

An expansionary economist against fiscal discipline in mid-19th century Spain. The lonely shepherd

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Abstract:

Since the early modern age, the debt of the State was a constant source for concern to the Spanish governments. Episodes of defaults caused by enormous expenditure to keep the Empire slowly faded out until a certain reorganization of public finance was attained in the central decades of the 19th century. The core idea that finance ministers and economists in general had at that time was to balance the public budget controlling expenses, in order to handle the problem of public debt. However, alternative views on government finance existed. Focusing on a crucial period for the consolidation of Spanish liberal regime and its public finance, this paper shows that, among a predominant concern for reducing public expenditure as the best way to stabilize the economy and promote economic growth, the character of Luis María Pastor emerges to support government expansionary policies financed with credit. Far from fearing deficit, Pastor, one of the leaders of the Spanish liberal school of economic thought, believed that investment in infrastructures financed through debt was the key to economic growth. Through a multiplicative effect, a program of public investment would enhance economic growth, eventually solving the long-term insufficiency of Spanish finance. This gives evidence that ideas on public finance of classical liberal economists were far from uniform, contributing to a more precise view on the body of doctrines of this school.

Keywords

Public finance – public debt – public budget – fiscal policy – liberal school

JEL Codes: B12, H54, H63

Introduction

Controversies on government financing have been never-ending since the time in which modern states began their processes of consolidation back in the Modern Age. The building of liberal regimes in the 19th century was a turning point, as governments assumed new attributions and hence expenses that required financing (Cardoso and Lains 2010, Yun and O’Brian 2012). Defaults and bankruptcies, relatively common in

the Modern Age, slowly faded away in Western countries during the liberal age, and by the second half of the 20th century remained a concern only to nations on their way to development. Most recently, the global crisis of 2008 and ensuing stimulus programs have revived the debate on government finance, in which countless economists have intervened.² The particular question of whether nations should observe fiscal discipline or engage in expansionary budgets has been one of the star topics at discussion. This debate is however far from new. Although the action of the government became a genuine part of economic science in the 20th century, and especially since the works of Keynes, it can be traced back to earlier times. In effect, economists of the 19th century dealt extensively with this matter, albeit with different perspectives.

Mainstream political economy in the 19th century, the classical liberal paradigm, established that governments should be small, keep the doctrine of balanced budget, and borrow only as an extraordinary resource. British classical economists believed that debt creation involved consumption of capital by the government, a decrease in private capital, and higher taxes (O'Brien 1975, 260). Hume is credited for having condemned debt in his famous sentence "either the nation must destroy public credit or public credit will destroy the nation" (1752, 135). Smith (1904 [1776], 400-404), Malthus (1803, 440), Ricardo (1951 [1817], 244-248) – more intensively – and Mill (1936 [1871], 873) expressed their rejection for public borrowing for those reasons. They only accepted it in wartime (O'Brien 1975, 262-264).³ French liberals did not detach much from this conception. Public borrowing was costly, created perverse incentives and had a crowding-out effect (Silvant 2017, 16-17). J.-B. Say's negative opinion on public debt (1803, II, 518)⁴ was adopted by his successors, for instance Droz (1842, 265) or Garnier (1846, 308-309). Puynode, in his entry "Public credit" in the Dictionary of Coquelin & Guillaumin (1852, I, 510) – the Bible of French liberalism – praised Ricardo's anti-debt

² This has been done in academic writings, the traditional media and the internet, where there has been an explosion of websites and blogging on these topics. Some controversies have become famous, as that on public debt and growth triggered by Reinhart and Rogoff (2010).

³ Ricardo did not even accept war borrowing. Mill considered that in an economy fully stocked with capital, government borrowing would not harm. Malthus approved debt as far as it entailed interest payments to unproductive classes, which would keep the level of consumption.

⁴ In his *Traité*, Say considered government consumption as unproductive, but he shifted opinion in the *Cours*, accepting that some public works are reproductive, because its value is not consumed immediately (1966 [1828-1829], II, 251).

position, and said that only wars and revolutions excused borrowing.⁵ In countries where classical liberalism prevailed, economists suggesting a more active role of public credit – for instance Saint-Simonians or socialists in France (Coste 2016) – had a limited presence in the public sphere. The main exception were German economists, who in the second half of the 19th century were “pioneers in recognizing the positive role that government and public debt could play in promoting productivity growth and capital accumulation” (Holtfrerich 2013, 24). This was the case of Dietzel or Wagner.

Ideas of Spanish economists on public debt in Spain were not different from French. While Say’s influence took over Spain at the beginning of the century, since the decade of 1840 the economic panorama was dominated by the followers of the *école de Paris*, the so-called *escuela economista*. Members got inspiration in the works of economists as Bastiat, Garnier or Dunoyer, the *Journal des économistes* or the Coquelin and Guillaumin’s *Dictionnaire d’économie politique* (Almenar 2000, p xxv; Lluch and Almenar 2000, 115-116).⁶ Therefore Spanish economists’ view on public credit followed the French lines, since the beginning of the century, for instance Valle Santoro (2012 [1820?], 63), Flórez Estrada (1828, 426-429) and Torrente (1835, III, 275), and continued with the *economistas* as Colmeiro (1859, 361) or Carreras (1865, 468). They considered public debt as a short-term solution to immediate finance troubles, bound to create major disturbances in the future. However, liberal economists’ views on public finance turned out to be not so homogeneous. Within the very heart of the orthodox group of the *economistas*, a powerful dissenting opinion emerged at the beginning of the decade of 1850. Luis María Pastor, an early and prominent member of the school, opposed the archetypical position of fiscal discipline and gloomy views on public debt, and supplied with a radically different view of public debt: a perfectly efficient instrument for economic development. In his works, but especially in a series of renowned debates in the Parliament, in a period of financial distress, Pastor faced the overwhelming pressures for cuts in expenses to balance the public budget, and

⁵ Puynode in any case reckoned that if national Treasury is exhausted, it is preferable to borrow than to raise taxes, although both are regarded as negative expedients. Léon Say, the author of the homonymous entry in the *Dictionnaire des finances* edited by himself in 1889, showed much less pessimism about the dangers of public loans (1889, 1341-1342)

⁶ Bastiat’s influence was particularly important. His negative views on the public sector rested on the idea that public officials did not act guided by self-interest, which rendered their actions less efficient (1851, 477).

supported an expansionary program of public investment financed with credit. Ensuing economic growth would raise tax revenues and solve the troubles of public finance.

