THE POLITICAL ECONOMY OF SPANISH FINANCIAL SECTOR AND FOREIGN POLICY

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EGE TEKİNBAŞ

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Prof. Dr. Sencer Ayata
Director

I certify that this thesis satisfies all the requirements as a thesis for the degree of Master of Science.

Prof. Dr. Meliha Altunışık
Head of Department

This is to certify that we have read this thesis and that in our opinion it is fully adequate, in scope and quality, as a thesis for the degree of Master of Science.

Assoc. Prof. Dr. M. Fatih Tayfur
Supervisor

Examining Committee Members

Assoc. Prof. Dr. M. Fatih Tayfur	(METU, IR)	
Assoc. Prof. Dr. Sevilay Kahraman	(METU, IR)	
Assoc. Prof. Dr. Elif Akbostancı	(METU. ECON)	

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Name, Surname: Ege Tekinbaş

Signature:

ABSTRACT

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TEKİNBAŞ, Ege
M.S., Department of International Relations
Supervisor: Assoc. Prof. Dr. M. Fatih Tayfur

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This thesis analyses the Spanish financial system and foreign policy from a political economy point of view. The foundation, development and transformation of the financial elite in Spain and its affiliations with the policy-making elite are the main concerns of this study.

The traditionally complex and interlocking relationship between the financial elite and the policy-making elite in Spain is a perfect showcase to demonstrate how policy and economy affect each other interchangeably. The financial system of Spain has always been highly oligopolistic which led to the continuation of its traditional political and economical protection for many decades before, during and after the liberalisation process went underway. This traditional protection has a very unique characteristic given the fact that it survived nearly a century, under a succession of various political and regulatory regimes with very different ideological agendas. "How could the banking sector preserve its power and influence under many different political ideals and economic orientations" is one the questions to which an answer is sought in this study. Naturally, this answer also covers the origins and structure of the power and influence that the financial elite held over the domestic and foreign policies of the country.

Also, the mutual and complex relationship between economy and foreign policy as well as policy-making elite and economic elite, is analysed in this thesis. In other words, the consequences of the shifts in foreign and domestic policy agendas on the Spanish financial elite are studied.

Keywords: Political economy, Spain, financial elite, national champions, Spanish foreign policy

ÖZ

İSPANYA FINANS SEKTÖRÜNÜN VE DIŞ POLİTİKASININ POLİTİK EKONOMİSİ

TEKİNBAŞ, Ege
Yüksek Lisans, Uluslararası İlişkiler Bölümü
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Bu çalışma, İspanya finansal sektörünü ve dış politikasını politik ekonomi bakış açısı ile incelemiştir. İspanya'da finansal elitin oluşumu, gelişmesi, dönüşümü ve siyaset çevreleri ile bağlantıları bu çalışmanın ana konularını teşkil etmiştir.

İspanya'da siyaset çevreleri ve finansal elit arasında tarihsel olarak süregelen karmaşık ve içiçe geçmiş ilişkiler siyaset ve ekonominin birbirilerini ne şekilde etkilediklerini göstermesi açısından çok doğru bir örnek teşkil etmektedir. İspanya finans sistemi her zaman oligopolistic bir yapı sergilemiş ve bu söz konusu yapı da sektörün liberalleşme öncesi, süreci ve sonrasında da gerek ekonomik, gerekse siyasi açılardan korunmasını sağlamıştır. Bu geleneksel korumacı yapı yüzyıla yakın bir süreye yayılması ve birbirinden çok farklı ideolojik görüşlere sahip rejimlerce sürdürülmesi açısından oldukça benzersiz bir örnek teşkil etmektedir. Bu sebeple, bu çalışmanın cevabını aradığı sorulardan biri de bankacılık sektörünün nasıl olup da birbirinden bu denli farklı bir çok siyasi ve ekonomik yönelim altında aynı gücünü ve etkisini koruyabildiğidir. Doğal olarak, söz konusu cevap bankacılık sektörünün iç ve dış politikada elinde tuttuğu bu güç ve etkinin kökenini ve yapısını da içermek durumundadır.

Ayrıca, hem ekonomi ve dış politika hem de siyaset çevreleri ve finansal elit arasındaki karşılıklı ve karmaşık ilişki de bu çalışmada incelenmiştir. Diğer bir deyişle, iç ve dış politikada değişen dengelerin finansal sector üzerinde yarattığı etkilere de bu çalışmada yer verilmiştir.

Anahtar Kelimeler: Politik ekonomi, İspanya, finansal elit, ulusal şampiyonlar, İspanya dış politikası

To My Family, Mete, Oktay, Didem, Ceren
and all members of the Muzlu Gofret

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INTRODUCTION

The study of political economy centres on the dynamic nature of the tension between the markets and the states, which means constantly changing the patterns of interest and values of the said actors. Therefore, an important debate in the field remains to be "why do government policy-makers regulate financial markets and what are the outcomes of the regulation of the markets - which can be explicitly phrased as: who is gaining what from these regulations?" These two questions are the main anchors of this study, whose focus is the dynamic and unique relationship between the financial markets and successive governments in Spain and its implications on the international position and the international bargaining power of the fastest growing economy of Europe.

The abandonment of state interventionism and embrace of liberal market – economy are two of the dominant themes of the late twentieth century, which are tended to be explained through a cause - effect scenario, in which the shift away from state interventionism is linked to the endless and irresistible pressures stemming from international market integration. The formerly interventionist states, have inevitably been obliged to eradicate the role of domestic policies in the financial markets as the international market integration provides a range of novel options to investors. This kind of a powerful market integration that inevitably limits the power, control and ability of states force the interventionist states to mandate some of their control areas to the institutions promising a "greater efficiency". However, such an argument, doubtlessly, underestimates the role the "politics" plays in the understanding of the modern political economy. If that was the case, then the same market pressures that fuelled the liberalisation process, should also have led the governments to reform domestic market structures, which would have strengthened the ability of national economies for a greater convergence. However, no matter how significant the efficiency loss was about to be, in some cases the authorities voted in favour of a protected financial oligopoly and limited liberalisation reforms.

Spain proves to be a perfect showcase in this argument with the two very district market systems that the country experienced. The Spanish financial system was rigid, underdeveloped, closed and heavily intervened until the late 80s, which helps understanding the very privileged position of the banking oligopoly. Following a restricted financial system of the Franco era, in which the government fixed the interest rates, implemented preferential credit policies, impeded the development of direct financial (bond and equity) markets and extracted revenue from the banking system, the Spanish financial system was shaken by the liberalisation wave of the post Cold War era but especially of the EU integration phase. Thanks to the regulations and transformations undertaken during the late 1980s and 1990s, today's Spain has a modern, diversified financial system, which is competitive and fully integrated with international markets (Gàmir, 2008: 153). However, liberalisation and integration did not yield dismantling of the financial oligopoly, rather they brought novel opportunities that all increased the structural power and profitability of the financial elite. Contradictory to the market centric efficiency theories, in Spain, while the socialist government was taking the necessary steps to abandon the interventionism, they deliberately failed to alter the oligopolistic structure of the domestic financial system.

The financial system of Spain has always been highly oligopolistic which led to the continuation of its traditional political and economical protection for many decades before, during and after the liberalisation process went underway. This traditional protection has a very unique characteristic given the fact that it survived nearly a century, under a succession of various political and regulatory regimes with very different ideological agendas.

"Why the liberalisation of the domestic financial system instituted in Spain during the late 1970s and early 1980s did not bear the fruits that neo-liberal reform is expected to produce: a truly competitive financial system[1]?" asks Sofia Perez (Perez, 1999: 1). To be able to answer this question, first of all it is needed to analyse the development of the financial system of Spain as well as its structure

[1] Here, what is referred with "a truly competitive financial system" is a modern, well-supervised, developed and diversified financial system fully integrated with international markets and with various options for credit and investment decisions.

in the wake of the big liberalisation wave stemming from the international financial capital.

A comprehensive analysis of this case, which can serve as a key for better conceptualising the complex relationship between market forces, society and policy-making elite, needs more than a simple explanation: a reasoning reaches beyond the structural economic power of the financial elite held within the Spanish capital. If the structural economic power had been the case, then the Spanish reformers could have easily challenged the banking oligopoly's position in the wake of the EU membership, while bulk amounts of European funds were directed to Spain. However, the Spanish financial elite managed to preserve their economic and political power independent of the country's political orientation or the economic functioning.

In addition to this preserved economical power, in the course of the long decades that the financial elite possessed a fierce control over the foreign and domestic policies of the country while Spain witnessed a number of significant turmoil in its modern history. In order to analyse the role of financial elite in the foreign policy of Spain, first it is needed to go through the very complicate contemporary history of Spain. Short after loosing its last imperial colony in Cuba, Spain was dragged into a civil war that pushed the country into a dictatorship that was going to last 36 years, during which the only and closest ally of the country was the United States. Following the death of Franco, the country intentionally turned its face away this explicit supporter of the fascist ruling and deployed a very firm Europeanization strategy in both its internal and external affairs. However, by the return of the right-wing tradition to power, Spain under Aznar ruling started to pursue a so-called pro-Atlantic external policy, this time aiming at upgrading Spanish international rank from the league of medium scale powers to the premier league of Europe. This pro-Atlantic policy of Aznar was broken prematurely by the Socialist victory on 2004 elections, following the terrorist bomb attacks in Madrid on 11 March 2004. The socialist government under Zapatero ruling distanced Spain from the former Atlantic allies and once again turned the wheel towards the continental Europe.

Independent of all of these very distinct foreign and domestic policy developments, there has always been one group of state elites that has kept their financial and political power: the banking oligopoly.

Development of the domestic banking system in Spain and its role in the Spanish industrialisation have always been major underlying factors that effected this mutual interaction between the way that the Spanish state pursued control over the economic and political policies and the privileged position that the financial elite kept. In the Spanish political economy, the public finance, the banks and industrialisation have always been strongly related to each other. The selective credit policies and the interventionist policies were commonly utilized in the industry financing and public financing, therefore fostering the creation of a big, impressive and strong banking cartel, as a natural consequence of being the main source of the national capital.

Apart from this role as the main financer of the Spanish state, the banking oligopoly also enjoyed a top-level position as the main shareholder of the Spanish industry and the practical hand of the Spanish state in its expansionist foreign policies. In line with the country's financial tradition, these banks kept securing their major share in the remarkably developing Spanish industry and the investments, either being national or international. Therefore, the economic power has been mainly enjoyed by the finance sector and by four other sectors, which are telecommunications (Telefónica), public utilities (Endesa, Iberdrola, Unión Fenosa), oil and natural gas (Repsol – YPF). Not surprisingly the banking cartel has also been a big shareholder in these above-mentioned companies. Added the intensive Spanish FDI to Latin America since 1995, concentrated in these five sectors listed above and realised through the national banking cartels, it would be realistic to suggest that the finance sector has always been the leading actor in the political economy of Spain

This is why; in order to soften the political costs attached the political transformation and the financial deregulation, the successive Spanish governments have traditionally chosen not to abandon the oligopolistic structure of the financial system. Since the state, financial elites and industry traditionally have been closely linked politically and economically, the political costs of altering the traditional structure of Spanish financing mechanisms would have been devastating for the policy-making community.

Studying this specific theme will be valuable as the Spanish example provides a contradictory alternative to the foremost and traditional political economy theories frequently utilised in order to provide an explanation to the issue of financial liberalisation and its unbreakable link to democratisation. The privileged status of the banking elite in the course of liberalisation stands as the key to understand how different actors with different agendas can produce different outcomes. Perez (1999) argues that the result of liberalisation in any case depends heavily on the character of the domestic elites, what risks they can assume and what measures they are ready to take in order to achieve political & economic gains. Given the fact that financial reforms feed into the configuration of conflict and identities among state elites, this study is expected to produce an overall analysis of the political economy related interactions among different state elites and the foreign policy outlook of a contemporary European country in line with these interactions.

The outcomes of this study are also expected to be quite useful for Turkey, a country trying to transform itself from the restrictive economy to a liberalised financial system for many years. Especially when it is considered that Spain undertook many of these reforms in the period of its accession to the EU and in the years of integration, this subject is likely to produce useful implications for Turkey as well.

The first chapter of this study provides a clear evaluation of the developments in the Spanish banking sector starting from the late 19th century until the death of Franco in 1975 with a political economy perspective. In this chapter a full-scale examination for the motives behind all protectionist tendencies are provided in the light of domestic and international political developments that motivated these actions. Moreover, a summary of different banking systems applied in the contemporary political economy (e.g. German Universal Banking System, Anglo Saxon Model, etc.) is also included for being able to better analyse the unique model of Spain in which different actors such as economic elite, state, industrial elite and foreign policy makers collaborated, conflicted or reconciled.

The second chapter covers the Europeanization of the Spanish economic and political life following the long isolation of the country. The correlation between the liberalisation of the country, socialisation of the domestic policy and further strengthening the financial system are analysed in this chapter. During this era (1975 – 1995) not only the young democracy in Spain but also the dominance of the financial elite in domestic and foreign policy is consolidated while Spain was finally integrating into the orbit of democratic European nations. Moreover, the first steps of the banking concentration and strengthened interlocking directorship structures between Spanish financial elite and the industry were taken during this era.

The third chapter of this study is dedicated to the latest decades of politics and economy in Spain, the recent domestic and foreign policy developments and the economic implications of these policies are analysed. In this chapter the Latin America policy and the Europeanization vs. pro-Atlantic foreign policy tendencies of Spain, in line with the struggle of Spain to upgrade its role among the strong actors of the EU, are studied. Moreover, this chapter provides an evaluation of the contemporary transformations of the financial system (mergers, acquisitions, interlocking ownership structures, international expansions, etc.) under a political economy framework, which aims at analysing "which" circles gained "what" from these policy and economy reformations.

The literature on the subject is mainly focused on the post-Franco years, 1976-1980s, however the period covering the end of 1990s and the 2000s can be considered as a green-field to study. This is why; in order to analyse this period the Banking Supervision Reports issued by the Central Bank of Spain (Banco de España), OECD reports, Economist Intelligence Unit Data, annual reports issued by the Bank for International Settlements and the European Commission, as well as the interviews held with the Spanish diplomats in Turkey and strategic policy analyses of the political parties and the Spanish newspapers and political reviews were all utilised. In order to draw the general framework of the Spanish political economy as well as the consolidation and formation of the financial elite before 2000s, the existing literature of Perez (1997), Lukauskas (1994), Tayfur (2003), Salas & Saurina (2003), Sánchez (2006), Tamames and Rueda (1997) and Tortella & Palafox (1984) were mainly consulted to. The contemporary political history of Spain was explained thanks to the rich and efficacious publications of

Tussel (2005 and 1996), Isbell (2004) Jimenéz Redondo (2006) and Chislett (2008). The comprehensive works of Salmon (1995), Powell (2001) Gàmir (2008), Tamames and Ruedo have been the bases to analyse the economic policies of the modern Spain.

CHAPTER 1: THE FOUNDATION OF THE FINANCIAL ELITE IN SPAIN

1.1. The Creation of the Banking Oligopoly (1850 - 1936):

Power relationships and different economic interests among the various political and economic groups as well as the institutions binding them together shape not only the national financial systems but also the political outlook of that country. This mainstream rule also applies for the Spanish case. The firm relationship between public finance, banks and industry, which has been the mainstay of the persistence of the oligopolistic finance market in the contemporary Spanish political economy, is rooted back to the end of the 19th century. For an accurate analysis of the political economy of today's developments, it is more than essential to go back to the formation of the finance market in Spain. The history of modern banking corporations in Spain starts in 1829 with the foundation of Banco Español de San Fernando, whose name was changed to Bank of Spain in 1856. The future Central Bank of Spain was the only banking corporation in the country until 1844, and so the Bank traditionally had been the main creditor of the Spanish government (Tortella, 1969:165).

The monopoly of the Bank of Spain had begun to be challenged starting from 1844, as several other corporate banks emerged not only in the capital Madrid, but also in other provinces such as Barcelona, Bilbao and Cadiz. Despite the unfavourable banking laws keeping the banking sector underdeveloped, the total number of corporate banks in 1846 was 7 and 4 of them were banks of issue. Following the slight improvement of the restrictive banking legislation, the number of corporative banks started to multiply. When reached to 1856, there were 58 commercial banks in Spain, 21 of which were banks of issue[2]. Due to the active discouragement of industrial enterprise by a law of 1848, which required governmental approval for each and every corporation in manufacturing sector, the investments rather channelled to railroad, banking and mining

[2] Bank of issue, today known as the Central Bank, refers to the banks that have the right to issue standardized currency of this country.

corporations where more freedom was assured to the investors. Therefore, these sectors, but especially railroads attracted a large share of bank assets, which ended up with the overcapitalization of the railroads. Thus, when the railroads could not produce the benefits and the profits that were forecasted, in 1866 the finance sector in the country underwent a serious crises, at the end of which most credit societies and some of the issue banks collapsed. Following this very first banking depression of the country, the government introduced series of regulatory reforms to ensure free incorporation and free banking. However, this first liberalisation attempt of the Spanish financial system only lasted 5 years and came to an end due to the public debt crisis of the Treasury and first state-led financial monopoly of Spain was created.

In 1874, the Spanish government, the very first government of the recently restored Bourbon monarchy under a parliamentary constitution, decided to grant Bank of Spain (Banco de España) with the monopoly of currency issue. The decision was taken in order to modify the banking system in Spain doubtlessly but more than anything else, in order to finance the growing public debts. The Bank of Spain had long had a privileged relationship with the Spanish Treasury as it was acting like its main creditor. When the government decided to take this step, it was clearly stated that the preferred party among 15 commercial banks then operating in Spain with a right to issue currency, Bank of Spain was the one that the government would have liked to see as the contracting party even though it was not the only option and in case Bank of Spain failed the conditions of the government, other banks were also welcomed to the negotiations. However, following long and heated debates in the Board of Directors, Bank of Spain decided to go with the governments offer in order to become the banking monopoly of Spain in return of an extra ordinary credit of 125 million pesetas granted to the state. Moreover, Bank of Spain signed a pact in which it guaranteed to:

1. Facilitate the monetary circulation within the Spanish territory through new branch openings;

2. Increase the bank’s capital;

3. Guarantee the capacity for emission of bank notes (Castañeda, 2001:12 and Perez, 1999:48-49).

Complying with all these conditions put forward by the government with an urgent financial need, Bank of Spain acquired the right to become the only party to issue currency in Spain, which in time brought a bigger monopolistic role to the Bank.

The main handicap of the banking system transformation in Spain had been the annulment by order in council of the privileges for currency emission, previously granted to the banks other than Bank of Spain. It was thought that such a transformation would be possible through "consolidation" (mainly by acquisitions rather than mergers) of all banks that had right to issue currency at that time. Such a measure was designed with a hope to facilitate the monetary circulation and use of bank notes thanks to the single and wide network of bank branches that it would create. For the banks which did not agree to merge with the Bank of Spain, the business area was limited to other banking operations. Among fifteen commercial banks to issue, only four decided not to merge with the newly emerged cartel but to compete with it.

However, it took more than a decade for the Bank of Spain to accomplish its remaining promises other than financing the chronic deficits of the Treasury. It was not earlier than 1883 that the Bank of Spain managed to accommodate bank transfer services, to provide smooth flow of banknotes to all provinces, and to spread its network of branches to other provinces, but especially to the provinces where its four remaining competitors -Bilbao, Santander, Barcelona and Tarragona- already had a local strength (Castañeda, 2001:6-8). Also in 1883, the Bank of Spain, using silver standard for currency emission different than the rest of the Europe, revoked the convertibility of peseta bills to gold, which was followed by the steady decline in the value of silver. Thus, the costs of debts of the Spanish state had been financed by the inflation itself, which turned out to be a popular practice during the upcoming century.

The formation of the banking oligopoly in Spain has a great value to understand and analyse the contemporary political economy of the recent transformations in the country. Sofia Perez (1997) argues that this very first consolidation in the

Spanish banking sector had been put in motion in order to achieve "an accommodation between the agrarian and financial interests of the Spanish aristocracy and those of the emerging Catalan, Basque and Madrilian bourgeoisies" (Perez, 1997:46 and Moya, 1975:55-91). Or to put another way, the Spanish state launched the basis of the Spanish financial oligopoly through granting a monopolistic power to Bank of Spain in return for financing the Treasury debt and through allowing the Bank of Spain to utilise inflationary practices to finance the cost of government debt. These selective credit policies for privileged groups, mainly for the state itself, formed the protectionist attitude of the finance system towards certain groups among the industrial elite.

However, the beginning of the 20th century signalled a sound transformation not only in the political dimension of the former colonial Empire, but also in the financial system of Spain. Thanks to the neutrality of Spain during the Word War I, the demand for Spanish exports was boomed, and this boom leaded a significant trade balance surplus. Naturally, the number of commercial banks in Spain almost doubled and banks became actively involved in the industrial development especially with regard to mining and railways construction (Tortella and Palafox, 1984:83 and Aguilera, 1998:325). On the other hand, despite this increase in the power of the financial elite, the end of the 19th century marked a serious budget deficit for the Spanish state, which had long been financed by inflationary practices and the bulk transfer of the large sums of capital from Cuba following the final colonial defeat of the country (Perez, 1997:49).

This is why; a new method for public financing was essential, and so, in 1917, a new system for financing public debt, which was definitely more efficient than "direct monetization", was introduced: "pignoración automática". This new way for public financing used to utilise automatic collateral lending method[3] in order to monitor the accumulation of capital in the financial system while keeping the public debt under the protective wings of the banking sector. The system consisted of a rediscount mechanism in which the state controlled privileged credits were provided to the commercial banks that subscribed to a certain

[3] A collateral loan is a loan obtained from a bank or other financial institution, where in exchange, the creditor may sell that which is offered for collateral if the loan is unpaid. A collateral loan is often offered at a lower interest rate than an unsecured loan, because there is a guarantee of repayment should the borrower default on the loan.

amount of public debt. According to the pignoración automática, the commercial banks could obtain automatic collateral credit from the Bank of Spain, up to the 90% of their purchases of public bonds. Not surprisingly, the commercial banks tended to invest these cheap and almost risk free credits into the industrial activities, which turned the commercial banks into the motor of the industrial development of the country.

Furthermore, this method for public finance assured that the control of liquid creation was kept in the hands of the banking system as the public debt and the money supply were now clearly linked to the banking elite. This is why; this "revolutionary" method of public financing not only increased the inflationary pressures on the Spanish economy but also impeded the utilisation of the monetary policy by the authorities as an instrument to intervene the malfunctioning of the economy[4]. In the end, the pignoración automática acted as the first stepping-stone of the current web of relationships between the government, the Bank of Spain, the banking sector and industrial firms.

By the early 1920s, the economic outlook of Spain was about to experience a similar pattern with Germany of the late 19th century, thanks to its so-called "Big Six" Banks (Banco Español de Credito (Banesto), Banco Hispano Americano, Banco Central, Banco de Bilbao, Banco de Vizcaya, and Banco Urquijo[5]) that became the engines of the industrial development with their mixed activities, just like the German "universal banks"[6] did for the lately industrializing country suffering from a lack of capital accumulation and entrepreneurial activity (Tortella and Palafox 1984:85-87, S. Perez, 1997:49-53, López, 2003:2).

[4] Given the fact that controlling the internal money supply is one of the duties of Central Bank, this practice of pignoración automática transferred one of the main responsibilities of the Central Bank to the banking oligopoly. Given the fact that the banks always carried a considerable amount of re-discountable debt within their portfolios, the banks were in charge of determining the amount of currency in the circulation depending on their self interests and preferences.

[5] In some texts and researches, "Banco de Santander" is also included in this banking cartel list.

[6] A universal bank participates in many kinds of banking activities and is both a commercial bank and an investment bank.

Here, it is needed to open up a parenthesis to explain the two mainstream banking approaches, and what the German "universal banks" were and how crucial they were in the process of late industrialization of Germany.

According to Gerschenkron, the "universal banks", providing all kinds of financial services were essential for industrial take-off of the latecomer economies, in the absence of capital resources and financial intermediaries to mobilise the savings. In order to provide all forms of financial services as mentioned above, the universal banks were engaged into mixed types of activities, such as:

a. Commercial activities (short- term credit, deposit taking, payment clearing)

b. Investment activities (underwriting, clearing of securities)

c. Relationship banking (activities to control, monitor and supervise the industrial firms, such as representation on firm's board, proxy voting, or holding equity stakes).

Such a framework of universal banks not only lowered the corporate finance costs but also provided the commercial banks with a significant control over industry (Gerschenkron, 1962:5-30, Fohlin, 2007:52). One other important feature of universal banking has been the government intervention. The government intervention has been exercised through the selective credit policies or through the establishment of state-owned enterprises (Aguilera, 1998:320-323). It should also be noted down that, according to Gerschenkron, the "catch-up industrialisation[7]", could only be achieved in the presence of an institutional mechanism, which would undertake the formation of capital, which was necessary for the rapid and large-scale investments that the industry seeks. As

[7] According to Gerschenkron the catch-up industrialization is a particular form of industrialisation especially relevant for developing countries. This term suggests that the countries that did not start industrialization until the twentieth century tended to generate neither new products nor processes. These, the late industrialisers, raised their income and transformed their productive structures using borrowed technology. The late industrialisers have moved into the more mature markets of the innovators and the productivity of long-established innovators has been successfully challenged by the learners' lower wages, intense efforts to raise productivity and firms supported by industrial policy.

late comers had no time to lose while waiting for the development of market mechanisms that could be utilised for the industry financing, they had to subsidise the free markets with other institutions, such as banks, the state, business elite, etc. At that point, banks and state were obliged to assume this liability in order to achieve the desired take-off of the industry. This is how and why the spread of universal banking, which became the prevalent model for industrial take-off in the continental Europe in the late 19th century, resulted in the rapid rise of large scale enterprises, monopolistic and oligopolistic formations and cartels (Teichova, 1988:2-7).

However, this system of universal banking has never been free of costs and setbacks. The costs associated with this structure could be summarized as follows: undermines the formation of strong financial intermediation system; produces conflicts of interests among the financial elites and the industrial development; gives a strong political influence to the financial elites; causes an influential industry cartelisation due to bank involvement in company management. Under such a pessimistic scenario, one must bear in mind the fact that, in the presence of a strong state managing, promoting and supervising the industrial development and capital formation, the system of universal banking could achieved the desired results of an industrial take-off (Gerschenkron, 1962:5-30).

As opposed to this German model, which was wide spread across the continental Europe, the Anglo Saxon Model, which was named so as it had been derived from the US and British examples, is mainly dominated by the free competition in the two largest stock exchanges of the world. While the German model was born out of necessity in the late-industrialised countries needed to deploy a specific role to the banks in mobilising savings, the Anglo-Saxon model has relied on developed and well-functioning financial intermediaries. This less committed way of financing is barely based on state policy but rather on the demand for increasing short-term profits for the shareholders. Therefore, the role of state has been very restricted in these countries and the industry, which could enjoy only a very negligible state protection compared to its continental European counterparts, was encouraged to increase profit under a framework of free trade and free competition. Therefore, under this working framework which clearly separated the interests of industry and finance markets, blending the industrial activity and the financing capital under one umbrella has never been so much in fashion as it used to be in the German banking system inspired countries. The industrial take-off has been financed by the free capital markets operating for the sake of profit rising.

That the exact same model of the German universal banks undertaking "mixed" financial activities achieved quite similar results to the other parts of the continental Europe, with a timing difference of 30 years. During the 1920s, Spain underwent a heavy industrialisation process, concentrated mainly in the naturally oligopolistic sectors (such as energy, transportation, metals and utilities) or the ones with tariff protections (Perez, 1997:49).

The most important setback of this model of industrialisation experienced in Spain was the lack of development of a state-led industry focused on the strategic sectors (e.g. mining, defence, information innovation, construction, etc.) rather than the most profitable and protected ones, such as the heavy industry and railways; and the abandonment of any programmatic plan to upgrade the level and quality of public works. The banking sector financed the industrial development doubtlessly, however the interests of the banking sector clashed with the interests of the industrial development of the lately industrialising country. Therefore, rather than forming a banking elite canalised the capital according to the needs and plans of the government like it happened in Germany, a banking elite forcing its own agenda was created in Spain.

This symbiotic relationship between state, banks and industry resulted in a high level of concentration in both the industry and the banking sector. Especially in the capital goods and utilities industries such as electricity, explosives, iron, steel, cement and mining, few large companies dominated the control over the whole economy and enjoyed high level of protectionism guaranteed through selective credit-policies and monopolistic tendencies such as barriers to entry. Added the similar concentration within the banking sector, the pressure groups in the country could exert a very strong control power, a power which was going to last for many decades (Simpson, 1997:356). Within the banking sector, the level of concentration was even stronger than the one in the industry. By 1923, the "big six" of more than 100 banks in the country, accounted for the 40% of the combined paid-in capital and over 50% of the total deposits. Moreover, by

1921, directors of the six largest banks were found on the boards of 274 corporations, whose combined capital amounted to half of the paid-up capital of all Spanish corporations (Tortella and Palafox, 1984:85-87). This complex web of relationships among the industry and banking created directorship interlocks with corporate banks surrounded by utility companies and capital-intensive large industrial firms (Aguilera, 1998:325).

The end of the 1920s brought new challenges to the existing system of political economy all around the globe. However, the effect of the Great Depression over that intense concentration of the finance system was nothing but extremely motivating in Spain. The ex-colonial state, isolated from the growing international markets, could unintentionally protect itself from the devastating effects of the Great Depression without experiencing any significant banking crises, unlike much of the rest of Europe. The banking cartel of the country utilized this advantage as an investment opportunity, thanks to the depressed stock market and the increased tariff protection by the Primo de Rivera dictatorship (Perez, 1997:50 and Velarde Fuertes, 1996:129). Therefore, while the small and medium sized commercial banks tended to limit their industrial portfolios, the "Big Seven" did the opposite and achieved even a higher market penetration ratio with a control of the 64.4 percent of the total industrial portfolios held within the banking sector (Tortella and Palafox 1984:85-87).

Not surprisingly, this constantly increasing economic power, combined with a complete control over the industry also had its political consequences. The strong personal connections between the financial capital and the state elite, which were about to influence the political economy of Spain for almost a century, were rooted in that era. The banking cartel not only acquired a significant political influence, but also, utilized that influence in a very effective way to guarantee the survival of their oligopolistic structure. In 1921, a new banking law issued (La Ley de Ordenación Bancaria de 1921) mandated the regulation of the sector to the Big Six through the creation of a corporative institution called "Higer Council of Banking" or "Consejo Superior Bancario" (CSB). CSB exerted a series of regulatory actions either to ensure the maximum profit for the banking cartel through fixing the maximum interest rate to be paid on deposits and the minimum interest rate to be paid for the credits; or to guarantee the survival of the banking cartel by creating barriers to entry such as the minimum capital requirement for the creation of a bank or the rules of proper business behaviour. Moreover, the new banking law obliged the modernisation of the banking techniques, took the necessary steps to transform the Bank of Spain into the "the banks of all banks", and finally enforced the new branch openings, which then strengthened the Big Six's control over the total Spanish banking system (Lukauskas , 1994:76).

The political influence of the financial elite over the state became so visible and strong that the downfall of the dictator Miguel Primo de Rivera is often attributed to loss of support from the financial establishment. This is why the Second Republic that ruled between 1930 and 1936 oriented their focus to the agrarian and industrial reform rather than a state-led industrialisation backed up with developed financial intermediaries and capital formation.

To sum up, the fate of the strong cartelisation in Spain can be explained by the failure of government to cover the public debt by its all means. The large Treasury deficit was a result of the increased government spending on the areas such as administration and defence rather than industry. Added the unwillingness of the government elites to change the fiscal system that would lead higher taxation and therefore loss of public support; public works, infrastructure and industry lagged far behind in Spain during the late 19th century although the public debt kept growing. In 1874, granting the monopoly to issue to the Bank of Spain in return for financing the public debt helped to postpone the high public debt problem. However, the government, now in cooperation with the Bank of Spain as its main creditor, still had to undertake new measures to deal with the growing public debt. This is how the inflationary public finance became the tradition of Spanish economy, which then turned out to be the motor of industrialisation in Spain. The banking oligopoly in Spain utilised these inflationary mechanisms and successfully capitalised the income that they generated through indirect monetization method of "*pignoración automática"* into the various industrial holdings. Thus, the inflationary public finance and the strong banking cartel became the engines of the industrialisation in Spain. However, as opposed to a state-led industrialisation that had been experienced in Germany, in Spain the banking cartel achieved very strong personal ties with the state elite, which turned into a great control and influence over the politics. This relationship constructed the basis for the future reciprocal bindings between the financial elite and the policy-making elite. Thus, on the eve of the Civil War, Spain had the most underdeveloped financial system in Western Europe (Simpson, 1997:356 and Perez,1997:55-59). Moreover, in the absence of a stronger political imperative, neither the state nor the banks promoted a proper and strong industrial development that would have allowed Spain to catch up with the rest of Europe (Perez, 1997:59).

1.2. The First Decades of the Francoist Period (1939 - 1959):

The Civil War dismantled the monetary system in Spain, just like it damaged many other aspects of the Spanish society and it has not been easy to repair the distortion up until the first half of the 40s. However, it is also true that the real industrialisation of Spain took place within the framework of the autarkical economy ("La Autarquía") pursued during the very first decades of the Francoist period. In this era, the nationalist attitudes towards economy were favoured not only by the traditional right-wing political elite of Spain, but also by the newly-emerged political group of National Syndicalists - or the Falangists (las Falangistas) with the more common name that they are usually known as. The nationalist economic policies designed to reach the self-sufficiency of the Spanish state, as stipulated among the doctrines of Falangists, promoted an industrial expansion characterised by a unique state intervention implemented through price and quantity controls and a strong protectionism involving sharp import restrictions, and severe limitations on foreign investment. The normative and institutional structures that had been established between 1938 and 1942 created the new status-quo which was about to last until the end of Francoist period (Perez, 1997:61 and Serrano Sanz, 1995:114).

However, the turning point for the Spanish industrialisation can better be marked by the establishment of a state-controlled institution in 1941, in order to supervise, to monitor and, more important than all, to finance and to undertake the industrial enterprises: *"National Institute of Industry"* / "I*nstituto Nacional de Industria"* (INI).

As also stated through the above paragraphs, as the Spanish Banking sector's main motivation was satisfying their self-interests rather than mobilising the industrialisation process of Spain, the expected consequence of the mix banking system[8], which is the full scale development of an industrialisation process similar to the one that had been achieved in Germany, could not be achieved in Spain. Added the lack of state planning and monitoring during the first decades

[8] Mix banking is a system, which blends banking with various financial activities and other types of commercial activities (e.g. industry, commerce, etc.) under one roof.

of the 20th century, Spain had to wait until the 40s to reap the harvest of mix banking system. The INI was created with an intention to promote the investments directed into the industries that were seem to be at the national interest but lacking proper private investment. Although the INI was supposed to assure a significant market penetration in terms of industrial domination to the state, the early activities of INI were restricted to the sphere of production in three basic industries, which were coal, steel and electricity (Perez, 1997:58-59). Moreover, the commercial banks invested quite heavily in the state economic enterprises such as petroleum distribution (Campsa), telephones (Telefónica) and tobacco (Tabacaera), which gave the banking elite a dominant position and a strong say within the boards of the state monopolies, while half of the important board positions of INI were filled by the members of the banking elite (Tayfur, 2003: 150 and 143). Therefore, it can be concluded that, despite the ulterior motives behind its foundation, the INI could not fully substitute the role of banking elite in the industrialisation of Spain and the banking oligopoly kept the lion share of the Spanish industry.

The highly interventionist attitude of the Spanish state can be attributed to several factors: the dominant ideology among the political elites, which is the national syndicalism; the isolation of the Spain from the rest of the Europe; and the lack of industrial development in the country.

National Syndicalism, the dominant ideology of the ruling Francoists, was based on nationalism, patriotism and social justice, and promoted abandonment of a liberal or market oriented economic policy for the sake of an influential state with a social role. Although this ideology had inherited some aspects of the traditional leftist thinking, the followers of the idea opposed very strongly against the class struggle and internationalist thinking of Marxism and instead they put the religion, family, state and trade unions up to the leading roles. This notion of the Falangist ideology resulted in the creation of the "Syndical Organisation" - the organisation of the employees-, in which the employees were supposed to recover the added value and own the property of the means of production as well as the control of the company (Serrano Sanz, 1995:114). However, the Syndical Organisation ended up being a vertical organisation in which employers and employees were obliged to cooperate basically to regulate wages the wages in favour of the employees (Tayfur, 2003:141-142) and with very high costs to the economy (Serrano Sanz, 1995:114). Therefore, up to the ruling Falangist elite, the state, not a specific class, was meant to be the main protagonist of the industrial and agricultural revolution.

It should also be considered that; even if the predominant ideas of the ruling Falangists had never existed, the fully isolation of the Spanish economy would probably have resulted in the very same way. During the second half of the 1940s and 1950s, the Western European countries developed new schemes to ensure the once destroyed co-operation among them; however they isolated Spain from all these novel mechanisms due to political concerns (Serrano Sanz, 1995:114). Also, despite the demonstrated desire of the Spanish government in 1947 for being included into the Marshall Plan of the US, Spain was deliberately excluded from the Aid, mainly due to the oppositions by the European neighbours of the country. Added the underdevelopment of the country to that scenario, the further cartelisation of the banking sector under a highly interventionist structure should be considered as a natural outcome.

The best proof of the increasing banking cartelisation during the Franco years can be traced back to 1946, the year in which the government passed the new "Status Quo" Banking Law (La Ley de Ordenación Bancaria de 1946). Thanks to this new law, the Franco government sanctioned the status quo -meaning the existing banking oligopoly- and guaranteed their co-operation with the regime's economic policy. The law favoured the oligopoly by adding too many institutional criteria for the new comers, prohibiting the establishment of foreign banks and by closing the access to the financial market for the non-bank intermediaries. Not but not least, the law re-established the CSB (Consejo Superior Bancario / The Superior Banking Council) - regulatory body with super powers- and made the registration to that institution obligatory for all the banks. Moreover, the recommendations of CSB were always followed rigidly by the Treasury and without any surprise these recommendations favoured the interests of no other actor but the Big Six, as the majority of the seats in the board of the Consejo were occupied by the directors of these banks. (Sánchez, 2006:20).

The very best indicator of this mutual link between this regulatory authority and the banking oligopoly was experienced when the government, following a recommendation by CBS, passed a decree in order to regulate deposit rates subject to a maximum, and credit rates subject to a minimum. By this act, Franco administration attempted to guarantee a high interest margin to the banks but more importantly the government aimed to sustain banking cartel's cohesiveness in an environment of high liquidity by eliminating the most important form of competition, which is the competition for funds, as this practice prevented individual banks from lowering their credit rates below a certain limit (Perez, 1999:60). Banks were also eager to maintain ceilings because they lowered the costs of liabilities. In addition, with an aim to reach an agreement on different aspects of the banking activity and to eliminate competition among various entities", including to fix the minimum loan interest rate, banks were allowed to negotiate several pacts, called "agreements to limit competition" (*Los Arreglos Interbancarios*) (Ruíz, 2001:3).

Furthermore, the authorities permitted the large national banks but not local and regional banks to open new offices and branches and increase their capital. Therefore, the national banks kept enjoying their privileged position to take over local and regional banks that had no means to compete with them under this unfair framework (Lukauskas, 1994:77). Therefore, the capital needed for industry finance had been accumulated under the command of a ruling banking elite that could control not only the amount of capital for the industrial development but also terms of the credit (in other words the interest rates and the pre-requirements needed for being eligible to credit). Doubtlessly, this act was quiet contradictory to the principles of fostering industrial development.

Apart from these facts, it is also essential to bear in mind that Franco relied heavily on the financial elite during and after the Civil War (Tayfur, 2003:143), which was well proved by the government's decision to entrust monetary and credit decisions (and as a natural consequence the investment decisions as well) in the hand of the banking elite united under the framework of CSB in return for the guarantee of their support (Sánchez, 2006:50-51 and Lukauskas, 1994:77). Franco met their demand for a limited cooperation in the financial sector in order to earn supernatural profits because he wished to reward the banks for financially backing the Falangists during the Civil War and to ensure the sustainability of their support for the regime. To Franco, their support was vital for the reconstruction of the Spanish economy and social life that had been devastated following the Civil War. Lukauskas provided an explanation for this unbreakable relationship based on mutual interest as follows: in return for generally favourable regulation, banks provided information, helped draft regulations, and promised policy-makers lucrative jobs in the private sector (Lukauskas, 1994:74). Thus, Franco administration was inadvertently moving away from its target to supervise, monitor and finance the industrialisation of the country, for the sake of the traditional method of financial elite controlled industrialisation process. In other words, Franco "favoured the elimination of political dissent in Spain and the consolidation of his regime over a regime of long-term economic growth" (Toral, 2005: 4).

