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December 27, 1993

To: Members of the Executive Board

From: The Secretary

Subject: Spain - Staff Report for the 1993 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1993 Article IV consultation with Spain, which is tentatively scheduled for discussion on Wednesday, January 26, 1994.

Mr. Reichmann (ext. 38610) or Mr. Roy (ext. 35356) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Unless the Documents Preparation Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the Commission of the European Communities (CEC), the GATT Secretariat, and the Organisation for Economic Cooperation and Development (OECD), following its consideration by the Executive Board.

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INTERNATIONAL MONETARY FUND

SPAIN

Staff Report for the 1993 Article IV Consultation

Prepared by the Staff Representatives for the
1993 Consultation with Spain

Approved by Massimo Russo and Mark Allen

December 23, 1993

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I. Introduction

A staff team comprised of Messrs. Artus (Head), Reichmann, Franks, Gleizer, Roy (all EU1) and De Gregorio (RES) visited Madrid during October 12-22, 1993 to conduct Article IV consultation discussions. The mission met with the Minister of Economy and Finance, Mr. Solbes, the Governor of the Bank of Spain, Mr. Rojo, and senior officials from these and other ministries and agencies. Mr. Marino, Executive Director for Spain, and his advisor, Mr. Merino, participated in the discussions.

The last Article IV consultation with Spain was an interim one, concluded on August 7, 1992 (SM/92/145). Spain has accepted the obligations under Article VIII of the Articles of Agreement.

II. Background to the Discussions

During the second half of the 1980s Spain experienced a period of rapid economic growth, that was helped by an important liberalization effort and the country's integration to the EU. From 1985 to 1989, real GDP grew at an average annual rate of 4.8 percent, propelled by rapid growth of investment and consumption expenditures. Foreign investment, in particular, played a key role in the modernization and expansion of the manufacturing sector. As a result, income per capita rose significantly toward the European Union average.

At the same time, inflationary pressures persisted throughout that period despite the existence of high unemployment. Even at the height of the economic expansion, the unemployment rate remained above 16 percent and the nonaccelerating-inflation rate of unemployment (NAIRU) may have been close to 18 percent. 1/ In part, this unemployment level reflected socio-demographic factors, including the incorporation of women to the labor force and the decline in agricultural employment, 2/ but it also stemmed from the severe rigidities induced by the legal and regulatory framework governing the labor market. Restrictions on laying off redundant workers, in particular, tended not only to limit new hiring but also to fuel wage increases.

1/ Available estimates suggest that the NAIRU increased markedly from the mid-1970s to the late 1980s as a result of an enlarging tax wedge, a widening and deepening of the unemployment compensation system, and a major restructuring of the economy. The measures facilitating the use of temporary employment contracts implemented in the late 1980s led to a partial reversal of this trend. The staff estimates that the NAIRU declined from 18 percent in 1990 to 16 percent in 1993.

2/ During the 1980s, the economically active population increased on average by 1.4 percent a year, with the male labor force growing by 0.4 percent a year and the female by 2.2 percent. Over the same period, more than 1 million jobs were eliminated in agriculture. See Appendix I of the accompanying Recent Economic Developments paper.

In a renewed effort to curb inflation, monetary policy was gradually tightened during the second half of 1988 and the first half of 1989 and Spain entered the ERM in June 1989. For the following three years, monetary policy remained tight with an inverted yield curve and real short-term interest rates in excess of 6 percent. Nonetheless, inflation remained high. Consumer price inflation declined only marginally from 6.8 percent in 1989 to 5.9 percent in 1991, while the rate of growth of compensation per worker in fact rose from 5.6 percent to 8.9 percent over the same period (Table 1). As a result, the peseta appreciated in real terms. Real domestic demand started to weaken in late 1990 and 1991, while the loss in external competitiveness fostered a rapid penetration of imports. The slowdown in economic activity (Chart 1) led to a decline in employment, which became widespread early in 1992, affecting confidence and limiting the growth in household income.

The onset of the ERM crisis in September 1992 found Spain in a position where the cumulative deterioration in competitiveness had become evident and where the growing unemployment precluded sustained recourse to increased interest rates. The initial devaluation of the peseta proved insufficient to satisfy the markets, nor was a short-lived reintroduction of capital controls able to stem market pressures, which in the end forced two additional corrections of the exchange rate, in November 1992 and May 1993. All in all, the devaluation of the central rate of the peseta amounted to 20 percent. Nonetheless, from September 1992 to May 1993, as the authorities resisted the exchange market pressures, real short-term interest rates were kept in a 7-9 percent range. This further rise in domestic interest rates and the exchange market turmoil itself made private spending even more sluggish, and pushed the economy into recession. GDP is likely to decline by 0.9 percent in 1993. The lack of wage flexibility and high financial costs contributed to a marked squeeze in profit margins followed by bankruptcies and labor shedding. In the first three quarters of 1993, employment declined by 4.5 percent, resulting in an increase in productivity and a moderation of the growth of unit labor costs but also in a sharp rise in the unemployment rate. 1/ By the third quarter of 1993, the unemployment rate stood at 23 percent.

Partly because of the depreciation but also because of the rigidities, inflation has continued to react slowly to the growing gaps in labor and product markets. Consumer price inflation remained unchanged at 5.9 percent in 1992 and is projected to decline to 4.7 percent in 1993. Underlying

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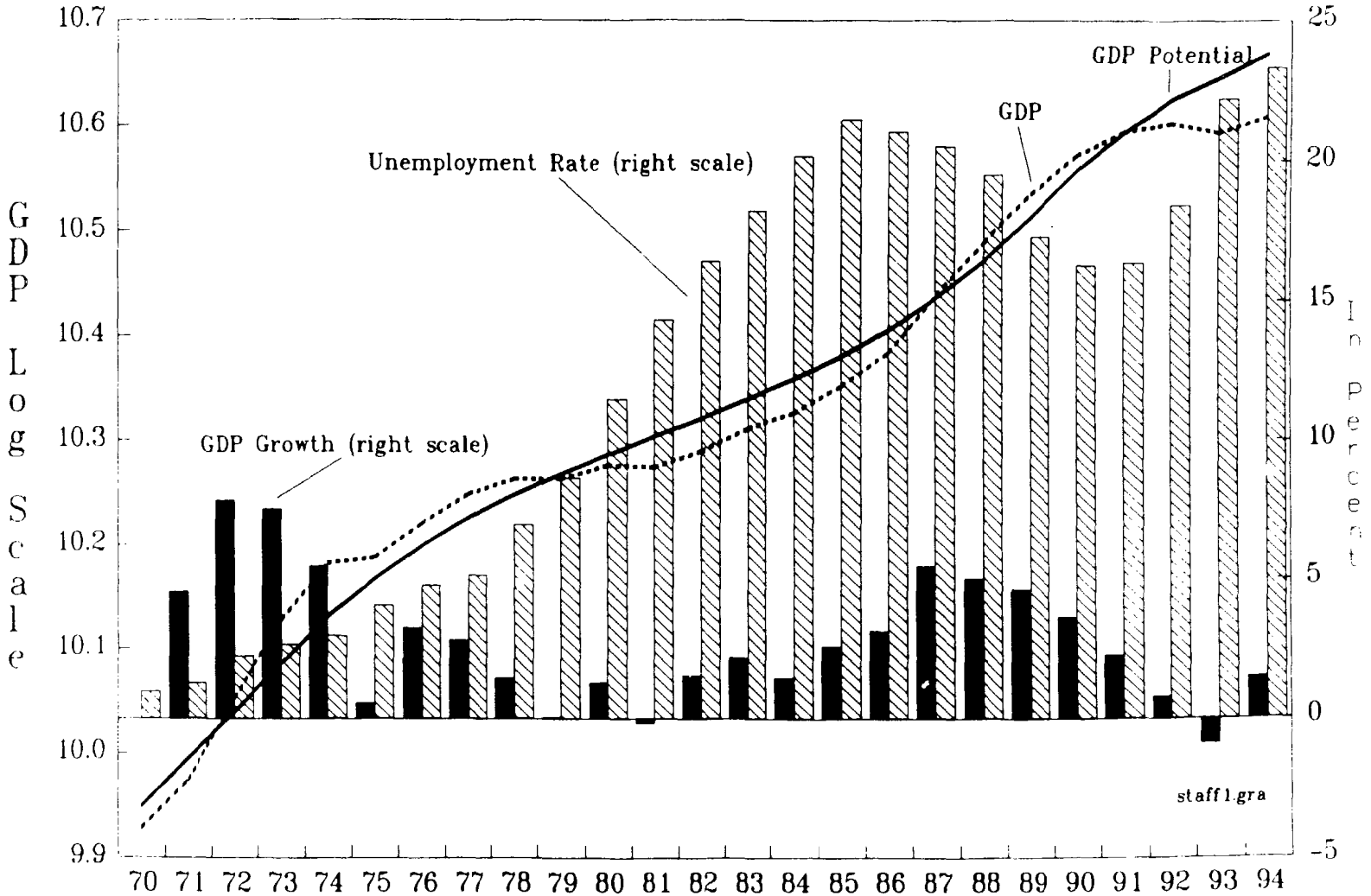
1/ Contrary to expectations, the cuts in employment have mainly affected permanent-contract employees, despite their higher cost of dismissal relative to temporary workers. Aside from the fact that company failures had been concentrated in sectors intensive in permanent employment, the authorities suggested that the relatively high cost of firing these workers had largely been capitalized into wages higher than those paid to temporary workers, making them susceptible to dismissal once the recession developed.

