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August 27, 1985

To: Members of the Executive Board

From: The Acting Secretary

Subject: Spain - Staff Report for the 1985 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with Spain, which has been tentatively scheduled for Executive Board discussion on Monday, September 23, 1985. A draft decision appears on page 25.

Mr. Beleza (ext. 8836) or Ms. Alonso-Gamo (ext. 8841) are available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

SPAIN

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives for the
1985 Article IV Consultation with Spain

Approved by P. de Fontenay and Eduard Brau

August 26, 1985

I. Introduction

A staff team, consisting of H.B. Junz, M. Beleza, P. Alonso-Gamo (EP) (all EUR), M. Blejer (FAD), N. Kirmani (ETR), and J. Gough (ETR) as secretary, visited Madrid from May 28 to June 15, 1985 to conduct Article IV consultation discussions. The mission met with the then Minister of Finance, Mr. Boyer, the Governor of the Bank of Spain, Mr. Rubio, and with officials of the Ministries of Economy and Finance, Industry and Labor, the Bank of Spain, the major public enterprises, the employers' and bankers' association, and the main trade unions. Mr. P. Perez, Executive Director for Spain, attended some of the meetings as an observer, as did Mr. J. de la Herran, Advisor to the Executive Director for Spain.

Spain continues to avail itself of the transitional arrangements in Section 2 of Article XIV of the Articles of Agreement.

II. Background

When the current government came to power almost three years ago, it inherited a burgeoning public sector deficit, large and growing absorption of resources by loss-making public enterprises, a rigid labor market characterized by shrinking employment opportunities and skyrocketing unemployment, a rising inflation rate, and a deteriorating external sector performance. These developments reflected in part a capital stock that was not well suited to changing world demand and an inflexible wage structure built on a sustained period of unrealistically high wage awards.

Against this background of deep-seated structural weaknesses and an adverse cyclical situation, the new government recognized that attempts to reflate the economy would fail to bring about sustained recovery, and that a medium-term strategy aimed at addressing the imbalances in the economy was needed. Accordingly, for the period from 1983 to 1986, the Government targeted a reduction in the inflation rate, as measured by the CPI, from over 14 percent to 6 percent to be achieved largely through tight monetary and credit policies, flanked by a restrictive wage policy. At the same time, the growth of the public sector was to be brought under control and a steady reduction of the deficit was targeted together with, and partly reflecting, a rationalization of the social security system and cuts in transfers to loss-making enterprises. The latter was to result largely from a basic industrial restructuring plan which would shed both capacity and labor in declining industries and set the stage for a regeneration of employment opportunities. However, basic improvement in the employment situation hinged upon restoration of the deeply eroded profit shares in the private sector and the introduction of greater flexibility into the labor market. In recognition thereof, the authorities adopted measures to liberalize work contracts and shifted some of the burden of the cost of social security provisions from employers to employees and to the state budget.

During the last Article IV discussions, Executive Directors were in full support of the authorities' strategy. They stressed, however, that this strategy could succeed only through forceful implementation of the planned measures to reduce the budget deficit, in particular the expenditure cuts in the area of transfer payments. Accordingly, they supported the plans to reform the social security system and the moves to withdraw financial support from ailing industries generally and from loss-making public enterprises in particular. They observed that an integral part of the recovery process would have to be continued wage restraint and an effective increase in the flexibility of the labor market. They commended the turnaround in the external current account position from deficit to surplus, but underlined that maintenance of gains in market shares would depend on further progress in reducing the inflation rate.

III. Recent Economic Developments

1. Developments in 1984

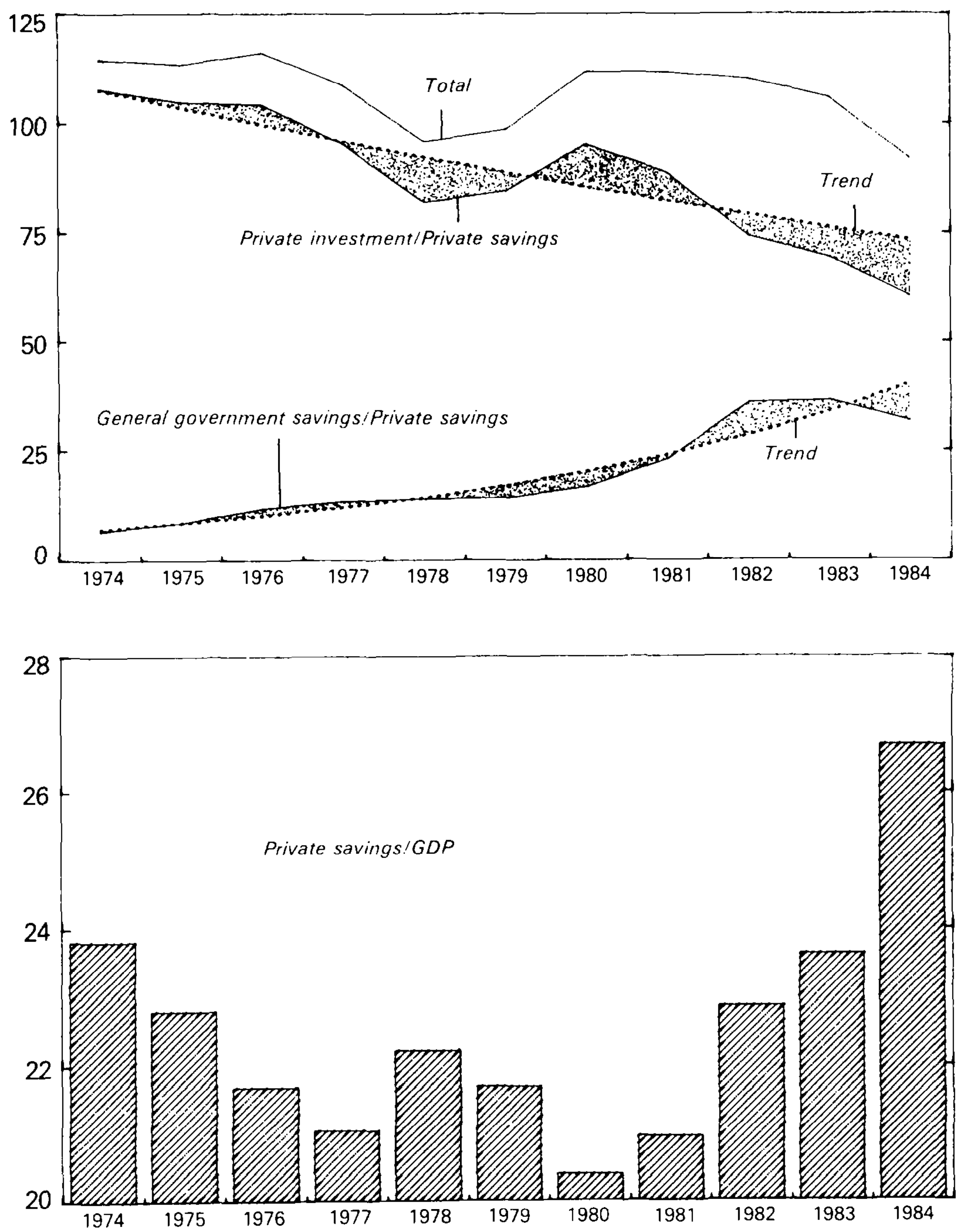
The Spanish economy in 1984 exhibited a rather greater ability to meet the short-term targets than had been expected and, in some areas, a number of important firsts were registered. First, the deceleration of the inflation rate, that began in 1983, was sustained into 1984 when the December-to-December rise in the CPI, at just under 9 percent, was within target. 1/ This marked the first time in many years that inflation was contained to one-digit levels. Second, the policy of wage restraint resulted in the first significant fall in real wages in over a decade. Third, the public sector deficit fell to 5.2 percent of GDP and the borrowing requirement, a more telling indicator, fell from 7 percent equivalent of GDP in 1983 to 6.4 percent, (after exclusion of nonrecurrent transactions associated with the privatization of the large bankrupt RUMASA holdings). Thus, the Government's objective regarding the fiscal deficit was more than achieved in 1984. However,

1/ Although, with an 11.3 percent rise, the 10 percent year-over-year target was overshot.

