

# **Outward-looking policy and structural change: The “Spanish Miracle” of 1959-1974.**

1498 words

## **Introduction**

The “Spanish Miracle” (1959-1974) is particularly interesting as an episode of structural change because it has received little attention outside Spanish literature and because policy played a vital role. Until 1959 the Spanish dictator Franco employed an autarkic approach to policy, a result of his fascist ideology, which inhibited trade and kept the currency overvalued. By the end of the 1950s, Franco recognized this was a blunder and reversed the stance by devaluing the currency and putting forward the 1959-60 “Stabilisation Programme”, a liberalizing policy package that transformed the tariff system. In 1959, he proclaimed “Countries cannot live in isolation, they need to exchange their products, to export and import” (Iruzun, 1959), reflecting his critical shift in thought which would shape the following decades. Furthermore, the political institutions, factor endowments, and macroeconomic environment were similar in the 1950s and 1960s, and neighbors Portugal<sup>1</sup> and Italy<sup>2</sup> did not experience such a transformation during this time, which highlights the policy shift as the crucial factor.

The share of GDP in agriculture dropped by 14% (from 24% to 10%) in 15 years, with a corresponding 9% rise in services (from 41% to 50%), and 5% in manufacturing (35% to 40%). After 1974, the share of GDP in agriculture stabilized at around 9% and structural change slowed (Spanish Institute for Fiscal Studies, 1959, and Spanish National Institute of Statistics, 1979).

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<sup>1</sup> The Portuguese structural change shock occurred in 1973-1990, it was mild throughout 1950-1973 (Freire et al., 2016).

<sup>2</sup> They underwent structural change earlier, by 1935 manufacturing already accounted for the largest share of GNP (Vaudagna, 1978).

Overall GDP growth averaged 6.8% during the time, substantially surpassing competitors France (4.2%) or Italy (4.3%) (Prados and Sanz, 1996).

This essay argues that a 43% devaluation of the Spanish peseta and a reform of the tariff system were the main contributors to structural change. It focuses on the service sector as it exhibited the most impressive growth. The first section analyses the devaluation of the peseta and its crucial role in incentivizing tourism. The second section explores the impact of the most important trade liberalization policy, the reform of the tariff system.

### **Section 1: Exchange rate devaluation.**

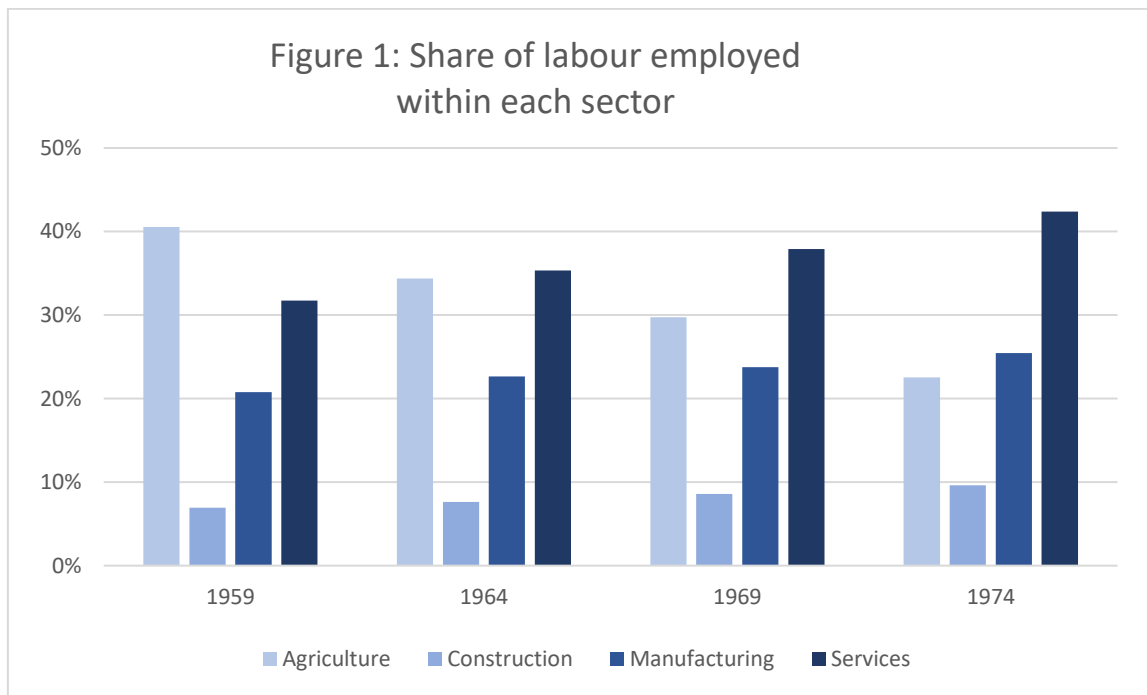
One of the dictator's key policy instruments to enforce autarchism before 1959 was to support an overvalued fixed exchange rate to promote import substitution. But inflation was high during 1954-58 (Donges, 1971), and imports during the 50s almost doubled exports (Prados and Sanz, 1996). This produced a current account deficit which meant the exchange rate had to be sustained by the country's foreign exchange reserves, which were almost depleted after an 86% drop in 1959 (Donges, 1971). Hence it became clear this arrangement was unsustainable, and as part of the 1959 "Stabilisation Programme" the peseta was devalued by 43%, and by a further 14% in 1967.

