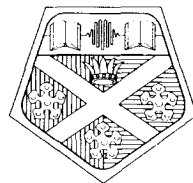


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*SPAIN AND THE
EUROPEAN DIMENSION:*

*The Integrated Market,
Convergence and Beyond*

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**SPAIN AND THE EUROPEAN DIMENSION: THE
INTEGRATED MARKET, CONVERGENCE AND BEYOND**

By

Paul Heywood

**Department of Politics
University of Glasgow**

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**Department of Government
University of Strathclyde
GLASGOW G1 1XQ
Scotland U.K.**

Abstract

Membership of the European Community since 1986 has not only been immensely popular in Spain, but also of major benefit to the Spanish economy. However, the introduction of the integrated market on 1 January 1993, and the convergence terms outlined in the Maastricht Treaty of February 1992, have posed significant economic and political problems. The determination of the Socialist government, first elected to power in 1982, to see that Spain continues to converge with the leading European economies in order to take part in the projected moves towards economic and monetary union (EMU) has led it to take a series of highly unpopular economic policy decisions. As Spain's leaders struggle to demonstrate the seriousness of their economic intentions in the midst of a European-wide recession, the political cost has been high: conflict with the unions has escalated and support for the government has fallen sharply, culminating in the loss of Socialist party's absolute majority at the June 1993 general elections. This study outlines the initial benefits of EC membership for Spain, before going on to highlight the challenges posed by the Single Market. It then analyses the government's central conundrum: the desire to demonstrate its *communitaire* commitment through rigid austerity measures whilst trying to persuade the electorate that the price is worth paying. By effectively surrendering autonomy over economic policy-making to the wider interests of European integration, the PSOE may find itself courting growing unpopularity as it strives to achieve goals which ultimately may prove impossible to realise.

Introduction: the positive impact of EC membership

Since entering the EC on 1 January 1986, Spain has become one of the most committed proponents of European integration and is a strong supporter of political as well as economic and monetary union. Long before the creation of any formal economic or political union, membership of Europe in the most abstract sense was seen by certain sectors of Spanish society as the best route towards modernisation: in the famous words of the philosopher, José Ortega y Gasset, 'If Spain is the problem, then Europe is the solution'. The old division between those who looked north towards Europe and those who saw Spain's natural position as being linked to Latin America and north Africa, has long been superseded. Indeed, well before the successful conclusion of Spain's post-Franco transition to democracy, membership of the European Community had been identified as central to the prospects of modernisation and democratic consolidation. Entry to the EC — applied for in the late 1970s by the government of Adolfo Suárez, but negotiated by the Partido Socialista Obrero Español (PSOE) of Felipe González — was immensely popular in Spain, a move which was seen as situating the country firmly and irrevocably within the First World. In the words of Alfonso Guerra, deputy premier between 1982 and 1991, 'Total insertion into Europe ... has been a central point of reference for the Socialist government' (*'La inserción total en Europa ... ha sido punto central de referencia del Gobierno socialista'* — Guerra, 1989). The PSOE administration has, however, also been anxious to stress that Spain's historic links with the Latin and the Arab world — particularly, the Maghreb countries — give it a special role within Europe, allowing it to act as a bridge between different political cultures and traditions.

Enthusiasm for Europe has been further enhanced by the undoubted economic benefits consequent upon membership. By joining the EC, Spain gained virtually unrestricted access to a market fifteen times larger than its own in terms of purchasing power. From the point of view of other EC members, the clearest advantage of Spain's accession derived from its obligation to remove high import barriers. Spain was an attractive prospect for potential investors: with traditional trade links to Latin America and a significant part of its labour force well-trained yet relatively cheap, the country offered the promise of high rates of return on newly-installed capital and technically-advanced equipment.

In spite of fears in some quarters that EC membership would have a devastating impact on Spain's economy (Preston and Smyth, 1985), economic development has been better than predicted by even the most zealous supporters of EC membership. From 1986 to 1991, Spain enjoyed the highest, investment-led, output growth in the OECD area. In this period, GDP per capita rose from 72.8 per cent of the EC average to 79.2 per cent. This dramatic advance followed a decade of poor economic performance during which GDP per capita had fallen from its historic high of 81.1 per cent of the Community average in 1975 to 71.8 per cent in 1985 (Alonso Zaldívar and

Castells, 1992). The unemployment rate, meanwhile, rose during the same period from 3.5 per cent to its highest ever level of 22 per cent (OECD, 1991).

Although membership of the EC was largely responsible for the extraordinary upturn in Spain's economic fortunes, the foundations for the upturn were laid in the restructuring policies initiated in the early 1980s. At the end of the 1970s, the Spanish economy was in deep structural crisis: activity was severely depressed and employment levels were falling rapidly. Rigid hiring and firing regulations inherited from the Franco regime meant that any adjustments in employment were becoming increasingly costly as workers' influence of wage determination was properly strengthened with the coming of democracy and the re-emergence of a powerful union movement. Rapidly rising labour costs were exacerbated by the impact of the two OPEC oil-price shocks, leading to a profit squeeze and the collapse of many firms. In turn, this led to a fall in investment which hampered Spain's ability to adapt to higher energy costs and new patterns of world demand.

Before joining the EC, the Spanish economy was one of the most protected in OECD Europe. Since EC entry, there has been rapid progress in liberalising foreign trade flows, harmonising the regulatory framework within which the economy operates and directing external transactions towards the EC (Salmon, 1992). It was not until the advent of the PSOE government in 1982 that major measures were instituted to tackle structural problems in the Spanish economy, following what Alonso Zaldívar and Castells (1992) have termed the 'missed adjustment' of 1979-82, when the political demands of the transition to democracy precluded effective economic reforms. The industrial reconversion programme, implemented in 1983, and the introduction in 1984 of fixed-term employment contracts, were instrumental in promoting employment flexibility, investment recovery and productivity growth. In the ten years to 1984, the volume of investment fell by a fifth; since then, it has nearly doubled in all sectors and types of investment.

In particular, foreign direct investments, especially from EC countries, have increased dramatically. In 1986, inflows exceeded those for the whole period 1970 to 1979, and were 50 per cent higher than for the period 1980 to 1985. Since 1986, foreign investment in Spain has grown substantially year on year reaching 3.7 per cent of GDP in 1990 (Anuario El País, 1991). The investment boom, efficiency gains and a stronger labour supply boosted output growth from the mid-1980s. Foreign investment also played an important role in the rationalisation and efficiency gains which derived from modernisation of the capital stock.

Overall, it is clear that Spain's accession to the EC has led to a number of major qualitative benefits (OECD, 1991). EC membership has provided a significant stimulus to aggregate demand, as well as to both actual and potential real GDP (mainly through greater investment activity and technical progress). The opening of domestic markets to foreign competition, together with supply-side improvements, helped reduce Spain's tendency to high inflation. Moreover, the opening of domestic markets to foreign investors and

improved rates of return on capital have made Spain an attractive country for capital inflows. Integration into the EC has also favoured specialisation and economies of scale. In short, there has been a profound structural transformation of the Spanish economy since entry to the EC.

Spain has also benefitted enormously from EC membership through direct financial transfers via the Community's Structural Funds — the European Regional Development Fund (ERDF), the European Agricultural Guidance and Guarantee Fund (EAGGF) and the European Social Fund (ESF). The EC's Structural Funds — reformed with an increased budget in 1989 — are distributed according to five priority objectives, of which Spain qualifies for three: Objective 1 (regions where per capita GDP is less than 75 per cent of the EC average), Objective 2 (regions which are undergoing industrial decline, whose percentage share of industrial employment and average rate of unemployment both exceed the EC average), and Objective 5b (rural areas in need of economic diversification, which are dependent on vulnerable agricultural activities). In addition, Spain will be the main beneficiary of the Cohesion Fund which was established in 1993 under the terms of the Maastricht Treaty.

