Spanish Society of Secondary Railways: the Failure of a Major International Project to Create an Additional Railway Network in Spain

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This paper analyses the origin, financial structure, and development of the company *Sociedad Española de Ferrocarriles Secundarios* (*SEFS*) and of its three subsidiaries: *Ferrocarriles Secundarios de Castilla* (*Castilla*), *Sociedad Civil de Obligacionistas de la Sociedad Española de Ferrocarriles Secundarios* (*SCOSEFS*) y *Compañía de Ferrocarril de Huelva a Ayamonte* (*Ayamonte*)- Spain's most ambitious project of foreign investment in narrow gauge railways. Data has been primarily obtained from company sources, and also from contemporary economic periodical publications. The paper begins with a short description of the legal framework on narrow gauge railways. This is followed by a section on the creation of the firm, where the complex financial framework is described. The paper ends with an analysis of company results, and a conclusion.

1. - The legal framework.

The first legal document to mention secondary railways in Spain dates from 1866. It outlines the main themes to be revisited in later legislation, but the subject was not properly addressed until 1888. The 1877 Railway Act (Ley General de Ferrocarriles) does little more than define the area: "the term secondary railways will be applied to all railway concessions to be made in the future that are aimed at public service, have mechanical traction, and are not included within the general network". In the same year 1877, a committee was charged with the drafting of appropriate legislation. It was to produce the first Project of the 1888 Secondary Railways Act, and the 1893 Plan. This plan envisaged the construction of 4,980 kms of track. Its gauge was to be narrow: 0.75 mts, in order to minimise construction costs. The aim was to provide with a railway network those regions that did not have one, and at the same time to connect them with the main lines. It was thought that this would increase the level of traffic, and that the local economy would benefit. The statement of intentions in the Act already acknowledged that they were not expected to be very profitable: “the country is poor and traffic is limited”. The most controversial aspect of the legislation relates to state subsidies. The state was to guarantee interest payments, a form of subsidy limited to the first years of exploitation. This legislative effort resulted in nothing.

The first Secondary Railways Act saw the light on the 30th June 1904. This Act classified railways on the basis of whether they received or did not receive a direct state subsidy. It fixed the rights and duties of licence holders who, in order to receive direct State contributions, had to be domiciled in Spain. Furthermore, it set up a Technical Committee that was to draft a plan and identify which secondary railways qualified for State interest guarantees. The gauge was now fixed at 1m.

The plan provided for the construction of about 5,000 kms of track, distributed all over the country without taking into account the demographic or economic characteristics of the provinces. The lack of a cost and benefit analysis was due to the need to obtain political support at parliament for the legislation. The subsidy system was modified. The State was to offer now an interest guarantee of 5% on paid off capital; in other words, the company was to receive a subsidy equivalent to 5% of the value of fixed assets, including rolling stock. An individual Act was required for each line that was to receive a subsidy, and this was the source of much political sleaze. There was a new Act on the 30th August 1907 that hardly modified 1904 legislation, except in the sense that it contained new protectionist clauses in order to make it consistent with the 1907 Protection of National Industry Act (Ley de Protección a la Industria Nacional). It required, besides the earlier condition that the firm and its directors should be domiciled in Spain, that all fixed and rolling stock should be manufactured in Spain with the exception of what could not produced in the country.

Despite all the incentives offered to licence holders, and the requests of the majority of provinces, individual entrepreneurs and private enterprise showed little interest in secondary railroads. The preface of the 24th January 1908 Act acknowledged this to be the case. In an attempt to awaken the interest of investors, the so-called Besada Act of 26th March 1908 reaffirmed and extended the State interest guarantee to a maximum of 5% to the end of the licence, but this time companies could include as the basis for the subsidy, besides rolling stock, setting up managerial costs, feasibility studies, land register fees, provisions. But, once again, there was a wide gap between what was built and the official plan. Neither the 1904 Act or the 1907 Act were able to stimulate investment, at least not as far as planned. A further attempt to put things right was made with the 23rd February 1912 Act and the Regulations of the 12th August of that year.

All the plans concerning secondary railways failed as a consequence of the Great War (1914-1918). During that period operating costs underwent substantial increases, while State-regulated maximum fares did not change. At the end of the war, the industry underwent a deep crisis from which it never recovered.

