

# **Free Markets vs. Planned Economy: A case study of economic measures in Spain**

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**Abstract:** Spain experienced an economic recession after its Civil War. While the first series of policies failed, the second series resulted in the “Spanish Miracle,” its economic boom during the 1960’s. This paper explores why some policies failed and others succeeded and draws conclusions about the factors necessary for the economic growth of a developing country.

After severe economic hardships during the 1940's and 50's, during the 1960's Spain had the highest economic growth in Europe. This drastic change is a result of a conflicting set of economic policies that were implemented in Spain during these three decades. Post Civil War Spain went into a form of economic seclusion, aiming to reach self-sufficiency through a set of government-organized plans. In contrast, the Stability Plan was a drastic policy turnaround, as it opened Spain to international trade and got rid of the artificial government controls over the economy. This paper introduces the main factors during the transition period and analyzes their impact on the actual economic growth. Further, to make sense of statistical data, it is applied to economic models such as the Lewis Model, the Solow Model, and the Big Push theory. The paper ends with a conclusion of which factors most contributed to the tremendous economic growth.

### **Autarky**

The main event of the twentieth century for Spain was its Civil War, which took place between 1936 and 1939, and left a lasting effect on the country for the rest of the century. When the war ended with the victory of General Franco's Fascists, the country was destitute. It is estimated that, as a direct consequence of the Civil War, "the Spanish nation was deprived of almost one million inhabitants" (Harrison 1978, 149). This number includes fallen soldiers and immigrants to other countries, both of whom could have contributed as workers, aiding the economy during the time that it needed a boost in productivity so badly. In the years leading up to World War II, Spain supported the Axis powers and even sent troops to the Russian front to help the Germans. After the war, Spain was out of favor with the Allies because of its past support of the Nazis and because it remained a Fascist regime. Thus, Spain did not receive the Marshall Plan, which helped rebuild other countries in Europe after the devastation of the World War. Moreover, the

Allies were reluctant to trade with the Fascist regime and Spanish index of imports dropped from 100 in the year 1935 to 64 in the year 1950 (Anderson 1970, 28). The European trade boycott augmented Spain's post war economic difficulties and, together with the Fascist ideology of protectionism, led the country to the state of autarky during the next ten years.

### **Economic Planning**

The post war era economic policy of Spain is characterized by an agrarian reform of price intervention and rationing, which had disastrous results for the economy. General Franco was a firm proponent of the rural life and tried to encourage growth in the sector through a set of economic controls. Servicio Nacional del Trigo (National Service of Wheat) was an organization founded in 1937 that fixed wheat prices and bought, stored, and sold the wheat harvest. As we have discussed in class, fixed prices are inefficient and lead to product shortages and that is exactly what happened in Spain. Joseph Harrison, a British scholar who specializes in the Spanish economic transition, found that "wheat yields fell from an average of 128 for the period of 1931-35 to 72.2 in the quinquennium 1941-45" (Harrison 1978, 157). The government is at fault for the wheat slump because its mistaken policies of fixing an artificially low price took away farmers' incentive to produce wheat and led them to abandon wheat for other, higher priced crops. However, some farmers could not switch crop production due to financial or other constraints, so they attempted to maximize their profits of selling wheat. Since the government prices were relatively low, the farmers turned to the black market to make a profit. Thus, the government policy of regulating wheat production backfired, as it led to bread shortages and the creation of the black market, which "was even larger than the official market – 55.4% of all wheat sales between 1940 and 1950 were on the black market" (Harrison 1985, 128).

Attempts to artificially foster growth in the agrarian sector also resulted in lack of funding and attention to the industrial sector. Combined with the loss of productive workers and minimal foreign trade, this resulted in a struggling economy, as “at the end of 1958, Spain had only \$10 million in reserves, and a \$60 million net deficit” (Anderson 1970, 118). During the late 1950’s General Franco was ailing and started giving in to political pressures of his advisors. An era of drastic change for Spain was about to take place.

### **The Stabilization Plan**

In 1957, aging Franco allowed for the creation of the cabinet of technocrats, who were highly educated, neo-liberalist elite. This group masterminded the drastic changes that occurred in Spain in the next decade. A questionnaire was sent out to Spanish economic and financial entities, intending to gauge the attitude towards proposed economic liberalization and integration with Europe. The overwhelming response was a positive one, “although the uncompetitive character of Spain’s economy was noted, there was generally an attitude of confidence that Spain could eventually compete on European terms” (Anderson 1970, 121). The country was exhausted after the Civil War and the subsequent food and job shortages and the people were ready for a radical change. The Stabilization Plan was instituted in 1959 with the intention to liberalize the economy while simultaneously controlling it; it was a multi-pronged strategy of investing into infrastructure and industry, opening up to tourism, and renewing international trade.

