that had the strongest repercussion on Spanish activity were the establishment of a unique exchange rate, the foreign trade liberalization and the reduction of restrictions on inward foreign investment.

The Plan also had other effects. It encouraged the adoption of complementary measures for stabilizing and liberalizing the economy (mainly due to the conditionality of the financial aid). A clear example is the set of reforms that facilitated monetary control, for example, by stopping the issue of government debt automatically pledged with the Bank of Spain. Despite this, monetary measures proved to be insufficient and left many people unsatisfied.[14] The lack of instruments forced the authorities to improvise and they used very inefficient instruments. However, they were the first crude steps in the right direction.

The Plan, along with the country's integration into the international organizations, contributed to the international normalization of Spain. Spain was excluded from the Marshall Plan but it was also left out of the first integration initiatives adopted by the Western European countries. Spain was not initially part of the OEEC, the European Payments Union, the European Coal and Steel Community, the Euratom or the European Economic Community in 1957. Thus, on the one hand, Spain had its sights set on Europe, and becoming a member of international organizations was a priority objective of the Franco government. On the other hand, the Plan and the entry into the international organizations were clear signs that Western European countries were more receptive to the future integration of Spain into their action schemes (Delgado 2001).

There were other political and social benefits associated with the Plan. On the one hand, it facilitated political change by reducing the influence of the most traditional and conservative sectors (the Falangists) in the power structure. On the other hand, the Plan facilitated the emergence of new elites (not only in the political area but also in business), who slowly displaced the traditional ones.

Finally, all the above-mentioned factors also encouraged the recovery of business confidence, the fall in inflation expectations and the creation of a more suitable climate for investment (Martín-Aceña 2004). As Calvo (2001) shows for the 1950s, the change in business expectations (as also happened with the Marshall Plan according to De Long and Eichengreen 1993) was definitely more important than the financial aid. Increasing stability and an improving business climate not only for Spanish investors but especially for foreign investors, in an institutional environment as complex and hostile as a dictatorship, were essential for the possibilities of investment growth in the 1960s.

Some studies tried to quantitatively estimate the impact of the 1959 Plan. The annual rate of GDP growth was 4.4% from 1952 to 1958 (compared to 2.1% from 1939 to 1951). After the Stabilization Plan, the rate of growth rose to 5.6% between 1959 and 1965. Moreover, the Plan facilitated structural change and transformed the foreign sector. In a simulation exercise, Martín-Aceña (2003) found that without the Plan the GDP in 1975 would have been between 46% and 69% lower than it actually was. Also Prados, Roses and Sanz (2011) found that without the Plan, per capita GDP would have been significantly lower in 1975, although the results varied significantly depending on the different scenarios they contemplate. It cannot be claimed that the Stabilization Plan was solely responsible for the rapid growth and structural transformations during the 1960s.[15] Nevertheless, the Plan made two main contributions: the stabilization of the economy and its effect on the foreign sector (foreign capital inflows and a change in the composition of exports). Through these two channels, it gave Spain the opportunity to take advantage of an expansive world economic cycle. Further, the Plan was a turning point because it represented a break with a previous period characterized by ostracism and autarky, which produced misery and backwardness.

However, despite the liberalizing advances, in the 1960s there was a pendular swing back towards more protectionism, interventionism and corporatism. Although some of the changes were irreversible, the main difficulties in going forward with these transformations derived from the lack of political will and the resistance to change: the regime had reservations about altering the foundations of its economic model, business-owners were troubled by liberalization and workers worried about the loss of job security (Requeijo 2005).

5.5 The Limits of Economic Reform in a Dictatorial State

As explained above, the main proponents of the Stabilization Plan believed that, after the declaration of convertibility of European currencies, Spain was facing its last chance to get on board the train of economic modernization that the world economy was experiencing. As Juan Sardà, then head of the Bank of Spain's research department and one of the inspirers of the Plan, stated: the programme of 1959 was designed to open the economy to international competition and to lay the foundations of a free market economy (Sardà 1970). In that sense, Spain can be seen as aspiring to keep abreast with the reforms that had been undertaken by the countries of Western Europe in the heat of the conditionality imposed by the Marshall Plan. To what extent was it able to do so?

With regard to the integration of Spain into international markets, without a doubt the main contribution of the Plan, the insistence on reserving the domestic market for domestic production, prompted the adoption of an excessively high tariff, which limited the pressure on domestic producers to improve their efficiency. Indeed, the Spanish export of goods never took off and the coverage rates of Spanish commerce remained at around 45% for the whole decade. Also, the continuous attempts to manipulate the exchange rate with interventions orchestrated through non-transparent, interposed companies clearly reveal that the mentality of submitting international relations to state control had not disappeared (Martínez-Ruiz and Nogués-Marco 2013). However, as shown, the opening up of the Spanish economy was one of the few areas in which the measures adopted had a significant effect.

In financial and monetary terms, on the contrary, the outcomes were poor. The new banking law passed in 1962 was intended to grant more freedom to financial institutions. However, in some respects, it was more interventionist than the previous one, as it introduced different investment coefficients and credit controls to redirect investment, while many regulations—such as the need to obtain official approval for expansion plans, opening of new branches, capital enlargement or the issue of new shares—were kept in place (Poveda 1980). It must be mentioned, however, that financial repression and intervention in the financial sector was the general rule during the 1960s in most European countries. Moreover, although limits were implemented on the issue of public debt which could be automatically pledged with the Bank of Spain, the amount of this type of public debt in the hands of the banking sector was so large that this limit failed to effectively control monetary expansion. Further, debt issuance to finance government investment and development plans was soon resurrected. In order to promote the growth of sectors considered a priority, the Bank of Spain committed to rediscount at preferential rates the credits granted by banks and savings banks to certain sectors and firms. Official credit institutions financed their own investment in those selected sectors, floating a special type of bonds ("investment cédulas"), which were then placed in private banks and savings banks through mandatory investment coefficients. Financial repression was not only aimed at providing low-cost funding to cover the needs of the Treasury, but also at directing investment to the sectors and firms designated by the government, although this was also the case in other European countries during the 1950s and 1960s. The main difference between Spain and other countries was its incapacity to control inflation. Although the rate of growth of the CPI fell from more than 7% in 1958/59 to around 1.1 in 1959/60, it increased again after that year, and in 1965 was around 13%, clearly above other developed countries (Fig. 5.3).

Thus, the intervention of the State in the industrial sector was never really abandoned, although it changed in nature somewhat. The INI, the large conglomerate of public companies created in 1939, was forced to adopt the principle of subsidiarity. However, it remained active, absorbing a large amount of resources. On the other hand, in 1963 the main industry intervention law, the National Industries Protection Act, was replaced by the Preferential Interests Law. Its objective was to divert investment to industrial sectors considered a priority for the purposes of economic and social development set by the government. Thus, state intervention in the allocation of investment in the industrial sector remained a staple of Francoist policy.

Also, in many other fields, the hesitance of the Francoist authorities to abandon interventionist policies was quickly revealed. Labour regulation,

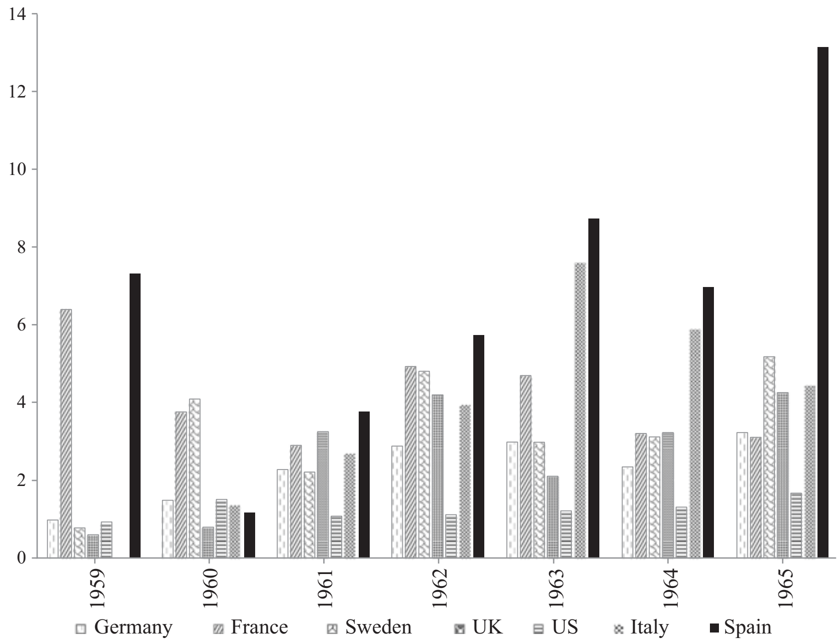

Fig. 5.3 CPI index 1959–1965. (Source: Spain, Maluquer (2013); other countries, Jordà, Schularick and Taylor (2017))

despite the notable laws enacted (collective agreements, internal regime and, finally, unemployment insurance in 1961), continued to be based on a lack of freedom of association and the prohibition of any form of protest by workers (Sola 2014). So, the State continued to take on the task of guaranteeing workers' rights through the exhaustive regulation of all aspects of labour relations: from the internal organization of work in companies, the approval of collective agreements negotiated under supervision and, of course, strongly restricted dismissals. With regard to wages, more realistic pay was never achieved, nor even a sufficient flexibility in setting wages, which even employers wanted, in order to increase labour mobility and their capacity to adapt to new technologies (Soto 2006). Over time, multi-employment and, in general, wage supplements became the mechanisms that allowed Spanish workers to improve their consumption capacity. However, this type of compensation, also regulated, failed to increase wages at the rate of productivity and further complicated the cumbersome legal framework of labour relations, introducing great rigidity into labour markets. The mere idea of a "social pact" was totally alien to a dictatorial regime like that in Franco's Spain, which on the contrary opted to replace redistributive agreements and measures with repression and inequality. In a few years, the social transformations caused by economic growth and cultural exchange abroad reactivated labour conflicts and political protest, thus serving to strengthen opposition to the regime.

Two pillars of the autarkic economic policy—the intervention in the labour markets and industrial policy—underwent only minor changes that did not alter the essence of the economic policy or its basic principles: distrust in free markets and private initiative. The lack of ambition for reforms in these fields cannot in any way be attributed to ignorance on the part of the authorities. In fact, the Plan explicitly announced that "it will tend to eliminate the rigidities derived from labour legislation, as well as those that have their origin in restrictions of competition". The battery of insignificant reforms in the labour market was in fact accompanied by a new law on competition, which was empty of content. If the economic authorities were aware of the problems that these interventions entailed when it came to achieving balanced growth, why did they not go ahead with the reforms? Obviously, there are several possible explanations. First, the economic and political powers that had opposed the Plan found the grave difficulties of the population during the initial months to be a useful weapon with which to attack the adoption of adjustment measures. The hesitant steps in the field of liberalization reflected not only the overwhelming unwillingness to abandon autarky, but also the pressures of some productive sectors and firms that supported the Franco regime. Further, the rapid recovery after the recession of the early months and the positive results obtained in the correction of the most serious macroeconomic imbalances relaxed the pressure on the Spanish economy, reducing the negotiating capacity of the defenders of the reforms. At that time, Spain's eventual incorporation into the newly launched European Common Market became the strongest argument for continuing the recently initiated path. The integration of Spain into the EEC bodies was understood within the regime as the last step in the total rehabilitation of the Franco regime in the international sphere. It was therefore willing to continue with the consolidation of a system based on private initiative and free markets. The negative response to Spain's request for entry in 1962 indicated to the regime that it was not enough to vary the course of economic policy. That was another knock to those with an appetite for reform, a faction which continued to lose strength. The Franco regime was not willing to renounce its very nature; indeed, many of the reforms needed to promote increased productivity, as other European countries had done, undermined the most basic pillars and principles of a dictatorship like Franco's.

Apart from labour regulation, the incompatibility of the reforms with the dictatorial nature of the regime was clearly demonstrated in its fiscal policy. The resistance of the Franco regime to undertaking a modernizing tax reform that would ensure a sufficient and equitable income structure prevented the Spanish State from assuming the economic functions essential for productivity growth. Neither the Plan nor the subsequent reforms altered the nature of the system, in which the taxes were outdated, labour bore a greater fiscal burden than capital and indirect taxes continued to contribute the bulk of income. After the 1957 reform, the system continued to be based on indirect taxation, which went from less than half of the tax revenue to almost 60% in 1969. In addition, the consumption tax, the main element of the system, was nothing like a modern value-added tax either in its design or in the means of collection, which increased the regressive nature of the tax system. Fraud was the other characteristic feature of this fiscal system, with a tax evasion rate at the end of the 1960s of more than 40% of the fiscal revenues (Comín 2016). The fiscal system was typical of a less developed country, with the negative consequences that this implied in terms of inequality and lack of fiscal resources to promote economic growth.

Therefore, the Plan maintained a reduced size of state and did not take on a fiscal reform that would have fostered not only Spanish economic transformations but also its convergence with other European countries. The budget was balanced not only by cutting spending but also by moving some expenditures and investments out of the state budget. The new public accounting that unified all state expenditures in the same budget, released in 1958, was soon surpassed with the emergence of parastatal funding channels as the preferred discount. As Comín (1996) states, regulation is the affordable instrument used by poor countries to replace their insufficient budgets. In those countries or periods where a tax reform cannot be implemented, or is not wanted, the regulation of markets for goods and factors replaces budgetary action, allowing the presence of the State in the economy despite resource shortage. The need to secure the income of groups related to the regime led to perpetuation of the intense public intervention in the economy, with levels of protection and regulation far superior to those of other European countries.

Further, in a context of growth with increasing public sector service demands, only fiscal reform would have enabled an increase in revenues and investment in education or infrastructure (Comín 2003). Also, social insurance had developed very slowly since 1959, which was mainly explained by the paltry financial commitment of the Francoist State. Thus, the unemployment insurance created in 1961 or the Social Security Act of 1963 did not represent a real advance towards a "European" welfare state, because the contributions of the State barely increased until the end of 1960s (Comín and Martorell 2013). The underdevelopment of the welfare state hindered the productivity growth of a country whose population was less healthy and less well trained than those of its European neighbours. Franco's refusal to use the tax system as a redistributive mechanism also had dire consequences for social stability as "firms became the scene of the redistributive struggle" (Serrano Sanz and Pardos 2002).

Lastly, in Spain the lack of more ambitious structural reforms had extremely negative consequences in the long term: an inefficient allocation of resources which propped up sectors that could not compete in the international market and the emergence of an entrepreneurial class dependant on political power and its decisions. Further, it produced two main effects. Firstly, the appearance of new imbalances during the 1960s and 1970s, and secondly, the absence of substantial improvements in terms of income and wealth redistribution. According to the estimates reported by Alvaredo and Saez (2009), the top income concentration remained around 0.6% from 1953 to 1971. Regarding the Gini index, the index for employees' wages and salaries (agrarian and industrial) declined from 0.29 in 1964 to 0.23 in 1973, while the Gini coefficient for household income fell from 0.39 in 1964 to 0.36 in 1974. The data reported by Prados de la Escosura (2008), in line with Goerlich and Mas

Table 5.3 Educational indicators, 1960–1970

	Average years of schooling			Upper secondary attainment rates (%)		
	1960	1965	1970	1960	1965	1970
Germany	9.6	10.04	10.48	34.19	38.29	42.2
France	6.43	6.67	7.03	12.31	14.99	18.2
Sweden	9.04	9.3	9.57	22.97	24.41	27.85
UK	6.69	7.13	7.58	5.51	8.07	10.63
US	10.56	10.97	11.33	43.81	48.74	51.06
Italy	4.95	5.21	5.46	1.08	1.49	1.9
Spain	4.7	4.82	4.95	1.76	2.04	2.33

Source: BBVA (2012)

(2001), suggest that there was a drop in inequality before 1974. Despite this, significant social and economic inequities remained. Although the illiteracy rate was 10% in 1970, in that same year only 6% of the population had completed secondary studies. The lack of public investment in education resulted in lower attainment rates (Table 5.3).

5.6 Conclusions

In 1959 there was a boost to the liberalization and flexibilization of the Spanish economy. The process began modestly in the 1950s but went further as a consequence of the approval of the 1959 Stabilization Plan. The Plan was not important because of the audacity or the originality of its measures, but rather because it definitively established that there was no way back in the liberalization process. The Plan was more successful in terms of stabilization than in liberalization and market flexibilization. Despite this, the liberalization and flexibilization measures had a great and longer-lasting impact on the Spanish economy, by allowing Spain to take advantage of the favourable international context in the 1960s. Spain achieved high rates of growth, considerable structural change, substantial transformation in export competition and managed to attract foreign capital. The Plan, therefore, favoured the creation of a framework that promoted growth and shaped both institutions and mentalities. The 1959 Stabilization Plan is a good example of the benefits for an economy of changing from autarky and interventionism to trade liberalization and market regulation. But it is also an example of how political restrictions (the dictatorship) restricted the scope of the reforms and the country's long-term development potential. To conclude, the 1959 Stabilization Plan was a decisive break in the economic evolution of Spain, although the modernization effort was encumbered by the limitations imposed by the dictatorial nature of the Franco regime, and the Spanish economy retained rigidities and inefficiencies that would weigh heavily on the system when responding to a new crisis.

Finally, as some studies have pointed out, one negative aspect of the Plan is that it facilitated the continuance of the dictatorship. As Martín-Aceña (2004) suggests, it cannot be asserted that without the Plan the regime would have disappeared; however, according to Varela (2004), it would have been "less bearable". Some other authors stress though that social modernization associated with growth increased popular discontent and social conflict, in line with what was happening in Western economies. In this way, the Plan allowed the continuity of the regime, by making it more bearable, but it would have also increased the social pressures for the political normalization of Spain in the European context, a goal that was finally achieved with the political transition process from 1975 on.

Notes

1. The sample includes France, Germany, Italy, Sweden, the UK, the US, Portugal and Spain.
2. Whereas the average annual change in the consumer price index (CPI) from 1952 to 1957 increased by more than 4.5% in Spain, the UK—one of the countries in our sample with higher inflation at that time—had an annual rate of growth of 3.7%, followed by Sweden (3.1%) and Italy (2.9%). By contrast, France and Germany had very low inflation growth (with an annual rate of 0.8% and 0.9%, respectively).
3. The entry in 1957 of a new government with Alberto Ullastres (Ministry of Commerce), Mariano Navarro Rubio (Ministry of Finance) and their closest collaborators (Juan Antonio Ortíz Gracia, Manuel Varela, and

Joan Sardà) was essential. They were conscious of the limitations of the autarkic model and of the magnitude of the proposed reforms. The persuasive skills of this new team were also a key factor (Fuentes Quintana 1984). These economists, linked to the Faculty of Political Science and Economics of the University of Madrid, identified their programme with the notions of the Falange, and that gave them considerable influence over the Franco government. Also a group of liberal managers, bankers and economists linked to Opus Dei acted as a "pressure group" and both had great influence on the political changes at the end of the 1950s. Franco never explained or justified the change in the cabinet in 1957, and therefore it is very difficult to know whether he was conscious of the importance of this change but the limitations of the nationalist economic programme were evident and Franco did not have many alternatives (Pons 2002).

4. The US government, alerted by its scepticism about the determination of the Turkish government to take the necessary steps to stabilize the economy, even warned Germany not to extend bilateral financial assistance to Turkey without regard to the views of the IMF and OEEC on its economic conditions (Fry 1971).
5. However, there were other political exchanges (the withdrawal of its forces from Egypt) and the aid was preceded by the announcement of an array of economic policy measures by the Chancellor Harold Macmillan (mainly spending cuts). Moreover, in 1958 the IMF advised the British government to restrict demand to reduce inflation and to improve the balance of payments and reserve positions (Clift and Tomlinson 2008).
6. The only country that had a Stabilization Plan with strong political instability at that time was Argentina.
7. For example, the ratio of exports to GDP for Spain was 0.024 in 1950. This was clearly below the European average (0.053 in 1950) and also below that of the other countries that received international aid (Argentina (0.057), Chile (0.15), France (0.06) and the UK (0.1)) according to Federico and Tena (2019).
8. See, for example, Carreras and Tafunell (2003) or Fuentes Quintana (1984, 1986).
9. Only between August and November 1959 foreign reserves increased by more than $80 million (OEEC Report 1960). On 1st February 1960 foreign reserves stood at $212 million.

10. Data on unemployment only reflect official figures, which are not credible. However, even these official figures show a clear increase in the number of unemployed people: from 92,828 in 1958 to 130,304 in 1960 and 133,151 in December 1961. Only in 1962 was the number of unemployed people around the figure of 1957: 88,145.
11. As Viñas (1982: 71) indicates: "In the years 1950-1960, the only ambitious operation of high economic policy of the Franco regime was carried out: the stabilization and liberation plan. This represented a sea-change in defining the interaction with the exterior, even if at the beginning the economic contacts with the surroundings were of the most limited scope".
12. It should be borne in mind that in early 1959, before the Plan was passed, liberalized trade represented only 9% of total trade. The rest was subject to quotas, special trade or bilateral agreements (Martínez-Ruiz 2003).
13. The level of nominal protection in 1950 was 11.8, and in 1959 decreased to 5.9. After the 1960 Tax it was 15.9 and in 1962 it rose to 18.2. In terms of effective protection, it was very high as a consequence of the introduction of other protection mechanisms such as the *Impuesto de compensacion de gravámenes interiores* (tax adjustments at the border) (Buisán and Gordo 1997) and several modifications of the 1960 tariff, with more than 1000 decrees that were passed as a result of specific interests of productive sectors and even pressure from individual companies (Requeijo 2005).
14. As Joan Sardà explained in an interview in 1991, the monetary policy measures adopted in the Plan were too rudimentary and far removed from other more sophisticated monetary policy instruments used in other European countries. However, the IMF considered that it was too early to introduce these instruments and that "the banking sector and country were not prepared" (Perdices and Baumert 2010).
15. For a more detailed analysis of the factors behind the 1960s economic growth, see Barciela et al. (2001), Carreras and Tafunell (2003), Prados and Sanz (1996), Serrano Sanz and Pardos (2002), Martín-Aceña and Martínez-Ruiz (2007), among others.