CHART 1

SPAIN

OUTPUT AND EMPLOYMENT, 1970-1994 1/



Sources: Ministry of Economy and IMF staff estimates.

1/ Figures for 1993 and 1994 are staff projections.

inflation (excluding food and energy products) still is projected to exceed 5 percent. Compensation per worker rose 8.8 percent in 1992 and is estimated at 6.9 percent in 1993.

The large devaluation of the peseta has allowed the authorities to lower interest rates gradually, particularly after the widening of the ERM band in August 1993. By end-November 1993, short-term interest rates had declined by about 2½ percentage points from the levels of early 1992. Differentials relative to the core ERM economies were also restored to those prevailing in early 1992. However, monetary policy is still squarely aimed at maintaining the downward pressure on inflation. Real short-term interest rates remain close to 4.5 percent and the yield curve is still inverted. Not surprisingly, as yet there are few signs of strengthening in domestic demand. Exports are expanding rapidly, partly in response to the devaluation, but by itself this is not enough to foster a significant economic recovery.

The long, largely inconclusive fight against inflation has been accompanied by a marked weakening in the public finances (Table 2). After remaining around 3 percent of GDP during 1987-89, the budget deficit of the general government worsened significantly thereafter. In 1991, at the peak of the economic cycle, the deficit reached 5 percent of GDP. 1/ In 1992, despite the weakening in economic activity, the authorities actually succeeded in reducing the general government deficit to 4.5 percent of GDP. In 1993, however, the deficit is projected to reach 7.2 percent of GDP, with a structural component of some 4.0 percent of GDP. The projected outturn for 1993 would represent a considerable slippage relative to the expected 3.6 percent of GDP deficit envisaged when the 1993 budget was adopted at the end of 1992. The unexpected fall in economic activity, marked by an unusually large reduction in employment, and the inability to contain discretionary spending as foreseen in the budget, explain the increase in the imbalance. The fiscal stance, which was expected to continue restrictive in 1993, will turn out to be neutral or slightly expansionary.

All in all, over 1992 and 1993, there was a cyclical deterioration of the financial position of the general government equivalent to some 3.5 percent of GDP, offset only in part by a structural strengthening of 1.2 percent. The latter resulted mainly from measures to expand tax revenues, particularly through increases in the VAT, excise taxes, and social security contributions. The level of unemployment benefits was reduced and capital expenditures were contained, although this was partially offset by larger spending on pensions and health care transfers.

The interest charges resulting from the growing outstanding government debt and the recent sharp increases in the average cost of financing are projected to reach almost 5 percent of GDP in 1993. The primary balance,

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1/ Appendix II of the accompanying Recent Economic Developments paper analyzes the effects of the economic cycle on Spain's public finances.

which was in surplus over 1987-89, is expected to show a 2.3 percent of GDP deficit in 1993. Thus, with an outstanding debt that increased from 44 percent of GDP in 1990 to 55 percent of GDP this year, the dynamics of deficit and debt are on a highly unfavorable path.

The deceleration of economic activity has also affected the quality of bank assets as well as their profitability. Doubtful peseta-denominated loans, in particular, have increased from 1.7 percent of the total balance sheet of commercial banks in 1990, to 2.2 percent in 1992, and from 1.7 percent to 2.7 percent in the case of saving banks. Preliminary information indicates a continuation of this trend in 1993, although there is no sign of systemic difficulties.

In the external area, exports showed remarkable resiliency during 1990-92 despite the deteriorating competitiveness (Chart 2); nonetheless, because of the strong growth of imports, the external current account deficit increased to 3.2 percent of GDP by 1992 (Table 3). The widening of the deficit added to the pressures on the exchange rate and reserves, and as net capital inflows declined sharply in 1992 reflecting mostly the unloading by nonresidents of Spanish government securities, there was a drop in excess of US$20 billion in the foreign reserves of the Bank of Spain. In 1993, the adjustments of the exchange rate and the domestic recession considerably strengthened the current account, and the deficit is projected to narrow to 2 percent of GDP. Calm returned to the capital account after the devaluation in May, and since then the Bank of Spain has been able to keep international reserves roughly unchanged at US$45½ billion.

III. Policy Discussions

The discussions took place against a background where unemployment had reached unprecedented levels, inflation persisted, and, in the aftermath of the ERM crisis, doubts had arisen about the speed, if not the actual targets, of the convergence process. The authorities were convinced that, more than in cyclical factors, the roots of the unemployment problem were to be found in structural rigidities. Many of these structural rigidities were also at the basis of the stubbornness of inflation. Moreover, the authorities were deeply concerned about the weakness of the public finances and its potential effect on long-term interest rates.

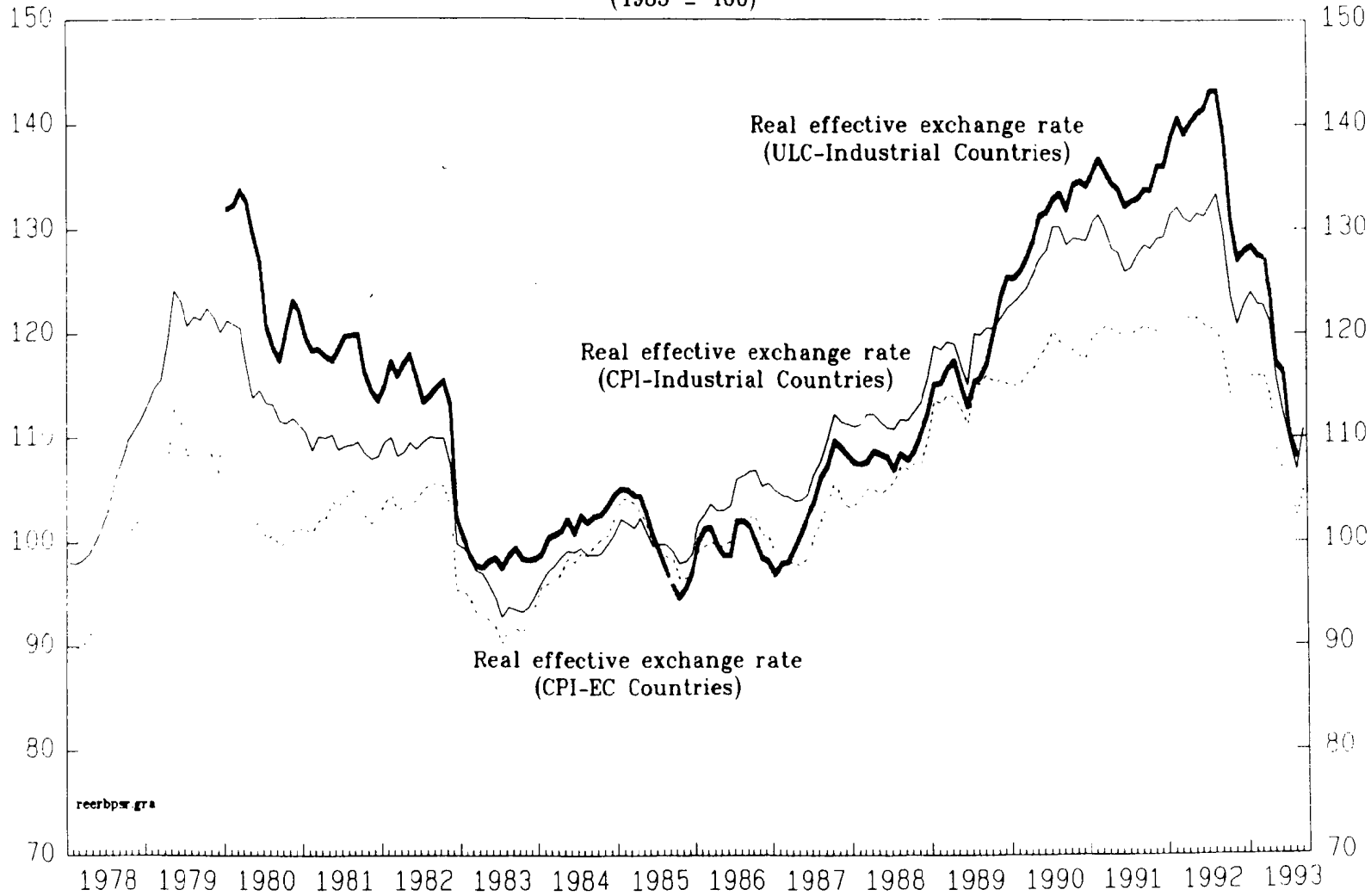
To make progress against inflation, the authorities had maintained a tight monetary policy for several years, even in 1993 in the face of a mounting recession. They were now convinced that to reconcile the need for economic recovery and the need to reduce inflation further, it was essential to effect structural reforms, especially in the labor market. Their strategy was to introduce such reforms at an early stage and support them with a renewed effort at fiscal consolidation. This would accelerate the decline in inflation and permit an easing of monetary policy that, in conjunction with the stimulating effect of the depreciation of the peseta, would foster an economic recovery and, over the medium term, a marked

CHART 2

SPAIN

REAL EFFECTIVE EXCHANGE RATES, 1978-1993

(1985 = 100)



Sources: Bank of Spain and staff estimates.

decline in unemployment. Subsequently, the Spanish Cabinet did approve (on December 3, 1993) draft bills and a decree that will form the basis of its legislation to reform the labor market.