2.- The Spanish Society of Secondary Railways

The Spanish Society of Secondary Railways *Sociedad Española de Ferrocarriles Secundarios* (*SEFS*) was incorporated in Madrid on the 16th July 1909. Its aim was to engage in an ambitious project of railway building. Its capital amounted to 5 million Ptas, in the form of 10,000 shares purchased by French, Spanish, and Belgium investors. Its president was Antonio de Cuadra y Raoul, second marquis of Guadalmina, an experienced entrepreneur in the railway industry. Besides the Board of Directors, the firm counted with the services of a study group whose role was to appraise available projects.

In order to meet the conditions of the 1907 and 1908 Railway Acts, that required companies and administrators to be domiciled in Spain, SEFS created a subsidiary with a capital of 3 Million pesetas: *Ferrocarriles Secundarios de Castilla* (*Castilla*). *Castilla* was to be headed by Mariano de Cuadra, brother of the marquis. *SEFS* was to contribute the projects already undertaken and the licences obtained; was to advance the funds needed for the works; and was to provide technical and administrative staff. In its turn, *Castilla* had to pay for the building of the lines and obtain the state subsidies. The subsidies were to be forwarded, together with the earnings from operations, to SEFS who was to distribute them amongst its shareholders.

Building work on the first of *Castilla*'s railways started in 1910. It originated in Medina de Ríoseco, and bifurcated in Villalón; one branch went towards Villada, and the other branch went towards Palencia. Both stations connected with the general network of the *Compañía de los Caminos de Hierro del Norte de España* (*Norte*). From the point of view of legal licences, it counted as two railway lines, each about 45 kms long: Palencia to Villalón, and Medina de Ríoseco to Villada. Both opened to traffic in 1912. These routes had already been contemplated at the end of the XIXth century by the *Société Anonyme Espagnole d'etudes de Chemins de Fer Secondaires*. That they were the first ones to be built is no surprise, as they crossed the most important cereal producing area of the country.

SEFS issued bonds valued at 14 million Ptas by mortgaging *Castilla*. The interest rate was 4% with a redemption period of 92 years. There was an issuing bonus of 13.25%. The interest was to be guaranteed by state subsidies on invested capital. Given the very favourable conditions, the issue was very well received by Spanish banks: Madrid (*Banco Español de Crédito*), Barcelona (*Banca Arnús-Gari*), and, above all Bilbao (*Banco de Vizcaya*) purchased bonds. *SEFS* went one step further in order to guarantee the regular payment of interest on the bonds by creating the *Sociedad Civil de Obligacionistas de la Sociedad Española de Ferrocarriles Secundarios* (*SCOSEFS*). The chairmanship of *SCOSEFS* fell on the managing director the *Banco Español de Crédito,* León Cocagne. As collateral for the new firm, *SEFS* deposited a sum equal to six quarters capital redemption and dividends. This fund was to be continuously renewed so that shareholders could always be paid. The operation of this system was very simple: *Castilla*, because licensee status, was, at least in theory, to receive state's subsidies, and was to transfer these to *SEFS*. *SEFS* would then further transfer these to *SCOSEFS*. In 1912, *Castilla* obtained a further 93 kms licence from Medina de Ríoseco to the Palanquinos, station of the *Norte*. This new licence forced *Castilla* to increase its shareholders capital from 3 to 6 million Ptas.

In 1913, *SEFS* established a new subsidiary in order to build and to manage yet another of its many licences, this time at the other end of the country: the railway line between Huelva and Ayamonte. Its chairmanship fell, once again, on the Marquis of Guadalmina. Shareholders' capital was to be 3,750,000 Ptas in the form of 7,500 shares. Only one fifth of this capital was fully paid off, holders of remaining shares paid 25% of their value as a purchase option.