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6

1977: Hopes Fulfilled—Building Democracy in Turbulent Economic Times

Joaquim Cuevas and María A. Pons

6.1 Why 1977 Was a Turning Point in Spain

Although the Spanish crisis was sparked by an external shock (the oil crisis), there are several particular features of the country that make 1977 a turning point in Spanish economic history.[1] The first of these particularities is that the crisis came later (in 1976/1977 instead of 1973) than in other countries as a consequence of the measures introduced by the Franco government and the first government of the democracy to "camouflage" the problems. Moreover, the impact was more severe. The 1977 Spanish crisis has been considered by Reinhart and Rogoff (2008) as one of the "Big Five" crises of the twentieth century. There were huge difficulties in terms of inflation, external imbalances, high unemployment rates and low growth rates. It was also a period of financial turmoil, with

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almost half the banking sector affected, along with currency and stock market crises.

Another distinctive feature is that the crisis also coincided with major political and institutional changes associated with the political transition after Franco's death in 1975, a combination which had economic consequences. The political transition and the weakness of the new governments of the democracy shaped responses to the crisis, with key economic decision-making postponed. Moreover, the fact that the arrival of democracy coincided with an economic crisis limited the country's ability to face the new challenges that appeared after forty years of dictatorship.

Finally, 1977 was a turning point in Spanish economic history not only because of the severity of the economic and financial crises and the upheaval of the political transition but also due to the efforts made to reach agreed solutions and the seminal nature of the reforms implemented from 1977 onwards. Spain came into the 1970s with an institutional framework characterized by a high level of state intervention that stood in contrast to the small size of the State. This interventionism was mainly instrumented through regulations and protectionist measures that distorted the role of the market. Therefore, when the crisis hit, Spain had a rickety state that prevented the correct use of fiscal policies, making it impossible to fight against the negative social consequences of the crisis, particularly the high unemployment rates. Moreover, it prevented investment in human capital and infrastructure to promote economic growth.

The political context is crucial in understanding the nature of the reforms and their timing. There was major political instability during the last years of the dictatorship and the first years of democracy: the assassination of Carrero Blanco in December 1973 (prime minister of the Franco government from June of that year), the serious illness of Franco from 1974 until his death in November 1975, the short duration of the first democratic governments (the first government lasted seven months and the second one a year) and four ministers of finance in only three-and-a-half years. Finally, in 1981 there was a failed military coup d'état. All this instability adversely affected the response to the crisis and led to a delay in the implementation of reforms to correct the strong imbalances that arose (once again) in the 1970s and 1980s. Adolfo Suárez, who was initially appointed as prime minister of the transition by King Juan Carlos and was eventually the first democratically elected prime minister after Franco's death, gave priority to policy rather than economy. The most urgent task was deemed to be the dismantlement of the Francoist institutional and political framework, and so the economic measures were postponed.[2] The Political Reform Law passed in 1976 called for democratic elections; they were won by Suárez, who formed his second government in 1977. Only then, when the crisis had already become very severe, were the economic problems addressed (Martín-Aceña 2010).

The economy urgently needed to be stabilized, which required the implementation of a modern monetary policy and an increase in revenues through fiscal reform. A tax reform was also a prerequisite for increasing social spending and constructing the welfare state. The hopes of reform by the Republican government in the 1930s were left unfulfilled as a consequence of the Civil War and the long-lasting dictatorship, and it was not until Franco's death that any significant economic modernizing reforms were implemented. This was the second historical opportunity to build a plural democracy and it came hand-in-hand with a serious economic crisis (Fuentes Quintana 1982). The transition to democracy entailed the introduction of reforms to radically transform Francoist economic bases, but also to meet the need for social dialogue and the growing public demand for progressive and redistributive policies.

Although Fuentes Quintana, who served as deputy prime minister of Spain between 1977 and 1979 with the *Unión de Centro Democrático* (UCD) government, prepared a major reform package, he convinced Suárez to reach an agreement with the main opposition parties given the crucial nature of the reforms needed to solve the economic difficulties; the result was the Moncloa Pacts (*Pactos de la Moncloa*) that were passed on 27 October 1977. The problem was not only one of priorities, it was also one of effectiveness. Spain lacked economic policy instruments and so first had to establish them. However, this happened in a context where other countries were moving away from Keynesianism and adopting supply-side policies (Skidelsky 1978). Consequently, there was a change in the Spanish policy framework at a time when other, more developed countries were gradual shifting towards a new paradigm.

Having learned from the lessons of history, the Moncloa Pacts were the result of a policy of consensus on economic and social issues referred to as “transition through transaction” (Powell 2015). This time, hopes were fulfilled and the country began a process of economic and institutional transformations that was not without its difficulties. The Moncloa Pacts, the new Constitution of 1978, the process of decentralization and the construction of the welfare state were crucial reforms that had to be introduced in turbulent times but that definitely altered the attitude governing the economy. With Spain finally being a democracy, the goal of integration in Europe became a priority and, for the first time, feasible.

The rest of the chapter is organized as follows. Section 6.2 describes the main characteristics and consequences of the economic crisis. Section 6.3 explains the nature and contents of the Moncloa Pacts, designed mainly to solve the economic problems but also to underline the possibility of setting aside ideological differences and finding agreed solutions in the interests of the democratization process. This section also addresses the main reforms related to the stabilization of the economy. In Sect. 6.4, other major reforms that changed the institutional framework are explained, with a special emphasis on the expanding State and the construction of the welfare state. Some concluding remarks are presented in Sect. 6.5.

6.2 Economic Crisis in a Context of Political Transition

Spain’s political and economic difficulties in 1977 placed it in one of the worst crises in its recent history. But the 1970s were also turbulent times in the international context. The decade began with an unexpected global crisis that ended two decades of prosperity and supernormal growth. Several factors destabilized the economy. The first was the collapse of the Bretton Woods system when in 1971 the US, experiencing major trade and fiscal deficits, declared the non-convertibility of the dollar into gold and other currencies; most countries then abandoned fixed exchange rates and their currencies entered a floating exchange rate regime. The second factor was the two oil shocks (in 1973 and 1979). Global growth problems were also influenced by other factors such as the growing process of tertiarization and the difficulties in increasing productivity rates. The emergence of new competing countries such as Japan, Hong Kong, Taiwan and Vietnam, which achieved higher growth rates in the 1970s and 1980s, also had a global impact.

The main effects of the rise in oil prices in the 1970s were inflation and lower growth, which negatively affected business profits, discouraged investment and drove up unemployment in most parts of the world. Inflation was also fuelled by other factors such as wage increases, or the rising prices of some raw materials and food, in addition to expansionary spending policies that favoured liquidity growth. These problems (high inflation with high unemployment rates, the so-called stagflation) forced policymakers to re-evaluate their response to these challenges. On the one hand, the traditional Keynesian tools (demand management policies based on fiscal instruments) failed to solve simultaneous problems of unemployment and inflation. On the other hand, monetary policy severely weakened growth and unemployment.

The 1977 Spanish crisis has some distinctive features in relation to other countries. Regarding the severity of the crisis, it is the second most severe crisis to affect Spain in the period from 1850 to 2015, surpassed only by the 2008 crisis. It was also more severe than in other OECD countries, with an output loss from 1976 to 1985 of more than 49% of GDP[3] (Betrán and Pons 2017). In the early 1970s, Spain was a recently industrialized country, with relatively low income (80% of the EU15 average), relatively late and rapid structural change[4] and very intensive in energy consumption. The fact that the external shock (the hike in oil prices) coincided with an economic growth model based on state interventionism, lack of competition and low productivity rates, along with the political problems of the end of the Franco dictatorship and the transition to democracy, created an explosive cocktail that aggravated the economic recession.

Regarding the growth model, the Francoist economy was characterized by controls that pervaded the whole system (barriers to entry, labour conditions etc.) and protectionism. As explained in Chap. 5, the 1950s began with a process of liberalization but this process was incomplete, involving advances but also setbacks. In addition, at the end of the 1960s, Spain had achieved high growth rates and improved efficiency[5] but accumulated internal and external imbalances that were exacerbated after the oil shocks of 1973 and 1979. Although many European countries suffered due to the oil crisis, the difficulties of the Spanish economy were exacerbated by its internal problems, in particular its larger imbalances, lack of competition and the unbalanced growth that was concentrated in the domestic market and in some specific industrial sectors. Liberalization efforts were insufficient and regulation prevented the Spanish economy from being exposed to market forces, with the corresponding increase in efficiency that this measure would have encouraged.

In this context, the political problems played a key role. Franco was eighty-one years old when the oil prices spiked, and the uncertainty due to political instability hindered the adoption of measures to adapt to the new situation. The last governments of the Franco regime and those of the beginning of the democracy tried to hide the problems by subsidizing the price of oil. Although this meant that Spaniards did not notice the crisis in the short term,[6] the decision worsened the consequences, with oil consumption increasing in 1974 and 1975 when OECD countries were reducing it, and with a dramatic impact on the external deficit. Oil imports accounted for 30% of total imports in the first oil shock and rose to 40% in 1979, and half of the foreign reserves obtained by exports went to pay for oil imports (Rubio and Muñoz 2018). During the 1960s and the first half of the 1970s trade deficits were easily covered by the surplus in the balance of services and transfers thanks to the tourism revenues and the migrant remittances. After the oil crisis, increasing trade deficits were no longer offset by the balance of services and transfers, which led to a serious deterioration in the current account balance.

Although economic growth was accompanied by trade liberalization, in the mid-1960s liberalization was halted (Buisán and Gordo 1997). In the early 1970s there was a new liberalizing push, linked to the signing of a preferential agreement with the European Economic Community (EEC), which was advantageous for Spain as it reduced tariffs on Spanish products. Spain became more open and went from an openness ratio of 12% in 1960 to 27.6% in 1973. Specifically, the oil crisis occurred in this phase of relative external liberalization and the result, as noted before, was a sharp deterioration of the external deficit. The devaluation of the peseta enabled a better external position in 1978 and 1979, and thus permitted a new push towards liberalization with various agreements and measures. As a result, in 1980, 90% of trade was liberalized (De la Dehesa et al. 1991). Although the devaluation of the peseta positively affected exports, it increased not only the cost of imports but also the cost of servicing foreign debts. This was particularly costly for some specific sectors such as the electricity industry.[7]

The second oil crisis again led to a deterioration in the external position, but thanks to a new devaluation in 1982, Spain's export dynamism recovered. In any case, the final process of trade liberalization was only completed after 1986 with the entry into the EEC. External deficits were accompanied by strong fiscal deficits as a consequence of the government's decision to absorb part of the rise in oil prices. Until the oil shock, the public deficit-to-GDP ratio had been very low (close to zero in 1973), whereas after the crisis it increased considerably, reaching a peak in 1981 (−6.32%). External imbalances and public deficit difficulties forced the Spanish government to apply for a special line created by the IMF amounting to SDR 689.32 million in 1975/1976. Only the UK and Italy received more financial aid. In 1977 Spain also obtained SDR 143 million, which it never used, and, finally, in 1978 received SDR 98.75 million (Varela and Varela 2005).

In addition to external imbalances and public debt deficits, inflation was creeping up (with a peak in 1977 of 25%) and was clearly above the inflation rates of Spain's European neighbours. As Fig. 6.1 shows, the annual rate of growth of the consumer price index (CPI) from 1970 to 1979 was high in comparative terms; in the period 1980–1984 only Italy had a higher CPI growth rate than Spain. In addition to the higher price of oil, another factor explaining the rise in inflation was wages. During the 1960s, wages and productivity increased rapidly and the real unit labour cost remained stagnant (Toharia 1997). However, in the 1970s wages increased above inflation as a consequence of the strategy adopted by the still illegal unions of using collective bargain as an instrument to achieve wage increases but also to fight against the Franco regime (Sanz 2018). The result was an inflationary spiral. In the initial years of the democracy, the demand for higher wages was even more intense and

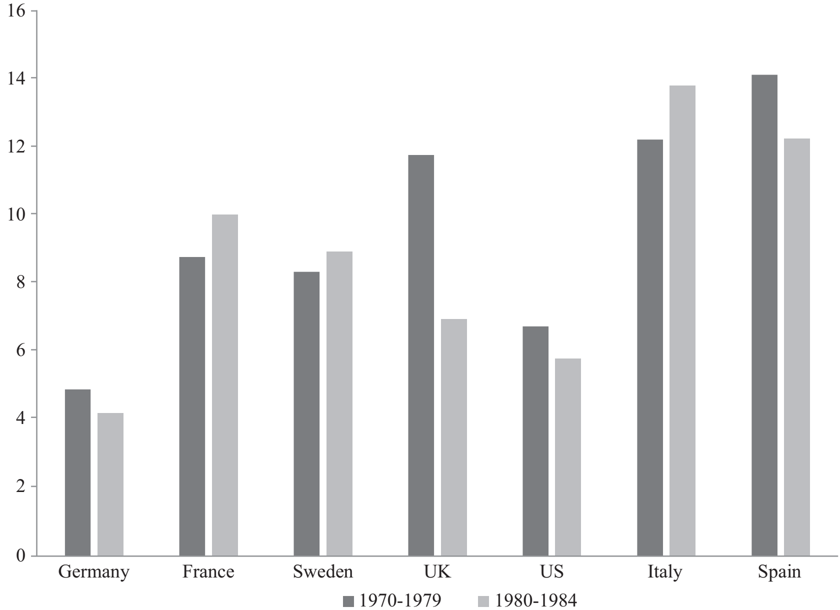

Fig. 6.1 CPI annual rates of growth, 1970/1979 and 1980/1984. (Source: Spain, Maluquer (2013); other countries, Jordà, Schularick and Taylor (2017))

social security costs also rose substantially. Between 1972 and 1978, the labour cost did not adjust quickly enough to productivity; the result was not only inflation but also an upsurge in unit labour costs (Andrés 1994). A "social agreement" was only reached with the Moncloa Pacts, and real wage costs started to decrease as part of a more general strategy to control inflation.

Inflation in a context of crisis lowered business expectations, collapsed private investment (with negative rates from 1975 and especially in the early 1980s) and from 1977/1978 saw the economy embroiled in an industrial crisis with a sharp rise in unemployment rates (which peaked at 16% in 1976).[8] Spanish unemployment rates were clearly above those in other developed countries (Table 6.1) and 1,200,000 people lost their jobs between 1977 and 1981. The OECD countries reacted to the crisis with an expansive fiscal policy and accommodative monetary policy, which allowed them to recover their economic activity but with an

Table 6.1 Unemployment rates in Spain and other countries, 1969–1985

	1969–1973	1974–1979	1980–1985
France	2.6	4.5	8.3
Germany	0.8	3.2	6.0
Italy	4.2	4.6	6.4
UK	3.4	5.1	10.5
US	4.9	6.7	8
Spain	2.7	5.3	16.6

Source: Layard, Nickell and Jackman (1991)

increase in inflation. By contrast, the Spanish government at that time lacked the capacity to implement fiscal and monetary policies[9]; the result was, as mentioned, a higher rise in inflation and unemployment than in the OECD countries.

The industrial crisis entailed the closure of many firms and it was eventually accompanied by a banking crisis. Spanish banks were in most cases mixed or "universal" banks with high participation in sectors such as electricity or construction (Tortella and García Ruiz 2013). Moreover, Spanish companies were very dependent on bank credit. When the economic and industrial crisis hit, it subsequently spread to the banking sector. The inability of many companies to make loan repayments increased the default rate, and the resulting bankruptcies had a depressing effect on the stock market that dragged down some mixed banks. The rise in interest rates also made it more difficult for companies to repay their loans. The 1977 banking crisis affected half of all banking institutions but the impact was predominantly on small- and medium-sized banks, most of which had been founded during the 1960s, rather than the core big banks. The total number of banks in 1977 was 110 and around half of these (63) were impacted by the crisis (Cuervo 1988). Six years later, in 1983, the banking crisis brought down a large industrial holding group (Rumasa), with more than 700 businesses, including several banks. The estimates provided by Cuervo (1988) of the total cost of the 1977–1985 banking crisis indicated that the public sector and private contributions jointly represented around 6% of GDP. Laeven and Valencia (2013) estimate the 1977 fiscal cost, showing that the cost in

Spain (5.6% of GDP) was below the average for a sample of countries (6.8%) but above the average for advanced countries from 1970 to 2011 (3.8%).

6.3 The Moncloa Pacts and the Stabilizing Measures

The fact that the economic crisis coincided with a political transition meant that efforts to tackle the crisis had to involve a political programme of reforms and not merely economic reforms. This perspective was often reiterated by the key players of the period, most of them economists. The economic reforms were designed by a small but influential group of people from different key institutions (Bank of Spain, Ministry of Finance, Bank Research Services, etc.). Among them was a professor of public finance, Fuentes Quintana, who ended up being the vice president of economic affairs in the first democratic government, and Luis Angel Rojo, professor of economic theory, who worked out of the Bank of Spain. Fuentes considered that the reforms were "inevitable", and had to be carried out "gradually and consensually". Rojo defended monetary control as the main instrument of adjustment, although he agreed with Fuentes as to the consensual nature of the reform.

It was essential for those who designed the reforms to consider political aspects. They bore in mind the experience of the 1930s, and how political instability had hindered the adoption of effective measures. The stabilization of the economic situation was impossible without the consolidation of a democratic regime that legitimized the adjustment measures. In the words of Fuentes Quintana (1982): "An economy in crisis constitutes a fundamental political problem" or "economic problems need political solutions". Political considerations meant two things. First, the reforms had to be "agreed" with the new political actors (political parties and unions, hitherto non-existent or illegal) and implemented gradually and sometimes experimentally, due to the high uncertainty and instability (Cabrera 2011). Second, there was a need to frame the reforms in the international context, mainly European, with an eye to integration into the EEC. As mentioned, the crisis called into question the Keynesian macroeconomic model. Moreover, other countries, with the support of the IMF and the OECD, proposed economic policy measures that sought to rebuild social consensus through agreements with trade unions and employers, especially on appropriate wage costs and inflation, and this influenced Spain's reform programme.[10] The need for monetary policy as the main stabilizing instrument was combined with collective bargaining agreements and wage negotiations to improve income redistribution (Trullen 1993).

The measures adopted between 1973 and 1976 transferred most of the adjustment to the public sector. In 1977, the responsibilities of the different ministries were restructured and the Ministry of Economy was created. This ministry took over responsibility for financial policy, which hitherto had been the remit of the Ministry of Finance. This allowed the coordination of and unified action on economic policy. The first initiative was the launch of the *Programa de Saneamiento y Reforma de la Economía* (Restructuring and Reform of the Economy Programme), which planted the seed for the Moncloa Pacts agreed months later, to reduce public deficit and fight inflation. The proposed measures reflected a consensus on the diagnosis of Spanish economic problems: the imbalances and defects inherited from the Franco regime had to be faced, as well as the lack of competitiveness of the economy; moreover, unlike in the past, the solutions should account for the future horizon of international integration, which would eventually lead to Spain's entry into the European Union in 1986.

The crisis-fighting measures and the reforms became a reality in the Moncloa Pacts signed in October 1977 by the group of political forces that emerged from the first elections. The agreements were based around ten sectoral points that covered two main objectives: economic stabilization (monetary, budgetary and wage adjustments); and the institutional reform of the Spanish economy (factor market liberalization, tax reform, financial reform and industrial restructuring). Franco's economic institutions had to be replaced with new, more inclusive ones that enabled the introduction of redistribution instruments but were also governed by market forces. Despite the consensual nature of the 1977 Pacts, they met with opposition from various sectors of society, and led to periods of enormous tension with the unions. In fact, the reforms proposed for the following three years could not be fully implemented until the period 1982–1986, with a majority socialist government.

The first point of the Pacts referred to economic stabilization, with the fight against inflation as a priority. The proposed measures addressed four different angles, with varying degrees of success. First, a monetary policy based on the control of the monetary aggregate should be applied, forcing the central bank to act. Second, the public deficit should be controlled through limits on expenditure and the issuance of public debt. Third, the enormous external deficit should be reduced through successive devaluations of the peseta. Finally, as in other surrounding countries, a wage moderation policy should be established. The main and most novel initiative was the wage indexation, in a collective bargaining framework that did not compromise, in principle, workers' purchasing power with regard to price increases. There was relative consensus given that, in return for agreeing to wage moderation and the necessary adjustments, trade unions and political parties successfully negotiated the granting of significant increases in budget items for social benefits (unemployment and pensions) and spending on education and health. The deal they secured marked the origin of the modern domestic welfare state.

The most important reform was the fiscal one, designed to increase revenues, modernize fiscal management and remove the Franco tax framework. It was also a clear precondition for building the welfare state. Moreover, it was accompanied by the attempt to implement a modern monetary policy and the liberalization of the financial sector, which was still operating under strong state intervention. Two additional aspects were subject to reform: the labour market and the industrial sector. Finally, other institutional reforms were implemented, such as the administrative and political decentralization of the State into autonomous regions. As explained below, not all the reforms were completed on time or achieved the expected results.

6.3.1 Monetary Policy: The Slow Run to Modernization

During the Franco period, financial repression was the primary way of monitoring the demand for money in the economy and controlling inflation. Monetary policy was subordinated to the objectives of the Planes de Desarrollo (Development Plans) designed during the 1960s (Rojo and Pérez 1977) and centred exclusively on controlling the monetary base through the control of bank reserves. The arrival of democracy did not change this situation suddenly or substantially. At the beginning of the 1970s, in Spain, as in other European countries—especially those in southern Europe—it was difficult to implement an active monetary policy.