Structural funds are allocated according to a Community Support Framework (CSF), drawn up for each priority objective by the central government in negotiation with the regions in question and the European Commission. It has been calculated that the 1989-93 CSFs, which were co-financed by the European Commission and the central government, contributed an extra 1.5 per cent to GDP in 1993 and helped create between 80,000 and 105,000 jobs (European Commission DG XVI, 1992). In the 1989-93 period, Spain received some 12 billion ecus in structural funds, about 23 per cent of the EC's total structural aid expenditure.

One of the regions which benefitted most was Andalucía, which received almost a third of ERDF assistance under the Objective 1 CSF, and 3 billion ecus from the Structural Funds as a whole. In 1987, the Instituto de Fomento de Andalucía (IFA) was set up, with EC financial assistance, to promote the region's productive resources, industrial competitiveness, technological progress and access to financial markets. Amongst its major initiatives have been the Cartuja 93 project for the partial re-use of the hugely successful Expo92 site, and the completion of the AVE high-speed rail network linking Sevilla to Madrid.

Given these undoubted achievements, it is unsurprising that the Socialist government should have remained deeply committed to ever closer European integration. EC membership has been a key element in the government's much-vaunted goal of modernisation, a process which, in the wake of the Maastricht Treaty, has remained firmly at the top of the economic agenda. However, after dominating Spanish politics since 1982, the PSOE has hit serious difficulties. A combination of policy exhaustion after more than ten years in power and the corrosive impact of a series of corruption scandals has steadily eroded support for the Socialist party. Even more important has been the divisions which have developed within the Socialist movement itself over

economic policy: market-oriented liberal technocrats in the government, committed to European integration whatever the short-term costs, have been pitted against leftist populists in the party, calling for a reflationary and redistributive policy mix. Felipe González — the staunchest supporter of the European option — was forced to call elections for June 1993 shortly after it had been confirmed that the Spanish economy had entered recession. Although the PSOE remained the largest party, it lost its overall majority and González faces the prospect of significantly more powerful parliamentary opposition to his plans in the coming years.

The costs of EC membership

In spite of its unquestionable benefits, membership of the EC has also entailed significant economic and political costs. Vertiginous growth in the period 1986 to 1989, during which GDP increased by an average 5 per cent a year, unleashed the economy's major disequilibria: high inflationary pressures, aggravated by excess domestic demand, and — more recently — a growing current account deficit. Of particular significance has been a sharp increase in import penetration ratios, reflecting the reduction of tariff barriers, real exchange rate appreciation of the peseta and a change in the composition of trade. Spain's pattern of trade has been marked by a dramatic shift towards the EC as a result of liberalisation measures. In 1980 trade with the EC accounted for 31 per cent of imports and 52 per cent of exports; by 1991, these figures had increased to 60 and 71 per cent respectively (Salmon, 1992).

Such a shift in trade patterns is a natural consequence of EC membership. However, the performance of imports and exports since EC entry has diverged sharply: the former expanded by 40 per cent in real peseta terms between 1986 and 1990, compared to a rise in the latter of 20 per cent during the same period. Spain's current account went from a surplus of 1.6 per cent of GDP in 1986 to a deficit of 3.4 per cent of GDP in 1990. The worsening trade deficit reflected an overheating domestic market, sucking in imports made more competitive by the removal of tariff barriers and the strength of the peseta. So severe were the disequilibria that the government was obliged to take a series of measures in 1989 and 1990 to cool the economy and try to engineer a 'soft landing' in preparation for the 1993 single market. These included bringing the peseta into the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS) in June 1989, a restrictive monetary policy combined with a tightening of fiscal policy, which up to 1990 had been moderately expansive, and a proposed 'competitiveness pact' later renamed a Progress Pact) which was ultimately rejected by the labour unions. The measures were blown off course, however, as a result of two factors: the short-term impact of the Gulf crisis and the longer term impact of a marked slowdown in world trade. Thereafter, the government found itself further constrained by the need to meet the convergence terms for economic and monetary union set out in the Maastricht Treaty (see below).

Developments in the Spanish economy since accession to the EC highlight the extent to which it has been integrated into the global economy and is ever more shaped by evolving international factors (Velarde et al., 1991). In the words of Wallace, '[t]he profound internationalisation of activity represented by the growth of capital markets and corporate production systems severely limits the degree to which national governments can shelter their domestic economies and citizens from the impact of external developments' (quoted in Salmon, 1992). Loukas Tsoukalis (1991) has referred recently to the emergence of the 'European economy', describing prevailing and future links between EC countries and their European neighbours. These links are seen as being halfway between the full integration of territorial units in a national economy and the interdependence of the world's leading domestic economies. Thus, EC countries are less closely linked in economic terms than are, for instance, Spain's autonomous regions or the German *Länder*, but their economies are more integrated than the German economy is with that of Japan, or Japan's with that of the USA.

The PSOE government has consistently defended its economic policies on the grounds that they have been ineluctably driven by the twin imperatives of modernisation and full integration into the EC. Indeed, the decision to use integration into the EC as a strategic option for modernising the country, broadly backed by all the democratic forces, has been the key policy of Socialist governments since 1982. Such an option entails economic and foreign policy implications which inevitably clash with some of the traditional principles defended by the political left, a fact which has contributed significantly to divisions between what might be termed technocrats and ideologues within the PSOE.

Although there is no realistic alternative to seeking full integration in the EC, there are two senses in which it could be argued that the government (intentionally or not) has surrendered economic - and therefore to some extent political - initiative to wider forces. First, foreign penetration of the Spanish economy since the mid-1980s is deemed by some to have entailed a significant transfer of control to multinational companies, with a concomitant reorganisation of trade (Salmon, 1992). According to a 1991 World Bank survey (based on 1988 figures), foreign companies generate half of Spanish production and employ 43 per cent of the occupied population. Critics of multinational penetration point to the risk of Spain becoming a 'branch plant economy', dedicated to assembling imported goods, and to the fact that in many cases foreign investors are more concerned with expanding market share than improving productive profitability. Equally, the lack of major multinational companies with headquarters in Spain is seen as working against the country's long-term interests, 'since it is at headquarters that a complex of high value added activities develop, including marketing, finance, legal, research and engineering' (Salmon, 1992).

Second, and of considerably greater significance, the logic of EC integration ties Spain into a macroeconomic process over which it inevitably has limited control. Economic and monetary union (EMU), the central pillar

of the Maastricht Treaty, has major implications for Spanish — and, of course, European — economic policy-making. There will be a single currency and one monetary policy set by the European Central Bank. Interest rates on similar assets will be the same in all member states, and short-term rates will be under the control of the central bank. There will be a Europe-wide definition of the money supply for which the central bank will set a target (Britton and Mayes, 1992).

The creation of an integrated Community necessarily involves increasing 'convergence' of economic behaviour in a number of respects, including policy, structure and behaviour (Britton and Mayes, 1992). Economic integration has already involved reducing the regulation and intervention capacity of individual states in various ways. Decision-making over certain activities — such as commercial, agricultural and fishing policies — has been transferred to Community institutions (a process which under the terms of the Maastricht accords will be expanded to encompass industrial, environmental, consumer protection, R&D, public health, education and cultural policies). The introduction of common regulations through Community directives adopted by majority vote will necessarily lead to uniform provisions and standards being adopted through the principle of reciprocal recognition. The power of domestic governments to provide grants and financial assistance to companies is being reduced in order to eliminate unfair competition. Finally, EC members have for several years been engaged in coordinating their macroeconomic policies, most notably in the field of monetary policy through the European Monetary System (EMS) (Alonso Zaldívar and Castells, 1992).

European economic integration is viewed positively in Spain: a Times Mirror Center survey on attitudes throughout Europe, conducted by Gallup in September 1991, found that 53 per cent of Spanish respondents thought that the overall community would be strengthened by economic integration, compared to equivalent figures of 45 per cent in Germany, 44 per cent in the UK, 43 per cent in Italy and just 31 per cent in France. Equally, 70 per cent of Spanish respondents viewed the post-1992 single market as a good idea, second only to Italy (77 per cent) and well ahead of France (66 per cent), Germany (64 per cent) and the UK (58 per cent). Spanish respondents were also reasonably optimistic about the prospects for agriculture, manufacturing, high technology industry and tourism under the conditions of the single market, a majority believing that each sector would do 'very well' or 'fairly well' (Times Mirror Center, 1991).

