12 Growth and macroeconomic performance in Spain, 1939-93

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1 Introduction

Spain's growth over the last four decades constitutes a distinctive case in postwar Western Europe. This was largely due to the acceleration of the 1960s and early 1970s, which could be partially attributed to delayed reconstruction. Before 1960, autarky was the rule and Spain's performance appears disappointing from a catching-up perspective, since its rate of growth fell short of the potential one implied by the country's backwardness. Two phases can be distinguished after Franco's death: one of economic retardation and political instability during the years of transition to democracy (1975 85), which coincided with the oil shocks; and another of return to fast growth after Spain became a member of the EC (1986), which ended with the recession of the early 1990s.

In this chapter, Spain's economic growth since the Civil War (1936 9) is assessed. After presenting trends in aggregate performance within a comparative growth accounting framework, institutional and macroeconomic features in the main postwar phases are explored as ultimate historical explanations for Spanish performance.

2 Spain's economic performance in the long run

After negligible growth in real GDP per head during the early nineteenth century, a sustained gain in product per head took place up to World War I (Table 12.1). New annual estimates emphasize the acceleration of growth between 1850 and 1890, particularly during the free-trading years (1860s to 1880s), and the slowdown that followed the tariff of 1891 and the suspension of the peseta's gold convertibility (Prados de la Escosura, forthcoming). The financial costs of the independence wars of Spain's last colonies (Cuba, Puerto Rico and the Philippines) also contributed to slackening economic growth.

The early twentieth century witnessed an acceleration in the rate of growth. A phase of remarkable acceleration in per-capita growth and structural change took place from 1913 to 1929, followed by the 1930s depression, in which real product per

Table 12.1. *Comparative performance of Spain's real GDP per head. 1850 1993 (log-linear adjusted growth rates)*

	Spain	Italy	France	Germany	UK	USA
1850-90	1.3	0.4[a]	1.3	1.4	'	1.6
1890-1913	0.8	1.5	1.4	1.7	0.9	. 1
1913-29	2.0	0.9	2.7	1.8	-0.5	2.0
1920-38	1.5"	1.5	1.3	2.6	1.5	-0.2
1950-60	3.5	4.7	3.5	6.7	2.2	1.0
1960-73	6.3	4.3	4.2	3.4	2.4	2.6
1973-93	2.0	2.3	1.7	1.9	•:	1.6
1850-1913	0.9	0.7[C]	1.3	1.5	1	1.7
1913- 50	0.3	0.6	0.6	1.5	l.i	1.8
1950-93	4.1	3.5	3.0	3.1	2.1	1.8
1913-60	0.7	1.2	1.4	2.1	1.2	1.9
1960-93	3.6	3.0	2.6	2.4	1.9	1"
1913-93	2.5	2.6	2.5	2.8	1.7	1.9
1850-1993	1.5	1.9"	1.7	1.9	1.2	1.7

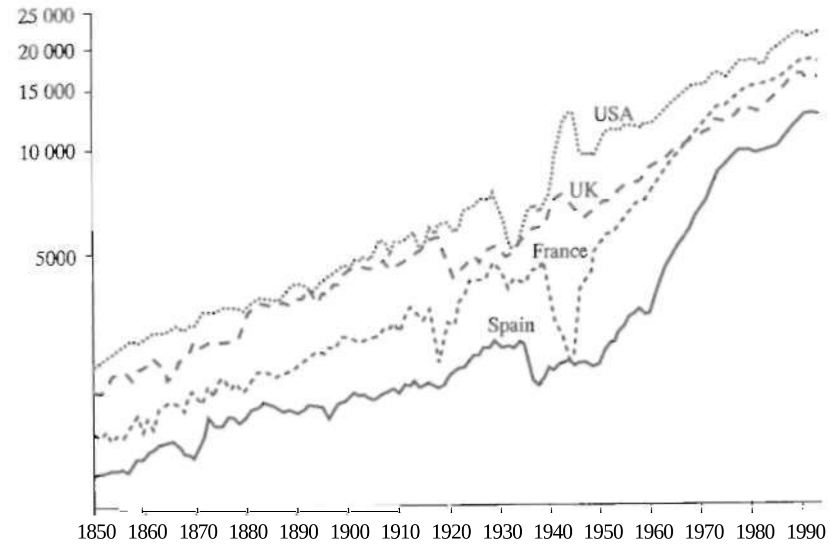
Source: Prados de la Escosura (1995).
[a] 1861-90. [b] 1920-35. [c] 1861-1913. [d]1861- 1993.

head fell at —0.4 per cent annually between 1929 and 1935.[1] Finally, the new evidence points to a fall in the level of economic activity per person, as a result of the Civil War (1936 9), at a compound annual rate of —3.4 per cent between 1935 and 1940.

The reconstruction period was longer in Spain than in Western Europe and lasted until the 1960s, resulting in the level of income per head for 1929 (the highest for the pre-Civil War ear) only being reached again in 1954.[2] Autarky presided after the end of the Civil War for a period of twenty years. After the economy practically stagnated in per-capita terms during the 1940s (0.2 per cent), the 1950s witnessed a substantial growth per head as isolation was gradually relaxed.[3] However, a remarkable acceleration took place after the major policy reform of 1959, and this lasted until 1975.[4] The post-Franco years were of falteringgrowth, with a yearly rate of 0.9 per cent per head between 1975 and 1985. Then, following the admission of Spain into the EEC, a return to the trend of the Golden Age took place up to 1990 (with per-capita income growing at 4 per cent), only to slacken again at the beginning of the 1990s.

In short, in early twentieth-century Spain, sustained growth took place up to the Great Depression, when it was abruptly interrupted by the Civil War, from which recovery was slow under Franco's economic autarky. Fast growth in the Golden Age, resulting to a large extent from the post-bellum reconstruction, ended abruptly after Franco's death (1975), which coincided with the first international oil crisis. With Spain's admission into the EEC (1986), an intense, short-lived recovery took place, before a return to slackening growth in the early 1990s.

When Spain's economic performance is placed within the international context,



Source: Prados de la Escosura (1995).

Figure 12.1 Spain's real GDP per head: comparative performance, 1850 1993 (1990 Geary-Khamis dollars)

several distinctive features emerge (Table 12.1). The remarkable increase in Spain's real per-capita income, over tenfold since the mid-nineteenth century, represents only a moderate pace of growth when it is compared to continental Europe's industrial nations. Spain's economic growth departed from a lower stand-point in terms of output per person, having stagnated over much of the early decades of the nineteenth century. By contrast, Western European nations industrialized, leading to a deterioration in Spain's international position. Thus, it intuitively appears that the (unconditional) convergence hypothesis, according to which growth rates correlate inversely to departing levels, does not seem to apply to Spain's historical experience prior to 1960.

In the search for differentials in Spanish economic performance, several significant periods emerge. From the mid-nineteenth century up to the Spanish Civil War (1936), only the moderately free-trading decades of the 1860s to the 1880s and the 1920s represent a mild attempt to catch up with Western European industrial nations. In the late twentieth century, the period 1960-75 is a major step in closing up the gap. Conversely, three periods appear to be responsible for the widening gap between Spain and the advanced Western European nations: 1890-1913,1939-59 and 1975-85. The turn of the century seems to have been a lost opportunity for closing the gap, as comparison with other late comers such as Giolittian Italy. Sweden and Russia suggests (Prados de la Escosura, fort hiroming). Economists and historians usually stress Spain's poor economic performance under autarky (1939 59), in particular during the 1940s. It appears, however, that the 1950s, a decade of generalized growth in Western Europe, could be associated in Spain with incomplete catching up, as the comparison with Germany and Italy tends to suggest. In the 1950s, as forces making for growth and convergence were stronger. those countries like Spain that failed wholly to catch up seem to have paid a heavier penally than would have been the case in phases of slowing down. Countries such as Spain which remained closed and did not compete in international markets could not share the productivity growth benefits deriving from the leading nations (Baumol. 1986).

Nevertheless, when the Civil War is excluded, the largest loss in relative levels of income per head (but not in productivity.due to high unemployment) emerges from the years between Franco's death (1975) and Spain's admission to the European Community (1986). Systematic historical research on the period is lacking and only superficial explanatory hypotheses relating poor performance to the difficult transition to a democratic regime have been proposed. However, deeper institutional reasons seem to have been at work, such as an overregulated, heavily protected economy which was cut off from the international market (see sections 7 and 8 below).

Resource endowments in the postwar period provide some clues about Spain's growth. Physical and human capital accumulation was significant in the post-1950 era, while labour expanded only slowly. Employment grew at 0.8 per cent annually between 1955 and 1974,[5] to decline, over the following two decades, at -0.5 per cent, while the labour force expanded at 0.7 per cent. Educational attainment, as measured by the average years of schooling, grew at an average annual rate of 2.2 percent in the period 1950 -75, and at 1.7 per cent per year from 1975 to 1985(Barro and Lee, 1993). In turn, gross fixed capital stock grew faster than output from 1950 to 1973, and the differential growth rates widened thereafter (Hofman, 1993a).[6] In the period 1950-73, capital deepening (i.e. increase in capital stock relative to population) took place at an annual growth rate of 5.7 per cent for non-residential capital stock, and even more rapidly for machinery and equipment (8.6 per cent). Although such a process continued over 1973-89, it slowed down for non-residential capital (to 4.5 per cent) and, especially, for machinery and equipment (down to 3.7 per cent).[7] A rapid catching up in terms of non-residential capital endowment per head occurred up to 1973, decelerating thereafter (Hofman, 1993b; Maddison, 1993)." Given the role attributed to capital in machinery and equipment, as carriers ofncw technology (De Long and Summers, 1991), its slackening after 1973 could be associated with lower joint factor productivity growth.[9]

A look at the sources of growth can help us to assess the proximate determinants of postwar Spanish performance. For the period 1965-90, an estimate has been carried out by Suarez (1992), who relaxed usual assumptions about constant returns to scale, perfect competition and exogenous technical progress.[10] At the economy's aggregate level, however, Suarez found evidence of non-increasing returns to scale. Table 12.2 summarizes his results.[11] Total factor productivity dominates Spanish economic growth in the long run, complemented by capital's contribution. Only after Spain's admission into the EEC (1986) did labour make a significant contribution to growth, offsetting total factor productivity's sluggish growth after 1975. Labour destruction in Spain represented a significant brake to growth over the decade after Franco's death. Deep changes in the composition of output and employment, together with a dramatic increase in R & D activities, help to explain total factor productivity growth up to 1975 (and TFP deceleration thereafter, when

Table 12.2. *Sources of Spam's economic growth, 1965 90*

	1965-74	1975-85	1986 90	1965-90
1 Real GDP growth	6.48	1.37	4.41	3.89
2 Labour	0.72	-1.62	3.00	0.15
3 Contribution to GDP growth	0.42	-0.90	1.69	0.10
4 Capital	9.82	3.46	5.28	6.21
5 Contribution to GDP growth	2.25	0.66	1.40	1.41
6 Total factor productivity	3.81	1.61	1.32	2.38
7 (3) as % of GDP growth	6.5	-65.7	38.3	2.6
8 (5) as % of GDP growth	34.7	48.2	31.7	36.2
9 (6) as % of GDP growth	58.8	117.5	30.0	61.2

Source: Suarez (1992).