1. Fiscal policies

In the light of the major slippages observed in 1993, the authorities emphasized the importance of restoring credibility in the budgetary process and in the government medium-term fiscal convergence goal by lowering the fiscal imbalance in 1994.

The proposed 1994 budget projects a decline in the general government deficit of 0.8 percent of GDP, to 6.4 percent, on the basis of a growth rate of real GDP of 1.3 percent, and an increase in the GDP deflator of 3.4 percent. The budget includes discretionary measures equivalent on a net basis to about 1.5 percent of GDP in 1994. Total general government revenues would grow by 5.1 percent and spending by 3.4 percent. The primary deficit is projected to fall by 1.2 percent of GDP; nonetheless, public debt would increase from 54.3 percent of GDP in 1993 to 59.7 percent in 1994. From the perspective of the fiscal consolidation that remains to be done, the mission regarded these budget targets as a minimum and stressed that several of the budget's projections appeared dangerously tight in the light of present circumstances.

The authorities explained that on the expenditure side, the 1994 budget for the central administration (comprising largely the central government and the social security system) represents a major adjustment effort. Current spending is projected to grow only by 0.9 percent relative to 1993; since interest payments are forecast to rise by 21.4 percent this would imply a fall of 1.3 percent in primary current spending. This is to be achieved by containing personnel outlays (through a wage freeze and a fall in net employment), reducing spending on goods and services, and cutting transfers. Contributing to the projected fall in transfer payments is the reform of the unemployment compensation system which, inter alia, lowers the level of subsidy and harden conditions of eligibility (savings worth around 0.5 percent of GDP). Also, for the first time pensions will be indexed to the expected CPI increase (3.5 percent) instead of previous year's inflation. Capital spending by the central administration (around 55 percent of total government capital operations) is projected to decline by almost 10 percent. Spending on defense (some 1.3 percent of GDP, of which 0.7 percent on personnel) is projected to increase by less than 1 percent in nominal terms in 1994.

On the revenue side, indirect taxes on tobacco and alcohol will be raised and income tax brackets and deductions will not be adjusted for inflation (with some exceptions). Also, starting in 1994, unemployment benefit recipients will pay income and social security taxes. On the other hand, there will be some increase in income tax credits and deductions to stimulate business investment and labor training.

The mission noted that the budget targets on the expenditure side are indeed ambitious. In particular, given the expected weakness in economic activity, the reduction in transfers (-1.6 percent for the central administration) will be difficult to reach. Therefore, the mission stressed the need to introduce rapidly the initiatives needed to secure the implementation of the proposed cuts. On the revenue side, there are some downside risks. Tax collection (especially for indirect taxes) has been problematic in 1993 (partly due to evasion) and the assumption of a large gain in 1994 is somewhat risky. This is compounded by the fact that the forecast of consumption spending underpinning the budget might be optimistic. Overall the mission noted that some slippage could occur again in 1994, and if this was the case the authorities should react promptly by adopting corrective measures.

As for the longer-run fiscal plans, the mission inquired about the continued validity of the targets that had been included in the Government's Convergence Plan of March 1992. The authorities indicated that they intended to revise this Plan and that, pending this revision, they were working with a preliminary target of reducing the deficit from the current 7.2 percent of GDP to around 3.5 percent in 1996. They recognized that the already high level of deficit and the sharp increase in the debt to GDP ratio in recent years were precluding an expansionary fiscal policy. On the contrary, the deficit had to be reduced, with economic recovery and expenditure containment being identified as the two broad avenues to this end. The mission agreed fully with this view and stressed that, while essential, a robust recovery would not be sufficient to achieve the needed fiscal consolidation. (The scenarios presented in Section 5 illustrate this point.)

Given the already high tax burden, and with the EU tax harmonization process virtually completed, further growth in revenues would depend on income growth, privatization proceeds, and reduction of tax fraud. On this latter point, the authorities were putting in place further measures to ensure compliance with tax regulations, and they expected that the recent agreement with the regional governments, granting them a 15 percent share of income tax collected on their territories, would contribute to reduce income tax evasion. 1/ On privatization, the Government intended to continue with their pragmatic case by case approach within the general framework of EU directives on competition policy. Receipts from privatization are projected to amount to some 0.3 percent of GDP in 1994.

As regards expenditures, the adjustment in the medium term would be centered on restraining consumption outlays and transfer payments, maintaining the share of capital spending in GDP. Moderate wage and employment growth are expected to keep the public sector's wage bill in check while reforms to the unemployment benefits system, health care and

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1/ General grants from the central government will be reduced in proportion to the increase from the 15 percent share of the income tax.

education programs, as well as reduced transfers to public sector enterprises, would contain the growth in transfers. The authorities also intend to prepare a reform of the pension system so as to ensure an appropriate funding of future liabilities over the medium term.

Regional and local governments, whose total expenditures amount to around one third of general government total outlays, enjoy ample autonomy in their budgetary allocations and are responsible only to their regional parliaments. The fiscal position of the regions deteriorated significantly in recent years following the transfer of spending responsibilities to these governments, without an adequate matching of revenue sources. A new financing agreement was reached in January 1992 with a view to eliminating most of the regions' budget deficits by 1996. The arrangement contains features that would improve the ability of the central government to monitor the financial performance of the regions, although there was no significant change in their borrowing constraints. The first year of the new general agreement showed a slight fall in the regional governments' deficit (from 1.6 percent of GDP in 1991 to 1.2 percent in 1992) and the authorities expressed cautious optimism that the medium-term consolidation plan will be implemented. The financing of municipalities is in need of revision and the authorities intend to discuss a reform in this area during 1994.

2. Monetary and exchange rate policy

In reviewing the developments in the past year, the authorities noted that until September 1992 high nominal interest rates and confidence in the short-run sustainability of the central exchange rate had persistently kept the peseta at or near the top of the ERM band, despite the marked deterioration in external competitiveness. Once market sentiment turned during the crisis and the flow of capital started to dry up, the authorities strenuously sought to stay within the system and work for a common solution to the crisis. In the event, the central rate had to be lowered by 5 percent on September 17 (Chart 3) and, because pressures persisted, shortly thereafter they felt compelled to impose controls on short-term open positions in pesetas.

These capital controls had their intended effect for a few weeks 1/ but, as they were also choking off regular trade finance, the authorities moved to relax some of their features. In the end, this relaxation together with growing tension in the exchange market, forced the dismantling of the controls and a second devaluation (6 percent) in November 1992. The staff inquired about the possible damage done by the controls to the confidence of foreign investors. On this point, the authorities indicated that the subsequent decline in long-term interest rates suggested that no long lasting damage had been done. Altogether, they regarded the controls as a temporary

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1/ The effectiveness of these capital controls is discussed in Appendix IV of the accompanying Recent Economic Developments report.

stop gap measure, whose appropriateness in the circumstances prevailing in late 1992 needed to be assessed by comparison with the costs of the increase in interest rates that would otherwise have been required.

After November 1992, apparent calm returned to the exchange market, but the authorities' inability to lower short-term interest rates back to the pre-crisis level revealed the continuation of underlying pressures; these gained strength in April 1993 after the call of early elections and resulted in the devaluation of May 1993 (8 percent). In the view of the authorities, this last adjustment did satisfy market perceptions about the viability of the exchange rate and set the stage for the gradual return of both short- and long-term interest rates to levels more in line with the circumstances of the domestic economy (Chart 4).