Support for Europe derives in large measure from the belief that it is only through membership of the EC that Spain can escape the traditional isolationism which has left it lagging behind its competitors and marginal to international developments. However, if Spain is to realise its ambition of being one of the core economies at the forefront of an integrated Europe, it has no option but to seek convergence with its major EC competitors. Hence, the macroeconomic priorities identified by the PSOE government in the run-up to the 1993 single market were to control inflationary pressures, reduce the budget deficit and improve the competitiveness of Spanish industry, all seen as

vital in preparing the economy for full integration into European EMU. If Spain's economy is not brought into line with others in Europe, the country could not only suffer damaging consequences, but would also be consigned to long-term second division status within the EC. It is for this reason that convergence is seen as being so vital.

Convergence, however, necessarily entails the adoption of a macroeconomic policy stance which will increasingly be determined by the wider needs of the EC, rather than the specific needs of Spain, and which therefore may entail significant political costs. For instance, the need to defend the Peseta within the ERM against currency speculators meant that the Bank of Spain was forced to resist demands to reduce interest rates in the spring of 1993, even after the Bundesbank had finally brought its own rates down. Concerted defence of the Spanish currency by its European partners was of little consolation to the domestic victims of crippling interest rates, and ultimately failed in any case as the Peseta was devalued by 8 per cent within the ERM on 13 May, just over three weeks before the general elections. Ironically, pressure on the currency derived in large measure from the political uncertainty generated by fears that the Socialists losing power to the right-wing opposition, the Partido Popular, which was far less committed to meeting the Maastricht convergence terms.

The Single Market, Maastricht and EMU

Supporters of full European integration may argue that there is no contradiction between Spain's needs and those of the EC: as a fully-fledged member of the Community, Spain will automatically benefit from the anticipated greater coherence of EC economic policy formation under the terms of EMU. However, the approach to economic policy which is expressed in the Maastricht Treaty has been adopted gradually by policy makers over the last two decades. As such, it is very different from the philosophy which guided economic policy in the late 1950s when the EEC was founded; different, too, from the views of policy makers in most industrialised countries during the 1960s and 1970s. The theory is ultimately based on classical economics and the liberal tradition of political thought, but also owes much to the re-assertion (and re-interpretation) of that tradition in the USA and Europe during the 1970s and 1980s (Britton and Mayes, 1992). Of central importance to the entire conception is the role of free markets and open competition, the very antithesis of state intervention or central planning (Elliott, 1992).

Traditional Keynesian policies depended, amongst other things, upon the capacity of a national government to establish its own fiscal and monetary policy, to decide upon the main parameters of its own economic development, and to negotiate about these with social partners at a national level. Economic planning required that a national economy could be sufficiently insulated from the surrounding world economy to allow governmental controls to have some

effect. However, the ever greater globalisation of world markets has undermined the independence of national economies. The Maastricht model recognises and reinforces this reality. In some senses, Maastricht mirrors the neo-liberal conception of placing economic limits on democracy: the economic sphere will increasingly be protected from immediate control by the *demos* (Pierson, 1992). It is thus no small irony that the staunchest defenders of EMU within an integrated Europe should be socialists like Jacques Delors, or the governing PSOE, whilst the greatest reservations have been expressed by right-wing neo-liberals throughout Europe, such as Margaret Thatcher and Charles Pasqua, concerned primarily about perceived threats to national sovereignty.

The first phase of EMU required Spain to liberalise capital movements by 31 December 1992, a step which was in fact taken nearly a year ahead of schedule. However, with exchange controls lifted, it has become impossible for Spain to maintain an independent monetary policy, which means that fiscal policy tools have become indispensable for achieving stable, balanced growth. The Spanish government has been forced to use fiscal policy to play the stabilising role that had been assigned to monetary policy in recent years — hence a series of major fiscal revisions in July 1992 aimed at reducing the public sector deficit.

One of the principal repercussions of free capital movement will be on the EMS, which from its inception was designed to allow for a certain flexibility. However, unrestricted capital movement will inevitably impose greater tensions on the EMS and greater limits on the independent design of national monetary policy. Capital will move rapidly from countries with weaker currencies to those with stronger currencies, as was prefigured in September 1992. If, in addition, there is no fiscal harmony, money will move to those countries with the most favourable fiscal conditions and the strictest control of bank secrecy. To maintain the parity of weaker currencies in the EMS without frequent adjustments, there are only two realistic short-term options: massive intervention to support the currency in question (which in turn would require considerable foreign exchange reserves or virtually unlimited borrowing facilities), or an increase in short-term interest rates to compensate for the effects of depreciation and avoid capital flight. The third option — exit from the EMS — would entail enormous costs in terms of credibility, thus spelling the end of any hopes for a country like Spain to remain at the forefront of moves towards EMU.

When we examine the implications of EMU for the Spanish economy, the reservations of many labour leaders are immediately understandable. Already there are major concerns over the impact of the introduction of the single market on 1 January, 1993 (Allard and Bolorinos, 1992). Although there is still enthusiasm for the EC in Spain, the internal market is presenting the Spanish economy with serious challenges. In spite of the central imbalances of high inflationary pressures and growing current account and budget deficits, the underlying problem concerns a worrying lack of competitiveness in much of industry, services and agriculture (Velarde Fuertes, 1992). Government

anxieties on this score underlie the insistence that more needs to be done to bridge economic differences between member states (see below).

• *Industry*

The long-term prospects for Spanish industry will depend in large measure on how it comes to terms with the EC's internal market. According to some studies, based on optimistic business expectations, Spanish production can be expected to grow much faster than the average for the Community, with significant increases in productivity and employment (González and Carrasco, 1990). Other studies, based on projecting forward from past performance, are rather less optimistic: they stress the risk that Spanish industry might derive little benefit from the internal market (de la Oliva and Orgaz, 1989). The terms of entry to the EC already entail the loss of all tariff and quota protection as from 1 January 1993, while the internal market will simultaneously remove all (or most) technical barriers to trade. One study of the impact of the internal market, completed in 1988, suggested that up to 40 per cent of European industrial firms could either disappear or be absorbed by others (Smith and Venables, 1988).

A number of factors suggest that Spanish industry could be vulnerable once the single market has been established. Spain's industry has enjoyed a greater degree of protection than that of the other major countries within the EC. Spanish industrial structure is also overly specialised in those sectors where demand is low, or where it will become so as markets contract (for instance, low technology production such as food products, shipbuilding, steel, clothing, non-metallic mineral processing, petroleum refining, cork and leather goods), while it is underdeveloped in high demand sectors (such as high technology production of office machinery, sophisticated electronic appliances and machinery, telecommunications equipment, precision instruments, pharmaceuticals and aerospace equipment). In comparison with EC average figures, Spain's value added share of GDP in high demand sectors of industry is 18.3 per cent against 22.6 per cent for the EC generally, in moderate demand sectors it stands at 40.6 per cent against an EC figure of 46.5 per cent, and in weak demand areas it is 41 per cent as against 30 per cent in the EC (Dehesa, 1990).

The size of Spanish industrial firms is smaller than that of the EC average: 80.1 per cent of Spanish industrial firms employ fewer than 10 workers and just 0.2 per cent employ more than 500. Moreover, the size of firms is smaller in the higher demand sectors, with a considerable number of Spanish plants below the size of technical efficiency. The small size of industrial firms has, though, been seen by some as offering the potential for Spain to benefit from the single market, since it will allow for improved competitiveness by exploiting enormous underlying economies of scale and increasing the size of firms, whereas this has already occurred in other EC countries.

