INSTITUTIONAL CHANGE AND ECONOMIC CHANGE IN 19th-CENTURY SPAIN

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ABSTRACT

The institutional changes which emerged from the liberal revolution in Western Europe were beneficial for economic growth. The concept of equality before the law, the simplification of the judiciary, more clearly defined property rights, and the opening of the market all contributed to a rapid approximation of the expected improvements in private returns with the increase in social returns. This article examines the institutional changes that took place in nineteenth-century Spain and concludes that deficiencies in the process of reform introduction led to smaller gains for economic growth than might have been expected.

Keywords: Liberal revolution, Institutional change, economic growth, Spain

JEL Codes: 043, N13, N43
RESUMEN

Los cambios institucionales que definieron la revolución liberal en Occidente tuvieron efectos positivos sobre el crecimiento económico. La igualdad de los individuos ante la ley, la simplificación de la administración de justicia, la definición clara de los derechos de propiedad y la apertura del mercado contribuyeron a una rápida aproximación entre las expectativas de una mayor rentabilidad individual y el logro del incremento de rentabilidad social. En el presente artículo se examina el cambio institucional operado en la España del siglo XIX, y se concluye con la afirmación de que los defectos en su práctica no aportaron todas las consecuencias favorables al crecimiento económico que cabía esperar del nuevo sistema.

Palabras clave: Revolución liberal, cambios institucionales, crecimiento económico, España

1. INSTITUTIONAL CHANGE, LIBERALISM AND ECONOMIC MODERNIZATION

There is widespread agreement about the positive consequences that the adoption of a liberal political system has for the modern economic growth of a given society. Without attempting to make a comprehensive list of such consequences, it is worth highlighting the possible effects of some of the institutional changes inherent in this model of society.¹

Since the times of Adam Smith, it has been generally accepted that market expansion leads to economic specialization, and this, in turn, generates increases in productivity, thanks mainly to economies of scale. Market activity existed at least twenty-four or twenty-five centuries before the triumph of mercantilism in Northern Europe, the French Revolution, or the independence of the United States. It is, however, undeniable that the implantation of the liberal model of society made a decisive contribution to the broadening of the market -this was the case in Spain- when the legal barriers that prevented the transfer of properties belonging to certain institutions, such as the Church or entailed estates of the nobility (mayorazgos), were removed.

¹ A first version of this study was presented at the tribute to Professor Miguel Artola that took place at the Universidad Autónoma de Madrid in March 1993. That version was published by A.M. Bernal et al. (1994). The author is grateful for all the comments and criticisms received, especially those of Concepción de Castro and other participants at the Contemporary History Seminar held in March 1994, at the Ortega y Gasset Foundation.
The common effects of the liberal revolution in western societies have included unified legal frameworks and the equality of individuals before institutions. The elimination of regulatory or legal peculiarities specific to a region or social class resulted in a clear reduction in the transaction costs of market activity. Thus, the generalization of the decimal metric system, the suppression of specific judicial procedures for the nobility, the universality of legal codes, the disappearance of internal customs and currency unification all served to encourage trading activity.

Two observations should, however, be made. The first refers to the potential conflict that may arise in a society with legal peculiarities if these are suppressed for the sake of greater uniformity with the rest of the regions and communities; in other words, as a result of the normative homogeneity the liberal State is attempting to impose. For the case of Spain, the socio-political consequences set in motion by the suppression of certain jurisdictional privileges and charters provide a clear illustration of this.\(^2\) The second observation refers precisely to the appearance of transaction costs that affect the economic relations between economic subjects, and which depend largely on the institutional system. In our opinion, the way in which the liberal revolution was carried out in different nations could have influenced the appearance of such costs.

Many experts have investigated these issues, both from a theoretical and a historical point of view; this has led to a rethinking of some of the assumptions made by neoclassical analysis. As North and Thomas explain, the growth of \textit{per capita} income, the true measure of economic growth, depends on two conditions. The first is an increase in the \textit{per capita} quantities of the productive factors. The second is increased efficiency of one or more of the factors of production. The latter will result from economies of scale, due to increases in the quality of the factors such as an improvement in human capital resulting from more education or job training, or physical capital thanks to new technology, or to reductions in market imperfections, for example, uncertainty and information costs, or to changes in economic organization.\(^3\) North recently insisted that the existence of transaction or entry costs runs contrary to the hypothesis of economic growth based exclusively on the integration of economic units in broad markets and free access to technology.\(^4\)