Table 12.3. *Relative growth of Spain s real GDP per head, 1950 85 (Spain's deviations from OECD growth)*

	1950 60	1960-73	1973-85
Actual growth deviation	0.3°	2.15	**-0.31**
Less Cyclical bias	-0.15	0.45	0.22
Catch-up	1.13	0.90	0.42
= *Adjusted growth deviation*	-0.09	0.80	-0.95
Less Employment deepening	0.21	-0.11	-1.27
Capital deepening	-0.25	-0.27	-0.24
= *Unexplained growth deviation*	-0.06	1.18	**0.56**

Source: Dowrick and Nguyen (1989).

structural transformation slowed down until 1985).

Empirical research within the on-going debate on convergence and catching up has provided evidence on the case of Spain. Thus. Spain's economic performance can be analysed using a convergence equation. Dowrick and Nguyen (1989) have tested whether post-1950 convergence within OECD countries is explained by total factor productivity catching up, or just by the growth of factor intensities, with their results supporting the former. Their individual country data set includes evidence for Spain which is presented in Table 12.3. Each country's deviations from OECD trend growth, after being adjusted for catching up, are decomposed into capital and employment deepening (i.e. relative to population growth) and unexplained growth. Dowrick and Nguyen's unexplained residual accounts for more than half of Spain's differential growth in the 1960s and early 1970s, and exhibits the opposite sign (doubling the size of the actual growth deviation) for the period 1973-85.

Such an outcome could provide enough grounds to dismiss the exercise on the basis of its low explanatory power. However, the story that emerges from it, when the unexplained growth deviation is associated with joint factor productivity, seems to be a plausible one, as it is consistent with the evidence already present in Table

Table J 2.4. *Differential growth of Spain's real GDP per head, 1965-90 (with respect to the OECD average)*

	1965-75	1975-85	1985 90
A Growth differential	1.19	-1.31	1.69
due to:			
B Initial income per head	0.28	0.23	0.30
C Real investment/GDP	-0.07	-0.16	**-0.10**
D Human capital	-0.12	-0.02	0.02
E Population growth	-0.12	-0.01	0.02
F *Solow factors* (B + C + D + E)	0.09	0.04	0.24
G Inflation	-0.15	-0.25	**0.07**
H Money growth	0.59	0.00	0.50
1 Variance inflation	0.08	0.26	0.37
J Exports growth	0.44	0.15	**-0.30**
K Lagged public deficit/GDP	0.00	-0.08	0.05
L *Macroeconomic performance* **(G + H + I + J + K)**	0.96	0.07	0.68
M *Unexplained residual*	0.15	-1.43	0.77

Note: Average GDP per head growth in the OECD, 1965-75, 3.35 per cent annually; 1975-85, 2.05 per cent; 1985 90, 2.45 per cent.
Source: Andres *et at.* (1994).

12.2, stressing the role of TFP in Spain's growth. Thus, according to Dowrick and Nguyen, catch-up accounts for the differential trend growth in the 1950s, and for half of it in the 1960s and early 1970s and, in turn, prevented a poorer performance from the 1973 oil shock onwards. When compared to OECD *adjusted* growth, Spain performed slightly below the average in the 1950s, with the increase in employment (relative to population) offsetting the low investment ratio per head. Since 1960, total factor productivity was the only positive contribution to *adjusted* growth as a result of poor capital and employment deepening.'[2] In fact, TFP growth (including a reallocation of resources away from agriculture) was not enough io maintain convergence towards the advanced nations after 1973, particularly as massive employment destruction took place from the late 1970s.

However, despite the usual association between the unexplained residual and total factor productivity, economists remain dissatisfied and try to take a closer look at the Solow residual. In a recent paper, Andres et *al.* (1994) have differentiated between Solow elements (derived from an augmented Solow model with human capital) and macroeconomic performance in OECD countries'growth since 1965.[13] Table 12.4 presents their results for Spain, showing positive deviations in OECD growth up to 1975 and from 1985 onwards, a negative deviation for the 'transition to democracy' decade, 1975-85, and in all periods a positive catch-up term and negative contributions of factor endowment growth. These results tend to support findings from a previous exercise (Table 12.3). As can be gathered from Table 12.4, macroeconomic performance, and the unexplained residual that can be associated with TFP growth, account for most of Spain's differential growth.[14] Prior to 1975,

macroeconomic behaviour seems to explain most (80 per cent) of Spain's positive deviation from the OECD average growth, with money and exports growth as its main factors. However, in the transition years from dictatorship to democracy, macroeconomic instability (high inflation, unbalanced budget) led Spain to underperform. Finally, after Spam became a member of the EEC (1986), macroeconomic performance (lower inflation and money, but nol export, growth) contributed to a positive growth differential (up to 40 per cent).

It may be concluded, then, that the analysis of proximate determinants of growth largely confirms, and extends, the more descriptive evaluation carried out earlier in the paper. In the rest of it, a closer look at the main phases of macroeconomic performance can illuminate the search for ultimate causes of growth, in which the role of incentives provided by the institutional framework appears to be determinant.

3 The legacy of the 1930s and the Civil War (1936-9)

The impact of the Great Depression on Spain is not only a major economic but also a political and social issue, as it coincided with the instauration of Spain's Second Republic (1931), after more than half a century of constitutional monarchy that ended in a bloody civil war. Was the depression a significant cause of the political and sock:' unrest? Did economic policies exacerbate the political and social climate, leading to civil strife and, eventually, to a military uprising?

Historical studies have tended to confirm contemporary perceptions of a relatively mild impact of the depression, as the relatively moderate decline in factor returns and prices would suggest (Comin, 1987). It has been argued, however, that a shift towards a restrictive budget policy and the interruption of public works, together with uncertainty about the new political regime, were major causes of the crisis of the 1930s in Spain (Palafox, 1986, 1991). Legal changes favourable to the trade unions, such as the reduction in the number of hours worked (Soto, 1989), might have reduced incentives for firms to invest under the Republic (Comin, 1994). Another view points to a tighter link to the international depression through the external sector, aggravated by inadequate financial and monetary policies (1 lernandez Andreu, 1980, 1986).

A look at the latest empirical evidence tends to confirm the idea of a milder impact of the depression on Spain, given the small decline in the level of real GDP per head (Prados de la Escosura, 1995), while outwardly oriented sectors suffered a deeper impact (Comin, 1987). Moreover, recent research suggests a less important role for the government in the economy, given its size, the policy instruments available and the dominant ideologies in Spain at the time. Policies, both monetary and fiscal, were not restrictive but the opposite, as the budget was used as an anti-cyclical instrument offsetting the decline in private investment and exports (Martin Acefia and Comin, 1984; Garcia Santos and Martin Acefia, 1990).

What caused the Civil War of 1936 9 then? A consensus appears to exist pointing to non-economic causes. However, expectations after the collapse of the monarchy were not fulfilled, as proposals for land reform, industrial relations legislation and welfare improvements were not completed or enforced, leading to social unrest and a military *coup d'etat* (Martin-Acefia, 1994; Palafox, 1991). Finally, given the vigorous growth during the interwar period, it could be boldly suggested that the

Spanish Civil War might be represented as a redistributional conflict resulting from the social and political tensions of an earlier rapid growth period, rather than from poverty and economic stagnation as has been advocated by historians.

The impact of the Civil War on production factors and institutions was not negligible. War affected the endowment and proportion of production factors, although, when compared to the wider European post-World War II experience, Spain's physical capital was probably damaged to a much lesser extent than its human capital. Industrial areas were hardly affected by war destruction, which concentrated on residential construction, the transportation network and livestock (Malefakis, 1987; Barciela, 1986; Catalan, 1992). In turn, postwar exile and internal repression removed a large proportion of human capital (Lopez Garcia, 1991). The postwar increase in the human physical capital ratio, apparently a feature common to most war-damaged countries and one which might have made a significant contribution to reconstruction, through an increase in the productivity of capital (Dumke, 1990), hardly took place in the case of Spain, and helps explain the country's poorer performance during the 1950s.[15]

4 Reconstruction: Spain under autarky, 1939 59

A major difference between Spain and the rest of post-1945 Western Europe (if Salazar's Portugal is excluded) was Franco's dictatorship, which emerged from the Civil War and lasted until 1975. The dictatorship presided over a four-decade period in which a clear distinction can be made between autarky and outward-looking development, with the 1959 stabilization plan as a turning point falthough clear differences are noticeable between the 1940s and 1950s). Franco's political regime may be defined as an authoritarian system based upon a limited pluralism of political groups around the dictator, who behaved as a maximi/.er of power (time and quantity) under constraints derived from internal political and economic conditions and the international context (Gonzalez, 1979). Although not without a background,[16] Franco's regime was a distinctive one, in which fascism and traditional authoritarianism blended from its very beginning. However, the autocratic regime evolved enough to adjust from isolation and self-sufficiency, in which the economy grew at below potential - even during the recovery of the 1950s (Table 12.3) to a cautiously outward-looking economy reaping opportunities to reduce the technological gap with advanced European nations (Donges, 1971).