From a technological point of view, Spain stands below the EC average level. Investment in research and development represents just 1.1 per cent of

industrial value added, as against 4 per cent in the EC, and the difference is more pronounced in high demand sectors. Overall Spanish expenditure on R&D as a percentage of GDP (0.82 per cent in 1990) is among the lowest in the EC. Whereas countries like Germany and the United Kingdom (and also the USA) allocate more than 2 per cent of their GDP to R&D activities, expenditure in Spain remains below 1 per cent of annual GDP (see Table 1). Spain's balance of payments coverage rate on technological goods stands at 24.5 per cent, against an EC average of 72.3 per cent.

Table 1: Evolution of gross expenditure on R&D in Spain and major EC countries, 1983-1990 (percentage of GDP at constant prices)

| | Germany | Britain | Italy | France | USA | Spain |
|------|---------|---------|-------|--------|------|-------|
| 1983 | 2.51 | 2.25 | 0.95 | 2.11 | 2.71 | 0.45 |
| 1984 | — | — | 1.01 | 2.21 | 2.77 | 0.47 |
| 1985 | 2.71 | 2.38 | 1.12 | 2.25 | 2.92 | 0.53 |
| 1986 | — | 2.34 | 1.14 | 2.23 | 2.92 | 0.59 |
| 1987 | 2.85 | 2.26 | 1.19 | 2.28 | 2.90 | 0.61 |
| 1988 | 2.83 | 2.20 | 1.23 | 2.29 | 2.86 | 0.72 |
| 1989 | 2.88 | — | 1.29 | 2.32 | 2.80 | 0.75 |
| 1990 | 2.84 | — | 1.29 | 2.38 | 2.78 | 0.82 |

Source: OECD and Comisión Interministerial de Ciencia y Tecnología, *Memoria de Desarrollo de Plan Nacional de I+D en el periodo 1988-1990 y revisión para 1992-1995* (Madrid, 1992)

Spanish industry does still enjoy the advantage of lower labour costs than in the leading EC economies, but the gap is narrowing. In 1985, unit labour costs in Spain were 43 per cent lower than the OECD average, but by 1988 were only 25 per cent lower. In 1990 they were estimated by the US Bureau of Labour Statistics to be 23 per cent lower than in France, 20 per cent lower than in the USA and just 2 per cent lower than in the UK. Thus, according to some analysts, for Spain to exploit this advantage, industrial activity must concentrate on sectors which are relatively labour intensive, whilst maintaining the differential in unit labour costs through a policy of wage moderation, labour flexibility and increased productivity. Such an increase in productivity will be possible only through improved technology and the achievement of more efficient firm size — which is, in effect, what multinationals which have invested in Spain have been doing.

Spain's pattern of trade with other EC countries is divided equally between inter-industrial commerce (that is, trade between different industrial sectors derived from Spain's specialisation in sectors where it enjoys comparative advantages, such as textiles, footwear and leather, non-metallic minerals, and paper products), and intra-industrial commerce (that is, trade between products in the same industrial sector based on segmentation of

production and economies of scale, such as the automobile industry). Concentration on labour-intensive sectors of industrial production would allow Spain to specialise in those products which best allow the exploitation of its relative advantages, especially through economies of scale, in terms of both inter and intra-industrial commerce (Dehesa, 1990). EC intra-industrial commerce is growing rapidly, allowing for specialisation in specific products within the same sector. Whether or not this occurs will depend in large measure on the strategies adopted by major European firms, which, since Spain's entry to the EC, have shown a willingness to invest in diverse industrial sectors, seeking to take advantage of economies of scale and increasing intra-industrial commerce.

• *Services*

The importance of Spain's service sector is set to continue growing. It currently accounts for over 57 per cent of GDP — a figure which is likely to rise to 65 per cent by the end of the century — and employs 60 per cent of the active population. Tourism, which accounts for between 9 and 10 per cent of total GDP, is of central significance to the Spanish economy, but those advantages which it possesses must continue to be exploited if the sector is to avoid the crisis which threatened between 1989 and 1991. In that period the number of tourists visiting Spain remained stagnant and receipts fell to the detriment of the current account (the boost provided by the events of 1992, when Spain hosted the Olympic Games in Barcelona and Expo92 in Seville, while Madrid was European cultural capital, was necessarily a one-off). More optimistic projections point to the fact that Spain enjoys the advantage of reliable climatic conditions, a relatively cheap labour supply, and a highly developed tourist infrastructure. Against this view, others have argued that after twenty years of heady growth the Spanish tourism industry is reaching capacity limits, competition from other destinations is far more severe, Spanish labour costs have been rising rapidly, the tourist infrastructure is beginning to look run down as a result of cheap and rapid construction — especially in coastal resorts — dating from the early days of the tourism boom, and global warming has been exercising an unpredictable impact on the weather (Spain has been subject to unusual storm activity and flooding in recent years, while northern European countries have enjoyed better summers). Furthermore, unchecked development of the Spanish coastline has given rise to chaotic and unsightly conditions in many resorts.

It is widely recognised that Spain must concentrate on building up tourism at the 'high quality' end of the market, which has been growing in recent years, as the economy's cost of living is rising towards other EC levels and as competition for the budget holiday in the sun intensifies, with Greece, North Africa and Turkey being more competitive on a price basis. Inland resorts in Spain offer considerable scope for expansion, while the growing number of northern European retirees and pensioners seeking homes in the sun, whether for all or part of the year, offers a further market to be exploited. In order to attract such a market, Spain will have to invest heavily

in basic infrastructure provision as well as in environmental protection. Tourist-based commercial stores, particularly the numerous small tourist shops, will face sharply increased competition under the conditions of the single market (Velarde Fuertes, 1992).

The Plan Marco de Competitividad del Turismo Español, announced in June 1991 by the Minister of Industry, Commerce and Tourism, Claudio Aranzadi, recognised many of these challenges. The plan, which anticipates spending Pta48.2 bn over the years 1992- 95, seeks to boost the tourist sector's competitiveness by improving product quality and diversifying its range. Divided into five 'Planes Operativos', the Plan Marco highlights the need to ensure greater cooperation between different administrative levels (central, local and autonomous) as well as between managers and unions, to modernise and innovate (especially as regards tourist infrastructure), to improve the basic 'sol-playa' product at the same time as offering new products, to enhance product marketing, and to sponsor excellence through environmental awareness. The Plan Marco, developed on the basis of a serious analysis of the main problems facing the sector, represented an ambitious attempt to relaunch Spain's tourist industry (Málaga Tello, 1992).

The sector with perhaps the greatest potential for expansion in coming years is professional and financial services. Professional services within the business world are already proliferating rapidly, in line with trends in other European countries. Spain has adopted a series of far-reaching measures to liberalise the financial system in preparation for the single market. However, Spanish banks are still faced with the need to reduce costs, improve their productive efficiency, and broaden the range of services they offer in order to raise income from commissions. One of the central problems for Spanish banks is high personnel costs, which in turn is linked to the excessive number of bank branches. There are 35,915 branches in Spain (including savings banks, with 14,407), three times the number in Germany and twice as many as in France, both of which have far larger populations. Within the EC, Spain has the lowest ratio of employees per branch (9.4 compared with 29.1 in Germany, 22.6 in France, 30.4 in the UK and 24.3 in Italy) and the second lowest ratio of inhabitants served per branch (2,339 against 9,382 in Germany, 5,680 in France, 3,920 in the UK, and 5,832 in Italy). Operating costs and the ratio of personnel costs to total assets are both higher in Spain than in these other countries.

It has been argued by some that this fact could give Spain an advantage when the single market arrives, since the high presence of Spanish branches will serve to crowd out overseas competitors. José Luis Leal, president of the Spanish bankers' association (AEB), has argued that physical proximity is the leading factor in a customer's choice of bank and that opening new branches is a legitimate way of seeking to increase market share. Moreover, efficiency relates to the ratio of employees to population served and here Spain does not compare badly with its EC partners. None the less, the need for even greater efficiency suggests that it is likely that Spanish banks will have to rationalise and reduce the number of branches, a route which has already been taken by

Spain's second largest banking institution, Banco Bilbao Vizcaya, which plans to close 25 per cent of its branches during 1993.