CHART 1

SPAIN

INVESTMENT, PRIVATE AND PUBLIC SAVINGS[1], 1974-1984



Source: Bank of Spain, *Annual Report* and *Statistical Appendix*.

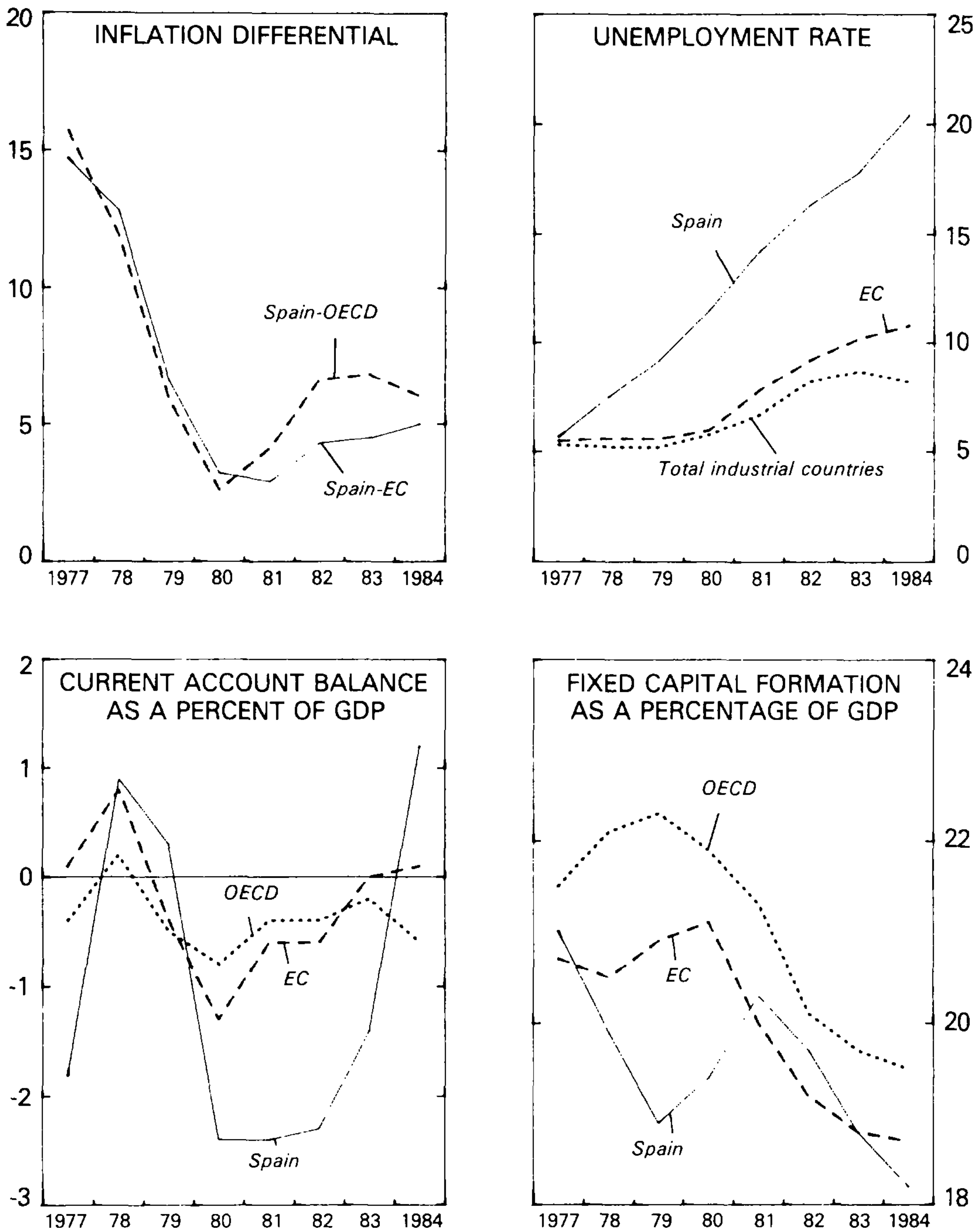
[1]Private sector includes public enterprises.

Note: The total in the upper panel equals the sum of the two ratios and, therefore, the ratio of the external current account balance to private savings with an excess over 100 indicating a deficit.

CHART 2

SPAIN

COMPARATIVE TRENDS IN INFLATION, UNEMPLOYMENT, INVESTMENT AND THE CURRENT ACCOUNT, 1977-84



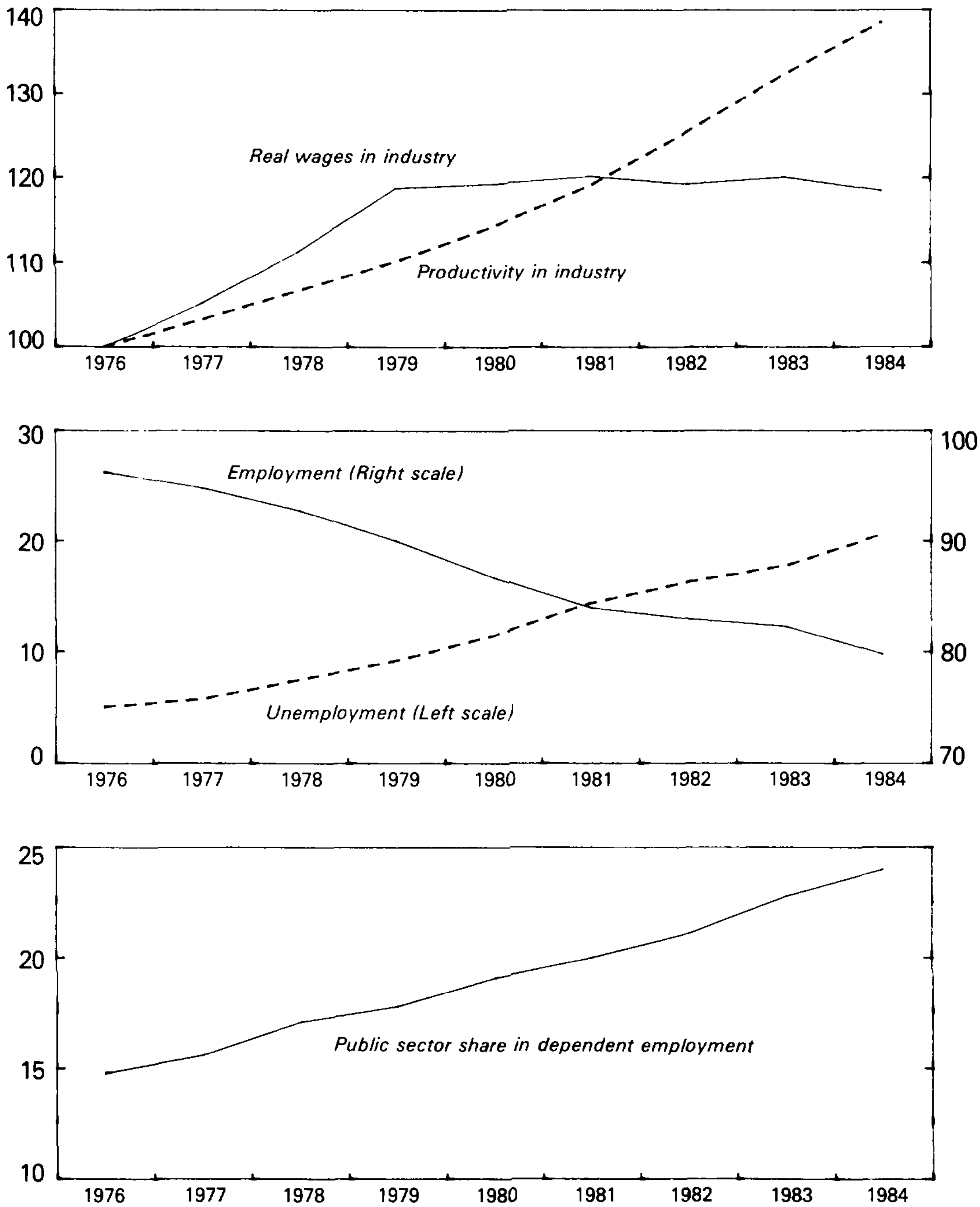
Sources: Bank of Spain, *Annual Report* 1984, OECD, *Economic Outlook* 1984, IMF, *World Economic Outlook* and staff estimates.