The authorities stressed that, while the recent widening of the ERM band had increased the freedom to adapt monetary policy to the circumstances of the domestic economy, in the case of Spain these circumstances warranted a very cautious stance. The devaluations of the peseta and the recent decline in short-term interest rates had already resulted in somewhat easier monetary conditions. The overall stance of monetary policy remained restrictive, but as long as decisive progress on the inflation front was not ensured, large additional declines in short-term rates could have adverse effects on the exchange rate and on medium- and long-term interest rates. The exchange rate, in particular, remained an important guide for the conduct of monetary policy. They regarded the parity that emerged from the ERM turmoil in early August as appropriate and they were gearing their monetary policy to maintain that parity. They noted, however, that some limited declines in short-term rates could still be envisaged in coming weeks, especially if it was in the context of a broader decline in European rates. 1/ A more significant decline in Spanish interest rates would have to await the forthcoming reform of the labor markets (see below) and the fiscal consolidation envisaged in the proposed 1994 budget.

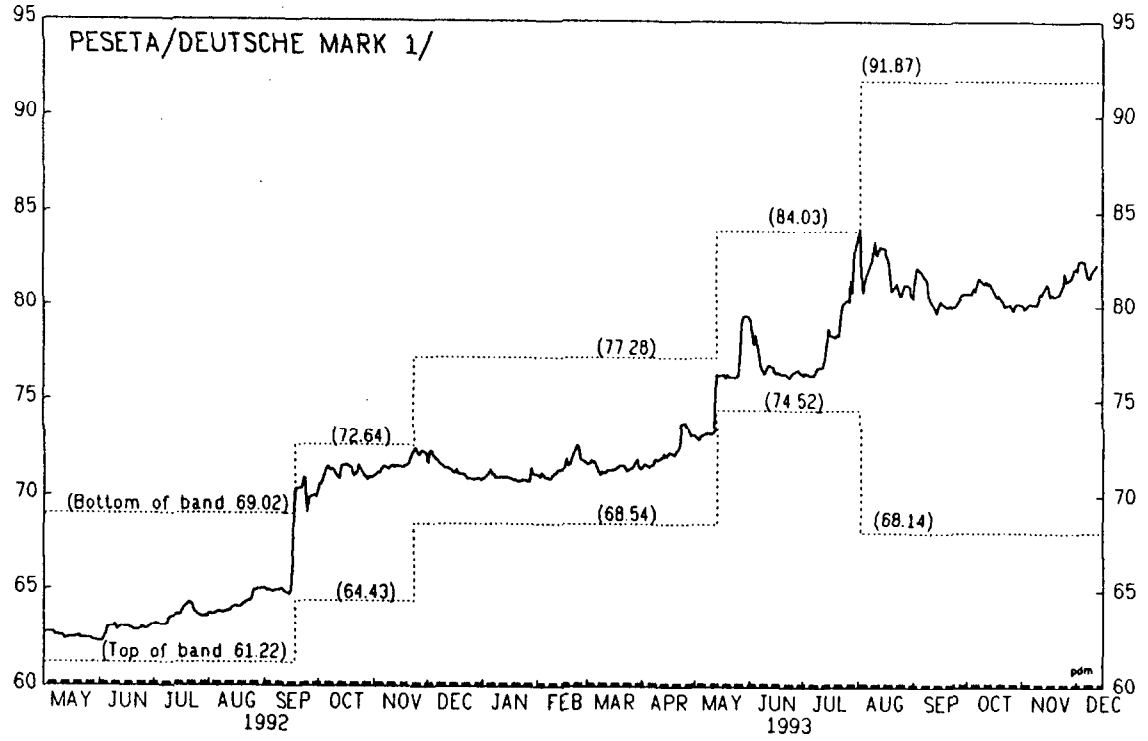
The staff generally concurred with the views of the authorities on monetary policy, indicating moreover that the differential vis-à-vis the German interbank rate (around 3 percentage points) was near an historical low and that under current circumstances a further marked depreciation of the exchange rate would be counter-productive. At the same time, the uncertainties regarding the economic prospects, including those related to the labor market reforms and incomes policy, remained considerable. This argued against any early narrowing of the fluctuation band vis-à-vis other ERM currencies.

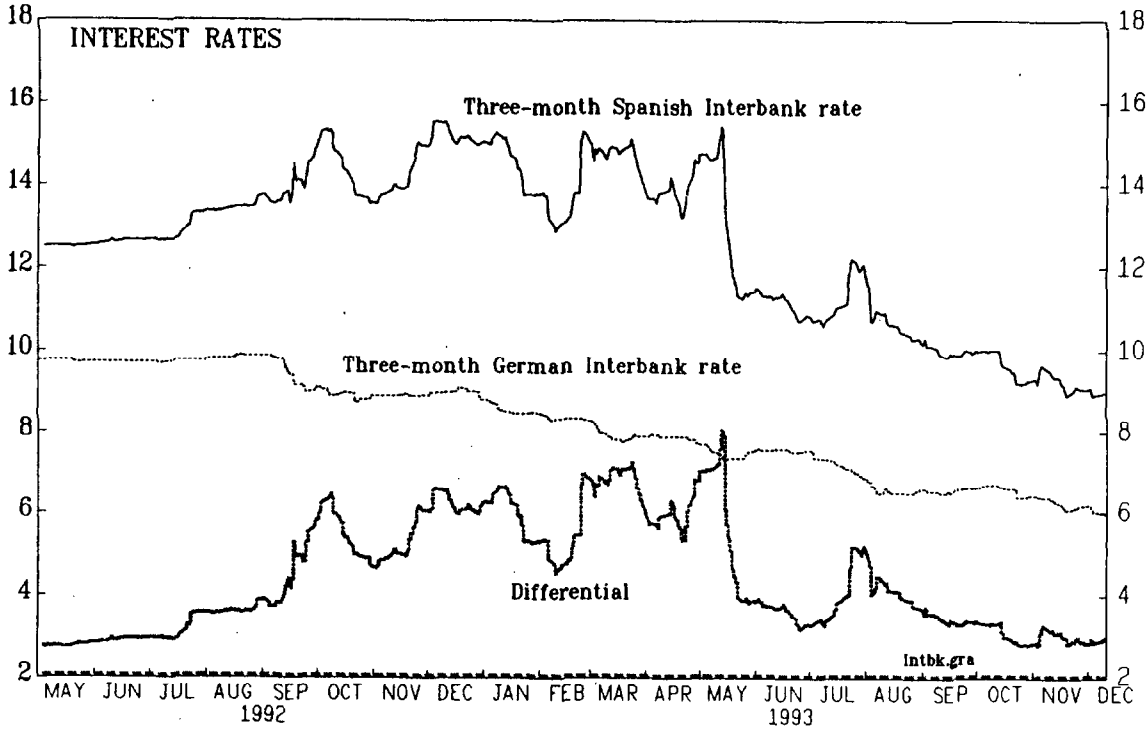
1/ Subsequently, the authorities reduced the intervention rate by 25 basis points in early November and a further 25 basis points in early December.