It is probable that overseas banking presence, which currently has 11 per cent market penetration, will grow sharply in Spain once all barriers to entry are removed in 1993 (between 1990 and 1993, the number of branches per European bank allowed in Spain rose from three to eight). Equally, however, the single market will provide opportunities for Spanish banks to expand their own overseas activities, and to this end several deals linking Spanish and European banks have been announced in recent years — notably between Banco de Santander and the Royal Bank of Scotland.

• *Agriculture*

Spain's membership of the EC has had one of its most notable impacts on agriculture, which has suffered under the highly controversial and bitterly disputed terms of the Common Agricultural Policy (CAP). Generally, Spanish domestic prices are higher than those prevailing in the CAP (except in fruit, vegetable and wine), while Spanish agriculture is far less efficient. Cereals and meat farming, in particular, have been adversely affected and are sure to be severely dented in the future. Spanish agriculture would appear to have some clear advantages compared with that in other EC member states, including relatively low labour costs, a climate which allows early production of certain goods, a large cultivable surface area, and considerable potential to increase productivity (Spanish productivity per agricultural worker is estimated to be about half the EC average).

However, the CAP is structured towards the explicit strategic goal of self-sufficiency in basic food supplies, and also seeks to harmonise agrarian income throughout the EC. This has made it difficult for Spain to exploit its competitive advantages to the full. For example, export restrictions have been placed on Spanish fruit, vegetables, wine and olive oil until 1996 — unless Spanish prices rise to the EC average level in the interim. This has been the source of considerable and understandable grievance in Spain, where it is argued that North African agricultural produce enjoys more favourable treatment within the EC. Equally, Spain receives low levels of subsidy through the CAP, with the major share of the EAGGF (European Agricultural Guidance and Guarantee Fund) funds in 1987 divided between France (25 per cent), Italy and Germany (17 per cent each), and Britain (11 per cent), while Spain received just 3.4 per cent — less than The Netherlands, Denmark, Belgium and the Republic of Ireland. Spain must therefore develop its potential in the area of agro-industry. That this has been identified as a key area is indicated by the steady rise in overseas investment in recent years.

• *The impact of overseas investment*

The biggest changes in Spain since entry into the EC have been occasioned directly and indirectly by foreign investment. Directly, the productive base and efficiency of service sectors have been massively improved by foreign investment. Indirectly, the increase in standards and modernisation of

attitudes caused by EC entry and foreign competition have profoundly affected attitudes and future prospects and the influence has been mostly positive. Overseas investment in the Spanish economy, both direct and portfolio, has grown rapidly since the mid-1980s. According to the Bank of Spain, in 1989, 6.4 per cent of all share portfolios issued by Spanish firms were bought by foreign investors, the biggest proportion since records were started. By the end of the year, a total of 29.2 per cent of firms were in foreign hands (as against 19.2 per cent in 1980), one of the highest levels of overseas penetration of any developed economy.

The economist José Manuel Naredo has estimated that foreign ownership of firms stands at 5.5 per cent in the USA, 15.8 per cent in Germany (referring to West Germany, prior to unification), 4.5 per cent in Britain, and still less in Japan. The central bank's report shows that the strong penetration by overseas capital in 1989 has been at the cost of a similar reduction in the power of Spanish families and firms, rather than banks or public entities. For the first time in 1989, Spanish firms and families lost not only in relative terms, but also in terms of absolute pesetas. However, over the decade of the 1980s, the presence of banks has fallen from 23.7 per cent of total share ownership to 14.7 per cent, reflecting the process of disinvestment which began during the years of industrial crisis.

Foreign firms have invested heavily in the Spanish economy in expectation of further expansion of the domestic market and the liberalisation of capital markets, as well as in response to Spain's relatively low (albeit rising) labour costs. Crucially, entry to the EC and political stability under the PSOE government of Felipe González — at least until early 1993 — have also promoted confidence. Foreign direct investment has spread across an array of different sectors, but particularly those which benefit from low labour costs. Subsidiaries of foreign multinationals dominate Spain's vehicle industry, electronics, tyres, pharmaceuticals, informatics and office machinery, detergents and perfume, chemicals and plastics, paint, car rentals and advertising. There is also a significant foreign presence in food and drink, glass, home appliances, metallic mineral mining, investment banking and tourism (Hudson and Rudcenko, 1988).

Perhaps surprisingly, there has been a marked lack of concern expressed in Spanish government circles at the scale of overseas investment. In contrast to the anxieties of some, particularly in the union movement, that Spain is being 'put up for sale', the Socialist administration has been anxious to welcome foreign investment, which has been seen both as vital to the modernisation of the Spanish economy and as giving a positive signal over perceived future trends. Felipe González is reported to have commented while on a visit to China in 1990, 'It makes no odds if the cats are black or white, so long as they catch mice' (*'Da igual que los gatos sean blancos o negros con tal de que cacen ratones'* — quoted in Gómez, 1991). Moreover, direct foreign investment makes an important contribution to balancing Spain's overseas account. In late 1990, however, the Ministry of the Economy announced new measures to control overseas portfolio investment.

Overseas direct investment has tended to be concentrated in extending and restructuring the activities of foreign investors, rather than creating new firms. For this reason, fears have been expressed that direct investment in Spain will start to ease off because of the uncertainties over future internal and external demand trends as well as higher labour costs. In the first six months of 1992, net overseas investment fell by 11.5 per cent compared to the same period a year earlier. Moreover, there has been considerable concern expressed in Spain that international investors will look increasingly towards the development potential in Eastern Europe. Whilst this will be true to an extent for Germany, two factors suggest there is little reason to suppose that projected investment in Spain will be redirected in the short term: in the case of investors from outside the EC, Spain's membership of the Community has the added attraction of providing an access route to the west European market, especially since the Eastern European economies will have considerable short-term difficulties in financing trade with the west; in the case of EC investors, which form the vast majority of foreign investors in Spain, the relative advantages of a cheap labour force in Eastern Europe will be offset by Spain's more fully developed infrastructure and more liberal legislation on the transfer of profits back to the investing countries.

Table 2: Net foreign investment in Spain, 1984-1990 (Pta bn.)

| Year | Direct | | Portfolio | | Real Estate | | Total |
|------|---------|------|-----------|------|-------------|------|---------|
| | Value | % | Value | % | Value | % | |
| 1984 | 156.1 | 47.1 | 37 | 11.2 | 138 | 41.7 | 331.1 |
| 1985 | 164.2 | 40.4 | 82.7 | 20.4 | 159.3 | 39.2 | 406.2 |
| 1986 | 284.2 | 39.9 | 238.4 | 33.4 | 140.5 | 26.7 | 713.0 |
| 1987 | 321.5 | 29.8 | 545.9 | 50.1 | 221.4 | 20.3 | 1,088.8 |
| 1988 | 514.2 | 44.3 | 380.4 | 32.7 | 267.5 | 23.0 | 1,162.1 |
| 1989 | 672.1 | 33.7 | 1,014.8 | 50.9 | 304.7 | 15.3 | 1,991.7 |
| 1990 | 1,080.2 | 54.1 | 669.9 | 33.6 | 245.6 | 12.3 | 1,995.9 |

Source: *Registro de Caja del Banco de España*

Unions and the '*giro social*'

The ability of the Spanish economy to cope with the demands of the European single market will depend in large measure on how the debate is resolved between competitiveness and efficiency, a principal aim of the government, and the '*giro social*' ('social shift') demanded by the unions. Although membership of Spanish trade unions, estimated at around 13 per cent of the active labour force, is among the lowest in Europe, the unions are able none the less to exert considerable influence on political life — as demonstrated by the success of the general strike of December 1988, and subsequent disputes in

various regions (most notably, Asturias and Cantabria).

Union activities are governed by the 1978 Constitution, the 1980 Workers' Statute, and the 1984 Organic Law of Trade Union Freedom. A series of reform measures proposed by the Socialist government in early 1993 and relating mainly to strike laws and short-term labour contracts, was put on ice pending the results of the June general elections. The Workers' Statute provides for an annual minimum wage to be fixed by the government and outlines both worker representation and collective bargaining procedures. In firms with between ten and 50 employees, workers are represented by up to three *delegados de personal*. In firms with more than 50 employees, there are *comités de empresa*, the size of which is governed by the number of workers. Elections to the committees take place by secret ballot every four years, the most recent of which were held between October and December 1990.