The case of Pastor is exciting for two reasons. First, he being one of the leading members of the classical liberal group of economists, his position, which he kept in time, was unique. Second, his enthusiasm is even more praiseworthy, as far as the issue of public debt was extremely sensitive in Spanish finance. Old famous episodes of default, and frequent operations of financial engineering in the first half of the century, made Spain to be regarded as a bad example of recklessness in public finance management. At a time when the liberal parliamentary system struggled to consolidate, Spanish policymakers were fully conscious of the need to gain a position of solvency and reputation in finance. Not only economic doctrine, but also political interests led Spanish economists and policymakers to seek an equilibrium in public budget. This was an obsession for finance ministers. José Echegaray would later coin an expression that conveys this idea: “To Christians, salvation lie in the holy fear of God; to ministers of finance, to the government, to the Parliament, to the nation [...] salvation lies in the holy fear of deficit” (DSC-CD 1905, 693).⁷

This paper explores the ideas of Pastor on public debt, using his works, but especially the debates on policy where he intervened. It is thus following an institutional approach to the history of economics (Coats 1993), stressing the importance of studying the political activity of economists, and very in particular their interventions in the Parliament. The objective is not only to determine in a more precise way their economic contributions, but also to better understand the nature and evolution of economic discourse. This is particularly relevant in a period of consolidation and diffusion of economics (Augello and Guidi 2005, 6). In this regard, this paper supplies with a new approach that comes to complete previous research on Pastor (García Ruiz 1996, Martín and Perdices 2000, Román 2003, Martín Rodríguez 2009). This paper is divided as follows. The first section is a brief introduction to Spain’s public debt problems in the second half of the 19th century. The second analyses the political debate where Pastor confronted his views on debt to conventional thought. The third traces Pastor’s ideas in

⁷ Cristóbal Montoro, the minister of finance of Spain in 2000-2004 and 2011-2016 recalled this quotation in 2014 to justify contention in public expenditure so that Spain could regain a position of international solvency after the Euro crisis. *El economista*, 17/02/2014.

a different framework, the decision to restructure public debt. The fourth section deals with Pastor's later works, and the last one concludes.

Spain's public debt in the second half of the 19th century: Tightrope walking

Recent research has established that in the second half of the 19th century there was a notorious improvement in the circumstances of public debt in Spain. Permanent debt crisis – the consequence of the legacy of the Ancient Régime – gave place to a situation in which all past debts were recognized by the Spanish new liberal governments and duties in general paid although not always in due time.⁸ This was possible thanks to a series of programs of debt restructuring, which were rearrangements of payments involving a certain reduction in them, that creditors were (more or less) constrained to accept (Álvarez-Nogal and Comín 2015, 377). This was not only a matter of debt sustainability; there also existed a crucial component of nation building. As García and Pro (2015, 187) have pointed out, the program of debt restructuring of finance minister Bravo Murillo in 1851 was the necessary supplement to the previous tax reform by minister Mon in 1845, with the neat objective of culminating the process of building of the Spanish liberal state. This process was led by conservative liberals, after an extremely convulse first half of century of civil clashes between absolutists and liberals. Financial stability was a requisite for political stability and the insertion of Spain in the group of modern European nations. Comín and Yun (2012, 260) conclude that after these two episodes, the everlasting problem of public debt started to solve. But despite these efforts the second half of the century was not trouble-free. The weight of debt to GDP grew in times of political convulsion and decreased with other rearrangements: After Bravo's action, debt fell from 91% in 1850 to near 60% of GDP in 1863-64. It then escalated until 1876, when it attained its highest historical level, over 160%. This was an extremely convulse period in which a colonial war in Cuba combined with an absolutist upheaval, the democratic revolution of 1868, the First Republic in 1873 and

⁸ It was in 1834 that, after the fall of the absolutists, liberal cabinets decided to acknowledge previous commitments. On the chaotic situation of public debt in the first half of the century, see Vallejo (2015). Canga Argüelles, a contemporary expert in public finance, stressed Spain's history of bad credit record (1825, 165-177).

the monarchy restoration in 1874.⁹ A new restructuring in 1882 managed to drop the debt ratio below 70%, remaining there all the decade of 1880. A new increase was the consequence of the war against the US, leading it slightly over 130% of GDP in 1902 (Comín and Díaz 2005).

Virtually every minister of finance considered debt a gigantic problem: First, because the debt service compromised a big share of the government revenues. Second, because political instability, weak economic growth and a poor record in its management (including suspension of interest payments and threats to repudiate past commitments with changes of regimes), made accession to credit for the Spanish government extremely dear. Although government borrowing was deemed an extraordinary resource, in practice it turned ordinary due to the impossibility of attaining the budget equilibrium, as the tax system revealed insufficient and inefficient (Comín and Yun 2012, 258-260). On the other side, risk of default made creditors prone to accept debt rearrangements, but they could also exert strong pressures on the Spanish government to get privileges (for instance, foreign syndicated creditors with support of their respective governments). The main task of finance ministers was to cope with the urgent problem of paying interests on time. The expression “arreglo de la deuda” (debt arrangement) became popular in the second half of the century.¹⁰ Although issuing public debt became a common exercise, from the doctrinal perspective finance ministers did not detach from the orthodox liberal doctrine of equalizing public income and expenses.¹¹ This was the position of the vast majority of economists, policymakers and the public opinion, resting on the liberal idea of loyal administration. Martín Rodríguez (2009, 244) pointed out that with the exceptions of Pastor and Mendizábal, during the decade 1844-1854 the idea of restrictive policies and equilibrate budget was wholly predominant. Only in the last decades of the century new interpretations for public debt gained scope, in particular the idea that borrowing could be a bridge to fulfill the need

⁹ Difficulties for Spain to borrow at that time were such that it deserved a mention by Puynode in the Coquelin-Guillaumin dictionary edition of 1873 (509).