CHART 3

SPAIN

FINANCIAL INDICATORS





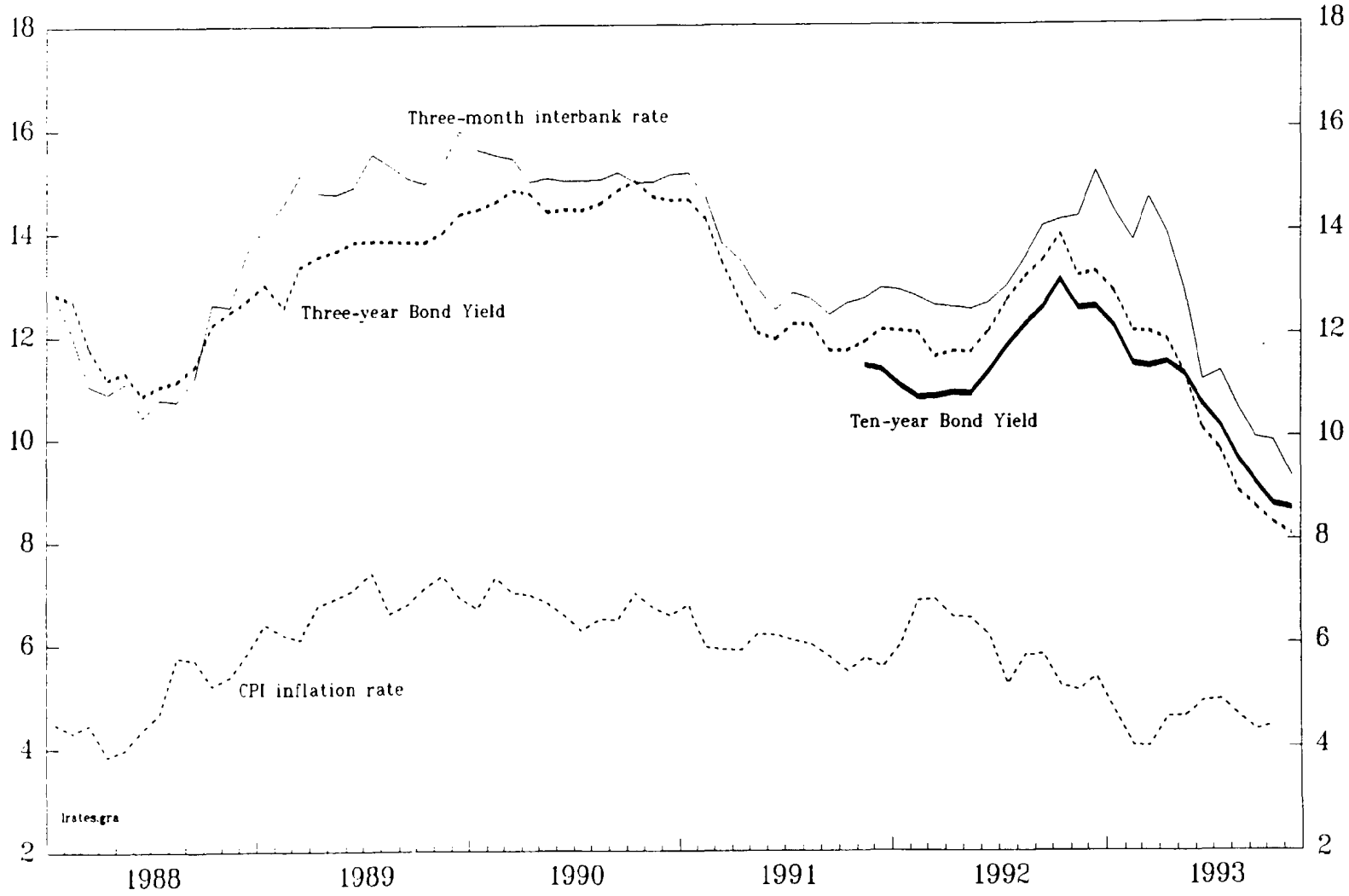
Sources: Bank of Spain and IMF staff estimates.

1/ Spain joined the ERM in June 1989 at a central parity of peseta 65.00 per DM. 5% devaluation of peseta on September 17, 1992, 6% devaluation on November 23, 1992, and 8% devaluation May 13, 1993. On August 2, 1993, the band widened from 6 to 15 percent.
Updated to December 10, 1993.

CHART 4
SPAIN

INFLATION AND INTEREST RATES, 1988-1993 1/

(percent per year)



Source: Bank of Spain

1/ Updated to November 1993. CPI to October 1993.

Legislation to grant autonomy to the Bank of Spain was to be approved before the end of 1993. The autonomy law would require the Bank to report periodically to Parliament on monetary developments and prospects, thus improving transparency and the flow of information to the public. As regards staff concerns over the framing of monetary policy under the new circumstances, the authorities acknowledged that monetary aggregates provided a very imperfect guide for the short-term conduct of monetary policy. 1/ Additional indicators needed to be taken into account, including inflationary developments, the exchange rate, and long-term interest rates.

In the view of the staff, the current level of competitiveness was quite favorable. 2/ The recent improvement in the competitive position had had a positive effect on external trade and this, together with the effects of the recession in Spain, had resulted in a sharp drop in the merchandise trade deficit and in a narrowing of the current account deficit. The stronger external performance was expected to carry over into 1994.

3. The labor market

The authorities, as well as the staff, felt strongly that a major change in arrangements in the labor market was required to provide a basis for a noninflationary economic recovery. Thus, issues related to the reform of the labor market dominated the discussions, with the mission generally supporting the authorities' intentions in this area.

At the time of the consultation discussions, there was already an intense national debate about proposals for reforming the labor market. The discussions were reaching a decisive stage and the authorities indicated that they wanted to have most of the relevant reforms in place before the end of 1993. They explained that reforms were needed in five areas. First, measures needed to be taken to increase access to employment, including steps to facilitate part-time employment, which is well below OECD averages, to permit apprenticeship contracts and in particular, to eliminate the legal monopoly of the National Employment Institute (INEM) as a job placement service. Second, workplace rules needed to be liberalized to permit more flexible use of the labor force; this would require, inter alia, the elimination of regulations that limit functional and geographical mobility of workers and the introduction of measures to improve flexibility in working schedules.

1/ For several years the Bank of Spain has used a broad monetary aggregate (liquid assets held by the public) as an intermediate target. Since the mid-1980s, however, disturbances originating mainly from the process of financial deregulation have reduced the information content of this aggregate in the short run. Nonetheless, the long-term relationship with the final variables has maintained acceptable levels of stability.

2/ Appendix III of the accompanying Recent Economic Developments report discusses competitiveness and the real exchange rate.

Third, and among the most hotly debated issues in this context, were initiatives to reduce the cost of laying off redundant workers. Although firing costs established by law are similar to those of other EU countries, actual costs can be several times higher due to the effect of administrative barriers (prior authorization) and the possibility of recourse to lengthy judicial appeals. A reduction of these costs would have a significant effect on the power of "insiders" in collective bargaining. At present, the bargaining stance of unions is primarily geared toward maximizing the income of permanent workers, who feel less responsive to labor market conditions because of the protection offered by the high cost of dismissal. A reduction in the cost of layoffs would also influence the willingness of firms to hire permanent workers thus reducing reliance on temporary workers, who at present constitute almost one third of the employed labor force. Temporary workers are not permitted to remain in a given job for more than three years, giving rise to significant efficiency costs and a high degree of rotation in the labor force.

The structure of collective bargaining was another area where reforms were being considered. Currently, collective agreements are negotiated centrally and are applied uniformly across sectors or regions, without taking particular circumstances into account. Moreover, the current legislation automatically extends the normative provisions of contracts (including those related to the rate of increase of salaries) beyond the life of the contract, introducing additional rigidities into the labor market and an upward bias to future wage settlements.

Finally, there was a need to streamline unemployment benefits. Steps were taken in 1992 to lengthen the period of employment required to qualify for such benefits and to shorten their duration. This notwithstanding, the Spanish unemployment compensation scheme remained among the most generous in Europe, and its high initial replacement rate acted to discourage quick re-entry into employment. To reduce some of these effects, in September 1993 the authorities had introduced a bill in Parliament to require income tax and social security payments by those receiving benefits, to tighten eligibility requirements and to reduce the level of benefits in some cases.

In a related development, the authorities explained that they had been discussing with representatives of labor and employers the possibility of reaching an understanding for the coming years on employment creation and on the containment of wage increases. Such an understanding was being sought to provide time for the reforms to improve flexibility in the labor market and to help contain the short-term output and employment costs of tight financial policies. The authorities' proposal contemplated a reduction in real wages of some 5 percentage points over the period 1994-96 in order to accelerate the disinflation process and foster a marked increase in the demand for labor. The staff generally supported this strategy. In particular, it noted that a temporary incomes policy for the overall economy would reduce the distortions that could arise from the tight incomes policy

envisaged for the public sector. 1/ It would also limit the spurt of layoffs that could initially result from the labor market reforms. At the same time, the staff noted that an incomes policy should not be viewed as a substitute for structural reforms. On this point, the authorities stressed that their priority was the introduction of the more fundamental reforms to labor market arrangements and that an understanding on wage moderation would not come at the expense of slowing the pace of these reforms.

In the event, on December 3, 1993 the Spanish Cabinet approved draft bills and a decree aimed at reforming the labor market. 2/ The decree concerns the legislation governing temporary employment and apprenticeship and will take effect in January 1994. The draft bills reform labor relations and the market for part-time workers. They should be debated in Parliament in early 1994 to be approved and become effective by June. Together they represent a very comprehensive reform. Access to employment will be liberalized along the lines discussed with the mission. In particular, INEM will lose its monopoly status as a job placement service, part-time work will be facilitated, and new types of apprenticeship/training contracts will be introduced. However, only "nonprofit" enterprises will be allowed to compete with INEM as job placing agencies, which will limit the beneficial effect of the change. Functional mobility will be enhanced and some steps will be taken to ease geographical mobility. Nonetheless, both functional and geographical mobility will remain subject to significant restrictions. 3/

The role of collective agreements in labor relations will be enhanced and the *ordenanzas laborales* will be gradually eliminated. In particular, upon agreement between its employer and employees, wage rates in a given firm will be allowed to deviate from those negotiated at the industry level. The new laws will also greatly reduce layoff costs for permanent workers. Firms will be allowed to lay off up to 10 percent of their work force (up to a maximum of 30 workers) without prior administrative authorization. For larger layoffs, employers will still need to ask prior authorization but the acceptable grounds for collective dismissal will be broadened considerably, making it easier to get the authorization and avoid judicial appeals. Most importantly, if the authorities do not make a decision within a short period (15 days) the authorization will be considered to have been given.