On paper, the Moncloa Pacts sought to implement monetary policy by controlling money, public loans and avoiding the inflationary mechanisms of public financing. However, the lack of independence of the Bank of Spain and its subordination to government interests and financing needs led to the failure of these attempts. Some steps in the right direction were made thanks to the efforts of Luis Angel Rojo from the Research Service of the Bank of Spain; as a result, there was a limit on the Bank of Spain providing resources to the Treasury as well as on credit from public banks. However, the inflation rate remained high (14%), between 3 and 5 percentage points above the rest of the European Union until practically 2000. The measures of the Moncloa Pacts were only the beginning of a long road of adaptation and modernization of monetary policy, which had to be completed in subsequent years with reforms in other areas of economic policy (Malo de Molina 2003). However, this monetary policy was the only one possible under the existing institutional framework, and it required ongoing financial repression of the banking sector to limit the expansion of monetary aggregates. Financial interventionism continued through compulsory banking coefficients, financial institutions remained the main holders of public debt and the Treasury continued to resort to heterodox financing through the Bank of Spain. In this sense, the growing public deficit (7% of GDP in 1985) had to be covered by an explosion of public debt issuance: it went from 8.5% of GDP in 1977 to more than 45% in 1986 (Comín 2012).

However, from the mid-1980s on the situation changed: budget stabilization, consolidation of the expansionary cycle and integration into the EU in 1986 put an end to financial repression and a new stage in monetary policy management began (Aríztegui 1990; Díaz Roldán 2007). The learning process from the implementation of these measures in such complex conditions constituted a historical milestone: by lowering the cash ratios in the banking sector, direct intervention in the monetary base was abandoned, allowing the country to fully adopt an approach based on the control of interest rates as a fiscal instrument. From then on, an effective monetary policy prevailed over intervention in the financial sector through quantitative liquidity restrictions. In fact, the modernization of monetary policy and the increasing macroeconomic and financial discipline allowed Spain to participate in the founding of the European Monetary System. As Malo de Molina (2003) has pointed out, it was something of a paradox that Spain's monetary policy fully achieved its stabilizing objectives just when it started to share its sovereignty through the unified European monetary policy. From a historical perspective, the process fully culminated in 1994, when the Bank of Spain assumed the function of a central bank with the capacity to act to address financial and macroeconomic imbalances.

6.3.2 Fiscal and Tax Reform

Although the fiscal and tax reform was a structural reform, it was also essential for the stabilization of the economy by reducing the public deficit. Admittedly slow and imperfect, the tax reform nevertheless placed Spain on the path of convergence with the rest of Europe and it was an essential requirement for adopting subsequent reforms.

At the end of the Franco regime, Spain had an underdeveloped fiscal system with very low tax rates, a predominance of indirect taxation, a lack of data about the tax bases, a weak administration to enforce tax payments and a huge amount of tax fraud (Pan-Montojo 2015). Most of the revenues came from the tax on personal labour and the main indirect taxes were on state monopolies (oil, tobacco and phone services), imports and some specific industrial sectors. It was in 1963 that the *Seguridad*

Social or social security system was established and replaced the old forms of pension funds,[11] unifying the various contributions to pensions, disability, and so on into a general contribution to the social security system. During the 1960s and the beginning of the 1970s, several economists, led by Fuentes Quintana,[12] highlighted the main problems of the Francoist tax system and the need for a fiscal reform. These efforts were finally embodied in two books: the *Libro Verde* (Green Book) in 1973, which was classified as a secret document and never printed, and the *Libro Blanco* (White Book), which was printed in 1976 but never distributed. This reflects the strong opposition to tax reform of part of the government and the elites. Only after the establishment of democracy was the fiscal reform implemented, giving Spain a modern tax system comparable to that of other European countries.

Although some of the targets established by the promoters of the reform had to be abandoned, the reform represented a clear break with respect to the previous situation (Comín 1996). Fiscal reform would have been impossible without the concatenation of three forces. First on the eve of the economic crisis, most economists and intellectuals had already been converted to the "cause" of the need for tax reform in particular, and the need to increase public sector spending in general. They effectively raised public awareness about the need to increase the size and role of the State. Second, the new political climate allowed the discussion and introduction of fiscal measures that would have been impossible during the dictatorship. Finally, the magnitude of the economic problems of the crisis made it crucial to look for financial resources. The income tax (*Impuesto sobre la Renta de la Personas Físicas*) was approved in 1978, the same year as the Corporation Tax (*Impuesto de Sociedades*). The main gap in this reform was that the indirect taxes (VAT) were not addressed until 1986.[13]

The most important contributions of the fiscal reform were the increase in revenues and the rise in fiscal pressure (from 20.4% in 1975 to 30.9% in 1986). However, there were two main weaknesses of this reform. First, the high level of fraud and the slow response in imposing measures to fight it. There was no fiscal information, and a lack of fiscal "culture" among taxpayers. In fact, in 1977, 45.2% of businessmen and professionals, 72.3% of farmers and around 31% of salaried workers did not pay the income tax (Martín Seco 1985). Second, the unequal distribution of the fiscal pressure, such that it mainly affected families, and to a much lesser extent firms. However, tax progressivity was insufficient but undeniable. In 1970, the revenues from income tax did not reach 2% of GDP, even below countries such as Portugal, and a long way off the OECD average of around 8%. After the introduction of the tax reform, the revenues from income tax as a percentage of GDP rose to 5%. This was still far below the OECD average (10%), but was a clear indication of the process of convergence, a process which was not completed until the 1990s (Torregrosa 2015). With respect to social security, in the 1970s the revenues from contributions on wages as a percentage of GDP was around the OECD average but it underwent a sharp rise until the 1980s, when it became the main source of financing of the public sector and was situated above the average for the OECD. To sum up, fiscal reform "made the public system more efficient and flexible … but the overall tax system was not made more progressive" (Torregrosa 2018).

It would not have been easy to adopt a more far-reaching tax reform. Whereas other developed countries transformed their fiscal system in a context of growth and full employment, Spain had to do it in a context of crisis, slow growth, growing unemployment and greater international competition. Moreover, these changes in Spanish taxation took place at a time when other countries were moving towards less fiscal pressure and less state interventionism. Therefore, despite its imperfections, the tax reform increased revenues and enabled a substantial rise in social spending, despite the fact it was not a particularly redistributive tax system.

6.4 Changing the Institutional Settings

Although during the first years of democracy the main challenges were to correct the macroeconomic imbalances and to tackle the industrial and banking crisis, other reforms were also urgently needed. A welfare state had to be built along with a framework of social agreement after forty years of dictatorship. Moreover, it was essential to continue dismantling the interventionist structure and to advance in the process of internal and external liberalization of the economy. All these challenges were crucial for Spain to lay the foundations for its future integration in Europe; however, they had to be reconciled with the construction of democracy and the new power distribution, with the pressure of the oligarchy and the business and banking groups, and the growing demands of the working class. Although not all the reforms were equally successful, and all of them were afflicted by imperfections and delays, they marked the beginning of the path to modernization, liberalization and international integration on a level with other European countries.

6.4.1 Growing State, Welfare and Decentralization

The main effect of tax reform was the growing role of the State in the economy, with an absolute and relative increase in public expenditure, basically tied to the emergence of domestic welfare. The other two features related to the State's reformist action were the change in the functional composition of public spending, and its decentralization through the creation of autonomous regions (*Comunidades Autónomas*). The 1970s definitively broke the historical budgetary backwardness, a situation that began and was consolidated during the Franco regime, that meant public expenditure in Spain lagged behind that in the rest of Europe.

The political cycle conditioned the evolution and growth of public expenditure, its nature and structure (Alcaide 1988; Sáenz 2008; Fuentes Quintana 2005). After the Civil War, there was a large decline in public expenditure—mainly social expenditure—with the lowest public expenditure-to-GDP ratio registered in 1952, at 8.7%, even below the pre-war figures (Espuelas 2013). This delay is more striking in comparative terms. After World War II, European countries adopted expansive fiscal policies and increased public expenditure to favour economic reconstruction and improving employment and income redistribution (Pan-Montojo 2002; Comín 2010). By contrast, the beginning of the welfare state was delayed in Spain until the 1960s, and only really developed with the demise of the Franco regime and the establishment of the democratic system.

Fig. 6.2 Government expenditure/GDP in Europe, 1970–1990 (%). (Source: Alcaide (1988), Bank of Spain and Eurostat)

In 1975 the public expenditure-to-GDP ratio was around 20%, below the average of the rest of Europe (43.3%). However, that year marked the start of a long convergence cycle and in 1986 the Spanish ratio was close to the European average (Fig. 6.2). Something similar happened with the social expenditure-to-GDP ratio: in 1975 it was only 59% of the European average and in 1980 it reached 85%, although in terms of social spending per capita the distance with Europe was greater (Espuelas 2013). It was in 1993 when the maximum level in the public expenditure-to-GDP ratio was reached, a high of 49.6%, similar to other Western countries.

In addition to the increase in public expenditure, the other main change was in its nature. The end of the Franco regime saw the first basic public supply of social services (social security and education). At the end of the 1960s, public expenditure began to shift from collective assets (defence, administration and economic services) to welfare (education, health and income redistribution). However, this transition did not take place harmoniously during the 1970s due to the economic crisis and the institutional-political change. The crisis triggered an increase in social demands (especially unemployment benefits), and the fact that it coincided with the arrival of democracy meant that social demands were almost automatically transferred to the public budgets. This was the result of the social and economic agreements of the first years of democracy: in exchange for wage moderation there was an increase in the expenditure items for transfers and social services (Trullen 1993). The establishment of democracy was supported by the various pressure/lobby groups (trade unions, business associations and political parties), and the promotion of public expenditure, especially social expenditure, was the result of such pressures, especially between 1975 and 1982, rather than rational planning. This offers an understanding of the hesitant nature of economic policymaking (or the lack of planning) as well as the explosive growth in public expenditure from 1976 on and its consequences: deficit, uncontrolled inflation and public indebtedness.

Regarding the functional distribution of the public expenditure, as seen in Table 6.2, the political commitments signed in 1977 increased

Table 6.2 Functional distribution of public expenditure, cumulative annual growth rate

	1975–1985
Unemployment	21.6
Debt interests	23.1
Subsidies	11.8
Transfers	18.4
Pensions	7.6
Housing	7.6
Education	7.2
Health	3.3
General services	5.3
Investments	5.0
Defence	3.0
Other	–2.9
Total public expenditure	**7.12**
GDP	**1.55**

Source: Own elaboration from Álvarez, Prieto and Romero (2003) expenditure aimed at combatting unemployment (with the highest growth rate of 21.6%, very close to the 23.1% corresponding to the payments to service the public debt) as well as transfers and direct subsidies to companies, generally public, but also private. In addition to unemployment benefits, there was a strong increase in pensions along with other social items (housing, education and health). The latter accounted for the largest share of social spending—greater than unemployment benefits[14]—and was influenced by the demographic trend; from 1977 the population began aging, while reforms in the system expanded the coverage. In addition, the crisis prompted more early retirements.

Public spending on education grew notably between 1975 and 1980, with an intense transformation of the educational system as a whole. By 1970, public and private spending on education was practically equal at around 1–1.5% of GDP (San Segundo 2003). Later on, public spending rose to 2.5% in 1980, and 3.7% in 1985. This fostered Spain's convergence with the rest of Europe in educational terms. There was also an increase in the schooling rate: between 1970 and 1980 the coverage rate of public education at all educational levels went from 26% to 45%.[15] Tertiary education also rose from 1977 on, with a growing enrolment of women in universities.[16] All this represented the beginning of path to redressing the country's educational backwardness; during the democracy, this progress enabled an increase in the stock of human capital in the Spanish economy, although it continues to lie below the average OECD levels.

Public spending on health was one of the functions that mobilized the most resources, in both absolute and per capita terms. The health item went from representing 3% of total public expenditure between 1965 and 1975, to reach 10% in the 1990s (Cantarero and Urbanos 2003). This strong relative increase was due to the universalization of the healthcare system and the rise in the number of people covered by the system, which by 1985 already covered 95% of the population. This was another area of convergence with other European countries, along with the modernization of the healthcare system. The inclusion of Health Protection was included in the 1978 Constitution and in 1977 a Ministry of Health and Social Security was created, as well as the INSALUD—National Health Institute—in 1978 (Blanco et al. 2003). Improvements to the public health system were part of the "agreed" nature of the reforms, although its growth had some negative effects in terms of rationality. It was in the following decade that reforms focused on efficiency (Cantarero and Urbanos 2003).

In short, in the 1970s public expenditure grew more and was oriented towards transfers to families, although also to businesses and investors in public debt. This situation intensified from 1977 on, due to the effects of the crisis and the political decisions taken to tackle it. The most significant aspect of this evolution was a more redistributive public expenditure structure, aimed at guaranteeing the operation of the automatic stabilizers (mainly unemployment benefits) and the provision of preferential assets.[17]

The last feature of the transformations of the State during the political transition was the process of decentralization carried out through the Moncloa Pacts and the new Constitution. Traditionally, the Spanish public sector was composed of two levels: the central one (State) and local entities (Municipal Councils). However, during the transition a new intermediate level was designed: Autonomous Communities. This detail is very important because this decentralized design of the State endures to this day. There were regional differences in intensity and speed in assuming management and spending powers. Political context also played a prominent role in this design. The historical claims of some Spanish regions (primarily Catalonia and the Basque Country) and demands for political autonomy, which had not been met during the Franco regime, were conceded during this period. In terms of public spending, the figures are clear: in 1980 (two years after the creation of this new level of decentralization) the proportion of decentralized public spending by the regional administration barely reached 0.3%, while twenty years later the figure had grown to 20% of the total public expenditure (more than 13% of GDP), being described by the OECD as quasi federal (OECD 1999). The decentralization process initiated in 1977 ended in 2002, when the State had transferred all the agreed responsibilities to all regions.

The process by which the Autonomous Communities were created is a good reflection of the nature of the period in general: it had an experimental and progressive character, and not all the regions acquired the same spending and management skills and services at the same time. In addition, the process was—and continues to be—complex from the revenue side, since spending at the regional level has developed much more harmoniously than the ability to obtain tax revenues. The latter responsibility remains, for the most part, in the hands of the central State, which subsequently transfers the funds to the Autonomous Communities for them to use. However, the regional level has acquired the functions of providing public goods such as health and education, which account for between 75% and 80% of the total funds transferred by the State. In addition to providing public goods, the rest of the region's expenditure is made up of investments in infrastructure, such as roads, homes and hydraulic works. The central State establishes the conditions of the services to be provided and transfers the resources to the regions, which finally provide these public goods to citizens. In sum, the creation of regional governments has led to the territorial distribution of the decision-making on public spending, one of the distinctive features of the contemporary Spanish economy.

6.4.2 Banking Reforms: Crisis and Liberalization

In the financial and banking sector, the reforms that began in the late 1960s and accelerated in the 1970s and 1980s changed the structure, characteristics and regulation of this sector. However, whereas the banking reforms can be viewed a relative success (albeit with some ups and downs), Spain had to wait until the 1990s to see positive results in terms of the monetary policy. As controlling inflation was one of the priorities of the first reformist governments, the implementation of an active monetary policy and the liberalization of the financial system became political priorities. The two reforms ran in parallel and contemporaneously, since the two sectors shared the same reformist objective: to achieve a more efficient allocation of the financial resources. Sometimes, however, the measures adopted in one of these two areas contradicted the other and progress was not linear but rather involved a series of setbacks and successive advances.

One of the main problems afflicting the banking sector in the late 1970s was the excess interventionism, which had negative effects on the level of competition and efficiency of the banking institutions. The low level of competition was due to financial repression from Franco. The system was intensively regulated, with barriers to entry, controls on opening branches, a rigid system of control over interest rates that protected bank margins and strict regulation of savings banks and commercial banks with the objective of financing the public sector, or those activities that were considered a priority by governments. In addition, and largely as a result of the lack of competition, financial institutions had a low endowment of their own funds and an acute lack of experience.

The Moncloa Pacts insisted on the need to liberalize the financial system. The beginning of the 1970s saw the introduction of some liberalizing measures related to geographic expansion (branches), interest rates or allowing the entrance of foreign banks,[18] among other issues. However, the process of liberalization was very slow: the crisis consumed financial resources and the different governments continued to use the financial sector as a source of financing. Moreover, the process of liberalization did not affect all financial institutions equally; it mainly affected banks but savings banks had very high levels of compulsory investments that affected the use of their resources. Public banking (ICO: *Instituto de Crédito Oficial*) continued to operate without major changes, and its privatization took place a decade later, between 1987 and 1992, although it reduced in size and public sector banks disappeared (Martín-Aceña et al. 2016).

The elimination of mandatory investments (usually in public debt) was the slowest and most complex part of the reform. Ten years after the Moncloa Pacts, in 1987, banks still maintained a small percentage of mandatory investment in public assets. It was between 1989 and 1990 when the coefficients as an instrument of monetary policy disappeared. Deregulation and liberalization of interest rates began in 1977, but as in the previous case, it was not until 1987 that the process was completed. From that date on, the interest rates in Spain would reflect the scarcity or abundance of loanable funds, leaving aside its historical interventionist role that penalized savers and claimants of free credits (Malo de Molina 2011).

The industrial crisis also affected banking performance. Banks faced an increase in competition in a context of an industrial and stock market crisis. The main problem was that neither the Ministry of Finance nor the Bank of Spain had adequate prudential regulation, since the existing one established low requirements in terms of minimum capital for newly created entities, and did not set limits on concentration and risk taking (Poveda 2011). The absence of significant banking crises during the second half of the twentieth century contributed to the fact that the Bank of Spain's inspections were limited to detecting accounting violations. In fact, when the first crises became evident, temporary solutions were improvised and the classic rediscount remedy was still applied as a basic aid instrument (Poveda 2011; De Juan 2017). The development of mechanisms and institutions was experimental and tentative, and only accelerated when the banking crisis became more acute (Banking Corporation in 1978 and Deposit Guarantee Fund in 1980). Although the cost of the intervention in the banking sector was very high, the adopted measures prevented a bank panic and in the end none of the big banks was seriously affected by the crisis. To date, this continues to be the main mechanism for solving banking crises in Spain.

The reforms and the banking crisis produced a more concentrated sector with the formation of groups led by certain banks that increased their size through mergers and acquisitions. There was a clear break with the banking model of the Franco era, and the result in the medium term was an increase in the average size of Spanish banks, which allowed them to compete in the international markets. The financial reform tended to equate savings banks with commercial banks, and led to the consolidation (via mergers) of four large entities with sufficient size to compete with private banks. The last consequence of the banking reforms was the transformation of the investment structure of the banks from the early 1990s, as a result of the elimination of repression and the privatization of public banks. There was also a reform of the stock market in 1988, with the creation of the National Securities Market Commission. In short, the reforms undertaken during this period led to a true expansion of the financial institutions (banks and savings banks) and mediation instruments. Laxer regulation and financial innovation formed the basis of the new banking sector and its international expansion in the 1990s.

6.4.3 Labour Market Shocks and Reforms: Unemployment as a Structural Problem

The crisis had dramatic effects on the labour market. Moreover, almost four decades later, large-scale unemployment persists as one of the structural features of the Spanish economy, as well as an anomaly within the OECD countries. At the beginning of the 1970s, the labour market relations framework inherited from Franco regime featured strong interventionism, low wages and productivity, a very favourable negotiating position for business-owners (the abusive use of overtime is a good example), and strong political repression that prevented workers from participating in the design of wage or sectoral policies as their European counterparts did. Against this backdrop, several factors came together during the 1970s: the return of emigrants, the end of the structural change from agriculture to industry, population growth above other that of European countries, and the economic and political crisis.

Moreover, the wage policy was essential for the countercyclical, reformative design of the Moncloa Pacts to be able to stop inflation. The wage adjustment was carried out through the implementation of a collective bargaining model based on wage indexation that accounted for expected inflation rather than past inflation. This represented a significant change in terms of both the results and the new macroeconomic approach that it entailed. In addition, institutional reforms dismantled Franco's labour regulations and placed negotiation between employers and unions, recently legalized (1977), at the centre of the process. The labour reform encountered resistance from various areas, as shown by the union strikes between 1974 and 1979.

The new regulation recognized the new actors (trade unions and business associations) and their autonomy to negotiate and to represent themselves, the right to strike, collective bargaining and a new unemployment insurance in the context of a universal social security regime. This basic regulation was progressively complemented by other laws, the creation of the National Employment Institute (INEM), as well as two key regulations that remained in force until the first decade of the twenty-first century: the Statute of Workers, and the Basic Law of Employment, both passed in 1980. These regulations built on previous aspects and established new elements, such as limits on the working day and the preference for stable contracts, although they also recognized labour flexibility (Toharia 2003; Sanz 2018). As growing unemployment depleted public accounts, the government stiffened the conditions for accessing unemployment insurance, which from 1980 covered less than 40% of unemployed people.

The results of the wage adjustment policy were clear and immediate. The annual growth rate of unit labour costs declined rapidly, from 21% in 1978 to 6% in 1984 (Malo de Molina 2003). The share of wages in GDP decreased by more than 7 percentage points between 1978 and 1985 (Muñoz del Bustillo 2010; Sola 2014). This was the result of the macroeconomic discipline of the Moncloa Pacts but also a reflection of the limitations of the unions' bargaining power. In return, inflation also declined rapidly: from 24% in 1977 to 8.8 on the eve of Spain's entry into the European Union in 1986. Despite this, unemployment was not eliminated, and remained at very high levels even with the change in the expansionary cycle from 1986 on.