Transaction costs appear in all market relationships, but their magnitude will depend on the institutional system in place. Some transaction costs are \textit{ex ante} (drafting of contracts, negotiation, the search for bidders or applicants, access to market information) and others are \textit{ex post} (price


\(^4\) North (1990), p. 135.
negotiation, damages for breach of contract, insurance and requests for party or governmental support of an agreement).\textsuperscript{5} Regarding the equality of opportunities of individuals before the law, our current focus, as a consequence of the liberal reform the greater the potential pressure of certain individuals or groups on the institutions that set the rules or settle conflicts, the greater the probability that transaction costs will increase. Obviously, the introduction of regulations that contribute to reducing such costs, as well as competent social bodies able to monitor compliance with these regulations - and sanction non-compliance with - is one of the basic functions of the State and has very clear effects on economic growth. This is not limited to the generation of effective social mechanisms to make sure that contracts are duly respected or to avoid monopolistic practices by individuals or pressure groups. Social investments aimed at minimizing information and entry costs, for example education, should also be included. Instruction, whether public or private, affects the possibility and ability to participate in exchanges, as well as productive capacity.

The liberal revolution brought with it a characteristic definition of property rights, in which individual rights become especially important, but without implying the disappearance of communal or collective rights.\textsuperscript{6} According to North and Thomas, the defence and protection of property rights in a liberal system are the responsibility of the State, given that this is cheaper for the State than it would be for any individual or private group.\textsuperscript{7} In any case, clearly defined property rights tend to stimulate investment on the part of the owners, or users, of productive resources and will move the potential profit rate of the economic system closer to the effective one or, as Eggertsson says, bring the structural production frontier closer to the technical production frontier.\textsuperscript{8}

Obviously, poorly defined property rights -whether individual or collective- will have the opposite effects. Investment, in this case, will be held back and the possibilities of economic growth will be lower than those permitted by access to the available technology and financial resources.

In addition to market expansion, the legal equality of individuals, the reduction of transaction and entry costs, and more clearly defined property rights, there is one last aspect of institutional change - in the case of liberal reform - to consider in relation to economic change. It concerns a society’s choice of tax system and of specific levels of fiscal pressure, as well as, at the same time, deciding exactly how public spending is assigned according


\textsuperscript{6} Alchian and Demsetz (1973), pp. 16-27.

\textsuperscript{7} North and Thomas (1973), pp. 5-16.

to defined functions and bodies. The consolidation of the idea of popular sovereignty comes together here with the awareness that the State must have specific resources at its disposal to meet social needs, without other powers -the Church, the nobility- having the ability to collect revenue and determine collective spending. It is not by chance that fiscal issues are at the root of some of the most significant liberal revolutions; neither is it a coincidence that some of the most eminent historians of liberalism dedicate considerable effort to the study of the transition of the Treasuries of the Ancien Régime to modern tax systems. Without effective control by society of the ways in which tax revenues are used, and the consequent quantification and distribution of public spending, the creation of institutional mechanisms capable of guaranteeing the legal equality of citizens and reducing transaction costs would not be possible. Conversely, it is also true that, without effective equality of opportunity and without institutions capable of correcting injustices or errors in the development of social activity, the creation of a sufficiently fair fiscal system would be unlikely. This leads us to the observation that the institutional changes inherent in liberal reform depend on each other.

2. INSTITUTIONAL CHANGES IN SPANISH LIBERALISM

It is difficult to verify the consequences that the institutional changes of liberalism had on the economic modernization of Spain in the 19th century. Firstly, and from a general methodological point of view, as critics of the new institutional history observed at an early stage, it is difficult to provide explanations for the interconnection between political or social factors and those of an economic nature using quantitative procedures. It is, then, not easy to put forward a rigorous definition of a precise causal relationship between an institutional variable and another of an economic nature; all the more so when univocal reactions of subjects or groups in the face of the same historical changes do not exist. Secondly, and moving to the specific case of Spain, it must be considered that the institutional creation of liberalism was a slow and contradictory process; its chronological limits being found in the Cortes de Cádiz, on the one hand, and in the Glorious Revolution (1868-1874), on the other. Thirdly, the liberal revolution in Spain coincided with two other important historical changes. One of these changes was the loss of almost all the American territories between 1810 and 1824, the economic consequences of which opened an interesting debate. On the other hand, Spain experienced a long, almost uninterrupted, period of wars lasting thirty years, from the confrontation of the monarchy of Carlos IV with the French Convention to the unsuccessful