¹⁰ Pérez Galdós, a very renowned literate of the epoch published a brief roman entitled *Miau* in 1888. “Miau” (the cat’s onomatopoeia), was also the acrostic of the novel main character’s project for Spain: morality, income tax, custom tariffs – *aduanas* – and unification of public debt.

¹¹ Comín (2000, 625) points out that finance ministers, despite their doctrinal and practical knowledge, were constrained to cope with urgent businesses and political pressures. This prevented them from implementing policies in line with their ideas.

for an increase in public expenditure to set the bases of a solid economic growth. Pastor heralded this idea much earlier.

Comín and Yun (2012, 261) pointed out that financial irresponsibility of the government (debt arrangements and – later – monetization) and insufficient tax revenues prevented a financial revolution in Spain. The bond market was closed to small savers, the consequence of the high risk of public bonds, and resource to loans from big banking houses would be recurrent when markets refused to negotiate Spanish bonds. Besides, the underdevelopment of Spanish financial markets prevented national savings, in particular in rural areas, to be channeled into public bonds, simply because of the lack of financial intermediaries (Comín 2010, 666; Moreno 2015, 281). As a result, the structure of the Spanish debt in the second half of the century was biased, with a high proportion of external debt (the largest in Europe). In spite of all this, Spain could in general obtain foreign credit without enormous difficulties, thanks to its mining resources and the revenues of Cuba, both of them used as collateral for loans. In any case, irresponsible debt management had a negative impact on the Spanish economy, as foreign creditors demanded excessively high rewards for lending (Nadal 1975). Consequently, debt servicing burdened too much on the budget.¹² A new solution to this problem emerged after 1874 in the form of inflation and currency depreciation, monetizing debt. Spain could do this because it was in a de facto fiduciary monetary system, as it had not joined the gold standard, staying in a silver standard when the price of silver fell dramatically.¹³

The debate on the public budget in 1850-51. To cut, or not to cut, that is the question

In 1849, replacing Alejandro Mon, the architect of the deep tax reform of 1845, Juan Bravo Murillo – a liberal moderate conservative – was appointed minister of finance. He had three most important businesses on his desk: the deficit in the public budget, the

¹² Debt servicing accounted for one third of the budget, except during war and the democratic six-year period, between 1868 and 1874 (Comín 2010, 236).

¹³ Coining silver and issuing banknotes would be the way to pay for the Cuban-American war of 1898, without surcharging taxpayers. Many economists condemned this practice of debt monetization. Leroy-Beaulieu (1906, 764) was particularly belligerent. Others saluted it, like Piernas Hurtado.

restructuring of public debt and the reform of custom duties. Bravo decided to prioritize the correction of the deficit. He had actually inherited quite a dramatic situation from his predecessor. The tax reform of 1845 had not been fully implemented yet, and ordinary revenues could hardly cover ordinary expenses.¹⁴ Once in office, and after analyzing the situation of the Treasury, Bravo concluded that his only option was to reduce deficit by cutting expenses.¹⁵ To this aim, he designed a plan for action, which comprised three points: a rationalization of expenses, a reform in public accounting and the simplification of public finance management. He expected that these actions would stabilize public finance and lead to the next big step, the rearrangement of public debt.¹⁶ Bravo gave two reasons to tackle the deficit problem. The first was doctrinal, a matter of principles: budget should be balanced, because differences between revenues and expenses were “abnormal and incompatible with the regular life of a State”:

“The Council should not expect ingenious maneuvers or empirical recipes to get out of this situation, making the future worse. I am convinced that the enormous deficit is an inevitable evil in these moments, and that attention should be called to diminish it, using the expenses budget, but in the least extent possible [...]. The fundamental principle, which must steer any arrangement in public finance is that expenses equal revenues, otherwise said, that the State budget is true.” (Bravo 1865, 50-51).

The second reason was politic: neglecting deficit might bring to Spain the “disruptions and commotions” that Europe had suffered in 1848. According to his plan, deficit should be tackled improving the tax collecting process (he discarded increases in tax rates), and reducing the government expenses, “without harming the services it must provide (DSC-CD 1849, 4, appendix, 19-20).¹⁷ As mandatory, Bravo took his plans to

¹⁴ Pro (2006), 202-207 says that privately (but not publicly), Bravo blamed his predecessor Mon for the disastrous circumstances of Spanish finances, perhaps as a maneuver for political promotion. However, Bravo, who had no previous experience in finance, appointed Santillán as his chief advisor, the man behind the tax reform of 1845. Bravo was not an economist but understood and accepted the liberal principles on public finance.

¹⁵ Bravo would have regarded with sympathy investing in public works. He had been previously Minister of Public Works and had encouraged the construction of roads and railways. But he knew that the current conditions of the Treasury did not allow that.

¹⁶ Bravo Murillo (1865), I, 46-55. This work, written years after he left the Ministry, served Bravo to vindicate his action as minister, stating that all these dispositions managed to level the budget (1865, I, 59).

¹⁷ As an immediate resource, Bravo announced the temporary suppression of one monthly payment to public officials and two to pensioners, on behalf of the urgent “circumstances”.

the Parliament. In his discourse he stressed the need for cuts in public expenses, underlining that his plan for cuts was feasible, and would not harm neither the State well-functioning nor the public interests. He faced the opposition of other members of the Parliament claiming for larger cuts. Bravo also announced that he refused subscribing new loans, in order not to increase the debt burden. As he said, a new loan “would set the bases for the bankruptcy of the country, and I will never vote for the bankruptcy of the country” (DSC-CD 1849-50, 953 and 1850-51, 458).