Table 3: Representation on works' councils

| No. of employees in company | No. of members on works' council |
|-----------------------------|--|
| 50-100 | 5 |
| 101-250 | 9 |
| 251-500 | 13 |
| 501-750 | 17 |
| 751-1,000 | 21 |
| 1,000+ | 21 |
| | (+ 2 per 1,000 employees up to a maximum of 75 members) |

Source: P Donaghy and M Newton, *Spain. A Guide to Political and Economic Institutions* (Cambridge: Cambridge University Press, 1987)

Unions which obtain 10 per cent or more of members of the *comités de empresa* are granted the status of 'most representative union', regardless of formal membership levels. Currently the General Workers' Union (UGT, historically affiliated to the PSOE but distanced from it since the late 1980s) and the Workers' Commissions (CCOO, closely linked to the Communist Party), as well as all their affiliated federations, enjoy this status. This automatically entitles them to form part of a negotiating committee for collective agreements and to nominate representatives to the boards of public bodies. Collective bargaining regulations allow for agreements to be negotiated at a variety of levels depending on the consent of the parties involved. At company level, workers are represented by the *comité de empresa*, with a maximum of 12 representatives per side. If agreements are negotiated at local, provincial or national level, a negotiating committee has to be formed, comprising up to a maximum of 15 representatives from those unions with the status of 'most representative union'. Agreement must be

reached by 60 per cent of each party to the negotiation before it can be finalised.

Thus, although Spanish trade unions have low membership, they retain very considerable importance in the area of wage negotiation (Allard and Bolorinos, 1992). The call for a *giro social*, as expressed in the unions' Priority Platform (1990) and Initiative for Progress (1991), goes beyond increased government spending on social welfare items such as health care and pensions (which are in any case likely to grow faster in Spain than in the rest of the EC as part of the wider move towards parity of provisions, since Spain still has some way to go to catch up with its Community partners). The demand for a *giro social* calls for, in addition to these measures, a faster increase in real wages within a framework of redistributive measures, a reduction in the number of temporary contracts (in June 1991, over 32 per cent of the wage earning population were on fixed-term contracts), and improved provisions for social protection in areas such as health care and safety at work.

Such a perspective is based upon the belief that new job opportunities can be created through public expenditure and investment, even at the cost of a slight increase in inflation. Naturally, if Spain's unions manage to force the government in such a direction without corresponding productivity gains, it would imply a greater public deficit and higher inflation as the result of more expansive internal demand policies in order to reduce unemployment, an increase in real wages to redistribute income, and the imposition of high social expenditure and increased labour rigidity. This, in turn, would almost certainly ensure that Spain fails to comply with the convergence criteria for economic and monetary union as set out in the Maastricht Treaty.

The solution to these competing demands, however, is likely to result less from the will of government or its opponents than from the external restrictions imposed by the need to harmonise macroeconomic policy in general terms within the EC once the single market is fully established. This fact has inevitably led to severe tension between the government and the union movement, especially as the slowdown in the economy since 1990 has led to an increase in already high rates of unemployment, which reached 3mn in early 1993. The government has made clear its belief that the union movement must adapt to the disciplines of international developments in the late twentieth century, or else see the Spanish economy suffer from lower growth rates and reduced possibilities for redistributive policies. However, it is equally arguable that the government and employers must make greater efforts to engage in a constructive dialogue to achieve a social partnership on the German model and, crucially, wage moderation.

Convergence and cohesion

Three main characteristics clearly differentiate the Spanish economy from those of its major EC partners: a high rate of unemployment, a deficient development of some basic infrastructural and social service provisions, and a

low level of productivity per person employed. Spain's welfare level is below the EC average level, the country employs proportionately fewer people than the leading EC nations, and they produce less (see Table 4). Spain's GDP per capita is 65 per cent of the UK and Italian level, and 49 per cent of the German level, while productivity per person employed stands at 70 per cent of the German level and 85 per cent of the UK and Italian levels.

According to Carlos Solchaga, minister of the economy, Spain could close the 'welfare/prosperity gap' with Britain if the employment level rose from 31 to 40 per cent of the active population and if productivity per person increased by 1 per cent. In order to achieve such a significant increase in productivity, the government would need to develop policies of demand control which stimulate investment in infrastructures, promote technological development and increase the level of education and training. An increase in long-term investment would also have to be linked to an increase in public and private saving. While it is widely argued that the latter goal should be achieved by transferring taxation to indirect areas and making capital markets still more flexible, evidence suggests that — as elsewhere in Europe — Spanish consumers during the second half of the 1980s proved resistant to demand control efforts, and the marginal propensity to save has fallen. Public saving will be possible only by reducing the public deficit, which has spiralled out of control in recent years. However, Spain's demand policy will have to be co-ordinated with that of the EC in general.

Spain's deficit in terms of infrastructural provision is still considered serious: despite massive investment throughout the 1980s, it remains 37 per cent below the EC average in terms of roads, 43 per cent in railways and 26 per cent in telecommunications. In particular, Spain's existing transport infrastructure is poor. Out of a total of 90,000kms of national roads, only 7,000kms will be motorway by 1999 (the same level as France and Italy had in 1990). In 1989, the projected cost of this road-building plan was Pta3 trillion. Plans announced in 1989 for investment in railways were Pta2 trillion up to the year 2000, mainly directed towards the development of a high speed network linking the major cities. In addition, a further Pta1 trillion was projected in order to adjust the Spanish track gauge to match the European norm. Including expenditure on ports, coasts and hydraulics, the total expenditure necessary at 1989 prices to bring Spain's infrastructure up to the level of the major EC economies is Pta15 trillion, with perhaps half as much again to be spent on energy and telecommunications.

These indicators highlight the scale of the challenge faced by the Spanish economy if it is to converge with its leading EC partners. The Maastricht Treaty, of course, set out specific convergence criteria for the implementation of EMU. At the time of writing (early 1993), it appears unlikely that the terms agreed at Maastricht will be implemented in unamended form: reservations on the part of various EC members, as well as legal challenges to the Treaty's ratification in Germany, presage some reconsideration of its key features as convergence deadlines approach. However, even if the Maastricht Treaty were to collapse, the likelihood is that some form of EMU — possibly

Table 4: Efficiency and equity in Europe, 1988

| | Spain | Germany | France | Britain | Italy |
|---|-------|---------|--------|---------|--------|
| GDP per capita (\$) | 9,600 | 19,600 | 17,000 | 14,950 | 15,000 |
| Relative GDP compared to EC average | 75.6% | 113.5% | 108.4% | 102.6% | 102.7% |
| Rate of activity or occupation of pop'n | 31.0% | 43.3% | 39.3% | 47.0% | 40.7% |
| GDP per employed person (Pta mn) | 3.65 | 5.3 | 5.1 | 3.7 | 4.3 |
| Share of wages and other income in GDP | 63.2% | 66.1% | 70.5% | 73.6% | 72.8% |
| Share of profits in GDP | 36.8% | 33.9% | 29.5% | 26.4% | 27.2% |

Source: Guillermo de la Dehesa, '¿Cómo será la economía española en 1999?', in Antonio Alférez (ed.), *España 1999* (Madrid: Temas de Hoy, 1990), p.360

involving just the core European economies — will take place by the end of the century. Moreover, the Spanish government has insisted that it draws a distinction between 'nominal' convergence, which relates specifically to the Maastricht criteria, and 'real' convergence, which refers to Spain's ability to compete on even terms with the leading EC economies. Achieving nominal convergence would imply that the economy was well run, but would not mean necessarily that Spain had achieved real convergence in regard to living standards, productivity, the quality of goods and services, the strength of Spanish companies or competitiveness. Real convergence with EC partners has thus been identified as a central priority of the current Socialist administration, even if the Maastricht Treaty does collapse.