Furthermore, Franco government re-established the inflationary budget financing system of "*pignoración automática"*, which favoured the interests of no other group but the banking oligopoly. As a consequence of these regulations, an extremely rigid monetary system was created with many setbacks such as inflationary tendencies, privileged practices and a close relationship between the banking cartel and the Treasury. Moreover, as a consequence of these practices, the first two decades of the Franco regime witnessed the 2nd consolidation wave of the Spanish finance system[9], through which between 1940 and 1962 the number of existing banks in Spain reduced from the number of 200 to 107 (Perez, 1999:61). Not surprisingly, all the acquisitions were undertaken by Big Seven and the cartel increased its share of total banks deposits to 72 percent in 1957 (Perez, 1999:61).

Despite the INI, which was supposed to reduce the leverage of the banking sector for industry financing, the bank credit still remained as the main source of private sector financing in the absence of a proper functioning stock market and other financial intermediaries. Thus the share of bank credit in the external financing of the private sector rose from 30 percent to more than 60 percent by 1959 (Perez, 1997:61). As the banks continued acquiring the shares of the industrial firms[10], by the mid 50s the Big Seven had the control of almost 60

[9] The first one was experienced during the late 19th century, when the financial power was divided between the biggest banking groups and the Bank of Spain was granted the right of issue.

[10] As also stated above, despite the creation of the INI, the banking oligopoly had already acquired the majority shares in the strategic sectors such as petroleum distribution (Campsa), communication (Telefónica), tobacco (Tabacaera), etc.

percent of the major firms operating in manufacturing, mining and utilities sectors (Tayfur, 2003:146). Therefore, during the first decades of the Franco administration, the Big Seven not only consolidated the banking sector but also multiplied their influence among the industrial enterprises. Although the Falangists ranked the state-controlled industrialisation as their number one priority, they assured the same banking elite controlled finance market and promoted it in order to consolidate the role of private capital controlled by banks in the Spanish economy. This is why; the Franco government not only turned upside down all the ideals of the national syndicalists aiming to create a massive public sector, but also recreated ineffective allocation of resources, a slow pace of growth and a poor quality of financial intermediaries compared to what could have been achieved under a scenario of a free market regulations.

However, since the cooperation of the banking sector was considered essential for the successful implementation of the autarkical economic policies, the status quo of the finance system and the industry-financing mechanisms were deemed to be necessary (Lukauskas, 1994:76). Therefore, banking sector's influence on Franco regime and the weak bargaining power of the political elite, given their dependency on the economic elite, were once more proved.

The pessimistic scheme that could have drifted the contemporary political economy of Spain to a dramatically different point began to be challenged by the mid 50s. The Cold War and the Korean conflict altered the position of the isolated Spain as the Western Block adopted a firmer, but still a bit discriminatory position towards the Francoist Spain. The pacts that had been signed with the US were symbolizing the start of a new era; however they were promising too little compared to the Marshall Plan. The Spanish accession to several international economic organizations such as IMF, OECD or World Bank followed this process (Serrano Sanz, 1995:122). However, economic crises affiliated with the chronic budget deficit and lack of technical expertise proved that even more radical steps were needed to be taken.

The US oriented military and economic aid package (estimated at $625 million between 1951 and 1957, Salmon, 1995:3), which had been extended to the UN boycotted Spain in return for establishing American military bases within the Spanish territory, and liberalisation of the Spanish economy, escalated slightly the burden of a closed economy. However, these aids could not achieve to become satisfactory enough to prevent the big economic crisis of 1957-1959 (Salmon, 1995:3). The balance of payments crisis stemming from the country's foreign exchange gap and the inflationary pressures of the *"pignoración"* mechanism, combined with the wage increases and the pressures of the Falangists caused the biggest crisis of the Francoist period (Perez, 1999:63). The only prescription to this crisis was found in economic liberalisation.

The cabinet change of 1957 marked a historical turning point for Spain with the emergence of new ruling elite: the Opus Dei technocrats. The members of this Catholic organisation with a notion of performing their tasks as pragmatically, aseptically and dispassionately introduced economic policies and well-tested economic techniques from abroad. These technocrats were strongly committed to the liberal economic ideology and therefore "the Opus Dei introduced for the first time in the history of Catholic Spain the typically Protestant notion of sanctification of work in the world through the professional calling" as Weber had affiliated with the modern rationale of the capitalism (Casanova, 1983:29). Thanks to the guidance and liberal ideology of these technocrats, the Stabilization Plan of 1959 (*"El Plan de Estabilización de 1959"*) could be realised. The plan, which was drafted upon the recommendations from the OECD and the International Bank For Reconstruction and Development, was nothing but revolutionary for the inward-looking Spanish economy: in return for IMF organised foreign lending many critical measures were taken: a ceiling on bank lending was imposed, tariff levels were sharply reduced, a single and convertible exchange rate was introduced; internal prices were deregulated, a new industrial development strategy based on external orientation rather than the old state controlled system was adopted; and most miraculously the pignoración mechanism, which had long been the motor of the Spanish industrialisation and the endless source of private banks for asset expansion, was terminated. However, the adaptation of plan could be achieved only upon the break out of a severe economic crisis in 1959, which strengthen the hand of newly emerged class of Opus Dei technocrats who sought to end the country's economic, and in an indirect way politic, isolation (Baklanoff, 1996: 107). The crisis put the Franco administration into a tight situation, which left no other remedy than the complying with the conditions of the international monetary organisations in order to receive their credits (Baklanoff, 1996: 107). The implementation of the

Stabilization Plan opened the pave for a period called as The Spanish Miracle (El Milagro Español), through which Spain was integrated into world markets and enjoyed the second highest growth rate, slightly behind Japan, and became the ninth largest economy in the world (Salmon, 1995:3).

1.3. The Spanish Miracle (1959 - 1975):

The Spanish Miracle, just like any other turning point in the economic history of nations, cannot be isolated from the political -either being domestic or international- forces and developments that fuel their emergence. In the Spanish case, the underlying factors that gave an impulse to the upgrade in the international position of the country from a level of a less developed country to an industrialised one can be found among the shifts in the political outlook of those controlling the economy. The desire by Spaniards for modernisation, as well as abandonment of the ruling ideology of autarky and the "detente" in the extreme isolation surrounding the country had tremendous effects on this upward moving.

The Spanish Miracle can also be demonstrated through the improvements in the economic figures of the country as well as the changing composition of the economy. During 1950s, Spain shared certain prevailing characteristics of less-developed, semi-industrialised nations of Mediterranean Europe and Latin America: a relatively low GDP per capita, low worker productivity, a predominance of unskilled labours, a large fraction of the labour force in agriculture, technological backwardness and an export profile dominated by primary commodities (Baklanoff, 1996: 107). However, between 1959 and 1971 the average annual growth of GDP increased to a record level of 7 percent, while the growth of domestic industrial product (value added by the industrial sector) was growing in real terms at an annual average of 9.4 percent. Moreover, the proportion of the labour force employed in agriculture declined sharply (from 49 percent in 1960 to 29 percent in 1970), while that in services grew. The rapid growth of foreign trade, the tourism boom, and the increasing foreign investment (especially by US, West German and Swiss firms) directed towards high-technology industry and services constituted the most salient features of the evolution of the recently liberalised Spanish economy in the 1960s (Salmon, 1995:4-5).

However, opposed to what one would expect from a country increasingly liberating itself and further integrating into the world economy, the autarkical economic policy of Spain was not swapped with a liberal one but with an extremely interventionist one. Very convenient to the traditional and complex web of relationships between the state, the industry, and the financial elite; the Opus Dei technocrats' ambitious attempt to change the legal framework in which these three main actors interacted started with a new **Banking Law** enacted in 1962. By these regulations, the technocrats prepared the grounds and instruments to intervene into the economy. Therefore, this new Banking Law created a revolutionary shift in the legal framework, compared to the one created by the Laws in 1921 and 1946, however, as it will be explained through the below paragraphs, no significant change that would affect the position of the banking elite came into practice and the cartel kept taking benefits of their status quo.

The most striking features of the new Banking Law of 1962 can be summarised as follows[11]:

I. Under the framework of this new law, the Bank of Spain and official credit entities (EOCs) were all nationalised. The official credit institutions were put under the control of the *Directorate General for State Assets* (*Dirección General del Patrimonio del Estado*-DGPE), and they were subject to the supervision by the *Official Credit Institute* (*Instituto de Credito Oficial*-ICO), which received funds from the state that were then lent to the credit institutions. The largest of these credit institutions was the *Industrial Credit Bank* (*Banco de Credito Industrial*), which specialized in general industrial loans.

II. A new institutional structure for the smooth functioning of the credit market and the banking system was established. In this new framework, three different institutions were mandated with the authority to regulate the financial system:

   a.) Bank of Spain: The recently nationalised Bank was given the authority to supervise the public banks

[11] Summarised from: S. Perez (1997:66-76), A.J. Lukauskas (1994:78-80), J.P. Sánchez (2006:41-51).

b.) Savings Banks Credit Institute: This newly created institution was donated with the duty and rights to control and monitor the Savings Banks (Cajas de Ahorros).

c.) Medium-and-Long Term Credit Institute: This institution was also created by the Law of 1962 and given the authority to coordinate and supervise the functioning of newly nationalised official credit entities, as well as the medium and long term credits issued by private banks.

III. The traditional but very costly system of budget and credit financing: pignoración automática was abolished.

IV. The portfolios and certain operations of the private banks were regulated. The technocrats took the very first steps to specialize the banking system in Spain by defining the activities and allowing the foundation of "industrial banks". By doing this, the technocrats attempted to swap the "universal" banking system with a "specialised" banking. This initiative was defended by a need to alter the mismatch between the long-term industrial investments and the short or medium term credits offered to their investors. However, the underlying political reason was far beyond this stated intention; the Opus Dei technocrats intended to rescue the Franco regime from the captivity of the financial cartel that captured a peerless strength through their full control over the Spanish industry (Perez, 1999:80-81). However, this purpose of the new banking Law could never be put in enforcement precisely due to the amendments added to the Law (Perez, 1999:81). The industrial banks were given full authority to be the solely issuer of long-term credit to industry but their competitive position against the commercial banks was limited by a decree set regarding the number of their branches, stating that they could not exceed three. Secondly, their establishment and operations were put under the strict control, supervision and approval of the Ministry of Finance, which set very high capital requirements for their establishment. Last but not least, the commercial banks were given a right to control and own industrial banks - which finally affirmed the fact that new Banking Law and the Opus Dei technocrats had no intention at all to challenge the dominant position and the de facto status quo of the banking elite. Not surprisingly, nine of the total of fifteen industrial banks operating between 1962 and 1972 were owned and controlled by already existing commercial banks, while the individual industrial banks composed only 2.5 percent of the banking sector's deposits. Therefore, the introduction of the industrial banking to the economic sphere of Spain neither created the intended specialisation nor altered the existing composition of the financial framework.

V. The foreign bank entry to the Spanish market was legalised. However, due to the banking oligopoly's pressures this initiative to internationalize the financial sector could never go beyond to be an article written in the Law, quite like the attempts to specialize the banking sector. During the times of wide-range liberalisation of the Spanish economy, the financial sector kept to be protected while most other sectors were opened to foreign competition. Thus, most of the capital flows stemming from the massive foreign investment to the country were transferred via the Big Seven and radically increased their profits and deposits.

VI. The law created the grounds for the selective credit policies, through which the state directly allocated the distribution of the private banks' credits, by defining the credit system as an instrument of the Planning Commission (Perez, 1997: 76)

Therefore, the Banking Law of 1962 and the new legal framework paved the way for the state's intervention in the economy through many means, but mainly through **credit regulation**, which gave the state officials a direct say in the allocation of financial resources. The instruments utilized to regulate the credit market were "interest rate controls" and "selective credit policies". The Franco administration had a long tradition of interfering in the *interest rates* imposed by private banks and the *credit allocation*, however, after 1960 authorities asserted even more control over the interest rate policy, which demonstrated nothing but a reciprocal consent among the banking elite and the policy-makers (Perez, 1999:80 and Lukauskas, 1994:78). In other words, banks traded jurisdiction over credit allocation for control over the financial system (Perez, 1999:80).

The ceiling set by the government officials for the maximum real loan interest rate was extraordinarily low, as the technocrats used to believe that providing cheap credit to the industry would encourage productive investment and thereby promote aggregate growth (Perez, 1999:84). As the method of cheap credit was utilised by many other European countries during the post war period in order to achieve an export-led growth; this notion of the Opus Dei was neither revolutionary nor innovative. Contradictory, such an attitude only served for artificially lowering the cost of capital and thus for encouraging firms to undertake overly capital-intensive modes of production in Spain (Lukauskas, 1994:81). This outcome is a consequence of the fact that in Spain this policy was not followed by domestic price stability and an undervalued currency that would increase exports and domestic savings (Perez, 1998:766). Instead, domestic savings and investments were discouraged as a result of the deposit rates ceilings imposed by the reconciliation of the government and the banking elite (Lukauskas, 1994:81). Here, it is needed to emphasize the relative strength of the bargaining power of the banking elite in Spain, compared to its European neighbours. Even though the new regulatory framework might seem to be conflicting with the interests of the banking cartel, it was based on a mutual consent, which guaranteed the profitability and status quo of the cartel in return for their sacrifice in certain aspects such as the abolishment of the *pignoración automática* or the new and more restrictive institutional framework.

The government intervened not only in the terms of credit but also to the address of these credits. *Selective credits*, which mean grants and loans with considerably low interest rates, were provided to a privileged circle (*circuitos privilegiados de crédito*) (Perez, 1999:79). The technocrats pursued a financial strategy that would favour the sectors suffering problems of adaptation to the changing climate of the economic liberalization but also deemed essential for economic development. Not surprisingly, these sectors were the ones that the Banking Cartel had invested heavily, such as: chemicals, steel, shipbuilding and transport equipment (Lukauskas, 1994:80). However, without any loss of time, selective credit policies became the principle means of distributing private benefits to favoured groups. The policy-makers preferred this method of interventionism as the selective credit policies did not require direct budgetary expenditures and their costs could be imposed on the financial sector, while their indirect costs, the opportunity cost of efficiency and the cost of the inflationary pressure they created could be diffused throughout the society (Lukauskas, 1994:80-81)

Bank credit has always been the principle tool of the Spanish state when it was needed to interfere in the economy; therefore, during the years of interventionism, the government developed some other methods than the ones listed above to use the bank credit as a monetary tool. The government abolished the inflationary public financing method of the pignoración automática but instead the state officials utilized two other instruments, the public funds coefficients and the special discount lines, to expropriate the seignorage, or in other words to balance the budgetary deficit through inflationary practices.

The coefficients provided a very handy way for the taxation of the financial system to the state officials upon having abolished the very common method of the pignoración. The "public funds coefficient" maintained the legal ground for a certain amount of the deposits of the Spanish banks to be invested in public debt or securities issued by government agencies. In addition, it required banks to purchase "investment certificates" at below market rates from the Treasury (Lukauskas, 1994:83). However, the utilization of "reserve requirements", enjoining banks to keep a certain amount of their deposits in the Bank of Spain, was postponed until the 1970s. Here, it is needed to emphasize that this compulsory public debt ratio did less harm than the benefit it caused for the banking sector. Considering the limited fiscal capacity of the state and the inadequate and obsolete tax structure of the country, this method of indirect taxation of the banking sector served as an alternative to a strict tax reform that would be totally devastating for the interests of the Big Seven, given their prominent position in the industry. Doubtlessly, if a rigid tax reform had been introduced, the Big Seven, with their tremendous industrial portfolios, it would have cost much more than what had cost under this structure of indirect taxation. Moreover, unlike the advantageous nature of this method, the direct taxation would have imposed direct and visible costs over the society, which would have shaken the stability of the state elite, as well as the banking elite that had very close ties with them.

The tool of special discount lines served as a mixture of recent practice of selective credit policies and abolished tradition of the pignoración. These discount lines encouraged lending to priority sectors by allowing banks to rediscount credits granted to them at the Bank of Spain. This method, just like its predecessor "the pignoración", provided means to inject liquidity into the financial system.

For an accurate analysis of the banking sector in Spain, it is more than essential to mention the cartel's reaction to the new and highly interventionist financial framework. As also stated through the above paragraphs, the new regulations were products of a mutual consent, rather than a strict sanction. Banking sector raised almost no oppositions to the expansion of the state control over their actions and operations. Instead, the banking elite itself participated in the formulation of the new framework, which was drafted at a time when they were powerfully represented among the policy-making elite (Perez, 1999:77 and Lukauskas, 1994:75-76). Moreover, the banking elite had almost full control over the industry, thanks to the shares that they were holding in their portfolio and to their permanent positions in the boards of these firms and their webs of interlocking directorships (mainly in the state-owned utility companies such as Telefonica, Iberdola, Endesa, etc) as well as a strong presence within the bureaucracy which made it impossible to create a public policy that would not serve to their interests (Perez, 1999:86). However, it is also worth mentioning that the interventionist framework did not only serve to the interests of one party but was quite practical for both the state and the banking cartel.

The banking oligopoly did not oppose to the state interventionism because in return, the state guaranteed the continuation of their oligopolistic power; persistence of ample central bank financing (even if now it became more controlled), and impediment of the development of financial markets, which would guarantee of their control over the industry and secure their profit margin by limiting the source of credit to financial system. Moreover, the banking elite was very well aware of the fact that the continuity of their high profits and their significant political influence could only be possible in the presence of a shift in the economic policy that would tie Spain to the world economy. Furthermore, any social unrest that would have strengthened the influence of the National Syndicalists, who were in favour of nationalising the banking sector, could be devastating to their interests. Thus, the support of the cartel for both the programme and political leadership of the technocrats must also be considered within this political framework.

The state pursued the interventionist economic policy as this policy provided them a control over the allocation of credit and foreign exchange; a robust growth despite low financial efficiency; persistent cheap credit provided to industry; and an inflationary method of public financing (Perez, 1999:86 and Lukauskas, 1994:75-76). The majority of the indirect costs associated with these state-wise benefits of the interventionist policies were distributed not over the financial elite, but over the society. For example, the inflationary method for public financing included taxation of the financial sector through credit policies whose direct costs were imposed on the financial sector while its indirect costs of loss of financial efficiency and higher inflation were distributed over the society (Lukauskas, 1994:76).

Therefore, despite the immature attempts to limit its power and control, the Big Seven consolidated its status quo and even strengthen its dominant position in the political and economic life of Spain. Given the robust growth of the economy and the huge capital inflows to the country, the banking sector increased the total amount of capital and reserves dramatically. Between the years 1962 and 1974, even if it seems that the savings banks (with 4 percent) and the industrial banks (with 8 percent) increased their share of deposits at the expense of the commercial banks, provided that most of the industrial banks were owned by commercial banks, the existing status quo was not challenged at all (Perez, 1999:85, Lukauskas, 1994:77 and Arroyo Martín, 2000:22) In addition, the number of the firms controlled by the Big Seven increased considerably in the absence of direct financial markets as an alternative to bank credit for industry financing. More strikingly, "throughout the 1960s and 1970s the Big Seven banks controlled some 70 percent of the total assets in the commercial banking sector, granted 60 percent of all loans, held 90 percent of all private assets and exercised direct control over a quarter of country's 200 concerns" (Tayfur, 2003:150).

However, the end of 1960s signalled a new wave of political economy for the highly interventionist but speedily liberalising Spain. The financial system based on cheap credits, and low deposit rates combined with special rediscount lines to compensate the banking elite's interests, resulted with a sharp rise in capital outflows. The presence of strong international inflationary pressures caused by the collapse of the Bretton Woods order, the sharp rise in international interest rates and the emergence of shore financial markets triggered the capital outflow, especially for the short-term capital. Given the low deposit rates and the repressed wage levels strictly arranged by the Syndical Organisation bring halt to industrial production, and therefore to the cheap-credit driven growth. The outbreak of MATESA[12] scandal the last resorts of the Opus Dei technocrats, and made the back-door contention between technocrats and newly ascending group of "central bank reformers"[13] public.

In 1969, the central bank reformers challenged both the Opus Dei technocrats and the banking elite by a law, transferring the right to fix interest rates from the Ministry of Finance to the Central Bank (Bank of Spain) and linking all banks rates to the central bank's rediscount rate. This had been a big challenge against the status quo not only because of the shift in the power dynamics but also because of the new system of setting the credits. Starting from that date the Central Bank issued a ceiling rather than a floor for the lending rates, which ended the policy of cheap credits. Upon this regulation expansion of the credit to the private sector reduced from 25 percent in 1969 to 10 percent in 1970. Not surprisingly, very shortly, the Opus Dei technocrats retaliated and the special rediscount lines were sharply expanded in 1969. However, winner of this contention became full-liberalisation oriented group of central bank reformers, headed by Enrique Fuentes Quintana.

In 1971, this new group of reformers achieved the highest ranks within the Central Bank and Ministry of Finance, and drafted the new and liberal economic

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[12] Matesa scandal refers to the headline hitting scandal of the public discovery of the massive financial loss of the largest privileged export grantor of the country. Matesa group fraudulently obtained governmental export credits by setting up subsidiary companies in Latin America, which then ordered large quantities of the export credits. Apart from the board of Matesa group, all members of Opus Dei were involved in the scandal.

[13] "Central Bank Reformers" is the name given to a group of liberals led by the Head of Bank of Spain Enrique Fuentes Quintana. The reformers challenged the interventionist state policies and demanded a more integrated and liberal financial system in which not the financial oligopoly but the Central Bank possessed the full control of the economic policies and financial control (Perez, 1999:94-96).

policy of the country. The foremost target of this group was to guarantee the Central Bank's control over the economic policy and alter the interventionist framework. Therefore, through a legislation passed in 1971, the reformers eliminated the special rediscount lines and replaced them with the "compulsory investment ratio", which obliged banks to invest a specific proportion of their deposits as credits to specified users. Moreover, the new Law transferred the control and supervision of a large number of regulatory bodies to the Central Bank. Therefore, a new saga started for the Spanish economic policy. First of all, the interference of the Opus Dei technocrats and the banking elite to the Central Bank's rediscount policy was abolished. Moreover, the fragmented regulatory structure of the finance system was reorganised under one umbrella: the Central Bank. The banking cartel seemed to accept these reforms because still they were protected from any domestic or international competition, including the threat of the direct money markets, which would certainly undermine their cartel position for short and long term credits and industry financing.

After 1973, the central bank reformers took the first steps to abolish the obstacles in front of the creation of a real money market. A well-functioning money market was their second target to achieve as the monetary authority used to lack the tools to regularly control the level of liquidity in the financial system. This time, not likely to what happened at the time that they abolished selective credit discounting, the reformers came into conflict with the banking elite. The Central Bank issued short-term credits in order to initiate a money market that would help to alter the Central Bank's inability to inject liquidity into the financial system. However, due to the strong hindering of the banking cartel, the creation of a direct money market took longer than a decade. These short-term credits issued by the Central Bank in 1974 were allocated to the banks in rigid proposition to their deposits rather than a public auction (Perez, 1999:103-104) and the Big Seven continued to enjoy its extremely privileged position.

Here, it would be useful to stress that the contestation between the central bank reformers and the Opus Dei technocrats and the one between the reformers and the banking elite were quite irrelevant in nature. The political power of the banking elite had something to do with this situation for sure, but there were some other very important underlying reasons as well. First of all, the relationship between the banking cartel and the reformers was cliental rather than competitive, as the banks were the primary client institutions of the Central Bank. Moreover, thanks to their enormous share in the industry, they were the main representatives of the private capital in the country. Thus, the central bank reformers had no other option than to seek for the cartel's partnership. So, the reformers publicly emphasised the future political, economic and efficiency-wise benefits of liberalisation, which made the cartel's open opposition quite difficult. Secondly, the reformers liberalised the bank branch openings and the interest rate controlling commissions, to compensate the banks for the imposition of the compulsory investment ration. In a very short time, these actions sharply increased the number of bank branches and therefore their operational costs. However, thanks to the liberalisation of the interest rates as well, the banks quickly transferred these increased costs to their customers. Even if these regulations paved the way for the upcoming liberalisation process, facilitated the future success of the reformer's agenda and secured the banking cartel's approval to the liberalisation, they damaged the economy with the increased costs at a time that the world economy was hit by a global recession due to the 1973 Oil Shock.

One fact is still worth mentioning to demonstrate the banking cartel's stance towards the overall political economy of the country. The reformers still undertook the measures that were strengthening the position and profitability of the cartel, even if it was at the cost of the Spanish industry that was going through a recession. However, the banks' reaction to the industrial sectors that were in crises and their overall investment behaviour against the recession was completely different and totally self-centred. Although the underlying logic of the universal banking system is to guarantee the bank's support to the industry, the Spanish banks became the first to abandon the problematic industries, such as coal, steel and shipbuilding, upon seeing the high financial troubles they were encountering with. As opposed to their German counterparts that took on the role of insulating the government from difficult and costly troubles by taking lead in organising rescue operations of large industrial conglomerates, Spanish banks initiated a process of disinvestment. As a consequence INI had no choice but to absorb unprofitable companies and the Spanish public sector became one of the less profitable ones among the OECD members (Perez, 1999:114).

The fact that the emergence of any other economic elite was almost impossible given the overall control of the banking elite over the industry and the capital helped the Big Seven to secure their privileged and protected status quo while the country was undergoing a strong wave of liberalisation, no matter this transformation was under the control of Opus Dei technocrats or the central bank reformers. Given the strong presence of the banking elite not only in the boards of commercial firms but also in the boards of public firms as well as the INI, it was almost impossible to detach the interests and political agenda of the financial elite from the ones of the state. Therefore, during the era of Spanish Miracle, the different political objectives and the different ideological agendas of two different groups of policy-makers both created an ambiance of mutual consent between the state and the banking elite.

CHAPTER 2: THE CONSOLIDATION OF THE FINANCIAL ELITE IN THE DEMOCRATIC SPAIN

2.1. Political Transition and the Early Years of European Integration (1976 - mid 1980s):

The death of Franco in 1975 and the economic recession following the 1973 Oil Shock paved the way for democratisation and further liberalisation of Spain, derived by a strong stimulus for integration with the European Community. By 1975, the economic domain of Spain had changed remarkably in comparison with its situation in the 1960s. Total production was 2.8 times greater, in real terms, compared to what it used to be 14 years ago; industrial production expanded nearly fourfold; the output of services was nearly 2.7 times greater and agricultural production had increased by 1.6 (Baklanoff, 1996: 108). Therefore, by 1975, not only the political outlook but also the economic performance of Spain was in a way more improved than the Spain of 1960s. This is why, not only the international political circles, but also the foreign financial elites led by American banks were urging for a financial liberalisation that would allow them to reap the harvest of the huge capital inflows directed to the Spanish economy. Therefore, during the years of political transition and establishment of the new democracy, the intentions of the government, the business elite and the political elite intersected with the overall goal to reorganise and liberalise the financial system, which implied dismantling, or at least weakening, the oligopolistic structure of the market. A stronger competition and better regulation were indeed needed in order to curb the high cost of credit and to evoke the stagnant industrial development. However, as it will be explained in detail through out the following paragraphs, this attempt did not bear fruitful results due to several factors. Among them, the most salient ones are the facts that the reformers sought for the alliance and cooperation of the banking elite for the reformation process, and also the political and economic fragility left no room to the government to take radical measures. Nevertheless, the steps taken since the finance package of 1977 still marked remarkable points in the process of market liberalisation of Spain and thanks to these steps a considerable amount of central bank control over the liquidity of the credit market was achieved.

During the late 1970s and the mid 1980s, the focus of the Spanish political economy witnessed a noteworthy transition from dictatorship to democracy, from centralism to regionalism, and from a peripheral industrial position in the world economy to a competitive one. However, such a transition carried along its costs as well. In the wake of the Oil Shock and following the halt of the economic miracle, the Spanish economy encountered itself with the perils of the biggest economic crisis in its history. The gradual increase of the cost of credit, huge public sector deficits, the dependency of the country on imported energy due to lack of domestic energy resources, high inflation and rising unemployment, and the global recession put the country into a deep investment crisis. This crisis was centred on those industries in which Spain had specialised in the 1960s, such as steel, shipbuilding, textile and chemistry (Salmon, 1995:4-5). The expansion of economy witnessed in the 1960s, based on the intensive use of labour and cheap energy, came to a halt with the increase in costs, the stagnation of the industry and the fall in demand (Bank for International Settlements, 2004:28).

The first democratic elections in 1977 resulted with the victory of the centre-right party of Adolfo Suárez (the prime minister appointed by the King in 1976 to oversee the transition to free elections), UCD (Union de Centro Democratico) that represented the progressive wing of the Spanish financial and industrial elite and thus the interests of Spanish capital (Tayfur, 2003:174). The appointment of Enrique Fuentes Quinta, the head of central bank reformers, as economics minister and the position that the reformers gained in the new regime signed the corner stones of the transition period. The policy makers as well as the financial reformers were aware of the fact that financial liberalisation was needed in order to enhance the competition and the efficiency of the overall Spanish economy. Thus it was not a big surprise that the new government's first action had been undertaking the necessary measures to adjust the economy to the recession and beginning the difficult process of economic liberalisation. The very first steps of this policy of adjustment were taken through the Moncloa Pacts (Los Pactos de la Moncloa), agreed between all political parties, employers and trade unions. The bottom lines of the Moncloa Pacts were an overall commitment to democracy and a strong focus to a liberal and open market economy, with an eventual target of membership of the European Community. This agreement was accompanied by a statement of intent on a variety of economic reforms to assure the simultaneous achievement to democratisation and to a democratic welfare state.

The measures of the 1977 reform package can be summarised as follows (Perez, 1999:103-106 and Gallego, Herrero and Saurina, 2002:29):

1. The technical control over the banking system's liquid assets was delegated to the Bank of Spain and any other institutions that would have a say in the financial policy were dismantled. Once more, the idea behind this was to create a domestic capital market. An auction system was designed in order to assure that the Bank of Spain controlled the liquidity through short-term bonds and credits, however, this attempt which had been vetoed by the banking cartel in 1974, ran fast into the bottlenecks once again as the access to the auctions continued to be restricted by the banks. Despite the fact that in a report drafted by a committee of prominent economists in the framework of the financial liberalisation agenda it was recommended that a short-term bond and credit market be created very soon, no measures were taken until 1988, when the prospect of European integration pushed the country to adopt the capital market liberalisation.

2. Interest rates were deregulated and market-regulated interest rates were introduced in order to achieve efficiency in credit allocation and industry financing. However, this regulation aiming at market-regulated interest rates would have jeopardised the supernatural profits of the banking elite. Thus, in the wake of the strong opposition of the cartel, only the long-term credits were regulated and the short-term credit rates (both for deposit rates and for credit rates) were left to be deregulated through the course time.

3. Institutional bases for selective credit regulation and privileged investment were eliminated in order to assure an effectively functioning financial market which would no longer transfer the burden of the costs associated with cheap financing of inefficient traditional industry onto the potentially efficient and fragile new industry.

4. Savings banks were allowed to discount commercial paper and to operate in the foreign exchange market. This step is worth mentioning, as it is the only measure taken despite the opposition of the banking cartel. The principle motivation behind this radical action was the fact that most of the savings banks were used to being ruled by the regional authorities that had begun to gain a louder voice upon the death of Franco followed by a fast democratisation process. In order to guarantee its prospective regulatory authority over the savings banks, the Bank of Spain had to harmonise the regulatory treatment among the banking sector. Moreover, the savings banks have never been considered to be a real threat in the eyes of commercial banks, as opposed to foreign banks or official credit entities. This assumption kept proving to be true until the early 1990s, when the legal restrictions on the geographical scale of the operations of savings banks were lifted. The savings banks did not only increase their deposit share at the expense of commercial banks but also the two largest savings banks (La Caixa and Cajamadrid) managed to be listed in the same league with big commercial banks. However, their operations were kept on being restricted to the households rather than enterprises, which enabled them to put a significant pressure on the commercial banks' profitability.

Doubtlessly, the context of the reform package was very contradictory to the self-interests of the financial elite, but still it provided a reconciling platform. However, it was the timing of the reform package that was extremely adventurousness. The reform package was brought to the agenda right after the elections with an intention to barricade any possible opposition or bottleneck against the reforms, including any alternative reform packages. Consequently, because of this bad timing, opposition came without any loss of time from the beneficiaries of the traditional financial system, including the banking elite, the industrial elite and the politicians. At that point, the reformers had no other option but to choose to obtain the support of the financial elite for being able to accomplish the difficult task of liberalisation. Fuentes himself explains why he sought the working alliance with the banking sector as follows:

> "I was convinced that these liberalisation measures were a critical part of the adjustment policy that the country would have to apply to get out of the crisis and even more convinced that without the support of the Spanish bankers and the heads of the savings banks, which together accounted for 90 percent of the Spanish financial system at the time, those reforms, no matter how adequate they were, would not become a legal reality or guide the daily practice of the Spanish financial system" (Quoted from Perez ,1997:122)

Given the prospective costs associated with such an action, it was not an easy task to assure a declared support of the financial elite for an unconditional liberalisation and to alter the way that the financial system had always functioned. However, the majority of the Spanish population saw its future in the further integration with Europe and the European Community, and therefore the reformists took the wind of public support for further liberalisation, which would lead the way towards the European Community. Furthermore, in the eyes of the public, liberalisation and an open-market economy were considered to be the only prescriptions to fight against the gradually increasing unemployment as well as against the deep investment crisis. Such dominant and severe public support left almost no room to manoeuvre for the financial elite other than reconciling with the reformers' agenda.

The creation of the AEB (*Asociación Española de Banca / Spanish Association of Private Bankers*) should also be evaluated considering this reformist intention to dismantle the cohesiveness of the banking framework lead by CSB. "Unlike CSB, where the big banks had exercised public powers behind closed doors, the AEB was meant to operate as a conventional lobbying organization that would orient the banking sector's position on policy issues and represent it in public" (Perez, 199:123). This new group, founded by the personal initiative of Fuentes himself, adopted the "financial liberalisation" as their motto and launched a reformist trend among the banking elite.

However, as it can also be explicitly seen through the content and practice of the reform package of 1977, the reconciliation was never meant to be a unilateral one but a reciprocal one. The reformers retreated when it was strongly needed to keep the unnatural profitability and the market dominance of the banking sector, so that they could possess an overall control over the financial market liquidity. The greatest compromise from a full-scale liberalisation came in the form of a sanction against foreign entry into the Spanish financial market. Despite the promising negotiations between the political elite led by Suárez himself, in 1977 the Ministry of Finance declared that foreign banks would not be allowed to establish offices in Spain. Therefore, while compromising their control over the credit market, the banking cartel guaranteed the oligopolistic structure of the financial market. In return, the reformers achieved the top priority item in their agenda: obtaining the control of financial liquidity and the credit market (Perez, 1999:126). Also, they managed to transfer the credit system's resources extracted by the dismantling of the compulsory investment ratio into the market (Perez, 1999:126).

Commencing from 1978, restrictions to foreign bank entry began to be lifted partially, however restrictions on the retail segment remained. The heavy restrictions imposed by the new legislation made it almost impossible for foreign entities to function properly and effectively (S. Gallego, A.G. Herrero and J. Saurina, 2002:29). The most striking of these restrictions can be summarised as follows: any foreign bank that would have planned to enter into the Spanish market was subject to the authorisation of the Bank of Spain and CSB controlled by the banking elite. Had the bank acquired the authorisation, it was still limited to only three branches in all Spain. And most strikingly, their assets were limited with the 40 percent of their lending to Spanish firms, which made it totally unprofitable and ineffective for foreign banks to operate on a full-scale in the Spanish market (Perez, 1997:127 and S. Gallego, A.G. Herrero and J. Saurina, 2002:33). Adding to the banking oligopoly's dominant and manipulative position in the interbank money market, any attempts of foreign banks to curb the interest rates in order to acquire a competitive advantage was blocked by the cartel's price fixing strategy (Perez, 1997:128). Thus, many of the foreign banks, especially big American banks, withdrew from Spain during 1980s due to lack of competitiveness.

One other measure that was considered but then was given up is also worth mentioning here. As stated through the above paragraphs, the creation of new firms traditionally has always been under the control and preferences of a certain economic group – the financial elite. Even though this scheme began to change slightly commencing from the creation of INI in 1941, and also thanks to the entry of foreign capital into the Spanish economy, the credit market remained as the main supplier for the industrial financing of the country. In 1978, a research conducted by APD (Asociación para el Progreso de la Dirección / Association for the Progress in Management) among 160 Spanish firms revealed that 49 percent of the participated firms diversified their financing among at least four banks, each of which had at least 10 percent in total firm financing. Only some 3 percent of the firms relied on private financing and 13 percent relied on savings banks (El País, 01. 01 1978). Therefore, the increase in the costs of credit following the liberalisation of the interest rates in order to maintain the profitability without transferring the costs to the customers was directly reflected negatively on the industrial development. The price difference between the one that paid to the deposits and the one charged for the credits constituted the main source for the revenues and for the inflows to cover up the administrative costs. In the eyes of the industry managers and central bank reformers this equation was quite unfair in nature. The authorities interviewed by the one of the leading newspapers, El País, analysed the case as follows:

> "...at a time that the country needs important sacrifices to halt the financial imbalances of the Spanish economy, and in an environment that these sacrifices successfully curb the wages, the internal demand, the balance of trade imbalances, and the balance of payments deficit, the credit institutions have dedicated themselves to boycott the political economy by maintaining their rigid position regarding the credit concessions. This policy (...) is clearly reflected through the practice of privileged lending observed in the recent months, through which the banks, especially the big banks, provided credits with a very high level of interest (around 17-18% per annum) to the firms that do not belong to their industrial portfolio, while maintaining the optimum conditions for the financing of the entities belonging to their own group" (Translated from El País dated 01.06.1978. See the article "El Gobierno quiere relanzar la inversión mediante una reducción del coste del dinero").

This is why the government, and the reformers as well, considered methods for forcing the financial institutions (commercial banks and savings banks) to a reduction in the costs of credit in order to encourage investment. One of the alternatives considered by the Government was to create a commercial bank owned by the State itself, which would be capable of reaching a full-scale competence in order to evoke the credit market. The proponents of this project indicated the inconsistency in asking for the state to abandon the possession of any credit institutions that would be allowed to take deposits while supervising efficiently the financial entities of the country. Therefore, the public entities (the EOCs) could never obtain a direct say over the financial market and could never be included into the decision making process for the banking regulations, which turned them into nothing more than administrative offices for official credit allocation (El Pais dated 08.08.1978, see the article "Responsables y técnicos del Gobierno, interesados en crear un banco comercial del Estado"). The foremost idea to accomplish this project was to utilise already existing financial entities owned by the State -the EOCs- and to transform them into a commercial bank allowed to take deposits in competition with commercial banks. Had this been achieved then the government could have challenged the oligopoly of the Big Seven and could have interfered into the credit market easily and effectively (Perez, 1997:130). However, once more the reformers postponed this alternative method, which would have provided them a great say over the financial market, until the foundation of Argenteria Group in 1991, in return for a working alliance with the cartel.

As it can be observed through the above paragraphs, the right-wing UCD government adopted a very sober attitude towards the financial reforms, despite their highly assertive liberal agenda. Such a moderate stance as the UCD's was very much needed in the highly unstable ambiance of democratisation. The top priority agenda of the government was securing and stabilising the democracy. Considering the failed coup d'etat attempt in the last year of the UCD government (1981), in which the economy was going through serious crisis, this was not an empty concern at all. Thus, any radical move that jeopardised the support of the financial elite as well as the public support could also have jeopardised the very fragile democracy and therefore could have taken the country to the point of no return. This is why, the UCD government had to put the target of dismantling the oligopoly in the financial sector to the second place in spite of the high and sometimes devastating results of this structure.