CHART 3

SPAIN

LABOR MARKET DEVELOPMENTS, 1976-84

Index numbers (1976 = 100) and ratios



Sources: Bank of Spain, *Annual Report*, 1984; and staff estimates.

it materialized at higher levels of both revenue and expenditure than had been programmed--a disturbing development, particularly if this pattern were to be carried forward.

Although the structure of the improvement in the deficit was not quite as desired, the outcome for 1984 indicates that the seemingly inexorable trend toward an ever-higher absorption of private savings by the public sector may not only have been broken, but actually have turned around (Chart 1). This is particularly important, given that the recorded upward trend of savings, especially in 1984, does not imply a genuinely higher propensity to save, but rather continued nonspending on investment. The associated low credit demand allowed the expansion of the central monetary target, liquid assets in the hands of the public (ALP), to remain within its range, albeit at the upper limit, despite the fact that the overall balance of payments moved into a surplus of about US$4 1/2 billion instead of into balance, as projected. Buoyed by the virtually exponential rise in exports of almost 18 percent in real terms, real GDP rose by 2 1/4 percent as projected, although all components of private domestic demand, and investment in particular, continued to decline (Chart 2).

The unbalanced growth of demand explains in part why, despite the positive performance with respect to the major policy targets set for 1984, the central policy objective, i.e., an improvement in the employment situation, was not achieved. The main impediments to a rise in demand for labor, however, remained structural. Thus, overall employment continued to shrink and the measured unemployment rate rose to exceed 20 percent (Chart 3).

The continued steep fall in private investment 1/ and associated labor shedding, suggest that the rationalization process that enterprises have been engaged in for several years still has not run its course. Although profitability rose significantly in 1984, and has been improving continuously since 1980, the previous erosion had been so large that, by 1984, profit shares in industry still were well below their 1970 level (Table 1). Moreover, profit shares in industry remained some 40 percent below those registered in the economy as a whole, compared to almost parity in the period until the early 1970s. Thus, it may not be surprising that the double impetus provided in 1984 by an actual fall in real wages per employee and a sizable reduction in interest rates went largely to bolster enterprise balance sheets rather than to increase investment.

1/ Investment expenditures under the industrial reconversion program--which are publicly financed--accounted for an estimated 10 percent of investment activity in 1984, indicating that private investment expenditures may have fallen by 8 percent in real terms.

Table 1. Spain: Changes in Profitability in Industry
Profit Shares in Value-Added 1970-84

(In percent)

	Labor Share	Profit Share
1970	55.9	44.1
1975	69.2	30.8
1977	79.4	20.6
1979	86.0	14.0
1980	83.6	16.4
1981	81.4	18.6
1982	78.2	21.8
1983	73.3	26.7
1984	71.5	29.5

Source: Bank of Spain.

As the restructuring of enterprise balance sheets continued and inventories were depleted, in part in conjunction with unexpectedly high export demand, the external financing needs of private enterprises diminished. Accordingly, the public sector was able to absorb over 90 percent of domestic credit expansion without overt signs of pressure in domestic financial markets. The fact that interest rates could decline in the process lends support to the view that the absence of effective private credit demand was largely voluntary. Still, a significant part of credit demand was crowded out of the peseta into foreign currency markets, as the credit needs of the enlarged public sector, i.e., including the public enterprises, exceeded domestic credit expansion by 15 percent (Chart 4).