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efforts to contain the Spanish-American emancipation movement. Josep Fontana clearly quantified the financial cost of these wars. In 1808, before the confrontation with the Napoleonic armies, the accumulated internal debt of the State was 7,198.7 million reales of which 71.2% corresponded to the reign of Carlos IV (from 1788 to 1808) during which the wars against France and England took place. In 1820, the State’s internal debt had almost doubled, reaching 13,120.5 million reales. Of this amount, 48.1%, that is, 6,305.8 million reales corresponded, according to Fontana, to unpaid expenses during the War of Independence and to interest payments pending on the public debt. After 1828, more than 7,000 million reales disappeared from the calculation of the internal debt without justification; this could be explained by the unilateral and arbitrary liquidation by the government of the obligations contracted at the end of the Ancien Régime with its national creditors, especially with the suppliers of the armies who had fought in the War of Independence.¹¹ This leads us to two conclusions: on the one hand, the cost of financing the wars at the end of the Ancien Régime fell unequally on the various taxpayers and economic sectors of the nation; on the other hand, despite the abrupt reduction of the debt at the end of the 1820s, Spanish society would still have to shoulder a heavy financial burden for many decades. This means that, coinciding with the possible consequences of political change, the Spanish economy of the 19th century would experience, simultaneously, the effects – even in the short and medium term - of Spanish-American emancipation and of the State’s indebtedness, with this financial burden probably representing more than 150% of the national income of the late eighteenth century.¹² Naturally, in addition to the effects brought about by these changes, we must also underline the marked influence that population growth, links with international markets, capital inflows, and the adoption of modern technology had on the evolution of the economy in the 19th century. This all means that it is practically impossible to even attempt to quantify the consequences of institutional change on the Spanish economy; we can, at least, put forward some explanatory hypotheses. In order to establish these hypotheses, an attempt will be made to relate some of the observations and deductions explained by the new institutional historians with the interpretations that some contemporary historians have presented regarding the liberal reforms in Spain.

In order to define precisely our objective, the economic consequences of the institutional change brought about by the liberal revolution, we can focus on the period 1833-1875; that is, from the regency of Queen María Cristina, when Isabel II was a minor, to the Restoration of Alfonso XII. In this period, the deflationary effects of the interruption of trade with the American continent had already been overcome, and, as previously


¹² The data are from the calculations of Prados de la Escosura (1993), pp. 271-176.
mentioned, most of the financial burdens incurred at the end of the Ancien Régime had been eliminated swiftly.\textsuperscript{13}

We will now examine how the main institutional changes of the liberal reform in Spain which could have affected economic growth were carried out; these included market expansion, the equality of all individuals before the law, a redefinition of property rights, reduced transaction and entry costs, and the fact that State income and spending were determined by the citizens’ representatives.\textsuperscript{14}

The expansion of the market as a result of the liberal revolution took various forms in Spain. The suppression of the guilds and the disappearance of the Mesta helped to eliminate barriers in the land market and the manufacturing sector. It was, however, above all, the land disentailment process, initiated in 1798, followed by the abolition of entailed estates in 1836 which became definitive in 1841 (although prolonged until the second half of the 19th century), the process that liberalized the real estate market. It can be assumed that Spanish agriculture expanded during the first half of the 19th century, that is, during the period when Church property was confiscated.\textsuperscript{15} As observed by Gonzalo Anes, this permitted an increase in population, alongside a trade policy involving the export of food products. The population grew by almost 35\% between 1800 and 1857. The same author reminds us that the Church owned the best land and that, according to some testimonies, much ecclesiastical land remained barren.\textsuperscript{16} In fact, once the Mendizábal and Espartero confiscation cycle had been completed, the new crops would be grown on lower quality lands and average yields tended to decrease, especially cereal crops. The data provided by Gabriel Tortella in a recent synthesis of contemporary economic history, indicate that the last stage in which assets belonging to the clergy were sold for a considerable amount, 1858-1867 (1,253 million reales compared with 3,447 million reales in 1836-1844), coincides with the period during which the production of wheat per inhabitant reached a peak, in the 19th century.\textsuperscript{17} Tortella stresses the fact that, as well as the changes affecting property, other innovations, such as the construction of the railway system or the increase in population, could have influenced the increases in agricultural production and productivity. However, the information available seems to confirm that the alienation of previously entailed properties -without forgetting the abolition of the nobility’s entailed estates (mayorazgos), leading to changes in properties previously held by the nobility-, and the

\textsuperscript{13} Sardá (1987), pp. 243-248.
\textsuperscript{14} For a more detailed review of these changes, see Tedde (1994).
\textsuperscript{15} Tortella (1994), pp. 51-54.
\textsuperscript{16} Anes (1970), pp. 235-263.
\textsuperscript{17} Tortella (1994), pp. 44-54.
disappearance of the Mesta, must have had a positive impact on the efficiency of the Spanish economy.