Thus, the extent to which fast growth under Franco after 1960 may be attributed to the dictatorship's economic policies and social stability is a still debated issue. Had it been the case, a painfully achieved, stable institutional framework might have provided permissive elements for economic development, such as an improvement in the definition and enforcement of property rights, a reduction in transaction costs, and a paternalistic attitude on the part of the state, gradually moving away from absolute ihterventionism during the 1950s (Gonzalez, 1979, 1989/90; Martin Acefia, 1994). To elucidate whether there was a causal link between Francoism and growth and catching up, macrocconomic performance under the dictatorship will be surveyed and its main policies discussed below. However, some caveats about the beginnings of Franco's dictatorship are required.[17] Uncertainty about its viability after World War II led Franco's regime to give priority to immediate political

stability over any other competing goal, even though such a choice would condition subsequent growth through a misallocation of resources. This strong constraint provided, in turn, a specially advantageous position to those (already powerful) small groups and coalitions which, in exchange for support to the dictatorship would derive rents from the public sector and even control the state's economic decisions (Fraile, 1991, 1993).

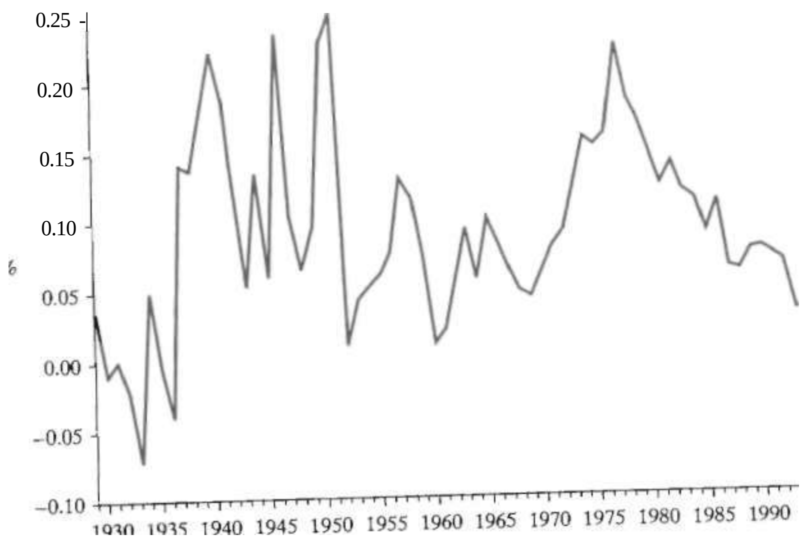
After the Civil War, the new economic authorities decided to follow a new scheme of autarkic development. Such a choice, favoured by the new authorities' ideology was conditioned by the international isolation that followed the Axis powers' defeat in World War II. A widely accepted perception of Spain as a backward non-industrialized society, in which both private firms (because of the lack of cntrepreneurship) and the government (through free trade policies) had failed to promote industrialization, led to a view of the new totalitarian state as the only institution able to achieve Spain's sustained growth and catching up through economic intervention (Martin Acefia and Comin, 1991).

In postwar Spain, as in the rest of Europe after 1945. government intervention was perceived as a crucial instrument for the post-bellum recovery World War II and the United Nations' boycott (1946), plus the exclusion from reconstruction plans and international organizations such as Marshall Aid and Bretton Woods reinforced nationalistic tendencies towards self-sufficiency, although the Cold War gradually relaxed Spain's isolation throughout the 1950s.'[8] Eagerness to embrace regulation and state intervention was a common feature of postwar Europe counterweighted by the Marshall Plan, which in turn provided the environment for a pro-market economic policy (De Long and Eichengreen, 1993)

Although American aid started in 1951 and led to influential economtc and military agreements in 1953, Spain's case provides support for the counterfactual proposit.on that, had the Marshall Plan not been enforced, product and factor market controls, quotas and foreign exchange rationing would have dominated economic policies. In fact, government intervention and planning in Spain aimed at reachingcconomicself-sufficiency.includingtcchnologicalindependence once the expectations of technological transfers from Nazi Germany vanished (Lopez Garcia, 1991) - regardless of the opportunity cost involved. Nevertheless Spain obtained $1.1 billion from the US government over 1951-9, which amounted to 18 per cent of the goods and services imported during these years (or 1.6 per cent of GDI). Had Spain received the S676 million aid in a single year expected from the Marshall Plan by the Francoist authorities, it would have represented over 20 per cent of GDP in 1949 (Donges, 1976; Prados de la Escosura, 1995)

The need to rely on a coalition of nationalistic and fascist elements during the initial uncertain stages of the new regime conditioned the dictatorship's industrial policy, aggravated by the lack of managerial and engineering skills needed to carry it forward. Industrialists, who had opposed the Republic's welfare and ^distributive policies, adopted a hesitant attitude towards Franco's regime in its early stages thus, the lack of human capital, on the one hand, and the new regime's urge to industrialize, on the other, made strategic factors of asymmetrical information and the How ol personnel from private industries to interventory agencies, eventually leading to the capture of these agencies by interest groups (Fraile, 1993).

The autarkic model of development was built around a policy of protectionism

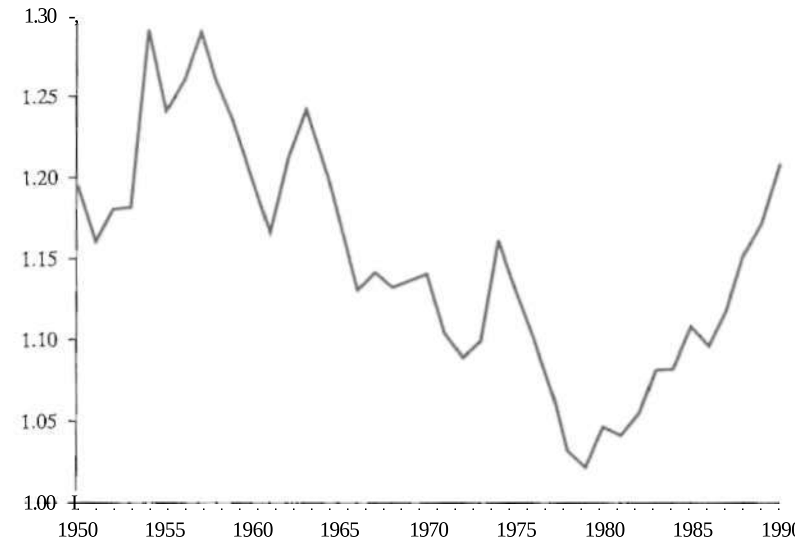


Source: Prados de la Escosura (1995).

Figure 12.2 Rate of inflation: Spain. 1929-93 (calculated from the GDP deflator)

which persistently aimed at import substitution, using two basic tools: quantitative restrictions and exchange controls. Indiscriminate protectionist policies had deleterious effects on Spanish economic performance, according to most economists and historians. The exchange control policy implied the imposition of an official fixed exchange rate within a context of persistent inflation differentials between Spain and its commercial partners, which const.tuted a permanent strain on the Spanish currency towards revaluation.[19] The appreciation of the real exchange rate of the peseta implied a drag on exports and a stimulus to imports and tended to exhaust foreign reserves. Such a tendency could not be compensated in the1950s ether by the multiple exchange rate system,- or by the 'special accounts'.[2]' B.lateral trade agreements (quotas by country and product) and a trade licensing system were an alternative that resulted in high costs, in terms of efficiency, by pwvKlmg the appropriate environment for rent seeking and corruption. A foreign exchange black market developed and the Spanish currency experienced substantial depreciation. The imposition of a top limit for foreign investments in Spanish industry (25 per cent of the capital of the firm) was a complementary procedure to prevent national firms from falling under the control of foreign capital.

A proximate measure of the import substitution bias induced by trade controls can be gathered from the ratio of domestic to c.i.f. prices.for ™*P°«fj*™^ According to Donges (1971), such a ratio multiplied by 2.5 between 1948/9 and 1958'9 Import substitution took place mainly among consumer goods, and to a lesser extent among intermediate and capital goods. The contribution of import substitution to output growth represented, for consumer goods 75 per cent m the 1940s and 60 per cent in the 1950s, while for intermediate and capital goods it



Source: Summers and Hcston (1993: PWT5.5).

Figure 123 Relative price of capital goods: Spain, 1950 90 **(ratio of investment to PPP price level of GDP)**

provided 70 and 49 per cent of its increase in the 1940s, and 24 and 106 per cent in the 1950s respectively (Donges, 1976: 155). Inward-looking policies created serious bottlenecks for industrialization, as traditional export earnings collapsed and the scarcity of foreign exchange put a brake on industrial growth by restricting the supply of raw materials and capital goods. Firms, usually small and relying on obsolete techniques, acted below full productive capacity due to shortage of inputs (or the uncertainty in obtaining them) and did not take advantage of economies of scale. In short, import -substituting industrialization (ISI) resulted in low organizational levels and low technical efficiency.

Another major feature of Spanish autarky was a systematic policy of government intervention and regulation of the economy. The state controlled every step in economic activity through a licensing system for starting and enlarging industries. The authorities also regulated prices for commodities considered vital for industrialization, and controlled the evolution of nominal wages in the labour market. A rationing system was introduced and remained in use until the early 1950s, while at the same time government agencies took control of food distribution (Barcicia, 1986), and price regulations for agricultural and industrial goods were established (although the latter were relaxed in the 1950s) (dc la Dehesa *et ai*, 1991). Distortion in intersectoral terms of trade contributed to diverting resources from agriculture to industry in an attempt to foster industrialization. In addition. protection and internal regulation forced relative prices of capital goods upwards, resulting in a lower rale of investment for a given level of savings and, consequently, reducing the rale of growth of the Spanish economy.[22]

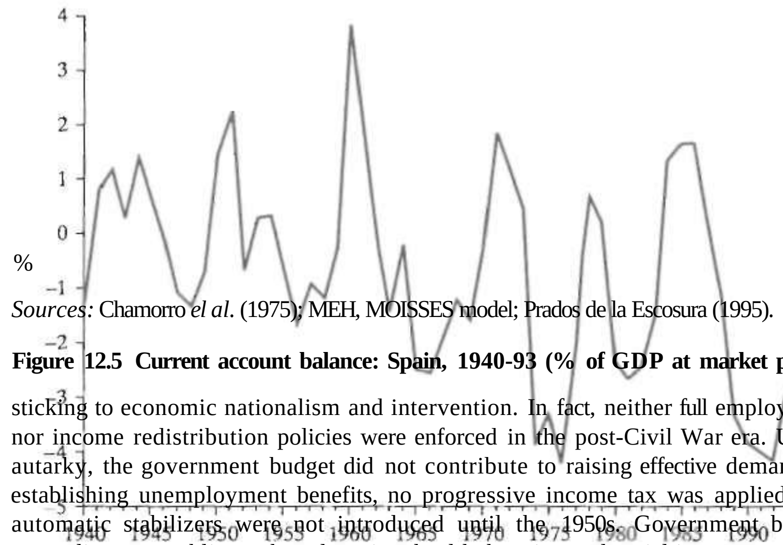
" Including centra! government.