From 1982 onwards, the new socialist government transformed the institutional labour framework and the wage adjustment policies were progressively complemented by successive labour reforms that favoured the use of temporary contracts. The increase in temporary hiring, considered a necessary instrument to better adjust the demand to the supply of employment, has sparked a wide-ranging debate about the more or less protective or rigid nature of the Spanish labour institutions, which are largely based on the 1977 reform (Toharia 1997). On the one hand, it is argued that the Moncloa Pacts prioritized the focus on labour aspects to correct macroeconomic imbalances (from this perspective, unemployment was the price to pay) (Ferreiro 2003; Sola 2014; Jimeno and Ortega 2003). However, others have claimed that the labour institutions that emerged from the 1977 reform are responsible for the rigidity of the Spanish labour market (excessive unemployment protection, recognition of collective bargaining, expensive dismissal etc.), and thus bear the responsibility for the persistence of unemployment in Spain (Bentolila and Jimeno 2003).[19]

6.4.4 Industrial Restructuring

Another reform that was not immediately undertaken was the industrial restructuring. The industrial crises had heavy costs in terms of unemployment and business closure. Some surviving firms went over to the black market, especially in sectors such as textiles and shoes. Many sectors lacked the capacity to adapt to this new context characterized by lower demand and more competition. The deterioration of the economic situation reduced demand in sectors with low income elasticity, such as food and beverage. Other sectors such as steel or shipbuilding were faced with the competitiveness of countries such as South Korea and Japan, and this revealed their weaknesses: low technology, high costs and excessive dependence on state subsidies. In this context, it became necessary to restructure the Spanish industrial activity.

The Moncloa Pacts, however, did not include any industrial policy and from 1977 to 1982 there was no coordinated, coherent industrial policy. The only measures passed were some specific programmes to help individual firms with problems, which were included into the Development Plans). In 1978 the Ministry of Industry and Energy justified this intervention in individual firms rather than a more general programme on the basis of the complexity of the problems. The result was that some particular firms received financial aid, through public or subsidized loans, and in some cases, firms were nationalized, implying the "socialization" of losses. As a result, the state holding company INI (*Instituto Nacional de Industria*, created in 1941) became a "business hospital". Priority was once again given to political aspects instead of economics and efficiency; the weakness of the first UCD governments and the fear of an even higher increase in unemployment are the reasons behind this decision. The difficulties and arbitrariness of intervening in individual firms and the worsening crisis made it necessary to implement more comprehensive action: an industrial restructuring with a sectoral focus. Between 1980 and 1982 several Decree Laws were passed. The problem was the delay in implementing this reform and the large number of sectors that had to be included in this restructuring. The resources targeted at industrial restructuring from 1981 to 1986 totalled 738.811 million pesetas, a substantial yet insufficient amount considering the seriousness of the Spanish industrial problems (Navarro 1990).

It was only in 1982, when the *Partido Socialista Obrero Español* (PSOE) came into power, that a real restructuring policy got underway. However, this reform was not achieved without difficulty, and it was concentrated in priority sectors (steel, shipbuilding, fertilizers, domestic appliances and capital goods). There was serious conflict between the government and unions, especially in sectors such as steel, which were geographically concentrated and where restructuring entailed major reductions in production capacity and employment. Fiscal instruments were used (e.g. tax deductions), as well as labour measures (early retirement, redundancy schemes) and financial aids (public credits and guarantees, subsidies, contributions from private financial entities through the application of mandatory investment coefficients etc.). The Law also created the so-called areas of urgent reindustrialization (ZUR by its initials in Spanish) with a regional focus.

Industrial restructuring also affected INI firms that had accumulated substantial losses, partly as a result of the process of nationalizing private companies during the crisis years. Thus, the INI had to reorganize and reduce its workforce and rationalize its investments. For example, in the shipbuilding sector production capacity was reduced by 55%, and in the fertilizer sector the least efficient companies were closed down and a new nitrogen plant was built. Feasibility plans were also applied to many other companies in the group, such as Iberia and *Empresa Nacional de Autocamiones SA* (ENASA), as well as privatizations. The result was a reduction in the INI workforce, which went from 216,000 workers in 1983 to 151,000 in 1989 (Martín-Aceña and Comín 1991).

The overall balance of the industrial restructuring shows that in the short- and medium-term workforce reduction goals were achieved (in some sectors by more than 50%). However, in financial and productivity terms, the results were below the forecasts, which prompted the start of a new phase of conversion after 1986 (Simón 1997). The main negative aspects were the high cost of this policy in terms of public spending, the discriminatory effect of some of the measures taken to support the sectors in crisis, such as pre-retirement, which placed workers in some of these sectors in a clearly privileged situation, and the limited results obtained in the reindustrialization of some areas. Moreover, the achievements in the ZURs were minimal. The main positive aspect was the necessary rationalization of the industrial structure through the gradual dismantling of sectors that were unable to cope with the growing international competition. Thus, in many sectors the reconversion solved the problem of excess capacity in productive and employment terms, improving the level of competitiveness of Spanish industry. However, a large amount of public resources had to be channelled into this restructuring, and the results in terms of reindustrialization and job creation were well below those expected.

6.5 Conclusions

The year 1977 was a turning point in Spanish economic history because a severe economic and financial crisis was accompanied by major political and institutional changes associated with the political transition after Franco's death in 1975. But it was also a defining moment because of the seminal nature of the reforms implemented from 1977 onwards. In a context of crisis and political transition, Spanish society would hardly have been able to absorb a more radical adjustment. The reforms put the economy on the right path. They also acted as a national reconciliation mechanism and served to demonstrate the legitimacy of a democratic government to introduce measures that were necessary but unpopular due to the potential social costs in the short term. One of the key features of the reforms was that they were achieved through negotiation between new political and social actors, unions and political parties, which facilitated the implementation of wage adjustment policies. The most evident example of this negotiatory process was the sustained growth in social spending and the construction of the first domestic welfare state, as a compensatory policy.

It is true that some reforms were left pending and some problems were not solved. An example is the failure in terms of unemployment. Although all European countries saw unemployment rates rise in the 1980s, in 1982 the Spanish unemployment rate was the highest of all OECD countries. However, the persistence of a high unemployment rate was consistent with a continued decline in income inequality, which had begun in the early 1970s and continued to decline until 1986 (Prados de la Escosura 2008); this can be interpreted as a sign of the effectiveness of automatic stabilizers launched in the 1977 Pacts. In terms of monetary policy, and also in public and private banks, the changes were slower than desired, although the first steps were taken in the right direction. However, in most aspects, hopes were fulfilled this time. The introduction of a modern tax system and the construction of the welfare state represented a clear break with the Franco regime and laid the foundations for the future convergence and external integration of the Spanish economy.

Notes

1. The economic crisis started in 1976 but worsened in 1977 as a consequence of the banking crisis that erupted in that year.
2. The economic situation was probably not correctly assessed, and the crisis was considered as temporary (Betrán et al. 2010).
3. The output loss is a way of determining the loss associated with a crisis. This is estimated by summing the differences between trend growth and output growth following the crisis, up to the point where annual output growth returns to its trend (see Betrán and Pons 2017).
4. The agrarian population as a share of the total population in Spain dropped from 50% to 25% in less than twenty years. The share of agriculture in GDP, which represented around 25% in 1960, fell to less than 10% in 1975 (Prados de la Escosura 2017).
5. During the 1960s and until 1975, the Spanish economy diversified and improved efficiency significantly, with an annual increase in total factor productivity from 1965 to 1975 of 3.8% for the whole economy (Prados de la Escosura 2017).
6. The decision had an asymmetric effect on different consumers because the subsidized prices were mainly for industrial producers and less so for end consumers.
7. The costs of loans doubled as a consequence of the peseta devaluation. This mainly affected certain sectors, such as the electricity sector. Eleven out of the fifteen most indebted companies in dollars belonged to the electricity sector (De la Torre and Rubio 2015).

8. In relative terms, unemployment rates in the 1970s were higher than in other countries but lower than the peaks of 21.5% in 1985, 24.5% in 1994 or 27% in 2008.
9. As explained in more detail in Sect. 6.3, the fiscal system was very underdeveloped and did not have the capacity to increase revenues, while the monetary policy lacked the necessary instruments to be effective.
10. The McCracken Report issued by the OECD in June 1977 was widely referenced (Trullen 1993). For details about other experiences in Europe of agreed wage policies, see Flanagan, Soskice and Ulman (1985).
11. For a history of the social security system, see Boldrin, Jiménez- Martín and Perachi (1999) and Pons and Silvestre (2010).
12. For example, during the 1960s Fuentes Quintana published several works about the need for tax reform, in the journals *Información Comercial Española* and *Anales de Economía*.
13. VAT was introduced in the EEC in the late 1960s, when that body consisted of only six members (Belgium, France, West Germany, Italy, Luxembourg and the Netherlands). However, in the UK it was introduced in 1973. Several reasons were given to justify why it was not introduced in Spain in the 1970s, such as the impact on prices (in an inflationary context) and the possible negative impact on exports.
14. In 1975 pensions represented around 36% of total public spending, rising to 40% in 1980, whereas unemployment was around 2.98% in 1975 and increased to 12.5% in 1980 (Espuelas 2013).
15. It was also a consequence of the compulsory eight years of basic education imposed by the General Law of Education in 1970.
16. In 1976, Spanish women's level of education was very low and from the late 1970s the number of female graduates from tertiary education increased substantially (Rodríguez-Modroño et al. 2016).
17. However, not to other public goods, such as justice.
18. Only thirty-five foreign banks entered the Spanish market and their market share in terms of deposits never exceeded 2%. However, their presence boosted the level of competition and also had a positive influence on financial innovations such as the loans tied to floating interest rates or the interbank market development (Álvarez and Iglesias 1992).
19. For information about the current structure of the Spanish labour market, as well as the effects of the Great Recession, see Andrés and Doménech (2015).

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7

2008: Spain in the Eye of the Perfect Storm

Jose Ignacio Conde-Ruiz and Elena Martínez-Ruiz

7.1 Why the 2008 Crisis Can Be Considered a Turning Point

The 2008 crisis was a watershed for the Spanish economy. After decades of economic and political isolation, Spain had entered a new stage by integrating into European institutions in 1986. This integration had allowed not only rapid growth, but had also served to strengthen the democratic coexistence and social cohesion in the country. The deepening of the European economic integration project from 1992 on meant a change in the economic regime for Spain that authorities and citizens greeted with hope. Having an anchor such as the common currency helped ensure the achievement of the desired economic stability, while

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forcing progress in reforms that would allow the definitive equalization of Spain with its surrounding countries. The outbreak of the crisis in 2008 broke the idyll, revealing two of the most onerous facets of integration: the impact of eventual external shocks and the need to coordinate a response. In this chapter, we analyse how these events have contributed to laying new foundations for the future development of Spain.

As highlighted by many studies on the Spanish crisis (Estrada et al. 2009; Ortega and Peñalosa 2012; Arce et al. 2019a), the country's membership in the EMU is essential to understand both the gestation and impact of the crisis in Spain, as well as the political response adopted by successive Spanish governments. In fact, the incorporation into the EMU, with the common currency and the freedom of capital movements, gave the Spanish economy the opportunity to access more foreign savings to finance their investment, since the euro removed investors' fears about a possible devaluation. In a country traditionally marked by the relative scarcity of capital, this meant the overcoming of a major obstacle. At the same time, the accumulation of excessive savings in the world economy during this stage of extreme stability known as the Great Moderation created very favourable financing conditions. As a result, Spain's indebtedness to the rest of the world, and especially its European partners, increased explosively as of 2004, without the external restriction acting as a brake on the excessive increase in debt. Spain took advantage of the almost unlimited supply of credit to grow vigorously, although this growth was not based on an increase in productivity that strengthened the competitiveness of Spanish products, but rather on a disproportionate expansion of the real estate and construction sectors.

When the turbulence of the US economy spread to international financial markets, the real estate bubble in Spain burst and in turn the prevalent growth model was shattered. For the first time in its history, however, Spain could not resort to the tool it traditionally used to face a crisis: devaluation. Under a common currency, monetary policy and the currency regime could no longer play their traditional roles in absorbing economic volatility. Membership of the EMU conditioned the response, and the economic policy of the Spanish governments generally followed the guidelines and recommendations of the European institutions. Further, the restrictions imposed by the European agreements and the conditionality of the aid received facilitated decision-making on difficult issues, such as fiscal consolidation, consolidation of the financial system or the implementation of structural reforms. But the problems were to be deeper and longer-lasting in Spain, given the large imbalances accumulated during the expansion stage. Disparities in the distribution of the burden of adjustment among different social groups created a climate of protest that ended up damaging the social cohesion in Spain. The population's growing detachment from the political establishment delayed the adoption of the most unpopular decisions, limiting the scope of the reforms and eventually leading the country to institutional paralysis.

Since 2014, the Spanish economy has been on the way to recovery. Some of the main imbalances, such as the oversized real estate sector or the excessive credit growth, have been corrected during these ten years of crisis, but some new problems have appeared. The upturn in unemployment rates, the fiscal deficits and the rampant advance of inequality represent new vulnerabilities the Spanish economy will have to confront shortly. It is still too soon to evaluate how this crisis and its resolution will have influenced the ability of Spanish society to face these difficulties and, of course, we can only speculate on whether the recent experience has served to identify a better way to tackle the challenges of the immediate future. The new path is still not clear, but, as we will argue in the following pages, the shockwave caused by the recent events has meant a significant turning point for the Spanish economy: on the one hand, because it brought to light the need to find a new, more balanced growth model; and on the other hand, because the strategy adopted to resolve the crisis, the austerity policy, has undermined public trust in the establishment and the main state institutions, creating a profound social and political crisis.

The chapter is organized as follows. In Sect. 7.2 we analyse the growth process of the Spanish economy since its integration into the EEC in 1986. Spain experienced an ongoing economic expansion and social modernization, although some important imbalances were accumulated in the process. Section 7.3 examines the impact of the international crisis in Spain and how the imbalances aggravated the situation and limited the scope for the government's reaction. Section 7.4 evaluates the recovery process since 2014, while Sect. 7.5 analyses the challenges to come in the near future, trying to establish whether the Spanish economy is now better equipped to face them.

7.2 Spanish Economic Growth from 1986

From 1986 to 2008, the Spanish economy went through two cycles of intense growth separated by a short but acute recession. This evolution was marked by Spain's entry into the EEC. During these years, there was a growing synchronization between the Spanish and the European economic cycle, although both the booms and the crises were more pronounced in the Spanish case. This greater amplitude of the oscillations of the cycle in Spain had been the norm since the 1960s. The relative backwardness of the Spanish economy vis-à-vis its European neighbours allowed it to grow faster in the stages of expansion, while the imbalances accumulated during the booms meant more acute slowdowns. As will be shown, this trajectory would be repeated in the case of the present crisis. The other factor that marked the direction of the Spanish economy in these years is globalization. The deepening of the integration of international markets for goods and services meant a change in the patterns of specialization and the international division of labour, while the increase in liquidity caused by the accumulation of excess savings in the world economy led to a general drop in interest rates and a rise in debt levels.

The period from 1986 to 1992 has been called the integration period. During these years, Spain registered very dynamic growth, with an average annual rate of over 4% (see Fig. 7.1) characterized by a strong investment impulse, which was the main driver of the expansion. Employment also registered a robust increase, with the creation of more than 1.7 million jobs, although the unemployment rate remained at very high levels: just over 16% in 1990. On the other hand, the establishment and expansion of the Welfare State, demanded by the working population who feared being excluded from the distribution of the benefits of integration, caused a vigorous rise in public spending. Encouraged by the increase in wages and business profitability, private consumption also rose. This large increase in domestic demand, which could not be satisfied by a parallel

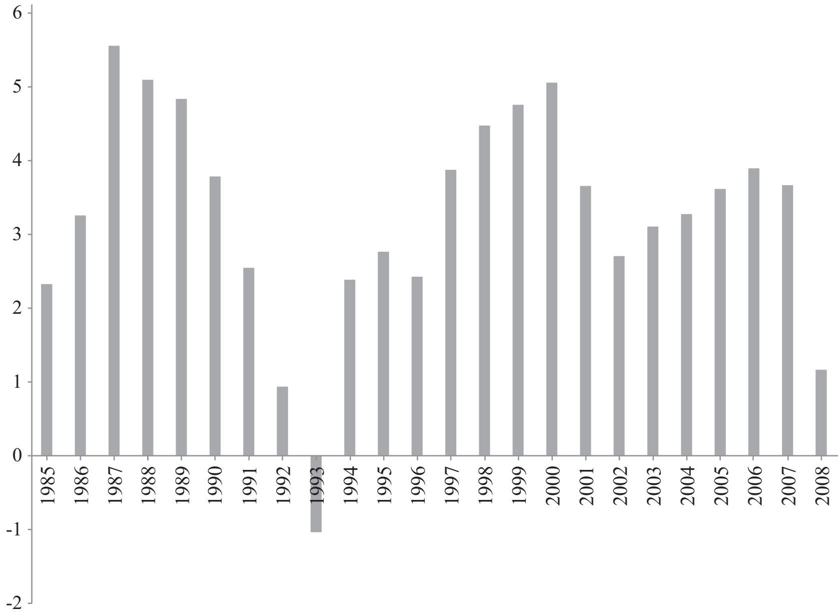

Fig. 7.1 GDP growth rate (2000 constant market prices). (Source: Boldrin et al. (2010))

increase in domestic production, led to an increasing deterioration of the trade balance.

The impact of the accession to the EEC was mainly reflected in the energetic process of external liberalization undertaken to adapt to the requirements; not only the requirements of a single market for goods, but of an integrated European market in which services, capital and labour would also circulate freely, as approved by the Single European Act in 1986. The results of the post-1986 dismantling of tariffs were striking: the degree of openness of the Spanish economy increased dramatically and the share of European products in total imports grew significantly. On the contrary, exports did not benefit: first, because integration into the EEC did not represent such a significant change given that pre-existing agreements already guaranteed access to European markets; and second, because the competitiveness of Spanish products was diminished by the appreciation of the peseta and the higher inflation. Thus, while imports increased at an annual rate of over 15% (17.4%), the growth rate of exports barely exceeded 5%. The upshot was an increase in the trade deficit and, crucially, in the current account deficit. As a result, the current account deficit reached around 3% of GDP (Viñals 1992).

This meant an increase in external financing needs, which was, in the early years, covered by foreign investments coming in part from European companies that took positions in the Spanish market. Thus, direct investment from Europe would play a leading role in increasing the investment in Spain in these years, especially in the industrial sector. The subsequent renewal of capital goods and the incorporation of new technologies allowed the industrial structure to evolve towards more advanced and dynamic sectors. From 1989 on, however, the nature of the foreign capital flows changed, becoming short-term financial investments attracted by the high profitability of public debt issued to finance a public deficit close to 5% of GDP. The high deficit also accentuated inflationary tensions in the economy and put upward pressure on interest rates, which created an additional problem for domestic private investment.

The adaptation to the acquis communautaire also required liberalizing measures to reduce state intervention in the economy and make these markets more flexible. However, with some exceptions, these provisions were not as ambitious as the reforms to regulate foreign trade. Thus, a limited liberalization of the services sector was undertaken, mainly affecting retail trade and the housing market; a new competition law was passed to root out anticompetitive practices; and the planned dismantling of exchange and capital controls continued. However, for a number of sectors reforms were either not undertaken or were largely cosmetic.

This was not the case of the labour market reform. With the aim of liberating the labour market from the rigidities inherited from the Francoist regime, the first of many successive labour reforms was launched in 1984. The regulation introduced new forms of temporary contracts that were intended to facilitate workers' market entry and exit. As we saw earlier, employment had grown at a good pace since 1985, which may have been partly related to this reform, initially conceived of as a provisional solution to the high level of unemployment. However, this regulation remained in place and its long-term consequences were very negative from several points of view. First, it resulted in the emergence of a dual labour market segmented between workers with fixed or permanent contracts and strong employment protection on the one hand, and those with so-called temporary contracts with minimal firing costs on the other. In order to maintain the flexibility offered by temporary contracts, firms opted in many cases to fire temporary workers at the end of their legal limit and hire new workers for the same position. This would ultimately have negative effects on growth by discouraging the accumulation of human capital and encouraging specialization in sectors with seasonal activity and high job turnover (Dolado et al. 2002, 2016; Albert et al. 2005).

In the 1980s, the economy experienced a strong expansion, interrupted by the 1993 recession. However, as can be seen in Fig. 7.1, the Spanish economy soon resumed its expansionary momentum. GDP grew at an average annual rate of 3.6% between 1995 and 2007, which allowed Spain's per capita income to approach that of its European neighbours, going from nearly 80% of the Eurozone (19) average in PPP terms in 1995 to almost 94.5% in 2007 (Eurostat). This catching up process was achieved despite the marked increase in the population, which, after years of moderate growth, went from 40 to 45 million in a ten-year period, an increase of more than 15%. The population growth was largely due to the intense influx of immigrants who arrived in Spain attracted by an increase in employment opportunities. Between 1995 and 2007, the Spanish economy created more than eight million jobs and the unemployment rate fell to 8% in 2007 (INE). Other positive aspects of this evolution were found in the structure of the workforce with a greater participation of women (the female participation rate rose from around 38% to 50%). On the other hand, the level of qualification of Spanish workers increased considerably. Whereas in 1978, 77% of workers had only primary education or lower, in 2007, 50% had finished at least secondary education (Boldrin et al. 2010).

