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The Great Depression in Spain ☆

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ABSTRACT

In the decade of the 1930s the Spanish economy reported a slowdown of 20%, less severe than the one in the US, France and Germany, but very similar to those experienced by Italy and the UK.
In contrast to the previous literature, we use an explicit macroeconomic model to analyze the Great Depression in Spain.
We study this period from the perspective of the neoclassical growth theory, taking total factor productivity [TFP] as exogenous. We find that TFP accounts for most of the downturn of the Spanish economy throughout this period, but overestimates the evolution of the GDP per working-age person as well as worked hours at the end of the period (1933–1935). When terms of trade shocks are considered, the model accounts for the evolution of foreign trade in the 1930s, but the results are not significantly improved.
Finally, introducing frictions in the labor market helps to explain the evolution of aggregate magnitudes and find a better performance of the model mainly for the period 1933–1935.

1. Introduction

The secular increasing trend in the Spanish economy was abruptly stopped at the beginning of the 1930s, and experienced a persistent slowdown throughout this decade (see Fig. 1). If we take a common detrended pattern (see Fig. 2) and compare the Spanish slump to those experienced by other countries, we find that it has been less severe comparatively with the US, France and Germany, yet very similar to Italian and the UK experiences. A sharp decrease in Spanish GDP, investments and imports – and later in exports – was reported along with a decline in consumption (see Fig. 3).

In contrast to the previous literature, we use an explicit macroeconomic model to analyze the Great Depression in Spain. We study this period of the Spanish economy from the perspective of the neoclassical growth theory, taking total factor productivity [TFP] as exogenous. We follow the methodology pioneered in the works of Cole and Ohanian (1999, 2002) and Prescott (1999), which suggests that any explanation for a Great Depression has to account for a supply shock source. Initially, we consider the Spanish economy in the interwar periods as a closed economy and calibrate a simple dynamic general equilibrium model. We feed the computed TFP into the model economy to generate the path for real GDP, capital, worked hours and other aggregates. The comparison of the model-generated path for each variable with the actual data for the same variable makes it possible to infer that TFP accounts for a substantial portion of the slump in terms of output, but do less well in explaining how hours and investment behaved at the end of the period, 1933–1935.

Next, we modify the baseline model to analyze the relevance of the terms of trade shocks. When terms of trade are considered, the results of the simulation slightly improve for the Spanish economic drop in the 1930s, mainly for the evolution of investment and consumption, while the path for the foreign sector are reproduced. Nevertheless, the evolution of the GDP per working-age person as well as worked hours at the end of the period is still missed in the model. The data show that hours worked and real wages increased in the period 1933–35, while we should expect a drop in both variables following the fall in productivity. This suggests that in the interwar period the Spanish labor market seems to exhibit particular features to be introduced in the model.

To reconcile these disparate facts, we explore the role of frictions in the Spanish labor market, whose existence has been reported by some authors (e.g. Domenech, 2011). Introducing a bargaining power in the labor market, the model reproduces better the evolution of the main Spanish economic variables.

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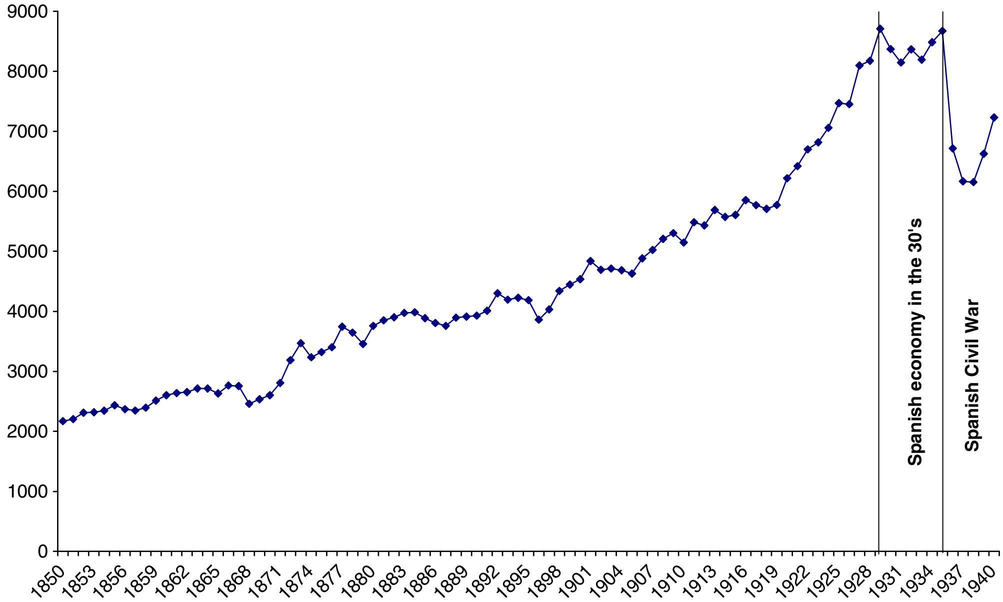

Fig. 1. Real GDP in Spain, 1850–1940 (billion of 1995 pesetas).