Sources: Comin (1993); MEH, MOISSES model; Prados dc la Escosura (1995).

Figure 12.4 Budget balance or central government and public administrations Spain, 1940 93 (% of GDP)

A strategic instrument for government intervention was the lnstituto Nacional de Industria (INI), founded in 1941 and replicated from the Italian IRI, which organized and directed public investment in the 1940s and 1950s, and still today provides a powerful instrument of industrial policy. Both the failure of post-Civil War attempts to promote private investment through government incentives and the political uncertainty of the Second World War led Franco's pro-Axis government to shift to direct intervention in economic activity. INI was established to coordinate a fast, self-sufficient industrialization through a programme of investments in public infrastructure and the creation of strategic industries (including defence), involving high capital requirements, high risk or short-run low profits. tNI's intervention included a great variety of activities, ranging from basic services to manufacturing and mining, but under autarky it specialized in the production of energy and intermediate goods, responding to the economy's bottlenecks and contributing to national defence. INI's role in postwar industrialization has been critically evaluated. In short, it has been argued that, while INI eliminated bottlenecks with its heavy investment, it was an instrument of inward-looking strategy that led to a misallocation of resources (Martin Acefia and Comin, 1991).

A differentia! feature in Spain with respect to the economic measures followed in most postwar Western Europe countries was the maintenance of a pre-Keynesian fiscal policy. In fact, franco's cabinets kept orthodox ideas about a balanced budget and the control of public expenditure (which was achieved in the 1950s), while



Sources: Chamorro *el al.* (1975); MEH, MOISSES model; Prados de la Escosura (1995).

Figure 12.5 Current account balance: Spain, 1940-93 (% of GDP at market prices)

sticking to economic nationalism and intervention. In fact, neither full employment nor income redistribution policies were enforced in the post-Civil War era. Under autarky, the government budget did not contribute to raising effective demand by establishing unemployment benefits, no progressive income tax was applied, and automatic stabilizers were not introduced until the 1950s. Government budget expenditure on public works, educa tion, health, housing and social insurance was of little significance in the post-Civil War years. In fact, social transfers and education remained on average below 10 per cent of total central government expenditure until 1950, and below 15 per cent until the mid-1960s (Comin. 1994). A full quantitative evaluation of the consequences of such a policy, as opposed to a Keynesian approach, is still awaited, but it is considered to have reduced economic growth (Comin, 1992).

A constant disequilibrium in the market between supply and demand, which provoked a persistently high rate of inflation, emerged as a consequence of price regulation. In an attempt to soften this continuous price strain, the authorities decided to allow gradual import increases, which worsened the current account balance (de la Dehesa *el al.,* 1991). In the 1950s, imports of goods represented 11.7 per cent of GDP, while exports were only 6.5 per cent (Prados de la Escosura, 1994).[23] Growing disequilibria in the external accounts in the late 1950s (Chamorro *e: at.,* 1975) would lead to reconsideration of self-sufficiency and, eventually, to the **end** of autarky.[24]

The economics dearly Francoismcan be summarized, therefore, as an attempt to achieve rapid industrialization based upon indiscriminate import substitution, with severe restrictions on imports and capital inflows, a complex exchange rate

Table 12.5. *GDP and employment composition: Spain, 1929 93*

	1929	1940	1950	1960	1975	1985	1993
Output							
Agriculture	29.2	32.7	30.7	23.6	**10.1**	6.0	3.5
Industry	25.2	19.3	23.5	30.9	30.3	29.4	25.6
Construction	7.8	4.0	3.4	3.9	8.1	6.3	8.3
Services	37.8	44.0	42.4	41.6	51.5	58.3	62.6
Expenditure							
Private consumption	76.7	78.4	72.9	69.8	65.1	65.0	64.7
Investment	16.6	7.1	14.7	19.4	28.5	18.8	21.2
Government consumption	10.3	17.6	11.0	8.7	10.1	14.0	16.0
Net exports	-3.5	-3.1	1.4	2.1	-3.8	2.2	-1.9
Employment							
Agriculture	47.7	52.5	50.0	42.3	23.8	18.2	9.9
Industry	28.3	2.3	20.2	21.8	27.3	24.5	22.4
Construction	3.4	4.0	5.5	6.7	9.7	7.3	9.4
Services	20.6	23.2	24.3	29.2	39.2	50.0	58.2

Source: Prados de la Escosura (1994).

structure, internal regulation and direct intervention. This set of policies led to a highly overvalued currency, a current account deficit, low reserves of hard currency, inflation (consumer prices increased by an average of 13 per cent per year in the 1940s, and 10 per cent in the 1950s), and a small and inefficient industrial sector.

A clear distinction should be made, however, between the 1940s and the 1950s, as the latter witnessed fast GDP growth per head together with a significant transformation in productive structure (Tables 12.1 and 12.5). In the 1950s, substantial changes took place in agriculture, where labour productivity increased while its relative size shrank in terms of both output (at —2.6 per cent annually) and employment (at — 1.7 per cent), leading to a fall in its relative labour productivity. The absolute reduction of the labour force in the agricultural sector represented 0.5 million workers, while it has been estimated that around one million workers emigrated from agriculture in the 1950s (Leal *et al.,* 1975). Meanwhile, total investment doubled its 1940s average share in GDP (10 per cent). It has been argued that the first industrializing push in the 1950s was a prerequisite for the fast growth of the 1960s, since human and physical capital accumulated and the domestic market expanded under protection (Gonzalez, 1979). In fact, capital deepening took place, with the stock of physical capital per head growing at 3.2 per cent yearly (or increasing by more than one-third), while non-residential capital per person grew at 4 per cent per year, an increase of 50 per cent (Hofman, 1993b).[25] Meanwhile, the average years of schooling for people over 25 years old rose from 2.7 years in 1950 to 3.4 in 1960 (Barro and Lee, 1993). ,

Industrialization, however, depended exclusively on internal demand, and the ability of Spanish firms to reach external markets was very low. Actually, commodity exports, after the postwar boom (1947-53) in which they rose to 8 per cent of **GDP,** fell to 5 per cent for the rest of the decade. By 1960, manufactured exports had hardly reached one-quarter of total exports and represented 7 per cent of industrial outpui. Moreover, volatility in import capacity due to scarcity of export earnings made investment risky, leading to a lower rate of capital accumulation (Donges, 1976). In turn, restrictions on foreign capital inflows made investment dependent almost exclusively on domestic savings. In addition, investment was penalized by high relative prices for capita! goods, slowing down GDP growth. Lacking the capacity to import the necessary inputs and technology, firms suffering from insufficient capital, obsolete equipment and old vintage technology were unable to compete in international markets. In the 1950s, Spain did not have access to innovation and technology through international trade in competing products, and as a result it was prevented from fully sharing the benefits of fast productivity growth in Western Europe.

5 The Golden Age: years of accelerated growth, 1959-75

In the late 1950s, the autarkic system imposed by the Francoist authorities after the Civil War collapsed. The need to put an end to Spain's isolation at the time of the Treaty of Rome (1957), and to restore internal and external balances, led to a drastic change in economic policy at the turn of the decade. Although Spain started a mild opening in the early 1950s, associated with the bilateral agreements with the USA, the pressure to open the economy increased as Spain joined the International Monetary Fund and the World Bank (1958) and the OEEC (1959). The creation of the Common Market (1957) and the introduction of external convertibility in Western European industrial countries (1958) provided a favourable atmosphere for growth. This helped a new cabinet in Spain to introduce a pro-market policy, but not without a clash within the Franco regime between pro-market and autarkic-groups (Anderson, 1970). The policy outcome of establishing links with international economic organizations was a most ambitious project of liberalization that began with a stabilization plan in 1959 (Fuentes Quintana, 1984). A gradual opening and factor mobility (capital inflows and labour migration) were achievements of the new pro-market orientation, while the lack of structural reforms affecting the tax system and labour and financial markets represented its main shortcomings (Donges, 1971).

The economic reform included specific measures aimed at controlling the growth of internal prices and achieving budget balance (Fuentes Quintana, 1989). Among the different measures passed to control inflation, it is worth mentioning the prohibition on financing the government deficit through monelization of the public debt.[26] Additional constraints were imposed on the loans drawn by the private sector from the banking system.[27] The government also decided to control public expenditure through orthodox fiscal policies centred around a balanced budget, and to raise the prices of certain goods (petrol, tobacco) and services (telephone, public transport) supplied by state monopolies, in an attempt to close the gap between official prices and their real costs of provision (de la Dchesa *el al.,* 1991; Comin, 1994).