1/ For public enterprises, the authorities have already announced that wage increases should be limited to 1.5 percent during 1994.

2/ Appendix I of the accompanying Recent Economic Developments paper analyzes the labor market problems and the measures proposed by the authorities.

3/ For example, in the case of relocation, the employee will have the option to choose to terminate its contract and be compensated by receiving 20 days of salary for each year of seniority up to a maximum of 1 year of salary.

4. Other structural issues

The authorities indicated that there is a continuing need to reinforce competition in the Spanish economy, particularly in the services sector, which is characterized by excessive market power and pervasive regulations. The Government has been addressing these issues through the implementation of antitrust legislation and actions to phase out public monopolies in line with EU directives on competition. Work on an initiative to eliminate the ability of professional associations to regulate market access had been completed, and the corresponding legislation was to be introduced to Parliament. The authorities' efforts were now focused on promoting competition in the services sector, particularly in areas where there was a significant presence of the State, such as telecommunications, transport, and electricity.

In the area of trade policy, the authorities highlighted the importance they attached to reaching a prompt conclusion of the negotiations on the Uruguay Round of GATT. In response to prodding questions from the staff regarding recent restrictions by the European Community on imports from central and eastern Europe, the authorities noted that they were favorably inclined toward facilitating the access of exports from countries in central and eastern Europe to the European Union, but care needed to be taken to prevent dumping or other unfair trade practices. They stressed that they were also eager to see a further opening to exports from neighboring countries in the Maghreb. On foreign aid, Spain's official development assistance continued on an upward trend, reaching 0.27 percent of GDP in 1992, but was still low relative to other donors and the DAC guidelines.

5. Prospects

There are no or little differences in the projections of the authorities and the staff for 1994. Underpinning both forecasts is the implementation of major labor market reforms in the first half of the year. These reforms, in conjunction with a large labor market gap, are expected to reduce the growth in labor compensation substantially from around 7 percent in 1993 to somewhat above 3 percent in 1994. 1/ Inflation, which should benefit from a favorable exchange rate and slower growth in unit labor costs, is projected to decline to around 4 percent in 1994. The authorities' projection for the end-of-the-year CPI growth is 3.5 percent. The aggregate demand stimulus would arise mainly from the effects of the past depreciations of the peseta, a recovery in partner countries, and an additional easing in monetary conditions. The lower interest rates and the improvement in profit margins are expected to increase private sector investment in 1994 (including housing). However, this would be largely offset by a flat or very small rise in private consumption, and a projected

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1/ While the forecast takes into account the incomes policy envisaged for the public sector, it does not assume an agreement on incomes policy for the private sector.

reduction in public consumption and capital expenditures. Overall, domestic spending is projected to increase by a meager 0.3 percent (the authorities project a 0.1 percent increase). The strength of exports (that should grow by some 8.5 percent in 1994), and a limited increase in imports (about 3 percent), would provide the impetus for a 1.5 percent increase in GDP (1.3 percent in the authorities' forecast). The further improvement in net exports and the trade balance is expected to reduce the external current account deficit from 2.1 percent of GDP in 1993 to some 1.2 percent in 1994.

Activity is expected to gather strength from 1995 onward as business investment and household spending resume growing and the recovery takes hold in Europe. The authorities did not provide the mission with a medium-term economic projection; however, to prompt the discussion of medium-term issues, the staff provided them with two scenarios (Table 4). The "reform scenario" assumes the implementation of significant labor and product markets reforms that would strengthen growth and employment in a context of lower inflation and falling real interest rates. Potential output is favorably affected by a recovery in business investment and a trend fall in the equilibrium unemployment rate. In the "status-quo" scenario, which assumes no significant structural reforms, wage and price moderation is more gradual. The pursuit of inflation convergence in this unfavorable setting requires the maintenance of a tight monetary policy in the medium term, resulting in a slow recovery of spending and activity. Relative to the reform scenario, this more restrictive demand policy implies lower business investment, a smaller participation rate, and a higher equilibrium unemployment rate.

In the fiscal area, both scenarios assume that revenues will grow in line with GDP whereas beyond 1994 spending, excluding interest payments and unemployment compensation, will follow the trend registered over 1985-93 (in real terms). Under these conditions, the slower economic growth and higher interest rates implied in the status-quo scenario would result in the continued increase of both the overall deficit and the public debt. Yet, the simulations show that, if past spending trends continue unchecked, even in the reform scenario the more robust economic growth and falling real interest rates resulting from the reforms would not be enough to bring the fiscal position to a level consistent with the authorities' medium-term targets. To attain the fiscal consolidation objectives, the structural reforms would need to be accompanied by discretional fiscal adjustment measures. Both scenarios assume full implementation of the expenditure restraint envisaged in the 1994 draft budget; early slippages would of course compound the magnitude of the subsequent adjustment problem. The authorities fully agreed with the policy implications of these scenarios. In particular, they stressed that by boosting economic growth the structural reforms would contribute to resolve the fiscal imbalance. However, they also shared the staff's view that government spending had to be brought under control on a lasting basis to achieve fiscal consolidation even under the rapid growth assumption of the reform scenario.

IV. Staff Appraisal

In the second half of the 1980s, Spain experienced a period of rapid economic growth spurred by the country's entry into the EU and the ensuing rapid opening of the economy. This expansion, however, was accompanied by a persistent inflation and high unemployment. For the past five years, the authorities have been engaged in a frustrating fight to tackle the inflation problem, largely through a tight monetary policy. While the reduction in inflation has been limited, the economy ground to a halt in late 1991 and then moved into a severe recession in late 1992. By late 1993, the unemployment rate was close to a quarter of the labor force. Not surprisingly, the recession also contributed to a marked widening of an already sizable fiscal deficit.

The authorities are fully aware that an early, vigorous, and sustained economic recovery is required to reverse the negative trends in employment and to help in the adjustment of the public finances. At the same time, the authorities are steadfast in their commitment to move toward price stability. The authorities correctly recognize that the only feasible strategy is to make prices and wages more responsive to the large gaps prevailing in the labor and goods markets by tackling the long neglected structural rigidities, especially those in the labor market. Once reforms are adopted and progress is forthcoming in this area, a relaxation of monetary policy could add to the stimulus already provided by the favorable external competitiveness, without hindering the progress toward price stability. Moreover, a reform of the labor market is the only possible solution to the long-run unemployment problem which obviously transcends cyclical circumstances.

The staff fully shares the authorities' sense of urgency on the introduction of comprehensive reforms of the labor market and welcomes their determination to put such reforms in place at an early date. Radical changes in labor market conditions are required if the tendency for the economic system to maintain inflation even in the presence of substantial slack in the goods and labor markets is to change. Therefore, the staff welcomes the approval of significant labor market reforms by the Cabinet on December 3, 1993. The staff also supports the recent streamlining of benefits aimed at encouraging quick re-entry into employment. These initiatives constitute a major step forward in increasing the flexibility of the labor market and reducing the role of regulations in labor relations. They should foster a moderation of wage settlements and gradually reduce the structural rigidities impeding employment.

There is also a pressing need to reinforce competition in the Spanish economy, particularly in the services sector, which is characterized by excessive market power and pervasive regulation. The staff urges the authorities to eliminate these impediments, especially where they are the outcome of noncompetitive practices sanctioned by the State, as in transport, telecommunications, energy, commerce, and professional services. Privatization would also contribute to enhance competition and efficiency.

As regards financial policies, the staff concurs with the strategy followed by the authorities. Until the recent change in the EMS, monetary policy had been conditioned by the commitment to the exchange rate objective. The widening of the EMS bands somewhat lifted this constraint, but the authorities have been prudent in balancing the need for lowering interest rates with the objectives of reducing inflation. Appropriately, they have taken advantage of the opportunities that have arisen to ease monetary conditions without affecting the exchange rate or inflationary expectations. The decline in long-term interest rates attests to the credibility of this policy. Nonetheless, in the immediate future the authorities should continue to pursue their very prudent course on interest rates. There will, however, be room for significant cuts in interest rates once the structural reforms are in place and the fiscal consolidation envisaged for 1994 is becoming evident. This room should then be fully used.

The move toward granting autonomy to the Bank of Spain is welcome, as is the Bank's commitment to price stability as the ultimate goal of monetary policy. Under the new circumstances, care will need to be taken to give monetary policy appropriate transparency and credibility. The requirement of periodic reports to Parliament on developments in and prospects for monetary policy will be important in this regard, especially if it leads to the adoption of specific medium-term targets for the inflation rate and a regular review of the progress toward these targets. The exchange rate should remain an important guide for the conduct of monetary policy. Following the recent adjustments, the current exchange rate implies a favorable competitive position. Thus, any marked further depreciation should be viewed with concern, in particular as it would reflect doubts about the credibility of monetary policy.

