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Statement by Mr. Buirra on Spain
Executive Board Meeting 82/33
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On behalf of my Spanish authorities I wish to express my appreciation to the staff for the excellent set of papers they have prepared, with which they are in broad agreement.

Spain has had to face the problems brought about by the international recession, the rise in oil prices and interest rates amidst a delicate and difficult process of transformation of the political and social institutions of the old regime to render them fit for a modern democracy. This added to the problems of economic management in Spain, which cannot be fully understood if account is not taken of the unusual influence of political developments on the economy and the priority understandably given to political reforms. Moreover, the country was hit by the world economic crisis at a critical stage in its economic development. Industrial production had tended to be concentrated in sectors where external and domestic demand was growing slowly and in which competition from other countries was particularly keen. Additionally, a number of reforms necessary to promote the movement of resources and improve the efficiency of the economy were hindered by structural and institutional rigidities.

I.

When seen against this background, the macroeconomic performance of the economy has been commendable, particularly with regard to inflation. The inflation rate has been gradually but steadily reduced from 27 per cent at the end of 1977 to 14.5 per cent last year, and it is expected to be around 12 per cent by the end of 1982. Indeed, Spain is one of the very few countries where inflation declined steadily over the last four years. This price performance has to be seen as a remarkable achievement, especially in view of the domestic (i.e., real wages growth) and foreign (i.e., exchange depreciation and higher import prices) pressures to which prices have been subjected.

In recent years, the growth of real GDP has been modest, 0.5 per cent in 1979, 1.2 per cent in 1980, and 0.5 per cent is estimated for 1981. The uncertainties associated with political change and the impact of international recession notwithstanding, Spain has not experienced negative growth rates, though it has certainly grown at rates well below the potential of the economy. One of the main reasons for this limited growth has been the weak performance of private investment over this period. This, in turn, was due not only to the uncertainties derived from political events and the accompanying structural economic reforms, but also to a considerable decrease in profitability resulting from the growth of real labor costs and the deterioration in the terms of trade.

A consequence of the decrease in the rates of investment and growth has been rising unemployment. The unemployment rate which was of the order of 9.6 per cent in 1979, rose to 12.6 per cent of the labor force in 1980 and further to about 14.5 per cent in 1981. This problem has also been aggravated by the substitution of labor by capital which resulted from the increase in the relative price of labor and by the low labor intensity of energy investments implemented in response to the oil price increase.

Naturally, the high level of unemployment is a matter of the gravest concern to the authorities, who are attempting to arrest its increase without abandoning their fight against inflation. To this end, a National Employment Agreement (NEA) was concluded as a mechanism designed to prevent the effect of anti-inflationary policies from falling largely on employment, without significantly affecting the rate of growth of nominal wages. Under this tripartite agreement comprising employers, labor, and government, nominal wage increases will be limited to between 8 per cent and 11 per cent per annum and higher than expected rates of inflation would lead to an upward adjustment of the range so as to achieve annual reductions in real wages of 2 per cent on average. In exchange, the Government is committed to implement a substantial program of public investment and to reduce gradually the burden of social security contributions. This agreement also encompasses other significant measures aimed at increasing labor mobility and the efficiency of the labor market. For 1982 the objective of the NEA is to stabilize the rate of unemployment at about the present figure and to reduce it gradually in the future.

Over the past two years the current account of the balance of payments recorded a sizable deficit of some US\$5 billion or 3 per cent of GDP. A continuing deterioration in the terms of trade, decreasing levels of activity in the major Spanish trade partners and the rising cost of the interest service on the external debt are among the major causal factors of this deficit. However, since the external balance has proved to be very responsive to Spain's real competitiveness, my authorities are not unduly concerned by that figure. In fact, responding to a considerable effective depreciation of the peseta in real terms, the figures for the last quarter of 1981 and estimates for the first quarter of 1982 show a notable increase in the growth of exports and approximate balance on current account in the first quarter of 1982.

My authorities in Spain consider that a lasting improvement of competitiveness can best be achieved through a steady deceleration of domestic costs and prices. Therefore in addition to the flexible management of the exchange rate--which is well described in the staff papers--the current anti-inflationary stance of financial policies will contribute to strengthen the balance of payments to the extent permitted by the evolution of the international economy.

Traditionally, Spain's public sector has achieved approximately balanced budgets. Therefore, the current 3-4 per cent ratio of the public sector deficit to GDP, though low by international standards, is a matter of concern for the authorities. Public expenditure has been subjected over the period to forces associated with the political transformation and therefore the deficit should not be seen as the result of a relaxation of fiscal discipline. The peaceful transition from the old regime into a democracy has certainly been one of the most remarkable in modern history, but it has by no means been a costless process in economic terms. The nature and growth of the public sector deficit reflect, to a considerable extent, the economic aspects of that process. Thus, several of the major sources of growth in public expenditure have been the result of parliamentary action, such as the law on employment, the extension of pensions to the relatives of the civil war victims, the law on the modernization of the armed forces, and others. Political factors aside, the public sector deficit has acted also as a shock absorber, reflecting and softening the impact of unemployment resulting from excessive increases in real wages and the deterioration in the terms of trade.

The 1982 budget reflects the authorities' objective of keeping the public deficit from rising beyond present levels, while at the same time shifting the structure of public expenditure in favor of greater investment. To this purpose, a three-year investment program is being implemented which centers on the promotion of labor-intensive activities such as construction and transportation infrastructure, as well as in energy sectors. The 1982 budget also includes measures embodied in the ANE to reduce labor costs and stimulate employment.

Over the period, monetary policy has been the main instrument of demand management in Spain. The Bank of Spain was among the first to formulate monetary policy within the framework of quantitative targets for monetary aggregates. Their reliance on quantitative targets is justified by the stability of the relationship between nominal GDP and money, particularly the M3 definition, and between money and the closer operational variable, i.e., banks' reserves. The Bank of Spain has shown notable success in maintaining money growth within the established targets. This has significantly contributed to the success achieved in the inflation field.

My authorities consider that a sharper reduction in the rate of money growth would result in a fall on output without any significant effect on inflation. They further believe that inflation cannot be arrested by monetary policy alone if monetary restraint is not accompanied by a reduction in the growth of real wages. This is the rationale underlying the National Agreement on Employment. When the different policy options available to the authorities are considered, taking into account the relevant domestic and international conditions, it is difficult to see what other policies could have been followed.

II.

Notwithstanding the difficulties of this period, several structural reforms have been launched, which will increase the flexibility and efficiency of the economy in the coming years. These include:

- In the energy field, a National Energy Plan was introduced in mid-1979 which has already achieved an important reduction in Spain's dependence on imported oil from 70 per cent of its energy needs to some 60 per cent by the end of this year.
- Further reform of the financial system, particularly reduction of the role of selective credit controls. Interest rates have been further liberalized, interest rates on commercial papers and short-term loans up to two years are now free (loans of more than two years were already free). In addition, nonresident accounts have been made fully convertible.
- Continued trade liberalization aimed at reducing the level and variance of the tariff and other barriers to trade.
- In the fiscal field, the introduction of the value-added tax, whose implementation has been scheduled for the beginning of next year. The VAT is expected to have a considerable balancing impact on the budget and will facilitate the negotiation with the EEC.