A second package of measures aimed at the gradual opening of the Spanish economy to the international markets, while preserving the external equilibrium. The system of multiple exchange rates developed under autarky was abolished, and the peseta was devalued by 43 per cent in an attempt to improve export competitiveness (Dongcs, 1976: 59). A gradual process of import liberalization was initiated by making flexible the different trade regimes effective under autarky.[28] A new tariff in I960 eliminated quantitative restrictions on 90 per cent of imports and marked the return to the use of *ad valorem* duties, as opposed to quotas, as a protectionist instrument.[29] The new tariff, still a protectionist one, tended to be biased in favour of consumer goods and had a cascading effect on customs duty rates, so effective protection was usually higher than nominal protection. Reforms of the 1960 tariff during the following years reduced effective protection (and its unequal distribution) sharply, from 77.2 per cent in 1962 to 38.4 per cent in 1968 (Bajo and Torres, 1990).[30] These measures were complemented by allowing a controlled inflow of foreign long-term capital that, according to Donges (1976), averaged an annual 7 per cent of capital formation over 1960-8.[31]

The stabilization plan proved most successful after a first year of adjustment, in which the severe measures adopted had a negative impact on economic activity (real income per head fell by 2.7 per cent in 1959) (Prados de la Escosura, 1995). The success of the stabilization plan was probably helped by the ban on free trade unions, which avoided wages claims after the severe devaluation in 1959 (Donges, 1976: 62). Inflation declined from around 12 per cent in 1957 9 to 2.3 per cent for 1959-61 (Comin, 1993). Meanwhile, the (commodity) trade deficit shrank from 7 per cent of GDP in 1957/8 to 3.2 per cent in 1961, and the current account cast a positive balance for 1960 (3.7 per cent of GDP) (de la Dehesa *et al*.. 1991). The increasing number of tourists and the inflow of foreign capital, together with the return of Spanish capital from abroad, led to the appreciation of the peseta over the official rate of exchange, the disappearance of the black market, and the consequent declaration of external convertibility for the Spanish currency in 1961.

As an outcome of the reforms, exports of goods and services experienced a sustained growth over the 1960s and early 1970s, raising their share of GDP from 5,8 per cent in 1959 to 10.7 percent in 1974. In turn, a higher degree of openness was achieved as exports plus imports grew from 13.9 per cent of GDP to 29.5 per cent during the period (Chamorro *etal,* 1975; Prados de la Escosura, 1994). Meanwhile, foreign investment constituted an average 5.8 per cent of fixed capital formation over 1959-74, of which 44 percent was direct investment, and 74 percent of it went to manufacturing (Donges, 1976: 108).

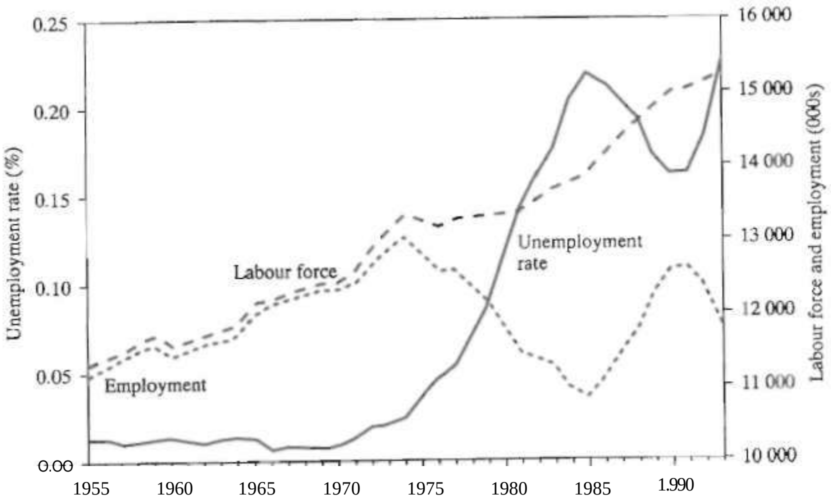
Since 1964, government intervention in economic activity was reoriented through successive four-year *planes de desarrollo* (development programmes). The plans, inspired by post-1945 France's *planification indicatif,* lasted until 1975. The *planes* allocated a prominent role to private firms as the engine of economic development, but maintained government intervention in economic activity by means of market regulation, public investment and enterprises, and direct intervention in specific economic sectors. *Planification indicatif was* implemented through a wide variety of measures, such as public subsidies, tax reliefs, tariff advantages and preferential access to official credit. The *planes* have been considered a setback for Spain's liberalization and associated with a deceleration in the rate of economic growth (Gonzalez, 1979). It is still debated why the government proceeded so cautiously in dismantling trade barriers and regulations. One explanation is based on the social costs in terms of output and employment derived from a sudden opening up

(Spitaller and Gali. 1992), which complements another one based on the pressure exerted by interest groups (Fraile, 1993). A last attempt to liberalize the economy took place under the dictatorship in 1970. linked to the preferential agreement with the EEC. However, it was cut short by the first oil shock (1973) and the death of Franco (1975) (de la Dehesa *et al.,* 1991).

In such a context of cautious outward-looking policies under close government supervision, accelerated growth and structural change proceeded in Spain, as a lagged response to the 1950s Western European experience of reconstruction and catching up, prevented by autarky at the time. Spain's economy grew and diversified between 1959 and 1975(Tablcs 12.1 and 12.5), while efficiency improved remarkably. Between 1965 and 1975, total factor productivity rose at an annual rate of 3.8 per cent for the whole economy (Suarez, 1992; Myro, 1983), while TFP in agriculture and industry grew at 2 and 6.5 per cent, respectively (San Juan, 1987; Gandoy, 1987).[32] A deep reallocation or resources took place. Agricultural share in GDP fell from almost one-quarter of GDP in 1960 to less than 10 per cent by 1975 (that is, at an annual rate of -6 per cent), while its contribution to employment shrank from over 40 per cent to below a quarter orthe total labour rorce(at - 3.8 per cent yearly), leading to a significant decline in its relative productivity." Meanwhile, services' reached one-half of GDP, employing two out ofevery five workers by 1975. Labour released by agriculture reached 2 million in 1961 70 (Leal *et al.,* 1975), which to a large extent was absorbed by the 'urban' sector (industry and services), although emigration to Western Europe also represented a decisive outlet.[34] However, a significant percentage of the labour force still remained in agriculture, as a comparatively low output per worker in European terms suggests, and as relative labour productivity indicates (Table 12.5).[35] Given the disadvantage in output per hectare derived from poorer soil, a lower endowment of land per worker is behind the Spanish agricultural productivity gap (O'Brien and Prados de la Escosura 199?- Simpson, 1995).

Outward orientation of Spanish industrialization remained limited over 1959-75. By 1972, two-thirds of manufacturing output was still produced by firms with fewer than five workers, so size remained a major shortcoming for industry's reaping economies of scale and, thus, having access to foreign markets. Manufacturing performance was impressive, growing at over lOper cent annually, withanincreasing role for producer goods industries (Carreras, 1992). However, it depended mostly on home demand (87.6 per cent over 1962-72), with exports accounting for only 22 per cent of the increase, and a negative contribution of import substitution (Donges, 1976: 158, 168). The increase in manufactured exports was due largely to competitiveness (50 per cent) (Donges, 1976:206). Spain exhibited revealed comparative id vantage mostly in labour and natural resource-intensive goods, but product-cycle goods were increasingly competitive.[36] The Spanish experience tends to suggest. nevertheless, that industries that had followed **ISI** strategies in the 1940s and 1950s gradually managed to export after 1959 (Donges, 1976).

In the 1960s, labour market rigidity represented a real obstacle for an outward shift of labour demand that could not match its supply. In fact, the low level of unemployment (1.7 per cent over 1960-75) did not increase, due to a steady migratory flow towards Western Europe. Migrant remittances contributed to balance Spain's current account. Underemployment remained present due to strict



Sources: Ministerio de Economia y Hacienda (M01SSES model).

Figure 12.6 Employment, labour force and the rate of unemployment: Spain, 1955-93

legislation that inhibited layoffs of redundant workers, together with low female participation in the labour force. The resulting pattern of development in the 1960s was, thus, largely dependent on capital accumulation and efficiency gains. Capital deepening was substantial, and fixed capital stock per head grew at 5.7 per cent annually (that is, more than doubling its size), while non-residential capital and machinery and equipment grew at 7.2 and 8.9 per cent pef capita, respectively (Hofman, 1993b). Suarez (1992) finds that, in the period 1965-75, most of real GDP growth is accounted for by total factor productivity gains (58.8 per cent) and capital accumulation (34.7 per cent), while increased labour input accounts for only 6.5 per cent (Table 12.2).

In turn, macroeconomic performance played a decisive role in achieving a positive deviation from OECD average growth, most of which was accounted for by the differential money supply and real exports growth (Table 12.4).[37] However, inflationary pressure (7.8 per cent annually in 1960 75), together with occasional current account disequilibria,[38] constituted a threat that forced the economic authorities to impose episodic stabilization measures.[39] In summary, orthodox fiscal policy, near equilibrium in the external sector, and expanding output. coexisting with unreformed factor and product markets and exchange controls, are the main features of the Spanish economy during 1959-75.

6 Shocks **and stagflation: the transition from dictatorship to** democracy, 1975-85

The oil shocks (1973,1979) coincided in Spain with the end of Franco's regime and the transition to a democratic society. Structural inefficiencies were inherited from

the Franco era (1939-75), and the post-1959 liberalization had been progressively curtailed by the pressure of interest groups, resulting in a mixture of market and *dirigiste* economy, whose negative effects would emerge with the supply shocks of the 1970s.[40] Thus, the late 1970s opened an unstable political phase in which economic performance was dominated by disinvestment, inflation and job destruction.

The oil crisis was aggravated by the fact that Spain was a heavily energy-dependent country,*[1] whose productive structure was biased towards heavy industry with weak demand. Furthermore, the situation was worsened by the fact that Spain's authorities perceived the oil shortage of 1973 as a temporary shock. The deterioration of the terms of trade, resulting from rising energy import prices, was not followed by a reduction in real wages. 1 n fact, between 1973 and 1976, wages (nominal and real) boomed. Political unrest, initiated in the early 1970s and reaching a peak after Franco's death, led the government to implement compensating policies, such as keeping low energy prices by direct price intervention and nomiaal wage indexation, thus enhancing the impact of the oil shock and fuelling the current deficit and inflation, which rose as high as 24.5 per cent in 1977.

Only after the first democratic elections (June 1977) were adjustment measures introduced (Garcia Delgado, 1990). The Moncloa Agreements represented a set of structural reforms and economic policy measures supported by the consensus of the main political parties and ratified by Parliament. A non-orthodox mix of incomes policies, plus accommodating fiscal and tight monetary policies, were its main features (Spitaller and Galy, 1992). Among those worth mentioning are the fiscal reform, in which progressive wealth and income taxes were included. An active monetary policy aimed at reducing inflation expectations followed.[42] A new exchange rate was fixed for the peseta (20 per cent lower) in an attempt to improve the external disequilibrium, from which derived short-run positive effects on the current account.[43] Trade liberalization resumed in 1977, but the 1979 oil shock, the unstable political climate and the negotiations with the EEC slowed it down (de la Dehcsa *et at.*, 1991).