The effort in the fiscal area planned for 1994 is sizable, given the weak economic activity. Nonetheless, the magnitude of the deficit is now such that the proposed adjustment has to be considered as a minimum and it will be crucial to avoid any slippage in order to give a clear signal to the markets about the seriousness of the fiscal consolidation. The staff is concerned that the difficult nature of some of the proposed measures, together with the usual forces pushing in the direction of fiscal expansion, may result in deviations from the intended path. The authorities must be prepared to offset any potential overrun with additional measures to control expenditures as soon as deviations are detected.

The staff agrees with the Government's objectives of fiscal consolidation over the medium term and encourages the authorities to formalize these objectives--along the lines of the 1992 Convergence Program--so as to re-establish a clear path for fiscal action in the coming years. Significant discrete measures will be required to meet such objectives since, if past spending trends continue unchecked, even a robust economic recovery will not be enough to achieve the needed fiscal consolidation. Fiscal restraint over the medium term will be particularly important in view of the pressures likely to arise from demographic changes, and of the need to increase

domestic saving in order to permit the capital deepening required to meet Spain's real convergence objectives. In the formulation of the medium-term plan of fiscal action, attention will need to be given to enhancing compliance with direct and indirect taxes, to restraining the growth of the wage bill, and to increasing the degree of self-financing in the fields of education, health, and public transportation. Social security arrangements will also have to be reviewed to improve the targeting of the benefits and to ensure adequate funding of future pension and related benefits. In addition, the Government will have to continue and even speed up the reforms needed to reduce the dependence of public enterprises on government transfers.

The staff commends the authorities for the positive role they played in the Uruguay Round of GATT. Further benefits of trade creation clearly exist in the case of the European Union's relationship with neighboring countries in the Maghreb, and in central and eastern Europe, and the possibility of expanding such ties should be explored further. The staff encourages the Government to take a positive attitude in supporting the access of these countries' exports to the European Union, including for goods such as steel and agricultural products. Spain should continue striving to increase its Overseas Development Assistance.

It is proposed that the next Article IV consultation with Spain be held on the standard 12-month cycle.

Table 1
Spain -- Selected Economic Indicators 1/

	1988	1989	1990	1991	1992	1993	1994
Spending & Output (% change)							
Real GDP	5.2	4.8	3.6	2.2	0.8	−0.9	1.5
Domestic Demand	7.0	7.8	4.7	2.8	1.1	−3.3	0.3
Exports	5.3	3.0	3.2	7.9	6.7	7.7	8.8
Imports	14.3	17.2	7.8	9.0	6.6	−3.3	3.1
Prices & Costs (% change)							
GDP deflator	5.7	7.0	7.4	7.0	6.5	4.1	3.7
CPI	4.8	6.8	6.7	5.9	5.9	4.7	4.1
Compensation per Worker	6.5	5.6	8.7	8.9	8.8	6.9	3.2
Unit Labor Cost per Worker	4.1	5.0	7.7	6.8	5.9	3.4	0.5
Labor Market & Output Gap							
Employment (% change)	2.9	4.1	2.6	0.2	−1.9	−4.1	−1.2
Unemployment Rate (% of labor force)	19.5	17.3	16.3	16.3	18.4	22.2	23.3
Output Gap (% of potential)	−1.8	−2.2	−1.3	0.0	2.3	5.3	5.9
Monetary Conditions and Aggregates							
Nominal Eff. Exch. Rate (% change)	3.3	4.6	3.7	−0.4	−2.1	−13.3	−6.0
Real Eff. Exch. Rate CPI (% change)	5.0	6.9	5.5	0.7	−0.1	−12.0	−5.0
Three-Month Interbank Interest Rate	11.7	15.0	15.2	13.2	13.3	11.8	8.7
Government 10-Year Bond Yield	...	...	...	11.4	11.7	10.3	8.0
Real Short-Term Interest Rate	6.5	7.7	8.0	6.9	7.0	6.8	4.4
Real Differential with Germany	3.3	3.4	2.0	2.6	2.8	4.3	1.5
Liquid Assets Held by the Public (% change)	14.2	14.0	11.5	10.7	5.1	7.7	...
M3 (% change)	12.8	14.1	13.6	11.3	4.3	7.6	...
Domestic Credit (% change)	17.2	17.1	10.0	9.0	7.2	3.9	...
Balance of Payments (US$ billions)							
Trade Balance	−17.8	−24.9	−29.5	−30.7	−30.8	−18.4	−14.4
Current Account Balance	−3.7	−11.5	−16.9	−16.7	−18.3	−9.8	−5.3
Official Reserves	41.9	46.9	56.0	70.3	49.7	45.5	...
Sources & Disposition of Saving (% GDP)							
Gross Investment	23.8	25.2	25.5	24.7	22.9	20.8	20.6
Gross Private Investment	19.9	20.8	20.3	19.7	18.5	16.4	16.1
Gross Public Investment	3.8	4.4	5.2	5.0	4.3	4.4	4.4
Net Private Saving	2.2	−0.2	0.5	1.8	1.3	5.1	5.2
Net Public Saving	−3.2	−2.8	−3.9	−5.0	−4.5	−7.2	−6.4
Cur. Ac. Balance	−1.1	−3.0	−3.4	−3.2	−3.2	−2.1	−1.2

Source: Ministry of Economy, INE, and Fund staff estimates.
1/ Figures for 1993 and 1994 are staff projections.

Table 2
Spain -- General Government Operations, 1987-94 1/
(percent of GDP)

	1987	1988	1989	1990	1991	1992	1993	1994
Current revenues	37.4	37.3	39.1	38.9	39.4	41.1	40.7	40.7
Indirect taxes	10.6	10.5	10.5	10.1	9.9	10.4	9.5	10.1
Taxes on income and wealth	10.1	10.3	11.9	11.9	11.8	12.2	11.7	11.4
Social security contributions	12.7	12.5	12.8	13.0	13.2	13.9	14.3	14.2
Other current revenues	4.0	3.9	3.9	3.9	4.5	4.6	5.2	5.0
Current spending	35.7	35.5	36.2	36.9	38.6	40.5	42.9	42.7
Public consumption	15.1	14.7	15.1	15.5	15.8	16.7	17.3	16.5
Current transfers	13.8	13.8	13.9	14.4	15.3	16.4	17.3	17.7
Interest payments	3.5	3.3	3.5	3.5	4.0	4.2	4.9	5.3
Subsidies	1.8	2.1	2.0	1.9	1.7	1.7	1.7	1.5
Other current spending	1.6	1.5	1.6	1.5	1.8	1.5	1.7	1.7
Current balance (deficit -)	1.7	1.8	2.9	2.1	0.8	0.6	-2.2	-2.0
Net capital transfers	1.3	1.2	1.3	0.8	0.8	0.8	0.8	0.3
Gross fixed capital formation	3.4	3.8	4.4	5.2	5.0	4.3	4.4	4.3
Primary balance (deficit -)	0.4	0.1	0.7	-0.4	-0.9	-0.2	-2.3	-1.1
Overall balance (deficit -)	-3.1	-3.2	-2.8	-3.9	-5.0	-4.5	-7.2	-6.4
of which:								
Central	-3.5	-2.9	-2.2	-2.7	-2.4	-2.4	-6.2	-5.2
Social Security System	0.3	-0.0	0.2	-0.3	-0.8	-0.8	0.0	-0.5
Territorial	0.0	-0.3	-0.8	-1.0	-1.6	-1.2	-1.0	-0.7
Net lending 2/	1.2	-2.6	1.3	1.1	0.4	1.7	1.6	1.4
Borrowing (-) requirement	-4.4	-0.6	-4.1	-5.1	-5.3	-6.2	-8.9	-7.8
Memorandum Items								
Gross Outstanding Debt	46.1	42.4	43.9	44.0	45.2	48.1	55.0	59.9
Nominal GDP (billions of ptas)	36144.0	40158.7	45044.1	50120.0	54820.6	58852.0	60999.2	63916.5

Source: INE, Bank of Spain, Ministry of Economy and staff estimates.

1/ Figures for 1993 and 1994 are from the Ministry of Finance and are consistent with the central government 1994 Budget.

2/ Net lending is defined as the change in the general government financial assets (excluding cash and other deposits). This definition differs slightly from the one used by the authorities.

