March 22, 1982 - 82/38

The Chairman's Summing Up at the Conclusion of the 1981 Article IV Consultation with Spain
Executive Board Meeting 82/33 - March 19, 1982

Executive Directors commended the Spanish authorities on the significant progress that was made in the last two years in adjusting the economy to the consequences of the sharp increase in the relative prices of energy and labor that occurred in the second half of the 1970s. Wage rates had been gradually decelerating and since 1979 energy policy has been aimed at passing on the full increase in imported oil prices to domestic energy prices. Directors also expressed their support of the monetary authorities in their efforts over the past few years to bring about a gradual reduction in the rate of inflation through a steady deceleration in the growth of monetary aggregates. Despite this progress, however, the Spanish economy continues to be beset by the combination of slow growth (in the last three years output grew on average by less than 1 per cent), relatively high rates of unemployment and inflation, and a significant deficit in the current account of the balance of payments. In the circumstances, they felt that there needs to be a careful balancing of priorities in economic policy and they generally agreed with the focus of the policy mix.

Directors expressed the view that a major root of the serious unemployment problem is to be found in the excessive increase of real wages in the past few years and they commended the authorities for their efforts to promote a social pact, "Acuerdo Nacional de Empleo," which targets a significant reduction in real wages in 1982. They cautioned, however, against expectations of a rapid improvement in the employment situation. A premature relaxation of policy would provide only temporary relief and lead to an acceleration of inflation.

While recognizing that the size of the current account deficit of the balance of payments remains modest in relation to GDP and is unlikely to pose financing difficulties in the foreseeable future, Directors stressed that this deficit is not the counterpart of a strong investment performance but rather of too low a level of domestic savings. They also noted that the continuation of the deficit at present levels could lead to a burdensome increase in external debt over the longer run.

Directors, in supporting the authorities' determination to maintain a cautious stance of monetary policy, stressed that firm monetary control needs to be supported by an effective tightening of fiscal policy, if an adequate flow of credit is to be provided to the private sector. Directors noted that the 1982 budget targets a significant reduction in the public sector deficit as a per cent of GDP, and hoped that the initial budgetary target could be adhered to. They urged the Spanish authorities to resist pressures for supplementary budgetary appropriations and to strengthen

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expenditure control. In a longer-term perspective, Directors welcomed the authorities' intention to shift the structure of public expenditure toward greater investment, to undertake a comprehensive reform of the social security system and of its financing, and to strengthen tax administration. More generally, Directors underlined the importance of addressing the problem of the structural rigidities that are still affecting the Spanish economy.

The Spanish authorities were commended for recent steps toward the liberalization of the financial system and encouraged to make further progress in this area. It was pointed out that present institutional arrangements tended to discourage the formation of financial savings. The desirability of fostering competition in the financial system was also noted. Directors stressed the need to create the conditions for a significant increase in nonmonetary financing of the budget deficit. Directors also stressed that the liberalization of the financial system should be accompanied by a number of steps in other areas, in particular with respect to the trade system. They believed that it was in the interests of Spain to make rapid progress in reducing the existing high degree of effective protection because it tends to perpetuate the existence of inefficient industries and hinders progress on the inflation front.

Executive Directors welcomed the flexibility of the Spanish authorities in the management of the exchange rate in the past two years and noted that the depreciation of the peseta during that period, along with the deceleration of labor costs, had allowed a substantial improvement in competitiveness. They expressed the hope that the float of the peseta would continue to be managed in such a way as to give full weight to the need for a strong competitive position.

Finally, several Directors noted the importance which they attached to regular Fund consultations with Spain.