The efforts made to meet the requirements for entry into the EMU, which culminated in 1999 with the introduction of the single currency, led to an important change in the institutional framework of the Spanish economy, as it became more oriented towards macroeconomic stability. At the same time, the world economy was experiencing an intense process of globalization and liberalization, while its economic evolution was characterized by the low volatility of the main macroeconomic variables (inflation was controlled, budget deficits were moderate and balances of payments were balanced). This time of "Great Moderation" was very positive for the expansion of productive activity, as the stability reduced the level of risk and uncertainty and brought about a drop in interest rates, thereby enabling an exceptional increase in credit. In the case of Spain, it led to a major boost in internal demand, resulting in an increase in imports and a growing balance of payments deficit. The expansion of internal demand also led to a persistently higher level of inflation than in other in Eurozone countries, which, together with a dysfunctional wage negotiation that transferred these price increases to wages, resulted in a gradual loss of competitiveness of Spain's economy.

In the run-up to the turn of the century, the economic evolution would be marked by the policies targeted at ensuring compliance with the conditions of entry into the single currency ratified in the Maastricht agreement in 1992. For Spain, the two main problems were the inflation differential and the public deficit. In order to reduce the fiscal imbalance, the government implemented a decisive strategy to contain spending. As part of the anti-inflationary struggle, in 1994 the Bank of Spain was granted independence, and, from that moment on, carried out effective monetary control. On the other hand, wage increases were moderated, due to the strong rise in unemployment during the crisis of 1992–1993 and two new labour reforms, in 1994 and 1997; these reforms made additional progress towards the flexibility of the labour market, further reducing restrictions on the use of temporary contracts and reducing firing costs for permanent contracts. Since the moderation in wage increases was partially offset by the reduction in inflation, social conflict was virtually non-existent in a period in which the objective of entering the common currency seemed to enjoy a consensus among all social groups.

With regard to the liberalization of internal markets, one of the key elements was the privatization of public companies. The privatization process intensified in 1996, with two objectives: first, to increase competition in Spanish markets; and second, to meet a fiscal objective. Both goals were achieved. On one side, the increased competition encouraged efficiency in key sectors such as banking, energy and telecommunications. On the other, the sale of public company assets also contributed to achieving budget deficit reduction goals, since European institutions allowed the proceeds of these sales to be accounted for in the public deficit figures. Likewise, the liberalization of capital controls was completed in 1992, coinciding with the intense globalization that international capital markets were undergoing. The Spanish financial sector underwent major development through its progressive internationalization. This was furthered by liberalizing reforms which reduced restrictions affecting banking operations and homogenized the regulatory framework for banks and publicly controlled savings banks ("cajas"). However, banks and cajas were unalike in one crucial aspect: their corporate governance. Spanish savings banks were non-profit organizations, whose profits went to fund social and cultural activities. Founded with the support of local authorities, which retained control, they were isolated from market control, as they did not have shareholders and were not allowed to resort to the stock markets to finance themselves. While allowing the cajas to enter into new markets and compete on equal footing with banks, the legal changes did not challenge the control of the cajas by local and regional governments, resulting in the capture of these institutions by the local political elites (Jimeno and Santos 2014; Santos 2014). At the same time, the capacity of the Bank of Spain to control banking entities was increased and changes in the regulation and organization of the stock market were introduced. All this prompted a process of absorptions and mergers among the large Spanish banks, with the seven big banks existing in 1986 consolidating into two large banking groups in 2000: Santander and BBVA.[1]

Another key element of the liberalization process that followed the 1993 recession was a second wave of reforms affecting the labour market. The 1994 reform extended the changes of the previous decade, by introducing a new type of contract aimed at young workers, while removing obstacles to functional mobility within companies, another remnant of the Francoist labour laws. Also, the state's monopoly in labour market intermediation was eliminated, allowing the operation of temporary employment agencies. Finally, measures were taken to decentralize collective bargaining. Three years later, the nature of the reform would take on a different character as it aimed to stem the increase in temporary employment. In 1997, a new indefinite contract was introduced with more favourable termination conditions for companies, reducing firing costs, and bringing them close to the European average. This reform contributed to wage moderation; however, the share of temporary contracts remained high, and the dual nature of the labour market continued to be a serious problem.

In summary, structural reforms had progressed slowly, but there had been some advances made in the flexibility and modernization of some sectors. The Spanish banking system had deepened its internationalization, with acquisitions that had turned some banks into global entities. Its business model was now focused on retail banking, which, together with an enhanced prudential regulatory framework introduced after the previous crisis, seemed to guarantee the resilience of the banking system. In the labour market, the rigidities inherited from the Francoist era were gradually being dismantled, although unemployment remained high. Finally, the evolution of the public sector offered reasons for optimism. Spain's debt and its fiscal accounts were far stronger than the European average. The fiscal consolidation policies, which enabled Spain to meet the criteria for entering the monetary union, continued in the following years, and in 2005 the country achieved its first fiscal surplus in 40 years (INE, Comín and Díaz Fuentes 2005). On the other hand, the level of public indebtedness was reduced to 36.3% of GDP in 2007. The general balance of the Spanish economy following the implementation of the euro therefore seemed positive. Overall, the Spanish economy appeared to be in a good position to face an eventual reversal of the favourable macroeconomic context.

However, this positive "consensual view of the time" (Jimeno and Santos 2014) has to be set against the serious imbalances that had been accumulating in the expansion stage, as in previous growth phases, and that would increase Spain's vulnerability to changes in macroeconomic and financial conditions. These vulnerabilities arose, in the first place, from an extensive growth model, based on the increase in employment but with very poor productivity performance. In part, this disappointing evolution of productivity was due to labour market institutions that favoured the use of temporary workers and discouraged the accumulation of human capital. This regulation led to a pattern of specialization in low-productivity, non-tradeable sectors, especially construction.

There is no better example of the accumulated imbalances than the excesses that were registered in the real estate sector. The strong growth in the demand for housing in this period was fuelled by a wide variety of factors: these range from the merely demographic, such as immigration or the emancipation of the baby boom generations, to those related to the economic expansion itself, such as declining unemployment or low interest rates, and housing policy, such as the favourable tax treatment of home mortgage payments. The demand was met by a construction sector strengthened by the strong momentum in the modernization of infrastructure of the previous years. Thus, housing investment increased by more than 40% between 1995 and 2007. As Carreras and Tafunell (2018) explain, the expansion of the real estate sector benefitted all sectors: on the one hand, consumers acquired housing assets which seemed to constantly increase in value; companies and banks linked to the construction process achieved fatter profits; and lastly, the State (including councils and autonomous communities) saw an increase in tax revenues, thanks to the various taxes that fell on construction activity and real estate transactions, without having to raise taxes.[2]

The real estate expansion was based on abundant cheap financing from a banking sector that was too large for the size of the Spanish economy and very efficient in attracting external resources through international wholesale markets. According to Jimeno and Santos (2014), the existence of a competitive banking system is in fact essential to an understanding of why the Spanish economy embarked on this speculative path. On the other hand, macroeconomic stability and the accumulation of liquidity at an international level stimulated a progressive reduction in interest rates and an almost infinite supply of credit, without which the housing bubble would have been impossible. This resulted in another serious imbalance in the Spanish economy: the rapid indebtedness of the private sector. The debt ratio of the non-financial private sector as a percentage of GDP increased to 193 in December 2007 (Bank of Spain).[3] This level of indebtedness of the private sector could only be sustained in a context of permanently low interest rates and a gradual increase in housing prices; as such, the adjustment would have been inevitable even without an international crisis. The international crisis, however, precluded any possibility of a “soft landing” for the Spanish economy.[4]

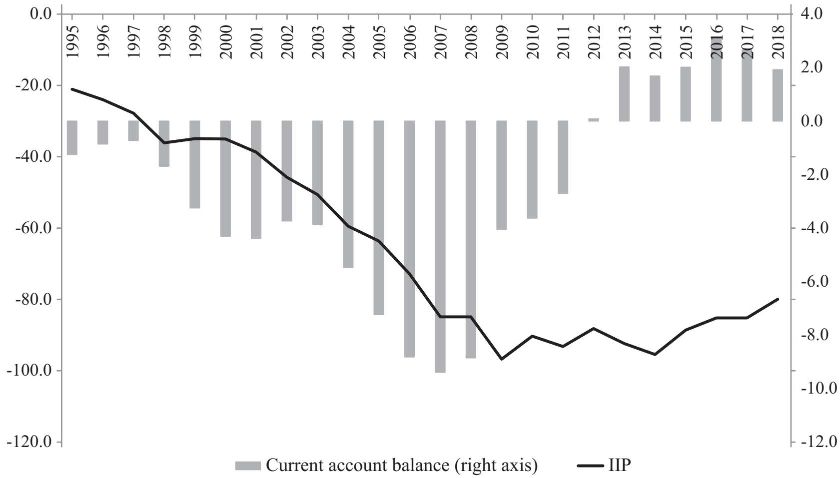

Fig. 7.2 Net international investment position and current account balance as percentage of GDP. (Source: Banco de España)

These imbalances had their correlation in the external deficit. From 2000 to 2004, Spain ran stable current account deficits of roughly 3–4% of GDP, approximately double the average of the previous decade (Fig. 7.2 right axis). From 2005 on, Spain's current account deficit roughly doubled again and reached 10% of GDP in 2007 (only Portugal and Greece recorded bigger deficits). This led to the increase in external net liabilities. The mass of international resources that financial institutions attracted and intermediated was used to finance the expansion of the real estate sector. Membership of the EMU is the essential factor in understanding the deterioration of the international investment position of both Spain (Fig. 7.2) and other southern European countries. As Estrada et al. (2009) explain, belonging to the EMU prevented the external imbalance from acting as a restriction that strangled growth by eliminating the exchange rate risk and allowing an unprecedented increase in foreign capital flows to Spain. Within the framework of a common currency, it was impossible to use monetary policy to try to curb the export of excess savings from countries such as Germany. The monetary policy of the European Central Bank (ECB), excessively lax for the economies that had entered the euro with positive inflation differentials, also failed to restrain such excesses.

Obviously, the external imbalance incorporated an additional potential vulnerability in the event of a deterioration of confidence in the financial markets.

Finally, behind the apparent balance of the public sector there was also a potential source of problems. The reduction in the weight of the debt and the fiscal surplus had been based on the extraordinary increase in tax revenue that was closely linked to the momentum of the construction sector and the associated sectors (Conde-Ruiz and Marín 2013). Thus, the taxes collected on housing transactions tripled between 2000 and 2006, while corporate taxes increased thanks to the extraordinary profits of banks and building companies. The trade deficit also provided tax revenues by increasing the VAT contribution from imported goods and services. These revenues were exceptional and unsustainable, but it was difficult to know to what extent this was the case (Ortega and Peñalosa 2012). As a result, during the boom, policy-makers put into place ambitious spending programmes that treated this extraordinary income as permanent, financing structural expenses with temporary income; this placed the finances of the Spanish state in a vulnerable situation.

7.3 Spain in the Eye of the Storm: Crisis and Initial Political Reaction

The trigger for the international financial crisis was the collapse of the subprime mortgage market in the United States. The process generated significant losses in financial institutions and unleashed a general climate of distrust that led to a blockage of global financial markets. The reduction in the availability of credit and a tightening of the financing conditions precipitated the correction of the real estate and debt excesses of the private sector. For Spain, the simultaneous occurrence of an international crisis, which caused global growth to be negative for the first time since World War II, and the serious imbalances that had been accumulated during the long previous expansion created a perfect storm. In 2008, GDP growth rate fell to 0.9%, turning negative in 2009 (−3.6%) (Banco de España 2014). Between July 2008 and December 2009, 1.8 million people lost their jobs (8.5% of total employment) (INE). Private consumption dropped and registered two years of negative growth (−0.6% and −3.6%), while gross capital formation plummeted at a dangerous rate, registering falls of −4.2% in 2008 and −17.2% in 2009 (Banco de España 2011, 2014). The crisis in Spain was more profound than in other European countries in terms of contraction of income and employment and proved to be more prolonged. It was also the most serious economic crisis in modern Spanish history.[5] The 2008 crisis was the Spanish Great Depression.

The collapse of housing investment is also key to understanding the dynamics and depth of the Spanish crisis. The slowdown in housing demand from households in response to the tightening of financing conditions caused an abrupt adjustment in the construction sector, which radically reduced its investment and its demand for employment, accounting for 52% of the total job destruction in 2008–2009. Moreover, real estate prices dropped by 14% (INE) between September 2008 and December 2009. The depressive effects of the construction collapse were soon felt in the rest of the economy. The reduction in production and employment in the economy had a direct impact on disposable income and wealth, which in turn provoked a change in expectations and weakening domestic demand, also driven by businesses' and families' need to deleverage. All of this sparked a damaging recessive spiral.

The bursting of the bubble impacted a banking system that was extremely exposed to the real estate sector. Between 1992 and 2007, the share of loans to the real estate sector in the total portfolio of loans to firms and households went from 32.7% to 62%, a figure which represented almost 60% of Spanish GDP (Jimeno and Santos 2014).[6] The first measures focused on the liquidity problem associated with the temporary closure of wholesale markets. In an attempt to restore frozen interbank activity, the ECB supported European entities with liquidity injections that resulted in almost unlimited and indiscriminate access to central bank financing (Bergés Lobera and Ontiveros Baeza 2019). In Spain, authorities began to design a policy intended to support recapitalization and the eventual rescue of insolvent financial institutions. For this purpose, in 2009 the Fund for Ordered Banking Restructuration (FROB by its initials in Spanish) was created, with two objectives: facilitating a process for integrating viable institutions, reinforcing the solvency of the resulting entity and promoting its restructuring; and liquidating non-viable entities. To this end, the FROB received an endowment of 9 billion euros. Additionally, it was authorized to finance up to 90 billion through debt issues endorsed by the State (Martín-Aceña et al. 2013).[7]

Despite this, in March 2009 the first of the troubled banks had to be rescued. Partly, this lack of vision can be attributed to the fact that the Spanish banking system seemed to overcome the first phase of the international crisis with relative ease. On the one hand, the ECB's full allotment policy temporarily allowed it to overcome liquidity problems. On the other hand, some specific features helped convey the impression that the banking system had resisted: for example, the generic provisions available to Spanish entities, which gave a false sense of security that the system had sufficient buffers; or the use of loans as a real estate investment vehicle, which delayed the appearance of the deterioration of assets on the balance sheets (Jimeno and Santos 2014; Bergés Lobera and Ontiveros Baeza 2019). Furthermore, given the growing difficulties that families were going through, any attempt to rescue the banking system, considered the culprit in this crisis, would have had a high political cost. Finally, the Spanish government soon faced a fiscal crisis that limited its range of action (Martín-Aceña et al. 2013).

The deterioration of the macroeconomic scenario had a very negative impact indeed on public finances. On the expenditure side, the situation degenerated (see Fig. 7.3): first, because of the impact of automatic stabilizers, which increased expenses in the contraction phase; and second, due to the adoption of discretionary measures of an expansive nature aimed at counteracting the contraction of private demand. In this first phase of the crisis, there was strong international pressure to carry out expansionary fiscal policies. Numerous IMF reports and several communications from the Commission to the European Council encouraged the adoption of expansive fiscal policies to support the global economy, notwithstanding large deficits and rising public debt levels.[8] As a result, many countries put in place the largest concerted effort in their history to support demand and employment.

In Spain, the package of expansionary measures in 2008 and 2009 amounted to 4% of GDP. On the revenue side, tax cuts amounted to

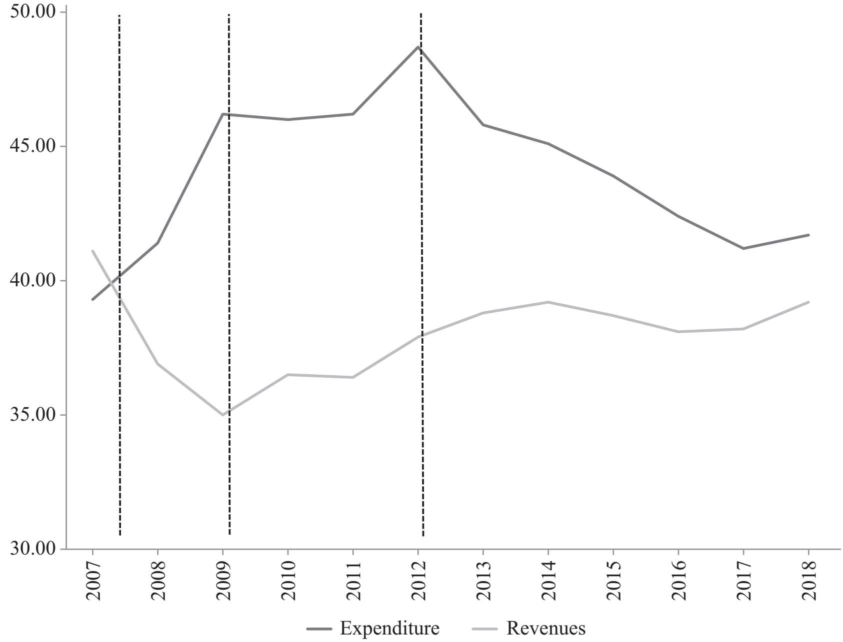

Fig. 7.3 State expenditures and revenues as a percentage of GDP. (Source: Eurostat)

1.8% of GDP (Conde-Ruiz and Marín 2013). Additionally, the government introduced liquidity support measures to households and companies, which reduced revenues by 1.2% of GDP in 2008 and 2009 (advances on income tax deduction for house purchases and monthly VAT returns for companies). On the expenditure side, the government introduced two main sets of measures: a fund for local public investment called "Plan E" endowed with 8 billion euros (0.7% GDP), and a special fund to improve the situation of certain strategic sectors (such as the car industry and R&D) and public consumption projects (0.3% GDP). According to calculations by international agencies, the Spanish economy is among those that made the greatest use of this resource as an economic policy, which would soon prove extremely detrimental as it exhausted any possibility of expansionary fiscal policies when they were eventually really needed.

The most important component in the deterioration of the fiscal situation in Spain (Fig. 7.3) was the collapse in tax revenues. This appears as a generalized feature of the processes of severe adjustment of private spending, and in the Spanish economy was exacerbated by the intensity with which the real estate sector had been contributing to the growth of tax revenue. Once the bubble burst, revenues decreased dramatically. As a result, in two years the surplus became a deficit of 11.2% of GDP and the debt ratio rocketed to a level of 54% in 2009. The exemplary situation of the public sector had completely reversed in less than two years.

7.4 From the Expansive Stage to the Consolidation Stage

The uncertainty surrounding the Greek economy, the obvious contradictions between the financial situation of several European states and their growth prospects, alarm about the strength of banks in various European countries and, last but not least, the problems of EMU governance that hindered and delayed the political response gave rise to a new type of crisis as the financial crisis turned into a sovereign debt crisis in 2010. The increase in borrowing spreads from 2010 on reflected the increasing anxiety in the financial markets, which abruptly brought an end to the delusion that country risk had disappeared. As a consequence, countries with the greatest fiscal imbalances began to experience difficulties in issuing public debt. At this point, the European authorities radically changed their recommendations, now exerting pressure to take urgent measures to ensure fiscal consolidation. Most countries in the Eurozone exceeded the deficit ceiling of 3% at the end of 2009, so they had to take measures to rectify their situation, becoming immersed in an Excessive Deficit Procedure. The increasingly unfavourable conditions in the financial markets and the difficulties in accessing financing forced Greece, Ireland, Portugal and, finally, Cyprus to ask for financial assistance from Europe to finance their debt, while a growing chorus of voices questioned the viability of the euro.

For the Spanish economy these developments came to a head in May 2010: with debt markets on the verge of collapse, the Spanish government was forced to introduce decisive measures to correct the budgetary imbalance. Public sector salaries were cut by 5%, pensions were temporarily frozen and various subsidies and tax deductions were revoked. Pharmaceutical expenses were reduced through the introduction of the co-payment. There were also cutbacks in public investment, especially in infrastructure. In addition, in the following months, VAT and excise taxes were raised, deductions for the purchase of a primary residence were eliminated and public sector hiring was practically frozen. Further, in 2011, a first pension reform was undertaken. The reform was launched with the agreement of trade unions and employers' organizations. But despite the government's best attempts, it did not have the support of the main opposition party due to the open hostility of an electorate that perceived the reform as unnecessary. This perception was partly based on the history of accumulation of cash surpluses during the expansion phase. In 2007, for example, the social security surplus reached 1.4% of GDP (Conde-Ruiz and Gonzalez 2015). The fact that international economic organizations and the European authorities insisted on recommending this reform contributed to the decision being interpreted as an external imposition that pushed the cost of the banking crisis onto pensioners. The reform modified two fundamental parameters: the retirement age was raised to 67, and the calculation period of pension income was extended to the worker's wage level over the last 25 years, instead of the last 15. While the 2011 reform was entirely necessary, it was only able to address a third of the system's future sustainability problem (Conde-Ruiz and Gonzalez 2015).

These decisions came in a context of heightened social unrest due to a deterioration in the economic situation that directly affected family economies. Everyday manifestations of these difficulties, such as evictions or the thousands of young people leaving the country weekly in search of work overseas, became a central focus of the media. The media attention contributed to the population's growing disaffection with a political system that they considered did not represent them, and did not offer them a real future.[9] In May 2011, thousands of people spontaneously gathered in the squares of the main cities of Spain to protest against the political direction of the country, forming the so-called 15-M movement. The concentration at Puerta del Sol in Madrid, the most numerous, lasted for 24 days.