Table 3. Spain: Summary of Balance of Payments, 1986-93

	1987	1988	1989	1990	1991	1992	1993 Proj.
	(Transactions basis; in billions of dollars)						
Trade balance	-12.8	-17.8	-24.9	-29.5	-30.7	-30.8	-18.4
Exports, f.o.b.	34.3	40.1	43.7	55.0	59.0	65.0	61.5
Imports, f.o.b.	47.1	57.9	68.6	84.5	89.7	95.8	79.9
Services	10.2	9.8	8.8	8.4	8.0	6.5	4.0
Tourism and travel	12.8	14.1	13.1	14.3	14.5	17.0	14.0
Factor income	-2.8	-3.4	-3.0	-3.8	-4.8	-6.6	-7.9
Other	0.2	-0.9	-1.3	-2.1	-1.7	-3.9	-2.1
Transfers	2.6	4.3	4.6	4.2	6.0	5.9	4.6
Private	2.3	3.0	3.2	3.0	2.2	2.6	...
Public	0.4	1.3	1.4	1.2	3.8	3.3	...
Current account	-0.0	-3.7	-11.5	-16.9	-16.7	-18.3	-9.8
Long-term capital	8.8	9.9	17.0	18.9	33.7	21.7	...
Private sector	9.3	10.6	14.2	15.5	18.5	18.2	...
Direct investment	1.9	3.3	4.2	8.0	5.7	5.9	...
Portfolio investment	3.6	1.7	6.2	3.7	4.1	2.2	...
Public sector	-0.2	-0.7	2.3	3.2	14.5	2.9	...
Banking sector	-0.3	0.1	0.5	0.2	0.7	0.5	...
Basic balance	8.8	6.2	5.4	2.0	17.0	3.3	...
Short-term capital 1/	4.7	1.4	0.8	6.3	-3.9	-10.3	...
Change in banking sector net foreign assets	-0.6	0.7	-1.2	-0.8	1.0	-10.0	...
Change in central bank foreign reserves 2/	-12.9	-8.3	-5.0	-7.5	-14.1	17.0	4.0
Memorandum items:							
Official reserves	34.4	41.9	46.9	56.0	70.3	49.7	45.5
	(As percent of GDP)						
Trade balance	-4.4	-5.2	-6.5	-6.0	-5.8	-5.4	...
Current account	-0.0	-1.1	-3.0	-3.4	-3.2	-3.2	...

Source: Ministry of Economy and Finance.

1/ Includes errors and omissions.

2/ A negative sign indicates an increase in foreign reserves.

Table 4
Spain -- Medium-Term Scenarios
(percent of GDP unless otherwise indicated)

	1992	1993	1994	1995	1996	1997	1998
Reform Scenario							
Output Growth (%)	0.8	-0.9	1.5	3.8	4.9	5.0	5.0
Potential Output Growth (%)	3.2	2.1	2.2	2.6	3.2	3.3	3.3
Unemployment Rate (% labor force)	18.4	22.2	23.3	22.6	20.3	17.7	15.0
Gap (% of potential)	2.3	5.3	5.9	4.8	3.3	1.7	0.0
Real Interest Rate on Debt (%)	3.2	5.8	5.8	4.9	3.6	3.6	3.6
GDP Deflator (%)	6.5	4.1	3.7	3.3	3.1	2.9	2.5
Overall Balance	-4.5	-7.2	-6.4	-6.3	-5.1	-4.6	-4.0
Primary Balance	-0.2	-2.3	-1.1	-1.4	-1.0	-0.6	-0.2
Interest Payments	4.2	4.9	5.4	4.9	4.1	4.0	3.8
Outstanding Debt	48.1	55.0	59.9	62.7	63.7	64.2	64.2
Real Primary Spending (%) 1/	3.1	3.5	-0.5	5.0	5.0	5.0	5.0
Status-Quo Scenario							
Output Growth (%)	0.8	-0.9	1.2	2.9	3.5	3.5	3.5
Potential Output Growth (%)	3.2	2.1	2.1	2.2	2.3	2.3	2.3
Unemployment Rate (% labor force)	18.4	22.2	23.5	23.9	22.9	21.4	19.8
Gap (% of potential)	2.3	5.3	6.1	5.5	4.4	3.2	2.1
Real Interest Rate on Debt (%)	3.2	6.0	5.8	5.0	5.0	5.0	5.0
GDP Deflator (%)	6.5	4.1	4.0	4.1	3.8	3.5	3.1
Overall Balance	-4.5	-7.2	-6.8	-7.6	-8.0	-8.5	-8.8
Primary Balance	-0.2	-2.3	-1.3	-2.1	-2.3	-2.6	-2.9
Interest Payments	4.2	4.9	5.5	5.5	5.7	5.8	5.9
Outstanding Debt	48.1	55.0	60.2	64.4	68.5	73.1	77.9
Real Primary Spending (%) 1/	3.1	3.5	-0.5	5.0	5.0	5.0	5.0

Source: Fund staff estimates.

1/ Net of unemployment compensation. Assumes that after 1994 the 1985-93 average growth of 5 percent a year is resumed.

Basic Data 1/

Area	504,800 square kilometers
Population 1992 (Est.)	39.1 million
Labor force 1992	15.1 million
GDP per capita (in thousands of pesetas)	Ptas 1,554 (US$12,249)

Use and supply of resources (1993)	In billions of pesetas	In percent
Private consumption	38,286.3	63.0
Public consumption	10,620.7	17.5
Fixed investment	12,452.2	20.5
Stockbuilding	210.8	0.4
Gross domestic expenditure	61,570.0	101.4
Exports of goods and services	12,320.8	20.3
Imports of goods and services	13,139.1	21.6
Gross domestic product	60,751.7	100.0

Selected economic indicators (annual percentage change)	1991	1992	1993
Real domestic demand	2.8	1.1	-3.3
Real GDP at market prices	2.2	0.8	-0.9
Unit labor costs (economy-wide)	6.8	5.9	3.4
Unit labor costs (manufacturing)	6.6	5.3	1.1
Consumer prices	5.9	5.9	4.7
Unemployment rate (average level)	16.3	18.4	22.2
Liquid assets held by the public (ALP) 2/	10.7	5.1	6.0
Public sector accounts (as percent of GDP)			
General Government			
Current revenue	39.4	41.1	40.7
Current expenditure	38.6	40.5	42.9
Capital expenditure	5.8	5.1	5.2
Overall balance (deficit -)	-3.0	-4.5	-7.2
Overall borrowing requirement (deficit -)	-5.3	-6.2	-8.9
Balance of payments (transactions basis; in billions of U.S. dollars)			
Exports	59.0	65.0	61.5
Imports	89.7	95.8	79.9
Trade balance	-30.7	-30.8	-18.4
Net invisibles	14.0	12.4	8.6
Current account balance	-16.7	-18.3	-9.8
(as percent of GDP)	(-3.2)	(-3.2)	(-2.1)
Long-term capital	33.7	21.7	...
Short-term capital (including errors and omissions)	-3.9	-10.3	...
Overall balance	13.1	-6.9	...

Sources: Data provided by the Spanish authorities; and staff estimates.

1/ 1993 data are staff estimates.
2/ Daily average data. Includes bank repurchase agreements with depositors.

Spain: Fund Relations

(As of October 31, 1993)

I. Membership Status: Spain became a member of the Fund in 1958. On July 15, 1986, Spain accepted the obligations of Article VIII, Section 2, 3, and 4 of the Articles of Agreement.

II. General Resources Account:	SDR Million	% Quota
Quota	1,935.40	100.0
Fund holdings of currency	1,162.45	60.1
Reserve position in Fund	772.96	39.9
Operational budget transfers (net)	35.60	

III. SDR Department:	SDR Million	% Allocation
Net cumulative allocation	298.81	100.0
Holdings	152.73	51.1

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	2/06/78	2/05/79	143.19	0.00

VI. Projected Obligations to Fund: (SDR Million; Based on Existing Use of Resources Only): None

VII. Exchange Rate Arrangement:

Since June 19, 1989, Spain has participated together with Belgium, Denmark, France, Germany, Ireland, Luxembourg, the Netherlands, and Portugal in the exchange rate mechanism of the European Monetary System. Under this agreement, Spain maintains spot exchange rates of the currencies of other participants within margins of 15 percent above and below cross rates derived from central rates expressed in ECUs. The Spanish peseta was included in the ECU currency basket on September 21, 1989.

Spain continues to apply exchange restrictions vis-à-vis Iraq and the Federal Republic of Yugoslavia (Serbia/Montenegro), which were notified to the Fund under Decision No. 144-(52/51) on 9/29/91 and 9/29/92, respectively.

VIII. Article IV Consultations:

The last Article IV consultation (Interim) was concluded on August 7, 1992 and the staff report (SM/92/145, 7/24/92 and SM/92/145, Sup. 1, 8/7/92) was not discussed by the Executive Board. The last full Article IV

consultation discussions were concluded on June 12, 1991 and the staff report (SM/91/154, 8/6/91 and SM/91/154, Sup. 1, 11/12/91) was discussed by the Executive Board on November 25, 1991.

IX. Technical Assistance: None

X. Resident Representative: None