After a twenty year period of autarky, the country welcomed international trade and was eager to buy cheaper products. Spanish National Institute of Statistics has an online archive, where data shows that in 1960, Spain imported 43,286,000 pesetas worth of goods and by 1969 that went up to 296,305,000 pesetas. These imported products raised the level

of life, as people had access to new goods, but also some imported goods were cheaper than the national ones, which made it more efficient to utilize them in agriculture and manufacturing. Moreover, opening the borders forced Spanish companies to become more efficient because they had to compete with foreign companies in order to survive. This not only raised the productivity of Spanish industries but also provided them with a potential market to sell in, which will lead to tremendous financial gain from exports.

In the first years of the development plan, World Bank sent a commission of experts to analyze Spanish economy and their report suggested “the need to aim for a high rate of growth based on transfers of labour and capital from areas of low productivity to areas of high productivity” (Harrison 1978, 155). Thus, in the 1959 Stabilization Plan, the government concentrated on encouraging people to immigrate to higher productivity urban areas. The Lewis model predicts that with the exodus of surplus labor from the rural area, there will be a lower supply of workers and the agricultural wage will increase. The Spanish experience is a perfect example, where the exodus of the rural workers provoked a spectacular increase in agricultural wages. Joseph Harrison finds that between 1940 and 1975 agricultural work force fell from 50.52 to 22.91 percent of the total active labor force. As expected, agricultural wage rose by 269 percent between 1957 and 1969 (Harrison 1978, 150). This intense rural to urban movement led to a significant social change, with people settling down around large cities to obtain industrial jobs, acquiring higher levels of education and receiving higher wages; this began the creation of the Spanish middle class.

Another aspect of the Stabilization Plan was development and a high degree of government aid to the industrial sector. Spanish entrepreneurs and industrialists were provided economic incentives and tax cuts in order to encourage development. This infant industry example is one of the only cases in which subsidies are a viable strategy. Moreover, new regulations were passed which offered incentives and guarantees to foreign

investors, which greatly aided the development of infant industries. Also a legal system of property rights regulations was put into place, which encouraged private entrepreneurship and also made foreigners more confident to invest in Spain. The foreign direct investment completed the top-down portion of the Big Push theory, flooding money to the production side of the economy. The FDI allowed for technological renewal and modernization, as well as resulted in sheer increase in size which led to the economies of scale. All these factors had a tremendous effect on productivity. The SEAT is the symbol of the miraculous growth of the decade, as the Spanish car industry was born during this time period. Joseph Harrison finds that in 1959, the industry produced 36,120 automobiles. By 1973, the figure went up twenty times to 706,453 automobiles.. The Spanish Institute of Statistics has an archive of historic data, which shows the index of industrial production during the 1960's in Spain. Holding 1958 production as a base where 1958 =100, they find that 1960 production is 104 and by 1969 the production increases rapidly to 190. During this period, Spain has the fastest growth of industrial production among countries, surpassed only by China and Japan. These occurrences support the conclusions of the Solow model that capital investment will contribute to the growth of the economy.

Due to opening of the borders after the Stabilization Plan, Spain's tertiary sector, service, began growing due to tourism. Spain's rich culture, delicious food, perfect weather, and friendly people attracted tourists, soon becoming one of the most popular vacation destinations for European citizens. In 1959 Spain received \$129 million from tourism and by 1973 that number rose to \$3,091million (Harrison 1985, 155). In addition, as Spain was gaining capital from people going inside the country, it was also gaining capital from people going outside of the country; this cashflow was in the form of remittances. Harrison and Corkill find that, in the period between 1960 and 1973, almost two million Spaniards emigrated to Western Europe (Corkill 2004, 36). Two million

citizens is quite substantial, especially if one considers, at that point, Spanish entire population was under 40 million. Moreover, the Solow Model predicts that a drop in the population will lead to higher capital per person and lead to growth. During the decades when capital was vital for the growth of the country's economy, the extra cash came especially useful, "emigrant remittances covered an increasing portion of the trade deficit. By 1971 they amounted to nearly 40% of the trade deficit" (Roman 2002, 99). This data can be applied to the Big Push theory, since the money in the form of remittances was sent directly to the people, thus enhancing their purchasing power and creating a bottom-up financial flow.

## **Conclusion**

Friedrich Hayek and Milton Friedman, arguably the best known and most respected economists of the twentieth century, dedicated their lives to the argument for the unconstricted and unplanned economy and fought against any type of government interference in the market. On a more basic level, in the introduction to economics class, every student learns that the market forces are self-regulating and that it is most efficient to just let them be. This paper explores this debate by using the economic history of Spain as a template. Forced self-sufficiency and a high degree of government interference only worsened the post Civil War recession. In stark contrast, the success of the following decades can be attributed to opening up the economy and letting the market determine its equilibrium. Thus, the Spanish Miracle occurred due to efficient allocation of resources, rural to urban movement, development of the industrial sector, international trade, and the cash flow from tourism and emigrant remittances.

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