But the pressure of the markets on Spanish debt continued to increase and in September 2011, the two major parties agreed to introduce an amendment in the Spanish Constitution that, in line with the German Constitution, enshrined the principle of budgetary stability and prioritized the payment of public debt over all other obligations. After the elections of December 2011, the new conservative government gave a new impetus to the fiscal consolidation policy with the increases in VAT and income tax, as well as the elimination of several corporate tax deductions. Civil servants' salaries were cut again, and public investment was also reduced, including the source of investment used to replace and maintain the existing infrastructure and the R&D expenditure. In addition, a serious cut was imposed on the expenditure of the Autonomous Communities responsible for much of the social expenses in Spain. The cuts were thus concentrated in items such as health, education and social benefits other than pensions and unemployment (Conde-Ruiz et al. 2016). The chosen approach to reduce spending would have profound implications for political stability in Spain, as it generated a growing disenchantment with the existing democratic system, which seemed incapable of offering a way out of the crisis, and eventually led to a serious social and political crisis. In Catalonia, the growing discontent with the adjustments resulted in the emergence of a strong independence movement.[10] The severity of the adjustments in Catalonia, which stood in contrast to the region's relative wealth in the Spanish context, spread the idea that independence would facilitate economic recovery by freeing Catalan citizens from the burden of an impoverished Spain they had to sustain. Further, austerity hindered the long-term growth prospects of the Spanish economy, postponing the implementation of some of the most necessary reforms, such as that of the education system. Besides, the sustained expenditure on pensions and unemployment benefits, as well as the huge cost of servicing the debt did not allow an effective reduction of the budgetary imbalance. As a result, in 2011, the public deficit rose to 9.7% of GDP, compared to the 9.5% of 2010 and, therefore, public debt as a share of GDP increased to 84.4%.

These attempts to adjust public accounts would be disrupted by the worsening banking crisis from 2011 (Martín-Aceña et al. 2013). As the recession continued, the provisions accumulated on the banks' balance sheets were depleted, the growing cost of wholesale financing compressed bank margins and profitability collapsed. Indications of fragility appeared in the segment of institutions most exposed to real estate investment (especially the "cajas"). The fragility of the financial system, the main holder of Spanish public debt, together with concern about the fiscal sustainability of Spain's finances created a vicious circle between banking and sovereign risk, which drove spreads for Spanish debt to unsustainable levels.[11]

After the rescue of the first savings bank, in 2009, the Bank of Spain began to put pressure on the weakest savings banks to address their insolvency problems through mergers with healthier entities (Martín-Aceña et al. 2013). With regard to corporate governance, more stringent requirements were stipulated regarding the professional qualifications and experience of those in positions of power, and the proportion of public representation positions was reduced. However, neither the creation of the FROB nor the previous legislative reforms prevented the collapse of a second savings bank. There were growing demands for transparency in terms of real estate risk, which constituted the bulk of the portfolio under suspicion. The entities were obliged to provide information on the share of the real estate sector in the loan portfolio. The second measure was the raising of capital requirements, especially for non-listed entities. Those credit institutions that could not reach the minimum required would remain in the hands of the FROB.[12]

The majority of savings banks carried out processes of integration of various kinds, but the mergers strategy would be unsuccessful (Martín-Aceña et al. 2013). The financial sector crisis reached a critical point in 2012. The deterioration of the economy and the governance problems of the EMU created a climate of distrust and uncertainty in the financial system, and Spanish banks continued to face serious obstacles to accessing the wholesale capital markets. The Bank of Spain thus maintained the pressure on banks to strengthen their capitalization levels and to increase their provisions. But the big shock came with the collapse of Bankia (the result of the merger of seven savings banks; five of the smaller ones and two out of the three largest). In May 2012, it was announced that Bankia would have to be bailed out with public money due to its undercapitalization and the emergence of large losses. The debacle was the result of a combination of lethal factors: unprofessional or incompetent managers, erroneous investments, a deep economic recession and continuous political interference. After nationalization, a new valuation of assets and the restatement of Bankia's accounts showed that the bailout would require the astronomical amount of 23 billion euros. It was the largest financial rescue in the history of Spain and one of the largest in Europe.

Given this situation, foreign investors' distrust intensified, and capital outflows from Spain rocketed. From August 2011 to July 2012, net outflows rose to 338 billion euros (32% of Spanish GDP) (Banco de España 2012). In June, the results of an aggregate-level stress test were published, and after several weeks of indecision, the Spanish authorities had no choice but to request the financial assistance of their European partners for an amount of 100 billion euros. For the funds to be released, a Memorandum of Understanding (MoU) was signed on July 20 with the European Commission.

The MoU established a series of mandatory measures to stabilize the banking system and a conditionality framework which included macroeconomic reforms and reforms of public finances. The Spanish government promised to make progress in correcting the macroeconomic imbalances: in particular, the excessive deficit had to be corrected before 2014. In this regard, it is important to highlight that the final amount of aid received, which exceeded 41 billion euros, representing 4% of GDP in 2012, would be consolidated as part of the public debt, so that it did not hinder Spain from fulfilling the deficit objective (Bergés Lobera and Ontiveros Baeza 2019).[13] To ensure compliance with the deficit objective, an independent budgetary entity had to be created to deal with analysis and advisory activities and to supervise fiscal policy. The Independent Fiscal Authority (AIReF) was created in 2013. On the other hand, Spain was advised to introduce reforms in fiscal matters, in the labour market and in the electricity sector.

The assistance programme was successful, as it managed to stabilize the banking sector, helping to normalize the credit channel. Together with the previous reforms, the rescue of the banking system was able to restore confidence in the Spanish economy. It should be mentioned, however, that the main factor in this recovery in market confidence was the renewed commitment of the European Central Bank with unconventional monetary policy measures. In order to address the rapid deterioration in financial conditions, in July 2012 ECB President, Mario Draghi, gave a speech where he restated the determination of the ECB to do "whatever it takes" to preserve the euro. With this statement, the president sought to allay investors' fears about the possible reversibility of the euro.[14] The implicit promise to provide unlimited support for member countries was materialized soon after with the announcement of the Outright Monetary Transactions (OMT) programme, which would include unlimited purchases of government bonds in secondary markets for countries that requested its activation. The credit spreads of banks and sovereigns immediately reversed, and the risk of a sovereign debt crisis was averted.

The Spanish government also promoted a new labour reform aimed at facilitating an internal devaluation, that is, a reduction in salaries, which would enable a rise in competitiveness, even though the unit labour costs of Spain had been falling since 2009 (Conde-Ruiz and García 2019). To this end, firing costs were reduced, and a new open-ended contract for full-time employees in small businesses was introduced with an extended one-year trial period.[15] Ultimately, the objective was to reduce the costs associated with dismissal for regular workers and, thereby, not only encourage the use of open-ended contracts, but also salary moderation. Another important feature of the reform was to give preference to firm-level collective bargaining agreements over sectoral or regional agreements, as well as making it easier for companies to withdraw from collective agreements and adopt internal flexibility measures (including lower wages) to prevent job destruction. All together this constituted the most substantial revision of the labour market regulation since 1984.

The reform had some positive consequences. It gave more relevance to companies' individual circumstances and introduced a greater degree of internal flexibility in firms (Conde-Ruiz and García 2019). It also had a somewhat positive impact in terms of job creation and undoubtedly achieved its main goal: wage devaluation. But it came at the cost of eroding the protected position of the regular workers, as those with the new contracts received a lower salary than the laid-off workers. Moreover, it could be argued that the improved bargaining power granted to firms to unilaterally change their labour conditions (including wages) may have had negative effects on inequality, with the emergence of a new class of poor workers. Specifically, this problem emerged because the reform did not introduce any relevant measure to eliminate the duality of the labour market (Conde-Ruiz and García 2019). On the contrary, the prevalence of temporary contracts increased, and companies tended to rely heavily on the turnover of workers, even when economic recovery was well under way. The average duration of contracts went from 90 days in 2006 to only 50 in 2016 (Felgueroso et al. 2017). This has meant that many workers, especially young people and those with less professional training, are trapped in low-paying jobs with little job security. This not only has undesirable long-term economic effects, but is also a major social problem, generating political instability.

Despite the advances, one of the main burdens of the past continued to hinder the economy, namely inefficient regulation and lack of competition in certain essential productive sectors. The best example is the energy sector. As of 2012, the Spanish electricity sector had a large shortfall between the system's regulated revenues and its regulated costs, which was referred to as the "tariff deficit". This tariff deficit, which resulted in an accumulated debt exceeding 25 billion euros,[16] was the key problem facing the electricity sector.[17] The government's initial reaction was to freeze the expansion of renewables and to increase electricity tariffs. These measures turned out to be insufficient to reduce the deficit, so the government introduced a series of additional measures including cuts to regulated revenues, which mainly affected producers of renewable power. The government's energy reform was successful in eliminating the deficit; a surplus was registered in 2014. However, the cuts to the government's support for existing renewable power plants was perceived by many as a violation of its commitments to investors and led to litigation in national courts as well as numerous arbitration claims against Spain by foreign investors. Furthermore, the reform failed to take a key step in ensuring the long-term sustainability of the electricity system: the government refused to hand over tariff-setting powers to the sectoral regulator despite repeated calls by the European Commission for it to do so.[18]

The last reform introduced was the pension reform. The intensity of the population ageing process in Spain made a more thorough reform inevitable.[19] From 2012 on, the social security deficit became the main obstacle to fiscal balance. As such, Rajoy's government approved a new sustainability factor, based on the proposal of an expert committee (Conde-Ruiz and Gonzalez 2015). This sustainability factor linked the initial pensions to the evolution of life expectancy of 67-year-old retirees in the seven years prior to retirement. This factor seeks to achieve a greater actuarial balance between pensions and the total contributions paid during the contributor's working life. Further, the reform established a new index for revaluing pensions, aimed at ensuring balance between revenue and expenditure. Thus, the revaluation is linked to the total budget constraint of the pension system. The law also set an upper and lower limit for growth in pensions, in order to guarantee that pensions grow in nominal terms. However, projections show that the structural deficit will persist. This means that pensions will essentially remain frozen for a very long time; moreover, for as long as the inflation rate is higher than 0.25%, pensions will decrease in real terms. The upshot of the reform was that the burden of the adjustment of the system would fall completely on pensioners. Obviously, there was a public outcry and the reform did not last long. In 2017, after an increase in inflation fuelled some small but notable protests by retirees, the execution of the reform was provisionally suspended. In 2018, pensions were revalued according to inflation. The retirees protest movement has since become stronger and the challenge now is to find a mechanism that allows an adjustment of expenses without inflicting the total cost on the retired population.

7.5 A Rainbow After the Storm?

The unpopularity of the adjustment measures perceived to disproportionately burden disadvantaged social groups and the inability of the main Spanish political parties to offer alternatives weakened the public trust in the political system. Furthermore, as a consequence of the corruption scandals that began to emerge, key institutions, such as the monarchy or the judicial system, fell into disrepute, creating a situation of

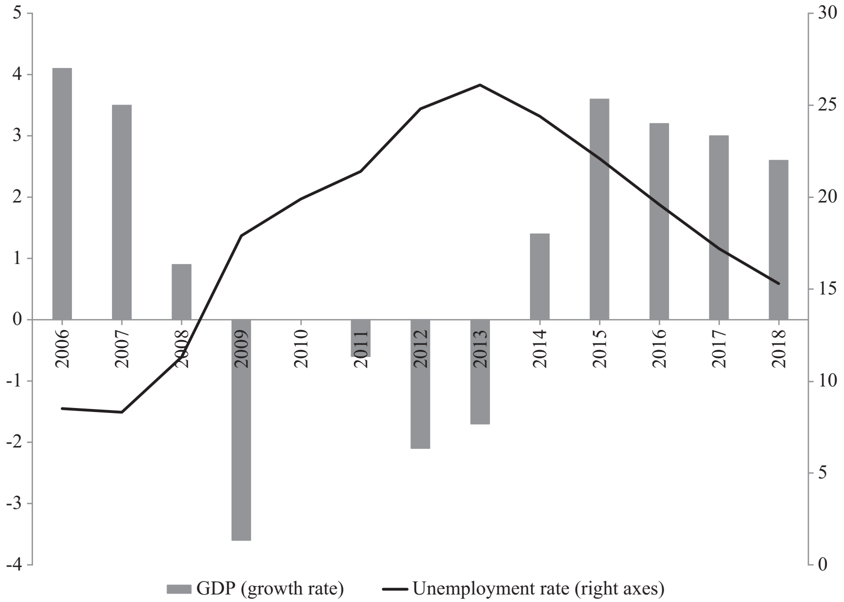

Fig. 7.4 GDP growth and evolution of unemployment. (Source: Banco de España)

enormous instability (Simón Cosano 2019). As a consequence, the reformist agenda came to an end in 2013. Yet another factor to consider in the paralysis of the reforms is the beginning of the economic recovery. As Fig. 7.4 illustrates, 2013 was the last year of recession. Beginning in 2014, the Spanish economy began to grow at a high rate, exceeding 3% annually, and significantly above the Eurozone average. The unemployment rate fell to 15% in 2018 thanks to the creation of 2.6 million of jobs. This vigorous recovery seemed to temper the reformist enthusiasm of a government that until the end of 2015 had an absolute majority in Parliament. Be it the improvement in economic conditions or the political instability, since 2016 Spain has been afflicted by a damaging institutional paralysis. The postponement of a much-needed pensions reform is the best example of the harmful effects.

When seeking the reasons for the vigorous recovery of the Spanish economy, we must first look to external factors, the so-called tail winds. On the one hand, oil prices began to fall from 2014 on. For Spain, an importer of crude oil, the lowering of oil prices has had direct and very positive effects on inflation, and the trade deficit. The conflicts that have plagued North African countries since 2011, when the Arab Spring broke out, also had a noteworthy impact, as they diverted millions of tourists from North African destinations to Spain. As a result, tourism contributed very positively to the recovery. On the other hand, the new approach to the Eurozone governance based on the creation of mechanisms and institutions for crisis management and resolution that guaranteed adequate supervision, while imposing strong conditionality on the countries that received assistance, helped to restore confidence in the international capital markets. In this regard, the launch of the European Banking Union in 2014 was particularly important, as the creation of the Single Supervisory Mechanism and the Single Resolution Mechanism enabled advances in the financial integration of the Eurozone and stabilized the weakest banking systems (Andrés and Doménech 2015).[20] But, without a doubt, the most important contributing factor to the recovery of the Spanish economy was the ECB's monetary policy. In mid-2014, in the context of weak growth and deflationary tensions, the ECB introduced a series of measures aimed at reinforcing the expansionary stance of monetary policy. It acted in three complementary areas: the introduction of negative interest rates, the provision of forward guidance and the adoption of a large-scale asset purchase programme that intensified the expansion of the ECB balance sheet (Arce et al. 2019b). The latter programme involved the outright asset purchases, including the direct acquisitions of government and private sector securities, and had a huge impact on the Spanish economy. The reduction of the debt burden has smoothed the fiscal consolidation as well as the deleveraging process of private agents. With the resulting normalization of capital markets, the financing problems seem to have been overcome and the flow of new credit has allowed the recovery of investment.

There are other internal factors worth noting. Fundamentally, the Spanish economy has been able to correct, or take steps towards correcting, two important imbalances. On the one hand, families and companies have reduced their leverage to levels close to 130% of GDP, compared to almost 200% in 2012. The consolidation of business balance sheets and the increase in savings by families have readied the Spanish economy to start a new cycle of increased demand in consumption and investment.

On the other hand, the Spanish economy has reversed the trade balance deficit, thanks to the increase in exports. The improvement of the foreign sector is structural in nature; there has been a significant increase not only in the number of companies that regularly sell their products to the rest of the world, but also in the geographical diversification of Spanish exports. Exports have gone from representing 26% of GDP in 2007 to 35% of NDP in 2018. Spanish companies responded with uncharacteristic promptness to the fall in national demand, and increased their exports accordingly (Almunia et al. 2018). However, the internal devaluation that has allowed better access to international markets has been mainly due to falling wages and less so to increased productivity. As a consequence, the burden of the adjustment has fallen almost exclusively on the working population, which has generated a huge social cost for Spain.

The increase in unemployment is the most visible manifestation of the impact of the crisis for workers, but there has also been a worrying rise in inequality and poverty in the Spanish economy. All of the most common indicators of inequality worsened during the crisis and, what is more alarming, they have only improved very slowly with the recovery (Ayala et al. 2018). For example, the Gini index has increased by 6.5 points and the bottom 20% of the income distribution only accounts for 6.2% of total income, compared to 7.7% on average in OECD countries (Hernández San Juan 2019). The increase in inequality in Spain has been mainly due to the fall in income of the low-income population, which has greatly exacerbated the sense of vulnerability and insecurity pervading the population. The main reason underlying this inequality is unemployment. However, the conditions of a labour market characterized by a high rate of temporary employment and a prevalence of part-time work have also had a significant impact on the increase in inequality (Ayala et al. 2018). As a result, more than 20% of the Spanish population is at risk of poverty, a figure much higher than in most of Spain's European partners.

Further, the most dangerous aspect for Spaniards' future becomes clear when looking at the population groups most affected by this evolution. The big losers in this crisis are young people and families with children under 16. Unemployment and job insecurity fundamentally affect younger workers. Low wages and intermittent incomes have condemned

Spanish youth to economic insecurity: 28.3% of young people are at risk of poverty compared to only 8.9% of those over 65 (Hernández San Juan 2019). This insecurity has hampered their ability to forge their own life path. Part of Spain's low birth rate is precisely due to this situation. Indeed, it is the children who are suffering the most from the increase in inequality in Spain, which undermines Spain's future prospects. It is important to point out how the structure of social benefits influences these trends. While pensioners have maintained, or even increased, their income, all benefits or aid for young people, children, maternity support or families have been reduced, from levels that were already low compared to Europe (Ayala et al. 2018). The cuts to the education system have only aggravated this situation, meaning it no longer functions as a social elevator, as it did in the final decades of the twentieth century.

As in many other European countries, this has led to an escalation in social unrest and growing distrust in the political system. Moreover, in Spain, tensions among different territories have also increased. Since 2012, the Catalan pro-independence movement has kept successive Spanish governments in check, creating an unusual climate of confrontation among the population. All this has been reflected in greater political polarization and growing parliamentary fragmentation (Simón Cosano 2019). In 2014, a new left-wing political party, Podemos, an offspring of the 15-M movement, stood for election to the European Parliament. Shortly after, a small liberal Catalan party, Ciudadanos, made the leap to the national level, participating for the first time in a general election in 2015. The last to enter Parliament has been a far-right party, Vox, which as a result of the second elections of 2019 has become the third most important party in the lower house.

7.6 Challenges and Risks Coming Out of the Great Recession

The Great Recession has undoubtedly been the biggest economic crisis faced by the Spanish economy in modern times, even worse than the Great Depression if we look at unemployment and the fall in GDP per capita. The international crisis severely affected Spain due to the large imbalances which the economy had accumulated during the long period of expansion following Spain's entry into the euro (current account deficit, job insecurity, high private indebtedness, high exposure to the construction sector, etc.). Although the economic recovery has enabled a reduction in some of these imbalances, the Spanish economy continues to show significant vulnerabilities.

The greatest improvements have been in the foreign sector and private indebtedness. The Spanish economy has managed to register sustained current account surpluses. It is remarkable that the improvement in competitiveness has been achieved for the first time in history without using the exchange rate or the devaluation of the currency. On the contrary, as explained above, it has relied heavily on wage reductions, which has shifted the burden of adjustment to the working population. The major deleveraging carried out by the non-financial private sector enabled a reduction in its debt-to-GDP ratio of more than 40 percentage points from the maximum level, dropping to a level below the average of Eurozone companies (Banco de España). Despite this effort, the net debtor position of international investment is still too high, representing 80% of GDP.

The main imbalances still present are found in the labour market and in the fiscal system. Notwithstanding some positive developments in the labour market, there are still some problems: an unemployment rate around of 14%; a temporary employment rate of 27%, mainly concentrated in young people; and a wage level that does not guarantee earners can avoid poverty—all provide enough evidence that Spain's labour market problems are far from resolved. On the other side, despite the reduction of the public deficit to below 3%, public debt has reached 99% of GDP, more than 60 points above the pre-crisis levels. Fiscal pressure will be further aggravated by the increase in expenditure associated with an ageing population, such as spending on pensions, dependency or health.

But, without a doubt, the most worrying vulnerability of the Spanish economy is that it has registered practically zero productivity growth. It is well known that productivity is not only the key to long-term growth per capita, but it is also the only way to remain competitive over time. Productivity is the true pending issue in the recovery of the Spanish economy. Total Factor Productivity has barely grown in recent decades. In fact, in the last 25 years it has grown by an average of 0.2% per year, three-tenths below the Eurozone average and well below that of the US economy (Banco de España).

As for the coming years, the Spanish economy, like that of other countries, will have to face three global challenges: an ageing population, the digital revolution and climate change. In terms of tackling the first two, Spain is in a worse position than surrounding countries. In the case of ageing, this is because Spain will be the oldest country in Europe in 2050. This will increase the fiscal pressure to finance the welfare programmes associated with ageing. Further, the technological revolution will lead to a transformation of the economy and will have a qualitative impact on employment, favouring the most qualified workers, whom technology complements rather than replaces. For this reason, it is essential to have a workforce with a level of human capital that allows adaptation to change. In this sense, the educational system is not fully up to the task, as shown by the high rate of early school leaving (18.3% of the population aged 18–24, compared to 10.6% in the European Union) and the disappointing results in the standardized PISA tests, with Spain coming at the tail end of European countries.

To face all these challenges, Spain must implement its agenda of pending reforms and thereby definitively modernize the economy. In the first place, in order to overcome the fiscal crisis, a tax reform is needed to increase revenues, as well as a reform of regional financing that improves the fiscal co-responsibility of Autonomous Communities. Second, a pension reform must be implemented to adapt to the new demographic reality. Third, the country needs a labour market reform that eliminates the high levels of job precariousness and at the same time is able to cope with the new forms of employment in the digital economy (gig economy). Fourth, an educational reform is necessary in order to adapt the currently poor education system to the new technological challenge and guarantee equal opportunities and social mobility. This reformist agenda will allow Spain to improve its productivity and thereby its competitiveness within the European Union, and help prevent the accumulation of imbalances as destructive as those experienced in this latest crisis. Further, it would reduce the level of inequality that has damaged both social cohesion and growth.