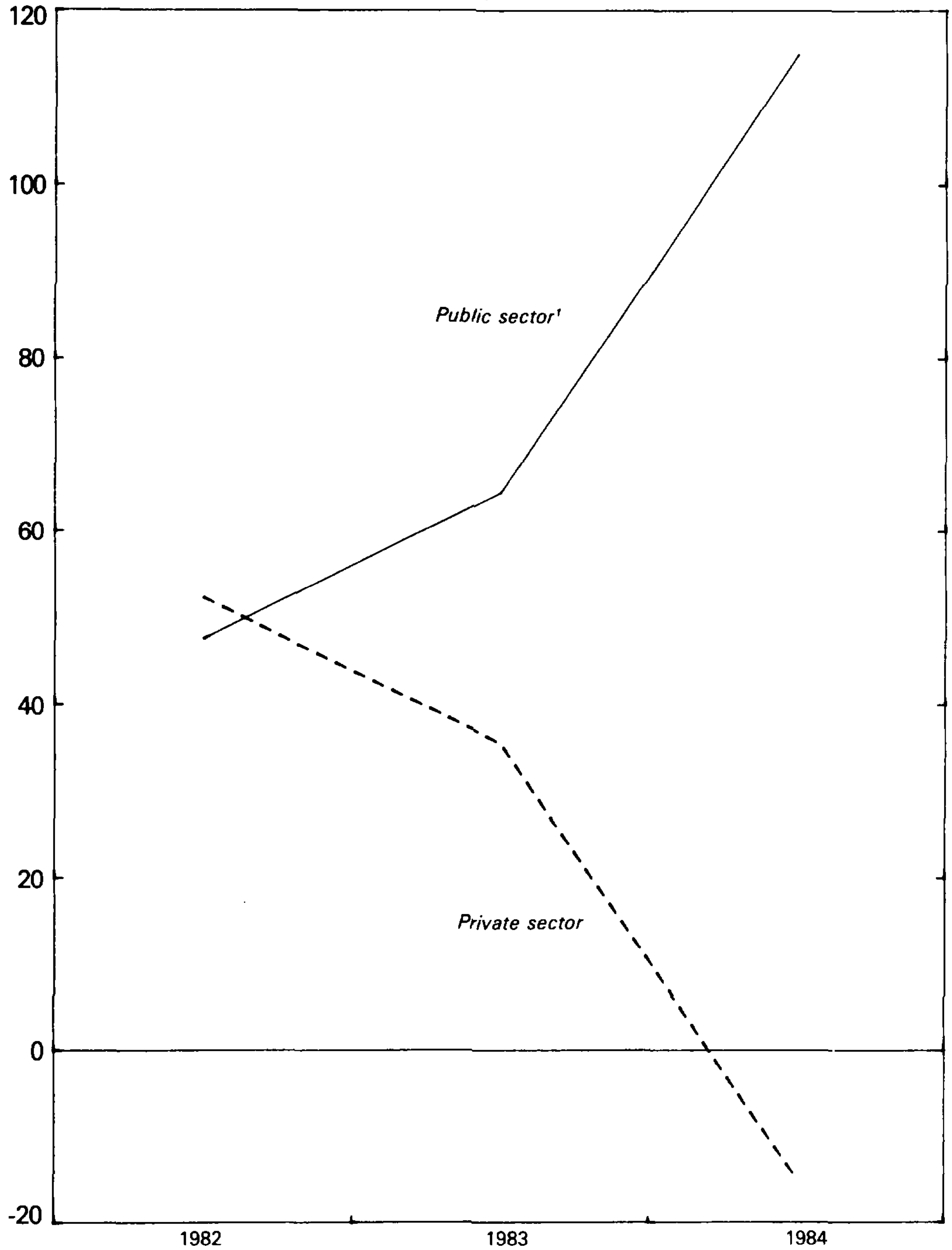
Increased recourse to foreign financing together with the much better than expected performance of the external current account balance made control of liquidity increasingly difficult. Early in the year, in the face of a growing external surplus that threatened the authorities' monetary targets and inflation objectives, the authorities moved to stabilize the exchange rate of the peseta. Subsequently, however, as domestic credit conditions eased, they appeared to steer a middle course, which by end-year left the peseta in real effective terms, almost 5 percent above its end-1983 level in spite of a rise of US$4.6 billion in net official reserves (Chart 5). The incentives to borrow abroad created early in 1984 by domestic credit conditions and the external exchange and interest rate constellation thus swung in the opposite direction later in the year. The end result was that the level of external debt outstanding at end-1984 was little

CHART 4

SPAIN

SHARE OF THE PUBLIC SECTOR AND OF THE PRIVATE SECTOR IN DOMESTIC CREDIT EXPANSION

(In percent)



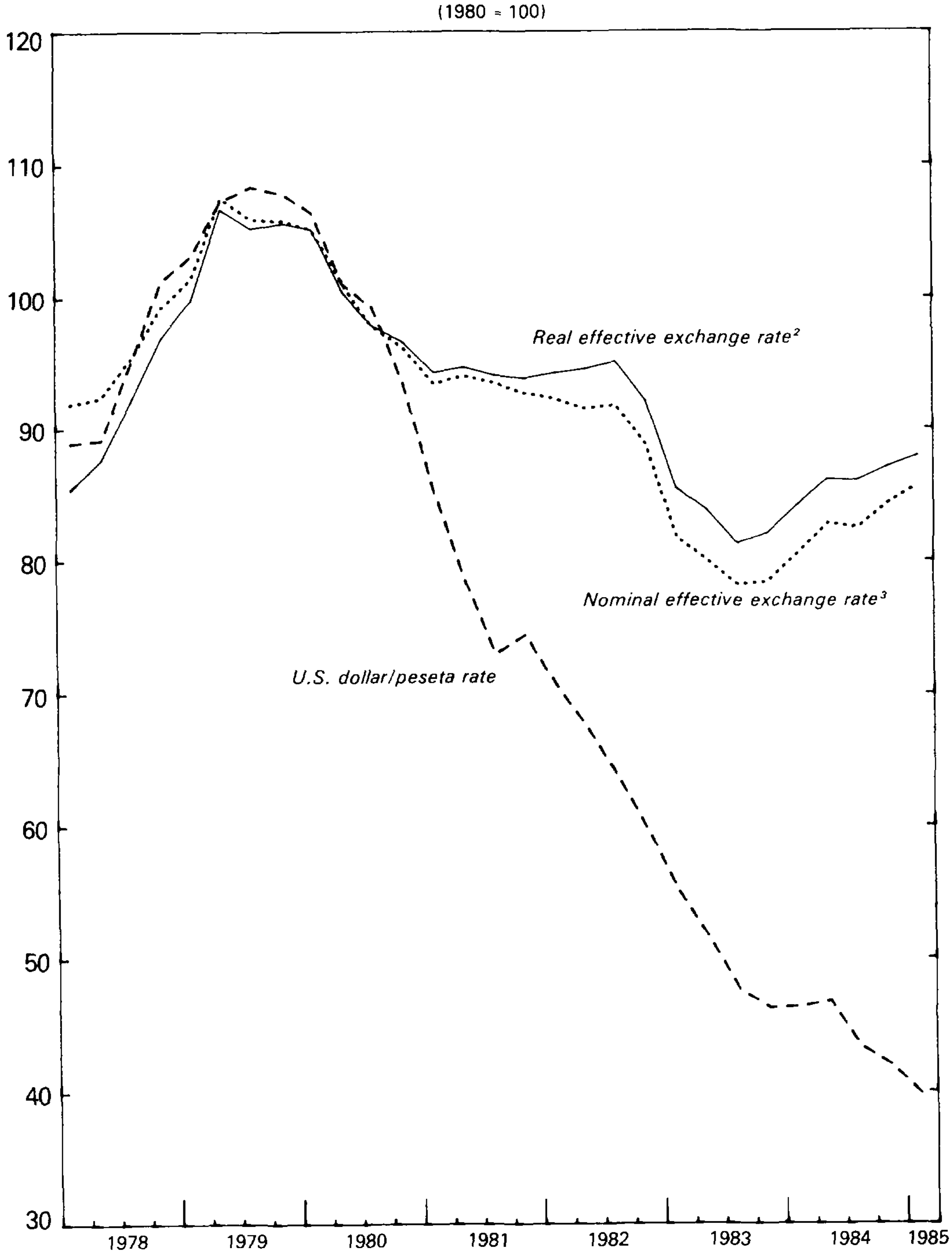
Sources: Bank of Spain; and staff estimates.
[1] General government and public enterprises.

CHART 5

SPAIN

EXCHANGE RATE DEVELOPMENTS[1], 1978(I)-1985(I)

(1980 = 100)



Source: IMF, ETR.

[1]The weights are based on the average distribution of exports, and imports, with 35 trading partners in 1980.

[2]Relative price levels are measured by consumer price indices.

[3]A decline in the index indicates the depreciation of the peseta.

changed from that of the previous year. However, the maturity structure was improved as part of the debt was refinanced at better terms. Debt service payments, reflecting the increase in amortization payments associated with prepayments and refinancing of debt, rose from 20 percent of exports of goods and services in 1983 to 24 percent in 1984.