But Bravo’s fiscal orthodoxy found a tough opponent in the Parliament, Luis María Pastor (1804-1872), a well-known character in the political and economic life of the country. Pastor was one of the founders of the liberal school of economic thought, the *escuela economista*. An apostle of economic liberty, Pastor strongly supported free trade and the doctrine of free banking (García Ruiz 1996). He was passionately fond of the study of political economy. To him, this was the key to economic progress and social development.¹⁸ Pastor had a deep knowledge of economic contemporary literature. He admired the works of Smith, Say, Flórez Estrada and Bastiat (Martín and Perdices 2000, 500). He had a long career as politician and public official: He was a member of the parliament from 1846 to 1873, first in the Congress of the Deputies (1846-1858) and then in the Senate (1863-1873), always in the ranges of the moderate conservative party, the same party of Bravo. He was the Director of Public Debt in 1846-47, a position which conferred him with reputation on debt matters, which was crucial to his appointment in 1849 as the representative of Spanish bondholders to lobby during the process of Bravo’s debt restructuring. In 1853 he was minister of finance for a brief period of three months. Seligman (1908, 180) said that he was “in Spain ... the chief of the earlier writers on finance”.

Pastor decidedly opposed Bravo’s policy of cutting public expenses. Instead, he proposed an alternative policy of expansionary budget, which included a big program of public expenses in infrastructures (particularly railroads), financed with credit. These investments in public works were necessary to supply the country with the means required to follow the path of industrialization and modernity, like other advanced

¹⁸ His discourse of entry to the Royal Academy of Moral and Political Sciences, in 1863, was meaningfully entitled “Reflections on the importance that the study of political economy is acquiring”. Pastor attributed the wonders of progress to the “conquests” of political economy, which “are producing a revolution which has already changed ... the face of the Earth” (Pastor 1863b, 27).

nations. The multiplicative effect of public investments would lead Spain into a phase of economic growth. Increasing tax revenues would cancel the endemic problem of deficit in national accounts. Restrictive budgets, Pastor thought, were just short-term solutions to the budget deficit, but did not tackle the true economic problem of the nation, namely its inability to start a process of sustained economic growth.

Pastor was actually very critical to the idea of reducing expenses to balance the budget. Claiming that only with “savings” it was possible to solve the difficult circumstances of public finance and eventually attain the nation prosperity was “a dangerous illusion”. “I do not think that prudent and politic individuals should praise too much ideas that later will prove impossible to put into practice”, he said. Pastor only admitted that a little reduction in the budget for the Army was possible, but he feared that the rest of Bravos’ cuts consisted simply on delaying or avoiding payments:

“Are we going on eternally calling ‘savings’ to the fact of not paying? [...] This cannot happen, it is compulsory to pay our commitments. We do not have here savings, because insolvency is not saving [...] It is necessary to get into the path of order and to pay scrupulously”. (DSC-CD 1850-51, 474)

Naturally, leaving aside his plans for investments, short-term commitments should be faced in time. How? Pastor made some proposals (which did not actually differ much from Bravo’s budget): First, a reform in the tax system, especially the collecting process (according to his data, the cost of tax collection in Spain was around 20% of tax revenues, whereas in other countries was 10%). Second, a reform – reduction – in custom duties. In both these recommendations, Pastor was in fully agreement with his fellows of the *escuela economista*. First, because they were wholly in favor of a complete liberalization of trade; and second, because Pastor supported the idea that ideally nations should level ordinary expenses to ordinary revenues. But, he would say later in the Parliament, he did not think that breaking this equilibrium temporarily was such a serious problem (DSC-CD 1850-51, 471-474).

But Pastor’s most original vision rested on his belief of the immense economic possibilities that credit opened to less developed nations. Credit could and should be used for investments, (“reproductive expenses”) aimed at increasing the national output. Credit conveyed a huge power:

“Credit [...] in modern nations has been the lever that has allowed them to get out of their troubles and lead them to the highest degree of prosperity [...] Does anyone believe to enter into the great movement of civilization thanks to tax cuts or economies? These colossal works cannot be achieved without credit.” (DSC-CD 1850-51, 474-475).

He censured the conventional opinion of politicians and economists that credit was an extraordinary resource for governments and that public debt was, in essence, an evil. On the contrary, Pastor proclaimed, debt should not decrease, but increase. The Spanish government should subscribe new loans to build railroads, in order to place Spain in the group of advanced nations (DSC-CD 1849-50, 782-783). Pastor did not avoid the criticism that taking loans meant transferring burdens to the future. For him, debt was not a burden for next generations, because they also took advantage of the investments made with credit.¹⁹

Pastor did not ignore that Spain’s financial circumstances were far from satisfactory, and that this was a permanent topic for debate in the public opinion. He played down this fact: Financial difficulties were natural in a nation having endured intense political conflicts and trying to start its path to development.

“I do not take part in this exaggerate fear that I have seen for the state of our public finance... It is not surprising that our country, which has suffered so much disturbance, has a bigger or smaller deficit”. (DSC-CD 1849-50, 786)

Even more, contrary to the opinion of economists, politicians and the public opinion, Pastor stated that Spanish debt, in relative terms, was not big at all, but much smaller than the debt of advanced European nations. A sensible debt conversion, which he forecasted creditors would welcome, could reduce public debt to a manageable size. Pastor did not stop there. To the astonishment of his fellow members of parliament, Pastor culminated his discourse mentioning something that was anathema to the majority of them and the public opinion:

¹⁹ This was such a common criticism. As O’Brian (1975, 259) pointed out, classical economists believed that debt transferred a burden to future generations for the very reason that it decreased private capitals and thus future growth (besides future higher taxes). Mill was the exception: Financing some extraordinary expenses with debt would be “mostly beneficial beyond the existing generation, there is no injustice in making posterity pay a part of the price” (1936 [1871], 876).