At the same time, income policy agreements attempted to moderate increases in nominal wages.[44] However, when the new, democratically elected authorities took steps to adjust to relative price changes resulting from the oil shocks, the lack of flexibility of input markets to reallocate resources acted as a brake. Until the early !9S0s, financial markets remained regulated and segmented, and exchange controls on capital outflows remained in place, while the still effective Francoist legislation impeded layoffs and flexibility of contracts in the labour market. Thus, if the set of measures included in the *Paetos de la Moncloa* are evaluated against economic performance over 1977-81, a favourable balance appears for (a still high) inflation, the external balance and firms' profitability (after wage moderation), while it was not so favourable for the labour market and GDP growth.[45]

The arrival of the Socialist Parly to government in 1982 extended and deepened the reforms initiated with the Moncloa Agreements (1977). In particular, the reform of the industrial sectors most affected by the crisis (steel, textiles and shipbuilding) and the opening of the economy became the top priorities of the new government. Financial markets experienced a major deregulation, as interest rates and capital movements were freed. After the Socialist electoral landslide in 1982, a devaluation of the peseta took place, with short-term positive effects on the current account (1984 6), while monetary policy became more restrictive to check the rise in prices.

In turn, the growth of public expenditure and the increases of fiscal pressure represented the main features of fiscal policy under all the Socialist cabinets(both up to 1986 and afterwards).

The growth of public expenditure from 25 per cent of GDP in 1975 to 36 per cent in 1985 was due to the increase in current transfers and public in vestment, and to the service of a public debt (which rose from 13 to 45 per cent of GDP in the'transition decade') associated with the introduction of the welfare state, and the costs of industrial reconversion and regional devolution (Gonzalez-Paramo, 1992). Such a major expansion in expenditure, without an offsetting increase in fiscal revenues, resulted in a sustained public deficit. In short, during the first three years of Socialist government, the reduction in the rale of inflation continued (from an average of 16 per cent in 1978-82 down to 10.8 percent in 1983-5), and external equilibrium was temporarily achieved, while substantial increases took place in unemployment (from) 1.6 per cent of the labour force in 1978-82 to 20 per cent in 1983 -5) and in the public deficit (from 3.3 to 5.7 per cent of GDP).

When the entire transitional period from Franco's death to Spain's EEC membership is considered, some major features emerge. The 1973 and 1979 oil shocks resulted in a deceleration of economic activity that lasted up to the mid-1980s and implied comparative retardation (Table 12.3 and 12.4). In fact, real GDP grew at an annual average rate of only 1.7 per cent between 1975 and 1985 (Table 12.2). Real investment stagnated, while growth depended mainly on private consumption. Job destruction (at — 1.6 per cent annually) becomes noticeable when the labour force increase over 1975 85 (0.6 million) is confronted with the 2 million fall in employment. Agriculture had the larger share of unemployed. 1 million workers, against 0.8 and 0.4 million in industry and construction. In turn, capital deepening continued, though at a substantially slower rate than in the years 1960 75. Thus, the stock of physical capital per head grew at 3.3 per cent annually (4.2 per cent for non-residential capital) (Hofman, 1993b). A look at the growth accounting exercise in Table 12.2 confirms a negative contribution of labour to growth (— 0.9 per cent yearly) that could not be offset by that of capital (0.7 per cent). Thus, between 1975 and 1985, employment destruction represented a severe brake on growth, while capital accumulation and, mostly, TFP gains explain it all. However, empirical evidence (Table 12.3 and 12.4) tends to suggest that capital deepening was not carried forward sufficiently, and TFP alone was not enough to close the gap with advanced countries over the 'transition years'.

Macroeconomic factors did not contribute to catching up with OECD growth between 1975 and 1985 (Table 12.4). Average inflation reached 15.4 per cent, doubling its rate for 1960-75, while a substantial fiscal disequilibrium, derived from the action of automatic stabilizers, raised the budget deficit up to an average 3.6 per cent of GDP. Besides, the slow reaction of the Spanish authorities to OPEC shocks contributed to fuel inflation, reduce competitiveness and provoke a rise in the current account deficit (up to an average of —1.1 per cent of GDP in 1976 85).[47] When compared to the OECD average, Spanish exports were more labour than capital intensive, and more intensive in physical capital and natural resources than in human capital, while they were mainly composed of goods with weak demand (Martin, 1992). In brief, a still highly protected economy,[48] dominated by small firms relying on obsolete techniques, prevented Spanish industry from achieving

economies of scale and having access to innovation and latest-vintage technology.[49]

Moreover, economic growth during the 'democratic transition' (1976-85) was severely constrained by overregulated markets. In the labour market, restrictive industrial rules introduced under Franco, which aimed at offsetting the prohibition of independent trade unions by banning layoffs, constituted a major shortcoming for employment creation (Bentolila and Blanchard, 1990). Among Spanish firms - most of them small in size, labour intensive and sheltered from competition - bankruptcies increased dramatically, while the rate of unemployment rose, with an average rate of 12.8 per cent over the period 1976-85. In fact, the non-accelerating inflation rate of unemployment (N AIR U) jumped from 3.4 percent in the late 1970s to 18.4 per cent in the early 1980s, to remain at a high level ever since (Dolado and Malo de Molina, 1985).[50] When aggregate demand contracted during the crisis years, demand for labour fell and, given institutional constraints, quantity, and not price (wage), adjustments took place, resulting in high unemployment. Sectorial wages in Spain depended on the consumption aggregate wage, and not on sectorial productivity or the unemployment rate. Therefore, unemployed workers could not exert a downward pressure on wages, and unemployment has become a persistent phenomenon (Andres and Garcia, 1992).

7 Recovery of the late 1980s and its legacy: the integration of Spain into the EEC

Spain's admission into the European Community coincided with an expansionary phase of the international economy, and both contributed to a fast economic recovery in Spain. From 1986 to 1990, real GDP grew at an average rate of 4.4 per cent, the outcome of cumulative efforts to fight basic disequilibria associated with integration into the EEC, and of a closer link to the international markets. Positive short-run expectations opened the door to foreign capital and induced a burst of investment that was helped by the increase in profit margins and political stability.[51] In fact, since a large technological gap existed between Spain and Western European industrial countries, direct foreign investment brought with it a technological transfer (Vinals, 1992). The positive effects on the labour market were immediate, and the unemployment rate fell from 21.9 per cent in 1985 to 16.3 per cent in 1990.[52] In all, employment increased by 3 per cent annually, which represented more than 1.7 million new jobs between 1985 and 1990 (as much as from 1957 to 1974), and job destruction persisted only in agriculture (0.5 million).[53] Suare/.'s (1992) growth accounting exercise reflects this improvement, showing that, from 1986 to 1990, job creation accounted for 38 per cent of real GDP growth, while capital, growing at over 5 per cent annually, contributed 32 per cent (Table 12.2).

When placed within the OECD context, Spain overperformed in the late 1980s, with a major contribution from macroeconomics. The control of inflation and the management of money supply, together with a reduced budget deficit, accounted for most of it (Table 12.4). However, although the public deficit experienced a substantial reduction between 1985 (7 per cent of GDP) and 1990 (4 per cent), it persisted over these fiscal expansionary years.[54]

Nevertheless, other economic disequilibria worsened. After the peseta joined the European Exchange Rate Mechanism (ERM), the competitiveness of Spanish products declined (as is reflected in the negative contribution of exports growth in Table 12.4). The loss of competitiveness due to an appreciated exchange rate reached up to 30 per cent from the mid-1980s to 1993 (Camarero and Tamarit, 1994). Despite inflation falling to 6.5 per cent over 1985-90, the price differential between Spain and its main trading partners (EEC countries) widened. It has frequently been argued that Spain's differential inflation reflected the lack of competition in non-tradable goods markets.[55] The implication of Spain's affiliation to the ERM coexisting with an increasing price differential was an appreciation of the real exchange rate of the peseta.[56] However, part of the appreciation of the peseta was due to real factors, such as a productivity increase translated into higher wages, which means that not all the exchange rale appreciation implied a net loss in competitiveness.[57]

In turn, the current account deficit reached —2 per cent of GDP in the period 1986 90.[58] Currently, Spain's integration into the EEC has had a larger impact on imports than on exports. Over 1986 90, while the *integration* effect accounted for 53 per cent of the increase in Spain's manufacturing imports from the European Community, it contributed to only 28 per cent of the increase in Spanish manufactured exports to the EEC (Martin, 1992).[59] However, the external deficit was largely due to the private capital inflow (mostly direct investment) that was required to renew and expand the productive capital stock. In fact, the currently account deficit was more than offset by long-term capital inflows due to its high returns over 1986-91.[60]

Successful restrictive monetary policy conflicted, however, with exchange rate management. When domestic interest rates rose, the inflow of foreign capital increased (reinforced by the liberalization of capital markets), leading to an increase in the amount of money in circulation.[61] The intervention of the Bank of Spain in the foreign exchange markets, with immediate sterilization measures to reduce domestic credit, raised domestic interest rates even more.[62] Fiscal policy, in turn, was clearly expansionary, and its pro-cyclical behaviour pushed the public deficit up from 1990.

An international recession has taken place in the early 1990s. In fact, sluggish economic activity in most of the OECD countries has shown particularly severe features in Spain. The strain in foreign exchange markets, and changes in the ERM resulting from the 1992-3 'monetary storm', led to three successive devaluations in Spain (up to 20 per cent altogether), which improved competitiveness. The authorities decided, however, to keep the peseta in the ERM, trying to avoid the loss of credibility that might have followed had the government decided to apply a discretionary economic policy.[63] Slackening GDP growth (at an average of 0.7 per cent), a substantial public and external deficit (-5.6 and —3.3 per cent of GDP, respectively), 5.5 per cent inflation, and job destruction (0.7 million and an unemployment rate reaching 19 per cent of the labour force) are the main features of the early 1990s.