2. Developments in and prospects for 1985

For 1985, the authorities seek to consolidate and extend the gains achieved in 1984. Accordingly, they targeted a further reduction of the public sector borrowing requirement to the equivalent of 5.1 percent of GDP, a fall in the rate of inflation to 7 percent through the year (consistent with a year-over-year increase of about 8 percent), stability in real wages, and a current account surplus of US$2 billion. To support the policy of wage moderation, a nationwide agreement covering 1985 and 1986 was reached according to which wages are to remain about stable in real terms. Under this accord, wage awards for 1985 were to range from 5 1/2 to 7 1/2 percent in the private sector and public sector wage increases were to be held to 6 1/2 percent. Monetary policy was to continue to support the deceleration of the inflation rate. Accordingly, the target growth for ALP (within a plus/minus 1.5 percentage band), was set at 13 percent, i.e, some 2 percentage points below the actual outcome in 1984. But if the actual outturn for 1985 were to tend toward the upper limit of the target range, as in 1984, monetary policy, in fact, would be more accommodative than in previous years.

Developments so far in 1985 suggest that the general targets set for the year may have been too optimistic. Policies were formulated initially on the basis of a 3 percent volume growth of GDP with the foreign balance contributing about 1 percentage point. But the erosion of external competitiveness through the appreciation of the real effective exchange rate, coupled with shortfalls in growth of foreign markets, has kept export performance rather below expectations. Accordingly, the foreign sectors' contribution to overall growth could well be negative in 1985, especially with reviving import demand.

With private consumption demand depressed in early 1985, the authorities released the equivalent of 0.5 percent of GDP of purchasing power by reducing income tax withholding rates. At the same time, the growth projection for GDP was scaled down to 2 percent, consistent with a volume increase in private consumption demand of 1 percent and a more significant revival of investment demand, largely concentrated in expenditures for equipment. An incipient upturn of private investment seemed indicated by increases both in domestic production and imports of capital goods.

Wage contracts concluded so far in 1985 have tended toward the upper range of the agreed band, so that including wage drift, wages may rise by perhaps 9 percent. Such an increase would imply some rise in real wages if the inflation target is achieved. However, it appears that inflation may be running at least 1 percentage point above target and, indeed, an 8 percent inflation rate through the year is now the working assumption of the authorities. In contrast with developments in 1984, the current account surplus is not likely to create a dilemma situation for the monetary authorities. The constellation of exchange and interest rates in the first half of 1985 created an incentive for repaying foreign debt and refinancing in pesetas. As a result, foreign exchange reserves at the Bank of Spain were no longer under upward pressure. Nevertheless, ALP began to exceed its target band in early 1985 and has remained outside the upper limit despite some increase in interest rates. The fiscal target, however, could well materialize even though economic growth will be lower than assumed in the budget, mainly because the improvement slated for 1985 is minimal in view of the overachievement of the fiscal target in 1984.

IV. Policy Discussions

1. Overview

It would seem that the basis has been laid toward a reduction of the fundamental disequilibria in the economy. The signs of an incipient revival of domestic demand, essential to halt the erosion of employment opportunities, appear to reflect the contribution structural policy measures have made to a basic change in public attitudes and to an increase in confidence.

However, the disequilibria in the economy appear to be so deep-seated that policy efforts so far may have been able only to stabilize the adverse trends of the past decade toward destruction of employment opportunities and excessive absorption of financial and real resources by the public sector. This is being fully recognized by the Government, which has taken care to emphasize that the recent changes on the economic side of the Cabinet do not portend any change in the priorities given to addressing the structural economic problems. This is considered even more important in view of Spain's accession to the EC, the terms of which will begin to be implemented as of January 1, 1986 and which will bring new opportunities, but also new adjustment requirements.

2. Fiscal policy

As noted in the previous staff report (SM/84/172), adequate control of the fiscal situation depends, in turn, largely on the ability to bring transfer payments under control. This essentially means that both the social security system and the public enterprises need to be put on a self-sustaining course and that the panoply of special incentives, subsidies and other budget supports, particularly to the enterprise sector, needs to be rationalized. In the view of the authorities, the level of consumption expenditures, at just over 12 percent of GDP, does not provide much scope for significant savings (Table 2). Indeed, the Government's pay policy already implies some decline in real wages. However, the question of overmanning, a significant problem for the public sector, which for many years has been the employer of last resort, is not being addressed explicitly. The Government has put only a ceiling on new hirings, rather than formulate plans for a reduction of the public sector's work force.

Table 2. Spain: Growth and Structure of General Government Expenditures and Receipts, 1970-1985

(In percent of GDP)

	1970	1980	1982	1983	1984	1985
1. Expenditure, total	22.1	32.2	36.6	38.0	37.7	38.3
Consumption	9.9	11.1	11.6	12.4	12.1	11.5
Investment	2.8	1.9	3.0	2.9	2.5 1/	2.5
Transfers to households 2/	8.5	15.0	16.5	16.9	16.7	16.9
Transfers to enterprises	1.9	3.3	4.9	4.6	4.5	4.5
Interest on debt 3/	0.6	0.8	0.6	1.3	1.9	2.8
2. Net lending	1.0	1.9	1.4	1.4	2.4	1.3
3. Revenues, total	22.4	30.2	30.8	32.6	32.5	33.1
Indirect taxes	8.0	6.5	7.4	8.4	8.7	9.1
Income taxes	3.5	7.2	6.7	7.7	8.0	8.1
Social security contribution	7.7	13.1	13.3	13.6	12.8	12.5
Nontax revenue	2.6	3.3	3.4	2.9	3.0	3.4
4. Overall balance (3-1-2)	-0.7	-3.9	-7.2	-6.8	-7.6	-6.4
5. Adjustment to cash basis	...	-0.2	0.4	-0.2	-0.6	--
6. Borrowing requirement (4+5) 4/	0.7	4.0	6.8	7.0	8.2	6.4
7. Official policy variable (3-1)	0.3	-2.0	-5.8	-5.4	-5.2 1/	-5.1

Source: Ministry of Economy and Finance, Bank of Spain; and Fund staff estimates.

1/ Adjusted for the recording of the sale of a public enterprise as a negative expenditure equalling 0.4 percent equivalent of GDP.

2/ Includes "other current transfers."

3/ Excludes accrued interest on Treasury bills amounting to 1.1 and 0.4 percent of GDP in 1984, and 1985, respectively.

4/ Sign reversed.

With the control of expenditures largely awaiting the success of policies directed to contain the growth of transfer payments, the major improvement in the public sector's financial situation has come from revenue increases. The Government's efforts to broaden the tax base by improving collection methods and curtailing fraud have borne considerable success, so that the tax burden 1/ has risen steadily even without rate increases. The authorities intend to make the temporary tax cuts implemented in 1985 permanent in early 1986. Although these are so modest as to do no more than moderate the projected increase in the tax burden stemming from further progress in broadening the tax base, they could be important if viewed as a structural rather than a cyclical measure, portending further such moves. Since the incidence of taxation in Spain is heavily concentrated on wage earners, a return of the benefits from increases in the efficiency of tax collections to the economy at large would serve to widen incidence in conjunction with the broadening of the tax base.