The fact that all citizens were equal before the law and before the courts, proclaimed by the Cortes of Cádiz, led to a reduction in transaction costs, by simplifying the procedures for claiming contractual obligations and universalizing the legal authorities responsible for resolving litigation. Thus, the end of entailed estates (mayorazgos) probably resulted in a reduction in transaction costs, by speeding up the procedures in claims before the courts involving the debts of those belonging to the nobility. Specifically, in cases of suspension of payments of former holders of entailed assets, creditors were able to exercise their rights more quickly and with greater guarantees as a result of the liberal reform.\(^\text{18}\)

However, the concept of equality before the law and the courts was sometimes more theoretical than real. This can be seen by the way in which the seigniorial regime was dismantled. In Spain, seigniorial estates became free property; a property now belonged to the former seigneur of the estate while jurisdictional rights over the estate disappeared, with the State taking over, thus bringing to an end the obligation to provide payments and services. Miguel Artola explained the lengthy series of social conflicts and lawsuits caused by this institutional change. On the one hand, there were cases in which the former lord claimed communal and vacant property as private property. On the other hand, attempts were made to confuse the benefits derived from the jurisdictional rights with the payment of land rent, characteristic of the rental system.\(^\text{19}\) Salvador de Moxó, in a book that deals with the dissolution of the seigniorial regime in Spain, notes that, on the old seigniorial jurisdictional estates, farmers often went from being hereditary cultivators and permanent owners of their farms to becoming temporary tenant farmers. In this way, not only was the obligation to make payments to the former lord, now the owner of the allegedly leased lands, maintained, but the legal link between the farmer and his land was broken, opening up the possibility of being displaced from the cultivated land.\(^\text{20}\) In other words, following the disappearance of seigniorial jurisdictional estates, peasants who should have become the legal owners of their land became mere tenants, lacking the security of perpetual ownership and without the powers derived from ownership, such as those of selling or transferring the property. Conflicts between lords and peasant communities were brought before the courts and tribunals, dragging on, in many cases, for decades. Moxó points out that jurisprudence usually favoured the former owners of estates or their successors. The same author highlights the fact that some of


\(^{20}\) Moxó (1965), p. 86.
the decisions which went against the interests of the peasants were made during periods with a liberal government characterized as revolutionary or radical, such as the period 1868-1874. The debates on agrarian reform, during the years of the Second Republic, featured many old peasant grievances regarding this cause. Claudio Sánchez-Albornoz refers to the "enormous fraud that was committed in the mid-19th century, a fraud that was supported by the Spanish Courts".21

The fact that the judicial system favoured the interests of the former lords distorted the hypothetical legal equality of all citizens and resulted in the alienation of large sections of society from the liberal regime and even in the political radicalization among peasants.22 Antonio Miguel Bernal recently highlighted the differences, on this issue, between the dissolution of the seigniorial regime in Spain and the French model of liberal reform. This author underlines the fact that the Spanish process was very slow, and the appearance of sequels more than a century after it had been concluded.23

This leads us on to another of the characteristic transformations of the Spanish liberal reform: the redefinition of property rights. The security provided by property rights, enshrined in law and protected from arbitrary acts or external interference, should have encouraged investment and therefore increased productivity. This phenomenon should have occurred even more clearly when the new owners enjoyed plentiful resources, as Richard Herr explained for the cases of land disentailment he researched.24 On the contrary, poorly defined property rights, in both the case of communal property and that of individual farms, over an extended period of time, would have the opposite effect, discouraging investment, especially that of a costly nature and, therefore, keeping productivity below potential levels.

In Spain, the adoption of rules favouring trade fluidity and providing security to investors, and in general to those involved in market activity because they tend to reduce transaction costs, took place relatively early. It is significant that during the last decade of Fernando VII's reign - in the midst, then, of an anti-liberal reaction - a series of regulations aimed at facilitating trade and productive innovations was announced. In 1826 the patent system was regulated.25 In 1829 the first Commercial Code, establishing a jurisdiction that affected all trade activity regardless of the condition of the parties was published, and trade records were established.