The convergence criteria for participation in EMU, as set out in the Maastricht Treaty, are as follows:

- Inflation over 12 months prior to EMU must not exceed the average rate of the three lowest inflation EC countries by more than 1.5 percentage points.
- Long-term nominal interest rates over 12 months must not exceed by more than two percentage points the average for the same three lowest inflation countries.
- The currency must remain in the narrow band of the Exchange Rate Mechanism (ERM) for at least two years without a devaluation.
- The budget deficit should not exceed 3 per cent of GDP.
- Total public debt should not exceed 60 per cent of GDP.

The latter two criteria in fact allow some room for flexibility if progress is deemed to be being made.

All EC governments were required to indicate what measures they proposed to take in order to meet the Maastricht terms. In April 1992, the government set out the framework for Spanish economic policy to 1996 in its controversial *Programa de Convergencia, 1992-96*. The plans established in the document were intended both to dictate and to justify economic policy over the following years, and represented an impressive commitment to ensuring that Spain takes its place in any initial establishment of EMU. One of the principal assumptions upon which the plan rested was that the Spanish economy would maintain an annual rate of growth of around 1 per cent above that of the EC average up to the end of 1996, a feat which it had achieved comfortably over the five years up to 1991. However, this latter period was exceptional, reflecting the investment and consumer boom that resulted from Spain's entry into the EC. Significantly, it was also a period of strong public expenditure growth. The particular problem facing the government in the run-up to EMU is the need to maintain above average economic growth in the context of a deflationary policy. In practice, compared to the plan's projections of 3 per cent GDP growth in 1992, the actual figure turned out to be 1.2 per cent. In March 1993, negative growth figures confirmed that the economy was in recession.

Table 5: Maastricht indicators (as at signing of Treaty, February 1992)

| | Convergence indicators | | | | Criteria satisfied? | | | | | Score |
|--------------|------------------------|-----------------------------|-------------------|------------------------------|---------------------|-----------------------------|-------------------|----------------|-----------|----------|
| | Inflation rate | Long-term govt. bonds | Budget deficit | Public debt (% of GDP) | Inflation rate | Long-term govt. bonds | Budget deficit | Public debt | Currency | |
| France | 3.0 | 8.5 | -1.5 | 47 | yes | yes | yes | yes | yes | 5 |
| Luxembourg | 2.9 | 8.1 | +2.0 | 7 | yes | yes | yes | yes | yes | 5 |
| Denmark | 2.1 | 8.5 | -1.7 | 67 | yes | yes | yes | no | yes | 4 |
| Britain | 4.1 | 9.9 | -1.9 | 44 | no | yes | yes | yes | no | 3 |
| Germany | 4.7 | 7.8 | -3.6 | 46 | no | yes | no | yes | yes | 3 |
| Belgium | 2.7 | 8.6 | -6.4 | 129 | yes | yes | no | no | yes | 3 |
| Ireland | 3.6 | 9.0 | -4.1 | 103 | yes | yes | no | no | yes | 3 |
| Holland | 4.4 | 8.1 | -4.4 | 78 | no | yes | no | no | yes | 2 |
| Spain | 6.8 | 10.9 | -4.4 | 46 | no | no | no | yes | no | 1 |
| Italy | 5.5 | 12.4 | -9.9 | 101 | no | no | no | no | yes | 1 |
| Greece | 17.8 | 20.8 | -17.9 | 96 | no | no | no | no | no | 0 |
| Portugal | 9.6 | 13.6 | -5.4 | 65 | no | no | no | no | no | 0 |

Source: The Economist, *After the Fiesta (A survey of Spain)* (25 April, 1992)

Spain and the European Dimension

Table 6: The Convergence Plan

Government's macroeconomic projections, 1991-96

| | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|--------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| GDP & components | | | | | | |
| (% real change) | | | | | | |
| Private consumption | 3.0 | 3.2 | 3.0 | 3.0 | 3.0 | 2.9 |
| Public consumption | 4.4 | 3.5 | 2.0 | 2.0 | 2.0 | 2.0 |
| Fixed investment | 1.6 | 3.2 | 5.1 | 6.2 | 5.8 | 5.4 |
| construction | 4.3 | 2.7 | 4.0 | 5.0 | 5.0 | 4.5 |
| equipment | -2.5 | 4.0 | 7.0 | 8.0 | 7.0 | 6.7 |
| Domestic demand | 2.9 | 3.3 | 3.4 | 3.6 | 3.6 | 3.4 |
| Exports of goods & services | 8.4 | 7.9 | 7.9 | 8.0 | 8.1 | 8.1 |
| Imports of goods & services | 9.4 | 8.0 | 7.1 | 7.0 | 6.8 | 6.6 |
| GDP | 2.4 | 3.0 | 3.3 | 3.6 | 3.6 | 3.5 |
| Prices & labour costs | | | | | | |
| (% change) | | | | | | |
| GDP deflator | 6.9 | 6.0 | 4.7 | 3.8 | 3.3 | 3.1 |
| Wages | 8.5 | 6.5 | 5.3 | 4.5 | 4.0 | 4.0 |
| Productivity per worker | 2.1 | 2.3 | 1.7 | 1.7 | 1.7 | 1.7 |
| Unit labour costs | 6.3 | 4.1 | 3.6 | 2.7 | 2.3 | 2.3 |
| Labour market | | | | | | |
| Population: % change | 0.4 | 0.6 | 1.0 | 1.0 | 0.9 | 0.9 |
| Employment: % change | 0.2 | 0.6 | 1.6 | 1.9 | 1.9 | 1.8 |
| actual change ('000) | 30 | 76 | 203 | 245 | 250 | 241 |
| Unemployment: % of active population | 16.3 | 16.3 | 15.8 | 15.1 | 14.3 | 13.5 |
| actual ('000) | 2,464 | 2,478 | 2,427 | 2,335 | 2,225 | 2,125 |
| Current payments account | | | | | | |
| Balance (Pta bn) | -1.59 | -1.71 | -1.83 | -1.75 | -1.78 | -1.81 |
| % of GDP | -2.9 | -2.9 | -2.8 | -2.5 | -2.4 | -2.3 |
| Public administration | | | | | | |
| Revenue: % change | 10.4 | 11.4 | 8.8 | 9.6 | 8.1 | 7.8 |
| Expenditure: % change | 11.5 | 10.0 | 7.6 | 7.4 | 5.9 | 5.9 |
| Deficit (Pta bn) | -2.43 | -2.37 | -2.25 | -1.84 | -1.32 | -0.79 |
| % of GDP | -4.4 | -4.0 | -3.5 | -2.7 | -1.8 | -1.0 |
| Total public debt: % of GDP | 45.6 | 45.8 | 45.8 | 45.3 | 44.1 | 42.3 |

Source: Ministerio de Economía y Hacienda, *Programa de Convergencia* (Madrid, 1992)

The convergence plan, to which the government has remained strongly committed, states that the only sustainable way for the economy to achieve the required above- average growth is by developing and implementing a series of structural reforms. These structural reforms involve labour market changes (including the elimination of the corporatist *ordenanzas laborales* established under the Franco regime to provide job protection, and enhanced geographical mobility), economic deregulation (aimed primarily at the service sector and, in particular, restrictive practices in the professions), liberalisation (implementing EC competition policy in areas such as telecommunications and transport), a reduction in the number of public agencies, a freeze on subsidies to the public sector (together with management reforms), defence of consumer rights in the financial sector, and extensive reforms of the health service, including devolved management of budgets to hospitals and increased cooperation between central, regional and local administrations.

The reforms represent a coherent policy framework. However, for all their wide- ranging scope, they were widely criticised for their lack of specific detail and for the scale of their ambition. Economic projections are, of course, notoriously fickle. Indeed, within months the government had been forced to announce further adjustment measures as a result of developments beyond its immediate control. The failure of the US economy to emerge from recession as anticipated, combined with the continued impact of the Bundesbank's policy on interest rates, undermined hopes of an early recovery of economic activity in Spain. The government was then dealt a further severe blow by the impact of the ERM crisis of September 1992 on its economic projections: the need to devalue the peseta by 5 per cent, followed by the temporary reimposition of exchange rate controls, dented confidence in the health of the Spanish economy. By the time the 1993 state budget proposals were approved by Parliament, the details originally outlined in the *Programa de Convergencia* just six months earlier looked decidedly unrealistic (and appeared even more so following a further 5 per cent devaluation later in November 1992). In fact, the feasibility of the plans is of rather less significance than what they mean for Spain's commitment to real convergence with the EC.