High unemployment (over twice the OECD average) represents today a unique feature of Spain's economy within the European Union. In fact, Spain's labour market suggests a case of hysteresis, since transitory shocks, such as changes in relative factor prices in the 1970s, have had permanent unemployment effects. Lack of market flexibility due to low labour mobility and high wage indexation are considered to be the main obstacles to reducing unemployment in today's Spain (Andres and Garcia, 1992).[6*] The indexation of nominal wages implies that anticipated demand shocks do not have any impact on employment. However, wage indexation amplifies the unfavourable impact of supply shocks on employment In addition, the high costs of layoffs have impeded labour flexibility and created a weak relationship between wages and the value of marginal labour productivity. Unemployed workers cannot exert enough downward pressure on wages, and as a result, unemployment becomes a persistent phenomenon.

It has been argued that not only legal and institutional restrictions affected the low flexibility of wages, but other factors, such as firms' recruiting methods, also account for it. Thus, given large differences in labour qualifications, together with the existence ofadverse selection and moral hazard, firms may offer wages over the market average in an attempt to recruit the best qualified workers, provoking a medium-term push on the average wage, and eventually increasing unemployment. Finally, severe restrictions on regional and sectorial labour mobility are posed by unemployment benefits that reduce incentives to migrate, and by housing market rigidities that make geographical mobility difficult.

Recent approaches to the labour market depart from a disequilibrium perspective (Sneessens and Dreze, 1986; [Jean and Dreze, 1990), assuming that the labour market is rationed by the installed capacity of the firm, which effectively restricts the number of workers that can actually be hired in the short run.[65] In addition, a firm may be ready to hire more workers at the given real wage, but a restriction on the size of the labour force prevents the firm from doing so. Finally, even when the firm has enough installed capacity and there is enough labour available, there may not be enough demand to absorb it.

In the case of Spain, Ballabriga *et al.* (1991) estimated the distinctive contribution of the different regimes (potential employment, demand-determined employment and labour supply) to explain the observed variation in employment between different periods during 1969 88. Two additional variables were included, labour utilization (whose increase contributes negatively to employment), and a residual term, structural mismatch, which accounts for market rigidities and information costs. The main results for the Spanish case are that, during recessions, restrictions on installed capacity and demand, plus structural mismatch, accounted for unemployment. Moreover, the utilization of labour tended to fall, offsetting the decline in employment.[66] This fact seems to imply job hoarding, a feature of labour markets under high adjustment costs (Sargent, 1978). In recent years (1989-91), the economic recession contracted investment levels as a result of firms' pessimistic demand expectations, while labour costs increased relative to capital, reducing the amount of employment required per unit of productive capacity, and the demand restriction operated again (Andres and Garcia, 1992).

From Spain's macroeconomic performance and policies in the late 1980s and early 1990s, some lessons can be drawn. The strategy of the Spanish authorities after joining the EMU was to gain credibility through a competitive deflation (Camarero and Tamarit, 1994). To do so, an overvalued real exchange rate was established for the peseta that allowed the purchase of raw materials and intermediate goods at relatively low prices, aimed at favouring structural change. I n turn, economic agents were forced to exercise self-discipline in order to avoid further losses in competitiveness within an open economy. This strategy worked successfully for the tradable goods sector, but not for the one producing non-lradable goods, which fed the inflation differential with the EEC countries. Moderation of wages and financial costs did not take place because of the high interest rales resulting from monetary and exchange rate policies and the public deficit. Thus, the attempt to mitigate the social costs of restructuring the economy, by combining restrictive monetary and incomes policies with fiscal expansion, faces strict limits as high interest rales and their associated effects (appreciation of the real exchange rate and budget and external deficits) cannot be maintained for a long time without putting the country's competitiveness in jeopardy.

In turn, market rigidities, which persisted in the post-Franco era and were reinforced in the labour market to keep social unrest at minimum levels, constitute a major inefficiency in Spain, with unemployment at the highest level in Europe.[67] In fact, a competitive deflation strategy, trying to improve competitiveness through wage moderation, cannot succeed given Spain's high unemployment, as is shown by the failure of rising unemployment in the early 1990s to have a downward impact on wages."[8]

8 Concluding remarks

As Spain eventually succeeded in the transition from a highly regulated economy under an interventionist, authoritarian political regime, to an industrial democracy, some lessons from recent Spanish economic history may be of interest for today's developing ex-Communist countries.

1. The autarkic period (1939-59) resulted in high costs in terms of growth. These costs are not restricted to the 1940s, hul include ihe 1950s, a decade of fast international growth and catching up, in which Spain remained relatively isolated and paid a heavy penalty in the form of growth that was unstable and below potential. International isolation, together with resource allocation aside from the market, are responsible, it is widely accepted today, for delayed postwar reconstruction and catching up.

2. Whether deeper and more rapid reforms in the 1960s increased the already impressive rate of growth and catching up is still a debated issue. It can be reasonably argued that faster growth (Table 12.1) might not have been feasible, but instead a more balanced development path, closer to that followed in Western Europe, would have taken place with lower efficiency and social costs.[69] In fact, the Spanish experience of the 1960s and the early 1970s seems to question the extent to which factors other than capital accumulation and access to innovation and technology played a major role in Spain's economic growth, once the main constraints of autarky were eliminated. In other words, the allocativc inefficiencies resulting from government overregulation and direct intervention in the late 1960s (particularly after the *planes de dcsarrollo* were implemented) do not seem to have put a significant brake on growth, as the institutionally oriented historiography has claimed.[70] Nevertheless, cumulative inefficiencies during the Franco era constrained further adjustment to international competition in future years.

3. Liberalization in post-1959 Spain was gradual, and several stages can be distinguished, linked to international agreements which posed no serious threat to Franco's dictatorship. In fact, both after autarky (post-1959) and during the transition to democracy (post-1977), financial stabilization was radical, but structural reform was gradual. These features make the Spanish case ofspecial relevance for countries on their way to industrial democracy and aiming to open up, while maintaining social and political stability. However, the fact that liberalization look place over a very long period of time makes the Spanish experience of limited use for countries in which the transition to a market economy occurs within a democratic context, and where, consequently, a strong social pressure exists to proceed as fast as possible.

4. Once Franco's dictatorship was over and the return to democracy took place, a restrictive monetary policy and high exchange rate were necessary but not sufficient conditions for resuming growth and structural change in Spain under a different set of institutions. A restrictive fiscal policy and moderate labour costs, together with supply-side policies to improve firms' productivity and increase the flexibility of economic sectors, such as microeconomic measures to increase the productivity and competitiveness of the non-tradables sector, are also prerequisites for sustained growth and catching up.[71]

NOTES

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1 Less intense than suggested by earlier GDP estimates (Prados de la Escosura, 1995).

2 Pre-Civil War highest GDP level (1935) was reached by 1951.

3 Annual growth rates are computed through exponential fitting. If. instead, the average rate of variation is chosen, the result for the 1940s improves (1.0 per cent, with a standard deviation of 4.4), while it remains unchanged for the 1950s (3.7 per cent, st. dev. 3.4).

4 The 6.3 per cent rate of growth for 1960 73 (Table 12.1) results from a new linkage of national accounts data (Prados de la Escosura, 1994). Official figures cast a lower rate, 5.5 per cent annually.

5 Employment grew at 0.82 per cent annually and labour force at 0.87 per cent between 1955 and 1974.

6 Non-residential capital grew even faster, doubling its ratio to output between 1950 and 1990 (Hofman, 1993b).

7 Thus, machinery and equipment doubled its share, reaching 0.44 of non-residential capital in 1973, although it contracted to 0.39 by 1989.

8 In particular, when machinery and equipment is considered, and Spain compared to the USA, France or Japan.

9 Dc Long and Summers(1991) predict a growth rate of 3.1 per cent for GDP per worker in Spain between 1960 and 1985, while the actual growth was 3.7 per cent.
10 An alternative estimate of Spain's sources of growth, using an *ad hoc* framework, has been carried cut by 1 lofman (1993a) for 1950 89, with similar results. The periodization by Suarez (1992) makes his estimates more adequate for our purposes.
11 Minor amendments have been introduced in Suarez (1992) TFP growth figures to allow inputs' contribution to growth and TFP to add up to the GDP growth rate.
12 It was a persistent phenomenon even though Spain performed well above the average up to 1973, and below- it thereafter.
13 They rely on previous research by Andres *et al.* (1993). We acknowledge their permission to use the unpublished results.
14 However, supply-side policies are not directly accounted for in this exercise and should, therefore, be included in the residual.
15 For instance, in 1950, the average years of schooling in Spain per 1000 US dollars (1985 prices PPP) of non-residential capital were one-third of Japan's (Barro and Lee, 1993; Hofman, 1993b; Maddison, 1993). This hypothesis is explored in Prados de la Escosura (1994).
16 The Primo de Rivera's *coup d'etat* in 1923 opened a dictatorial era that ended in 1930.
17 As Fraile(1993) reminds us, dictatorships are constrained by specific circumstances, incentives and preferences, within which they maximize their utility, conditioning their economic performance.
18 **FAO** was joined in 1950 when financial links were established with the USA, leading to an economic agreement between the USA and Spain in 1953. Later, in 1955, Spain was admitted as a member of the UN.
19 Catalan (1993) provides a preliminary attempt to derive a series of the real exchange rate for the 1940s and 1950s that confirms the peseta's tendency to be overvalued.
20 Tom 1940 to 1947 the exchange rate remained unchanged. In 1948, a multiple exchange rate system for activities related to exports, imports, tourism and capital movements was adopted, lasting until 1959 (Donges, 1971; Gonzalez, 1979). A weighted average exchange rate is provided by Serrano Sanz (1992) for 1949-58, using the shares of imports and exports under each exchange rate as weights.
21 It allowed exporters to keep the foreign exchange they obtained from their sales nbroad, as a means of payment for future imports. The introduction of a system of export subsidies aimed at improving the competitiveness of Spanish goods also failed in such a context.
22 This hypothesis is tested in Taylor (1994) and Lee (1994).
23 In fact, commodity imports reached an average of 11.7 per cent of GDP for the period 1947-59. In the early 1940s they remained around 5 per cent.
24 A foreign exchange crisis took place in 1959 as foreign reserves fell to S8 million from S58 million the year before, while Spain's committed payments represented $60 million.
25 Machinery and equipment per head more than doubled in the 1950s, growing at 8.2 per cent annually.
26 This procedure, called *pignoration,* was frequently used in the last century, and constituted an indirect mechanism for (inancing the public deficit that would be used as collateral against credit from the Bank of Spain. In fact, at the end of 1958, the issue of automatically pledgable securities ceased (de la Dehesa *et al,* 1991).