On the core expenditure problems, the Government's efforts in 1985 have concentrated on rationalizing the pension system within the social security system and on containing the losses of the public enterprises. In recent years, the financial base of the pension system has been eroding rapidly as early retirements and disguised unemployment in the disability schemes worsened the already demographically declining ratio of the active to the passive population within the system. At the same time, the value of the average pension has been increasing rapidly, in part as the natural consequence of the phasing out of old pensions but increasingly as a consequence of fraud. The pension reform seeks to curtail fraud and inequities by reducing the possibilities for inflating declared salaries in the base period for calculation of pensions; increasing the qualification period to reduce the current ability to "buy" a pension cheaply through an actuarially inadequate contribution period; and by tightening the rules for eligibility for disability pensions. Finally, cost of living adjustments for most pensions are to be made automatically on the basis of expected inflation as used in budget calculations. The implementation of the reform is expected to have a minimal budgetary effect in 1986, but savings are to rise quickly over time to about two-thirds of the current cost of the system by 1993.

The reforms had been criticized heavily both by employers and unions in part because each side had wanted the pension reform to be folded into a comprehensive reform of the entire system. Also, both social partners looked for basic changes in the revenue system so as to finance the social security system from general taxes, in particular from the revenues to be generated by the VAT. The authorities had resisted these pressures and the pension law was passed largely unscathed in July of this year. The authorities, however, felt that this success was achieved at the loss of any remaining room for maneuver and that additional measures would have to await digestion of the recently instituted ones.

1/ Tax revenues as percent of GDP.

Although further fundamental expenditure reforms are needed, especially for the health insurance scheme, the authorities estimate that there is considerable room for improvement on the revenue side of the system through increases in the contribution base. Such improvement, in turn, depends in part upon an increase in employment. Consequently, the Government has sought to increase the incentive for job creation, particularly in the smaller-size labor-intensive companies by reductions in the cost of social security to employers. This policy appears to have contributed to an increase in participation in the system despite the drop in total employment. Further, the share of income subject to social security contributions has been raised steadily (to reach 90 percent in 1983), but these increases did not suffice to stem the need for a continual rise in budgetary support.

The second focal area of policy has been the rationalization of the financial situation of the public enterprises. Their mounting losses have constituted a rising drain on the budget and have been the main component of the increase in budgetary aid to the enterprise sector. The continuing financial deterioration of the public enterprises basically resulted from past rescue operations of lossmakers and the soft budget constraint under which they subsequently have been able to operate. Indeed, wage awards generally have been higher and productivity increases lower in public sector enterprises than in the private sector. For the bulk of the public enterprises, it is estimated that labor costs in the early 1980s were 5 percent higher than in similar private firms and that by 1984 an estimated 20 percent of their industrial capacity was allowed to be idle--a condition impossible to sustain in the private sector. Under the impact of the industrial reconversion plan and individual restructuring plans, employment in major public enterprises fell in 1984 and operating losses stabilized for the first time in some years. For the group of public enterprises under the aegis of the National Institute for Industry (INI), which together with the railway company (RENFE) account for the major share of public problem enterprises, losses in cash flow terms were reduced to zero in 1984. The objective is to maintain that balance in 1985 and to achieve balance on their general income and loss statements by 1988.

The positive results achieved so far, however, have involved substantial additional budgetary resources as the Government has taken over some liabilities and provided capital injections in order to improve the balance sheets of some public enterprises. These operations, in part, reflect the growing element of privatization in the Government's strategy. The authorities deem expenditures made to put enterprises on a sufficiently sound footing so that they can be sold well spent, inasmuch as the greater contingent liabilities associated with possible closure are being transferred to the new owners. The authorities were adamant in their insistence that they themselves would not accept any further responsibility for enterprises once sold so that, in the case of subsequent failure, there was no basis--moral or otherwise--upon which further demands on budgetary resources could be made.

3. Monetary policy

Time and again monetary policy has been at odds with the rising financial needs of the public sector. This conflict was particularly sharp in 1984 and, bowing to realism, the authorities formulated their monetary targets for 1985 to be rather less restrictive than in preceding years. Thus, the main intermediate monetary target, ALP, was set to grow almost 2 percentage points faster than projected nominal GDP--in contrast with the initial program for 1984 which had provided for parallel growth. Even so, early in 1985 ALP began to move outside the upper limits of its target band (Chart 6).

With the apparent shift of monetary policy toward a somewhat more accommodating stance than had been adopted in preceding years and the unfortunate coincidence of the reacceleration of the inflation rate--partly weather-induced--the progress made so far toward lowering inflation expectations appeared to have come to a halt, if not to have been reversed. Therefore, in the spring, the authorities decided that continued resistance to a rise in interest rates, in an effort both to support a recovery in investment and to contain debt-service charges to the Treasury, would prove to be self-defeating. However, the upward movement was sufficiently limited to maintain the earlier incentives to finance in pesetas. External reserves thus remained largely unaffected, precluding thereby revival of the dilemma situation between the exchange rate objective and the targets for domestic liquidity that characterized the first half of 1984.

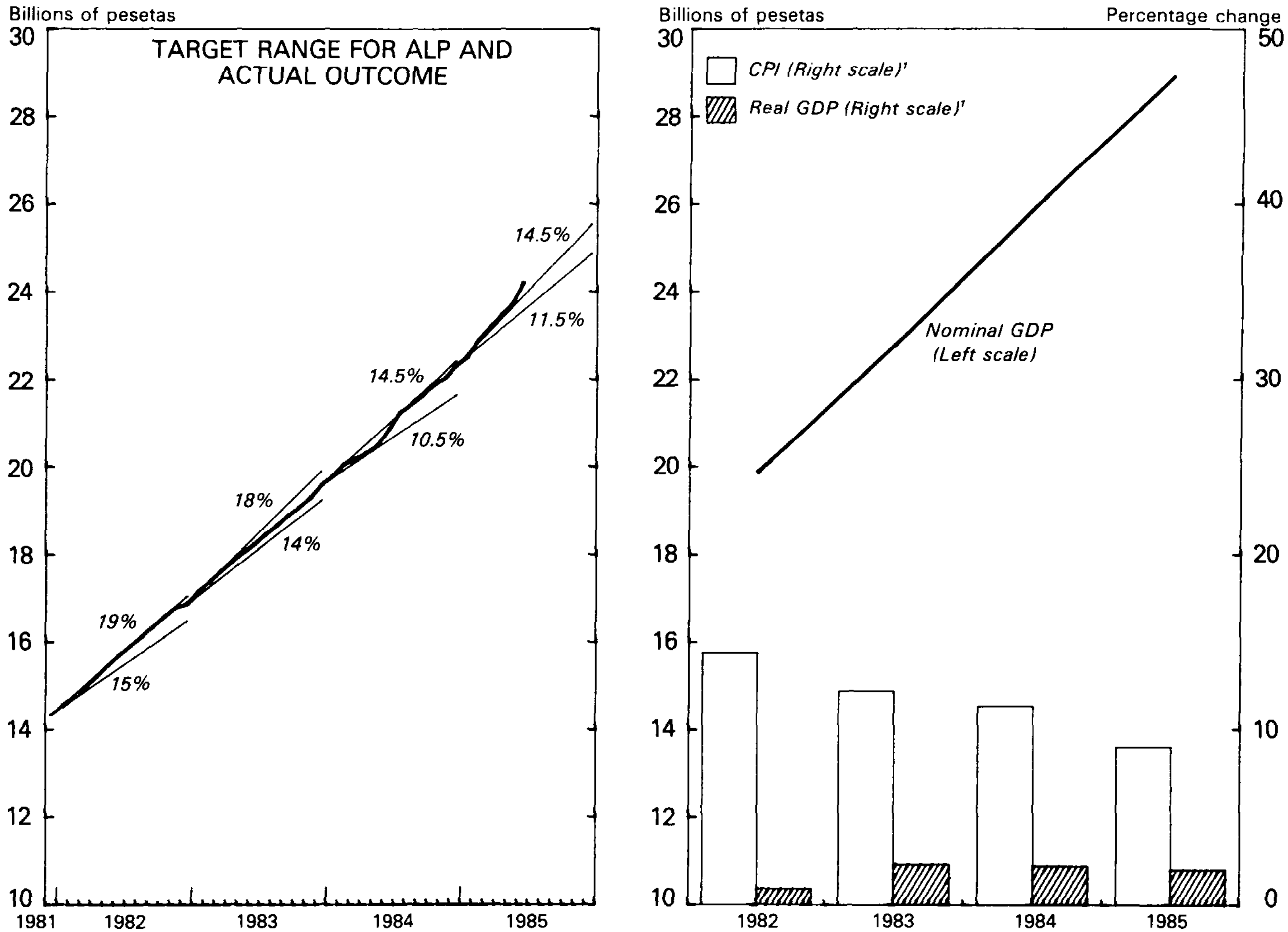
The level and movement of interest rates has become a more central policy issue with the change in monetary policy instruments that occurred in 1984. At that time, the Treasury moved to finance budgetary transactions through the issue of Treasury paper rather than through non-remunerated advances from the Bank of Spain. In the process, Treasury bills became the central bank's main intervention instrument for monetary control as well as the main asset used by financial institutions for short-run adjustments of their portfolios. A major consequence was to make explicit the interest cost of financing the deficit--which previously had been absorbed by the central bank--and through the debt-management operations of the Treasury, surface more clearly than hitherto the interdependence between monetary and fiscal policy. With private credit demand low, banks invested some 17-18 percent of their assets in Treasury bills, well above the required 11 percent. But recently, interest rates on new issues have not been sufficiently attractive, and the central bank has taken up entire issues to place them subsequently at a higher rate with the commercial banks.