The rest of the paper is organized as follows. Section 2 summarizes the most relevant historical economic and political events in Spain from the Great War to the Spanish Civil War. In Section 3, we show Spanish macroeconomic performance from 1929 to 1935. In Section 4 we present our base case model, a dynamic general equilibrium model to assess the role of productivity in the Spanish slump in the 1930s. Section 5 expands the baseline model to allow for terms of trade shocks. In Section 6, we explore the role of rigidities of labor market in the evolution of the economy in the 1930s. Finally, Section 7 summarizes and concludes.

2. A historical review: Spain 1914–1935

The studies of the interwar period for the Spanish economy have been commonly divided into three subperiods: the Great War and the post-war period, the Primo de Rivera Dictatorship, and the Spanish Second Republic.[1]

Spain remained neutral during the Great War (1914–1918). The Spanish economy boosted as the export sector grew to become 15% of GDP. Massive exports to both sides of the conflict also resulted in a huge surplus in the balance of trade, so that Spanish firms increased their holdings in foreign currency. However, entrepreneurs could not make use of this foreign money, since the possibilities to import machinery were scarce because of the destruction of the foreign industrial sector. In addition, Spanish legislation restricted international movements of capital, so the Banco de España (the Spanish Central Bank) sterilized part of this foreign money and exchanged it for gold, and Spain became the fourth country with the largest reserves in the world in the 1920s. Accordingly, the Spanish economy did not need to borrow money from abroad after the war like other European countries involved in the conflict did.

The end of the Great War marked a sharp decline in exports, which dropped by 39%, while imports grew by 33% between 1919 and 1922. This came together with the closing of enterprises, the fall of prices and production activity and the subsequent decrease in profits for export firms. Principally, the large main big industrial companies (coal mining, textile and iron and steel industries) were affected, and they lobbied the government to increase foreign protection and to restrict workers' demands for wage increases. The social atmosphere deteriorated, mainly in industrial and urban areas, where terrorist violence as well as government repression of unions escalated. This period of turmoil ended in September 1923 with a military coup by Primo de Rivera with the support of King Alfonso XIII.

Primo de Rivera governments (1923–1930) supported big Spanish companies with legislative measures and financial aid, and were involved in a huge infrastructure program (roads, railways, hydroelectric plants, dams, etc.). This brought with it an increase in foreign protection throughout the 1920s, and expansive public spending.

The dictator Primo de Rivera resigned on 29 January 1930, three months after the stock market crash in New York. The government of General Berenguer returned to orthodox fiscal policies and opened a political transition. The new dictator called local elections, and this resulted in the defeat of the monarchist parties in most of the largest cities in Spain. As a consequence, King Alfonso XIII resigned on 14 April 1931, and Spain became a Republic.

The economy during the Second Republic (1931–1936) was driven by internal and external factors. Concerning the impact of the international Great Depression, Carreras and Tafunell (2004, Chap. 5.6) argue

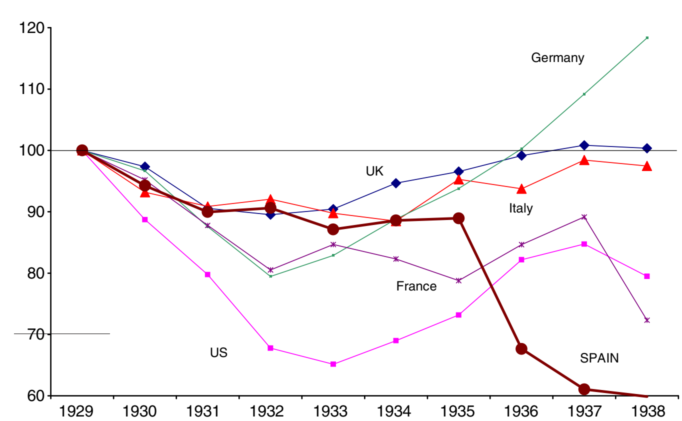

Fig. 2. Detrended real GDP per capita for several countries: 1929–1938.

[1] For an overview of this period, see Comín (1987, 1988 Chap. 5, 2002), Palafox Gamir (1991) and Carreras and Tafunell (2004, Chap. 5).