The second oil shock of 1979 caught the Spanish economy, which was already suffering from high financial costs, by surprise and put the industry into an even deeper crisis. The industrial companies backed themselves with very expensive credits in order to protect their shares in the time of recession (Perez, 1997:135). Two main negative effects of this initiative were the aggravated inflation and an even bigger budget deficit (Perez, 1999:135). The damaged popularity of the UCD government was wounded once more in 1978 when the head of reformers, Fuentes, resigned from his duty as an economics minister due to the factionalism within the UCD and the increasingly open stand-off between Suárez and bankers (Perez, 1999:135).

The year 1978 witnessed another trauma, which not only damaged the political elite, but also, and even more aggressively, the overall banking system. From 1978 to 1983 Spain suffered the biggest banking crisis in its history, with the closure, merging or acquisition of 52 banks out of 116 existing at the start of the crisis Gallego, Herrero and Saurina, 2002: 29). In terms of deposits, these 52 banks amounted to over a quarter of total commercial bank assets, which can easily signify the scale of the crisis (Gallego, Herrero and Saurina, 2002: 29). The crisis began with the failure of small institutions but later on it reached the big banking groups and conglomerates, the most important of which was the Rumasa holding that will be explained below. Many of the collapsed banks were industrialised banks built upon the successful and miraculous industrialisation of the country in the previous decades and therefore specialised in medium and long term industry financing. Based on the information given above, the causes of the crises can be summarised as follows: the economic crisis, poor bank management and weak regulatory framework (Bank for International Settlements, 2004:29 and Gallego, Herrero and Saurina, 2002:30).

The reasons and the consequences of the economic crisis and industrial stagnation have been explained through the above paragraphs. But the banking crisis aroused inevitably when the two other factors added to that scenario.

Poor bank management stands for poor risk management caused principally by single borrower lending[14], very rapid growth of bank credit and unplanned bank expansion following the 1974 decree. Moreover, it is worth mentioning that increased competition caused by the liberating reforms of 1977 eroded market power and monopoly profits, which also played a role in the increase of the risk-

[14] In many cases the credits were concentrated in related parties or single borrowers belonging to the banks' managers or main shareholders.

taking behaviours of the Spanish firms (Salas and Saurina, 2002:8 and Bank for International Settlements, 2004:28). As their privileged earnings diminished and it became less costly to lose from economic distress and bankruptcy (Salas and Saurina, 2002:30) it turned out to be more attractive to take higher risks that could lead to higher profits. Furthermore, a considerable amount of investment credits were directed towards the traditional sectors suffering from the recession and to the risky real estate sector, which experienced a boom during the 1960s and then a serious decline following the depletion of the migratory flows. Therefore it can be claimed that the credit decisions were not given according to efficiency considerations. When the economic stagnation got even harder to cope with, many of these loans became non-performing and banks' assets stopped earning interest. The only quick alternative solution that the banks could come up with was purchasing their own shares to disguise their poor performance as well as offering higher interest rates and opening more branches, at the expense of increasing their costs and drifting themselves into even a bigger problem, in order to attract funds and to solve the liquidity problem. In some cases even fraud was committed in terms of speculative financing or manipulation of accounts (Bank for International Settlements, 2004:29).

The other factor that accelerated the demise of the banking sector was the lack of proper regulatory framework that would have let the authorities intervene with the banks in trouble before their collapse. Moreover, the supervision was far away from being adequate, which made it too hard for the authorities to understand the scale of the crisis before it had been too late. Lack of regulations for bank management (including the minimum qualifications needed for bank managers and regulations on doubtful assets) also contributed to the aggravation of the crisis. Furthermore, when the crises began, there was no deposit insurance scheme in Spain.

The size of the problem (with a cost about 5 percent of GDP) signified the fact that the crisis was systemic in nature (Bank for International Settlements, 2004:28). However, the crisis was not only very threatening for the Spanish financial market but also for the whole industry and even for the policy-makers given the framework of the country's political economy. Thus, had the banking sector failed, all the democratisation process along with the economic stability would have been jeopardised. In 1978, as it was no longer possible to ignore the magnitude of the crisis, a limited deposit insurance scheme, Corporación Bancaria, was founded under the joint financing of private banks and the Bank of Spain. In 1980, this institution was merged with Deposit Guarantee Fund, which became the sole body authorised to take control of a bank and to write-off losses. This mechanism was utilised with the exception of the RUMASA case[15] in 1984 and regulators agreed that tight regulations and supervision along with authorised bodies to perform them were needed for the sake of the financial and political stability of the country. Therefore, by the end of the crisis 51 of the 102 banks existing in 1977 were rescued by the Deposit Guarantee Fund (Peréz, 1997:149). Even if the depositors did not loose their savings at the end of the crises, a massive cost was transferred to the taxpayers, which also transferred the political burden of this failure to the ruling government.

Therefore, the end of Francoist era signalled anything but a stable system for the Spaniards. The very fragile democracy and also the economic system were under siege from every possible corner. In terms of economics, the country founded itself in two major crises both of which triggered the rising unemployment. From a political point of view the country was desolated by "left-wing and right-wing and Basque terrorism" accompanied by the growing demands of the nationalist parties for further autonomy (Solís, 2007:208). Considering the history of the militant ruling in the country, the damaged credibility of the government provided the most favourable ambience for the attempted coup d'état on February 1981.

The attempted coup d'état of 1981 was closely related to the events of the Spanish transition to democracy. The four main elements that triggered this attempted military coup can be summarised as follows: problems arising from the economic crisis, difficulties in creating a new territorial organization of Spain, growing terrorist activity by ETA, and open opposition by some parts of the army to acceptance of the democratic system (Hilton, 2003). On 23 February 1981 a group of two hundred armed Guardia Civil agents raided the Spanish Congress of Deputies during the process of electing Leopoldo Calvo Sotelo as the new Prime

[15] RUMASA case proved to be quite distinctive than the other failing banks due to the fact that it was the first newcomer that could challenge the oligopoly of the Big Seven. Moreover, it was a big cluster whose failure could have threatened the sector´s stability because of the 4 percent of the banking system's deposits they owned. This case will be explained below.

Minister. However, this attempt backfired mainly thanks to the personal intervention of King Juan Carlos himself and this way, with regards to the mainstream academicians and to the media, the democracy was consolidated in the contemporary Spanish political history following this failed coup attempt. Adding to the fact that this coup attempt had been further triggered by the legislation of the Communist Party and the strengthening power of the socialists (PSOE), this recently won victory of the democracy turned out to be the last straw in the diminishing power of the ruling party.

Following two important crises and one failed coup d'état attempt, which all reflected the high costs associated with the process of democratisation and liberalisation, it was no surprise that the Socialists (PSOE - *Partido Socialista Obrero Español*) were the most likely-to-win party before the 1982 elections. Following the failure of the Suárez government to satisfy the business and finance elites, who began to see their future within Europe (Tayfur, 2003:184), the PSOE who managed to acquire the support of these prominent circles paved their way to the legendary electoral victory of 1982. However, this prospective victory carried a lot of concerns and doubts among the business elite and the central bank reformers. Few years prior to the elections, rumours concerning the disputes between the banking elite and the directors of PSOE, mainly stemming from the heavy "nationalisation" emphasis within the economic programme of the party, were hitting the headlines. However, in 1982, the future Prime Minister and then Secretary General of PSOE, Felipe González, took the initiative in order to reconcile with the cartel and personally organised a series of business lunches with the heads of the Big Seven. According to the reports of the Spanish press (El Pais, 07.02.1982, see the article: "Reuniones entre Felipe González y los grandes banqueros para conocer el programa socialista del gobierno"), in these meetings, which were held with the participation of some significant political figures within the PSOE such as Javier Solana, Enrique Barón, Miguel Boyer, etc., the issues of new political structure, the political crisis that the governing party was going through, as well as the posture of the PSOE against the theme of nationalisation were discussed.

The meetings were organised upon the invitation by the PSOE, however, the banking elite was even more enthusiastic than the politicians to attend them. Following these meetings, socialists stated that they had to respond many democratic concerns among the banking elite (El Pais, 07.02.1982). Meanwhile, the consulted bankers evaluated these meetings as a very useful opportunity for being able to conceptualise the political and economic agenda of Felipe González, which they rated as a very realistic one, and added that they were keen on maintaining the role as a bridge in the sour relationship between the socialists and the business elite represented under the framework of Spanish Business Co-operation (Confederación Española de Organizaciones Empresariales - CEOE) (El Pais, 07.02.1982).

The problematic relationship between PSOE and the business elite is worth mentioning. The heads of the CEOE used to be quiet worried, and even disturbed, regarding the political and economic posture of González, and they even went to the extreme point of calling him "a leader with a very francoist conception of politics" (El Pais, 07.02.1982, see the article: "Reuniones entre Felipe González y los grandes banqueros para conocer el programa socialista del gobierno"). This is why, during these meetings with the bankers, González emphasised strongly that he did not have any specific nationalisation targets, however, yet he had not given up the idea of nationalisation for good (El País, 07.02.1982). He classified nationalisation as progressive and conservative, adding that all the governments had nationalisation targets within their agendas, and these attempts had never resulted with a change in the structure of the society (El País, 07.02.1982). Moreover, he repeatedly stated their desire to keep up with the reforms needed for a possible Accession, which had been the principle concern of the business elite (El País, 07.02.1982). Therefore, it is possible to state that PSOE started its reconciliation with the banking and business elites even before coming to power, and the socialists, just like the conservatives, always let the banking sector undertake the leader and the mediator role.

This rapprochement between the Big Seven and PSOE was also reflected in the very traditional party programme of the socialists. Upon exchanging ideas with the banking and business elites, the socialist party saw that the only path that could lead them to an electoral victory was dropping their early commitment to nationalisation and offering a quite liberal agenda instead. Hence, in the electoral programme of 1982 PSOE the party suggested an alternative and less radical financial reform which would focus on the aim of ending the industrial stagnation by introducing a new role undertaken by the official credit entities (EOCs) (PSOE, Programa, 1982:15). In addition to this soft measure of utilising the already state-owned financial institutions rather than nationalising the banking sector as a prescription for the industry financing crisis of the country, another, but a bit more radical, electoral agenda was also introduced: PSOE put its intention to intervene into credit rates in order to push them downward when necessary by keeping the banks needing to be rescued by public funds in public hands instead of privatising them. Therefore without a need for nationalisation the state would have had pubic banks to be utilised to intervene into financial markets. Moreover PSOE went to the extreme point of explicitly emphasising this consolidation with the banking elite in its new electorate programme by stating that it was needed "to restore the banks' role as great investors and promoters in the industrial sector" (Perez, 1997:140).

It is also be worth emphasising that the logic of socialism had to be adapted to the expectations of the society and of the business and financial elites. Some national and international facts also accelerated this "liberalisation" of the socialist agenda of the PSOE.

First of all the failure of the Keynesian socialism in France in 1981-1982, which proved to be a showcase of the impossibility of adopting national Keynesianism, accompanied by heavy nationalism in the major world economies served as a catalyst for the new magnitude of the PSOE (El Pais, Interviews with Felipe González, 27.10.2002). According to his own words, instead of pursuing an unobtainable socialism which can be scaled between communism and British labour movement, he adopted a moderate social democracy which is mainly characterised with the Northern European countries (Tussel, 2005: 337).

Secondly, González wisely observed and evaluated the fact that the Spanish business elite saw its future in Europe and wanted to see Spain as a major and powerful actor in the European league (Tayfur, 2003:175). It was quite obvious that the traditional Marxist rhetoric of the socialist government did not have any affiliation with the neo-liberal policies of the European Community (Agudin, 2002:3), and González, who aimed at eliminating all the economic and political obstacles in front of an integration with Europe, (Tayfur, 2003:175) knew very well that adopting a similar liberal stance was the only way to acquire the support of the business elite.

Added the fall in foreign reserves, the speculative pressure against peseta and the ongoing banking crisis to this scenario, during the process of re-adaptation of Spanish notion of socialism, which took place in the course of the party congresses between 1979 and 1981, PSOE adopted a centre-left position and eliminated Marxism from its party program following an initiative by Felipe González and Miguel Boyer, the soon to be Minister of Economy, and clarified very clearly that their slogan "por el cambio / to a change" did not imply a societal / religious / financial change but rather a political change towards the Western world (El Pais, Interviews with Felipe González, 27.10.2002 and Marín Arce, 2000:190).

Therefore in the course of their electoral campaign the socialists calmed down the society by explicitly stating that this change would not imply a change in the way that the Church, the Military or the Banking System functioned but, with the very own words of Felipe González, "a change in the way that Spain functioned" (Marín Arce, 2000: 190). González summarised his intentions as the head of state as "forming a legal and unique government capable of consolidating the democracy, enhancing the framework of liberties, overcoming the ongoing economic crisis, forming the State of Autonomies (which had a great value in the eyes of the electorates from the Catalonia and Basque regions), improving the framework of political parties, securing the position of civil power against any military intervention and finalising the process of the EU integration (Marín Arce, 2000: 194).

Against the allegations claiming that with this new policy the PSOE left its socialist past behind Felipe González himself defended this new policy of the PSOE as a "liberal political economy, which aims at increasing the competitiveness, liberating the economy, eliminating the barriers, accompanied by a very coherent social policy, which aims at universalising the standards of the systems for pensions, health and education. (El Pais, Interviews with Felipe González, 27.10.2002). Here, it is also worth opening a parenthesis to mention a unique and reformist characteristic of the Spanish business elite: they always wanted a political voice which would have the capacity to foresee, analyse and represent their economic interests. Therefore, they always supported the progressive wing, which was UCD against Popular Alliance Party in 1977, and PSOE against UCD in 1982 (Tayfur, 2003: 183).

Therefore, in addition to the societal facts such as urge for a full democratisation following the decades long authoritarian ruling and a very recent failed 23 February 1981 attempted coup d'etat, thanks to this quite liberal party programme that would please both the business and financial elites, October 1982 witnessed the final step in the democratisation process of Spain and PSOE, under the ruling of Felipe González - the very first public face of the anti-francoist period- took over the government. Following this date, UCD, the political group that played the leading role in the transition of the county not only lost their power but also was eliminated from the political scene for good. Moreover, in the long run, the victory of PSOE consolidated the democracy and minimised any possibility of a prospective coup d'etat (Tussell, 2005: 335 - 336; Marín Arce, 2000: 190; and Solis, 2007:223).

The first ten years of the PSOE, which is usually referred as the golden age of the socialists (Marin Arce, 2000: 189) proved to be quite successful thanks to the weak parliamentary opposition and high number of political and economic reforms implemented. When the socialists came to power, there were three main problem areas waiting to be solved (Tussel, 2005: 343):

1. The permanent consolidation of democracy, especially against the threat of any possible military coups.

2. The adjustment of the economy

3. The integration of Spain into the orbit of democratic European nations.

Therefore, the first term of the socialist government functioned rather smoothly with a general public focus on the economic and political adjustment, and Spanish adhesion to the European Community. Among these domains of interest, the consolidation of democracy had the foremost importance as its achievement let the Spanish government focus on other policy domains such as economical adjustment, the construction of the system of autonomies, and the establishment of the welfare state (Tussel, 2005: 335). In terms of foreign policy, it is possible to state that, the foreign policy attitude of the first PSOE government had been a good indicator of the foreign policy preferences of the successive socialist governments. In order to achieve their goal of integrating Spain into the democratic western nations, the PSOE government adopted a populist stance, always picked the middle course in between the USA and USSR, criticised the NATO and the US politics while also affiliating with them, and intended to increase their political sphere of influence via playing the role of the spokesman for Europe in Latin America (Tussel, 2005: 340). Although the PSOE government softened the tune of their strong opposition against NATO, and even asked their citizens to vote for the NATO membership just before the referendum (see below for the details), the tensions between the PSOE government and the US clearly showcased the European tendency in the contemporary Spanish politics. As the first socialist government following the long years of the dictatorship of Franco, González wanted to detach Spain from the strongest and the most loyal ally of the Franco regime and align the country with Europe at any cost. This policy also implied taking a position against their NATO ally with regards to the Central and Latin American disputes and nominating for the role of Europe’s spokesman regarding the economic and political affairs in the region.

However, while taking this populist foreign policy attitude, the PSOE successfully implemented series of political, social and economic reforms that paved the way for Spain towards the European Community.

One should also note the fact that many of these financial and political reforms were initiated by the UCD government but could never be fully implemented (Marcin Arce, 2000:193). This is why the PSOE government and the right-wing opposition barely had significant disputes. The top priority agenda of the socialists was of course realising the ongoing Europeanised foreign policy orientation which would pave the way to the European Community. This time the shift in the political agenda of the country was very definite and coherent. Almost all interest groups in Spain saw their future in the European Community. This is why; they all supported the political reforms, such as democratisation and further alliance with the EEC, as well as the financial ones, such as further liberalisation and increased international competition (Marcin Arce, 2000: 198).

The only significant divergence between the government and the opposition was observed regarding the role of military (Marcin Arce, 2000: 195), which was quiet closely linked to the relationships with the NATO and the USA. In the course of their electoral campaign, the PSOE kept criticising the UCD government's position towards the Atlantic Alliance and promised their electorates that they were ready to go to a referendum in order to exit from the recently joint Alliance. Upon coming to power, PSOE announced a freeze on the integration of Spanish armed forces into NATO's integrated Military Command and scheduled the referendum as promised. However, very surprisingly and also very radically (as it was going to be defined by Felipe González "as one of his two major mistakes" 20 years later, El Pais, Interviews with Felipe González, 27.10.2002) upon taking over the government, PSOE changed their attitude towards NATO membership and declared their full support for it just before the referendum (12 March 1986) which resulted with a majority of "yes for NATO" votes. As the Minister of Foreign Affairs Fernando Morán declared, "in order to assure the international political stability, the political parties are obliged to undertake some international policies which had been initiated by previous governments, even if they do contradict with the party's principles" (Marcin Arce, 2000: 195). Therefore, following this referendum Spain withdrew from the military structure of the Alliance, but stayed as a member provided two extra conditions: Spain would keep its right to prohibit installation, storage and deployment of nuclear weapons within the Spanish territory, and the USA would progressively reduce its military presence in Spain[16]. Moreover, Felipe González exploited this golden opportunity in order to complete the reform process of the Military, which had started in the course of the first democratic government (Tayfur, 2003: 181), and therefore in order to fully abolish the threat of a prospective coup. Hence, combined with the obligations stemming from the prospective adhesion to the European Community, under the PSOE ruling, the traditional duty of the armed forces, "preventing possible internal revolts and defending the institutional order against the enemy from within" (Tayfur, 2003: 181), was totally abandoned. Both the command structure and the political role of the military were also reformed, modernised and re-oriented towards the NATO and the UN (Solis, 2007:209). However, one also should bear in mind that

[16] See the (web page of the Spanish Defence Ministry: http://www.mde.es/multiContenido.jsp?id_nodo=4229&navegacion=T&&keyword=&auditoria=F, 16.7.2005).

this reformation and re-orientation of the army, which eventually resulted in a weakened military power, played a crucial role in the foreign policy formation of the following decade. The policy-makers, all of which aimed at moving Spain into the league of core European players, were about to be obliged to use other means than strong and consolidated armed forces in order to reach their foreign policy goal. These alternative means were so called soft measures such as economic sanctions, financial expansion, international commerce and alliances with other nations. Therefore, Spain, knowing that it had to enlarge its domain of economical influence in order to reach the desired political goal of becoming a middle power in the non-existence of strong armed forces, invested heavily on building a strong economy.

In the economics domain, González allied with the only group that could help him realising the criteria needed to catch up the European Community standards: the central bank reformers. Upon their electoral victory, one of the very first attempts of the González cabinet was appointing some very salient figures among this group to the top economic positions in the new government (such as the appointment of Miguel Boyer, the person who designed the new liberal economic agenda of the socialists, as the minister of finance, economy and commerce) (Tussel, 2005: 344). Therefore, under the socialist ruling the financial authority was kept in the hands of the central bank reformers, just as it used to be under the centrist UCD government, and the new socialist government maintained the austerity policy recommended by these reformers as the only possible way to combat against increasing unemployment (sailing around 15%), rising inflation, negative external trade balance, and growing budget deficit (above 5% of the GDP). Therefore, as opposed to the very unorthodox economic policies presented in their electoral programme, it is possible to comment that the González government never had any doubt on the fact that they were obliged to strictly follow the orthodox economic policies in order to answer their electoral promises in the social domains, such as creating 800.000 new jobs via FDI, which could never be achieved without causing to devaluation and inflation (Tussel, 2005: 345).

The financial and industrial transformation of the country was indeed very closely linked to the ongoing transformations in policy domains. Without securing the internal and external political stability the González government could never have implemented the economic reforms, many of which were contradictory to the interests of the finance elite in the absence of a prospective EC membership. These circles traditionally used to benefit from a highly protected domain of interest and they used to enjoy high levels of profitability in the absence of any significant international competition. Moreover, with the adaptation of White Paper of the Re-industrialisation (Libro Blanco de la Reindustrialización) in 1983, the traditional industrial policy of the country based on heavy industries in crisis was put under a significant transformation (Marin Arce, 2000: 199 and Tayfur, 2003: 172).

The new industrial policy mainly focused on reorganising the sectors in crisis, improving the productivity of the industry, decreasing the number of inefficient factories focused on heavy industries, and financially strengthening the companies which were willing to undertake innovations. Hence, by adopting this novel policy paper, the Spanish industrial policy shifted its focus from supporting the traditional industries in investing into new sectors and new technologies, which challenged the dominance position of the traditional and underdeveloped industrial elite (Tayfur, 2003: 173). Therefore, the highly liberal agenda of the socialists drafted under the leadership of Miguel Boyer could have been considered to be a threat against the status quo of the business and financial elites. However, the ongoing economic stagnation, the rising unemployment and the very serious lack of industry financing left no other means for them but to reconcile with Boyer's agenda, which was the only way to revive the Spanish economy. The industrial enterprise limited by the capacity of the absolute superiority and predominance of the highly monopolistic private banking sector was looking forward to the financial inflows expected after the membership. Moreover, the interlocking relations between the political elite and the financial circles also eased this liberalisation process. Many of the politicians were also linked to private companies, all of which had a direct interest in these potential inflows (Jerez, 1992). Therefore, many of the reforms undertaken by the socialist government were results of the mutual consensus among different interest circles in the country. However, with regards to the interrelated developments in the business sector, the financial elite and the politicians, there are two major cases that should be emphasised.

The first clash of interests was observed in the field of budget financing. Until the early 1980s, the budget deficit was used to be financed via monetization due to the absence of effective short-term debt markets. The Central Bank used to be the mediator between the financial markets and the Treasury. Upon having covered the Treasury's shortfall via monetization, the Central Bank used to utilise special certificates called CRM in order to collect back some of the excess money supply from the market. However, participation in the auctions for CRMs were restricted by law to commercial and saving banks, which hampered the Central Bank's ability to fight with rapidly raising inflation triggered by an excess money supply. Moreover, the interest rate that the Central Bank was committed to pay for the CRMs was much higher than the market rate. Therefore, it would not be a far-fetched idea to suggest that this method was just a modified version of the traditional, inflationary and obsolete mechanism of pignoración, which was one of the main pillars of the German type of universal banking clusters and the key for securing bank profitability under this scheme. Hence, it was essential to alter the system for budget financing in order to curb the inflation and reduce the burden of monetization on the Central Bank's shoulders.

Here, it is worth mentioning that the attempts to transform this inflationary system had long been started in the last years of the UCD government. The governor of the Bank of Spain, Jose Ramon Alvarez, initiated the negotiations among the banking elite and the state in order to create short-term public debt instruments that could be utilised by the Treasury for covering the budget deficit (Pérez, 1997). However, given the bankers new orientation towards the socialists, these negotiations failed. This is quite understandable considering the fact that subscribing to the new Treasury debt rate, which would have been below the rate that they had been receiving from the Bank of Spain issued CRMs, was not at the best interests of the finance elite. Therefore it became the socialist government who first introduced this reform towards a modern budget financing system, which would benefit the overall economy, and the first treasury auction for PTs (pagarés del tesero) was performed in early 1982 (Pérez, 1997).

However, the socialist government did not have any intention to hamper its positive relationship with the banking elite. Upon the bankers boycott against PTs due to their low level interest rates (same as the market level), the Treasury raised the return on PTs to the level that they used receive on the Central Bank issued CRMs. Therefore, the coexistence of two different public debt instruments with different interest rates forced the most prestigious issuer in the market, which is the Treasury, to offer much higher rates of return than many private, and much riskier, issuers of securities (Ortega, 1987).

This malpractice was partially fixed in 1983 by a reform package introducing a compulsory ratio of 12% for the PTs subscribed by banks, reducing the existing compulsory ratio for the industry financing and abolishing the central bank's obligation to finance the shortfalls of the Treasury (C. Arasa Medina, 1985).

However, these reforms were not taken based on the sole initiative of the government but rather were negotiated intensively with bankers in order to come up with a solution for the budget deficit problem, which was hampering the overall economy (Peréz, 1997). The PTs provided a very beneficial and handy tool for the Spanish banks that were suffering from a dramatic collapse in the demand for credit by private firms in the midst of a deep economic crisis (Peréz, 1997). As the banks did not have any intention to lower their high rates of credit that they fixed in mutual agreement among themselves, the high-paying and risk-free Treasury papers provided a golden opportunity to Spanish banks facing a liquidity crisis. Therefore, between the years of 1984-86 the banks held even much more PTs than it was required by law (Perez, 1997) and by doing so the made supernatural net earnings (the highest among the other EEC countries) despite their high costs of inefficiency (OECD, 1988); and they could sustain the high levels of their oligopolistic credit rates which they would otherwise have been forced to reduce in the midst of a sharply falling demand for credit by firms. Moreover, the high minimum-bidding ratio kept these auctions under the hegemony of the domestic banks, and not only other financial agencies but even the foreign banks were excluded from participating in these auctions by practice (El País, August 19, 1984).

Therefore, not surprisingly, the national banking sector started to recover from the heavy crisis of the late 70s and despite the big losses experienced by the international banks operating in Spain the national banks began to declare huge amounts of profits (103.000 million pesetas for 1981, 96.000 million pesetas for 1982 and finally 128.000 million pesetas for 1984, El País 01.04.1984), which was continually criticised by many other sectors as it was considered to be quite contradictory that the banking sector had increased its profit during the times of crises (El País 01.04.1984). These allegations, implying the strong and favouring relationship between the banking oligopoly and the state, were parried by statements emphasising the fact that it was more than necessary that the banking sector be kept profitable as otherwise it would have meant that the overall Spanish economy was going through a very serious and intolerable crisis.

On the other hand, there are couple of very important consequences of this reform package for the Spanish state and the financial system as well. First of all, this step was a step taken towards a modern financing structure. In the modern economies the budget financing is under the sole control of the Treasury as the long-term hampering effects of Central Bank intervention has long been proved. Second, replacement of the original compulsory investment ratio by the newly introduced coefficient ratios for budget financing signalled a slight transformation from a German type banking system to an Anglo-Saxon one.

The second important case that should be mentioned here is the RUMASA case and the end of the banking crisis which paved the way to the regulations and transformations that started at the end of 1980s, which all will be discussed in the following chapter. As it has been explained above, the banking crisis that shook not only the Spanish economy but also the right-wing government at the time lasted until the first years of the socialist government. The first major bank that was taken over by the Deposit Guarantee Fund was the Banca Catalana, followed by the RUMASA group. The RUMASA case proved to be quite distinctive than the other failing banks due to the fact that it was the first newcomer that could challenge the oligopoly of the Big Seven. Moreover, it was a big cluster that brought together the banks and industry in order to make high profits through industry financing. Therefore, "with 4 percent of the banking system's deposits their potential failure also represented the first real threat to the sector's stability" (Peréz, 1997). Hence, in the very fist year of the socialist government, following the heavy solvency crisis in the wake of fraud allegations against the founder and head executive of the bank, the RUMASA group was expropriated. However, despite the socialists' electoral programme strongly emphasising that the expropriated banks would be kept in public hands, the government did not lose any time in re-privatising these banking groups. The Vizcaya group easily won the tender for the Bank Catalana, outbidding the tender from the major Catalan savings bank La Caixa (Peréz, 1997). However, the RUMASA case kept hitting the headlines for a couple of years. Despite the expressed interest by savings banks and foreign banks to participate in the tender, the consortium of buyers was rather limited to the Big Seven (see El Pais, 01.04.1984). However, it is also important to make a remark on the fact that before the finalisation of the terms of this purchase, the salient figures of the Big Seven made a number of press statements, all of which strongly emphasised that they were not willing to take any definite positions until all the details of this re-privatisation had been discussed in detail, and they kept on expressing their concerns about the fact that the cost of the amortisation of the "Rumasa hole" had been transferred on their shoulders (El País, 04.03.1984 and 01.04.1984). Therefore, a final agreement which would satisfy the banking group while amortising the debts of the Rumasa group was finally reached among the Minister of Economy, heads of Banco Central and Banco Banesto and the Head of AEB (El País, 01.04.1984, 05.05.1984 and 06.06.1984). The overall cost of this purchase, compared to the real value of the Holding, was almost insignificant for the Big Seven (El País, 01.04.1984, 05.04.1984, 24.05.1984, 11.07.1984, 01. 08. 1984 and 02.08.1984) but thanks to this purchase in the wake of higher competition which would be triggered in the following decade by savings banks and foreign banks, the domestic banks had an opportunity to strengthen their fiscal and industrial positions and get better prepared for the European Community led increased liberalisation of the sector. Moreover, the socialist government showed their determination to keep their promises to the banking sector even if it meant giving up their promises to their voters. At the end of the RUMASA case, the role of the Bank of Spain as a "trusted friend of the banking sector" as well as the mutual dependence between the policy makers and the banking elite were once more proved (Peréz, 1997).

To sum up, the PSOE government achieved what was impossible and managed to create a balance between policy makers, central bank reformers, and the business and the banking elite, which would have continued to be impossible in the absence of the signing of the EC accession treaty. It is for sure that the co-herent support for the country's external policy made it possible for the PSOE government to undertake some very challenging financial and political reforms.

However, the second term of the socialists was in fact going to be even more challenging under the pressure of the abolished protectionism, increased international competition and huge capital inflows aimed at improving the functioning of the country's institutional framework. Felipe González himself was very well aware of the fact that financial and industrial institutions of Spain had to be improved and reorganised for being able to meet this upcoming challenge. In the following chapters, the political and economical measures undertaken by the following PSOE government and the successive Aznar governments will be explained in detail.

2.2. European Community Membership and Opening of the Spanish Economy (1986 - 1993):

As stated above, the second term of the socialists marked a significant change in contemporary Spanish policy. The Spain of 1986 was a way too different than the Spain of a decade ago in many economic, societal and political means. This is why this study considers that this period is of great importance in shaping the prospective relations between the economic elite and the policy - makers. Not much to anyone's surprise, the EC membership has been the corner stone of this period with its repercussions such as integration with the Community simultaneously in various spheres, managing and directing huge cash inflows following the membership, fulfilling the economic criteria leading the country towards the EMU (European Monetary Union) and therefore accomplishing the final round of the liberalisation while keeping the country competitive enough to upgrade its economic and equally important political positions. The political outlook and foreign policy stance of the country will be evaluated under this headline in order to assess their relationship with the reforms undertaken in the banking and financial systems during the following decades.

Spain, following its application for membership in July 1977 (under the ruling of right - wing UCD government of Suárez) and opening up the negotiations in 1979, became a full member of the European Community in January 1986. Here, we can emphasise one distinctive feature of the Spanish politics: all political parties, not only the mainstream PSOE and UCD but also the communists (Partido Comunista de España, PCE) and the right-wing Allianza Popular (later on Partido Popular) wholeheartedly supported the integration process (Tayfur, 2003: 187; Tussel, 2005: 348; Álvarez-Miranda, 1995: In Spain the political parties easily defined that their future was embedded in Europe. Such a political ambience may have happened as a result of three causes (Álvarez-Miranda, 1995: 3-4), all of which are great importance to this study:

1. *The prospective economic impacts of the adhesion, such as economic development, infrastructure investments, cash inflows, etc*. Therefore, here the focus lies on the limits of the confidence in Spain regarding the capacity

to reassign and adopt factors of production to the regions and sectors that can lead to a competitive advantage and hence that would permit to modernise the economy to reap the harvest of a membership in the long run. Spanish business and financial elites saw their future within the Community as they believed that the EC membership would force Spanish entrepreneurs both to modernise and to compete in international markets (Tayfur, 2003: 177). Moreover, they envisaged an important market opportunity in selling to a market composed of 250 million people and considered the booming effect of the potential expansion of the volume of European capital in Spain (Tayfur, 2003: 177). Hence, on this pillar, all the Spanish political parties, even the socialists and the communists, supported the EC.

2. *The economic and the political limits on the stability of the newly established current democracies.* Following the long decades of fascist ruling, the young democracy in Spain looked for an economic and political role model that could carry the country to the major leagues. The answer to this search was the liberal market economies of their Northern neighbours. So, the strictness in following and adopting the EC rules and regulations was also shaped by the confidence in the own political stability of Spain. According to Álvarez-Miranda (1995) wherever the risks (especially the risks stemming from the military bodies) were higher against the establishment of the above-defined liberal system, then the dependency to the EC was also higher. As stated above, the fragility of the democracy, and also the very existence of the political parties, were clearly at jeopardy against a military coup, therefore the consensus was easier to be reached in Spain.

3. *The international position of Spain and foreign policy related pros and cons of a membership.* There used to exist a strong "consensus among Spaniards across the political spectrum that the US had given credibility to the Franco regime by its economic and military support, and hence sustained him in power" (Tayfur, 2003: 184). As the democratic Spain wanted to detach itself from its Francoist past and its foremost supporter, the US, all the political parties in Spain declared Europe as their new and best ally following the death of Franco. Moreover, the determination of the country to upgrade

Spain in hierarchy of states positively affected its willingness to adapt and harmonise its economy to EC practices (Tayfur, 2003: 178).

Therefore, in the light of the above analysis, we can emphasise that all political and economic circles saw their future within the EC. This is why, the decade long ruling of the PSOE government was fully pro-European in their internal and foreign policy, as well as their economic agenda. Hence, following the accession, the country transformed into a main supporter of an integrated Europe in all spheres (economy, monetary, defence, and foreign policy) and was proactively involved in all institutional bodies in order to assure this (Tayfur, 2003: 189), while taking a negative and a stance against the NATO and US.

In the course of the 1980s the polls witnessed the steady support for the socialists (ranging between 30 - 40 % of the overall population), and even a higher support for González himself (46-60 % of the overall voters), which resulted in a stability (Tussel, 2005: 355) that permitted the González government to diverge from pleading for the support of financial and business elites for maintaining his political power. Therefore, when it came to internal politics, the gravity of politics shifted from industrial transformation to social issues; such as dealing with the Autonomies, fighting against corruption, mediation with labour unions and solving the Basque terrorism (Tussel, 2005: 355 - 357). Moreover, this shift was also reflected in the overall course of financial reformation in Spain. Until the EC membership, the financial reformation of Spain reflected the reconciliation process between three groups: the Central Bank reformers who were willing to strengthen the position of the Bank of Spain, the policy-makers, and the financial elite. Therefore, during the first term of the socialists, the burden of financial reforms were all transferred into sectors other than finance, which aggravated the economic recession and unemployment (Perez, 1997: 152).

However, the second term of the PSOE government signalled a new era in the Spanish economy. Two impacts of the EC membership positively affected the economic performance; first of all the prospect of European financial integration motivated the government to implement a full-scale reform agenda, which was to cover the areas which had long been neglected (Perez, 1997: 152) as they were opposed to the interests of different power groups such as the financial elite. Therefore, measures to achieve European integration dominated the economic policy in the course of the second and third terms of the socialists (Salmon, 1995: 13). And secondly, the EC membership tremendously triggered the level of the economic activity in the country (Perez, 1997: 152). Hence, following the EC accession the Spanish economy created its second miracle and reached up to a growth rate between 4.5-5%, which was 1-2 points higher than the European average (Tussel, 2005: 360; OECD, 1990:11). Moreover, almost 1.800.000 new jobs were created. Although not sufficient, these new jobs helped to decrease high unemployment in the country (from its peak rate of 22% in 1985 to just over 16.5% in 1989), especially to the advantage of youths and women (Tussel, 2005: 360; OECD, 1990:11). In addition, job market rigidities were gradually abolished.

Moreover, the public spending on infrastructure increased with an annual rate of 0.5% and reached up to 5% of GDP in 1991 (Tussel, 2005: 360). Combined with the positive political climate created by the EC accession, relatively low labour costs and the new legislation of 1986 that enabled foreign investors to transfer unlimited amounts of capital, profits and dividends to Spain, a boom was observed in the foreign direct investment levels (Tayfur, 2003: 176). Between 1985 and 1990, the foreign capital inflows, and especially FDI, contributed as much as 40-50% of the growth of total investment (OECD, 1990:11). Spain became the fourth most attractive country in the world for FDI, after the much larger economies of the United States, the UK and France (Salmon, 1995:17). Although the FDI rate was multiplied almost by five during this period, it is also worth stating that majority of these investments were not directed towards green field operations, but instead, triggered by the high interest rates, they focused on acquisitions of already existing firms (almost 25% of total Spanish companies were faced with foreign acquisition), exclusively in food and automotive industries (Tussel, 2005: 360) and significant control over the economy was transferred to foreign entrepreneurs (Salmon, 1995: 21).

One other important aspect of the period is the increased privatisation of the public companies. The socialist government did not only give up the idea of nationalisation but also transferred the majority of the public entities to the private hands. The 15% of Telefónica (communication), the 20% of ENDESA (energy), the 50% of Argenteria (banking), the 80% of Repsol (petroleum) and the 91% of ENAGAS (natural gas) were sold during the socialists' second and third terms in government.

However, despite this high - speed liberalisation in all segments of the economy, the political authorities remained single-mindedly obsessed with protecting only one segment from foreign competition: the banking sector (Perez, 1997: 152). Still, the requirements of the EC membership and approaching Single European Market made it obligatory that the Spanish government undertook some steps in order to make the financial sector capable of meeting the challenge of eventual European competition. Two reform processes marked the period: the realisation of the long prolonged capital market reform and the start of the banking consolidation reforms.

2.2.1. Capital Market Reform:

Until the mid 1980s the Spanish stock exchange was underdeveloped, mainly as a result of the banking cartel's hindrance of the creation of a well functioning capital market that could be the salvation of the chronic industry-financing crisis in the country. Of course this resistance was not without lack of reason. The underdevelopment of the capital market used to benefit the extra high profits of the banking sector via two different ways; first, as the underdevelopment of the stock market doomed the industry to bank credits, banking sector could easily maintain their strong position as the main shareholders of the Spanish industry. Secondly, under the current legislation banks were both the main issuers and the main investors of the capital market. Therefore, in the absence of transparency, banks could easily control the fate of their own stock (Perez, 1997: 153). This is why, the Big Seven kept impeding a capital market reform that could damage their supernatural earnings.

However, commencing with the EC membership things started to change. The boom in the number of European investors who turned their faces to Madrid, and their increasing demand for better quality services, combined with the approaching Single European Market, raised an interest among the banking elite and the government circles for realising the long postponed reform. Until that day, there were no market makers or a sophisticated system that provided a wide range of services, but rather there existed only publicly licensed agencies (agentes de cambio y bolsa) whose main clients were the banks (Perez, 1997: 154). Although it would have been logical to reform and modernise these agencies in order to increase their capacity to offer a wide range of services, the government preferred to share this lion share with the Big Seven. Through the law of 1988, the monopoly of the agencies was ended, and the banks, who used to be the clients of the system until that day, became the oligopolistic service providers of the system, just before its opening to foreign competition (Perez, 1997: 154).

Therefore, once again in the Spanish economic policy history, the foreign policy preferences of the economic and political elites (like the pro-European Community stances held by these elites), and the consequences of these preferences, shaped the formulation of the economic policy of the country. The approval and support of the financial elite was once again asked for before implementing the liberal economic reforms that the EC membership (in other words the policy preferences) obliges, and finally the reform was implemented in a way to further benefit the interests of the financial elite.