“If Spanish debt is not disproportional, I believe that deficit is even less. Deficit is something that should not frighten us at all”. (DSC-CD 1849-50, 786)

Deficit is big when it is mistakenly financed with reductions in expenses. Deficit should only be financed through public loans (provided that Spain has recovered investors' confidence). All advanced nations have big budget deficits, and have resorted to bonds issuing. Spain, instead, was just relying on cuts in expenses and tax revenues, exhausting taxpayers and damaging creation of new capital. Pastor was an optimistic: This situation could be reversed. Moreover, it was then the opportunity to do that. Spain had avoided the convulsion of 1848 that had shaken Europe, so the country was in a good international position. It was the right time to restore the nation's credit, and resource to loans in good conditions.

“Credit is still not available for us as we would like, but I hope that it will not take long to see it strengthened and placed in the position that corresponds to it”. (DSC-CD 1849-50, 787).

Transparency would be the necessary complement to get creditors' confidence. To attain this, Pastor uttered that the regulation of the national accounts should be very strict.²⁰

Between Bravo's austerity and Pastor's expansive program, it is interesting just to mention the intermediate position of the third economist taking part in the budget debate, the former finance minister Alejandro Mon. He was at discomfort, because he was pointed out as the responsible for the financial troubles of the nation (or for not having been able to solve them), so he tried to vindicate his actions when in office.²¹ Mon stood against the claims for bigger cuts in expenses that many parliamentarians and a part of the public opinion demanded,²² and supported measures such as improving the transport infrastructure and liberalizing markets to promote trade. But his strategy was diametrically opposed to that of Pastor. Instead of borrowing, it was first necessary

²⁰ DSC-CD 1849-50, 868-869; 1850-51, 471-475. Pastor's expertise in the management of public debt was not neglected. Some of his indications were incorporated into the law of public accounting.

²¹ Mon was criticised essentially for two matters: First, for having overstated revenues and understated expenses (the archetypical charge made to any finance minister); second, for having taken some unclear loans with big banking houses (DSC-CD 1849-50, 1005-1011).

²² Targets for cuts were the expenses in the Army, justice and education. Some politicians demanded closing down some universities and secondary education institutions.

to solve the public debt problem and then make public investments, but out of the regular budget (DSC-CD 1849-50, 1037-1041). This was not pure naiveté: Mon was recalling his 1845 tax reform, still not at full capacity, under attack from some sectors of the Parliament for not having given the expected outcome. Mon hoped that, when completely developed, it would apportion enough revenues to invest in infrastructures. He shared however Pastor's views that budget deficit was not such a big concern, thus playing down criticism to his action when minister (DSC-CD 1849-50, 1039 and 1061-1062).²³

Bravo's budget plan was supported by the Parliament conservative majority, endorsing cuts in expenses and postponing investments in public capital (DSC-CD 1849-50, 605). Bravo was nevertheless moderate in his policy of diminishing expenses. The right wing of the conservative party, demanded a combination of more radical cuts, a reduction in taxes (especially the land tax) and a deep reform in the administration and the Army. (DSC-CD 1849-50, 671-691 and 787-789).²⁴ Only three progressive liberals, led by Juan Pedro Muchada (the author of a well-known book on tax reform), opposed the budget project. They regretted that only a minimum share (less than 2%) was devoted to finance public investments, "at a time in which all nations hurry to open new roads, build new railways and begin works of public utility" (DSC-CD 1849-50, 697-702).²⁵ Bravo eventually managed to equilibrate the budget, which granted him with a high reputation of efficiency.

Debt restructuring: Gain financial reputation to spend more

²³ In any case, he acknowledged, deprived from the possibility of issuing bonds (since payment of interests was suspended in 1836), Spain was bound to have deficit.

²⁴ A large number of parliamentarians distrusted the budget presented by Bravo's cabinet, as historically provisions hardly fulfilled. A report by the Member of Parliament Bermúdez de Castro, showing that the assessment of public revenues was completely overstated, is a classic example (DSC-CD 1849-50, 661-666).

²⁵ These parliamentarians claimed for a quick rearrangement of public debt, so that, once the credit of the nation is restored, new loans could be subscribed to finance these works. As progressive liberals, they also suggested a reduction in custom tariffs and the abolition of consumption taxes in the future (the old aspiration of the progressive party). They also joined the general demand of reducing unproductive expenses and simplifying the administration.

In 1851 Bravo was appointed Prime Minister, but did not leave his position as finance minister. Bravo premiership combined authoritarianism and meticulous management, putting back discussions on principles and ideas and prioritizing pragmatism. His policy of austerity continued. It was time now to address the problem of the excess of public debt, through a full restructuring.²⁶ Bravo opted for expediency: He put aside considerations on creditors' rights, ignoring voices that deemed the commitments of the State "sacred", and focused on the actual capability of the Treasury to pay. His objective was an arrangement that adjusted exactly future public debt commitments to realistic expectations of availability of financial resources, not incur into further deficit. In order to make payments of interest shrink, Bravo planned a reduction in the nominal of sovereign bonds according to their actual market quotation. He justified this action on the fact that, in practice, bonds were negotiated in the market, so actual bondholders had acquired them at a lower price than their nominal value (Pro Ruiz 2006, 354-355). Aware of this plan, creditors complained, inducing Bravo to make some changes in the bill of debt restructuring. Eventually the majority of bondholders accepted the conversion, agreeing to a reduction on their claims, in exchange for guarantees that they would be effectively paid.²⁷ Bravo's arrangement was probably inescapable, to make Spanish debt sustainable (it was in fact a declaration of insolvency), but was also beneficial to the Treasury and most bondholders. His ulterior objectives were to rebuild Spanish credit abroad, try to start a solid line in the management of public debt (abandoning past erratic behavior) and attract rentiers to the Spanish bonds, getting rid of short-term speculators (Moreno 2015, 266).²⁸ In general, after Bravo's plan was implemented, the Treasury managed to pay interests in due time. For the largest part of

²⁶ It is important to have in mind that Spain had a poor record in the fulfillment of debt commitments. A significant share of Spanish public bonds had interrupted interest payments in 1836. The quotation of Spanish securities had plummeted in European exchange markets, and some of them did not quote at all. The rearrangement of debt was crucial to restore Spanish lost credit, so that borrowing would not be in the future as onerous as it used to be (Comín 2016).