Efforts to place a significant amount of Treasury bills outside the banking sector so far have not proved successful. The commercial banks have little interest in making an active market for Treasury paper as this would tend to cut into their deposit base and, thereby, raise their costs of funds. The cost of transformation of funds is very high in Spain, partly reflecting the oligopolistic character of

CHART 6

SPAIN

MONETARY TARGETS, LIQUIDITY GROWTH AND TRENDS IN REAL GROWTH AND INFLATION, 1982-85



Sources: Bank of Spain, *Annual Report*, 1984; and staff estimates.
[1]Percent change over previous year.

the banking sector and partly the heavy regulatory requirements, which pre-assign a large part of banking assets. The latter alone is estimated to raise transformation margins by some 3 percentage points. The Government has announced that the level of preassignment of bank assets will be reduced by about one half by 1990. However, debt management needs in the past have conflicted with progress toward liberalization of the banking system, so that realization of further steps likely will be dependent upon the achievement of the fiscal targets. Deregulation of the banking sector also has tended to run against the preference of the Spanish banks themselves to maintain the status quo. But this attitude is becoming less viable in view of the competition from foreign banks, which will rise further with accession to the EC.

In May 1985, the authorities broadened the withholding tax on income for financial assets to include practically all types of assets, except equity issues and Treasury bills, and applied a 45 percent rate to securities issued at discount in bearer form. These changes in the fiscal treatment of financial assets is likely to have marked effects on portfolio structures. In particular, Treasury bills--as intended--are likely to have become relatively more attractive. However, this may complicate the exercise of monetary policy yet more, first because recent and prospective developments in the monetary aggregates are likely to be more difficult to interpret as induced portfolio shifts take place and, second, because possible conflicts between the market rate of Treasury bills and the desired intervention rate may become more pronounced.

4. Labor market and industrial policies

a. Labor market

The reasons for the intractability of the employment problem in Spain, i.e., the high cost of both employing and laying off labor, have been discussed in previous reports. In support of their wage policy, the authorities actively negotiated a tripartite national Social and Economic Agreement (AES) covering 1985 and 1986. Such an agreement was considered necessary to forge a consensus not only for the Government's policy of wage moderation, but also to gain support for structural labor market policies and for the reform of the social security system. The authorities held that no further reduction in real wages was necessary and, that from 1985 onward, it would suffice to hold wage levels stable in real terms. Their view was based on the large increases in profits registered in recent years and the good export performance of 1984, which attested to a comfortable competitive situation. However, as shown in Table 1, profit shares are still well below the levels of the early 1970s and, the rise of real hourly earnings in Spain, despite its progressive deceleration, has continued to outpace that in other high-unemployment countries (with the exception of the United Kingdom) (Tables 1 and 3).

Table 3. Spain and Selected European Countries: Employment Trends, 1975-84

	1975-79	1979-82	1980	1981	1982	1983	1984
	Percentage change in total employment						
Spain	-1.5	-2.3	-3.1	-3.1	-1.2	-0.9	-1.9
OECD-Europe	0.3	-0.4	0.5	-1.0	-0.7	-0.8	0.5
Low unemployment countries							
Austria	0.9	1.5	0.6	0.7	-1.1	-1.1	0.1
Greece	1.1	0.4	0.9	0.7	-1.1	0.3	-1/2
Norway	2.3	1.3	2.3	0.9	0.7	0.6	0.5
Sweden	0.7	0.3	1.2	-0.2	-0.1	0.1	0.7
High unemployment countries							
Belgium	0.1	-1.1	-0.1	-2.0	-1.2	-0.8	--
Denmark	1.1	-0.8	0.6	-3.6	0.6	0.3	1 1/4
Italy	0.9	0.5	1.5	0.4	-0.2	0.3	0.4
Netherlands	1.0	1.0	3.1	0.6	-0.4	-1.9	-1/4
United Kingdom	0.3	-2.1	-0.5	-4.1	-1.9	-0.6	1.4
Other countries							
France	0.5	-0.2	--	-0.8	0.1	-0.8	-1.0
Germany	0.2	-0.5	1.0	-0.8	-1.8	-1.6	-0.2
Portugal	0.6	0.9	2.0	1.3	0.5	-1.9	-2 1/2

	Long-term unemployment (12 months and over) share in total unemployment				
	1979	1980	1981	1982	1983
Spain	27.5	34.7	43.6	49.4	53.8
Low unemployment countries					
Austria	8.6	9.2	6.5	5.6	10.3
Norway	3.0	2.0	3.0	3.0	7.0
Sweden	6.8	5.5	6.0	8.4	10.1
High unemployment countries					
Belgium	58.0	57.9	52.4	59.5	62.8
Netherlands	27.1	25.9	22.0	31.6	43.7
United Kingdom	24.5	19.0	21.6	33.3	36.2
Other countries					
France	30.3	32.6	32.5	39.8	42.7
Germany	19.9	17.0	16.2	21.2	29.6

	Real hourly earnings in manufacturing (percentage changes per annum)			
	1973-79	1979-82	1983	1984
Spain	7.7	2.6	2.2	1.3
OECD-Europe	3.8	0.4	0.3	-0.4
Low unemployment countries				
Austria	3.7	0.3	1.2	-0.7
Greece	6.9	4.7	-1.4	4.8
Norway	3.6	-1.6	--	4.4
Sweden	1.2	-2.1	-0.9	1.5
High unemployment countries				
Belgium	3.5	1.4	-3.5	-1.4
Denmark	3.0	-1.1	--	-1.4
Italy	8.5	1.3	0.2	0.1
Netherlands	2.1	-1.5	-0.1	-1.9
United Kingdom	1.4	-1.3	4.2	3.6
Other countries				
France	3.7	1.8	1.5	0.7
Germany	2.4	-0.1	--	--
Portugal	...	...	-7.4	-10.1

Sources: OECD; and Spanish authorities.