In a clear parallel with the *Castilla* case, *SEFS* was to build the line, and was to receive 2500 shares in payment from *Ayamonte*. What was the rational for building this line? Because from the early XXth Century, Portugal had been looking for a link with Spain at the South of the peninsula. In line with this policy, a Portuguese government decree promised generous subsidies to any firm prepared to operate a railway between Huelva and Ayamonte, both in Spain. However, all work on the line stopped when just over 10% of the amount budgeted had been spent because of the Great War. Guadalmina requested an extension until March 1917, and tried at the same time to sell the unfinished works to the company *MZA*, but he was unsuccessful. At the end of the war, and in order to mitigate the deficit on this line, the administrators of *SEFS* asked shareholders to pay off in pesetas 50% of the shares that had not been issued, but this was not well received. International instability, price level changes, interest rates, and foreign exchanges were not favourable.

Guadalmina died in December 1921. The chairmanship of *SEFS* was taken by the Count of Gamazo who was chairman of the board of directors of *Arnús Garí*, member of the *Castilla* board, and majority shareholder in the railway between Valladolid and Medina de Ríoseco (*CFEVR*). Two years later General Primo de Rivera, after a military coup, established a dictatorship that was to last until 1930. The first government of the Dictatorship, also known as the Military Directorate, engaged in an economic policy based on nationalism and intervention. This was a time when railway companies were in deep crisis as a consequence of the Great War. The Dictatorship issued a Railway Statute (Estatuto Ferroviario) in 1924 and supported any company that accepted it.

Castilla agreed to operate by the rules of the Statute in 1925. During this period, the shares of *Castilla* were nationalised, as was the case with all other railway licence holders. The chairmanship of *Castilla* fell on an industrialist specialising in the manufacturing of railway material, the viscount of Escoriaza. In its attempts to control expenditure and optimise resources in the building of a railway network, the State rescued the small railway line of *CFEVR* and rented its exploitation to *Castilla* for a 20-year period. Primo de Rivera also decreed in 1926 that the Huelva-Ayamonte licence had lapsed, and, after taking over the building of the line, compensated the owners; the company was then extinguished.

Confusion between *SEFS* and its subsidiary *Castilla* ended in 1932 when, after an agreement of the special meetings of the board of both societies, they decided to merge under the new name *Compañía de los Ferrocarriles de Castilla y Española de los Ferrocarriles Secundarios*. The new firm was registered in 1934 with a social capital of 6 million Ptas paid by *Castilla*, and the bonds of *SEFS*, by then amounting to 13,569,000 pesetas. Given the State's reluctance to bring up to date the obsolete conditions of the Valladolid-Medina de Ríoseco Railway, results fell even deeper in deficit, and the profitability of the property titles dropped to 3%.

3.- *Castilla*: the results were worse than expected.

All three railway lines built by *Castilla* were to run along the "Tierra de Campos". This is vast plain- 3,000 square kilometres- located at the north of the river Duero, with a large production of wheat. A canal- the Canal de Castilla- had been dug in the XIXth century to reinforce a trade well served by carts and other transport: the exit to the sea via Santander. From the middle XIXth century, the canal and the road had to compete with the railway network of the *Norte*. However, the interior of the Tierra de Campos, despite being the country's granary, did not possess an appropriate road network. *Castilla* tried to provide an appropriate connection with the main railway network. There was no shortage of trade to be done.

CFEVR must have seen a very promising business when it decided to build, without any subsidy, a 44 Kms narrow gauge line between the Castilian capital Valladolid and Medina de Ríoseco. However, the venture was a fiasco. Goods traffic did not stand to expectations, and the number of passengers carried did not reach the minimum needed. Financial costs were very high, and operating costs rocketed because of the Great War.

It is in this context that *Castilla* set up to build its network, but there was an important difference with respect to *CFEVR*: *Castilla* was subsidised. Given that agriculture in Tierra de Campos was extensive and traditional, trains were subject to seasonal variations, and this was depending on the weather conditions. Other goods, such as building materials, fertilisers, and some craftsman production amounted to very little in the operations. People continue to use traditional travelling methods, as the train was too expensive, a luxury that few could afford.