²⁷ Some moderate conservatives stood against the project. This was the case of Alejandro Mon, in a new episode of the rivalry between Bravo and himself (DSC-CD 1850-51, 1712-1720). Although most creditors accepted the arrangement, some were far from satisfied, in particular the British. This made that Spanish bonds did not quote in London, and later in other markets. A new arrangement in 1867, more favourable to creditors, would redress the situation.

²⁸ Moreno pointed out that the final objectives were, first, to set up a stable legal framework conferring guarantees to bondholders and lowering transaction costs to the government; and second, to create a market for the Spanish bonds with transparency in rules and information.

this period, the Treasury had primary surpluses, so, leaving the service of debt aside, revenues were over expenses.²⁹

Pastor was closely following this process, but this time his situation – and interests – were diverse. He had accepted the position of secretary of the Commission of Bondholders of Madrid, so he was a representative of Spanish creditors. In a discourse addressed to the board in charge of drafting the bill of the debt rearrangement, he attacked the reduction in the nominal value of bonds for two reasons: First, this was arbitrary, and had never been done in previous plans of debt arrangement. Second, and more important, taking as benchmark for this reduction the market quotation entailed giving some creditors preeminence over others, when their right to be reimbursed was equal. But, aside from these particular points, Pastor warned that this operation would prevent Spain from getting new loans. As he uttered in the budget debate, credit supplied with enormous advantages to nations. But these advantages were the natural consequence of honoring commitments, with no exception. This, he said, was the key of the “colossal power of England”, which Spain should imitate, instead of maneuvering to illegitimately reducing the debt burden. The government should apply these “sound economic principles” (*Documentos relativos al arreglo de la deuda pública* 1851, 86-88).³⁰

Pastor was actually reproducing ideas he had expressed in a well-known booklet written slightly earlier, in 1848, *La bolsa y el crédito*, which condensed his experience as the Director of Public Debt. This was an analysis of the bust of Madrid stock exchange of 1848, and the shrink in the quotation of public bonds, after the revolution in France. Pastor was enthusiastic of stock markets; he considered them essential instruments to channel private savings to finance public works and infrastructure, and to supply investors with secure rents. He despised the opinions of those who considered them instruments for speculation and immoral gains, especially concerning forward transactions.³¹ Pastor considered that the irregular behavior of the quotation of Spanish

²⁹ Actually, this financial mattress allowed the government to tackle debt restructuring. This does not mean that it could impose its terms in the negotiations (Moreno 2015, 267).

³⁰ Pastor’s statement in the budget debate that Spain had a small debt (and consequently should honor service) was also in other creditor’s pleas to Bravo, local and foreign. *Documentos* (1851), 52-53, 61, 66 and 76.

³¹ France banned forward transactions in 1846, with harmful consequences on the quotation of public bonds. Spain followed shortly after, also with the same effects (Pastor 1848, 28).

sovereign bonds was due to the fact that a large share of those bonds were in the hands of speculators. Stability of Spanish bonds required that they should be replaced with long-term bondholders, this is, rentiers (here he agreed with Bravo's aims). For this to happen, bonds should be trustworthy, and that depended on a definitive and convincing arrangement of the Spanish debt. In this book, Pastor's expectations on such an operation were very optimistic, if properly done (1848, 45).

In 1850, when Bravo's plan was being designed, Pastor published his book *Filosofía del crédito*. In the introduction, recalling his experience at the head of the office of public debt, Pastor admitted the difficulties policymakers faced when trying to apply doctrines into policy, as other factors beyond theoretical statements (he was referring to vested interests), intervened (1850, viii-ix). After a protracted analysis of public debt in England, France and Spain in the previous three centuries, Pastor concluded that nations, at all times, incur into expenses larger than ordinary revenues. Budget deficit, therefore, turns into a very common "necessity". According to his calculations, nations required around 10% of their annual income to finance State basic services. Tax revenues cover the expenses of these services. However, at any moment, any event (wars, social turmoil, natural disasters, etc.) requires an increase in expenditure, compelling citizens to make bigger sacrifices. Budget equilibrium breaks off and the government has to face the dilemma whether not fulfilling all commitments (which damages national credit), or raising new revenues increasing taxes. (1850, 141-143).

Pastor's answer to this trade-off was straightforward, anticipating ideas that would become commonplace one century later. Pastor fully opposed pro-cyclical policies: What becomes necessary in periods of crisis is to implement expansionary policies. Increasing taxes in time of national distress should be totally discarded; instead, the right decision is precisely to cut taxes (but he observed that such was the first resource of policymakers when national finances are in precarious conditions – "mistakes prevail").³² The judicious way out in a situation of financial crisis is just public borrowing, acting as a counter-cyclical policy that does not depress further the economy: "Debt preserves the welfare of individuals, and therefore of nations in

³² Actually, Pastor said, the most common behavior in public finance is a combination of two actions: Some commitments are left unpaid (for instance, wages of public officials and the military and payments State's purveyors), with the consequent decrease in the quality of services provided, and taxes are raised (1850, 144).

general” (1850, 144). Facing a threat or big calamity, the government should calculate its extra needs of funds so that taxes are not increased and financial commitments are honored. The economic activity will thus not be harmed and public services will continue to be provided. Pastor regretted that Spanish cabinets were most obstinate in persisting on the mistake of solving their financial distresses just diminishing expenses (1850, 148-150).³³

But public borrowing was not just a resource to manage crisis. Pastor’s original vision of public credit now surpassed by far the considerations he expressed in the budget debate of 1850-51. To him, public credit was the one and only means for societies to “follow the secular movement of the world”. This was not a matter of economy; it was a matter of the progression of History, civilization and humankind; the natural force that led human beings to strengthen bounds. This evolution, which was inevitable, compelled governments to make extraordinary expenses:

“Normal expenses of States are limited to preserving their mere existence. But in order to improve, to progress, to follow the relentless movement of civilization, something more is required”. (1850, 151)

This “something more” meant “reproductive expenses [...], the object of which is to create the capital of nations”. They were wholly indispensable for nations not to standstill while the rest moved forward. But nations could not finance these crucial expenses out of the ordinary budget. Nor they could wait to accumulate savings until they could afford a network of railroads, because in the meantime they would be overcome by other nations, leaving them hopelessly unable to compete. Funds to finance these huge projects could not either be raised from extra taxes; first, because taxes only can cover ordinary expenses; and second, because it will not be fair to present generations to pay for a long-term investment that will benefit future generations.³⁴ Nations should inescapably resource to public borrowing (1850, 151-158).