2.2.2. The Consolidation and Concentration of the Banking System

As emphasised above, the economic policy of the PSOE government was mainly shaped by the foreign policy preferences of the Spanish state, the focus of which was detaching the country from its Francoist past and aligning it to where it had originally belonged: Europe. Therefore, in all segments of the economic activity the priorities and the reform agendas were determined based on the requirements of this foreign policy goal. This is why the top item of all reform agendas was the same: further liberalisation and integration with the European Single Market as soon and effective as possible. For example, the accession treaty of Spain was composed of devastating clauses for domestic industry and agriculture (Perez, 1997: 158), but still, not only the government but also the financial elite obeyed this treaty, as it was the leading path to the ultimate foreign policy goal. However, the exception of this rule was, not to much surprise, the banking sector[17]. While easily making sacrifices in other domains,

[17] The only sector that was also favoured from a similar kind of a special treatment was the energy sector, a sector in which the banks and state continued the lion share (Perez, 1997:159).

when it came to the banking sector reforms the negotiators held a firm attitude and obtained temporary opt-outs for financial liberalisation that granted an extra seven-years protection to the Spanish banks (Perez, 1997: 158). Thanks to these opt-outs, entry of foreign banks was postponed until 1992, while operations of the currently existing foreign banks in Spain kept being restricted until that date. Starting from 1992, banks throughout the EC would be able to establish branches, without any legal restrictions, in any of the then 12 member states. Moreover, in the absence of any restrictive barriers, foreign banks were more than eager to enter into the Spanish market due to the high oligopolistic profits, which were unique across Europe. However, it was very clear that the domestic banks were not ready for free international competition yet. Despite their dominance in the domestic market (and mainly because of this), the largest Spanish commercial banks were of only small to medium-size by world banking standards and none were in the top 50 by value of assets (Salmon, 1995: 215); the largest among them, Banesto ranked only 74th in 1986 (Perez, 1997: 159). For the Socialists and the business elite the problem was clear: there were too many banks employing too many people. There was a branch for every 1,200 residents, compared to one for every 1,541 in West Germany and for every 4,500 in both UK and France (New York Times, March 14, 1988). However, 70% of the sector was controlled by the Big Seven: Banco Central, Banco de Bilbao, Vizcaya, Santander, Popular, Hispano-Americano, Banesto (Banco Español de Credito). While four of these banks (Bilbao, Vizcayo, Santander and Popular) were relatively smaller in size but more efficient in management, the remaining three (Central, Banesto and Hispano-Americano) were used to being faced with more operational problems despite their advantage in terms of economies of scale. Here it is very useful opening a parenthesis to provide a short history of these banks at that day:

Banco Santander: When it was founded in 1857 it was the largest bank in Spain and was one of the banks of issue until 1878, when the note-issuing privilege was granted to the Bank of Spain. Commencing from its foundation, Banco Santander always had a tendency to turn its face towards the outside world. Located at the northern port city of Santander it specialised in the business between Spain and Latin America. Between 1900 and 1919 the Banco Santander duplicated its balance sheet and increased its capital to ten million pesetas. Starting from the 1920s, the bank began spreading its branches throughout Spain, which meant acquiring a large number of local banks until the late 60s. Banco Santander opened its first foreign representation in Cuba in 1947, and offices in Argentine, Mexico, Venezuela and London followed it. Finally, in 1956 it launched a special Latin American Division. Through the acquisitions it made in the course of 70s and 80s, it became the pioneering commercial bank in the Latin America region. However, at home, although it grew via acquisitions, Santander remained a mid-sized institution until late 1980s[18].

Banco Bilbao: Banco Bilbao was founded by merchants and industrialists in 1886 as a result of their need for a bank of issue that could take the advantage of the traditional and profitable discount mechanism "pignoración". It served as the key financier for the steel industry in the Basque region and played a leading role in infrastructure development projects. Like other commercial banks, after it lost its right of issue it focused its activities on retail banking. The bank opened its first foreign office in 1902, in Paris, but limited its focus on the domestic market. During the 1980s, Banco de Bilbao's strategy was to attain sufficient size in order to participate in financial operations generated by increased competition and advances in banking services[19].

Banco Vizcaya: Banco Vizcaya was also founded in the Bilbao region, in 1901. However, as opposed to Banco Bilbao, Vizcaya always had a strong foreign orientation. Beginning with Paris, it opened branches in New York, Amsterdam, London, San Francisco, Mexico, Frankfurt, Tokyo and Rio de Janeiro. Apart from these foreign operations, Banco Vizcaya was actively involved in the creation and development of Spanish industry. Moreover, it pursued a very proactive acquisition strategy, among which the most important action was the acquisition of Banca Catalana in 1984, which then growed into a large banking group by the second half of the 1980s[20].

[18] See: http://www.santander.com (reached in: Acerca del Grupo/ Historia, 17.10.2008) and Guillén & Tschoegl, 1999: 5 – 6.

[19] See: http://www.bbva.com (17.10.2008) and Guillén & Tschoegl, 1999: 5 - 6

[20] See: http://www.bbva.com (17.10.2008) and Guillén & Tschoegl, 1999: 5 - 6.

Banco Hispano-Americano: The bank was founded in 1900, with the capital repatriated from Cuba, following the Latin American War of 1898. However, the bank remained relatively domestic in terms of its operations and became one of the three biggest banks of Spain (Guillén & Tschoegl, 1999: 5 - 6).

Banco Central: The Banco Central was established in 1919, through the merger among 8 small-sized banks. The bank kept pursuing this corporate strategy and via acquisitions it became the biggest private bank of Spain in the 1980s (Guillén & Tschoegl, 1999: 5 - 6).

Banesto: Banesto was founded in 1902, in Madrid, with an intention to serve the global financial needs of Spanish business and industry, in their activities at home and abroad. Commencing from 1940, it initiated an expansion and acquisition strategy, which paved its way to becoming one of the biggest banking groups of the country (Guillén & Tschoegl, 1999: 5 - 6).

Banco Popular: The bank was established in 1926 and began its international operations in 1968 by opening an office in Paris. As opposed to other banking groups, Banco Popular focused its operations in Europe, and opened branches especially in France and Portugal (Guillén & Tschoegl, 1999: 5 - 6).

Therefore, by the end of the 1980s, the banking sector was in the hands of these seven banks and these banks not only controlled the Spanish industry but also they had a say in the policy orientation of the country. However, with regards to competitiveness, they used to suffer a lot from inefficiency in management. A British expert, Jack Revell, issued an assessment report in 1987 on the effectiveness, competitiveness and future of Spanish banks. In this report commissioned by the government, Revell clearly emphasised that there were lots of problems and dead weight in the Spanish financial system and concluded that two main bottlenecks of the system were:

1. the exaggerated number of banks building the system

2. the fact that smaller banks were better managed and they were more dynamic than the larger ones (Perez, 1997: 160; New York Times, March

14, 1988)

Therefore, the most optimum strategy appeared to be merging the large banks with smaller but more efficiently managed ones. Hence, commencing from the late 1980s, the Bank of Spain adopted a proactive and even aggressive strategy in order to lead the possible mergers. The first bid, backed passionately by the Bank of Spain, came from Banco de Bilbao (one of the small and dynamic banks) in order to take over Banesto (one of the largest conglomerates) in the late 1987. However, this bid was impeded by the blockade of the ruling of the Madrid stock exchange, who were searching for support from the Big Seven (and especially from the largest bank at the time - Banesto) in order to manipulate the capital market reform, and therefore, the Central Bank ended up in a position in which its authority and decisions were being questioned publicly. However, it did not take longer than two months before the first mergers among the Big Seven hit the headlines. Contrary to what the Central Bank reformers had foreseen and planned, two of the smaller and more dynamic banks, Banco Bilbao and Banco Vizcaya, announced their merger. The agreement, which created Spain's largest bank, put the newly created Banco Bilbao Vizcaya in the 69th rank in the world and 33rd in the European Community; and the two merged Basque banks acquired the 20% control of the total Spanish market (New York Times, March 14, 1988).

Following the merger among two big banking groups, the newly created BBV was considered to be the government's "bank of choice" and was donated aconsiderable support in the managerial and operational obstacles it faced with (Perez, 1997: 161). On the contrary, when it came to Banesto, the bank backed out from a possible merger with Banco Bilbao, and the Bank of Spain adopted a fierce attitude and punished the bank until its collapse in 1993. Moreover, the Bank of Spain granted tax forgiveness on the huge capital gains in order to motivate future mergers, which was the only possible way to prevent the foreign penetration into the Spanish market (Perez, 1997: 161). Apparently, in the eyes of the central bank reformers "the real advantage of size was not efficiency but its ability to protect a bank from being taken over" by foreign financial groups (Perez, 1997: 162).

However, the new decade signalled serious changes in the traditional functioning of the sector. First of all, the gentlemen's agreement whereby the banks agreed on not to sell their problematic subsidiaries to foreigners began to shatter as the Big Seven started searching for alliances that could assist them in the foreign markets and also that could help them to escape from hostile take-overs (Perez, 1997: 159). Moreover, the monthly business lunches organised among the heads of the Big Seven were abandoned following Santander's aggressive interest rate strategy that ended the gentlemen's agreement in 1990. This step had to be taken in an environment in which foreign competition could no longer be ignored (Perez, 1997: 161). However, this was the first step of the aggressive competition among the Big Seven. Although the interest rate war was alleviated by the late 1990s, this split among the Big Seven had become a shaping factor in the future consolidation of the sector.

The beginning of the 1990s witnessed another radical change in the Spanish financial system. The socialists had long claimed that they had abandoned the nationalistic stance and they did no longer pursue an agenda that would lead the expropriation of private banks. However, the protective measures designed to maintain the nationalistic characteristic of the banking sector impelled the government to take more aggressive and challenging measures. Frustrated by the failure in framing the banking sector via planned mergers, the government took the initiative to achieve a consolidation among the official credit entities (the EOCs) and to transform them into a commercial bank. This is how the state pillar of the banking sector was completely reorganised into the government financial agency ICO (*Instituto de Crédito Oficial*) and the banking group Argenteria.

At the beginning of the 1990s, there were six state banking institutions (five EOCs and one savings bank), all of which were then functioning under the umbrella of the official credit agency of the Spanish state, ICO:

- Banco de Crédito de Agrícola (BCA - Bank of Agricultural Credit)

- Banco de Crédito Industrial (BCI - Bank of Industrial Credit)

- Banco de Crédito Local (BCL - Bank for Municipalities)

- Banco Exterior de España (BEX - Export - Import Bank of Spain)

- Banco Hipotecario de España (BHE - Housing Bank of Spain)

- Caja Postal (Post-Office Savings Bank)

In early 1991, the government merged the Official Credit Entities (EOCs) with the Post-Office Savings Bank and transferred the control and supervision of the EOCs from ICO to a newly established umbrella organisation called *"Spanish Banking Corporation" (Corporación Bancaria de España* - CBE), which therefore transformed into the largest financial institution in Spain, with its control over 13% of the banking system in the country (Perez, 1997: 163; Salmon, 1995: 214).

Meanwhile, while forming a giant banking group via merging the existing EOCs, the PSOE government redefined the description and functioning of the existing ICO and transferred it from a holding company to the government's financial agency and the development bank of the State, whose principle mission was to support certain economic policy programmes, such as supporting financially and economically the private initiatives that can contribute to the development of the country. ICO has been given two missions, one as the development bank / credit entity of state (*entidad crediticia estata*l) and the other as the financial agency of state (*agencia financiera de Estado*). As the development bank, ICO granted subventions, financed middle and long-term international expansion projects, and supported modernisation and technological innovation of the Spanish companies during the early 1990s. As the financial agency of the State the ICO was responsible for managing public funds allocated to alleviate the consequences of natural catastrophes, massive accidents, economic crisis, etc; attending to the financial requirements of specific sectors of the economy (such as iron and steel, fertilisers, etc.); contributing to the implementation of the Social Housing Policy; providing support for the export sector; and collaborating on the aid and development plans destined for the Third World (Salmon, 1995: 212; http://www.ico.es/web/contenidos/home/home.html 23.10.2008).

However, this long avoided reformation did not come into force with a purpose of exerting a competitive pressure to the credit market in order to provide better credit terms for industry. In addition, the fact that the existing credit entities (EOCs) did not truly merge but rather were simply placed under a common institutional structure curtailing any possible positive effects that this merger could have on industry financing. Instead, the reform was implemented in order to promote future mergers among the banking cartel that could shield them from foreign take-overs (Perez, 1997: 163). Not surprisingly, the risk proved to not to be in vain, and two banking giants, Banco Central and Hispano Americano, announced their merger in 1991, two weeks after the foundation of the CBE. This merger was also contrary to the Central Bank reformer's plan to merge smaller banks with the giants, however, by the creation of the Banco Central Hispano (BCH) the publicly owned CBE group lost its prominent position and asset superiority to the newly created BCH. Although it was not the ideal merger scenario in the minds of the policy makers, the government, in order to lead the pave to further consolidation, granted a tax break similar to the one extended to the BBV (Perez, 1997: 163).

In 1993, the government took another progressive step towards financial market consolidation and restructured once again the recently reformed public finance sector. The socialists- realising the fact that Corporación Bancaria de España group was neither changing the market structure to serve industry interest better nor operating profitably in the existing market structure- decided to transform the CBE into a commercial bank called Argenteria, directly responsible to its shareholders (Perez, 1997: 164). Therefore, Argenteria was established in 1993 and in May 1993 24.9 percent of shares in Argenteria were sold on stock exchange, followed by a second operation in November 1993, through which the total state holding in the Argenteria group was reduced to just over 50 per cent (Salmon, 1995: 214). Moreover, the group not only became the first and only financial entity that embraced both commercial and savings banks, but also took advantage of the nation-wide branch network of the Caja Postal and the cross-selling opportunities that its rich portfolio of services provided. In addition, the Argenteria group extended its services abroad through the Banco Exterior de España (Import - Export Bank of Spain) and provided an international banking network to its customers seeking opportunities to expand their operations to Europe and Latin America (Salmon, 1995: 214). Therefore, the Argenteria group became one of the five largest banking groups of the country.

The consolidation of the banking sector was further accelerated with the Banesto case. In 1993, an overvaluation exceeding $4 million was discovered in Banesto's assets, which resulted with the Bank of Spain taking over the banking giant (Tussel, 2005: 381). This fiasco was mainly attributed to the "aggressive industrial dealings and unorthodox accounting operations of its management, headed by Mario Conde, a self-made entrepreneur and outsider who had come to rescue of the bank's board during the Bilbao's 1987 hostile bid and who was eventually convicted for fraud" (Perez, 1997: 161). Thus, the fraud was committed in a vain attempt to impede the government led mergers and consolidation, however even this malpractice could not prevent Banesto ending up being sold to another banking group. Here, it is very crucial to emphasise and underline the position held by the Central Bank in the long course of this selloff. It is commonly acknowledged that the Head of Bank of Spain met the heads of the two then biggest private banks (BBV and Santander) in order to arrange a rescue operation that would prevent Banesto's assets and branch network from being taken over by foreign banking groups (Perez, 1997: 162). Therefore, although there were no legal barriers to the entry of the EC banks to the bidding, given the time restrictions and the complexity of Banesto's problems which made it impossible for any party without an inside information to bid at such a short notice, only three Spanish banks, Argenteria, BBV and Santander, bid for Banesto (Perez, 1997: 162). Finally, Santander beat its two contenders and established itself as the largest bank in Spain in 1994.

When the Socialists 14 years of ruling came to its end in 1996, the banking sector was already consolidated in the hands of four banks: Banco Bilbao Vizcaya (BBV), Banco Santander, Banco Central Hispano (BCH) and Argenteria group and three quarters of bank deposits were controlled by these four, roughly equal - sized banks (Salmon, 1995: 217). Liberalisation had increased competition in the banking sector: among domestic banks, between commercial banks and savings banks, between domestic banks and other financial services, and between domestic and foreign companies (Salmon, 1995: 211). Thus, increased competition led to a search for greater efficiency and greater market share.

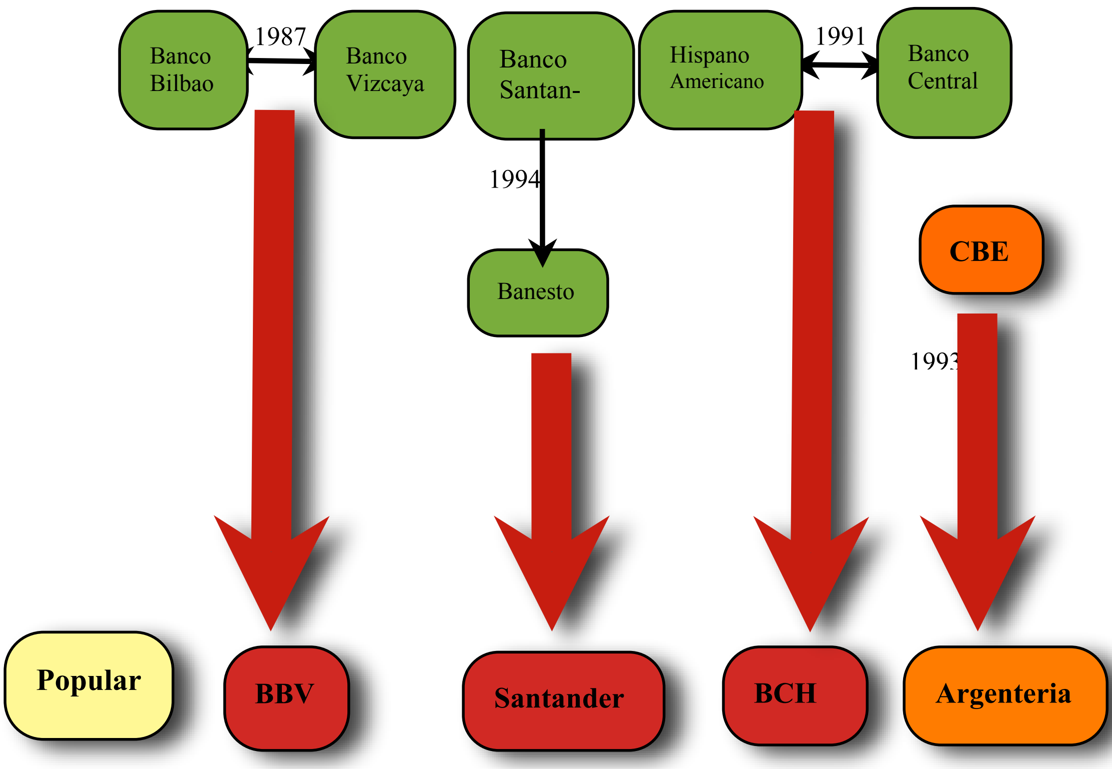
However, instead of waiting to see the expected results of increased competition, the Bank of Spain took the initiative and promoted the banks' ability to "exploit the existing degree of oligopoly in the credit market so that they could enter the single market with the greatest possible amount of capitalisation" (Perez, 1997: 164), which could prevent the hostile take-overs and preserve the national character of the sector while modernising the management techniques employed. One other feature of this consolidation period is the fact that it marked the end of the industrial disinvestment that had begun in late 1970s and 1980s. In order to increase their profit margins that had been badly affected by the increased competition and the violation of the long existed gentlemen's agreement, banks began reinvesting into industry in the early 1990s (Perez, 1997: 165).

Not much to anyone's surprise, these protective measures proved to be very useful in impeding the foreign competitive pressure and the foreign banks that entered into the Spanish market continued to be unprofitable while the Spanish ones kept recording supernatural profits despite their still very high costs. Spanish banks as a group continued to beat the European banks in terms of profitability in 1991,1992 and 1993, despite the worldwide recession shaking the bank profits elsewhere (Perez, 1997: 166). However, as stated above, the mergers implemented during the period of the socialist ruling were not driven by an efficiency concern in mind, but rather by a principle motivation for preventing the foreign penetration. Therefore, they did not bring about the cost savings that had been anticipated, as the banks had agreed with unions that they would not let massive downsizings or any radical measures that could lead to lower operational costs (New York Times, March 14, 1988).

The mergers were designed especially to keep the financial system under the control of the domestic financial elite, in a way to protect their oligopoly and supernatural profits. Moreover, it is very difficult to talk about any significant foreign expansion target in mind during the implementation of these reforms. Therefore, contrary to the second term of the consolidation process that took place during the Aznar government during the second half of the 1990s, the banking system consolidation under the socialist ruling was far from harmonius with significant foreign policy and / or economic policy goals. Instead, it was a domestic move, which was taken in order to protect the domestic market as well as the domestic power balance between the banking oligopoly, industry and politicians.

As stated above, the foreign policy targets of all parties of this equation intersected at the European Community and the single market. Therefore, the banking reforms were inevitable. It is very crucial to point out the fact that, still the banking sector was still protected from foreign competition and every possible measure was taken in order not to hamper the oligopolistic profitability of the sector. This privilege was not shown to any other domain, either political or economic. However, as these reforms were not far-sighted reforms implemented in line with broader foreign policy goals, their consequences also remained within the Spanish territory. The domestic market was successively protected but this did not improve the performance of the Spanish banking sector (or the industry as well) on a global scale. However, as it will be explained through the following chapter, the Aznar government pursued similar means but broader goals. Therefore, during the second half of the 1990s, not only the Spanish foreign policy and the international position of Spain but also the global position of the Spanish banks have changed significantly, and the so-called second re-conquest of the Latin America was achieved.

Figure 2.1: The Big 4 in 1996: BBV, Santander, BCH and Argenteria



CHAPTER 3: DOMESTIC POLICY, ECONOMY, FINANCE AND FOREIGN POLICY IN SPAIN DURING AZNAR AND ZAPATERO PERIODS

3.1. The Aznar Period (1996 - 2004):

The second half of the 1990s marked a new era both for the foreign policy goals and for the economic strategies of Spain. The victory of the right wing, which has long been linked to the Francoist tradition, and the end of 13 years of orthodox ruling of the socialists, inaugurated a very radical and risk taking method of policy making in all spheres of Spanish governance. Before explaining the new era and the interrelated effects of this policy shift in detail, it is worthwhile to provide a brief summary of the reasons behind the fall of the PSOE from its long possessed power.

Above all, the political power stemming from being the party who consolidated the democracy in Spain and carried the underdeveloped Spain to the league of big European powers left the legacy of an over self-confident tradition of policy-making to the socialists, which hampered their capacity to realize the lack of a concrete policy objectives behind their domestic and economic policies. Instead, they insisted on pursuing orthodox policies that had already given them a certain power and they remained ignorant to the governmental scandals and economic stagnancy hitting the headlines. Taking political and economic risks became less praiseworthy than ensuring the smooth functioning of their positive and mutually beneficial relationship with the financial elite. Moreover, it is also worth underlying that during their last term in government, the socialists were under siege from every corner as the need for the Catalan and Basque support to maintain the coalition government put them into a paralysed position in which they could not consider taking the risk of giving up the strict orthodox economic policies (Tussel, 2005: 380). Therefore, following the 13 years in power, the Socialists lost not only the wind of change that carried them to the government but also their image of the “saviours of Spain” and the “consolidators of democracy". They rather began to be perceived as the successors of the UCD government (Tussel: 2005: 386) due to their strong resistance against reconsidering the foreign and economic policies of the country while their political reputation was being shaken by fraud and corruption related scandals.

Moreover, the overwhelming confidence of obtaining an absolute majority and not losing this power (although the absolute majority could not be maintained and the support of other parties, including the Basques and Catalans had to be sought in the following years) dragged the socialists into a long list of fraud and corruption scandals and a dirty war against ETA terrorism led by GAL (Grupos Antiterroristas de Liberación) composed of death squads illegally set up by PSOE officials. Moreover, following the long and exhausting years in government, the discrepancies between the party and the government became more than apparent. It would be insufficient to put the blame of this tension solely on the shoulders of the opponents within the PSOE, but in addition it should also be noted that González himself declared his unwillingness to keep his duty as the President of the government and he clearly stated that he was put into a candidacy contrary to his own will (Tussel, 2005:386).

Here, it is also necessary to open a parenthesis to emphasise the situation of the economy at the time: although the growth and productivity of the Spanish economy gradually increased beginning in 1985, like all other European countries Spain was also shaken by the economic crisis that hit Europe between the years 1992 and 1993. The growth rate shrank back to 0.7% in 1992 and even recorded negative numbers in 1993, which was the sharpest decline in 30 years (Tussel, 2005: 380 and Salmon, 2000: 18). It was a hard landing considering the earlier economic boom triggered by high public spending and significant European investment. While high interest rates eroded the domestic demand, the increasing disinvestment by the multinational companies in an urge to improve their solvency ratios and the completion of infrastructure projects associated with Barcelona Olympic Games and the Seville International Exhibition aggravated the effects of the global economic crisis for the Spaniards (Salmon, 2000: 19).

Moreover, during the 1992-1993 recession the employment was reduced by 7 per cent and 1 million jobs were lost (OECD, 1996: 10), contradictory to the labour market improvements experienced between 1986 and 1991, during which over 2 million jobs were created (Salmon, 2000: 19). Therefore, no matter if the crisis was global or not, this was a striking loss of credit for the Socialists. Although the party programme of the last González government deployed political reforms accompanied by sound measures to fight against the economic crisis and to combat against once again rising inflation, due to the commonly held belief that the crisis was temporary in nature and would not harm the Spanish economy in the long-run, (Tussel, 2005:379) the government found itself in a relief that did not satisfy the liberalising expectations of the business elite and of the overall society.

Here, it is worth underlying that for the economists this crisis was in accordance with the classic economic cycle and an immediate improvement was commonly expected, however, this crisis cut in favour of the opponents of the government as well as the novelty seekers, and these groups used this economic failure to express the need for further liberalisation and a more aggressive economic policy. Despite the growing pressures, until then the PSOE governments held back from radical measures to reform the labour market, fully privatise leading companies, or open up the remaining areas of the economy that were still subject to protection (Salmon, 2000: 36). Therefore, although the economic growth returned in 1994, the credibility and reputation of the Socialists was damaged in an irreversible way in the course of the economic recession of 1993.

Therefore, in the wake of the general elections of 1996, all the political parties in Spain, the business elite, the trade unions and media were in accordance with the general belief that the Socialists were no longer powerful enough to pursue the reformation of the country and to meet the aggressive demands of the industry and business elites (Tayfur, 2003: 210). Moreover, the polls indicated that despite the political and economic reforms taken in 1994, one out of every two Spaniards did not believe the words of González and before the end of the year more than one third of the population commented that early elections should have been held as soon as possible (Tussel, 2005: 181). Not surprisingly, following the dissolution of the parliament and the announcement of the elections, all the polls were already signalling the victory of the right: Partido Popular (PP) led by José María Aznar. Here, some of the credit should definitely be attributed to Aznar himself, as he successfully managed to convince the

Spanish electorate that the ex-Francoist party was not a successor of the country's Francoist past, but instead it was now a European centre-right party (Tayfur, 2003: 211). However, the new period of office started with a less satisfactory electoral victory than what had been foreseen. The Partido Popular achieved 39% of total votes, which indicated a total four point increase in their votes, and they acquired 156 seats in the Parliament. On the other hand, despite their fall from the government, the PSOE obtained 141 seats in the Parliament while still preserving their self-confidence that they would get back the government very soon given the lack of experience and preparation of the PP, just as it happened in Greece (Tussel, 2005: 385). Thus, this change in office leading to a major shift in foreign and domestic policies of Spain took place in a great harmony and calmness, if not with a huge welcome.

Before analysing this radical shift in Spanish politics it is worthy to underline the main achievements of the successive González governments as follows (Tussel, 2005: 339 - 386)

1. The modernisation and liberalisation of the Spanish economy;

2. The improvement of human capital, in line with the social cohesion policies;

3. The improvement of the capital resources;

4. The accomplishment of the Constitutional reform, with respect to the establishment of the "State of Autonomies";

5. The end of international isolation and integration of Spain into the European structures;

6. The realisation of the military reform, which had always been considered to be impossible up to that moment;

7. The integration of the civil society, especially by the means of NGOs, to the areas of policymaking and good governance.

As of March of 1996, Spain inaugurated a new stage in its history with regards to policy making. First of all, the inevitable condition of a functioning democracy was achieved thanks to the fact that the governmental elections transferred the political power to the centre-right wing Partido Popular established on the ashes of Alianza Popular. On the other hand, this shift in the power also signified the change of the political elite that had been ruling the democratic Spain for 13 years. This point lies as one of the fundamental basis of the shift in the policies in both economic and political domains. Aznar was neither a representative of the francoist right nor he witnessed the era of fight against fascist ruling. On the contrary, Aznar was the representative of the new generation in Spanish politics with his experiences in politics[21], as well his understanding of Spanish politics, which diverged significantly from the orthodox conception of the political elite who had achieved the political transition of the country following the death of General Franco (Tussel, 2005: 415 and Powell, 2001:596-570). Aznar never hesitated to explicitly state that Spain was to achieve a great jump and to enter G-8 by the new decade, and that Spain was no longer a problem area for Europe but instead a world power (Tussel, 2005: 435). Therefore, his ideology was very far away from the traditional right-wing thinking of Spanish politics but rather he was a part of the European central right with his strong commitment to ultra-liberalisation as he saw this line of policy as the only functional ideology of the day, which means an ideology that could be put forward against the endless ruling of the socialists.

This reconciliation and consensus between the Spanish right-wing and the mainstream political parties (especially the regional parties of Catalans and Basques) spread into other domains of policy making as well (Salmon, 2000: 37). Therefore, the Partido Popular set a coalition government backed by the support of regional parties, but differently than the last term of the PSOE government: they managed to bind all these parties within a framework of common centre-right foreign, domestic and economic policies (Tayfur: 2003, 211). This is why the first task of the coalition government was to roll up the

[21] As a teenager, Aznar was a member of the *Frente de Estudiantes Sindicalistas* (FES), a student union supporting the fascist falange. After the death of Franco and the restoration of democracy Aznar joined Alianza Popular in January 1979. In March he became the Secretary General of the party in La Rioja occupying the post until 1980. He became Assistant Secretary General in February 1982 and in 1982 he was elected to the Parliament. In 1987 he was elected as the new leader of Partido Popular.

sleeves to crate an inclusive economic reformation process that would satisfy the needs and demands of the economic elite that carried them to power. As also stated above, the liberalisation of the economy and shrinking the public sector in favour of a stronger private Spanish industry were the top priority items on the agendas of both the PSOE and the PP governments, however their methodology differed significantly (Tussel, 2005:418). The liberal economic and political policies held by the PSOE government lacked a strong ideological enthusiasm and rigour (Tayfur, 2003: 211) as opposed to the PP, which based its whole ideological and administrative agenda on liberalism (Tussel, 2005: 419).

Therefore, immediately after his electoral victory, Aznar put forward very clearly that his intention was not a suitable reorientation but a radical change. Aznar's economic agenda was very closely linked to his policy agenda on mind. He, like his predecessors, remained attached to the further Europeanization goal, but he pursued different means in order to achieve the very same goal. Aznar used to believe that in order to increase the Spanish voice within this new, crowded and multilateral Europe they had to hold a firmer and a more aggressive foreign policy. Moreover, he was very aware of the fact that any successful foreign policy had to be built accordingly with similar economic policy targets (Salmon, 2000: 17).

When Aznar came into government, hardly a week passed without an acquisition and it seemed that Spain was up for sale. This is why, in this tougher economic environment further triggered by the FDI boom after the EC entry, the largest Spanish companies –especially the state-run companies in oligopolistic sectors such as telecommunications, oil and natural gas, electricity and banking- were all under the threat of the fast liberalisation of the domestic market (Chislett, 2008:27). Therefore, while remaining loyal to the Spanish promise to keep up with the reformation agenda for meeting the Maastricht criteria needed for making Spain one of the founding members of the European Economic and Monetary Union as of 1999 (Powell, 2001:576-577), he also focused on restructuring the financial and industrial sectors in order to prepare them for the upcoming European competition and to create national champions (big conglomerates formed by the horizontal mergers among the Spanish industry and financing elite) that could carry the Spanish power in foreign policy beyond the limit of integration with the European Community into the domain of being one of the principle policy makers of this very same community (Salmon, 2000: 22-23, Tayfur, 2003: 202). The strategic response to this need for reconstruction of the oligopolies was to make them even bigger via mergers and to go on the offensive (Chislett, 2008:27). Aznar was very aware of the fact that in order to transform Spain from being a peripheral country within the European politics to one of the key players, it was of the outmost importance to open up the Spanish economy in a way to transform it from being the receptor of foreign aid and foreign investment into being a donator and exporter of capital and technology, especially toward the Latin American market (Tussel, 2005: 418).

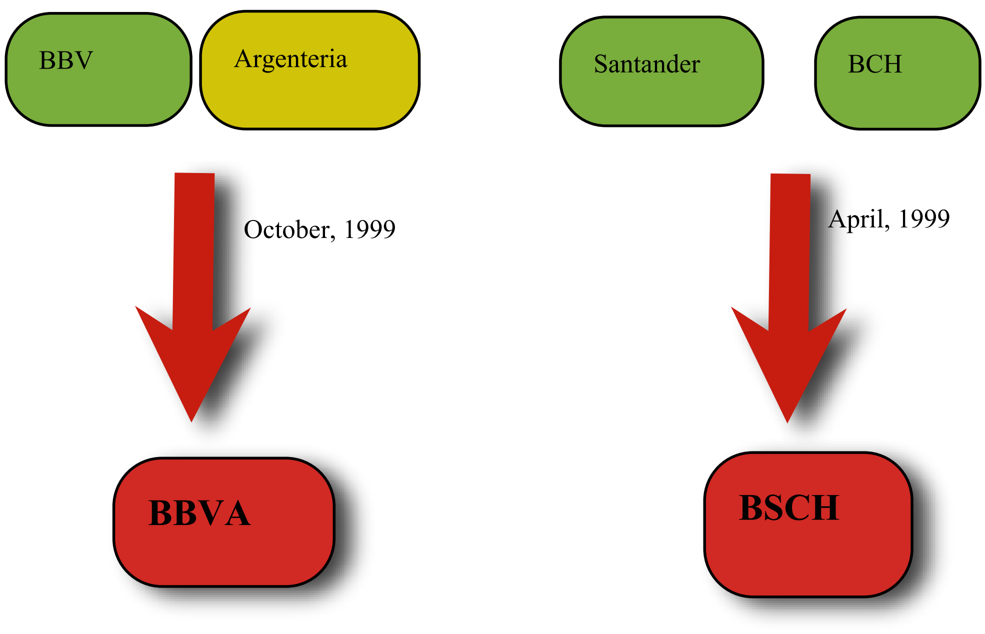
Hence, upon taking over the government Aznar had a very clearly drafted roadmap in his mind: encouraging mergers among private financial groups (a sector in which the consolidation had already started) in order to facilitate transfer of the publicly owned companies to these stable shareholders made of the financial elite (Tayfur, 2003: 199 and Salmon, 2000: 23), which long had the tradition of being the main owners and supporters as well as the sole lenders in the Spanish industry at the same time. Then afterwards, in accomplishing the third pillar of the roadmap, the financial elite and the industry were to be directed towards the Latin American market (Tayfur, 2003: 1999). Therefore, industry and finance were two of the first sectors that the new PP government targeted for a change. Aznar started by appointing strong and reputable figures to the head of economy related ministries and institutions and increased the authority of these departments, which restored the confidence of the financiers and foreign investors (Tayfur, 2003: 211 and Tussel, 2005: 418). Moreover, considering that further consolidation of the financial and industrial sectors was a preliminary must for the creation of the national champions, the Aznar government appointed his close business acquaintances to the heads of large public companies that were on the pipeline for privatisation in order to facilitate prospective mergers and acquisitions among the Spanish business elite while appointing some key business and finance figures to key political positions (Salmon, 2000: 39; Tayfur, 2003: 211). Therefore, the business elite and policy makers became even closer connected than before, which made it almost impossible to distinguish the political decisions from the economic ones. Moreover, following the accomplishment of the privatisations, the outlook of the Spanish political economy shifted from "public monopolies" to "private oligopolies" (Tussel, 2005: 418).

As a very natural consequence of interlocking relations among the business and policy-making figures, the restructuring of the economy and privatisation became a highly politicised process where the lines between foreign policy, domestic policy and economic policy were gradually blurred (Salmon, 2000: 38). Not only in the Argenteria case that will be mentioned below, but also in the cases of many public giants such as Repsol-YPF (the state petroleum and oil company), Sol-Meliá (the hotel group), Iberdrola (the state-owned gas company) or Telefónica (the state owned telephone monopoly) strengthening the administrative and the competitive structures of these monopolies before selling them to the financial giants was the main roadmap in transforming the Spanish state into a bigger player in the globalised economy, while realising the re-conquest of Latin America, which was not only an economic target but also, and especially, a foreign policy goal aiming at increasing the Spanish power within the European policy-making process. Therefore, it should be emphasised once again that privatisation was a political process for Spain rather than being an economic one as the decisions on which companies were to be privatised were based mainly on political considerations (Salmon, 2000: 38). Thanks to these public enterprises, the government and business came closer during the PP ruling and it became evident that these companies would be used as political instruments, while the companies would use their political connections to manipulate governmental policies according to their private interests (Salmon, 2000: 39)

The consolidation and strengthening of the Spanish economic domain began with the banking sector mergers that resulted with the consolidation of then Big Four in the hands of two banking giants. The Spanish banking system has traditionally been branch intensive (measured by the bank branches relative to inhabitants) Spain turns out to be the most over-banked euro area country (OECD, 2000: 76) and therefore suffered from inefficiency problems such as high operating costs and high intermediation margins (OECD, 2001: 85). However these high costs related to the operational inefficiency had long been neglected since the sector was under a privileged governmental protection that enabled high profits despite high operational costs. This is why, the upcoming European and international competition signalling the end of this privileged era started to put pressure on the existing oligopoly, and therefore when the traditionally high levels of profit begun to shrink towards the European levels (OECD, 2000: 76) the banking sector's salvation was found in bank concentration that could eventually improve profitability by reducing capacity and operating costs through a rationalisation of banking networks (OECD, 2000: 77). Following the almost a century long domination of the sector by seven big banks, in the month of April of 1999, the Banco Santander and Banco Central Hispano were merged into BSCH while the state-owned Argenteria was sold to Banco Bilbao Vizcaya and formed the banking giant BBVA in the month of October of the same year.

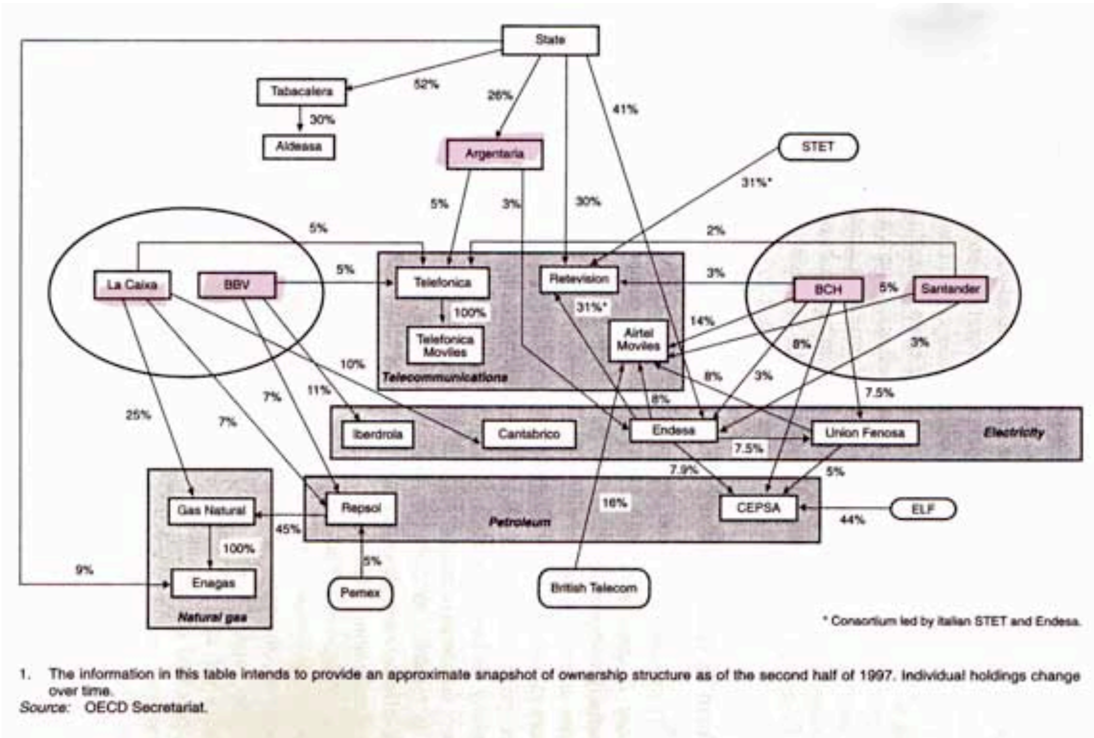
However, this banking consolidation that accumulated the financial power in the hands of two commercial banking groups (BBVA and BSCH) and one savings bank (La Caixa) should not be taken solely as a financial concern for protecting the bank profitability but the political and industrial agenda related to these mergers should also be analysed.