Some errors could have been avoided. *Castilla* connected at the north with the *Norte*, but, except in Palencia, the link was in small localities such as Palanquinos or Villada. Palanquinos is a good example. It is a small town in the vicinity of Leon and not far from La Robla. A railway line transported minerals from this last locality all the way to Bilbao. If the *Castilla* line had been extended to La Robla, it would have gone past León, and the cereal growing area of the Tierra de Campos would have been connected with the coal producing mining area and with the Basque industrial hinterland. The principal city in the south, Valladolid, was also out of reach by the network. It is true that there already was in existence the line between Valladolid and Medina de Ríoseco, administered by *Arnús-Garí*, but there was no link then. It would have been logical for this railway to have provided *Castilla* access to Valladolid, and this would have allowed *Castilla* to breathe, but the tracks on the line from Valladolid to Medina de Ríoseco were fragile, and *Castilla*'s trains could not travel on them.

After the merger, the results of *Castilla* and *CFEVR* worsened. It was in vain that an attempt was made to reduce operating costs; these continued to increase all the way to the end. The main reasons: being salary increases; an increase in the number of employees brought about by the reduction of the working day; and the nationalist economic policy that forced licence holders to consume Spanish coal, more expensive and of worse quality than imported coal. In contrast, income remained stationary. *CFEVR* suspended payments in 1920. *Castilla* managed to survive thanks to the state subsidies on financial charges.

4.- Española de Ferrocarriles Secundarios: a financial business

After the failure of several plans for secondary railways, *SEFS* concluded that it would only be successful if it came to an arrangement with the main railway lines: *Norte*, *MZA*, *MCP* and *Andaluces.* This was an attempt to ensure that its projects were not opposed by the four main line operators. *SEFS* had to prove that its railway lines would not compete with main line lines and that, on the opposite, they would contribute to increase their business. No price war was to be feared.

Furthermore, in order to avoid suspicions, as Guadalmina besides being the chairman of *SEFS* had shares in *MCP* and *Andaluces*, *SEFS* did not request concessions for lines that would be tributary to the ones owned by these two companies. Anyway, it was highly unlikely for the lines operated by *SEFS* to be profitable. *SEFS* directors knew only too well what was going on with *CFEVR*. Clearly, the business was not in the operation of the lines. We will briefly explore what the directors had in mind.

It was only when the Government offered a financial guarantee for setting up the railway lines contemplated in the 1908 plan, that Guadalmina put himself in motion. The board of directors of the bank *Español de Crédito* immediately decided to support the marquises of Guadalmina and Urquijo in the creation of the secondary railway companies. The Spanish State had granted 5% interest support for the building of the railways, even though *SEFS* had serious doubts over the profitability of the railway operation. This support covered, besides rolling stock, other items such as administrative setting up costs, project drafting, valuation, workers' insurance, and provisions, all of which substantially increased the capital that was the object of the subsidy. Thus, remunerations of 5% were guaranteed for management and administration, and for the interest of the capital advanced for building the railway.

Under the circumstances, all that was needed was the necessary capital for the works, and political support for the licences to be granted. In July 1909, Guadalmina managed to convince various financial institutions to advance the money and to form *SEFS*. But some of these financial institutions were linked to engineering firms, building firms, and raw materials providers, so that other benefits would follow from the building of the lines. The banks issued bonds, and they purchased most of them, at a highly discounted rate of 13.25%. They also benefited by intermediating in the financial dealings of other clients. Moreover, as there was a difference between the value of the titles and the costs of the infrastructure plus the purchase of materials, *SEFS* distributed an extra dividend of 20% on the paid off value of shares.

As soon as trains started to move, the Spanish State paid the promised guarantee of 5% for capital employed in the construction and, from that moment on, *SEFS* serviced the bonds at the rate of 4.11% for interest and debt cancellation. After this, managers of the society still had in their hands a considerable surplus whose distribution is unknown to us.

In summary, the partners benefited at every step. It is not surprising that contemporaries described the railways built under the 1908 Act as "financial railways". All risks were covered. First, no money was spared in their building, as the more the builder spent, the higher would be the State subsidy paid to banks that advanced the funds. On the other hand, very few shares were issued, since the state subsidies covered the interest on bonds and it was even possible to transfer profits to entrepreneurs without these appearing in the profit and loss account.

Such a business should have known not end. However, during the Great War, the French Government forbad the export of capital, and the peseta increased in value, with the consequent loss of incentives to investing in Spain. The conflict greatly increased the cost of railway investment. As the Spanish Government guaranteed forecasted setting up expenses and these were not revised, construction stopped.

