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SM/84/172

Correction 1

CONTAINS CONFIDENTIAL
INFORMATION

August 21, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Spain - Staff Report for the 1984 Article IV Consultation

The following corrections have been made in SM/84/172 (7/17/84):

Page 2, Table 1, column 6, line 1: for "22.1" read "23.7"
line 2: for "25.8" read "25.6"
line 3: for "32.1" read "32.0"
line 4: for "33.8" read "33.6"
line 6: for "38.4" read "38.5"
line 7: for "37.6" read "36.5"
last line, column 2: for "2.8" read "2.7"
column 3: for "16.5" read "16.1"
column 4: for "4.8" read "4.7"

Page 28, Table 7, second subheading: for "(In billions of U.S. dollars)"
read "(In millions of U.S. dollars)"

third line from bottom, column 1: for "-6.4" read "-5.9"
column 2: for "-6.5" read "-6.9"
column 3: for "-4.2" read "-6.0"
column 4: for "-12.9" read "-12.7"

footnote 7: for "relative consumer prices adjusted"
read "relative unit labor costs adjusted"

Corrected pages are attached.

Att: (2)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

SPAIN

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives
for the 1984 Article IV Consultation with Spain

Approved by L. A. Whittome and Subimal Mookerjee

July 16, 1984

I. Introduction

A staff team consisting of H. B. Junz, L. Perez, K. Swiderski (all EUR), A. Penati (RES), and B. Barrington (ADM) as secretary, visited Madrid from May 10 to 25, 1984 to conduct Article IV consultation discussions. The mission met with the Minister of Economy and Finance, Mr. M. Boyer, the Governor and the Deputy Governor of the Bank of Spain, Messrs. J. R. Alvarez Rendueles and M. Rubio, and with officials of the Ministries of Economy and Finance, Industry and Labor, and the Bank of Spain. Mr. J. L. Feito, Alternate Executive Director for Spain, attended the meetings as an observer. Spain continues to avail itself of the transitional arrangements in Section 2 of Article XIV of the Articles of Agreement.

II. Background

1. Policy problems and objectives

Since the mid-1970s, the Spanish economy has been characterized by a high rate of inflation, relative stagnation in activity, rising unemployment, and growing public sector deficits. After 1979, despite the downward trend of investment, which has a high import content, the current account of the balance of payments moved into significant deficit (Chart 1). This deficit was associated with the loss of competitiveness in the preceding years, the heavy dependence on imported oil, the deceleration in world economic growth, and higher interest rates abroad. To avoid a further deterioration of the current account that would otherwise accompany escalating labor costs, the authorities pursued an active exchange rate policy. Even so, the deteriorating terms of trade and rising labor and financial costs depressed profits, leading to sharp cuts in employment and investment. Despite expanding public sector investment, the share of fixed investment in GDP fell from 22 percent in 1976 to 18 percent in 1983, and employment in the private sector fell by 19 percent. As unemployment mounted and the private sector shrank, the public sector increasingly became both the employer of last resort and the financial supporter of declining industries (Chart 2). In the process, the public sector's financial balance (on a national accounts basis)

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shifted from a small surplus in the mid-1970s to a deficit equaling about 6 percent of GDP in 1983, thereby progressively depriving the private sector of access to financial resources at reasonable costs.

Against this background of structural weakness, the Government in 1982 tried to boost activity through an easing of financial policies. This attempt failed. While the rate of inflation, as measured by the CPI, remained at around 14.5 percent, unemployment rose by 2 percentage points to 17 percent of the labor force, and the overall balance of payments deficit soared to US\$3.3 billion, almost five times the level of the previous two years.

The Socialist Government, that took office in December 1982, recognized that a return to higher employment levels and a sustainable growth path could not be achieved, except through a correction of the imbalances in the economy. This required, in particular, reducing the rigidities in the labor market that, year after year, had allowed real wages to rise in the face of mounting unemployment and falling demand for labor, and cutting government support of failing enterprises, while containing that of consumption (Table 1). The former would lay the basis for increases in profitability and in turn for employment, while the latter would reverse the trend toward accelerating public sector deficits so as to create room for expansion of private sector investment.

Table 1. Spain: Growth and Structure of General Government Expenditures, 1970-84

(In percent of GDP)

	General Government Expenditures					Total expenditures
	Own expenditures		Transfers		Interest on debt <u>2/</u>	
	Consumption	Investment	Households <u>1/</u>	Enterprises		
1970	9.9	2.8	8.5	1.9	0.6	23.7
1976	9.4	2.4	11.1	2.3	0.4	25.6
1980	11.0	1.9	15.0	3.3	0.8	32.0
1981	11.2	2.1	16.1	3.5	0.7	33.6
1982	11.8	2.9	16.3	4.6	1.0	36.6
1983	12.1	3.5	16.7	4.8	1.4	38.5
1984 <u>3/</u>	11.3	2.7	16.1	4.7	1.7	36.5

Source: Ministry of Economy and Finance.