Figure 3.1: The banking consolidation by the end of 1998: BBVA (Banco Bilbao Argenteria) and BSCH (Banco Santander Central Hispano)



The consolidation the financial elite accelerated the process of acquiring shares in the ownership of newly privatised industry giants (OECD, 1998: 100) and therefore their traditional role of being the sole lender and owner of the Spanish industry were even strengthened. As of the end of the 20th century, the ownership structure in Spain was revolving around these two commercial banking groups and one savings bank, with their control over oil refining / gas, electricity, the media, construction, urban and environment services, real estate, transport and telecommunications sectors (OECD, 1998: 100 and Salmon, 2000: 23). Therefore, the major financial groups did not only grow in size but also increased their domain of influence horizontally into these other cross-cutting sectors formerly held under public control.

Figure 3.2: Key Elements of Ownership Structure for the Main Spanish Enterprises



Source: OECD, 1998: 101

The economic advantage of this model lies in the stable environment it created for managers who took the advantage of making investment decisions with a long pay-back period, whereas it is also known for the systemic deficiencies it creates such as less liquid stock market, diminishing attractiveness for foreign investment and difficulties in obtaining finance for businesses that do not belong to one of these conglomerates (OECD: 1998: 100, Tayfur: 2003: 202). However, in the Spanish case, despite the potential systemic deficiencies that this continental system possessed they did not cause a setback for the Spanish economy and Spain ended up achieving a unique success as opposed to what the major international institutions such as the OECD had predicted. In other words, although the international trends signalled a dismantling of public enterprises in favour of small enterprises as well as the weakening of banking power, in Spain the concentration of financial and industrial power in their hands of limited numbered strong players resulted in another way. This divergence in the practices and outcomes was mainly caused by the foreign and domestic policy orientation of the Spanish case as it will be explained below.

Moreover, this radical change in the ownership structure did not imply a total foregoing of the publicly owned giants for the government as they kept the practice of retaining the golden share (acción de oro) within strategically privatised firms, which let the Government retain substantial control over key strategic decisions such as large share transactions or decisions related to management efficiency (OECD, 1998: 102and Powell, 2001:581). This notion should be evaluated from two different angles. First of all, by doing so, the government did not fully transfer its control over the industry and domestic economy into the hands of the financial elite but kept its institutional ties and formal control over these two (Salmon, 2000: 24) and therefore could direct and lead the industry and financial power according to its foreign policy goals. Secondly, this double role as the sole regulator of the economy and as the main player of the very same mechanism provided a room for protection for the Spanish industry, newly adopting itself to the notion of global competition (Salmon, 2000: 24).

Here it is crucial to open up a parenthesis in order to explain what globalisation meant for Spanish policy-makers, which is automatically linked to the Spanish foreign policy. First of all, it should be underlined that globalisation was not a symmetric and well-calculated process for the Spanish policy-makers, but rather it was Euro-centric in nature and had a natural outcome of growing business involvement in Latin America (Salmon, 2000:28). Although Spanish trade with parts of the world other than Europe remained relatively small (only around five percent with Latin America), the expansion of Spanish business towards its ex-colony gradually accelerated thanks to the above-mentioned national champions to whom a substantial governmental support was provided via tax incentives[22]. The managers of these national champions which long had been shielded from international competition were now aware of the fact that liberalisation was inevitable. Further triggered by the "single market" initiatives of the European Union, the state was withdrawing its direct involvement in the economy while all forms of protection that inhibited the operation of market forces and free competition were now being eliminated (Salmon, 2000: 37). Therefore they saw the Latin American market as their salvation as the fall of entry barriers was not unique in Spain but it was a global tendency and they could also take the advantage of it (Toral, 2005: 11). The countries of Central and Eastern Europe, Africa, Asia and Latin America were opening up and not surprisingly the Latin American countries possessed an additional charm of the shared culture and a very visible and concrete political orientation (Toral, 2005:11). Moreover, Spain had already assumed a commanding lead over Latin America as of the mid 1970s and Spain became a significant exporter of manufactured goods, had acquired a remarkable share in the Latin market, and had developed into a new source of foreign direct investment, credits and technology for Latin America (Bankloff, 1996: 108). Therefore, the first contacts had already been achieved and a favourable business climate had already been created. This is why, by the mid 1990s, in order to avoid the slow long-term growth in the domestic market while obviating the negative consequences of liberalisation, but also in order to pursue the foreign policy of the of the Spanish state, the Spanish companies that once were publicly owned emerged into the Latin American market following the footsteps of the financial giants who acted as both their shareholders and lenders. By the end of the 20th century, the Iberian country became the leading investor of foreign investment in Latin America and Latin America emerged as the main destination for Spanish investment with three-quarters of total Spanish investment (Salmon, 2003: 33). In other words, liberalisation provided Spanish companies with the chance to become multinationals and they seized this opportunity starting in the mid-1990s thanks to the privatisation of companies in Latin America. Spain's outward FDI has exceeded the inward FDI every year since 1997 (with the exception of 2002), producing a major structural transformation in the economy (Chislett, 2008: 28)

[22] These tax incentives were mainly composed of a system of public insurance to protect the investments from the risks of the host countries and credit facilities.

3.1.1 Latin American Expansion and Spanish Foreign Policy:

Here it should be underlined once again that for the new generation Spanish policy-makers globalisation was an asymmetric process which focused on the European Union and Latin America, and aimed at achieving a global leader position via these two regional blocks (Jiménez Redondo, 2006: 58, Salmon, 2000: 18). A very solid proof of this fact can be found in the 1978 Constitution: Article 56.1, which refers to the monarchy[23]:

> "As Chief of State and the symbol of its unity and permanence, the King shall moderate the regular functioning of its institutions and assume the highest representation of the Spanish State in international relations, particularly with the nations of its historical community."
>
> (Quoted in Baklanoff, 1996: 110)

The term "historical community" in the Constitution mainly refers both to Europe and Latin America (Baklanoff. 1996: 110) demonstrating the asymmetric slope of the Spanish foreign policy. Moreover, the three governmental development agencies that were founded in the late 1980s and 1990s (The International and Ibero-American Foundation for Public Administration and Policies[24], Secretariat of State for European Communities[25] and General Secretariat of Foreign Policy), all together stand as another very concrete proof of this asymmetrical process of globalisation in Spain. Therefore, it can clearly be stated that Spanish foreign policy has traditionally been based on two pillars: Latin America and Europe. Therefore through this and the following headlines it is aimed at analysing the reformation and expansion of the Spanish financial system within the frameworks of these two foreign policy pillars.

Given this traditional structure of Spanish policy making and the foreign policy outlook at the time and the political orientation of his party, Aznar decided to pursue a neo-liberal foreign policy championed by the United States, United

[24] FIIAPP - Fundación Internacional y para Iberoamérica de Administración y Políticas Públicas

[25] Secretaria del Estado para las Comunidades Europeas.

Kingdom and many international organisations such as the World Bank, IMF or OECD. The ulterior aim of this foreign policy was to challenge the dual leadership of the European Union controlled by France and Germany by forming an alliance with the Atlantic block (Tussel, 2005: 420). Here, it is crucial to understand that this shift in the foreign policy was a very radical one considering the country's long commitment to the European centred foreign policy anchored by the franco-german block, and its negative conception of Anglo-Saxon foreign politics (Jiménez Redondo, 2006: 20). However, Aznar believed deeply in the fact that if Spain wanted to get a lauder voice in foreign politics, the only way out was changing the orthodox way of policy-making. Therefore, Spain under Partido Popular ruling had to pursue a multi-pillared foreign and economic policy aiming at becoming a European power via allying itself with the Atlantic block. Aznar himself explained this policy shift in various occasions before his electoral victory:

> "Spain is a European nation which is open to Atlantic with its very special links with Latin America, also it is a Mediterranean country which looks at its southern neighbours with a great sympathy and hope; it is a country which maintains good relations with the emerging countries of Asia; and it is a nation of the widened world which cannot fall outside the scope of these global tendencies"
>
> (Quoted from José María Aznars´s speech at INCIPE[26], 1996).

This is why Latin America was of the greatest importance for Spain, which was a country that was ready to challenge maybe not global but definitely the regional leadership (Tussel, 2005: 420). First of all it was the only target location for Spain in terms of the competitive advantage that the country possessed compared to other European states. The shared cultural heritage including the commonly spoken language provided a very clear competitive advantage to the Spaniards and eased the process of transfer of management styles (Chislett, 2008:29). Secondly, sheer size of the Latin American market as well as the certain degree of its underdevelopment provided a source of attraction to the Spanish investors (Chislett, 2008:29). Moreover, Spanish executives were ideally

[26] Instituto de Cuestiones Internacionales y Política Exterior Ensayos / The International Affairs and Foreign Policy Institute

suited to handling new businesses in Latin America, as they had already acquired experience on how to compete in industries under deregulation in their own country (Chislett, 2008:29). Last but not least in importance, the region's historical, cultural, economic and political ties with the US eased the Spanish pave towards its ultimate goal of being the voice of the Atlantic alliance within the continental Europe. Therefore Latin America provided a gateway to Spain for strengthening its ties with the US via the North American Trade Association - NAFTA (Salmon, 2000: 34). In other words, the greater presence of Spain in Latin America has been driven as much by foreign policy considerations as desire for profit (Baklanoff, 1996:121).

In the 1990s, following the pave led by the Spanish banks, Spanish industry invaded Latin America. Apart from the foreign policy expansion of the Spanish state that explained above, there are several economic reasons behind the special attraction experienced by the Spanish banking groups towards Latin America. First of all, the saturation of the Spanish market and aging of the Spanish population left no other room than expansion to the Spanish financial elite (Minda, 2007: 57). Financial globalisation and oligopolistic structure of banking markets led banks into operations aiming at enlarging their capacity via mergers and acquisitions, and then increasing their world-wide market shares in order to reach the critical size needed for efficiency and profitability (Minda, 2007:49). Western Europe was already well-served by domestic institutions and Spanish banks have already expanded into their nearest neighbour, Portugal (Guillén and Tschoegl, 1999: 8). Therefore Spanish investors were to direct their attention to the new emerging markets of Asia, Eastern Europe or Latin America. However, in that time the Asian financial markets were still only partially open to foreign investment and most Asian countries did not permit foreign acquisitions in the banking sector (Guillén and Tschoegl, 1999: 9). Moreover, Spanish banks did not possess any competitive advantage against other European countries neither in Asia nor in Eastern Europe, where countries like Germany and Austria, which enjoyed a historical and cultural proximity with the region, had already dominated the sector (Guillén and Tschoegl, 1999: 8). However, Spaniards have always considered Latin America as the natural prolongation of their own land as they share the same language and the same culture (quoted in Baklanoff, 1996: 117). Therefore, given the difficulty in obtaining increased market share within Europe and the cultural proximity of Latin America, the Spanish banking groups expanded their businesses towards the Hispanic market, which was also going through the second wave of liberalisation at the time.

Here, it should also be underlined that the big financial groups, now regrouped under two giant banks, traditionally have always been the practical hand of Spanish state in terms of economic expansion. Although these investments failed to include a policy dimension that could have achieved the re-conquest of the region earlier, this pre-invasion paved the way for the second-generation investments. Nearly a one third of total Spanish investments realised in Latin America during 1975 -1980, and almost half of the total investments during 1980 – 1995 had already been achieved thanks to the banking oligopoly, then Big Seven (Baklanoff, 1996:109 and Toral, 2005: 12). The new developments in the Iberian country, combined with global and regional challenges that Latin America was facing with, enabled Spanish state not only to radically improve the volume of the investments addressing the region but also to realise the ulterior motives of these investments – establishing Latin America as the natural satellite of Spain and upgrading the country's rank within the international hierarchy of states.

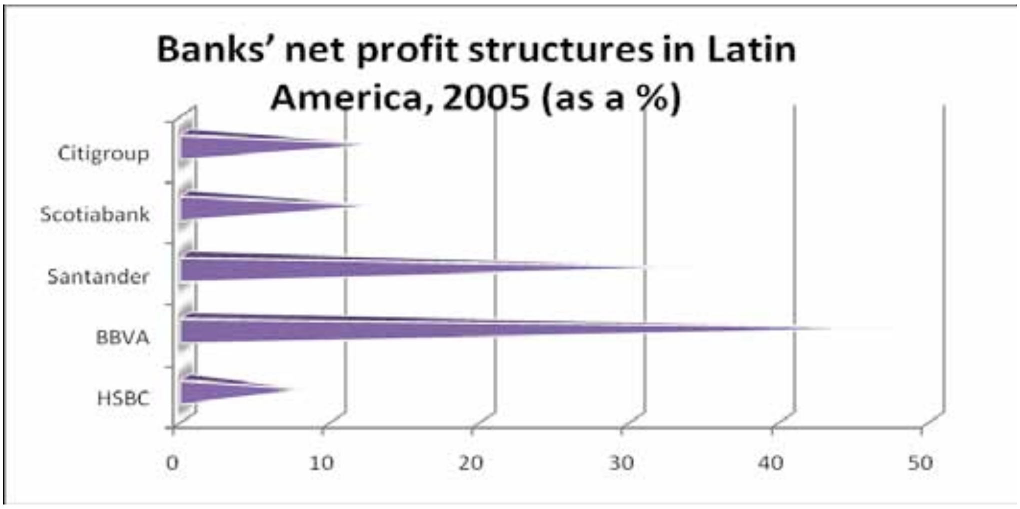
Following the first wave of the liberalisation of Latin America (Mexico in 1994 – 1995, Brazil in 1999, Argentina in 2001) most of the countries in Latin America underwent what has been called "a silent revolution" in their economic thinking and policies, which paved the way for second-generation reforms that liberalised their trade regimes, reformed tax systems and improved legal procedures governing direct investment (Minda, 2007: 51 and Baklanoff, 1996: 117). In addition to all these very refreshing improvements, the banking crises that followed this first wave of liberalisation enhanced the capacity and scope of the banking supervisory mechanisms (Minda, 2007: 51 and Baklanoff, 1996: 117), and therefore increased the attractiveness of the region in the eyes of the European investors. Moreover, the Latin American countries welcomed these new investors as these investments provided a gateway to attract new technologies and reform the service sector (Toral, 2005: 11) and so, as the governments put banks and other state-run enterprises that they owned on the auction block, Latin America officially opened its doors to foreign investment (Guillén and Tschoegl, 1999: 11). Among these European investors, the newly merged two Spanish banking giants carried the banner in this conquest of the

Latin American market, thanks to their cultural proximity and political closeness to the region. Moreover, the shared language also eased the way of doing business for the Spanish firms as it permitted easier communication, eliminated the need for translation and minimised the number of misunderstandings that can be caused by translations. In addition to these systemic competitive advantages, Spain also enjoyed the privilege of being one of the first comers to the region (Guillén and Tschoegl, 1999: 9). Thanks to the historic past they shared, Spanish commercial activity has always been intense in the territories of its ex-colonies and this is why many Spanish banks had already opened branches in Latin America commencing from the early years of the century, and they even intensified these branch openings as of the 1970s. Although these branch openings were far from being solid investments, they paved the way for the mergers and acquisitions of the 1990s.

BSCH, which experienced its first foreign expansion to Portugal via its acquisition of Portugal's Banco de Comércio y Indústria in 1990, concentrated its sphere of influence in Argentina, Bolivia, Brazil, Colombia, Chile, Mexico, Paraguay, Peru, Puerto Rico, and Venezuala via direct 100% acquisitions (Tayfur, 2003: 203 and Guillén and Tschoegl, 199: 6, Minda, 2007: 57). Meanwhile, BBVA started its expansion via opening branches in New York, Amsterdam, Paris, Mexico, Rio de Janeiro and San Francisco, and then concentrated its business in Argentina, Brazil, Colombia, Chile, Mexico, Peru, Puerto Rico, and Venezuela via taking majority holdings (Tayfur, 2003: 203 and Guillén and Tschoegl, 1999: 6, Minda, 2007: 57).

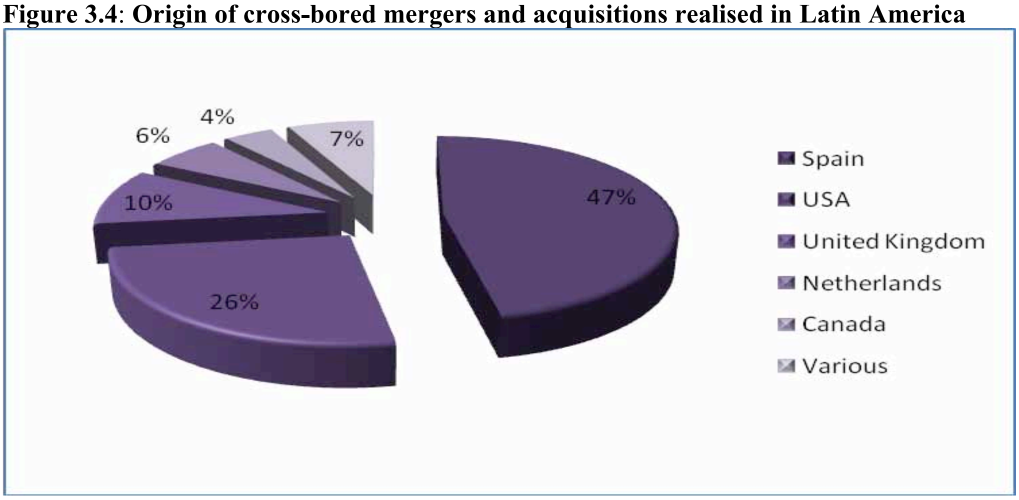
As a consequence of this Latin American expansion, the first goal of banking consolidation was reached and the Spanish banks became better positioned in the euro-area (OECD, 2000: 76). It did not take longer than couple of years that these two banking groups, which together represented more than 30% of the balance sheet totals of Spanish credit institutions, occupied the leading positions on the Latin American financial market with regard to retail banking, pension fund management, banc assurance, and investment banking activities (Minda, 2007: 57).

Figure 3.3: Bank´s net profit structures in Latin America



Source: Alexandar Minda, 2007:58

Figure 3.4: **Origin of cross-bored mergers and acquisitions realised in Latin America**



Source: Alexandar Minda, 2007:58

As it can also be seen in the above figure, almost half of the financial sector's FDI in the Latin American market was realised by Spanish financial groups penetrating the region massively (Minda, 2007: 57). It should also be noted that as Spain became the main investor to the region, the same could also be argued for the role of the Latin American market for Spain. Latin American market has constituted an important part of the bank's net profit structure: 47 % for BBVA and 34 % for Santander in 2005 (Minda, 2007: 57).

Table 3.1: Bank's net profit structure by region, 2005 (as a%)

Banks	Home	Europe	Asia	North America	Latin America	Other	Total
HSBC	22	10	39	21	8		100
BBVA	32			1	47	20	100
Santander	31	27			34	8	100
Scotiabank	60			3	13	23	100
Citigroup	54		17		13	16	100

Source: Alexandar Minda, 2007:58

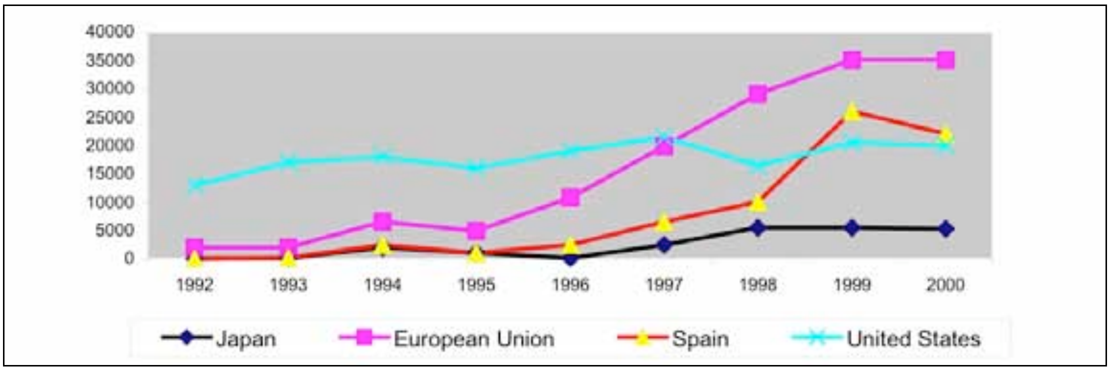
These above indicators stand as a clear proof of the fact that Spanish banks played a vital role in restructuring of the finance sector and therefore the industry in Latin America, via diversifying the saturation and competition related risks that they used to face in their homelands. Moreover, in accordance with the expectations of the Latin American governments that opened their countries' banking sectors to foreign investment, the Spanish banks transferred banking skills and expertise, new information systems, risk assessment methods, and innovations including banking products with differentiated features such as lottery-linked accounts or fast-approval mortgages (Guillén and Tschoegl, 1999: 10). Thanks to their expansion towards the Hispanic lands the Spanish banks favoured the strengthening of Latin American financial markets via active involvement into the development of pension fund management programmes, mutual funds, capitalization of stock exchange, development of capital markets and extension of banking services to a wider range of the population (Toral, 2005: 12). In other words, rather than competing in a niche like what the Barclay and Citybank group did, Spanish banks have chosen to compete in the mass market and targeted the lower and middle-income markets where they became the key competitors of the largest domestic banks (Guillén and Tschoegl, 1999: 10).

Although the large market share in Latin America raised concerns related to the potential risks associated with the macroeconomic fluctuations in the areas, a stable consolidation of the Latin banking sector within the hands of big Spanish banking groups was reached thanks to the fact that Spanish banks maintained management control of the banks that they acquired and they applied the strict controls and regulations of Bank of Spain over these new branches in Latin America (OECD, 2000:88 and OECD, 2001: 76). These measures led the pave for the Spanish re-conquest of the Latin American economy and industry.

There exists a positive correlation between the amount of FDI targeting a country and the provision of financial services provided in the target country (Minda. 2007: 48). Therefore, entry of foreign banks can be considered as a prerequisite for prospective FDI, which the Spanish financial elite successfully accomplished. Not surprisingly, following the banking expansion towards the new continent, the leading industrial giants, in which the banking cartel acquired the majority of shares during the last round of privileged privatisation explained above, expanded the scope and magnitude of their business towards the Latin American market and Spain became the second home of FDI in Latin America following the US. Endesa, Iberdrola, and Únion Fenosa in public utilities, Repsol-YPF in oil and gas, Telefónica in telecommunications invested heavily in Latin America and therefore obtained the overall control of public utilities and infrastructure related services of the region (Toral, 2005:8)[27]. These five firms and two banking groups generated about 70 percent of the total FDI that Spanish firms invested in Latin America between 1990 and 2005 recorded (Toral, 2005:8). This is a concrete and important piece of data that reveals the fact that Spanish FDI in Latin America was concentrated in the hands of these seven commercial groups. (Toral, 2005:8).

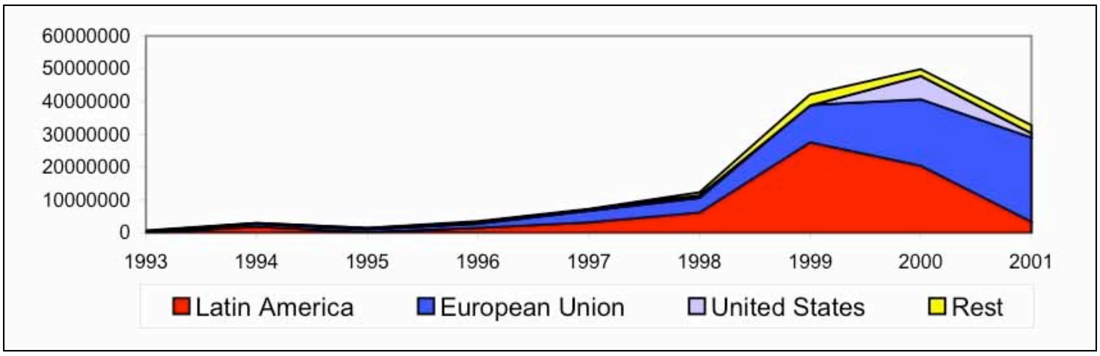
[27] See the Figures 3.5 and 3.6 (Toral, 2005: 8)

Figure 3.5: Inward FDI flows in Latin America and the Caribbean (1992-2000) / millions of dollars



Source: (Toral, 2005: 8)

Figure 3.6: Flows of Spanish FDI by destination (1993-2001) (millions of dollars)



Source: (Toral, 2005: 8)

Therefore, the Latin American competitiveness became dependent on the Spanish cartels, as they were not only the main service providers but also the credit providers for the Latin American industry.

During the second wave of Spanish investment to Latin America, the small and medium sized enterprises (SMEs), especially the ones concentrated on automotive, food and beverage, tourism and construction, were encouraged by their creditors, BSCH and BBVA, to expand their scope of business toward Latin America (Toral, 2005:12).

Here it is also worth opening a parenthesis to underline the fact that the structure of Spanish economy had already transformed into a modern one that was capable of exporting technology and making big-scale investments abroad.

The strategic focus of corporate Spain transformed from one of defending the relatively mature home market to aggressively expanding abroad (Chislett, 2008: 27). The currency was now fixed in the euro-zone and the interest rates were determined by the European Central Bank (Salmon, 2000:21). Flexible labour market, continued improvements in infrastructure, raid technological change and communication technologies reduced the business costs and increased international competitiveness of the country (Salmon, 2000: 21). The whole economy was now more deeply embedded in the world economy and Spain was listed among the important economies of the Europe region. After all, during the first term of Aznar government (1996 – 2000) Spain reduced the income gap with the EU average by 3 points and reached the highest convergence ratio in its history-83% (Tussel, 2005: 428). The evolution of the Spanish economy under the first Aznar ruling had been so positive that it was even labelled as a milestone by a number of academicians and researchers (Tussel, 2005: 432). The macroeconomic stability, creation of new jobs, the more disciplined and shrunk public sector, improving trade and investment figures and reduced income gap with the EU all interacted positively with Spanish international position. In other words, Aznar's plan of creating national champions capable of carrying the Spanish flag abroad was succeeded thanks to the sound reforms in ownership structures and regulatory structures.

Apart from the Latin American market, the Spanish investors also targeted Europe, as a natural extension of the asymmetric foreign policy of the country. Following the slow pace of the FDI towards the European zone, as of the mid-1990s the investment into this region picked up momentum (Salmon, 2000: 33). Mainly stimulated by the membership to the Monetary Union, Spaniards turned their attention into European mergers and acquisitions. Not surprisingly, the two most prominent actors among Spanish investors to Europe were two giant banking groups, BSCH and BBVA, trying to strengthen their position within the European banking and financial services sector (Salmon, 2000: 33). Among all the European countries, Portugal that possessed a cultural and a linguistic proximity to Spain was the main destination of Spanish national champions. Therefore, by the end of the decade Spain built up significant investments in banking and financial services, telecoms and energy in Portugal (Salmon, 2000: 33). Providing goods and services across the peninsular and therefore access to markets and cheap labour seems to be a good rationalisation for this investment tendency. However, it should be underline that one ulterior motive behind these investments was conquering the Brazilian market, which is the largest in Latin America, should also be underlined (Salmon, 2000: 34)

At this point, it is crucial to highlight the divergence experienced in Aznar's foreign policy as well as his domestic policy during his second term of office. As stated above, Aznar's foreign policy always had a tendency towards the Atlantic bloc. However, until his second term on government, this policy had never gone to the radical extremes and Aznar preferred a balance seeking foreign policy. Rather than radically altering the traditional foreign policy making of modern Spain, he kept loyal to the liberal and democratic agenda set by the PSOE, while carefully managing the global tendencies (e.g. increasing importance of soft politics by the end of the Cold War) and seeking for a sphere of influence for Spain aiming at a regional leader status. This mildly challenging foreign policy backed by positive trade and investment figures, thanks to the national champions, recorded not only successful financial figures but also a sound success in the international area. However, as of the beginning of the 2000s, the positive investment climate backed by the common foreign policy goals shared by the countries of Latin America, the EU and Spain was shaken by the glob-wide policy shifts. In order to better analyse this new ambience it is needed to explain the political role of Latin America in Spanish foreign policy.

As also referred in the Constitution 1978 of (see above), democratic Spain has always acknowledged and appreciated its historical roots with Europe and Latin America and positioned itself as the liaison actor between these two. Even during the so-called Atlantic era under Aznar ruling, the main foreign policy goal of the Spanish state had been reaching the "big power" status in the European Community. This is why, the rapprochement of democratic Spain with the former best ally of the ex-dictator Franco, the US, should be viewed from this particular point. United States, rather than emerging as the third pillar of Spanish foreign policy, served as a catalyser in the European pillar.

It should also be noted that Spain has always considered its liaison role between the Latin American nations and the European Community as an indispensable factor. In other words, Spain presented its special relationship with Latin America to its new partners as a sort of "dowry" (Bermúdez, 2004:1). For

Spanish policy makers it was a clear fact that without the Spanish initiative it was quite unlikely that the strategy of the European Community for democratisation and liberalisation of Latin America could have ever been achieved or carried out with such firmness under exising prevailing difficult circumstances (Baklanoff, 1996: 112). This policy of putting forward the historical and economic ties with Latin America in order to balance between Europe and the United States had long been neglected during the last terms of the Socialists. Thus, it was Aznar who turned this potentiality into a solid account. The ambitious leader played the Latin America card in order to seek a balance between the US and the European Community.

However Aznar was mistaken by his overvaluation of the importance of Latin America for Europe. Although he proactively encouraged Spanish investment to its ex-colony and strengthened the financial, then political status of the "mother land" in the region, Latin America has never been promoted to the premier league of political agenda of the European Community. During its accession to the EC, Spain had hopes for the extension of trade and aid privileges enjoyed by the former colonies of Britain, France, Belgium and Netherlands to its own former colonies in Latin America (Baklanoff, 1996: 112). However, as opposed to what had been hoped, Spain was required to abandon all its former trade agreements and privileges donated to non-member states, and it was obliged to export to and import from the European at the expense of Latin America and even at the expense of its own benefits (Baklanoff, 1996: 113). Although Aznar's aggressive foreign and economic policies upgraded the political weight of Spain within the EU, Spain could never achieved its goals of augmenting the rank of Latin America in the European policy agenda[28]. This is quite understandable considering the fact that when Aznar was pushing forward to Latin America both economically and politically, the other member states, and especially the big

[28] However, it should also be noted that although Spain could not transform Latin America into one of the first priorities of the Community, at least it managed to advocate efficiently on behalf of the region, and achieved some favourable European actions that marked a clear shift in EU foreign policy. Moreover Spain influenced the European Community decisions related to political upheavals in Latin America. Last but not least, Spain played a leading role in the strengthening of institutional ties between the European Community and Latin America via foundation of cooperation units within the European Commission for regional bodies such as SELA (Sistema Económico Latinoamericano) and ALADI (Asociación Latinoamericana de Integración), and also via achieving extension of Community granted tariff treatments and trade agreements to Latin America (Baklanoff, 1996: 115 – 117).

powers of the EU, Germany, France and the UK, had already turned their eyes to the new democracies of Central and Eastern Europe, and to the Middle East. Although the EU - Latin America relations reached their peak during the first EU-Latin America Summit (Rio de Janeiro, 1999) where it was agreed to establish a strategic partnership based on selected cooperation areas such as trade liberalization and democratic consolidation, the September 11 attacks altered once again, but this time more radically, the international policy agenda shifting the focus of concern from economic cooperation and further liberalization to the security matters and Islamic countries (Bermúndez, 2004:1-2). This is how and why Latin America has virtually fallen off the map of European interest.

On the other hand, the other side of the story is also worth mentioning. Although the first Aznar government's milder policies were welcomed in Latin America, Aznar's full commitment to unilateral post September 11 US policy during his second term was not welcomed by the Latin American nations looking up to Spain and the EU as a counter-balance to Bush policies (Bermúndez, 2004:2). The most significant proof of this very striking discrepancy was the fact that Spain did not ratify the final document of the EU-Latin American Summit (Madrid Commitment, Madrid, 2002), which stated that both the Latin American and European nations rejected all measures of unilateral character and with extraterritorial effect (Bermúndez, 2004:2). When Spain rejected to ratify this final document where a clear reference to post September 11 polices of the US was apparent, the discrepancies between Spain and the other Latin American nations became apparent to everyone. Aznar underlined this new conception of Latin America in the context of his speech at the US Congress on 4th February 2004, during which he emphasized that Spain was the second investor in Latin America after the US and their common interest was unifying the American continent with respect to EU Ibero-American relations (Bermúndez, 2004:3). Moreover, despite the heavy Spanish investment to Latin America, the Spanish presence in the region mainly concentrated on limited number of sectors all of which were once publicly owned, which is a fact that also contributed to the worsening public image of Spain in the eyes of Hispanic population (Tussel, 2005: 200).

As also explained above, Aznar's challenging Latin America policy shift was aiming at increasing Spanish voice in the European politics, however, Aznar's ambitious and aggressive alignment with the Atlantic block alleviated maybe not the economic but definitely the political power of Spain in Latin America.

As of the second half of the 2000s, despite its economic contributions to the economic position of Spain the Latin America card was no longer capable of serving as a foreign policy tool. However, thanks to the heavy investment mobilization that helped Spain control its ex-colony economically with the close collaboration with its now best ally, the US, Aznar could preserve Spanish power in the region.

3.1.2 Europeanization vs. Americanism

The experiences of Aznar government, and especially the Iraq war, revealed a long observed but not much spoken reality about Spanish foreign policy: Spain has traditionally failed to develop a concrete and solid external policy like the ones deployed by its European neighbours: France, Germany and the UK (Palacio and Rodrigo, 2003:1). This traditional deficiency can easily be comprehended taking into account the internal upheavals and sharp policy shifts that the country has gone through since the end of the 19th century. Short after losing its last imperial colony in Cuba, Spain was dragged into a civil war that pushed the country into a dictatorship that was going to last 36 years, during which the only and closest ally of the country was the United States. During this period of the dictatorship, although some attempts to reconcile with Europe were observed during the heydays of the Opus-Dei elite administration the country in the 1950s and 1960s, the basic foreign policy orientation of the country was based on the isolation of Spain from the rest of Europe. This is why; the US had been the only gateway for the Spanish foreign policy under Franco dictatorship. Following the death of Franco, the country intentionally turned its face away this explicit supporter of the fascist ruling and deployed a very firm Europeanization strategy in both its internal and external affairs. However, by the return of the right-wing tradition to power, Spain under Aznar ruling started to pursue a so-called pro-Atlantic external policy, however, this time aiming at upgrading Spanish international rank from the league of medium scale powers to the premier league of Europe (Jiménez Redondo, 2006:58 and Isbell, 2004:2).

In this regard, Spanish external policy can be grouped under two dimensions: the European dimension and the state dimension (Palacio and Rodrigo, 2003:4-5, Guerrero, 2004:2 and Youngs, 2000:210). Here, the European dimension refers to the Community policies regulating the functioning and harmonisation of the Member State practices, and EU dominated supranational defence and security policies (CFSP – Common Foreign and Security Policy, and ESDP – European Security and Defence Policy). With regard to the "community policies", Spain has already transferred much of its sovereignty to the supranational bodies of the EU and could not reflect its domestic policy concerns and high-policy agendas directly into the EU legislations. Commencing from its entry to the European Community and until mid 1990s, Spain always explicitly declared its priority of establishing itself as a co-operative team player rather than maximizing specific short-term outcomes (Youngs: 2000:211). However, under the Partido Popular ruling, European level policy making of Spain transformed into a one in which increasing robustness in defending national interests was witnessed in relation to number of sectoral policies, especially in agriculture and fisheries (Youngs, 2000: 212). Regarding the "defence and security" related EU matters; Spain has always possessed a relatively higher degree of autonomy compared to the "community policies" and the pressure groups (policy-makers, trade-unions, the catholic church, financial conglomerates, business associations, media and NGOs) has enjoyed a higher degree of control which they utilised in order to manipulate the European politics according to their own interests (Guerrero, 2004:2) – in accordance with the common practice in all Member States. This is why; the European policy of Spain forms an integral part of its domestic policy while its domestic policy concerns play a relatively less vital role in shaping the European policy of the Spanish state.

However, the sphere in which Spain has managed to make a good use of its domestic policy concerns is the state-level policy making. EU membership is a corner stone of this sphere, however, as opposed to the European level, at this level not the Spanish power and role on the EU policies but the role of EU in the international position of Spain is referred. The European Union membership, but most importantly the country's increasing power within the Union, has provided a strong competitive as well as comparative advantage to the Spanish economy, and Spain took the advantage of this polished international position in order to represent itself to Latin America and Maghrep regions as an upper-medium scale power ready to carry the flag of regional leadership.

Apart from the EU, the United States constitutes the second pillar of this state-level policy making sphere. Hence, all the Atlantic policies of the Spanish state such as the NATO membership, the Latin American expansion, and the Iraq intervention fall under the scope of this second pillar. Generally speaking, the relationships with international organisations, or bilateral relations with other countries take part in accordance with the Spanish balance policy between the US and EU. This is why; as opposed to the European-level policy-making, Spanish foreign policy at the state level is highly sensitive to the governmental ideologies and agendas (Guerrero, 2004:2). Therefore, the ideas, tendencies and ideologies of the ruling parties exploring the ways to imprint their stamps on foreign policy decisions join the scenario at this level.

Therefore, the bottom line with regard to Spanish foreign policy consists of two main characteristics: considering the EU sphere, the Spanish foreign policy is rather consistent and smooth, whereas when it comes to the state level it becomes much more polarised and politicized between the US and the EU.

In the light of the above-mentioned information with regards to the Spanish foreign policy tradition, it can be better conceptualised that during the second Aznar government the slope of this balance policy shifted away from the Franco-German axis towards the US and the UK, in accordance with the high hopes and ideals of the conservative and liberal PP government aiming at upgrading Spanish position within the hierarchy of states. Apart from the Aznar's own perception of foreign politics, the changing agenda of the EU that explained above also contributed to this radical shift. In this new and enlarged Europe, the centre of gravity has been displaced from the Southern axis to the Eastern one, and obliged Spain to start talking with its own voice in order to defend its Community policies related interests such as budget allocation or CAP reformation. This is how and why the line between two traditional spheres of Spanish policy was blurred and the PP government started to exploit the state-level foreign policy in order to make a better use of Community policies (Palacio and Rodrigo, 2003:5).

Therefore, although Aznar was a firm supporter of further EU integration and enlargement as well as creation of a single European financial market in the course of his presidency of the EU in early 2002, when it came to global-scale problem areas such as military interventions, functioning of the global finance and commerce markets, humanitarian actions, Kyoto protocol, International Penal Court or fight against terrorism, Spain under Aznar ruling preferred to align itself with the Anglo-Saxon block in order to challenge the Franco-German hegemony within the EU (Palacio and Rodrigo, 2003:5).

Aznar yielded himself so deeply in his aggressive policy making that he could not see the growing tension and opposition within the society against the waterfall of reforms and challenges he put in the Spanish agenda (Tussel, 2005: 435). Aznar even went to the far extreme of supporting the U.S. position on disarming and then interfering to Iraq by force, despite the widely criticisms of Spanish population (91% of Spaniards were against the war) and other member states. However, it should be underlined that while repositioning itself in global scale, Spain has never forgone its European identity and tried to upgrade its ranking via reshaping its foreign policy tendencies within a European Union framework, taking advantage of the economic, politic and military strengths of this European club as well as the privilege of belonging to this prestigious club (Palacio and Rodrigo, 2003:5). Aznar himself explicitly emphasised this urgent need for a new understanding of the European pillar of Spanish external policy just before the elections that carried him to power: "Between Euro-enthusiasm and Euro-scepticism I would position myself in a position in which I believe that our position in Europe does not require a novel approach but a different action plan, which should be permanent, vigilant, effective, and firmer in defending our concrete national interests" (quoted from the José María Aznars´s speech at INCIPE[29], 1996).