In addition, just as there was an international component to the origin of the 2008 crisis, coming out of the crisis will also involve an international dimension. Even if Spain manages to implement its reformist agenda, successfully facing up to global challenges also requires deep reforms within the EU. On the one hand, it will be necessary to further develop the institutional architecture of the euro, completing the banking union with a European deposit protection fund to limit the impact of future financial crises. On the other hand, moving forward decisively in the single market will also be key, especially regarding energy and digital issues, in order to achieve a more efficient economic environment and be able to reduce the productivity gap with our global competitors such as the United States or China.

Having exhausted the recourse to fiscal policy, with most countries registering a public debt level close to 100% of GDP, and to monetary policy, with interest rates around zero and an unprecedented quantitative expansion, only structural reforms can address the situation. However, the implementation of the reforms at both national and European levels is threatened by political instability. The 2008 crisis has broken many consensuses and has brought about changes in the traditional rules of the game that were key to driving reforms. One major consequence of the Great Recession, which we sometimes overlook, is that parliaments are more fragmented and polarized than ever before, and this political situation also poses a new challenge for decision-makers.

In Spain, the so-called Social Dialogue, which brings together trade unions and business representatives, has become less and less relevant. This adversely affects its role as a key institution in negotiating labour or pension reforms. In addition, the national parliament is increasingly fragmented, with the emergence of new parties, resulting in four general elections in the last four years. Such circumstances make agreements on a reformist agenda unfeasible. In Europe, the situation is not much more promising. The economic crisis, and how it was dealt with, has opened up a gap between Northern and Southern countries. Indeed, they have even been unable to agree on the causes of the crisis, making it hard to imagine that they are ever going to agree on the reforms needed to continue advancing in European integration. Added to these complex political and social environments are the Catalan conflict and Brexit. In short, it is crucial to unlock the political stalemate, at both the Spanish and European level, to achieve a broad consensus on undertaking the reforms required to head towards a more inclusive, sustainable and efficient economy.

Notes

1. A third much smaller bank Banco Popular remained in existence until 2017, when it was intervened and absorbed by Santander.
2. Of course, Spain was not the only economy where a real estate bubble occurred: the United States, Ireland and the United Kingdom are other cases.
3. The ratio continued to increase until it reached its peak in June 2010 of 205% of GDP.
4. "Soft landing" was the expression the incumbent government used between 2004 and 2007 to refer to political measures aimed at diminishing the significance of the real estate sector in the economy.
5. At least in terms of output loss (Betrán and Pons 2013).
6. This figure includes mortgages and loans for housing renovation, and loans to construction companies and real estate developers as a percentage of loans to households and firms (Jimeno and Santos 2014: 132).
7. See Martín-Aceña, Martínez-Ruiz and Pons (2013) for a more complete account of the developments in the banking sector up to 2012.
8. For example: "The Commission is proposing that, as a matter of urgency, Member States and the EU agree to an immediate budgetary impulse amounting to € 200 billion (1.5% of GDP), to boost demand in full respect of the Stability and Growth Pact", Communication from the Commission to the European Council, A European Economic Recovery Plan (26/11/2008). "Fiscal policy must play a crucial part in providing short-term support to the global economy", IMF 2009 WEO April. "Notwithstanding already large deficits and rising public debt in many countries, fiscal stimulus needs to be sustained until the recovery is on a firmer footing and may even need to be amplified or extended beyond current plans if downside risks to growth materialize", IMF WEO 2009, October.

9. Some of the organizations present in the concentrations had names like “Youth with no future” or “Real democracy now”.
10. As Simón Cosano (2019) explains, the economic crisis is not the only possible explanation for the emergence of this movement.
11. A mutually destructive dynamic began to form whereby the sovereign debt crisis harmed the banks, the main holders of that debt, while the increase in bank fragility threatened a State that could not handle an eventual rescue of the banking sector. Of course, Spain was not the only country trapped in this destructive spiral.
12. The level of principal capital was set at 8% for entities with more than 20% of capital held by private investors or with little dependence on wholesale financing, and 10% for the rest; that is, for entities with more than 20% of their financing from the wholesale markets and with at least 20% of their capital placed among third parties.
13. According to the Bank of Spain, the total cost of the interventions in the banking system from 2009 to 2018 was 65,725 million euros. *Nota informativa sobre ayudas financieras en el proceso de reestructuración del sistema financiero español*, 2009–2018, 20/11/2019.
14. The so-called redenomination risk was based on the negative self-fulfilling predictions of the possibility of an imminent euro-area break-up.
15. The circumstances in which a firm’s economic difficulties could justify lower compensation for firing were expanded and the required administrative authorization in the case of collective dismissals was eliminated.
16. https://www.mincotur.gob.es/es-es/gabineteprensa/notasprensa/2013/documents/presentacion_reforma%20el%C3%A9ctrica120713_v5.pdf
17. The concept of tariff deficit was introduced in the year 2000, when a law was introduced that prevented electricity tariffs from rising above the rate of inflation. However, it was from 2005 onwards that the deficit grew significantly. The growth in the tariff deficit was the result of the government’s reluctance to increase electricity tariffs in the face of growing system costs due to the strong expansion of subsidized renewable power, expansion of the electricity transmission and distribution networks, and the use of the electricity tariff to fund public policies such as support for coal mines. The tariff deficit problem was further exacerbated by the crisis-related drop in electricity demand after 2008, which meant that revenues had to grow more than the drop in demand to prevent electricity system revenues from falling.

18. This step was finally taken in 2019 after the EC opened an infringement procedure against Spain for this issue.
19. Spain will be the oldest country in Europe in 2050 for three reasons. First, Spain has one of the highest life expectancies in the world, both at birth and at age 65. Second, it has one of the lowest fertility rates in industrialized countries. In addition, the ageing process is occurring some time after that in other countries because the baby boomer generations came later and the immigration process of the 2000s led to the rejuvenation of the population.
20. The intervention of a Spanish bank, Banco Popular, in 2017 was the first time that the SRM acted.

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8

Epilogue

Concha Betrán and María A. Pons

All countries have had defining moments which have brought about important transformations in their economies and societies. These turning points, which may be triggered by wars, new technologies and markets, or crises, require new policies and reforms to help countries adapt to the fresh challenges.

We have identified six turning points for the Spanish economy in its recent history (the last 200 years). The aim of this book has been to explain this society's capacity to respond to the challenges of shocks, and the resulting continuities and discontinuities. Moreover, the shocks in question were also international shocks that affected most developed countries at that time. However, the book argues that Spain, as a small peripheral country, faced greater restrictions than core countries when it came to resolving its main issues.

The first turning point was the Napoleonic Wars. This turning point was an international one, given that it was a tumultuous period throughout Europe. European countries were involved in a war that started in 1792 when France declared war on Austria and Prussia, and a year later

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Great Britain, with the conflict lasting until 1815. The consequences for the countries involved were fiscal crises and the interruption of trade and blockades until Napoleon's defeat in 1814. The Napoleonic Wars also had long-run consequences for the European economies. On the one hand, they promoted protectionist measures (such as the 1815 Corn Law), delaying the application of policies promoting trade (repealed the Corn Law in 1845), although in general tariffs were high during the nineteenth century. On the other hand, there was an important geopolitical change: the loss of the American colonies for European countries (Great Britain, France, Spain and Portugal), which meant free trade for the newly independent countries, the establishment of protectionist policies and the end of monopolies in trade with the former colonies. Tariffs were put in place instead (Findlay and O'Rourke 2007). Moreover, the Ancien Régime's institutions were affected, with different factions aligning in favour of either change—to meet the bourgeoisie's new demands—or continuity—to maintain the social privileges of the Ancien Régime society.

The Napoleonic invasion of Spain took place in 1808 and the main consequences were a long liberal revolution until 1840 and a period of civil wars and political instability that lasted until 1874. This period witnessed various reforms aimed at the formation of a liberal State and the abolition of the Ancien Régime. However, there were difficulties in achieving the liberal reforms due to the lack of a substantial bourgeoisie to support the reforms and the eventual need to reach an agreement with the nobility.

As a consequence, although the institutions were modernized, the reforms favoured the landowners and financier elites, and there was no fiscal reform to resolve the fiscal crisis produced by the loss of the American colonies. The drop in customs revenues and taxes from the colonies led to the bankruptcy of the public treasury, which lasted until 1851. The fiscal system established was not a progressive one, which would have allowed increased spending on education and infrastructure. Likewise, the fiscal problems had negative consequences for other crucial policies carried out: these included land disentailment by means of public auction to obtain fiscal revenues; tariffs to obtain customs revenues; and banking, railway and mining laws opening up these sectors to outside investment to secure funds to finance the budget deficit.

Although core European economies started their industrialization processes in the late eighteenth century, peripheral countries such as Spain began in the mid-nineteenth century. Spain had a number of challenging characteristics, such as being on the periphery of Western Europe and not being very well endowed with land for cereal agriculture, due to the irregularity and scarcity of rain, which also limited pastoral livestock farming due to the poor pastureland. Nomadic sheep farming was better adapted to the circumstances, making use of the pastureland of the lower southern areas in winter and of the northern mountains in summer. As a result, agriculture had low productivity with only a moderate increase over the nineteenth century. While Spain was well endowed with metallic-mineral resources, it had a poor supply of fuel resources, such as coal. Moreover, the educational level of the labour force was relatively low, and the country's population was relatively small. These factors, which acted as domestic restrictions, explained the relative underdevelopment of the industrial sector and determined the small size of the middle class or bourgeoisie. At the same time, institutional change was limited to achieving an improvement in the domestic conditions which affected economic growth.

The main result of the Napoleonic wars was the abolition of the Ancien Régime, the introduction of new political and economic institutions and the adoption of reforms that contributed to the modernization of the country. These reforms included two Constitutions (1812, 1837), the liberalization of private sector activity (creation of the market for factors of production, liberalization of the goods market and redefinition of property rights), the establishment of private ownership of land, new business legislation (in banking, public limited companies, stock exchange, etc.), the establishment of a monetary system, a liberal tax system, public debt reform and also education reform. Estimates indicate that GDP per capita levels were 12% higher by the mid-nineteenth century than they would have been if pre-war trends had prevailed (i.e., without the liberal reforms) (Prados de la Escosura and Santiago-Caballero 2018).

However, not all the reforms achieved positive results and many Ancien Régime practices persisted. The liberal agrarian reform meant the dissolution of the feudal lordships, the abolition of primogeniture and the disentailment of the lands of the clergy and the municipal councils, among other measures. The positive results of this reform were an increase in agrarian production and the creation of a labour market (wage workers) because some peasants were expelled from the land. However, the agrarian reform also had adverse effects in that it consolidated an unequal distribution of property, due to the fact that disentailment was carried out by public auction, in which the elites and big landowners enjoyed advantageous access to land while peasants were deprived of the free use of common land. Thus, the agrarian reform was not an inclusive reform and in fact even aggravated inequality. In the same way, the fiscal reform was unable to solve the financial needs of the State and did not improve inequality. The divergence in terms of fiscal efficiency occurred in the nineteenth century when other countries such as France, Germany (Prussia) or Great Britain were able to modernize their fiscal structure while Spain was not (Yun-Casalilla et al. 2012). Fiscal incapacity and inefficiency had negative consequences in many areas, such as defence (with the powerlessness of the Spanish army), infrastructure and education (with a low level of fixed capital stock and human capital). The lack of revenue also imposed a cost in terms of public debt issues, which increased the costs of financing of the State, as well as the private companies. Finally, this insufficient fiscal revenue shaped most of the reforms implemented (tariff policy, mining laws, etc.).

Therefore, pressures from the elite moderated the scope of the reforms and allowed the persistence of political and economic practices of the Ancien Régime (such as political corruption and tax avoidance), which led to Spain's divergence from other European countries. The continuance of an unequal, non-inclusive society, among other factors, contributed to the weaknesses of the domestic demand and hindered the possibilities of expansion of the industrial sector. As a result, there was a deceleration in growth from 1860, and although per capita industrial production multiplied by 2.2 between 1850 and 1890, it remained a long way off the per capital level of the most industrialized countries (Carreras and Tafunell 2003).

The second turning point was the Fin de Siècle crisis. This was a domestic turning point because Spain's loss of most of its remaining colonies (Cuba, Puerto Rico, the Philippines and Guam) after an international war against the USA. While other countries were increasing their colonial power and imperialism in the late nineteenth century, Spain lost its colonies (with the exception of part of Morocco and Equatorial Guinea). This event sparked currency and debt crises, although the economic impact was not particularly severe. Another consequence was the loss of the American markets: these countries abandoned their trade agreement with Spain and established protectionist tariffs. Spain's exports to its colonial markets represented 24% of total foreign trade in the years prior to 1898, but fell to 6% before World War I. In addition, there was a repatriation of capital and citizens to Spain. As a result of the loss, Spain had to recognize that it was no longer an imperial power, which led to a profound crisis in society. At the same time, it created an awareness of the need for reforms to increase fiscal resources for infrastructure and education, to promote industrialization and to adapt the country to globalization.

European countries and the USA were growing faster due to industrialization and increased geopolitical power (both military and political, extending their empires). However, Spain had not managed to industrialize and its geopolitical power decreased after its defeat in the war against the USA. In terms of globalization, more intense competition in the 1880s with an agrarian crisis due to cheap New World and Russian grain, which affected the non-competitive wheat production, increased protection in 1891. This protection continued with the 1906 trade tariff. Spain managed to recover some international markets in other Latin American countries (Argentina and Mexico), the USA and Europe. Migration flows also started at that time, producing a positive effect in the country, along with the repatriation of capital, which was invested in banking and electricity, among other sectors. A series of reforms took place which, although timid and slow, put the country on the path towards industrialization at the beginning of the twentieth century.

The fact that the high cost of the war did not lead to a collapse of the economy nor to the financial bankruptcy of the State was thanks to the stabilization programme adopted in the years 1899–1900. The main measures implemented were debt restructuring and a fiscal reform accompanied by cuts in ordinary expenditures, while in the area of monetary policy, the stabilization programme sought to deflate prices and stop the depreciation of the currency. Although the scope of some reforms was limited (e.g., not all the proposed measures of the tax reforms were approved), the stabilization programme was a success: the debt conversion was widely acclaimed, the budget deficit eliminated, prices were stabilized and there was a quick appreciation of the peseta.

In addition to the stabilization measures, other initiatives were implemented to regenerate and modernize the country in economic, social and administrative fields. However, in many aspects, the reforms did not go far enough. Just as occurred after 1808, the end of the nineteenth century and the beginning of the new century were accompanied by high levels of political instability and continuous changes of government that hindered the dismantling of the previous regime and conditioned the effectiveness of the reforms. The limits imposed on the fiscal reform impeded the development of the State, which remained financially weak, with insufficient resources to carry out its modernizing programmes. One of the clearest examples of this deficiency was in education. Despite new initiatives such as the creation of the Ministry of Public Instruction in 1900 and some improvements in the design of secondary and university education, the lack of resources led to very poor results in this area.

Despite this, the Spanish economy grew faster after the 1898 "disaster". In fact, in the early years of the new century, GDP per capita rose, the population grew, the rate of urbanization increased, new modern sectors developed, foreign capital complemented domestic savings and was invested in new industrial and banking companies, some firms grew bigger (through mergers), the financial sector expanded and the electrification of the country accelerated, all of which are clear examples of the dynamism of this period. However, relative to other European countries, the results gave less cause for optimism and there was a period of divergence and higher inequality. Economic growth took place in a protectionist context, especially after the 1906 tariff. This protectionism was not a reaction to the events of 1898 as it had already increased in the 1890s, especially with the 1891 tariff. Although wheat had the highest tariffs, protectionism also affected other industrial sectors (coal, steel and iron), with the cotton industry having the highest level of protection. Globalization and international competition at the end of the nineteenth century forced many countries to adapt to the changing conditions, and greater protectionism was the response of many European countries; however, resorting to protectionism to fight against globalization was more typical of the poorer European nations than of rich ones. The main problem was the level of protectionism: in 1902, the countries with the highest manufacturing tariffs were Russia (144%), Spain (77%) and Portugal (75%), with Spain clearly lying above the European periphery average (51%) and far exceeding the average of the European core (20%) (Tena 2010). In addition, protectionism was not the only possible response to globalization. In other less protected countries, some policies were adopted to compensate workers for the adverse consequences of competition, such as regulations in labour conditions and social insurance programmes (Huberman and Lewchuk 2003). However, Spain was in the group of countries with the highest levels of protectionism and the lowest levels of worker protection, and despite the attempts to introduce some reforms, there were no clear structural reforms such as investing in education, or improving land distribution or infrastructure. The end result was the maintenance of a narrow domestic market with an increase in inequality (the Gini index increased from 0.36 in 1898 to 0.49 in 1913).

The next turning point was 1936. We consider this year because it marked the start of the Civil War, which lasted three years. This was a domestic turning point that became an international one and a prelude to World War II. The consequences for the Spanish economy were disastrous, generating a long-lasting impact on economic growth, a setback in the reforms undertaken, subsequent autarky and interventionist policies, and a 40-year-long dictatorship.

The interwar period was a difficult one because the consequences of World War I affected all countries in different ways (current accounts and budget deficits) and the policies applied against globalization (capital and trade controls and tariffs). However, the Great Depression was the pivotal economic event of this time. Industrial countries, especially the USA, and Germany and France in Europe, were severely affected and suffered long-term impacts. Orthodox economic policies were called into question and conflict intensified between different ideological solutions from authoritarian regimes and weakened democracies. But agrarian countries like Spain also suffered a serious depression, even more severe than in the UK, brought about by the impact of trade on agriculture and raw material goods (especially iron). In Spain, the Great Depression had a lower impact on the monetary and financial system, both because the country was not internationally indebted and because it had abundant international reserves as a consequence of its neutrality in World War I. However, the terms of trade (falling agricultural prices) and trade shocks due to the decline in income and protectionist policies applied by other countries led to a marked drop in Spanish exports and emigration stopped. Other countries such as France and the UK could divert trade to their colonies, but Spain had lost all its colonies and was not a member of a trade bloc. One of the most important sectors affected was exports of dynamic agricultural products (oranges, olive oil, dried fruits and horticultural products), which had high-income elasticity and were consumed in high-income countries. Exports helped to pay for equipment goods and raw materials from abroad, contributing to the process of industrialization. The decline in exports thus drove up unemployment, especially in the countryside.

Moreover, there was a domestic change as the political system underwent a crisis. The restauration of the Monarchical regime in 1874 maintained the traditional elites, although there was a process of regeneration of policies and institutions in 1898; however, the King allowed a dictatorship from 1923 to reduce social unrest after World War I. The Second Republic was peacefully constituted in April 1931 to restore democracy. It had an ambitious project to modernize institutions (advanced democracy and civil rights) and the economy (meeting new economic demands after substantial development towards industrialization during the 1920s), and attempted to carry out the pending reforms (education, land, labour, taxes), some of which had been started after 1898. However, there was a capital flight as a consequence of the regime change, along with the uncertainty generated by the proclamation of the Second Republic and the crisis that intensified the downward investment trend. This modernization project was attempted in the midst of a depression and in a pre-World War II context, which made it harder, and eventually impossible, to achieve due to dwindling domestic and international support for the initiative. The reforms were too ambitious and came into conflict with a part of the still small emerging middle class, especially those related with the secularism of society and land and labour reforms.

The republican government introduced reforms in different fields. In monetary and fiscal areas, the government tried to gain an international reputation and to stabilize the economy by intervening to maintain the *peseta* and control the public deficit. Trade policy was aimed at relaxing the protectionist system, but the international context made this more difficult due to the Great Depression and the protectionist reaction adopted by many countries. The most important reforms attempted to solve the great problem of income distribution and inequality in the Spanish economy: the land reform, the labour laws and the educational reforms. The land reform (which consisted of land expropriation through compensation) mainly affected central and southern regions. However, there were huge difficulties in implementing this reform and it was a continuous source of conflict. The labour laws introduced improvements in labour conditions and wages (minimum wage, working week limitation, increased bargaining power and the right to unionize, with the extension of these conditions to agrarian workers) and definitely contributed to a reduction in inequality. The efforts made in education were enormous, increasing the educational budget, creating more schools, providing more and better trained teachers with better labour conditions and trying to encourage a progressive secularization of education. However, the lack of resources and eventually the war prevented the achievement of all the proposed goals.

Despite the positive yet modest results obtained from 1931 to 1933, political confrontation and social unrest were constant occurrences from 1934 on. The high expectations of the new republican government and the ambitious programme of reforms were met with an adverse international context. Moreover, some reforms worsened business expectations due to the political instability and their negative impact on profits. All these changes provoked a reaction from the conservative and traditional groups that were opposed to the reforms, but also from the working class and the multiple left-wing parties and unions who felt the reforms were too slow, generating continuous internal clashes. Conflicts escalated from 1934, and in July 1936 there was a military coup and the start of a civil war. The hopes of moving the country towards a democratic, more egalitarian system were dashed. The international context had not helped but domestic restrictions played a role. While there had been strong opposition to the reforms from the conservative groups (not only to the economic reforms but also to the government's political and religious ideas), the government had also suffered from a lack of internal cohesion and had lost the social consensus about the reforms as well as about their timing and scope in turbulent times.

Although the coup d'état met with resistance, the support for the military coup from the elites as well as the authoritarian governments in Germany and Italy, along with the lack of international aid provided to the republican government, meant that Franco's troops could not be contained and facilitated his victory. The political, economic and social consequences of the war were tremendous. Spain once again suffered under a dictatorship and a repressive political system. The macroeconomic contraction due to the war and the autarkic, interventionist model adopted by the regime caused the Spanish economy to diverge from that of most developed countries. Real wages dropped, unions were banned, industry lost out to agriculture, there was a fall in consumption and a decrease in productivity as a result of more labour-intensive techniques, lack of technological change and a backwardness in human capital. The main social result was a reversal in the trends towards greater equality that were characteristics of the final years of the first third of the twentieth century.