³³ Here Pastor gave the examples of two nations with opposed financial behavior (a common topic in Spanish economic literature). England was the good case, financing its deficits through loans, and Spain was the bad case, raising taxes and cutting expenditure.

³⁴ It is interesting that Pastor here turns around the problem of intergeneration transferring of tax burden, reversing the traditional argument against public debt.

The final part of the book is an obvious attempt to lobby on Bravo's plan of debt restructuring. Pastor now focused his attention to stock markets. These are institutions where the weight, power and influence of nations are measured through the quotation of their bonds and the ability to market new issuances. Sovereign debt not only apportions funds to invest to promote economic growth, but is an essential tool to set many small capitals in motion, in exchange for an interest. All this splendid mechanism only works if governments honor their commitments regularly. In some countries public bonds are a primary object for people's investments, as yields are certain and constant and capital can be recovered if necessary (1850, 255-266). Unfortunately this was not the case of Spain. However – Pastor continued – Bravo's plan, if well designed, could redress this situation and give a big push to national output in the form of railways and roads, financed with new credit (1850, 286). A successful restructuring would entail two advantages: First, Spain would benefit from an appreciation of the quotation of sovereign bonds in stock markets; second, reputation gains would imply that future loans would be less dear. Pastor proposed three measures to this end (with the aim of them being incorporated to Bravo's scheme): First was resuming payment of interests to consolidated bonds. Second was accelerating annual amortization in order to decrease the debt burden. This would be done selling public properties and increasing the part of the budget for debt servicing (around 20% of public revenues). Third, detach the administration of debt from the Ministry of Finance, and set up an independent "Direction of Public Debt", after the models of the commission of debt consolidation in England and the amortization fund in France, in order to separate the resources to finance debt from those for current expenses (1850, 321-334).

Pastor's extremely optimistic views on public debt were rare, if not unique, among Spanish contemporary economists. As Silvant (2017, 17-18) has shown, some French liberals had a more positive view on public debt: Blanqui highlighted in 1826 the fact that it avoided a big burden on taxpayers. Rossi considered public loans "a useful and precious resource, which can render a government the most valuable service" but then warned of its inconvenients (1865), while Courcelle-Seneuil thought that it was useful "when capitals has been well invested" 1858). But none of them showed such a positive

opinion on the immense possibilities of public loans.³⁵ A close opinion was that of Portuguese politician Fontes Pereira de Melo, who was the Minister of Public Works and later Prime Minister. An enthusiast of railroads, he favored public borrowing to finance investment in infrastructures to modernize the country (Mata 2002, 35-37). According to Mata, his policies have been interpreted as a variant of Saint-Simonism (2002, 35). Coste (2016) pointed out that Saint-Simonians advocated using public loans to finance public policies, but (up to now) there is no evidence that they had influences on Pastor.

Pastor's late works: Public finance, politics and institutions

Filosofía del crédito had a second edition in 1858. The structure of the book changed completely, but ideas remained unchanged.³⁶ This is a much better organized text, written without the hurry of the first edition, issued in the framework of the negotiations of Bravo's arrangement. Joaquín Sanromá, a fellow of the *escuela economista*, in his preface to this new edition, praised it as the first specific book on credit in Spanish economic literature (1858, III). He also pointed out Coquelin's influence on Pastor, more precisely the idea that credit serves to channel capitals and accelerates their positive action on national output (1858, xvii-xviii). In effect, Coquelin praised the action of credit and banks in his articles and his long *Du credit et des banques* (1848), where he spoke of the "magic effects of credit" (1848, 54) and of its advantages: it makes capital reserves active, multiplying its "reproductive power", enhances circulation (1848, 63). He expanded them in a long chapter (1848, 111-156). But he was mainly referring to private credit, and did not mention whether these effects would be the same for public loans.

Pastor's enthusiastic judgement on the effects of public credit on economic growth revived in his most well-known work, *La ciencia de la contribución*, a two-volume

³⁵ Much later, in 1877, Leroy Beaulieu recommended using public debt to finance public works which could not finance out of taxation (Silvant 2017, 18). But Pastor went far beyond, never considering taxes to finance public investments.

³⁶ This second version of the book was edited by Enrique Pastor, Luis María's son, who was the director of *La Tribuna de los Economistas*, one of the short-living journals (it was published just in 1857-58), which served as outlets for the ideas of members of the *escuela economista*.

textbook on taxation and public finance edited in 1856, which attained quite wide circulation, turning into one of the main texts of the *escuela economista*. In this book, Pastor condensed his ideas on public credit scattered in his previous writings and parliamentary interventions. Neither in the second edition of *Filosofía del crédito* nor in *La ciencia de la contribución* Pastor's experience as finance minister in 1853 led to a shift in his previous views.³⁷ Nevertheless, in *La ciencia* he developed slightly more his position on public debt. Supporting the need for the government to subscribe loans to finance reproductive expenses, now he acknowledged clearly that this was a big point of disagreement with his liberal fellows:

“[Public] loans escape from the narrow bounds that the heads of the *escuela economista* considered. Instead of being used for unproductive expenses, which don't leave any trace but are negative consumption, they turn now into reproductive creations, useful capital, to the development of wealth [...], and also supplies with an interest and a quick amortization to the lender” (1856, II, 226-227).