The rationale behind the aborted line between Huelva and Ayamonte was very similar. Guadalmina, as chairman of *MCP*, a railway with capital French-Portuguese-Spanish, had under his chairmanship five directors of the *Real Portuguesa Company*. Portugal, being interested in joining Sevilla and Lisbon, had promised a very high subsidy to any firm that would build the railway line between Huelva and Ayamonte.

As it has just said, operating costs escalated with the Great War but fares did not increase at the same speed. Many licensees could not manage the situation. Foreseeing the imminent failure of secondary railways, and trying to rescue its capital, the bank *Arnús Garí*, in October 1917, recommended to the other Spanish investors of *SEFS* - *Español de Crédito* y *Banco de Vizcaya*- the setting up of an investment bank guaranteed with state subsidies *Caja de Emisiones con Garantía de Anualidades Debidas por el Estado* (*CEGADE*). This saw the light in 1918. From the start, the state issued Royal Decrees to support it. Its objective was to acquire all the titles issued by secondary railway companies that were showing losses. Its first action was to try to recover the advances made to *SEFS* for the building of the line Ríoseco-Palanquinos. It acquired the documents that guaranteed state subsidies on this railway line and, in order to raise the necessary funds for the purchase, 19,157 bonds valued at 500 pesetas, 5% interest rate, were issued; these enjoyed a 9% bonus and had a 93 year redemption period. This initiative of the Spanish banks was a success. Taken in the context of the important profits brought about by Spanish neutrality in the Great War, it is easy to justify this issue. Small investors found an attractive and well rewarded destination for their savings, and the banks recovered the money they had spent in railways and could invest it in more profitable business.

In the end, the *Castilla* network was completely in the hands of the interventionist policies of the Military Directorate. In 1926, the Public Works Ministry put forward a rescue plan for the Valladolid to Medina de Ríoseco railway line and its transfer to *Castilla*. This line had accumulated a large deficit, and its operations were in a very sorry state. We must remember that, at that particular moment, both societies are headed by the Count of Gamazo. In order to protect the interest of the parties, the State undertook to completely restructure *CFEVR*, because it also was in a sorry state. We know the result.

Conclusions

In attempt to recover lost time, the Spanish state primed railway investment. The 1855 Railway Act foresaw the payment of subsidies, guaranteed investment against risks, and gave fiscal benefits to the importation of rolling stock. The massive influx of foreign capital, technology, and initiative, were crucial. At the end of the XIXth century, and at the beginning of the XXth, the main network was already built but its radial structure left too many gaps. The vacuum was filled by a diversity of lines of smaller gauge, subsidiaries to the main network. The State was forced, once again, in order to achieve its objectives, to create a favourable context that would stimulated private investment, and did so, early in the XXth century, by creating an appropriate legal framework, and by giving very generous subsidies to the companies that offered to build the lines.

SEFS was the most ambitious of all the societies that emerged to take advantage of the situation. Its main entrepreneur was the Marquis of Guadalmina, a manager and banker with plenty of experience in the industry, and with good political contacts, a person who was well placed to unite the captains of industry and foreign finance, particularly French and Spanish. As the regulations forced societies to be domiciled in Spain, *SEFS* created a subsidiary: *Castilla*. The region appeared to be ideal: Medina de Ríoseco, granary of Spain. Work on the first railway line- Medina de Ríoseco to Villada- started in 1910 and work on the last railway line- Medina de Ríoseco to Palanquinos-, in 1913. A year previously, in 1912, *SEFS* had created *SCOSEFS,* whose objective was none other than to ensure that the titles were serviced.

From that moment on, Tierra de Campos, counted with a relatively dense network, but the results of operations were, as it could not be otherwise, disappointing. Tierra de Campos was a region dominated by traditional and extensive agriculture, and with a deprived population. Guadalmina must not have been surprised by the poor results, since even before the start of the works, he asked the government what would happen if the results were negative. The business was, clearly, not in the operation but in the subsidies. And the same story is true of the railway line between Huelva and Ayamonte, although this line was never completed.

We can assert without any doubts what the title of the paper already suggests. The society was created to obtain and income, and not to create wealth through an industrial activity.