The fourth turning point considered was 1959. There was a long-lasting impact on economic growth due to the autarky and interventionist policies adopted by Franco's regime: it took Spain 18 years after the start of the Civil War to recover its pre-war level of GDP per capita (achieving it in 1954). While the Bretton Woods system entailed capital controls and fixed exchange rates based on the gold-dollar standard, most of the countries had overvalued exchange rates due to inflation and public deficits after World War II and growing public investment, which reduced their export competitivity and thus increased their trade deficit (Findlay and O'Rourke 2007). This also happened in Spain; in addition, the import substitution policies implemented and the inward-orientation of the industries, while needing to import equipment goods and raw materials, gave rise to higher current account imbalances and scarcity.

Spain did not receive aid from Marshall Plan in 1948 after World War II; however, when the international situation changed due to the Cold War, the dictatorship regime took advantage of it to obtain financial funds from the USA in exchange for military bases, particularly from 1953 on.

Most countries established convertible currencies around 1958, which helped to increase international trade and investments. Economic growth was accompanied by macroeconomic imbalances—mainly inflation and external imbalances—and this led to the implementation of stabilization programmes promoted by the International Monetary Fund (IMF) in different regions of the world. Spain also became a member of the IMF and the World Bank in 1958, and the Organization for European Economic Cooperation (OEEC) in 1959. In 1957, it made an attempt to unify the exchange rate with a sharp devaluation, and definitively achieved unification with the 1959 *Plan de Estabilización* (Stabilization Plan) supported by the IMF. The stabilization measures taken allowed the changes to the autarkic economy needed for full integration into the international economy, which facilitated the "economic miracle" of the 1960s. The Plan dealt with the macroeconomic imbalances, current and budget deficits and inflation control; however, it maintained the same fiscal system based on indirect taxes, which prevented the public sector from expanding and increasing spending on education, social transfers (pensions, health insurance, child and family allowances and other social safety nets) and infrastructure. This delayed the emergence of the welfare state in relation to other countries. Additionally, the level of intervention in the banking and financial system, the labour market and industrial sectors continued to be higher than in other countries.

The most important changes associated with the Plan were liberalization and the dismantling or relaxation of controls in the foreign sector. The change towards a more open economy allowed the introduction of new technologies, the entry of foreign investment and the acquisition of patents and registered trademarks, and all these factors facilitated an increase in productivity and a rapid catching up process. Moreover, the greater openness allowed Spain to take advantage of a favourable international context. That meant not only higher exports but also more tourists and higher migrant remittances. The result of a more open economy was a change in the allocation of resources towards the industrial sector, which was also reflected in the composition of exports. It also favoured the entry of foreign direct investments in some crucial sectors such as the automobile, chemical or electric material sectors, among others. In the end, the Plan improved business confidence and created a more suitable climate for investment and growth. Indeed, the rates of growth during the 1960s were clearly above those of other European countries.

However, the ideology of the regime imposed strong constraints on the reforms. In fact, some of the liberalization measures were reversed in the 1960s. Moreover, other reforms that should have been considered necessary to promote long-term growth and reduce imbalances were not adopted (such as the fiscal reform that would have been key to ensuring a more equitable and inclusive society, and also increasing revenues and investment in education or infrastructure). The result was that Spain managed to grow, but while maintaining an inefficient allocation of resources that hindered competition in the international market. It also proved an obstacle to the emergence of a new entrepreneurial class less dependent on the regime. As a consequence, at the end of the 1960s macroeconomic imbalances reappeared and imposed serious restrictions on the economy as well as on social conditions. Whereas other European countries took advantage of their growth during the golden age to modernize their tax systems and develop the welfare state, Spain began the 1970s with many rigidities and inefficiencies still in place, which weighed heavily on it when the new crisis struck.

The 1977 turning point was a consequence of the international crisis that coincided with the restoration of democracy in Spain. The crisis was due to the supply shock caused by oil producing countries (OPEC) raising oil prices in 1973. There was a drop in the previously high growth rates as well as inflation and unemployment. The Bretton Woods system based on the gold-dollar standard collapsed in 1971 and exchange rates were floated, which disincentivized control of the money supply, producing more inflation. Interest rates skyrocketed first in the USA to reduce inflation and later in other countries. In order to pay for social spending, governments printed money or borrowed, which led to worsening inflation. The new economic context meant that these spiralling macroeconomic problems had to be resolved. Moreover, newly industrialized countries (NIC) produced cheaper goods, which increased global competition, and it became necessary to alleviate trade and current account deficits by promoting increasing exports.

In Spain, the oil prices increased later than in other countries because the dictatorship and the death of the dictator in November 1975 delayed the adjustments. In this sense, political instability affected the response to the crisis. Some of the necessary measures would have been unpopular and the government was not strong enough to withstand the social unrest they would cause. For example, the Spanish response to the crisis was atypical in the European context and contrary to what happened in other Western countries: energy consumption or energy intensity increased substantially from 1973 to 1980, whereas other countries introduced changes to save energy (Sudrià 1987). As a result, the main imbalances were exacerbated (external imbalances, inflation and extraordinarily high unemployment rates). But the political transition to democracy also shaped the way the reforms were implemented. The transition meant that this time was different from 1931: there was a strong social and political consensus (unions and politicians) on assuming the cost of economic restructuring (for employers and workers) in exchange for social and civil rights and the extension of the welfare state, which had been started at the end of the 1960s but did not reach the European standard until the 1990s. In other circumstances, these changes would not have been possible. The budget and current account deficits were greater due to the lack of a modern tax system and the greater import dependence on equipment goods, raw materials and oil. The adjustment was made even harder by the fact that Spain was a country that had only recently begun industrializing (in the 1960s); moreover, its industrial sector was huge, especially the industries that competed with the NICs, and energy intensive. As a result, inflation (which peaked at 25%), external imbalances and unemployment rates (of over 15%) were higher in Spain than in other countries, while its economic growth was lower.

On this occasion, hopes of reform were fulfilled with the Moncloa Pacts (*Pactos de la Moncloa*), which consisted of a stabilization plan and other important changes in monetary (to control inflation and provide new policy instruments), fiscal (the establishment of an income tax) and labour (wage adjustments, collective bargaining) policies. The Moncloa Pacts also included a modernization and liberalization of the economy that provided the basis for putting the Spanish economy and society on the path towards international standardization and integration into Europe, which eventually took place in 1986. The reforms attempted to dismantle the Francoist institutional and political framework, to stabilize the economy and to lay the foundations for the future integration of Spain in Europe.

In international comparative terms, a serious handicap for the Spanish economy was the lack of economic policy instruments and inexperience in their use. The tax system was typical of an underdeveloped country (very low tax rates, lack of data about the tax bases and tax fraud) and the lack of revenues limited the possibility of implementing other reforms. With respect to monetary policy, it was subordinated to the objectives of the government and its financing needs made it difficult to instrument. Moreover, the design and implementation of reforms happened at a time when other countries were undergoing a shift in the prevailing macroeconomic paradigm. All over the world, inflation and unemployment were rising simultaneously and the traditional Keynesian recipes seemed not to be effective. Therefore, whereas other countries were moving towards less State interventionism and less fiscal pressure, Spain transformed its fiscal system and established the welfare state. This happened in adverse conditions and turbulent times: in a context of crisis, slow growth, growing unemployment and greater international competition.

Not all reforms were tackled and some that were implemented were not successful. The tax reform in 1978 represented a clear break with respect to the previous situation and it enabled a substantial increase in revenues and a rise in fiscal pressure. However, fraud remained at high levels and there was not a complete, progressive reform (because fiscal pressure mainly affected families and businesses to a lesser extent). Regarding monetary policy, some steps were made in the right direction but the path towards a modern monetary policy was hard and long, and it was not completed until the 1990s. In this sense, not all the goals were achieved and some reforms such as the industrial restructuring or the labour reform took more time to be adopted. However, considering the extraordinary political, social and economic challenges raised by the political transition and the crisis, this time the glass could be considered half full. The year 1977 was the beginning of a lengthy period of profound institutional changes. The reforms allowed the country to implement a democratic system, to introduce a modern tax system, and to lay the foundations of the welfare state, which permitted a boost in social spending (mainly on health and education) and a significant increase in social fluidity over time, especially for women. It also introduced modern economic policy instruments to meet the requirements for integration into Europe in 1986.

The most recent turning point was 2008. The Great Recession, which was most similar to the one in 1929, occurred after more than a decade of Spain's greater integration in international markets, especially trade and financial markets, and new technologies (information and communication) that produced economic growth and macroeconomic stability. There was a huge expansion of the financial sector fostered by financial liberalization, which caused low interest rates. Financial integration drove up international borrowing, while financial innovation that tried to reduce risk conversely ended up increasing it. This was the case of the securitization of the subprime mortgages, which were given to low-income people to buy houses, despite them being highly risky borrowers. At the same time, a housing bubble was formed. When the housing bubble burst, the financial and banking sector collapsed and most developed countries were thrown into crisis due to the credit crunch that affected trade and investment.

Spain registered particularly high economic growth during the previous period (with an annual rate of growth from 1996 to 2007 of 2.9%, even above the UK (2.2), the USA (1.9), France (1.7) and Germany (1.3)). This was due to its initially low income level and the positive effects of the complete integration into the European Union (the customs union in 1986, greater labour and capital integration with the Maastricht Treaty in 1992, and the euro system in 1999), as well as international markets. The main positive effects of Spain's integration into the European market were twofold. Firstly, the common currency and removal of barriers to capital movements in a context of capital globalization gave Spain the opportunity to access more foreign savings to finance its investments. Moreover, as one of the poorer countries in the EU, Spain received large sums of money through the Cohesion Policy (the Structural Funds and the Cohesion Fund). For a country marked by the relative scarcity of capital, these funds allowed the renewal of capital goods, the incorporation of new technologies and the financing of infrastructure investment. Secondly, Spain had to adapt to the European directives in different fields. There was a rapid process of trade liberalization, whereas in other fields the implementation of reforms to increase competition was slower. The most important result was in terms of macroeconomic stability. Spain made a significant effort to achieve more stable inflation rates, to adopt an effective monetary policy and in terms of fiscal consolidation. In fact, in the mid-1990s Spain was one of the candidates for EMU membership that was furthest from meeting the requirements set out in the Maastricht Treaty, and deficit control was essential for joining the euro.

Although Spain enjoyed a prolonged phase of growth with job creation (from 1994 to 2007 there was an increase in employment from 13.3 to 20.6 million workers), and macroeconomic stability, this growth was based on weak foundations and there were many imbalances. One of the main problems was the maintenance of an extensive growth model, based on the increase in employment, mainly unskilled workers, with low increases in productivity and concentrated in low-productivity and non-tradeable sectors, such as construction and services. These competitivity problems were behind the high current account deficits (around −2.64% of GDP from 1986 to 2007 and nearly -5% in the period 1999–2007) as a consequence of increasing import demands, the highest current account deficits in its history. The banking and financial sector was liberalized and internationalized; although it escaped the problems stemming from subprime mortgage securitization, it was not free from the increasing foreign indebtedness that financed the formation of a housing bubble. The government had not previously been indebted, and had even increased fiscal revenues as a result of the housing boom; but as a consequence of the crisis, due to lost fiscal revenues and the growth in social spending, its budget deficit and debt increased. A similar situation was also seen in other countries (Greece, Ireland, Portugal and Cyprus) and for the first time in its history, the viability of the euro was in doubt. This meant a higher risk-premium to secure financing in the international markets, and increased the fiscal debt cost, producing a debt crisis.

The adjustment was harder for the Spanish economy given that a key monetary policy instrument, devaluation, could not be used this time. Instead, it was necessary to implement an internal devaluation or wage adjustment along with spending cuts (in particular in education, health and social assistance), the so-called austerity policies. These policies exacerbated inequality, especially for young people, and generated greater polarization and conflict in society. Finally, Spain was one of the countries with the highest unemployment rates in Europe and with the strongest economic decline until 2014, making this crisis worse than the 1929 one.

The initial measures to fight against the crisis were expansionary, in line with other countries; still mindful of the economic troubles of the 1930s, policymakers were under strong international pressure to carry out these counter-cyclical measures. The main result was a fiscal deficit deterioration (due to the recession, the banking sector intervention and social expenses), dropping from a surplus of around 2% of GDP in 2007 to a maximum deficit of −11.1% in 2009. That led to a debt crisis in 2010, and the public debt-to-GDP ratio increased from 29.2 % in 2007 to 51.7% in 2010 and 99.48% in 2014.

Moreover, to tackle the banking crisis, the Fund for Ordered Banking Restructuration was created in 2009, with the first banks in trouble being rescued this same year. In 2011 and 2012, when the situation deteriorated, new support measures were implemented. The Spanish government also introduced measures to correct the public deficits (public sector salaries were cut, pensions were temporarily frozen, subsidies and tax deductions were revoked, and there were cutbacks in public investment and tax increases, among others), which went even further after 2011 under the new conservative government. There were also two labour reforms (2010 and 2012) to make the market more flexible and to limit salaries, as well as a pension reform in 2011 that delayed the retirement age.

All these measures (helped by the European Central Bank (ECB) quantitative easing to address liquidity problems in European banks) managed to stabilize the banking sector, to restore confidence and to reduce lending constraints. Moreover, families and companies deleveraged. Labour reform fostered job creation and wage devaluation. Exports recovered (they went from representing 26% of GDP in 2007 to 35% in 2018) and current account deficits became more moderate (going from a deficit of −9.5 in 2008 to −1.5 in 2013). However, these reforms also had negative consequences. Being in the euro zone meant that Spain had lost the use of an exchange rate policy and lacked economic policy instruments (mainly monetary) to tackle the crisis, having to rely instead on wage adjustment. Moreover, workers received lower wages and faced more job instability in a context of less social protection. This had an extraordinary impact in a relatively recently developed welfare state; in order to make cuts, the government was forced not only to abandon some social measures (such as the law passed to support the care of dependent people) but also to reduce expenditure on basic social needs such as health or education.

The high cost of the Spanish bank rescue in a context of social cuts and with continuous scandals about corruption and malpractice in the banking sector had a high political cost, producing a great deal of social unrest and a lack of trust in key institutions. Moreover, it contributed to growing tensions among different Spanish regions, mainly in Catalonia, with the emergence of a strong independence movement. It also resulted in the emergence of new political parties and a situation of enormous instability.

The economic situation started to improve in 2013, and Spain managed to correct some imbalances. External factors contributed to this improvement (oil prices began to fall from 2014 on, there was a recovery in tourism, the ECB's expansionary monetary policy, etc.). However, there are pending problems and a need for further reforms. The crisis has shown the importance of having a more balanced growth model. Moreover, economic agents need to be conscious of the high imbalances that can build up during expansionary periods (the high levels of private sector debt, the excessive reliance on external financing or the excessive weight of the construction and real estate sector) and that countries need to introduce new targets such as sustainability into their policy agenda. Furthermore, productivity remains a pending issue in the Spanish economy, and structural reforms are needed to foster competitiveness. It is also necessary to guarantee fiscal sustainability, and to develop early warning instruments to detect macro-financial risks and excessive imbalances. However, although being in the euro system has helped the Spanish economy to recover, it has also had adverse effects by depriving Spain of certain policy instruments, in particular the exchange rate. The 2008 global crisis brought to light the imperfections in the design of the euro zone, the need to coordinate regulation and to establish common institutions (a banking union to solve financial and banking problems, a fiscal union to provide instruments to face crises, etc.). What is more, the 2008 crisis has shown that in a more globalized, interconnected economy, individual responses may not be enough to fight the crisis, calling instead for international policy cooperation.

As we have seen, some of the Spanish turning points were also international turning points (1808, 1977 or 2008) and most of them were the result of wars or crises (1808, 1898, 1936, 1977 and 2008). However, the results of the policies enacted in these six turning points in some cases fostered the development and modernization of the economy, whereas in other cases the changes produced an economic setback. The reforms adopted after 1808, 1898, 1959 and 1977 led to Spain's economic modernization, but within limits, as not all the needed reforms were implemented, and those that were introduced lacked the scope to really transform the economy. Political instability and the reluctance of the elites to introduce modern and more inclusive institutions explain the limits of the reforms.

However, economic growth and modernization do not guarantee convergence. The main difference between the nineteenth-century (1808, 1898) and some twentieth-century (1959, 1977) turning points is that in the mid-nineteenth century and the early twentieth century, Spain was not able to catch up with the developed countries, whereas the 1950s and 1960s were clearly a period of convergence; in the same way, the reforms implemented after the 1977 crisis allowed Spain to keep catching up until 2007. The two turning points that clearly produced a recession and contributed to Spain falling behind Western countries were 1936 and 2008. Although the two turning points are not directly comparable, both produced a severe contraction of the Spanish economy. After the Civil War, Spain did not reach its peak pre-war real GDP per capita level (1929) until 1954 and in the 2008 crisis, real GDP per capita surpassed its pre-crisis 2007 peak in 2016.

In addition to economic growth and convergence, the challenges linked to the turning points and the reforms had an impact on income distribution. Although the liberal reforms contributed to economic growth in the nineteenth century and had a positive impact in terms of development (as the Human Development Index shows), this improvement was accompanied by a rise in inequality, as measured by the Gini index, until World War I (see Table 8.1). In line with the Kuznets inverted-U hypothesis, economic growth in this period led to a rise in inequality. But the liberal reforms and those implemented after the 1898 disaster did not favour Spanish catching up, and as they did not reduce inequality, they cannot be considered inclusive reforms. However, the situation changed during the 1920s and 1930s, when, despite the lack of convergence, growth was accompanied by an improvement in the development indicators and a more equal distribution of income. Inequality narrowed as a consequence of economic growth, capital accumulation, structural change, rural-urban migration, urbanization and some institutional reforms such as the reduction in the number of working hours, among other factors, which contributed to a rise in wages relative to property incomes (Prados de la Escosura and Sánchez-Alonso 2019). This improvement in inequality continued into the 1930s thanks to the social reforms implemented by the republican government. Unfortunately, this trend was reversed by the Civil War and the resulting low growth rates, increase in the share of agriculture in GDP (or re-ruralization) and low wages in a context of top-income improvements. Thus, the phase of reduction in inequality associated with the Kuznets inverted-U hypothesis, which had started in the 1920s and 1930s, was interrupted by the war. The subsequent increase in inequality reached a peak in 1953 and there was no substantial decrease in inequality until the second half of the 1950s. The liberalization reforms implemented in the late 1950s and the growth rates during the 1960s contributed to an improvement in income distribution.

From the 1950s on, Spain finally managed to begin a process of convergence and was also able to reduce inequality (in the decline phase of the inverted-U curve). Despite the severity of the 1977 crisis, inequality did not increase and absolute poverty was eliminated (Prados de la Escosura 2008). The social reforms and the construction of the welfare

Table 8.1 Growth and development in Spain, 1800–2015

	Spanish relative real GDP per capita (%)	Gini index	Years of schooling	Education Index	Human Development Index	State capacity
1800	56.58					
1850	65.77	0.37				26.75
1860	64.34	0.28				23.86
1870	55.77	0.32	1.51	0.075	0.073	46.62
1880	68.52	0.33	2.04	0.089	0.082	33.24
1890	59.59	0.35	2.63	0.102	0.105	30.98
1900	55.23	0.38	3.12	0.105	0.116	34.38
1910	52.55	0.40	3.47			35.49
1920	59.68	0.50	3.69			30.90
1930	57.90	0.47	3.77	0.196	0.250	30.86
1940	40.71	0.38	4.57	0.215	0.318	29.04
1950	40.55	0.47	4.90	0.223	0.377	36.17
1960	41.76	0.35	5.50	0.293	0.438	32.62
1970	55.57	0.34	6.41	0.335	0.536	24.97
1980	64.02	0.34	7.3	0.416	0.620	41.91
1990	71.90	0.31	8.4	0.515	0.713	49.73
2000	77.24	0.32	9.5	0.635	0.812	43.94
2010	79.12	0.34	10.26	0.908	0.824	
2015	75.34	0.35		0.929	0.862	

Notes: Spanish relative real GDP per capita is Spanish real GDP per capita (in 2011 US$) as a percentage of the average real GDP per capita of France, Germany, Italy, the UK and the USA; the Education Index and the Human Development Index (HDI) are from 1933 and 1938 instead of 1930 and 1940; State capacity: Income tax as a percentage of Total Tax revenue

Source: GDP as a percentage of the average in 1800, Bolt et al. (2018), and the rest of the years from Prados de la Escosura (2017); Gini index, Prados de la Escosura (2008); Years of schooling, Van Leeuwen, Van Leeuwen-Li, and Foldvar (2013); Education Index and HDI, Prados de la Escosura (2015), updated in http://espacioinvestiga.com/inicio-hihd/; and State capacity, own calculation from data provided by Comín and Díaz (2005)

state were inclusive reforms that helped ensure the crisis did not have more severe results in terms of inequality. By contrast, inequality clearly rose in 2008. The reforms were able to restore macroeconomic stability but with a major social cost in terms of inequality and poverty.

To sum up, this lengthy period has seen Spain evolve into a developed economy, with phases of progress and catching up. The last turning point, the 2008 crisis, showed that Spain still has some important weaknesses that have their roots in the past. This book has studied how Spanish economic problems have been similar to international ones but have also been conditioned by domestic restrictions. It has also examined the responses to the challenges that the country adopted at key moments.

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[1] Note: Page numbers followed by 'n' refer to notes.

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