This policy was very successful in stimulating the Spanish tourist industry, which was the key driver of service sector growth (Vallejo, 2011). The share of GDP in tourism grew at an impressive annual rate of 4,0% between 1959 and 1973 (ibid.), as opposed to 1,5% for overall services. By the mid-1950s it was the most important and fastest-growing demand driver for services, and its rapid surge is primarily explained by the devaluation. As Gerakis (1965) argues, tourists became attracted to the destination given their increased purchasing power using Spanish currency and as a result, visitor inflow and average spending per individual increased.

These monetary incentives transformed Spanish employment. The endless flow of tourists provided an overwhelming demand for new urban jobs in the service sector, often in rapidly growing coastal cities like Benidorm, capturing a large share of the workforce previously employed in agriculture.

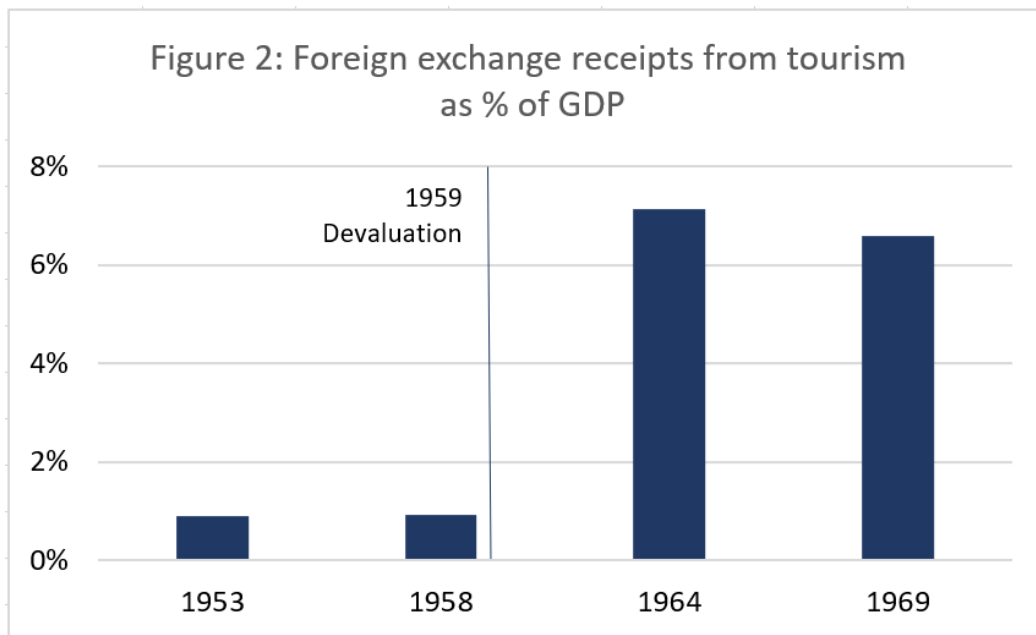
### Section 1 evidence

The employment share in agriculture dropped almost 20% between 1959-1974. The workforce was predominantly absorbed by the service sector, which grew in share of total employment by 11%, and additionally by the manufacturing and construction sectors (5% and 3% respectively).



Source: Prados (2003)

The growth in the service sector was, as suggested above, most intensely driven by growth in tourism activity. Earnings from tourism exhibited a breathtaking surge in the years after the policy was implemented. Just six years after the devaluation foreign tourism receipts, which had been stagnant throughout the 1950s, had grown tenfold.