As stated above, Spain before Aznar had traditionally pursued a balance seeking foreign policy rather than implementing self-determined policy objectives. Aznar, for the first time in the history of democratic Spain, intended to put self-determined policy priorities and challenged the dual leadership of the EU. Although it would be difficult to claim that all these objectives could be turned into solid accounts, Aznar tried, and at least economically succeeded, to upgrade international status of the Spanish state. However, it should also be noted that in all these foreign policy shifts the preferences and interests of business elite played a crucial role. This is why, the pro-Atlantic policy restructuring of Aznar government should be analysed from this particular point as well. The Spanish interactions with the world's largest and most dynamic economy, the US, were considered to be underdeveloped by the business elite, who had high expectations from the closer US cooperation and collaboration, just like once they expected high returns from the EC membership.

[29] Cuestiones Internacionales y Política Exterior Ensayos / The International Afairs and Foreign Policy Institute

Bilateral trade and investment relations with Spain and the US showed an inconsistent but a promising tendency. Aznar's close circle strongly argued that in order to achieve a healthier and a more mature diversification of Spain's economic internationalization, and to take advantage of a potentially profitable but relatively untapped bilateral economic linkage with the US, Spain should have begun to more actively pursue trade and investment as well as political ties with the US (Isbell, 2004:3). Moreover, the rapidly growing "US Hispanic market, which had "achieved almost the same size as Spain itself in terms of population and total purchasing power", strongly backed this pro-Atlantic tendency held by thinkers around Aznar (Isbell, 2004: 3). Closer economic and political ties with the US were hoped to produce a beneficial spill over effect for the stability of Latin American economies, where Spain was the largest or the second largest national investor in most countries. This is why, such a policy-shift considered to be vital for the prospects of Spanish companies operating in what historically has been the US's political and economic "backyard" (Isbell, 2004:3).

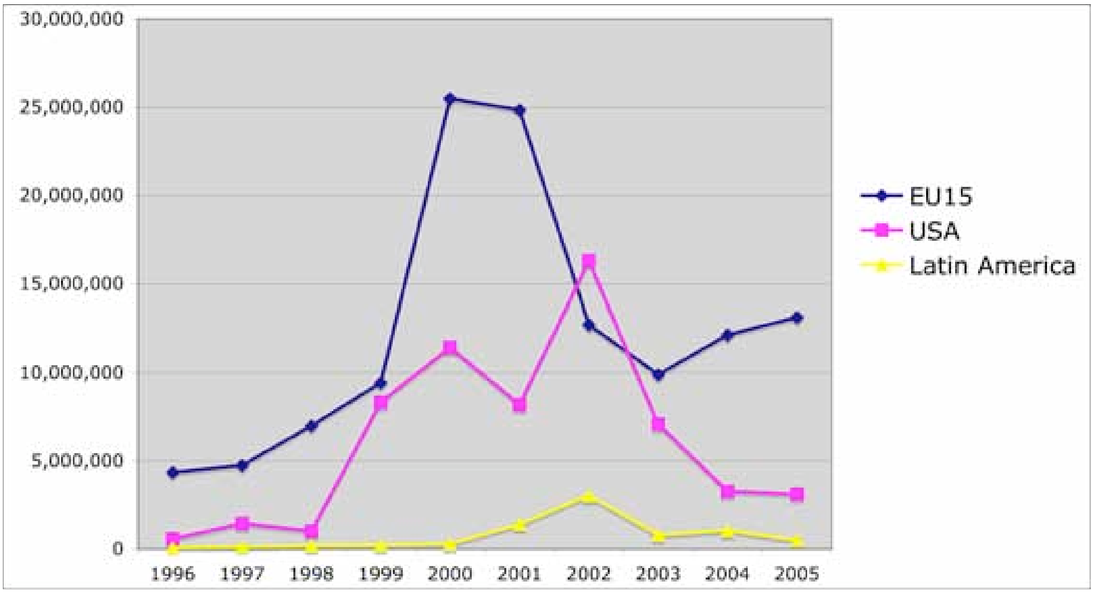
Given the under-developed nature of Spanish-US economic ties, Aznar's close circle assumed that more profound political relations would provide an important gateway needed to capitalise the Spanish-US economic relations. The business elite believed that a growing political sympathy and an increasing collaboration would pave the way for Spanish business interests in the US market as well, especially among the rapidly growing Hispanic segments. Hence, Aznar preferred challenging the EU leadership via allying Spain with the Atlantic bloc, a policy, which meanwhile also fulfilling the economic expectations of the business elite, and stepped into furthering economic, political and security related relations with Latin America and Maghreb (Isbell, 2004:2).

However, as it can also be seen in the below-figures, except the year 2002, the American investment towards Spain has kept recording lower amounts compared to total EU investment[30]. Although in 2002 the traditional scenario changed and the US investment outscored the European one, the EU-15 has constituted the lion share with regard to the total investment flows to Spain. The same comment

[30] However, if the unit of analysis is changed from regional economic blocs to countries, then the US stands out as the single largest national investor in Spain since the turn of the decade (Isbell, 2004:2).

can also be made regarding the Spanish investment abroad. Even though the Spanish foreign direct investment towards Latin America peaked up and exceeded the FDI towards the EU-15 during the Aznar's first term on government, the extreme foreign policy stances of the second Aznar government, as explained above, pushed back these financial figures back to the PSOE levels (See the Figures 3.7 and 3.8 below).

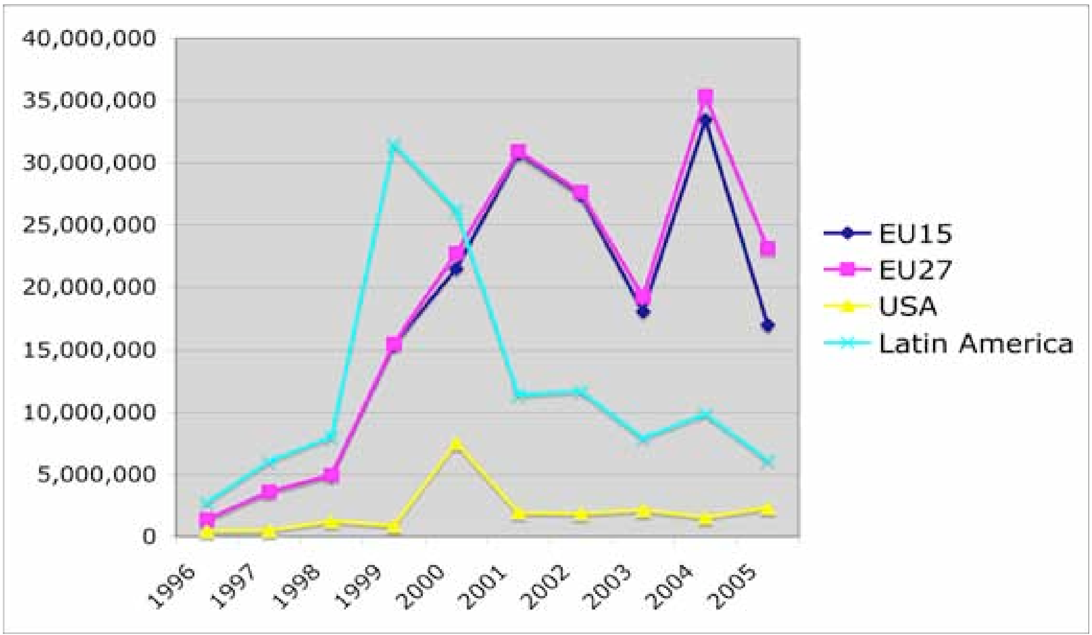
Figure 3.7: Foreign Investment to Spain (Thousand Euros)



Destination	2000	2001	2002	2003	2004	2005
EU15	25,501,948	24,855,242	12,718,775	9,901,121	12,149,769	13,131,943
USA	11,430,662	8,196,200	16,316,488	7,088,666	3,282,984	3,117,711
L. America	292,678	1,413,903	3,052,335	818,953	1,062,996	511,438

Source: Ministry of Industry, Tourism and Commerce
(http://datainvex.comercio.es)

Figure 3.8: Spanish Investment Abroad (Thousand Euros)

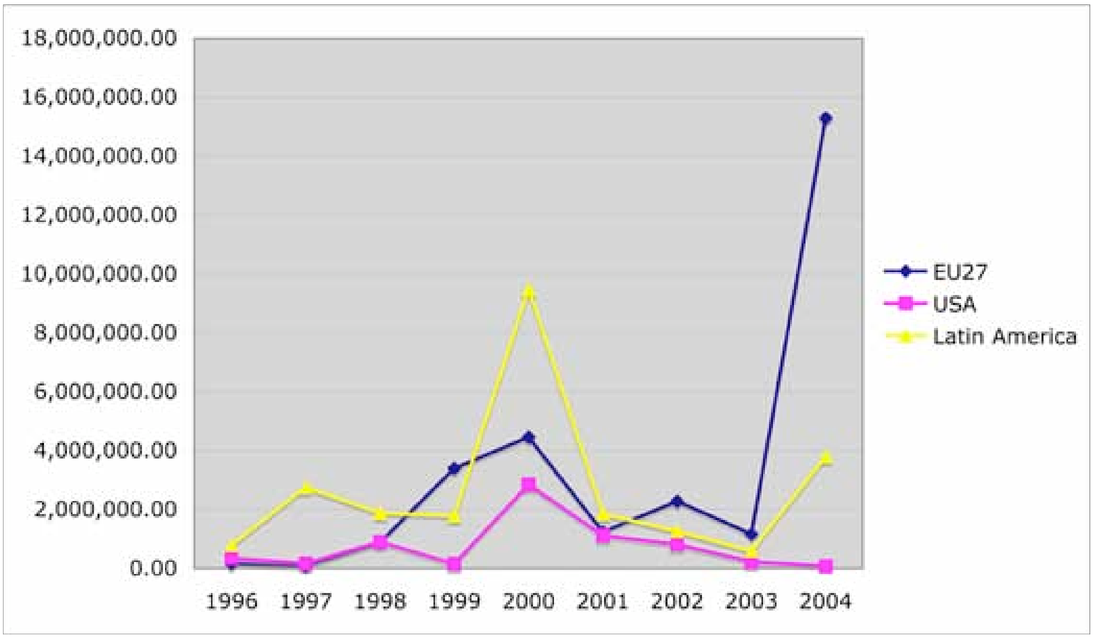


Origin	1998	1999	2000	2001	2002	2003	2004
EU15	4,907,578	15,367,329	21,477,924	30,693,010	27,359,755	18,024,876	33,463,453
EU27	4,975,279	15,522,015	22,749,173	30,953,692	27,656,197	19,226,086	35,378,415
USA	1,255,160	911,005	7,551,318	1,937,733	1,877,687	2,142,972	1,571,222
L.America	8,044,319	31,484,191	26,231,284	11,418,221	11,720,692	7,935,637	9,875,393

Source: Ministry of Industry, Tourism and Commerce (http://datainvex.comercio.es)

Especially Spanish FDI in the banking sector recorded a very consistent line with the foreign policy developments of the country. In the course of the first Aznar government the banking sector recorded the then highest sectoral FDI ratio of the modern Spanish state towards Latin America (see the below graph). However, the first year of the second Aznar government was drastically problematic with regards to the FDI recorded in the banking sector, which experiences a similar trend with the general FDI figures of the country. The extremely challenging and pro-American foreign policy deployed by the second Aznar government and radically worsening public image of Spain in the eyes of the Latin American countries as a result of these policy decisions negatively affected first the Spanish – Latin American relations (see page 96) and then Spanish FDI to Latin America. Not surprisingly, the banking sector deeply consolidated in the Hispanic countries was the slowest one to react. Meanwhile this downturn in the FDI towards Latin America was balanced thanks to the increase in the FDI toward Europe, the banking sector was not that flexible and fast to adapt to this changing environment.

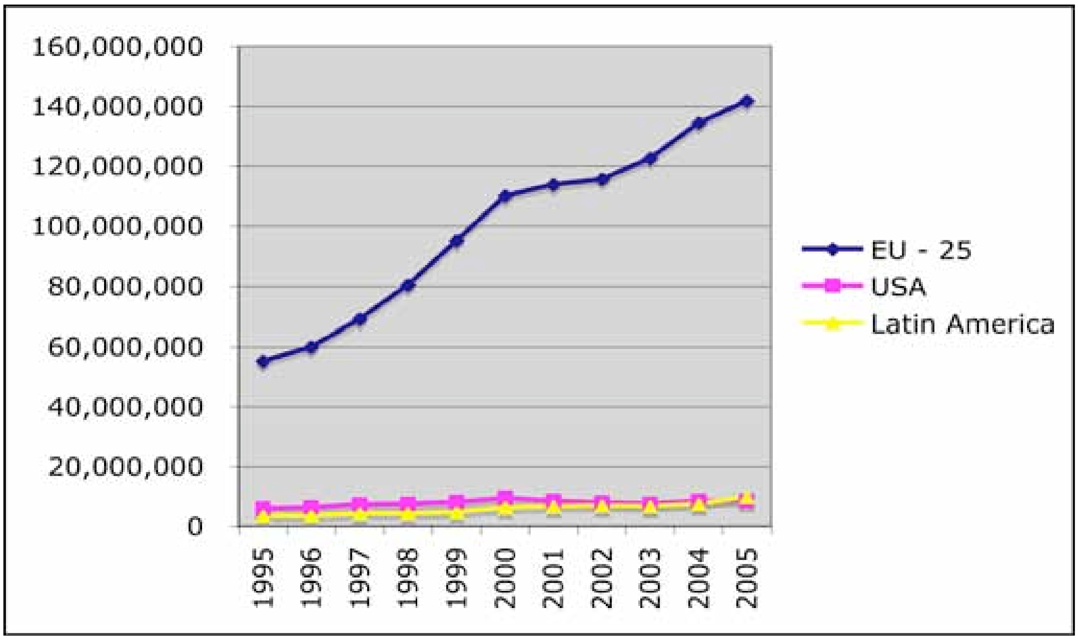
Figure 3.9: Spanish Banking Sector FDI



Source: Ministry of Industry, Tourism and Commerce (http://datainvex.comercio.es)

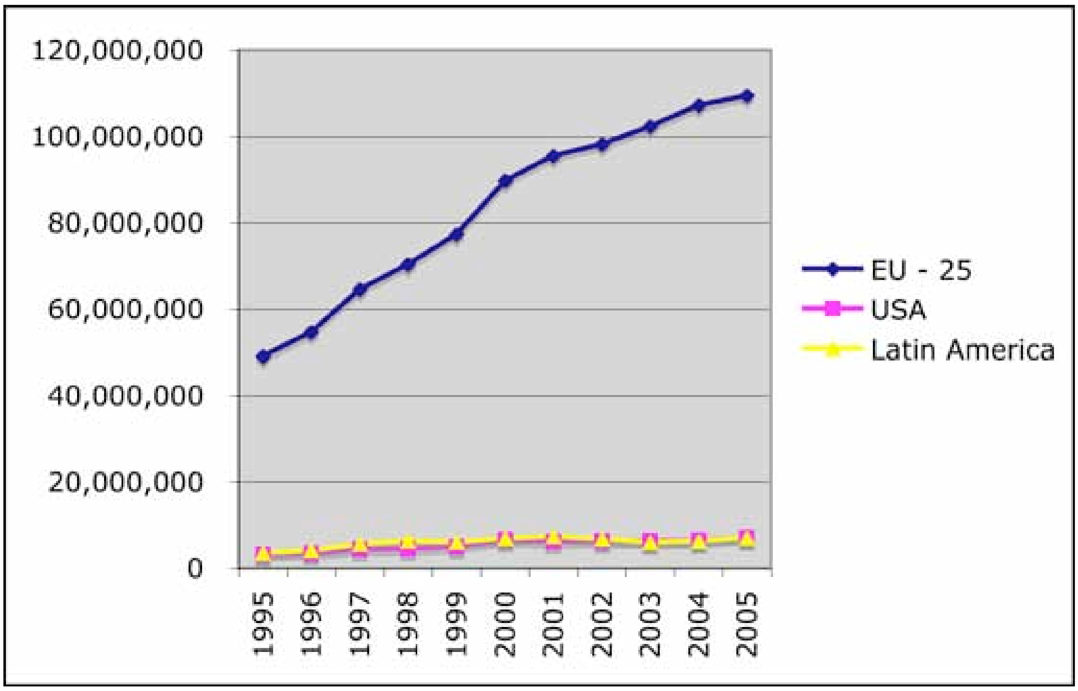
Apart from the investment figures, the bilateral trade between the US and Spain also has recorded a marginal level compared to the commercial activity between Spain and the EU (see the below graphs).

Figure 3.10: Imports to Spain (thousands of Euros)



Source: Ministry of Industry, Tourism and Commerce (http://datacomex.comercio.es)

Figure 3.11: Exports from Spain (thousands of Euros)



Source: Ministry of Industry, Tourism and Commerce (http://datacomex.comercio.es)

Therefore, it can be argued that Aznar´s rhetoric of developing the political linkages with the USA in order to achieve further consolidated and advantageous economic relationships with the world´s greatest economy failed to fulfil the promised results. Aznar promised the economic elite a prosperous return from this policy shift and mobilised them as national champions ready to carry the Spanish flag in the economic sphere. Economic dominance and strength was a crucial and indispensable part of his policy shift. In Aznar´s eyes, an economically strong Spain, transformed from being the receptor of foreign aid into being one of the leading donators of the EU, a Spain investing heavily into Latin America, which has been the favourite investment location of the world´s greatest economy, the US, was supposed to challenge the Franco-German hegemony of the EU politically as well. However, modern Spanish society has always been Euro-enthusiastic and strongly opposed the pro-American policies of Aznar government, which went to the far extreme of suggesting the idea of creating a US-EU free trade area (The Atlantic Economic Association) by 2015 (Isbell, 2004:3). Moreover, even the national champions, although they recorded a significant amount of financial returns, were not enough to change the direction of the Spanish economy, which had to be Euro-oriented given the physical and legislative proximity.

Aznar even drafted a Strategic Asia Plan, with which he expected to see a Spanish expansion towards the Asian market, as it was observed in Latin America. However, among his national champions, only BBVA followed Aznar to Asia, which demonstrated once again that despite their historical, financial and managerial linkages, the business elite (and especially the financial elite) followed policy-makers in abroad only if they shared the same ambitions and expectations with policy-makers. In addition to these, as stated above, the over-supportive attitude of Aznar government towards the unilateral US policies damaged the Spanish credibility in the eyes of other Hispanic countries looking up to Europe for a counter-balance to the very same policies.

This is how and why, the Aznar´s challenge failed in societal and most importantly economic pillars, which led to his political regression. Therefore, it can be concluded that, Aznar's challenging foreign and economic policies failed to prove their sustainability in the long run. Although it cannot be neglected that thanks to these policies Spain took the advantage of EU merger and competition regulations, and actively promoted the domestic mergers and acquisitions facilitating national champions capable of reaching a global presence (Youngs, 2000:218). Thanks to these national champions, Spain finally became one of the leading European economies, and thus, Spain under Aznar ruling managed to upgrade its position in the hierarchy of states. In other words, economic relationships helped make political advances possible. Without any economic interests and / or economic orientations the regional policy goals could not become successful (Freres, 2000: 69). Therefore, although in the long run Aznar's aggressive policy could not be sustained and Spain ended up turning back its face to where it geographically belonged, Spain could finally claim a regional leadership position within the European politics - thanks to these economic advances.

3.2. Back to Europeanism-Zapatero Period: Change or Continuity(2004-)

14 March 2004 witnessed another important political development in the Spanish political economy. The victory of José Luis Rodrìguez Zapatero was taken by surprise given the fact that Zapatero, contrary to Aznar who was already a public figure before his electoral victory, was little known by the Spanish society. However, the desire for a change in the Spanish society was so dominant that it facilitated voting for a little known leader (Tussel, 2005: 436). It would be quite speculative to claim that had the September 11 and the successive 11 May events not happened, Zapatero could not have won the elections. However, still it can be argued that under such a scenario the odds would have signalled Aznar and his economic transformation agenda.

With regard the Spanish economic policy and its economic performance, it should be emphasised that Aznar era witnessed the most prosperous and expansionist times of the Spanish democracy. During his second term in office, the annual economic growth rate was ranging between 3.1 per cent and 2.3 per cent, which was 1.2 point above the European average growth rate at the date (Tussel, 2005: 448 and Kennedy, 2007:189). By the end of Aznar's second term, Spain had the world's eighth largest economy, and had become the world's ninth largest investor abroad, as well as being the eight largest recipient of foreign investment (Kennedy, 2007:189). Moreover, the unemployment rate fell down 11 percent thanks to more than four million jobs created due to the sectoral and the geographical expansion of the country between 1996 and 2002 (Tussel, 2005: 448 and Kennedy, 2007:189). Public debt decreased from 68 percent of GDP in 1996 to 50 percent in 2004 while the public deficit, which recorded 6.6 percent in 1995, transformed into surplus by 2003 (Kennedy, 2007:189).

However, Aznar's economic revival plan had some deficiencies as well. For example, it is certain that Spain could never have achieved such a prosperous scenario had the European funds not been extended. Secondly, the economic reform was not carried out in line with a sound social reform, aiming at modernising the living standards of the Spaniards. This discrepancy between the social policy and the economic policy can be exemplified by the social security and health system transformations, which were left behind the scope. Last but not least important, Aznar's industrial and financial policies lacked a concrete focus on productivity and innovation, but rather focused on short and medium term gains (Tussel, 2005:448). Therefore, the time that the Spanish society began to complain from the side effects of Aznar's economic policy aiming at a fast pace of growth and expansion coincides with the peak point of the critics against his social and foreign policies that climbed up dramatically following Aznar's decision of sending troops to Iraq in 2003. It was a decision coinciding with the economic and political tendencies of Aznar as explained through the previous chapter. It was a challenging decision because 61% of the Spaniards were against any kind of military intervention to Iraq, while 24% of them expresses that they would confirm sending troops only under the UN flag (Tussel, 2005: 451). Moreover, the Latin American societies, towards which the Spanish economy had expanded massively during the Aznar period, were against the USA's intervention to Iraq. However, Aznar still preferred to line his country with the then the best ally of Spain, the USA. He was definitely aiming at realising his dream of creating a "Strong Spain". However Spain ended up being categorised by its European allies as an uncomfortable and unfriendly ally, which established special bilateral links with the USA (Tussel, 2005: 451). Unlike any other electoral race since the return of democracy, the primary issue in this election was foreign policy, and especially the trans-Atlantic foreign policy preferences of the Aznar government (Armington, 2005:1). Therefore, Spanish society voted for the little known socialist leader, José Luis Rodrìguez Zapatero, and his dream of a "Strong Spain" cost Aznar an electoral victory[31].

In the 2004 elections, the socialist PSOE gained 3 million votes and thus won 42.6% of the total votes, which corresponded to 164 seats at the Parliament, while Aznar's conservative PP remained at 148 seats.

It should be underlined that the Zapatero's understanding of socialism diverged significantly from the ideological understanding of his predecessor's. Even some figures from his own political party attributed his victory to the "reformation of the reformed" due to the fact that he furthered the reforms of González. Zapatero eliminated the militarists and the marginal figures of the post-war era

[31] Aznar utilised a rhetoric of "Grande España / Strong Spain" and "España en el mundo / Spain in the world", while Zapatero positioned Spain during hic electoral campaign as "en el corazon de Europa / in the core of Europe" (Blanch, 2005:95).

from his team and he further diverged the orientation of his party from the orthodox socialism to the centre left ideology (Tussel, 2005: 436). In other words, rather than replacing the Aznar government he copied Aznar's strategy of yielding within centralist ideology, and applied it successfully to his party.

Zapatero's weakness in financial programming has always been evident (Tussel, 2005: 437). Neither his electoral promises regarding his economic plan nor the constantly changing composition of his economic team persuaded the economic elite and the academicians. Not surprisingly the majority of the headlines of his electoral agenda consisted of reforms targeting the social issues such as gender mainstreaming or social security reform. Although these promises were not necessarily contradictory to the budgetary considerations of the country, they were far from being a part of an integrated understanding binding the economic reforms with the social ones (Tussel, 2005: 437). "Continuity" has characterised the PSOE's economic orientation, as the new government broadly maintained the policy inherited from the previous PP government with an aim to sustain macroeconomic stability (Kennedy, 2007: 191). Stability and maintaining the status quo rather than employing challenging and novel strategies was the main concern of the new Prime Minister. He even let the Felipe González's last Finance Minister, Pedro Solbes, carry out the same duties under his new government. Apart from Zapatero's enthusiasm to stick with the stability, the fact that by the time Zapatero took the office Spain already had the world's eighth largest economy (and also had become the world's ninth largest investor abroad and the eight largest recipient of foreign investment) made the need for any challenging economic policy questionable. Therefore, sustaining the status quo rather than risking it seemed much more reasonable to the newly elected leader.

Thus, so hesitant to take any challenging, novel or aggressive steps with regard to economic policy, Zapatero mainly focused on contradictory and widely supported social policy issues, especially the ones related to civil and gender rights social justice and individual freedom, instead of putting the "low politics", in other words the economic considerations, in the top rank of his governmental agenda (Kennedy, 2007:187).

By the end of his first term in office, the economic indicators signalled a high but also a concerning growth. The high economic growth was sustained while the unemployment rate was brought down to its lowest level for three decades, to 8.1 per cent, which was even lower than the EU average (Kennedy, 2007:192). However, technological innovation and investment in Research and Development remained low in comparison to the UK, France, Germany and the US and the competitiveness was hampered due to inflation differential with the euro zone (Kennedy, 2007:193). Not surprisingly, current account deficit, which was around 9 per cent of GDP and was the highest in the European Union, raised concerns about the sustainability of this high growth.

This economic policy orientation of Zapatero that eschewed innovation and novel methodologies in favour of an economic stability was a clear indicator of the real divergence between Zapatero's understandings of political economy and Aznar's. While Aznar pursued challenging policy that fostered consolidation, strengthening and mobilisation of the economic elite, Zapatero, as opposed to his predecessor, has not pursued an integrated economic policy that united the interests of the economic elite and the policy-makers. Rather, he believed that economy could survive without a political orientation backing it and also foreign policy could be carried out without an economic policy behind. This lack of a coherent vigour with regard to economic policy bared some significant consequences for the national champions as well. Zapatero put a clear distance with the government and the "national champions" and did not hesitate to put this into concrete words:

> "My socialism is not of the old "tax and spend" variety, i.e. where there is unlimited public spending paid for by tax increases. Nor is it the socialism of a state with lots of public sector companies in areas where private initiative obtains better results. Nor am I, as regards the day-to-day functioning of the economy, a supporter of government meddling in companies' activities. I think that it is necessary to establish a set of clear and transparent rules for companies, and that public finances should be managed rigorously."
> (Quoted in Calamai and Garzia 2006: 83)

However, in a country like Spain in which ownership structures has traditionally had a dominant role, it was impossible that a government fully isolate itself from the functioning of the economy. Despite the government's claim to deploy a fully liberal economic policy in line with the free-market conditions, the Zapatero government did not hesitate to take protective measures when the interests of the economic elite were at stake. The most concrete examples of this attitude can be found in the Endesa and Ferrovial cases.

Upon the aggressive bid of German energy utility E.On in order to take over the Endesa[32] group, the socialist government, ignoring the fierce criticisms of the EU Commission for the violation of open market and free competition principles, put a very protective stance, which ended up with E.On withdrawing its bid. Zapatero defended his act claiming that: "the government's response must be viewed in terms of energy sector being of strategic importance" (Kennedy, 2007:193). However when the Spanish infrastructure company Ferrovial[33] turned its attention to BAA[34], this time the PSOE government stood with the aggressor and supported the acquisition, highlighting the fact that free market principles could be violated with a double standard when the key national interests, in other words key interests of the economic elite, were threatened.

However, in the field of foreign policy, one cannot argue that the term "continuity" has been the slogan of the new PSOE government. Zapatero, unlike his predecessor Aznar, preferred a less assertive Spain cooperating with the Franco-German block instead of challenging it through identifying itself with the Atlantic block. Zapatero has preferred the safe waters of the EU to the risky and almost unconditional political alliance with the US. As a consequence, Spanish – US relations have undergone a rapid and major change following the 2004 general elections. The first eight months of Prime Minister Zapatero's term witnessed mutual recriminations and hostile rhetoric in both private and public segments of the society (Isbell, 2004:5). One of the very first decisions of the new government was to comply with their electoral promise of withdrawing Spanish troops from Iraq, which was followed by a strong reaction from the US administration that reflected in the US press (Isbell, 2004:5). As opposed to the

[32] Endesa, S.A. (Empresa Nacional de Electricidad, S.A) is the largest electric utility company in Spain.

[33] Grupo Ferrovial, S.A. is one of the world's leading infrastructure and multinational Spanish companies involved in the design, build, financing, operation and maintenance of transport, urban and services infrastructure.

[34] BAA is one of the world's leading airport companies, operating three London airports, Heathrow, Gatwick and Stansted. In June 2006, BAA was bought by a consortium led by Ferrovial, the Spanish construction company, and in August BAA officially delisted from the London Stock Exchange.

economic policy arena, in terms of foreign policy, the new policy orientation was concrete and solid. The motto of the PSOE government, which was publicly supported, was "return to Europe", a return to Spain's historical and geographical roots after a parenthesis characterised by Aznar's priority on trans-Atlantic relations above Europe (Crespo, 2005:30). Zapatero himself, hoping to receive appreciation from Germany and France and also to motivate the Spaniards to vote "yes" in Spain's 2005 referendum on the European Union constitution, put his trajectory of "returning to Europe" into concrete words as: "First comes Europe, then our historic ties with Latin America, and the Mediterranean and after that comes trans-Atlantic ties" (Mitchell and Bond, 2004:1)".

The plan of the Aznar's intellectual circle's to bring a renaissance to the US-Spanish bilateral relations was defeated politically in the ballot box despite the economic prosperity it achieved. Meanwhile, the Bush administration did not hesitate to exhibit its clear preference between the two political parties, PP and PSOE, and put a clear distance between the US and the Zapatero government. While Zapatero did not loose time to make a bold public announcement saying that Spanish troops in Iraq should have been withdrawn as soon as technically possible, Bush even went to the far extreme of inviting Aznar as is first foreign visitor for a 40 minute private meeting in the White House and waiting two weeks to reply Zapatero's congratulatory call (Mitchell and Bond, 2004: 2), giving such an impression that Spanish-US bilateral relations were out of its trajectory for good.

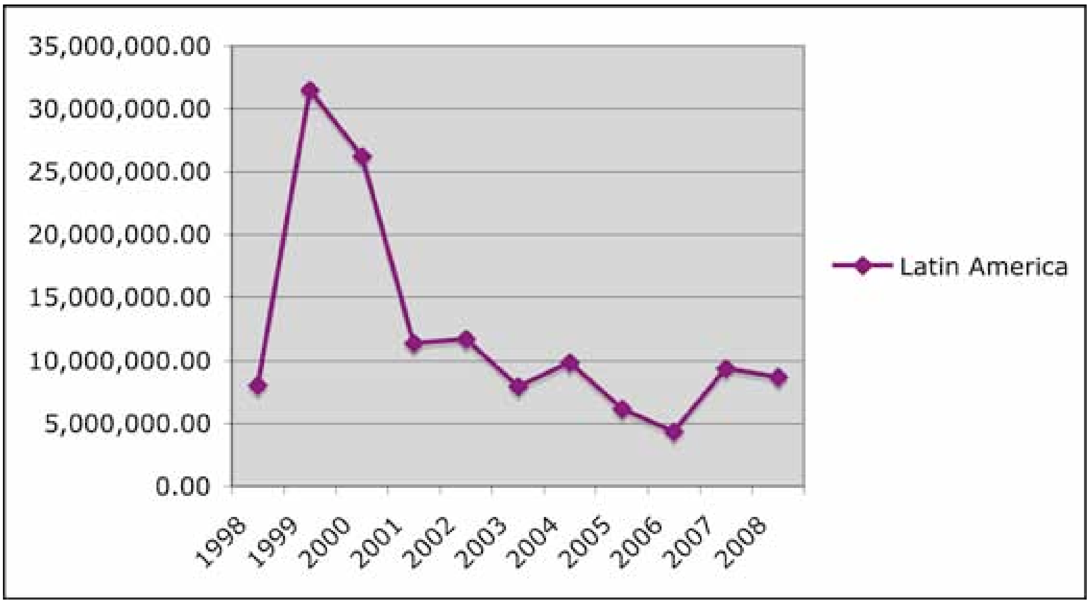
This negative ambience raised some noticeable concerns among Aznar's national champions who had already directed a considerable amount of their operations towards the US or towards Latin America. In the wake of the Aznar's electoral defeat many Spanish companies, especially the biggest ones, have already established strong links with the US and some of them have recently been won important public works projects in the US. Although the positive correlation between bilateral political and economic relations has not been proved yet, many Spanish firms used to hope that they would benefit from at least informal facilitation at winning contracts and establishing maybe small but definitely an important position in the US economy as a result of this closer political relationship that Aznar's intellectual circle intending to develop (Isbell, 2004:6).

However, the successive Zapatero government apparently did have scant interest in pursuing the US Hispanic market as a direct target for Spanish business interests.

Apart from this, the foreign policy conception of the two successive governments differed significantly with regard to Latin America as well. While Aznar pursued the commonly held belief that Latin America has been the backyard of the US and the path to success in these Hispanic lands passed through positive political relations with the US, Zapatero aligned Spain with socialist governments of the region and even went to the far extreme of accusing Aznar for supporting the attempted coup d'etat against Hugo Chàvez in early 2002 (Isbell, 2004:5). This is why; one other concern in the minds of the business elite was the possibility of losing once hoped-for cooperation with the US in Latin America, and even the possible threat of US veto against Spanish business interests in Latin America (Isbell, 2004:7). It has been a well-known fact that local governments possessed a considerable control not only over public procurement and public works but also over various investment and pricing decisions. Therefore the business elite's concern was the high possibility that the local Latin American governments would sacrifice Spain in order to appease Washington (Isbell, 2004:7). Given the fragility of Spanish business interests with respect to the Latin American market, this concern was very understandable.

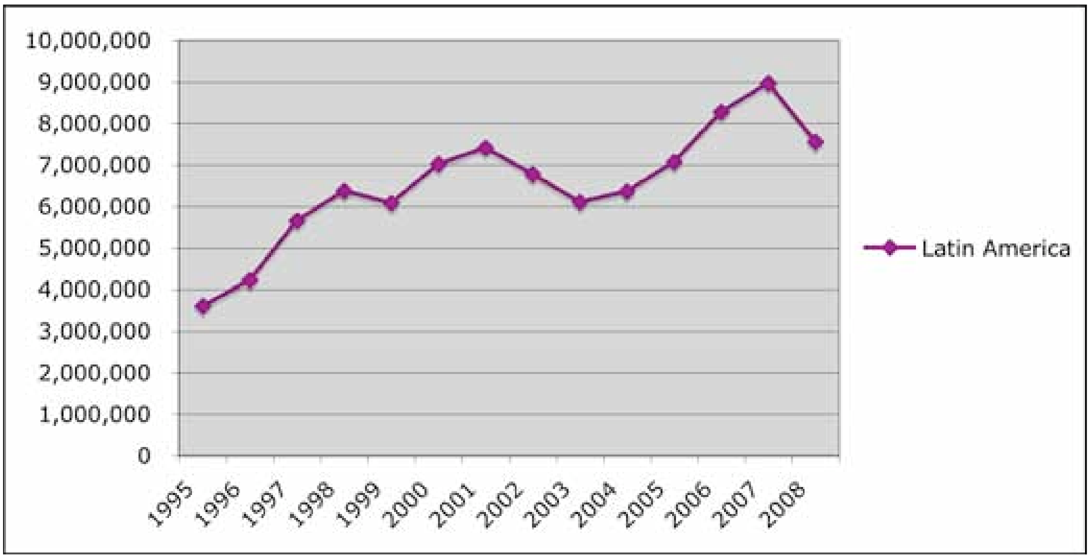
However, as opposed to what had been foreseen, this change of office did not result with a huge decrease (considering the 2004 levels as a benchmark) in the commercial activity with and the investment to the Latin American nations. The investment figures ranged between their already saturated levels whereas the bilateral commercial activity between Spain and Latin America kept its upward trend (See the Figures 3.12, 3.13 and 3.14).

Figure 3.12: Spanish FDI to Latin America (1998-2008) (thosuands of Euros)



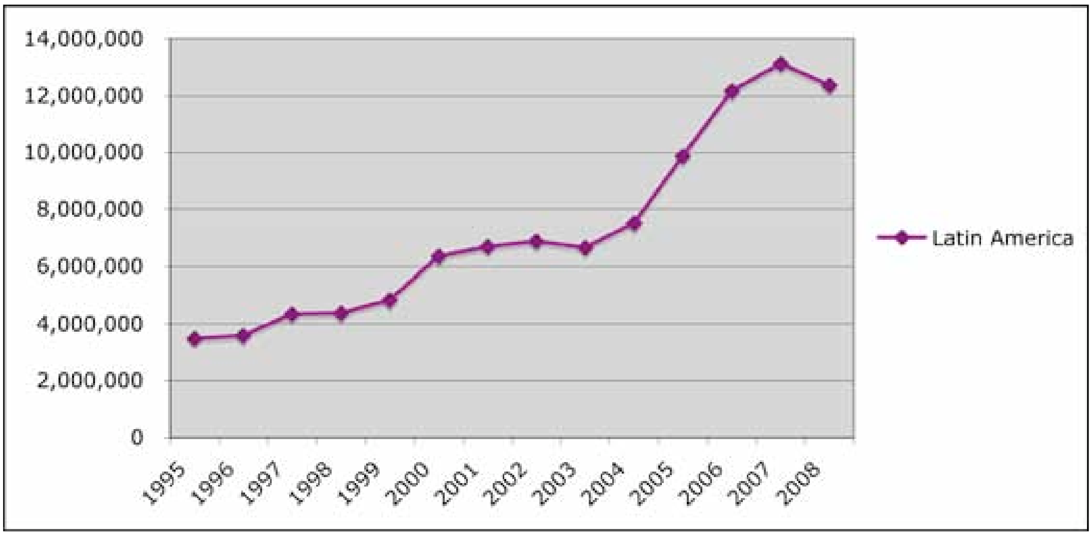
Source: Ministry of Industry, Tourism and Commerce (http://datainvex.comercio.es)

Figure 3.13: Spanish Exports to Latin America (1995 – 2008) (thosuands of Euros)



Source: Ministry of Industry, Tourism and Commerce (http://datacomex.comercio.es)

Figure 3.14: Imports from Latin America to Spain (1995 – 2008) (thosuands of Euros)



Source: Ministry of Industry, Tourism and Commerce (http://datacomex.comercio.es)

This result is far from being surprising giving the fact that when Zapatero took the government, the US had already lost its influence over the governments in Venezuela, Brazil and Argentina (Isbell, 2004:9). This is why; the pro-continental, pro-Latin America stance of Zapatero was welcomed by many of the countries in the region (Armington, 2005:2). Apart from this, both the US and a number of European governments had already dropped Latin America from their priority agendas. Zapatero administration seized this opportunity in order to re-offer Spain as the gateway to Europe for the Latin American nations and took various political actions such as reviving Latin American Summits (Las Cumbres Iberoamericanas), appeasing Venezuela's Chàvez and Cuba's Castro, trying to help mediate peace talks between the warring factions in Colombia's decades-long civil war (Armington, 2005:2). Moreover, the Spanish firms in the region have concentrated in service sectors, thus they were broadly vulnerable to the economic evaluation of domestic markets rather than instability in foreign policy, which may have an influence on factor prices (Isbell, 2004:9). Still, it should be noted that the upward slope of the growth rate of bilateral economic activity between Spain and the Latin American nations under the PSOE ruling has been much flatter compared to the levels recorded when Aznar took the government. This can be very easily comprehended taking into account the fact that a very close bilateral cooperation with the US was needed in order to re-conquest Latin America, however the same cannot be argued for sustaining the already cultivated and saturated position.

Not as serious as the concerns related to Latin America, Spanish-US bilateral economic relation was another focus of concern for the economic elite. However, despite the fact that the USA has always been a fundamental figure in Spanish economic and industrial life, it could never reach up to European level (excluding the year 2002) neither in terms of investment nor in terms of commercial volume (See Tables 3.1 and 3.2, and Figure 3.15), and independent of the political rhetoric Spanish FDI has always been directed towards to main directions: Europe and Latin America (See the Figure 3.15). As it can also be observed in the below tables and figure, independent of the foreign policy change the growth rate of the trade volume between the US and Spain remained almost the same after Zapatero took the government. The total trade volume increased by 7 percent between 2003 and 2004, which means during the heyday of Aznar's US policy and increased by 4 percent between 2004 and 2005, when Zapatero took the government.