In the same year, the Banco de San Fernando was founded in the capital of the kingdom, and two years later the Madrid Stock Exchange commenced its activity. Without a doubt, these two institutions were created with the main objective of obtaining financial resources for the State, but, even to a limited extent, this situation facilitated the exchange of financial assets and the generation of means of payment. As happened for decades in the mid-20th century, an anti-liberal political regime was able to coexist with the introduction of rules favouring market activity. It cannot be ruled out, in either case, that those first steps on the path of economic freedom and equality in the market finally required deeper institutional changes. On the other hand, the survival of regional legal systems until the end of the 19th century brought higher levels of transaction costs than in other countries. However, special norms of general scope, such as the Mortgage Law of 1861, were included in the aspects of the civil law of a more economic nature. In this line, the unification of the monetary system and that of weights and measures should also be mentioned.

Likewise, when taking into account the transaction and information costs which the State could have reduced, we must also consider the relative slowness in the construction of railways in Spain; this meant that clear physical difficulties for market relations persisted for several decades. The poor public education system in Spain, lagging behind other European countries, must also have resulted in low levels in the formation of human capital and in the persistence of entry barriers affecting technical innovation, investment, and the market.

Thirdly, the poor allocation of resources for the administration of justice -with clear effects on the resolution of economic conflicts- is evident if we observe how spending in this area, in proportional terms, rose by only half of the increase in total public spending between 1845 and 1860. And that happened after the period between 1830 and 1840 when total spending decreased in absolute terms.

We now turn our attention to the liberal reform of the tax system and public spending policy. Firstly, as Enrique Fuentes Quintana, Miguel Artola and Francisco Comín, among others, observed, the modernization of the tax system in Spain clearly took place rather slowly; during almost the whole of the first half of the 19th century a fiscal situation reminiscent of the Ancien Régime persisted. Following the reform of 1845 - which was

to remain almost unchanged, in essence, for more than half a century - problems such as insufficiency, rigidity and lack of equity in the distribution of the tax burden became clear.\textsuperscript{30} The oligarchic character of 19th-century Spanish society, observed clearly in the reform of the seigniorial regime as previously mentioned, was also present in the design of the fiscal system. It was easier for those with most power to evade part of their tax obligations, given the way the principal tax (on agricultural production and real estate) was structured. In addition to this situation, some highly productive economic activities were hardly affected by taxes. Likewise, the relative weight of indirect taxation, generally seen as more regressive than its direct counterpart, was very high. This resulted in a situation of chronic budgetary deficit, the need for State indebtedness and, as became clear over time, high levels of fraud. The need to pay high amounts of interest on the debt each year meant that other areas of public spending were limited to relatively modest proportions in comparison with other European countries. The negative consequences for economic modernization are obvious.\textsuperscript{31} It should be pointed out, at this point, that the Spanish case is not unique. As Gabriel Tortella observed, the liberal system in Southern Europe (Spain, Portugal, Italy) during the 19th century and the first half of the 20th century, was fragile and poorly constructed. The financial system of the State is one of the aspects in which such deficiencies are seen most clearly. In Southern Europe the oligarchic nature of political organization meant that the vast majority of society was excluded from collective decision-making. Furthermore, the low productivity of the economy, the fact that most of the population lived in rural locations, and the low levels of per capita income made it difficult to access information and political decision-making centres. There was, then, an interaction between slow economic growth and a defective political system.\textsuperscript{32}

We can conclude by remembering that in Spain, as in other southern European countries, the pace of economic modernization during the 19th century was too slow; it was not until well into the 20th century that these economies were able to approach the levels of northern economies. Factors such as the Mediterranean climate and the excessive altitude of many agricultural areas, the lack of good entrepreneurs, and the almost total lack of integration of industry in foreign markets have been cited as lying behind the backwardness of the Spanish economy. Institutional causes related to the circumstances mentioned in this paper also played a part. In Spain, as in other nations, the results of the liberal reform as regards its effects on economic modernization, were contradictory. Neither information nor

\textsuperscript{30} Fuentes Quintana (1990), Tedde (1984).
\textsuperscript{31} Tedde (1985), Comín (1988).
transaction costs were reduced by appropriate amounts, property rights remained poorly defined for a long period, and the financial organization of the State did not respond to the needs of the new society. This is not to say that the liberal revolution should not have taken place or that its influence on the economy was totally negative. Spain’s 19th-century liberal reform probably had more positive than negative consequences; this should not cover up the defects and deficiencies of some institutional changes. Similarly, economic change did take place, albeit at an excessively slow rate. Gradual economic growth, then, took place alongside an incomplete process of political modernization.

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