Source: Donges (1971), Spanish Institute for Fiscal Studies (1969), Bank of Spain (1975), Bank of Spain (2021).

There is ample evidence that a devaluation leads to growth in tourism-related activities. Nwanna (1996) uses a 2SLS regression to find a positive impact of a devaluation on growth in a tourism-based economy, a similar conclusion to Pratt (2014). Gerakis (1965) analyses the Spanish devaluation of 1958 specifically, and finds that the rate of increase in tourism receipts was 134% in Spain, -46% in Portugal, and -1% in Italy after the policy was implemented. An impressive shift given that these countries had averaged 115% tourism receipt growth in the 1950s. The devaluation meant that Spain captured much of Portugal's and Italy's tourism demand.

## **Section 2: Tariff system reform**

The government not only used an artificially overvalued exchange rate to encourage import substitution before 1959, they penalized foreign trade through a tariff system based on quantitative restrictions and capital controls which had barely been modified since the 1920s. For example, industries benefitting from public incentives were prohibited from importing raw materials and capital equipment if the state considered these inputs were available domestically.

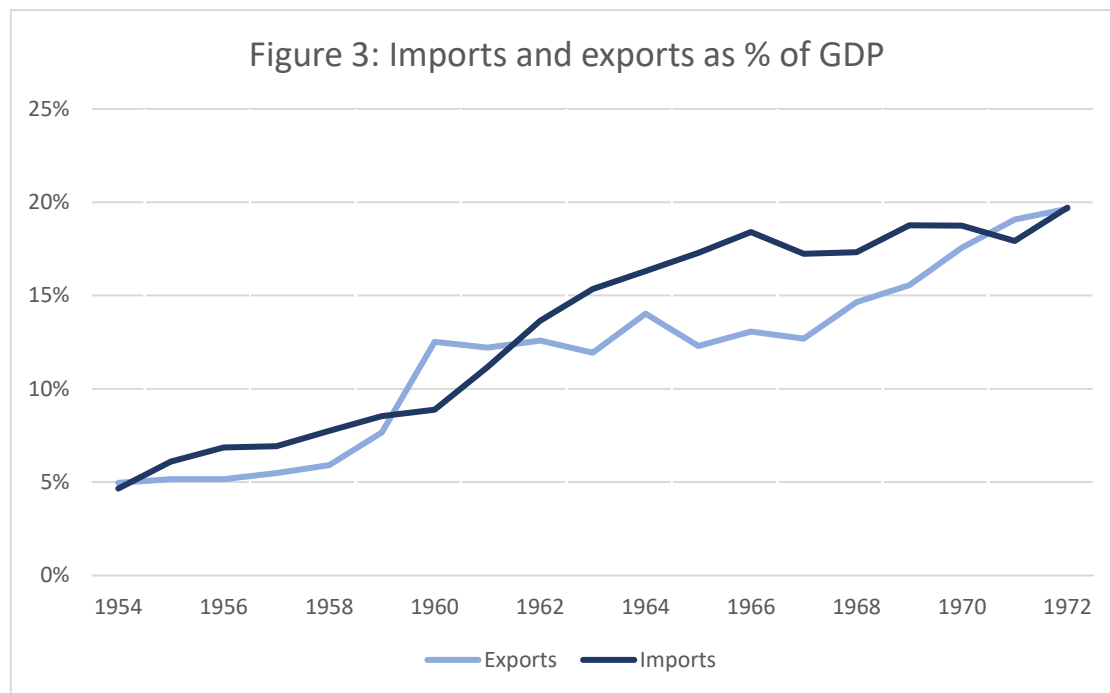
But this changed with the new policy package. This section explains Spanish trade liberalization in 1959-1974 by focusing on the impacts of the new tariff system.