1/ Includes "other current transfers."

2/ Does not include all the interest payments on treasury bills, which only became an important source of financing in 1983 and 1984.

3/ Official projections.

Table 6. Spain: Main Economic Variables, 1980-84

(Percentage changes)

	1980	1981	1982	1983 <u>1/</u>	1984 <u>2/</u>
Demand and output					
Private consumption	1.3	-0.9	0.6	0.7	0.5
Public consumption	4.4	1.5	6.2	4.1	3.5
Fixed investment	1.3	1.0	-1.8	-1.5	-0.7
Stockbuilding <u>3/</u>	0.6	-1.3	--	--	0.3
Total domestic expenditure	2.1	-1.5	0.7	0.6	0.9
Exports of goods and services	0.6	6.9	7.1	7.6	9.0
Imports of goods and services	3.8	-2.8	4.5	-0.6	2.0
Foreign balance <u>3/</u>	-0.6	1.8	0.6	1.7	1.6
GDP	1.5	0.2	1.2	2.3	2.5
Industrial production	1.2	-1.0	-1.1	2.6	2.0
Wages, costs, and prices					
Wages per man (industry) <u>4/</u>	16.0	15.4	13.5	13.0	9.0
Productivity (industry)	3.7	4.3	5.3	5.5	3.5
Unit labor costs (industry)	11.9	10.6	7.8	7.1	5.3
Consumer prices	15.5	14.6	14.4	12.2	10.8
GDP deflator (at factor cost)	13.9	13.6	13.3	11.3	11.0
Employment	-3.2	-3.1	-1.2	-0.9	-0.5
Unemployment rate (average levels)	12.2	15.0	16.9	17.9	19.8
Disposable income of households	14.6	14.2	15.2	13.0	10.4
Savings ratio (levels)	7.7	6.9	7.1	7.0	6.6

Source: Spanish authorities.

1/ Provisional estimates.

2/ Staff forecast.

3/ Changes in stockbuilding and the foreign balance are expressed as a percentage of GDP in the previous year.

4/ Including social security contributions

Table 7. Spain: External Developments, 1980-84

	1980	1981	1982	1983 <u>1/</u>	1984 <u>2/</u>
	(Percentage changes)				
Trade developments					
Imports, c.i.f. <u>3/</u>					
Unit value	38.1	31.2	13.2	21.0	9.1
Volume	4.1	-7.6	3.1	-0.4	2.0
Exports, f.o.b. <u>3/</u>					
Unit value	20.0	19.0	12.5	18.3	10.3
Volume	1.9	6.2	6.3	6.5	10.0
Market growth	7.9	3.1	--	-0.6	6.3
	(In millions of U.S. dollars)				
Balance of payments summary					
Trade balance, f.o.b.-f.o.b.	-11,725	-10,115	-9,181	-7,402	-5,713
Services	4,489	3,443	3,383	3,698	4,010
Of which:					
Tourism	5,720	5,709	6,122	5,942	6,260
Investment income	-1,548	-2,410	-2,422	-2,354	-2,350
Transfers	2,048	1,692	1,581	1,171	-1,000
Current balance	-5,188	-4,981	-4,217	-2,533	-703
(As a percent of GDP)	(-2.4)	(-2.6)	(-2.4)	(-1.5)	(-0.4)
Capital balance	4,538	4,274	882	2,214	
Of which:					
Changes in net foreign position					
of banks	732	638	53	463	...
Long-term capital	4,195	4,294	1,827	3,089	...
Overall balance	-650	-706	-3,335	-319	...
Memorandum items:					
Gross official reserves <u>4/</u>	12,480	11,422	8,272	8,019	
In months of imports <u>5/</u>	5.6	4.4	3.5	3.3	
Spanish pesetas per U.S. dollar					
(period average)	71.7	92.3	109.9	143.4	
Nominal effective exchange rate					
(percent change) <u>6/</u>	-7.6	-8.1	-5.9	-17.0	
Real effective exchange rate					
(percent change) <u>6/7/</u>	-5.9	-6.9	-6.0	-12.7	
Medium- and long-term external debt <u>8/</u>	23,719	27,205	28,772	29,462	
Debt service ratio	17.3	21.5	20.9	19.9	

Sources: Data provided by the Spanish authorities; IMF, International Financial Statistics; and staff estimates.

- 1/ Provisional estimates.
2/ Staff forecast.
3/ Customs basis, in pesetas.
4/ End of period, in millions of U.S. dollars with gold valued at US\$42 per ounce.
5/ Imports of goods during the following 12-month period.
6/ The weights are based on the average distribution of export and import trade with 14 industrialized countries in 1980.
7/ As measured by relative unit labor costs adjusted for exchange rate changes.
8/ End of period, in millions of U.S. dollars.