Table 3.1: Exports from Spain (thousands of Euros)

	2002	2003	2004	2005	2006	2007	2008
EU – 25	98,160,321	102,422,358	107,275,130	109,407,913	118,091,099	128,217,044	108,345,387
USA	6,440,563	6,332,867	6,463,511	7,101,229	8,307,598	8,187,927	7,029,536
Latin America	6,780,307	6,108,834	6,355,688	7,064,212	8,282,369	8,974,110	7,556,463

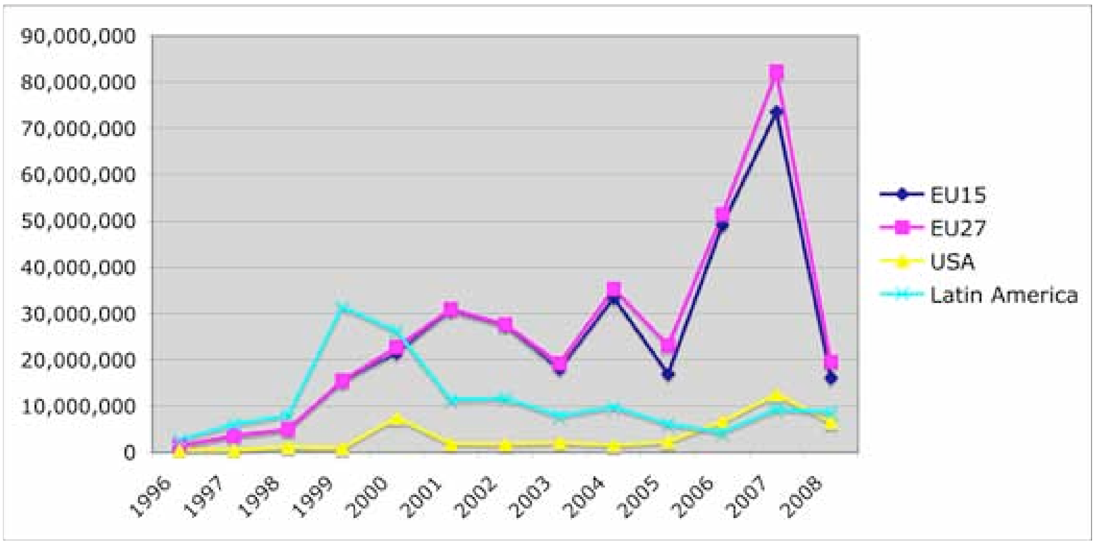
Source: Ministry of Industry, Tourism and Commerce (http://datacomex.comercio.es)

Table 3.2: Imports to Spain (thousands of Euros)

	2002	2003	2004	2005	2006	2007	2008
EU – 25	115,705,958	122,532,414	134,498,200	141,875,835	153,678,720	170,200,043	131,362,258
USA	7,945,753	7,482,611	8,428,843	8,487,369	9,358,532	10,896,982	10,664,805
Latin America	6,867,000	6,662,006	7,519,273	9,870,597	12,166,700	13,122,028	12,361,131

Source: Ministry of Industry, Tourism and Commerce (http://datacomex.comercio.es)

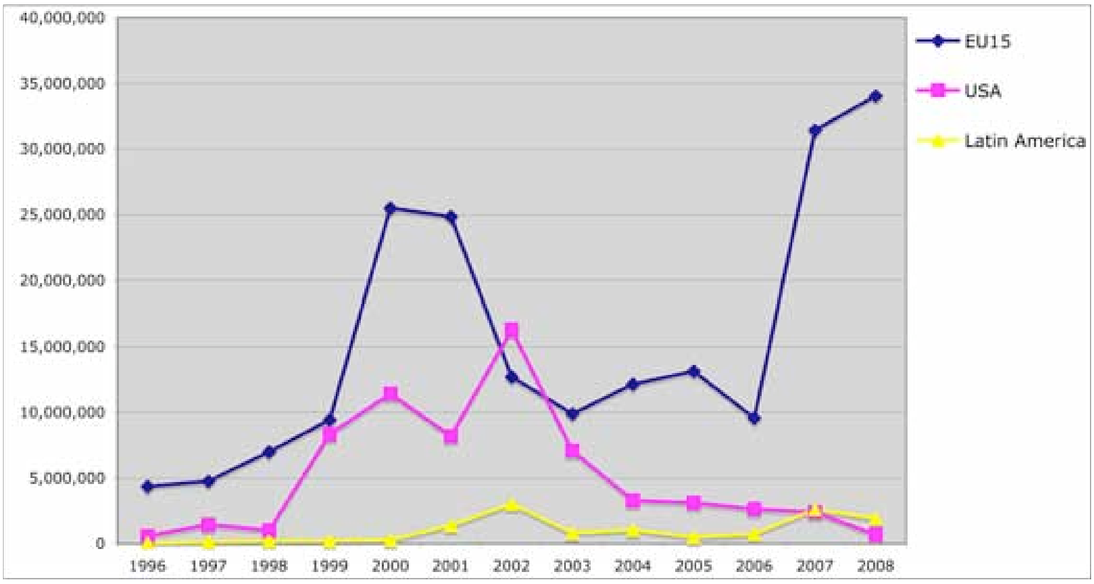
Figure 3.15: Spanish FDI (1998-2008) (thosuands of Euros)



Source: Ministry of Industry, Tourism and Commerce (http://datainvex.comercio.es)

It was Aznar's plan to fully utilise the commercial and financial capacity with the world's biggest economy. However, even if the investment volume increased in favour of the US and at the expense of EU between 1998 and 2002, the US investment levels began to retreat during the heydays of the Spanish-American political cooperation, despite the intensity of cooperation in the political area. Immediately after the electoral victory of Zapatero the investment trends moved backwards to their original state and the European FDI figures has once again recorded a positive slope, pushing back all the 3rd parties to minor importance (See the Figure 3.16).

Figure 3.16: Foreign Investment to Spain (Thousands of Euros)



Source: Ministry of Industry, Tourism and Commerce (http://datainvex.comercio.es)

Considering this positive slope recorded between 1998 and 2002 in the US investment toward Spain, some scholars argue that Aznar's well-known rhetoric of building much tighter political relationships so that reaping the harvest of the bilateral cooperation on high politics by obtaining much closer economic linkages with the US could have been proved correctly had the March elections not resulted in favour of Zapatero (Isbell, 2004:7). According to this argument, Aznar did not have sufficient time for the political cooperation being able to yield any new and significant economic opportunities in the US and Latin America, or directly with the US government via the public procurements (Isbell, 2004:7). Zapatero's sharp U-turn and immediate troop withdrawal left Aznar's dream of materialising a renaissance in Spanish foreign policy and economic performance as an intangible hypothesis.

However, many others remained sceptical that this kind of a political closeness to Spain would ever resulted in such a renaissance in the Spanish – US economic relations and insisted that Spain has always been a part of the European continent, not of America's, and last but not least, appeasing the US demands, especially the military ones, has never yielded plausible consequences for Spain.

Moreover, if only the Spanish-US financial cooperation volume is concerned, it is clear that the decisions affecting US investment in Spain were only marginally influenced by the political climate as the primary factors affecting investment decisions rather focus on the relative performance of the Spanish economy. A proof of this theory can be found through the numbers in the above figures and tables (See the Table 3.1 & Table 3.2 and the Figure 3.15 & Figure 3.16) exhibiting a downward trend in Spanish – American investment and commercial activities during the heydays of the bilateral political cooperation agenda.

To sum up, it cannot be estimated what the outcome of Aznar's aggressive alignment with the Atlantic policy would be, if Zapatero had not immediately started to execute his plan of "returning to Europe". Still, it is difficult to claim that Aznar government could have managed to change the orientation of Spanish economic life. However, a credit should also be given to his plan given the fact that his strategy to mobilise Spanish national champions to increase overall Spanish presence in the European economy and finally upgrading Spanish status in the hierarchy of states. Although the marginal contribution was negligible, as claimed in the above paragraph, it should also be stressed that international political economy is a dynamic ground and political actions may easily yield some very important indirect economic consequence. For example Aznar's Atlantic policy seems to have marginal impacts over the economic volume between the direct parties (Tables 3.1 & 3.2), however, the gradually strengthening Spanish presence within both economic and political spheres, and also very visible success of the national champions, opened up new opportunities in the old continent as well. It is quite doubtful that Zapatero's "return to Europe" rhetoric could have achieved in the same positive economic indicators and political results if he had not succeeded Aznar. Zapatero did not only inherit a strong economy and developed commercial and investment links with the rest of the world, but also a stronger voice in Europe[35] on which he could capitalise

[35] Thanks to the **Nice Treaty**, which was signed by European leaders on 26 February 2001 and came into force on 1 February 2003, Spanish voting power in Europe was equalled to the four most prominent European nations and Spain was ensured a strong position in decision-making process. Aznar's success in getting Spain a disproportionate number of votes in EU decision-making stands as a compensation for the fact that Spain was to lose in several ways (e.g. losing its privileged position as the low-wage economy of choice for foreign investors wanting to set up in the EU, or transforming from being the biggest net beneficiary and into a net contributor, from the expansion of the EU (Economist, 6.26.2004 and Papí, 2004:2).

his foreign and economic policies. This is why, a considerable portion of Zapatero's economic success, or at least his success at the preservation of the status quo, should be attributed to Aznar's term on the government.

3.3. The Banking & Financial Sector And Foreign Policy:

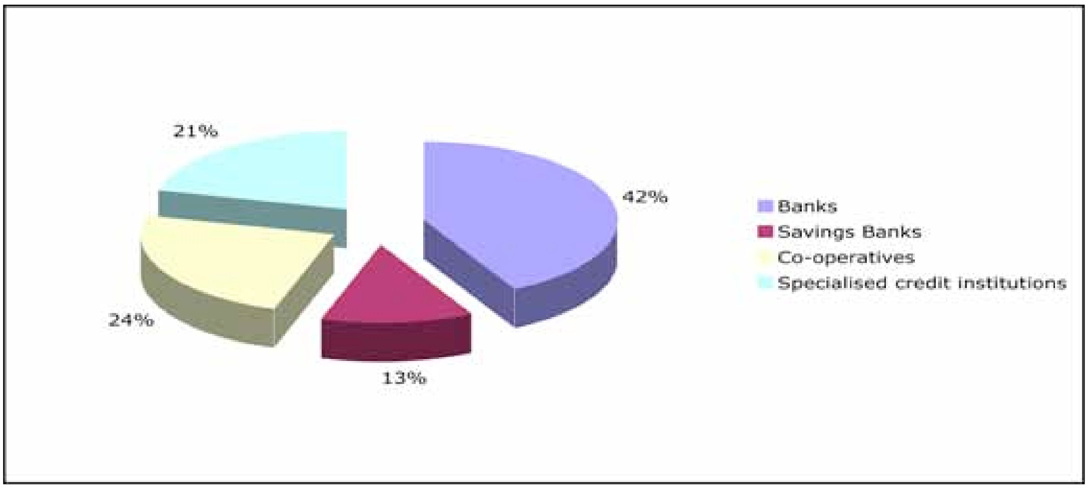
In order to understand the full picture, apart from the orientation of the investment flows it is also worth emphasising the banking regulations and their implications, given the fact that economy and policy-making do not constitute a one-way and simple relationship but rather an interchangeable and a complex one. Therefore, the banking supervision and regulations are also essential to better conceptualise the mutual interaction between the financial elite and the policy-making one. This is why; in this section, the recent domestic banking regulations will be evaluated from the perspective of political and economic developments during the Aznar and Zapatero periods.

The further integration with the EU meant an inevitable process of competition and liberalisation of the Spanish banking system, which had traditionally been highly protected and regulated via an oligopolistic market structure, administratively fixed interest rates, compulsory investment ratios and entry restrictions to foreign banks. However, as explained in the previous chapters, the entry to the EU carried along some very vital compromises for the financial elite, the most important segment of the economic elite of the country. According to the Spanish financial world, the future of the contemporary Spain was definitely in the EU, which made the financial elite to support these compromises in exchange for the prospective benefits of the EU membership. Therefore, the oligopolistic and highly protected structure of the Spanish banking system underwent some significant and obligatory transformations. Although the liberalisation of the financial system had been launched by the González government (via measures such as the liberalisation of the interest rates and controls on fees, permission to open nation-wide branches granted to the savings banks, adaptation of the capital adequacy requirements with the EU rules, etc.), many of the vital reforms were done by the Aznar government. Therefore, the increased competition triggered by the EU integration led to a unique market consolidation for the Spanish banking sector, a sector which had aimed to increase size for competing in the European market while preserving the traditionally large profit margins via increased market penetration and scale of economies (Benito, 2008:15 and 16). The mergers and acquisitions explained in this chapter resulted with the high concentration of the industry, and the entrance of the foreign competition was avoided taking refuge behind the excuse of the fact that the finance industry was of strategic importance to Spain.

However, the competition was not only global but also domestic for the Spanish finance elite. The savings banks, which had always been kept under strict geographical restrictions, were now free to open up nationwide braches and to compete freely with the commercial banks. Thanks to this new regulation, the deposits held by savings banks almost reached to the level held by commercial banks (Benito, 2008:16).

By the end of 2007, the number of savings banks operating in Spain was 46, whereas the number of the commercial Spanish banks 151 (a number that corresponds to %42 of the total credit institutions operating is Spain). Also in terms of operating income, the commercial banks held a much better position with 61.61% of the total operating income, while the savings banks produced 34.68% of the total. However, in terms of aggregated balance (assets and liabilities) this difference was quite impressive for the savings banks. While the commercial banks had a market share of 53.13%, the savings banks enjoyed a 39.58% of the total credit market. Therefore, despite the lower number of the savings banks and the less profitable operations that they had, the savings banks managed to reach a market share very close to the commercial banks' by the end of 2007 (See the Figure 3.17, the Figure 3.18 and the Figure 3.19). The importance of these figures can be understood better if the evaluation of this market share considered. In 1980, the commercial banks owned by the financial elite controlled 70.50% of the total aggregated balance, whereas the savings banks only had 25.60% (Vicente, 2006:6). Therefore, it is very clear that the liberalisation wind carried by the EU membership cost a significant market loss of 17.37% between 1980 and 2007 for the financial elite.

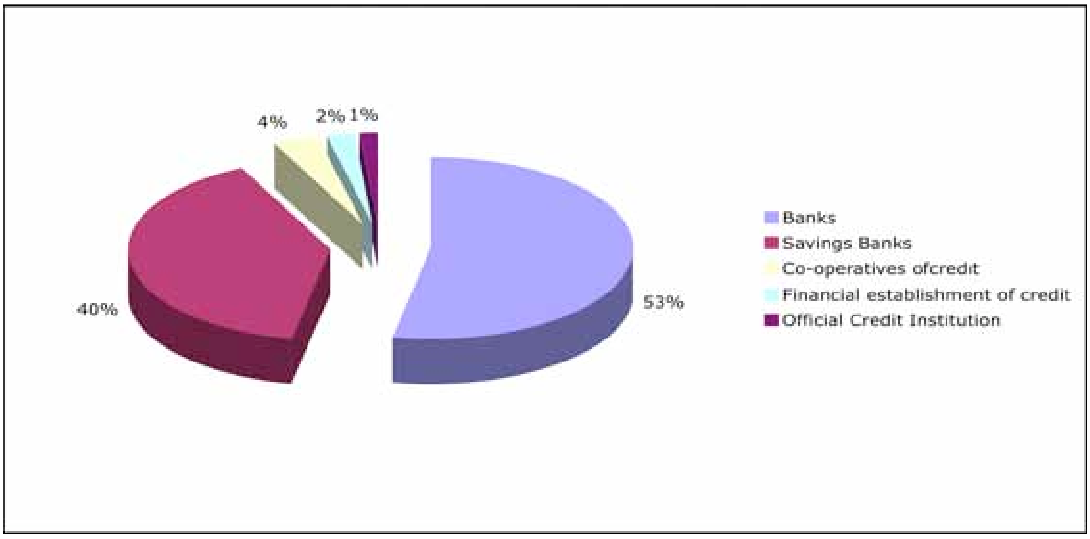
Figure 3.17: Credit Organizations: Number (2007)



CREDIT INSTITUTIONS IN SPAIN (2007)		
Commercial Banks	151	42.18%
Savings Banks	46	12.85%
Co-operatives	85	23.74%
Specialised credit institutions	76	21.23%
Total	358	100.00%

Source: Banking supervision document 2007. Banco de España

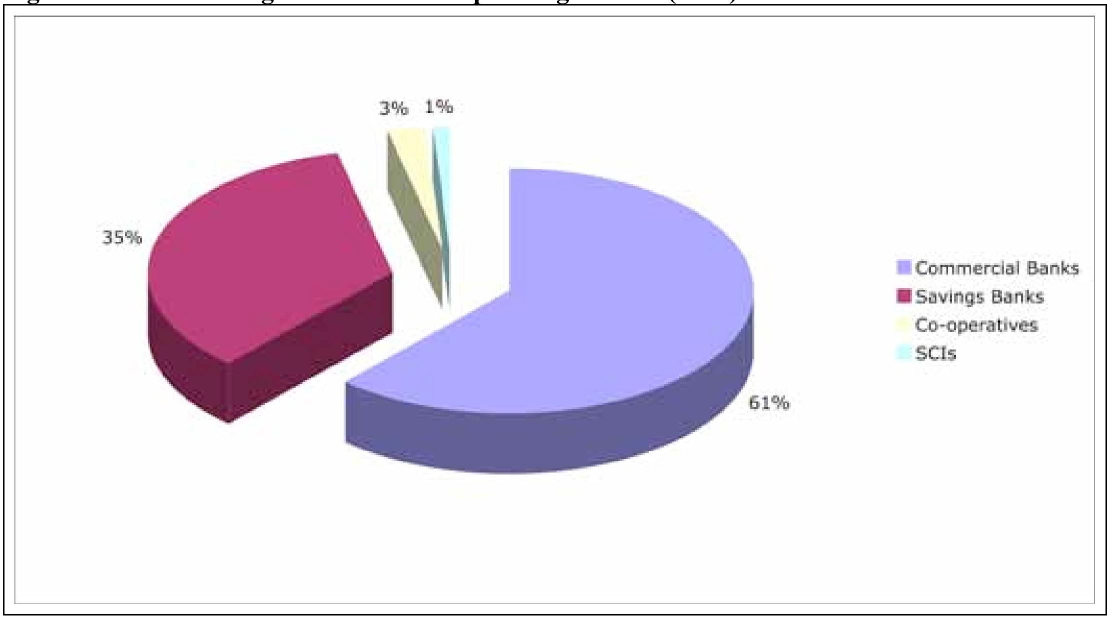
Figure 3.18: Credit Organizations: Agregated Balance (2007)



CREDIT ORGANISATIONS: Agregated Balance		
December 2007; million euros	Asset/Liability	% over all
Commercial Banks	1573.5	53.13%
Savings Banks	1172.3	39.58%
Co-operatives of credit	110.4	3.73%
Financial establishment of credit	65.3	2.20%
Official Credit Institution	40	1.35%
Total credit organisations	2961.5	100.00%

Source: Banking supervision document 2007. Banco de España

Figure 3.19: Credit Organizations: Net Operating Income (2007)



NET OPERATING INCOME		
December 2007; million euros	Income	% over all
Commercial Banks	32,540	61.61%
Savings Banks	18,317	34.68%
Co-operatives	1,405	2.66%
SCIs	558	1.06%

Source: Banking supervision document 2007. Banco de España

Apart from the savings banks, foreign banks constituted another pillar of the increased competition for the Spanish financial elite. Although the strong regional presence and significant market share of the savings and commercial banks made it difficult for foreign banks to penetrate the Spanish market, the gradual entrance of foreign banks through the opening of subsidiaries and branches was also an inevitable fact (Benito, 2008:16). So, the foreign banks have gradually increased their presence in the Spanish financial market.

Such a big loss of the market share, which has traditionally been preserved thanks to the political ties that the financial elite had with the policy-making elite, was very disappointing for the old financial elite, once called Big Seven, which used to control the whole financial market since the foundation of the banking sector to the 1990s.

Considering the fact that in Spain no political party could have ever succeeded to attain stability and control without the support of the financial elite, Aznar was obliged to substitute this lost market share for the big players of the financial elite if he wanted to achieve a stable and strong government whose reforms are backed both financially and intellectually. Therefore, the Spanish mobilisation led by the financial elite toward the underinvested Latin American market stood as a compensation prize to this compromise. Hence, the financial elite preserved its profitability thanks to the revenues extracted from these new Latin American markets. By the end of the Aznar's first term in power, the banking sector investments to Latin America outperformed all other investment flows. To give a concrete example to this compensation for the lost market share in Spain in favour of an increase in the Latin American market, the BBVA's operations should be mentioned: Spain accounts for 40% of BBVA's profits while Mexico for 26% (Economist, November 8th, 2008: 12).

One other fact related to preserving the profitability of the banking sector is the high banking concentration achieved since the late 1990s. The successive Aznar governments witnessed a considerable market concentration with a total 13.37% decrease in the number of total credit institutions. The commercial banks shrank 9.15% in number but in terms of asset consolidation this change was even more significant. The mega sized mergers and acquisitions realised among the Big Seven that reduced the number of the biggest players to two (BBVA and BCSH) and this move helped the old oligopoly preserve its high operational income. Although the total number of registered domestic banks in Spain did not change considerably (from 153 commercial banks registered in 1998 to 146 in 2007), as stated in the first chapter, "throughout the 1960s and 1970s the big seven banks controlled some 70 percent of the total assets in the commercial banking sector and granted 60 percent of all loans.

Table 3.2: Credit Organizations: Concentration (1998-2003)

Number	1998	1999	2000	2001	2002	2003	% Change
Commercial Banks	153	147	143	146	144	139	-9.15%
Savings Banks	51	50	48	47	47	47	-7.84%
Credit Cooperatives	97	97	94	92	87	86	-11.34%
Financial establishment of credit	103	96	86	85	83	78	-24.27%
Total Credit Organizations	404	390	371	370	361	350	-13.37%

Source: Banking supervision document 2003. Banco de España

Table 3.3: Credit Organizations: Concentration (2003-2007)

Number	2004	2005	2006	2007	% Change
Commercial Banks	137	140	144	151	10.22%
Savings Banks	47	47	47	46	-2.13%
Credit Cooperatives	85	85	85	85	0.00%
Financial establishment of credit	79	78	79	76	-3.80%
Total Credit Organizations	348	350	355	358	2.87%

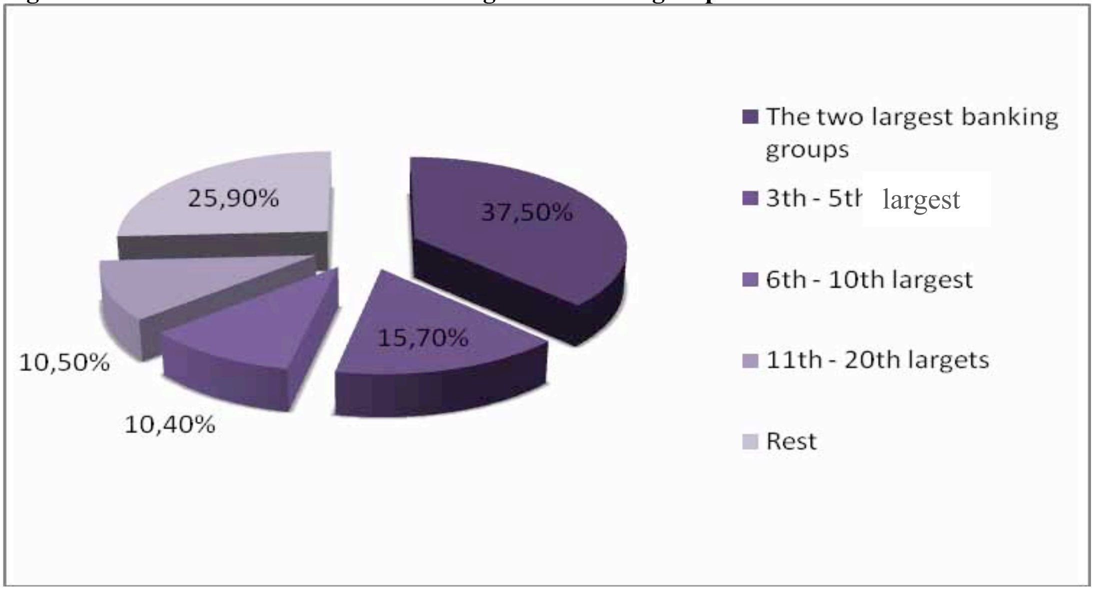
Source: Banking supervision document 2007. Banco de España

By 2001, the five major Spanish banking groups accounted for 53.2 % of the assets of the system, which indicated a change of 15.7% compared to the 1997 level of 38.0% (Memoria de Supervision Bancario, Banco de España 2001, 2006 and 2007; Ehrmann, Gambacorta, Martínez-Pagés, Sevestre and Worms, 2003:10).

It should also be noted that, following the 2000, the two commonly used index to indicate the banking concentration (market share of the 5 largest credit institutions and Herfindhal[36] index) started to indicate a further market concentration due to the fact that the mergers of Banco Santander and Banco Central Hispano and of BBV and Argentaria, made room for two new institutions, although smaller in size than the ones they replaced. So, 37.5% of the total assets belonged to the five largest banks were owned by the two largest ones.

[36] The Herfindahl index is a measure of the size of firms in relation to the industry and an indicator of the amount of competition among them. According to these indicators, the bank concentration differs substantially across Euro area countries. It ranges from very high levels in the smaller countries (Belgium, the Netherlands), where a limited number of banks exist, to intermediate levels in the larger countries (France, Spain, Italy), to very low levels in Germany, where the banking system is notoriously fragmented.

Figure 3.20: Concentration of assets among consolidated groups of credit institutions in 2001



Source: Banking supervision document 2001. Banco de España

Therefore, it is a clear fact that the increased competition due to the EU membership and increased influence of the savings banks and foreign banks did not alter the profitability and strength of the financial elite, as opposed to the general rule for the performance of oligopoly in a significant increased competition. Not only Aznar, but also his successor Zapatero, who claimed the principle of continuity for his economic policy, paid a considerable attention on the preservation of the existing strength of the banking oligopoly, which also controlled the majority of the assets of the national champions.

The change of office had almost no consequences on the traditional high profitability of the banking sector, despite the excessive operational costs, which altogether produced a unique scheme (See the Table 6). One other fact that contributed to this high profitability in the sector was the continuity of policy PSOE government, which copied the PP's economic policy in order to sustain high growth rate and low unemployment rates. Therefore, the high growth rate backed by the huge current account deficit helped the big commercial banks increase their earnings.

Table 3.4: Profitability of Major Banks

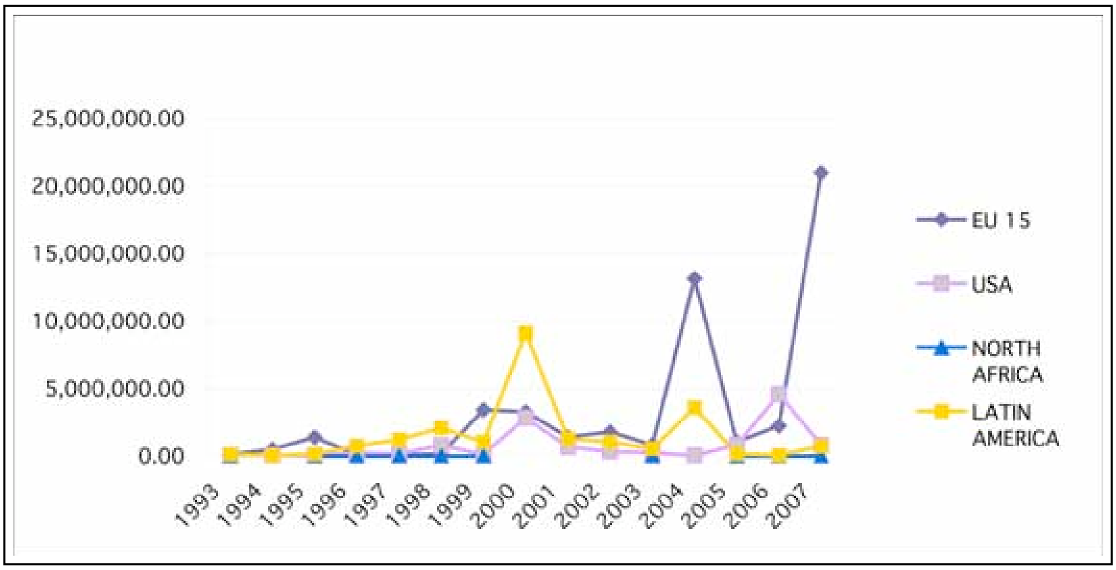
As a percentage of total average assets						
Country	Pre-tax profits			Operating costs		
	2005	2006	2007	2005	2006	2007
Austria	0.85	1.64	1.29	2.1	2.4	2.4
Australia	1.52	1.62	1.67	1.7	1.64	1.63
Canada	1.01	1.32	1.27	3	2.56	2.57
Switzerland	0.66	0.87	0.31	1.67	1.73	1.7
Germany	0.38	0.55	0.28	0.96	1.32	0.98
Spain	1.15	1.51	1.65	1.7	1.91	1.96
France	0.76	0.87	0.41	1.47	1.43	1.28
United Kingdom	0.87	0.97	0.67	1.59	1.7	1.36
Italy	1.23	1.12	0.88	2.34	2.34	2.01
Japan	0.66	0.67	0.5	1.05	1.15	0.8
Netherlands	0.58	0.57	0.38	1.29	1.48	1.37
Sweden	0.9	1.06	0.98	1.07	1.11	1.07
United States	1.93	1.82	1.02	3.44	3.12	3.51

Source: Bank of International Settlements, 2008, 78th Annual Report

The one and only significant change in the banking sector under Zapatero government has been the orientation of the sector investment. Following the above-explained Latin America orientation of the banking sector between 1997 and 2002, the two giant banking groups now consolidated, grown in size and achieved the necessary standard to compete with their European rivals in the old continent, turned their interests toward Europe. Again, this strategic move was in line with the foreign policy direction of the country under the Zapatero government. In a couple of years the investment flows headed to Europe overreached what had been foreseen and left behind the investment flows to Latin America (see the Figure 3.21)[37].

[37] The peek that can be observed in 2004 should be attributed to the merger between Barclay and Banco Zaragozano, and to the acquisition of the UK bank Abbey National Plc. By the Spanish banking giant BSCH.

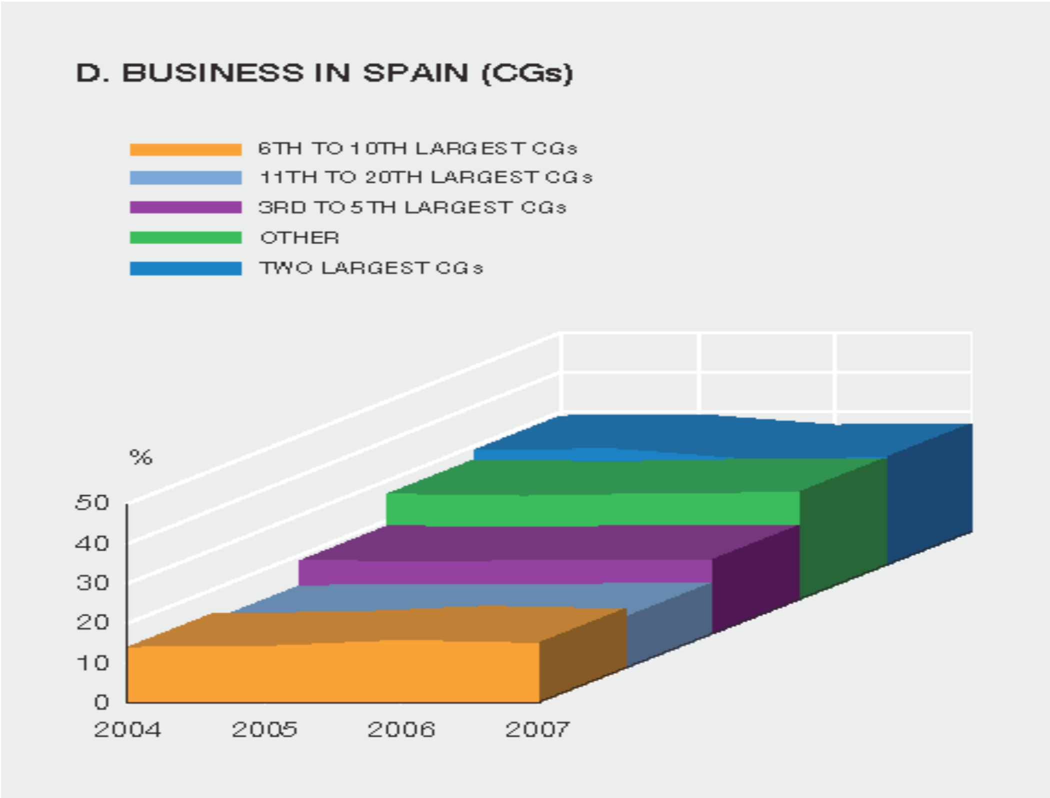
Figure 3.21: Banking Sector FDI (1995 – 2008) (thosuands Euros)



Source: Ministry of Industry, Tourism and Commerce (http://datainvex.comercio.es)

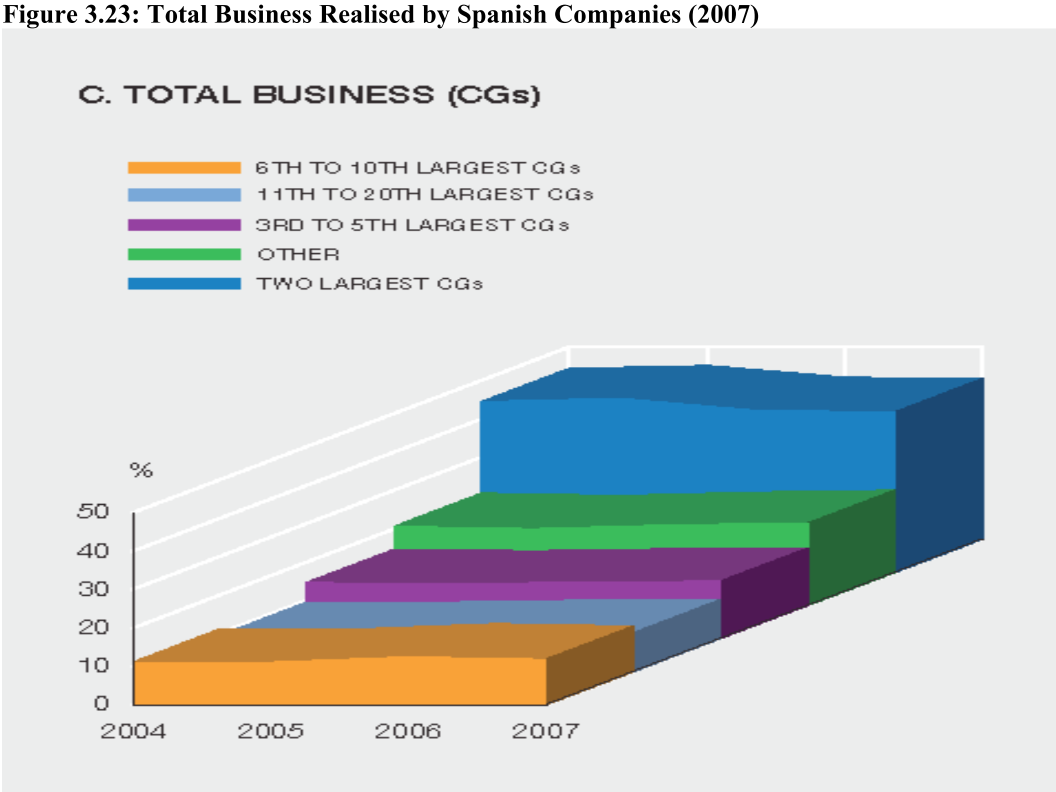
Therefore, the traditional role of the banking elite, as the main financer of the industry - and the foreign policy as well- has always been sustained independent of the government in office, and even independent from the type of governance of the country given the fact that this traditional role has never been shaken under either monarchy or republic, or even the dictatorship. This mutual benefit relationship between the financial elite and the political elite can easily be conceptualised looking at the history of the banking sector explained in the first chapter as well as the role of the banking elite in the overall functioning of the Spanish economy. As it can be observed in the below graphs, Spain's economic life is broadly dependent on the smooth functioning and the profitability of the financial elite, especially of the two main banking groups that control 46 per cent of the total business by Spanish firms and 30 per cent of the all business take place in Spain (Memoria de Supervision Bancaria, Banco de España, 2007:21).

Figure 3.22: Total Business in Spain (2007)



Source: Banking supervision document 2007. Banco de España

Figure 3.23: Total Business Realised by Spanish Companies (2007)



Source: Banking supervision document 2007. Banco de España

Considering this heavy domination of the Spanish business activity by the Spanish financial elite, it would be easier to conceptualise that the success of the any political group in Spanish policy-making has always been closely linked to the sustainability of the banking sector. This is why; the transformation of the banking system in Spain, and especially the transformation of the financial system from the Aznar period to the Zapatero period, stands as a powerful case study exhibiting some important fundamentals of the discipline of political economy. Neither domestic policy nor foreign policy of Spain could be executed without taking economics, either being global or domestic, into consideration. So, while the transformation of the Spanish financial system was shaped around the concerns and orientations of the policy-making elite, the domestic and foreign policies were also affected by the interests of the economic elite.

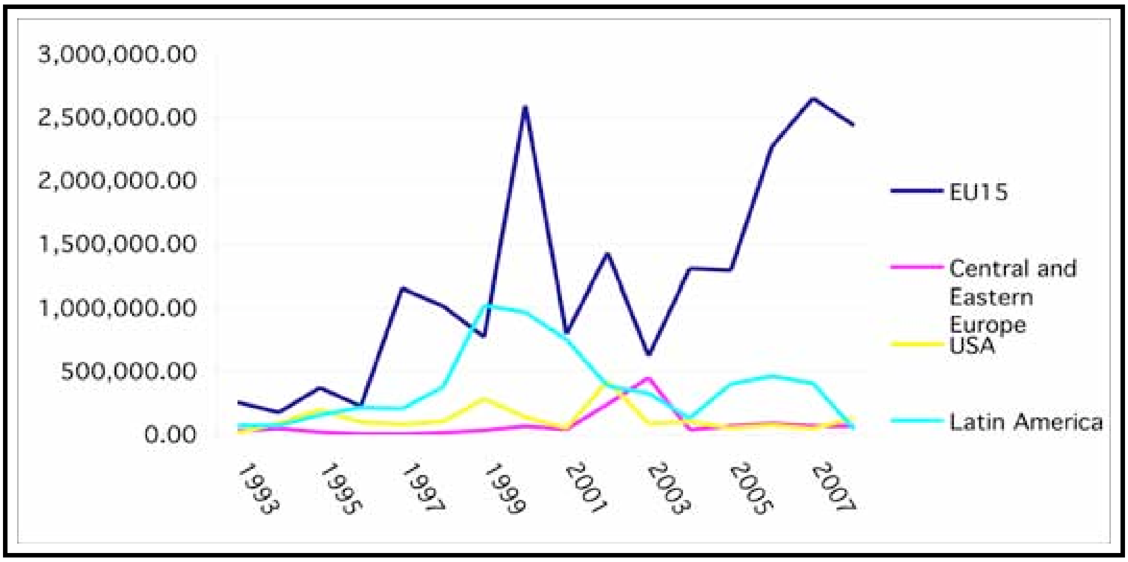
Here it is necessary to remember the foreign policy orientations of successive Aznar and Zapatero governments. The three main characteristics of Aznar government can be summarised as follows: promote Spain to the premier league in world politics; finalise the process of economic liberalisation, which had been started by Gonzàlez (liberalisation of the domestic markets, free competition, reduction of the state intervention, dismantling of the monopolies), and finally the consolidation of democracy (Portero and Torreblanca, 2007). The foreign policy during Aznar government can be conceptualised by the term "*Atlantization*", which indicates the attempts to establish a privileged relationship with the US in order to develop a new and stronger international identity for Spain, which is characterised by the Aznar´s policy circle as a European and an American nation (Blanch, 2005:90). Aznar wanted to offer the US an ally as faithful and strong as the UK (Portero and Torreblanca, 2007). Such a plan could never be achieved without creating a sphere of influence for Spain. This is why; Latin America region and the consolidation of the Spanish economic strength in the region via the expansion of Spanish market to the region were of great important for the Aznar government.