A new feature was that now he showed very enthusiastic on public investments in railways, which he forecasted would render high profits. This would make the government able to repay credits fast.³⁸

Pastor recalled his old idea that financial reputation was necessary in order to afford public loans. But now he turned to politics, making a strong case for representative regimes. They were preferable from a financial standpoint, as these regimes follow the rule of law, whereas absolutist governments and revolutionary governments were ruled by the monarch's will or by “popular passions”. The evidence he provided was the market quotation of sovereign debt.³⁹ Financial reputation is attained when current expenses are paid out of current revenues, this is, when the ordinary budget is equilibrate. Exceptions were unforeseen cases, which – Pastor insisted – might happen

³⁷ Pastor was minister of finance for less than one year, in 1853. In this brief period he issued bearer banknotes and other short-term instruments (with little success), and tried to involve the Bank of San Fernando (the precursor of the Bank of Spain) into credit operations with the Treasury. Ramón de Santillán, in his memories (1996, 387-388), criticized these measures.

³⁸ This comment was new in Pastor's writings, probably because his previous works were written when Spanish railway network was still very small. Pastor's predictions would prove wrong, however.

³⁹ This comment is not trivial in the context of Spanish public finance history, when absolutist governments repudiate the debt commitments of previous liberal cabinets. It entailed also a criticism to the authoritarian drift of Bravo's cabinet, who had closed the Parliament, and successive cabinets, which ended in the liberal revolution of 1854 opening the “progressive biennium” (1854-1856).

quite frequently happen. Pastor added two new conditions – institutional – to hold the credit of nations: First was a solid respect to property rights. In this direction, Pastor criticised a recently passed piece of legislation that favoured the administration when facing claims of individuals having contracted with the State. This kind of measures, Pastor uttered, made public borrowing dearer. The second was transparency, which Pastor had already mentioned in the budget debate of 1850-51. Pastor demanded that government agencies supplied investors with precise information of the economic circumstances of the nation. Even if these were difficult, transparency would strengthen credit, whereas ambiguity would harm it. (1856, II, 232-234).

A new book in 1863, *Historia de la deuda pública española y proyecto de su arreglo y unificación*, culminated Pastor's reflections on public debt, this time addressing the history of Spanish public debt, and the projects for its rearrangement.⁴⁰ Debt restructuring was, in his view, such an important matter as that of the reform of custom duties (considered by his fellow *economistas* the most crucial problem of Spanish finances). Recurrent “mistakes” on debt management along history exasperated Pastor, who denounced bad practices and claimed for “sound doctrines”. Restlessly, Pastor highlighted the importance of public loans, adding now a new interesting perspective: In his opinion, public debt steered the country's rates of interest, because public bonds represented the cost of opportunity of any other investment on behalf of its stability, safety, flexibility and liquidity. The rate of interest is a crucial variable for the progress of industry and trade, for it leads investment. In this regard, Pastor regretted the low quotation of Spanish public bonds, as investors demanded higher yields than to other countries (1863, 5-6).⁴¹ Pastor believed that mistakes in the processes of public debt rearrangements in Spain had been essentially two. First was giving preference to some securities over other, arbitrarily. This criticism pointed out directly to Bravo's plan (1863, 178-180).⁴² Second was failing to give enough confidence to investors, when successive cabinets decided not to honor previous commitments. This lack of trust had

⁴⁰ After Bravo's arrangement, Spanish public debt decreased. However, interests servicing as the share of State total ordinary revenues had increased continuously since 1850, reaching 25% in 1862 (Álvarez-Nogal and Comín 2015, 198). Another restructuring was made in 1867, by minister Barzanallana.

⁴¹ Here Pastor appears to contradict an idea of his book *La ciencia de la contribución* (1856): Bond quotation seemed independent of circumstances which should matter, such as the form of government.

⁴² Pastor was attacking Bravo's reduction in the nominal value of some bonds, which not only was arbitrary, but benefitted privileged bondholders twice, because the quotations of their securities increased. Pastor believed that although the conversion of 1851 seemed successful, there were still problems, in particular that the government was deprived of the right to amortize bonds at its will.

placed Spanish public securities at the bottom of European bonds (1863, 219-227). And – Pastor reaffirmed his crucial message – restoring the nation's credit was essential to attract non-speculative capitals and get loans to finance the infrastructures the country required to join the group of advanced nations (1863, 252-253).

Concluding remarks

Debt and public finance in general turned a subject of increasing concern to economists and policymakers that run parallel to the strengthening of the liberal state in the 19th century. In the particular case of Spain, in the framework of the consolidation of a liberal parliamentary regime, redressing the long history of defaults and mismanagement of public debt was felt necessary to obtain economic and credit status within the European sphere. Mainstream thought, inspired in the ideas of the liberal school, stated that the means for restoration of financial reputation and credit was austerity in the public budget, cutting expenses to correct deficit and reduce the debt burden. This problem solved, it would be time for the nation to invest in public works, to promote development and growth. But the panorama of economic ideas was not so uniform. Dissent emerged from the very heart of the liberal ranges. Luis María Pastor, one of the founders of the liberal school, a credited expert in public finance, supported a radical opposed view that considered that the solution to debt and deficit was the opposite. In his view, expansionary budgets to invest in public works to promote economic growth would have a multiplicative effect that would cancel the problem of debt, as a wealthier nation would apportion more revenues to the State. This would be financed with credit. Reducing expenses would have a disastrous effect on the economy, because this deprived the country of investments required for development. In times of crisis this expansionary strategy is even more necessary. Credit and financial markets, channeling savings to productive investment were the sole key to prosperity. This such optimistic opinion – rather rare in this context – allows saying that liberal economists in the 19th century kept different views on some matters regarding public finance. Even if agreeing in the idea of balanced (ordinary) budget, there were disagreements on essential matters of policy.

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