The success of the government's convergence plans is likely to depend in large measure on its ability to hold its EC partners to the promise made at Maastricht on implementing a cohesion fund. According to the policy on cohesion, it was agreed that a fund should be established to help create an infrastructure in both physical and human capital which would give the less advantaged regions an equal opportunity to compete with the rest of the Community in the single market. The new fund is for 'projects in the fields of environment and trans-European networks', and applies to less favoured regions in member states whose average GDP per head is below 90 per cent of the EC average figure. None the less, considerable controversy has emerged both as to the size of such cohesion funds, and also their efficacy. In the view of some, income transfers to disadvantaged regions achieve relatively little and may actually reinforce the causes of disparity by creating a culture of

dependence in the receiving regions; equally, the need for such transfers can create resentment in the providing regions (Britton and Mayes, 1992). It is for this reason that the focus of the cohesion policy is on fostering sources of indigenous growth by providing necessary resources to develop them through investment in infrastructure, communications, training and so forth.

The initial sum proposed for the cohesion fund was relatively small (a total of Pta1.3 bn over the period 1993-97), but the Maastricht protocol recognised that it would be revised during the negotiations over the Community budget for 1993-98. In practice, negotiations on cohesion soon stalled. The Germans, stung by the costs of unification with the GDR, were reluctant even to discuss implementing the Maastricht protocol on cohesion. Moreover, the Portuguese presidency of the Community during the first half of 1992 refused to call a special meeting of EC leaders to discuss the issue: since direct flows of EC funds account for about 5 per cent of Portugal's GDP (compared to less than 1 per cent of Spain's), Lisbon was not anxious to open a discussion which could alter that balance. The British presidency also refused to push cohesion to the top of the agenda during the latter half of 1992.

Although Felipe González managed to resist German and British attempts at the June 1992 Lisbon summit to postpone the implementation of the cohesion fund, the first reading of the so-called Delors II Package, which set out the EC budget proposals for the next five years, was approved at the end of the following month with no reference to the Maastricht protocol on creating a cohesion fund. Spain had not only sought to see such a fund formally established, but also hoped to see its budget doubled, of which it intends to claim at least 60 per cent over five years. This stood in sharp contrast to the European Commission's initial proposal which called for the funds to be divided more favourably towards Ireland, Portugal and Greece. The issue of a cohesion fund was of sufficient importance for Spain to have threatened that it would oppose the Delors II Package unless its demands were met, and González adopted Thatcher-like negotiating tactics at the Edinburgh summit of December 1992 to ensure that his EC partners agreed to its establishment in 1993. However, even with a cohesion fund (which, at 15bn ecus over seven years, was lower than the government had hoped even though Spain will receive the lion's share), the convergence plans remain immensely ambitious.

Conclusion

The Spanish government has found itself caught in a classic Catch-22. An unquestioned commitment to Europe means that it must continue on a journey to a destination which is liable to change the closer it approaches. At present, the destination is EMU by the end of the century. The Spanish government has gambled on a bid to ensure that Spain joins the European elite in time to pass the economic fitness test agreed upon at Maastricht, but success will

require a herculean effort. The government's convergence plan looks draconian, and will undoubtedly lead to social clashes as public spending is reduced, and interest rates remain high in an attempt to squeeze out inflation. Spain is already strike-prone (see Table 7), and relations between the government and unions had plumbed new depths even before the convergence plan was announced. The gamble appears all the greater in the light of the results of the general elections of 6 June 1993, which took place in the midst of economic recession. The government's attempt to protect the Peseta against speculators during the pre-election period of political uncertainty by maintaining a policy of high interest rates — in spite of reductions elsewhere in Europe — failed in spectacular fashion as the currency was devalued by 8 per cent in mid-May. In the event, the Socialist party managed none the less to hang on to power, but fell short by 17 seats of winning an overall majority.

However, in regard to convergence the government remains damned if it does and damned if it does not. The attempt to achieve convergence ('real' or 'nominal') will probably provoke some degree of social unrest and therefore carry significant political costs as the government lays itself open to the charge of making workers bear the brunt of the effort. Abandoning the attempt would condemn Spain to second division status within the EC and would also carry significant political costs, leaving the government open to the charge of having 'failed' Spain. Meanwhile success — should it come — would leave the government open to the charge that it had abandoned any vestige of social democratic principles and would once again carry significant political costs as it wrestled to square the circle of moving towards socialism within the context of a free market Europe.

Table 7: Working days lost through strikes, per 1,000 employees, annual average (1986-1990)

| | | | |
|----------|-----|------------|----|
| Greece | 887 | France | 75 |
| Spain | 647 | Denmark | 40 |
| Italy | 271 | Holland | 8 |
| Ireland | 244 | Luxembourg | 7 |
| Britain | 136 | Germany | 5 |
| Portugal | 84 | | |

Source: European Commission

By committing itself wholeheartedly to Europe, the PSOE government has surrendered a substantial degree of autonomy over the elaboration of economic policy. Antoni Zabalza, secretary of state at the Treasury, recognised as much when he commented in Brussels in late July 1992 that 'we are at a stage in which there are fewer economic policy instruments to which we can turn, and more obligations which are not easy to comply with' (*'estamos en una etapa en la que hay menos instrumentos de política económica*

a los que echar mano y más obligaciones que no son fáciles de cumplir.' — El País internacional, 27 July 1992) This is a process which will intensify in years to come. Under the Maastricht terms, once EMU has taken place the European System of Central Banks (ESCB) — composed of the national central banks and the European Central Bank (ECB) — will be charged with maintaining price stability within a clear framework of free market principles. In order to do so, it will be responsible for defining and implementing monetary policy, conducting foreign exchange policy, and managing foreign exchange reserves. The ECB will act as an executive organ within the ESCB, and both bodies will operate independently from national governments and other Community institutions (Britton and Mayes, 1992). The fact that the ECB will be run by a six member executive board appointed for a non-renewable term of eight years, and that its voting structure will be based on member states' population and GDP, inevitably highlights the thorny issue of both equity and political accountability.

EMU is, of course, just a stage in the process towards 'ever closer union' among the peoples of Europe. As such, it may be seen as a necessary price to pay for the greater goal of achieving the political proposals enshrined in the preamble to the Maastricht Treaty, such as a common foreign and security policy, common citizenship and free movement. It is clearly the belief of the PSOE government that Spain must be at the heart of the process if it is to help shape its future course (González, 1991). The dangers inherent in such a strategy are twofold: on the one hand, the proposals on monetary union are more highly developed than those on political union and there exists a risk that progress towards the greater goal will remain stalled once EMU has taken place; on the other, Europe is changing fast and there is no guarantee that the rules and targets set at the end of 1991 will remain valid five years later. Already, major reservations have surfaced in Germany and Britain, while the French and Danish electorates have demonstrated considerable doubts. Even if the Maastricht rules remain unmodified, which must be considered highly unlikely, the opening of Eastern Europe will inevitably have an impact on the future shape of the EC.

The PSOE government's dominance of the Spanish political scene was severely dented by the results of the June 1993 general elections. A large part of the reason for its sharp decline in popularity during the early 1990s can be attributed to the economic difficulties consequent upon its commitment to convergence with Spain's major EC competitors. After the heady years of economic growth in the latter part of the 1980s, austerity measures and recession — exacerbated in Europe by the Bundesbank's responses to the costs of German unification — have hit hard. Ironically, even though the PSOE remains in power and will continue to work towards achieving real convergence, Spain may find itself making a major, albeit unavoidable, effort to meet the terms of EMU only to find that the heart of Europe has shifted eastwards.

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