The reform was introduced in 1960. Over 90% of the quantitative restrictions on imports were eliminated, and quotas were substituted by ad-valorem duties, which were gradually reduced during the 1960s. The effective rate of protection averaged 77% in 1962, 51% in 1966 and 38% in 1968 (Prados and Sanz, 2011; Balasa, 1972). Some products continued to exhibit radical tariff rates as late as 1966, such as textile products (200%), or motorbikes and bicycles (229%) (Ibid.), but according to Donges (1971), as compared with similar semi-industrialised countries at the time, Spain reasonably liberal.

The new liberal tariff scheme crucially stimulated the service sector by increasing foreign investment. In 1963, for example, controls on the share of foreign capital in “Hotel construction and operation” were completely lifted (Vallejo, 2011). The tourist frenzy meant coastal regions found themselves overwhelmed with demand for basic services such as running water, sewage, parking, healthcare, and lighting, as their population often grew ten-fold in the summer. The construction of the necessary infrastructure was only achieved with the access to foreign investment and technology that the new tariff system enabled, an effort that drew both land and labor from agricultural use (Ibid.).

## Section 2 evidence

Trade liberalization during the “Spanish miracle” was remarkable. The import and export share of GDP grew from a mere 12% in 1957 to 40% by 1972. The tariff reform in 1960 was followed immediately by a prolonged period of rising imports as a percentage of GDP, from under 8% in 1958 to almost 20% in 1972.



Source: Bank of Spain (1975), Spanish Institute for Fiscal Studies (1969)

But was this in support or detriment of structural change? Rodrik (2001) finds no conclusive evidence that liberalization *alone* encourages development, considering practically all developed economies have been protectionist in the past, and believes it will be beneficial depending on comparative advantages contingent on each country. However, as argued by Vallejo (2011), Spain enjoyed a comparative advantage as a touristic destination, with abundant sunny beaches, an attractive culture, and a favorable geographical location in Western Europe, providing ample demand for service sector growth. This suggests that, after the policy u-turn, the existence of factor endowments in a key export (tourism) ensured trade liberalization led to structural transformation.

### **Conclusion**

This essay has argued that a devaluation of the Spanish peseta and a reform of the tariff system were the main policies that contributed to the rapid flight from agriculture into the service and manufacturing sectors. The 43% devaluation prompted an extraordinary inflow of

tourists which stimulated demand for Spanish services, and this growth resulted in a pronounced shift from increasingly redundant jobs in agriculture. Trade liberalization was an important pillar in the new outward-looking Francoist regime, and it was achieved mainly through the 1960 tariff reform. The introduction of ad-valorem duties in place of capital controls and quotas attracted foreign capital and technology into the country, which helped translate the service demand into growth.

Many important industry promotion policies were not covered in this essay, but these relate only to the manufacturing sector, so I omitted them. Most literature on the “Spanish Miracle” (1959-1974) tends to focus on Spanish industrialisation, but as data shows, structural change was predominantly led by the service sector. This essay attempts to account for this fact by drawing attention only to policies that influenced it. Going forward, a more comprehensive study of the development of FDI during this time would be of great interest to this topic.

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