27 Specific limits were established to rediscount financial assets in the Bank of Spain, and the rate of rediscount was increased to make these specific loans more expensive.
28 There were four different trade regimes (state, bilateral, globalized and libera lized), depending on the degree of control and on the restrictions imposed over the different varieties of imports (de la Dehesa *et al,* 1991).
29 Still 20 per cent of imports were ruled by bilateral trade agreements and government agencies.
30 By weighting sectorial rates of protection with the sector's share in output, an *ex-post* (weighted average) effective rate of protection was derived for manufacturing by Donges (1976: 72, 76) for 1962 and 1968. Manufacturing (excluding food) was nominally protected by 31.3 percent, and by 68.4 per cent effectively in 1962, while for 1968, in turn, it fell to 23.9 and 31.2, in nominal and effective terms, respectively. Durable consumer goods received the highest nominal and effective protection, whereas machinery and equipment had the lowest.
31 A Stabilization Fund was also created with resources provided by the IMF, the OEEC and the private US banking system, to face disequilibria in the current account without affecting the rate of exchange (Donges, 1976: 59).
32 Kendrick (1990) estimates a4.2 per cent growth rate for TFP in the period 1960-73.
33 From 0.56 to 0.41 between 1960 and 1975, taking 1 as the average labour productivity in Spain's economy.
34 Spanish emigration to Western Hurope (excluding seasonal) was 0.7 million in the same period (1961-70), according to Spanish official sources, but it was over 1.3 million if receiving countries' sources are consulted. For the entire period 1960-75, official estimates recorded a figure of 1.1 million permanent (non-seasonal) migrants to Europe.
35 In 1975, Spanish final agricultural output per worker represented, in purchasing power parity terms, 29.9 per cent of the UK.'s,44.5 per cent of France's, and 16.1 per cent of the USA's (Prasada Rao, 1993), despite the significant catching up experienced over the period 1960-75 (O'Brien and Prados de la Escosura, 1992).
36 Such as leather and wooden goods, footwear, clothing, furniture, pottery and glass, minerals and metal manufactures, on Ihe one hand, and chemical fertilizers, plastic, rubber and paper goods, and transport equipment, on the other (Donges, 1980)
37 According to Andres *el al.(* 1994), only Italian macroeconomic performance has a comparable explanatory power of differential growth.
38 However, for the period 1960 -75, the current account deficit only represented on average —0.6 per cent of GDP. In turn, the commodity trade balance and the trade balance (including services) represented —6.S and —5.5 percent of GDP.
39 Adjustments were introduced in 1967,1970 1 and 1975 (stop-and-go policy)(de !a Dehesa *et al,* 1991).
40 An idea of misallocation of resources in the post-1959 years is provided by Donges'(1976: 225) estimates of the high opportunity cost of domestic resources in Spanish industry.
41 Up to 75 per cent of its energy consumption was imported (de la Dehesa *et al.,* 1991: 158).
42 As opposed to the traditional passive monetary policy followed since the Franco years, which adjusted to the public sector need for resources and led to high rates of inflation.

43 In 1978 and 1979, the negative trade balance fell sharply and the deficit on current account disappeared.
44 Pay increases were defined as a function of expected inflation, instead of last year's inflation. This measure, despite being a great step forward to break the traditional wage bargaining mechanism, would become a big obstacle to fighting inflation in the 1980s. In fact, nominal labour costs grew steadily at a higher rate than inflation.
45 A brief sketch of the delayed Spanish reaction to the oil shocks could be as follows. When the relative price of energy and raw materials rose, firms reacted by reallocating their inputs so as to increase their marginal productivity. The fall in the demand for energy and raw materials reduced labour marginal productivity. and firms had to compensate through a reduction in their number of employees at a given real wage. The contraction of the demand for energy, raw materials and labour also reduced capital marginal productivity, leading firms to reduce their volume of investment. As a consequence, the change in relative prices of energy and raw materials provoked a contraction in aggregate supply, which reduced real output growth and raised the rate of inflation. Workers suffered an important fall in real wages as a result of increases in prices, and reacted by demanding higher nominal wages. As a consequence of higher input costs (raw materials, energy and labour) and the fall in internal demand (as unemployment increased), profitability declined and firms reacted by reducing investment and employment demand once again. Some firms tried to avoid the economic crisis with new credits (thanks to the negative real interest rales, due to moderate nominal interest rates coexisting with high rates of inflation). Eventually, the measures of monetary restriction and the new attitude of lenders in a context of high inflation provoked an increase in real interest rates which produced a financial crisis in many firms.
46 Which was reinforced by the authorities' decision to keep Spain in the NATO military structure after joining (1981) and to accelerate economic integration into the European Community, achieved in 1986, which was widely viewed in Spain as the only means to reach political stability and to secure democracy (de la *DchesaetaL,* 1991).
47 Meanwhile, the commodity trade deficit and the (total) trade deficit represented an average —5.4 and —4.1 per cent of GDP, respectively.
48 The average effective protection in 1980 was 33.7 per cent (Bajo and Tones. 1990).
49 In fact, by 1985, 80 per cent of firms still had fewer than ten workers, and R & D represented 1.1 per cent of manufacturing value added, against 4.6 per cent in the EEC (Martin, 1992).
50 De la Dehesa *et al* (1991) provide alternative NAIRU estimates for 1974-9.6.6 percent, and 1980 4, 11.3 percent. Crafts (1993), in turn, suggests that NAIRU reached 9.7 per cent in 1969-79, and 15 per cent in 1980-8.
51 The yearly increase in real investment reached a peak of 15 per cent in I9S8.
52 For the years 1986-90, the unemployment rale represented, however, an average of 19.1 per cent.
53 Employment grew faster than active population (1.1 million). Labour creation in 1985-90 represented 0.3, 0.4 and 1.5 million in industry, construction and services, respectively.
54 An average public deficit of 3.8 per cent of GDP for 1986-90.
55 In fact, given their lower productivity, because of a lower capital/labour ratio and similar wage levels, non-tradables (and services, in particular) reached higher prices.

56 Spanish relative prices rose both because of structural change and internal imbalances, i.e. the impact of non-tradables on tradable goods, the small size and backward technologies of firms, and labour market rigidities.
57 Factors that favoured an appreciation of the peseta were the inflow of capital and the terms of trade gain derived from a fall in oil prices, while the reduction of tariff barriers with entry into the EC and changes in consumer preferences towards foreign goods tended to cancel it out.
58 Over —5 per cent of GDP for the trade balance.
59 Martin (1992:156) found that in the years 1986 90 final demand contributed 35 per cent and competitiveness 12 per cent to the increase in Spain's imports of manufactured goods from the EEC. In the case of Spanish manufactured exports to the EEC, Common Market demand provided 72 per cent, while competitiveness made a negative contribution. The overall increase in manufactured exports was only 38 per cenl of that for manufactured imports.
60 Long-term capital inflows represented 2.8 per cent of GDP over 1986-91, and direct investment, 1.4 per cenl. Meanwhile, the current account deficit reached — 1.5 per cent and the trade deficit, —5.2 per cent.
61 Plus an overvaluation of the peseta and negative consequences on the current account.
62 In 1987 ihe targets for the monetary aggregate were revised, and some years later certain less orthodox measures were implemented. For example, in 1989 the Bank of Spain made explicit recommendations to commercial banks to impose credit rationing, and from 1987 to 1989 the control of exchange became a frequent policy.
63 The decision to stick to the **ERM,** in contrast to the cases of Italy and the UK, might also be related to the negative experience ofthe 1 S90s, when Spain gave up the gold convertibility of the peseta (Martin Acena, 1993). The poorer performance of Spain, as compared to these two other countries, deserves a thorough investigation (cf. Camarero and Tarnarit, 1994).
64 This paragraph draws heavily on Andres and Garcia (1992).
65 Thus, potential employment is the number of workers that corresponds to the full utilization ofthe installed productivity capacity.
66 From the quantitative exercise it emerges that, in the late Franco years (1969 70 to 1971-4), the levels of installed capacity (0.6 per cent), demand (0.3 per cenl) and labour availability (1.3 per cent) accounted for all observed employment growth (2.0 per cent), although structural mismatch (-0.4 per cent) and a high labour utilization (-0.6 per cent) reduced the explained employment growth (1.2 per cent). After the first oil shock and during the 'transition' years (1971-4 to 1975 82) there were negative effects on employment derived from restrictions in the installed capacity (-2.1 per cent), in demand (-4.8 per cenl) and in structural mismatch (-1.9 per cent), while positive effects were due to the fall in labour utilization (1.9) and supply (0.1), which together account for all the observed employment destruction (-7.7 per cent). A similar picture is obtained for the post-1979 oil shock (1975-82 to 1983-6), in which the negative contribution of capacity utilization (-5.6 per cent), demand (-5.9 per cent) and structural mismatch (-3.3 per cent) increased, hardly offset by the decline in labour utilization (0.6 per cent) and supply (0 1 per cent), amounting to all the observed decline in employment (-12.9 per cent). Finally, over "the 1980s (1983-6 to 1987-8) positive contributions to observed employment growth (3.8 per cent) are derived from recovery of the levels of installed capacity (1.5 per cent), demand (2.5 per cent) and supply (0.2

per cent), while the rise in labour uttli/ation played a negative part (—0.9 per cent).

67 Thereis an ongoing debate about the reliability and feasibility of unemployment figures for Spain, as the informal sector represents a non-negligible share of total economic activity. Adjusting for employment in the informal sector would probably cast a lower unemployment rale that, nevertheless, would have increased significantly since 1976.

68]n fact, Spain's unit labour costs have increased to those in the EEC.

69 The comparison of industrial performance in Spain and Italy seems to reinforce the argument (cf. Carreras, 1987, 1992).

70 As Blanchard (1993: 232) recently put it. when one looks at postwar growth rates, the basic impression is that all countries had impressively high growth, no matter what strategy was being pursued'. If the post-1959 Spanish fast growth is viewed as a delayed postwar recovery, that contention would apply to Spain.

71 In particular, the reform of the services sector (transportation, health, education), which is linked to the reform of public administration.

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