However, Zapatero clearly defined his foreign policy orientation as a pacifist, idealistic and a European foreign policy, which was far from the realistic and pragmatist policies of his predecessor (Blanch, 2005:90). Zapatero himself explained this new understanding as he did not want to be a "great leader" but a "good democrat" (Time Europe, 21 September 2004). This is why; the interests of the country were in Europe and the regions which were of importance for the EU; such as Middle East. This is why; the Zapatero government tried to direct its orientation to the Muslim world and North Africa, where a considerable portion of the European interest was laid[38].

The financial elite, which controlled the major stakes at the Spanish economic life, copied and also shaped these policies explained above. Liberalisation and globalisation were inevitable for the continuity of their success; however liberalisation also possessed a threat against their super high profit margins. Thanks to the re-conquest of Latin America led by Aznar the economic circles, the banking sector improved its profitability even more, while enjoying the increased competition and liberalisation needed for their consolidation with the European markets. The economical re-conquer of Latin America was achieved thanks to the pro-Atlantic foreign policies of the Aznar government. This Latin America expansion provided a compensation price to the banking elite for the lost market share due to the increased competition and further liberalisation. So, during the first term of the Aznar period the Spanish investments to Latin America were increased considerably especially in sectors such as industry, construction, telecommunication, transportation and of course banking, a sector which was the main shareholder of the rest.

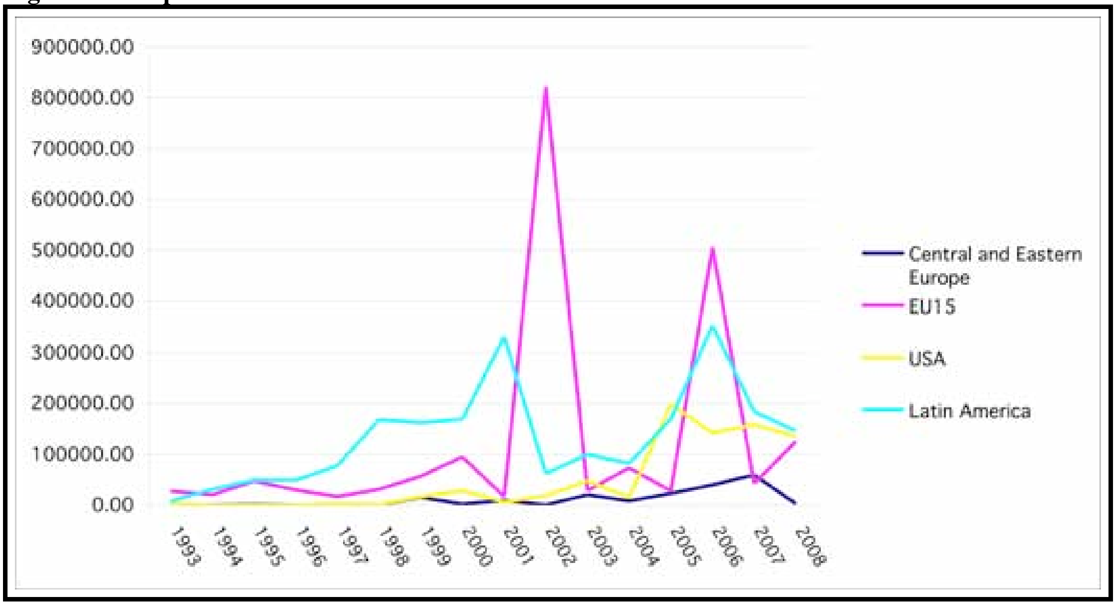
Figure 3.24: Spanish FDI in Industry

[38] This information was gathered by the interviews conducted with the Spanish diplomats in Turkey.



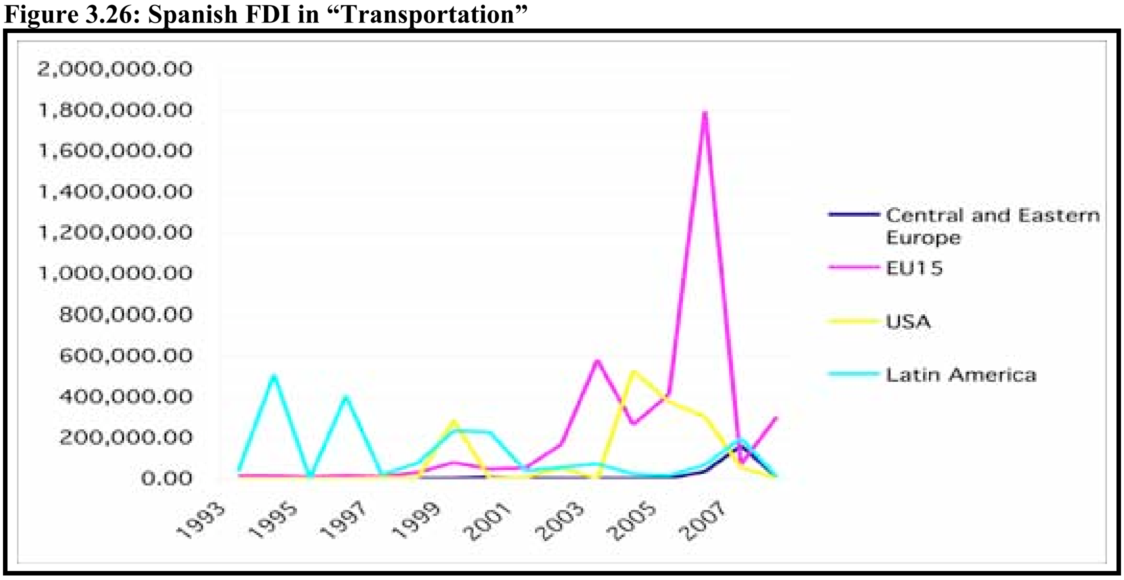
Source: Ministry of Industry, Tourism and Commerce (http://datainvex.comercio.es)

Figure 3.25: Spanish FDI in "Construction"



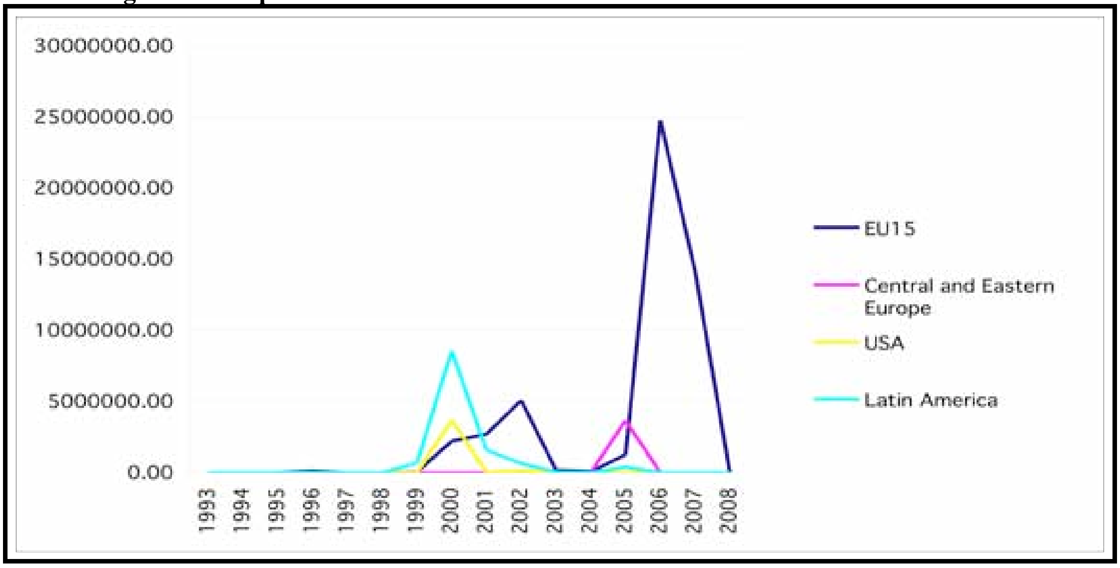
Source: Ministry of Industry, Tourism and Commerce (http://datainvex.comercio.es)

Figure 3.26: Spanish FDI in "Transportation"



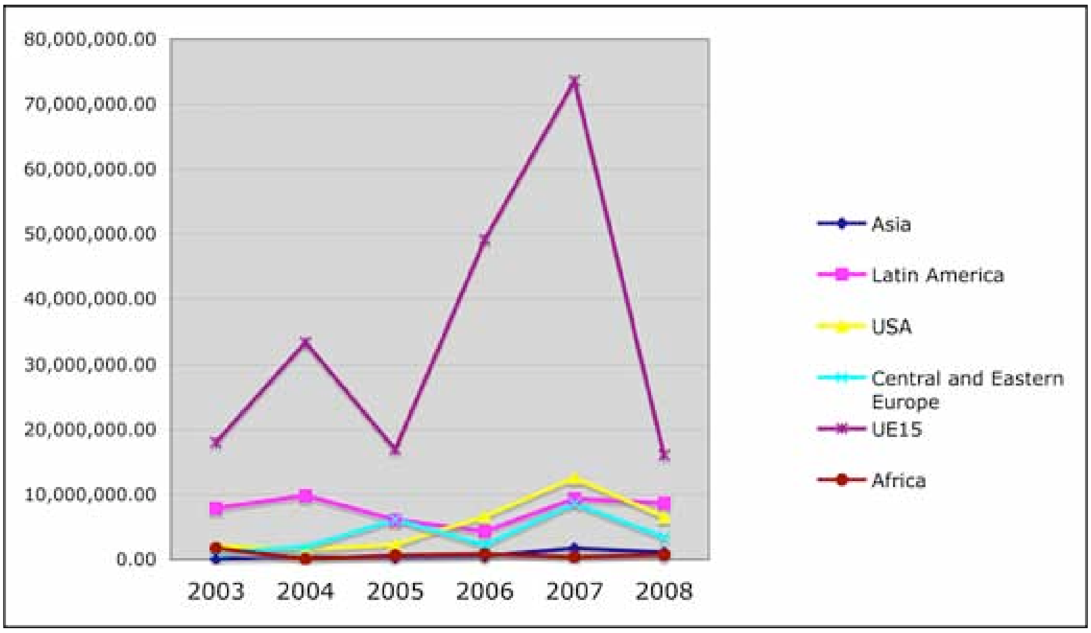
Source: Ministry of Industry, Tourism and Commerce (http://datainvex.comercio.es)

Figure 3.27: Spanish FDI in "Telecommunication"



Source: Ministry of Industry, Tourism and Commerce
(http://datainvex.comercio.es)

Figure 3.28: Spanish FDI in "Banking"

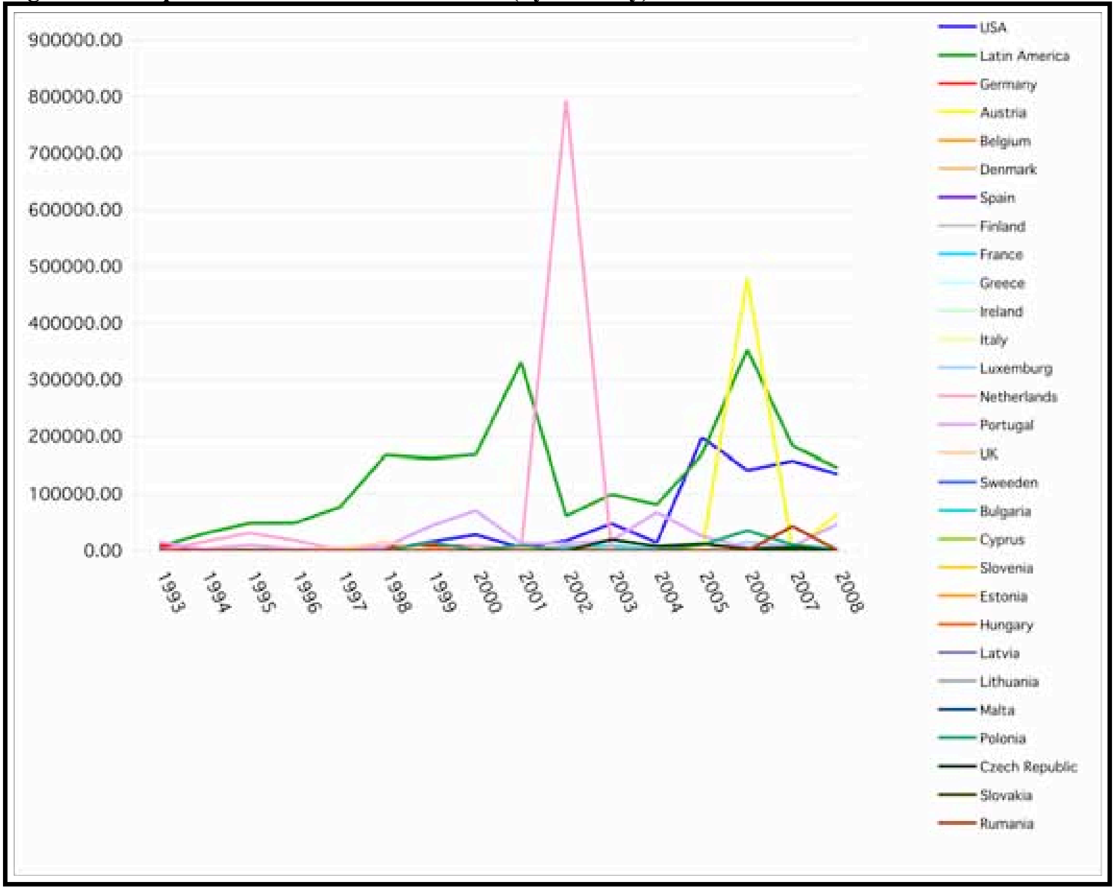


Source: Ministry of Industry, Tourism and Commerce
(http://datainvex.comercio.es)

However, despite this increase in the volume of investment to Latin America, which also helped Spain consolidate its global position as a medium level power, the main interests of the Spanish business and the financial elite remained in the old member states of the EU. This why; the aggressive pro-Atlantic policies of the Aznar government causing a sour relationships with the EU 15 led by the Franco-German block signified an important trade off for the Spanish economy, given the proportion of the Europe oriented investment in total Spanish investment.

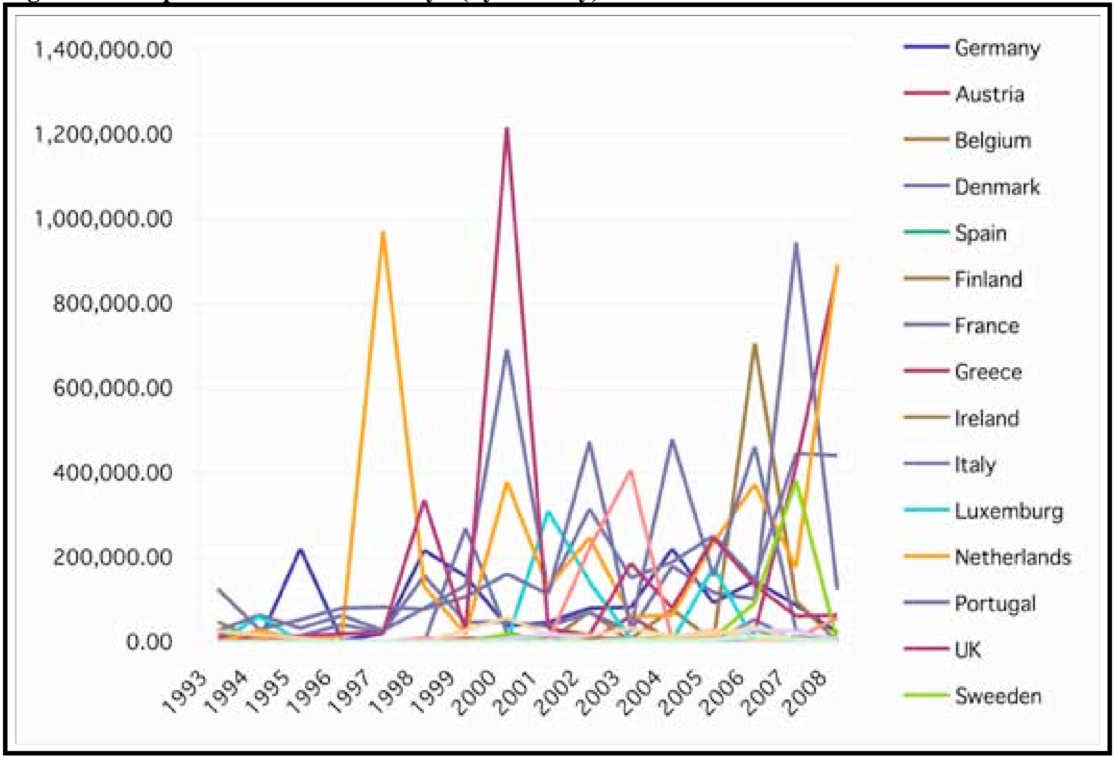
Therefore, the "back to Europe" rhetoric of the Zapatero government promised an increased profitability and business volume for the Spanish economic sector led by the financial elite. As it can be seen in the below figures, the old members of the EU (Netherlands, UK, Germany and France) have always captured the lion share in terms of the Spanish business circle's interests.

Figure 3.29: Spanish FDI in "Construction" (by country)



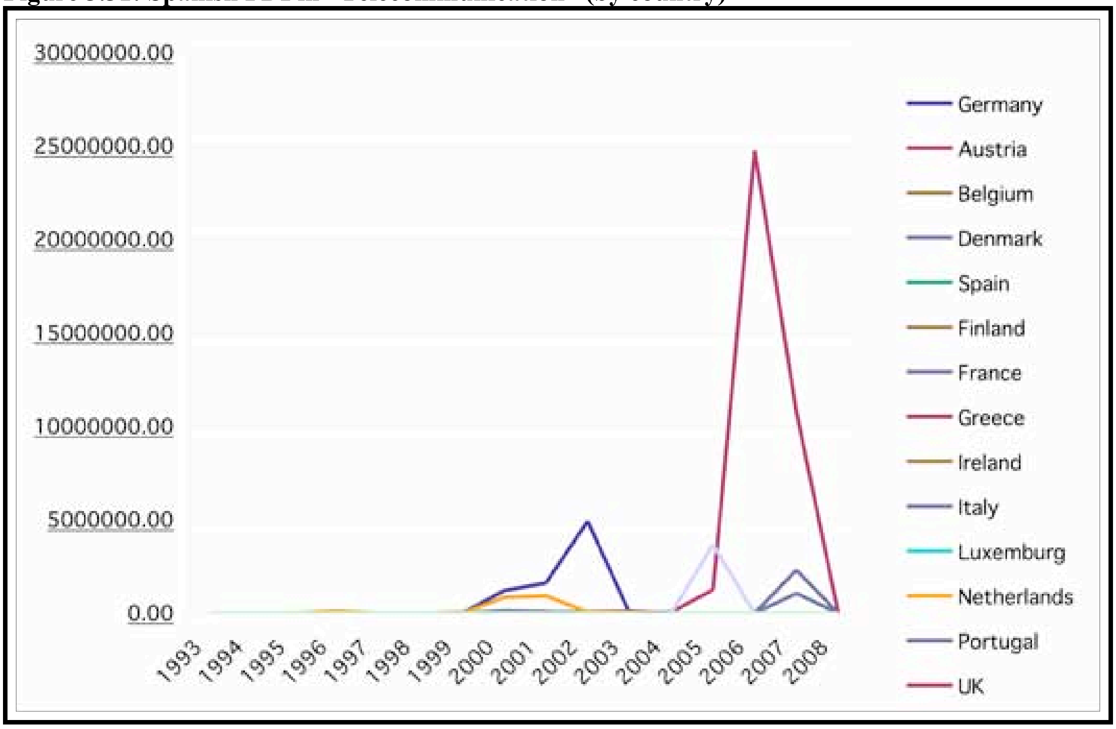
Source: Ministry of Industry, Tourism and Commerce (http://datainvex.comercio.es)

Figure 3.30: Spanish FDI in "Industry" (by country)



Source: Ministry of Industry, Tourism and Commerce (http://datainvex.comercio.es)

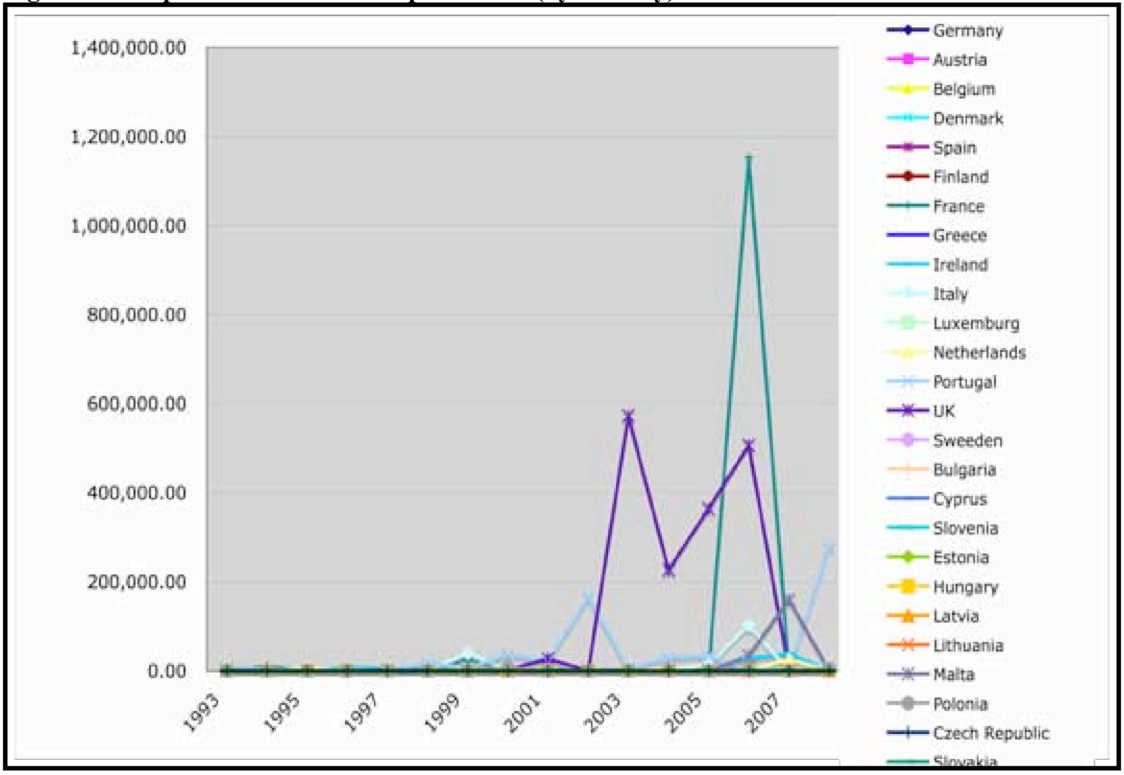
Figure 3.31: Spanish FDI in "Telecommunication" (by country) [39]



Source: Ministry of Industry, Tourism and Commerce (http://datainvex.comercio.es)

[39] The biggest mobile operator in the UK (O_2) is owned by Spanish multinationals.

Figure 3.32: Spanish FDI in "Transportation" (by country)[40]



Source: Ministry of Industry, Tourism and Commerce (http://datainvex.comercio.es)

Especially for the financial elite, maintaining good relations with the EU-15 was obligatory, given the high volume of the investment volume of the financial elite to the EU 15. Considering the fact that the Spanish banking sector has always controlled not only the economic activity within the Spanish territory but also the Spanish economic activity abroad, it is quite comprehendible that the survival of the positive relations between the Franco-German block and the abandonment of the pro-Atlantic foreign policy was essential for the financial elite, and directly for the overall Spanish business circles.

Therefore, it can be seen that, during the Aznar period and the Zapatero period, the formation and execution of the domestic policy and the foreign policy of Spain were in line with the interests of the financial elite. Financial elite backed the foreign policies that were in line with their interests and all the successful foreign policies were strongly supported by the financial elite. However, when

[40] Spanish railway company Renfe invested heavily to the UK and France. Moreover the air-ports in the UK are managed by the Spanish multinationals.

these foreign policy preferences no longer answered the needs of the financial elite, the elite did not keep supporting these policies with the investment power and economic strength that they possessed.

CONCLUSION

From the very beginning of its foundation, the Spanish banking sector was one of the great beneficiaries of the protective policies of the Spanish state. This privileged position was further consolidated in the course of the Franco era, during which the Spanish dictator favoured and rewarded the politically and economically strong financial elite of the country in return for their strong support to his regime. Until about 1970s, the financial regulation mainly reflected the interests of the powerful national banks. The banking oligopoly enjoyed a considerable bargaining power stemming from their central role in economy. Through the regulations limiting foreign competition and thus reducing risk, the government allowed the banking sector to earn supernatural profits and to dominate the industry with the majority shares they owned.

That uncommon relationship between the state, banks and industry led to a conflict of interest among these actors, a conflict which fostered the abandoning of the interventionist policies in 1980s while still protecting the oligopolistic structure of the banking sector that had an unbreakable and persistent bound with the public officers.

In the early 1980s the Spanish financial system was rigid, underdeveloped, closed and heavily intervened. However, following the end of the Franco dictatorship and immediately after the entry to the European Community, this oligopolistic structure was obliged to change into a modern, diversified financial system which is fully integrated with international markets and operating abroad. In the transition period, and particularly in the 1990s, the Spanish financial system underwent an important process of liberalisation followed by concentration, search for new markets and the extension of existing ones; all of which further triggered by the adaptation of Single Market in 1993, the EU Economic and Monetary Union membership[41] and the introduction of the euro single currency. Although the political gains related to the European integration

[41] Spain was included among the first group of countries forming the EMU in 1999.

signalled liberalisation and dismantling of the oligopoly, the historically binding common interests of the financial elite and the state elite kept them together. As not only the political future but also the economic future of the modern Spain was in further European integration, the EC membership was the only way out for the financial elite as well. Therefore, in the wake of this inevitable membership, and thanks to the upcoming financial inflows to the country, a more competitive financial system had to be created.

This need has led to a process of alliances and coalitions among commercial banks and savings banks, as well as a major process of modernization in order to face the challenge of the increased competition. As a result of this concentration process, the seven big banking groups in the country (so called Big Seven) merged into two Spanish banking groups – Banco Santander Central Hispano (BSCH), Banco Bilbao Vizcaya Argentaria- which dominated the banking system in a collaboration with two major savings banks: a Catalan bank -Caixa d´Estalvis i Pensions de Barcelona "la Caixa" and Caja de Madrid.

The ulterior motive behind the governmental support backing and even obliging this concentration process was nothing but protecting the Spanish banking system and their peerlessly high profit margins in the wake of a big liberalising process forced by the European Community. The strong public support but even more importantly the industrial community's strong determination for the European integration challenged the privileged and traditionally protected status of the banking elite. Here, it is noteworthy to mention that all of the succeeding governments, either being conservative or socialist, still intended to come up with formulas which would strengthen the relatively weak competitive position of the banking sector compared to its European counterparts in order to secure their high profit margins and well-established economic dominance. Even though the first impulse for the banking mergers was given under the ruling of the socialist government of Felipe González, conservative government of José María Aznar further motivated, even obliged the mergers and acquisitions among the banking sector, which concentrated the financial oligopoly in the hands of two main actors, as mentioned above.

In line with the country's financial tradition, these banks kept securing their major share in the remarkably developing Spanish industry and the investments, either being national or international, that these firms realised. Therefore, the economic power has been mainly enjoyed by the finance sector and by four other sectors, which are telecommunications (Telefónica), public utilities (Endesa, Iberdrola, Unión Fenosa), oil and natural gas (Repsol – YPF). Not surprisingly the banking cartel has also been a big shareholder in many of these above-mentioned companies. Adding this to the intensive Spanish FDI to Latin America, which was further fostered since the pro-Atlantic foreign policy shift of the Spanish policy-making elite in 1995 and concentrated in these five sectors listed above and realised through the national banking cartels, it would be realistic to suggest that the finance sector has always been the practical hand of the Spanish foreign policy.

To better explain this statement above, it should be emphasised that the Spanish state and the financial elite have traditionally fed each other mutually via various tools either economic or politic, such as the indirect taxation of the customers, *pignoración automática* or the expansionist policies toward new markets where the banking sector as well as the Spanish industry could consolidate. Therefore, thanks to this mutual collaboration, the Spanish state managed to back its financial existence while the Spanish banking oligopoly strengthened to reach to a glob-wide competitive position under protective and privileged market conditions.

Not surprisingly, in return, the banking elite of the country has financially backed and supported the foreign policy transformations of the country, no matter if they were directed toward the continental Europe or toward the Atlantic block, and in return they were rewarded with the protection of their high profit margins and the strong oligopoly. Hence, the financial elite of Spain managed to extend its power to the new territories crucially valuable to both the continental Europe and the Anglo Saxon block, and embraced the role as the representative and spokesperson of the EU regarding the Latin American or Maghribian issues. On the other hand, the banking elite easily dropped their support to these very same foreign policies, if these policies failed to satisfy their interests any longer.

One of the main findings of this study is the banking sector's preservation of its power and influence under many different political idealogies and economic orientations. For example, it is very understandable that the banking elite possessed a very influential power during the times of the interventionist economic policy that lasted until the EC membership given the fact that financial policy is an important tool for entrepreneurial states seeking to develop competitiveness in industrial activities. The restricted economy aims to subsidise the industrial activities that are currently not profitable but promise to become profitable with some government assistance. According to a group of scholars, a strong and influential banking system, which enables to utilise a strict credit control to channel the funds to the preferential sectors, is a must for a restricted economy – like the one in Spain during the Franco ruling. This kind of a banking system can be characterised as model derived from the German Universal Banking System.

However, an important number of scholars argue that the strong bounds and permanent mutual support between the policy-making elite and the financial elite in Spain cannot simply be explained via the restricted economy that the country experienced until the 1970s. A more comprehensive explanation to the Spanish case is needed considering the fact that this reciprocal support has never been hampered and it managed to survive under many different political and economic agendas. According to these scholars[42], policy-makers regulate the financial markets mainly to advance their private goals, especially for their primary goal of political survival. Hence, the politicians implement interest rate and credit controls to direct scarce resources to political supporters or groups. Under this second scenario, the enthusiastic support provided by the banking oligopoly to the Franco regime, and the broad privileges that were extended to them as a reward for this support, or González's seek for banking sector's approval for his economic policy even before his election, or Aznar's fierce support for banking mergers can all be better understood.

This is why Sofia Perez (1997) suggests that the financial liberalisation and the following financial concentration in Spain is not a due product of the international financial market forces or of the pave of democratisation, as many political economists tend to claim. Rather, she explains this untouchable privileged position by the "historical origins of the reform agenda in Spain and in the political dynamic to which this political agenda gave rise in the course of the

[42] See Perez (1997), Lukauskas (1994), Gámir (2008) and Isbell (2004).

reform process" (Perez, 1997:4). That means, according to Perez, considering the consolidated power and oligopoly of the banking sector independent from the political agenda of the successive governments, it can be concluded that the financial liberalisation in Spain reflects a highly complex and long process, which can be tagged back until the early days of Spanish industrialisation at the beginning of the 20th century. This process can be characterised by the reconciliation between "the succeeding groups of state elites with different political and ideological agendas, and the private banking sector" (Perez, 1997:4).

Combining these two above-mentioned tendencies aiming at analysing and explaining the power of financial elite, this study suggests that the importance of the historic process of Spanish industrialisation and banking sector's full involvement in this process stand as two of the most important reasons behind the unbreakable and vital bounds between the policy making elite and the financial elite. Through their economic support to the foreign and domestic policy agendas of the policy-making elite, the financial elite claimed a political power for itself too. In other words, the economic power of the financial elite shaped the decisions of the Spanish policy-making elite. However, the other way around is also true. Late industrialised and long isolated Spanish state needed a motor for being able catch up the rest of Europe. So, for any political group who claimed the government, the support of financial elite was more than necessary.

One of the final remarks of this study is the concrete and solid demonstration of the interchangeable and complex relationship between the market forces and politics. The Spanish case demonstrates that the economic interest groups in a country can easily capture a great control over the functioning of not only the national economy but also domestic and foreign policies. To give a concrete example, the early Europeanization attempts of the González government, realignment with the US and re-conquest of Latin America by the Aznar government can all be summed under this category. Latin America was the compensation price for the Spanish financial elite that had lost their direct monetary gains in their homeland because of the market liberalisation triggered by the European Community membership. The Latin American market was the best possible location for the Spanish entrepreneurs seeking for a new market for expansion due to the reasons explained in the third chapter of this study.

However, the success in the Latin American market had been dependent on the US approval as well. This is how; in return for creating its own sphere of influence in Latin America, Spain backed the US policies even if these policies contradicted with the European ones, which marked the corner stone of Aznar´s pro-Atlantic foreign policy.

On the other hand, the financial transformations were also adopted to or affected by the foreign and domestic policy considerations of the country. For example, the banking elite were rewarded by Franco with a rigid, closed, and profitable market conditions in return for their support to the dictator during the Civil War. Moreover, when the financial liberalisation was inevitable for the country seeking for the European Community membership, it was implemented with side reforms that explained in the third chapter in order to eliminate, or at least to alleviate, its negative effects on the direct momentary interests of the financial elite, and in order to sustain the power and profitability of this elite. Thanks to the government policy to encourage mergers and acquisitions in order to consolidate the financial market and increase its competitiveness, and to expand the reach of the financial elite further to Latin America and Europe, helped the banking sector even further increase their profit margins. In the end, the members of the financial elite lost their extra gains that they achieved via backing the public deficit or via indirect taxation, however, they gained even more from the increased market share, consolidation and the political wind that carried them to the Latin American and European markets, where lays 80% of their portfolio nowadays.

Therefore, the Spanish case proves that the policy-making elite always has to consider the interests of the interest groups holding an economic power in their hand. All the financial reforms taken in Spain have been significantly affected by the policy orientation of the country, while the same financial transformation reforms required policy adaptations as explained in detail through the third chapter of this study. As demonstrated above (third chapter) the financial expectations of a foreign policy could even motivate the society to support a certain foreign policy and / or a political party that advocating this foreign policy orientation. On the other hand, the same lobby groups have never hesitated to work against certain political parties and / or policy agendas if they were against their ulterior motives. The role, power and domination that the Spanish financial elite has traditionally achieved made this statement even more concrete. Therefore, considering the fact that the international political economy is a discipline that deals with “who” gains “what” from “which”, then it can be concluded that both the functioning of the financial market and the foreign policy agendas in Spain have kept changing throughout the history, however, the winners of the system remained the same with their overall control over the system and with their permanent domination of both the total business in Spain and total Spanish investment abroad: the financial elite.

The bottom line of this study is the fact that the mutual and complex relationship between economy and foreign policy as well as policy-making elite and economic elite cannot be ignored while analysing the foreign policy developments in a country, as it can be observed in this study.

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APPENDIX: THE FINANCIAL INSTITUTIONS IN SPAIN:

The operators in the Spanish financial system can classified as follows:

- **The central bank:** The Bank of Spain / Banco de España

- **Traditional credit institutions:**
  - Commercial banks (Spanish and foreign banks)
  - Savings banks
  - Credit cooperatives - Rural savings banks.

- **Other credit institutions:**
  - Official Credit Entities (Credit Financial Establishment- introduced by Law 3/94, implementing the Second EC Directive on Banking Coordination). These are credit institutions specialized in certain asset products —e.g., leasing, financing, mortgage loans, etc., which cannot take public deposits.
  - Electronic Money Entities (introduced by Law 44/2002 on Measures for the Reform of the Financial System or Financial Law). These are credit institutions specialized in issuing electronic money.
  - The Spanish Confederation of Savings Banks (Confederación Española de Cajas de Ahorro - CECA): this association groups together some of the Spanish Savings Banks and is also a credit institution in its own right.
  - Instituto de Crédito Oficial, ICO (acts as the State's finance agency and investment bank).

- **Investment institutions:**
  - Collective investment institutions:
  - Investment companies:
    - Open-end investment companies (SICAV)
    - Real estate investment companies (SII)
  - Mutual funds:

        - Securities mutual funds (FI)
        - Real estate investment trusts (FII)
    - Money market assets:
        - Mortgage securities
        - Pension plans and funds, and others.
    - Venture Capital companies and funds.

- **Investment Services Companies:**
    - Brokers (Agencias de Valores) and Broker-Dealers (Sociedades de Valores).
    - Portfolio Management Companies
    - Other management companies
    - Collective Investment Institution Management Companies
    - Securitization Fund Management Companies
    - Pension Fund Management Companies
    - Venture Capital Entities Management Companies

- **Insurance and reinsurance companies and insurance brokers**

- **Other financial entities**
    - Mutual Guarantee Societies
    - Supporting-Guarantee Companies

The main credit institutions (commercial banks, savings banks and credit cooperatives, play a particularly important role in the financial industry in Spain, because of the volume of their business and because they are active in all segments of the economy. Credit institutions are authorized to engage in what is referred to as "universal banking", i.e. not to confine themselves to traditional banking activities consisting merely of attracting funds and financing by granting loans and credit facilities, but also to provide para-banking, securities market services, private banking and investment banking services.

Commercial banks constitute the dominant group among the credit institutions and they are allowed to enjoy all privileges explained in the above-paragraph without being subject to any kind of limitations and restrictions.

The second major group in the banking system consisted of savings banks, which predominated in rural areas that could not attract branches of the leading private banks. These banks did not come under the control of the Bank of Spain until 1971, having previously had their own official governing body, the Credit Institute for Savings Banks. Therefore, they had generally accounted for about one-quarter of total lending in the private sector. Since the late 1970s, savings banks have raised their share of total national deposits from 34 percent to 45 percent--a feat that was accomplished despite severe restrictions. In the mid-1980s, these restrictions were gradually being relaxed. For example, barriers that limited their operations to specific areas or regions were lifted in June 1988, and by 1992 they were to be free to open up branches anywhere in the country. In terms of deposits, the Barcelona-based Caja de Pensiones para la Vejez y de Ahorros de Cataluna y Baleares, popularly known as La Caixa, was the country's largest savings bank. Another large savings bank was La Caja de Madrid. After the relevant restrictions were lifted, a large-scale merger process commenced among savings banks. Legally, savings banks were nonprofit institutions, but in reality they were quite profitable; in 1987, for example, they were more profitable than rival commercial banks. One reason for this was that savings banks were self-financed foundations without stockholders. The seventy-seven savings banks operating in the late 1980s lent mostly to families and to small and medium-sized businesses.

The third pillar of the Spanish banking industry consisted of official credit institutions, each with a specialized sphere of influence. These credit institutions were under the control of the Directorate General for State Assets (Direccion General del Patrimonio del Estado--DGPE), and they were supervised by the Official Credit Institute (Instituto de Credito Oficial--ICO), which received funds from the state that were then lent to the credit institutions. The largest of these was the Industrial Credit Bank (Banco de Credito Industrial), which specialized in general industrial loans. The Mortgage Bank of Spain (Banco Hipotecario de Espana) provided mortgage loans for urban and rural properties. The Agricultural Credit Bank (Banco de Credito Agricola) provided credit for agriculture and related sectors. Provincial and municipal administrative bodies were served by the Local Credit Bank (Banco de Credito Local). Also under the ICO, but only partially so, was the Overseas Trade Bank (Banco Exterior de Espana), which had been founded in 1923 to promote exports. More than half the bank's capital was in private hands. In addition to its participation in foreign trade, it competed with domestic commercial banks and ranked just below the former Big Seven in terms of its size. Like the official credit institutes, the Overseas Trade Bank was among those bodies belonging to the DGPE.

Of the three main groups of banks in the Spanish banking system (private banks, savings banks, and official credit institutions--private banks were the most important. In 1962 private banks were divided into commercial banks and industrial banks. The latter had the right to invest a higher proportion of their resources in equity holdings than the former, and they specialized in industrial investments. Commercial banks, which were larger and more numerous, served the general public; they were the principal source of short-term credit for the private sector, though they also competed for long-term loans. By the late 1980s, the distinction between the two kinds of banks had lost much of its meaning, for each had gradually been allowed to operate in the other's area of specialization.