Although the rise in Spanish wages has been mitigated by relatively large increases in productivity, EC Commission estimates put the level of productivity in Spain still at some 25 percent below the EC average. Further, labor shares in real value added in Spain had risen more since 1970, and by 1984 retreated less, than elsewhere in Europe (Table 4). Moreover, the rise in productivity may have been the result of the rise in real wages rather than the cause thereof, as enterprises were forced to cut back their labor force and upgrade their capital stock to stem the erosion of profits.

Table 4. Spain and Selected Industrial Countries: Evolution of Labor Shares in Value Added in Constant Prices, 1970-84

(Index: 1970 = 100)

	Period High	Period Low	1984
Spain	154.2 (1979)	100.0 (1970)	126.3
High unemployment countries			
Belgium	114.1 (1975)	105.5 (1984)	105.5
Denmark	103.5 (1979)	84.9 (1984)	84.9
Italy	109.7 (1975)	94.1 (1980)	96.1
Netherlands	115.7 (1980)	97.5 (1984)	97.5
United Kingdom	110.5 (1980)	97.5 (1973)	99.5
Other countries			
France	111.3 (1975)	100.0 (1970)	103.3
Germany	112.5 (1981)	100.0 (1970)	104.6
Norway	122.2 (1978)	100.0 (1970)	116.8
Sweden	117.7 (1977)	92.3 (1984)	92.3
Switzerland	115.9 (1975)	98.9 (1984)	98.9
Japan	135.4 (1974)	100.0 (1970)	130.3

Sources: OECD; Fund staff; and Spanish authorities.

The staff took the view that this evidence points to the need for a more ambitious incomes policy than had been formulated, in particular because the AES reintroduced provisions for indexation of contract rates. This is a particularly negative development in view of the increasingly apparent difficulties the Bank of Spain is encountering in controlling the growth of liquidity and because the shift toward higher indirect taxation adds to the measured inflation rate. The success in increasing turnover tax collections may itself have contributed to the recent adverse shift in inflation expectations to the extent that these taxes have been shifted forward into prices. 1/ Anticipation of the implementation of the VAT in early 1986, which is estimated to raise the CPI by at least 2 percentage points, may play a role as well. The authorities, so far, have not considered the possibility of offsetting these effects by encouraging the social partners to agree to exclude the effects of discretionary tax measures from wage adjustments, nor have they formulated such a policy for the public sector.

The authorities noted that in a recent survey ranking the impediments to taking on more labor, the heavy burden of social security costs was cited most frequently, followed by the cost of layoffs. They had taken measures to reduce the gap between wage payments and total labor costs as noted above. But employers' contributions, at 21 percent of total labor costs, have remained the highest in Europe after France, although the social security schemes as such are, if anything, less generous than in some other European countries. The high share of social security in total labor costs results from the fact that the lion's share of social security costs--83 percent--falls on employers, while in the rest of Europe the typical cost distribution is 60/40.

The authorities have shifted the focus of changes in the social security contribution scale away from across-the-board to selective rate cuts in order to create greater employment incentives for particular segments of the labor force. Thus, there are special incentive schemes, inter alia, for the hiring of the young, the inexperienced, the long-term unemployed, those over 45 years of age, those affected by the industrial reconversion scheme, and for the conversion of temporary work contracts into permanent ones. The authorities were not quite clear about the total cost to the system involved in the adoption of these incentive schemes, as many were not mutually exclusive. The staff, acknowledging the logic of employing scarce budgetary funds in areas where they are estimated to have the greatest leverage, took the view that the institution of such a plethora of special incentives has large drawbacks, among which the loss of transparency on the cost side and the further fragmentation of an already fragmented labor market are not the least.

The authorities explained that from 1987 on it was their intention to effect general rate cuts for social security in conjunction with increases in the VAT. They estimated that a 2 percentage point increase in the VAT could finance a 5 percentage point cut in social security rates. The mission noted that, to the extent that the incentive schemes foreshadowed the final rate structure desired by the authorities, they could be defensible. However, shifting a part of the burden of financing social security to the general tax system--in particular to indirect taxes--could be successful only if the wage negotiation process did not preempt the room created by the lowering of contribution rates, a questionable proviso. The authorities further argued that especially

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1/ In 1984 increases in indirect taxation may have added 1.2 percentage points to the 8.8 percent rise in the value-added deflator.

in the case of youth unemployment, the demonstration effect that a lowering of labor costs could increase hiring rates was important. However, as this effect would be achieved through a tax subsidy, it would not necessarily result in the willingness of job seekers to reduce their acceptance rate to market clearing levels. Accordingly, there was a clear and present danger that such tax subsidies could well become permanent.

With respect to the cost of and difficulties associated with layoffs, the authorities noted that the legal framework did not stipulate seemingly excessive severance payments. However, the administrative rules, which require union consent to general layoffs, have led to voluntary payments that often amount to the equivalent of two or three years' salary. In addition, where disputes regarding layoffs have gone to the courts, more than 90 percent have been resolved in favor of workers and awards have tended to be in the region of more than a year's salary. These problems were in part addressed in the AES, which includes the principle that layoff procedures should conform to those in the EC. Those procedures generally allow enterprises, in the end, to lay off personnel for economic reasons, without union consent and without court action. The interpretation of this particular provision has been hard fought by the unions and the possibility of nonimplementation is causing employers to threaten to withdraw from the agreement. The authorities have agreed to further consultations in this regard, but appear to feel that current rules already are in accord with EC practices.

b. Industrial policies

The Government's industrial policies have largely centered on the industrial reconversion program as formulated in 1983. As noted in last year's report, both the experience with and the resistance encountered to the implementation of the program has led to some scaling down of the initial plan, which foresaw the release of some 70,000 workers. So far, about 45,000 workers have been laid off largely in the steel, shipbuilding, home appliance, and textile sectors. The whole operation, including the attendant capital injections necessary to make the slimmed-down sectors viable, has turned out to be considerably more costly than originally expected. Total costs through 1987 now are estimated to exceed Ptas 1.1 trillion, 1/ of which, two-fifths already has been expended. The lion's share has gone to redundancy payments and into funds created to provide incentives for reemploying workers and only just over one quarter of public funds and loans put into the reconversion schemes since 1983 have been used to upgrade physical plant. Since a relatively large share of job cuts--about one-quarter--has been achieved through early retirements, additional burdens devolved upon the social security funds and in some sectors, particularly shipbuilding, labor contracts were suspended only, implying further costs down the line.

1/ Almost 5 percent of 1984 GDP.

In order to create alternative employment opportunities in the areas in which industries covered by the reconversion plan are located, the authorities have instituted an incentive program that in many cases is additional to those approved under general employment and modernization schemes. The generosity of these schemes makes it theoretically feasible to start a new activity with a minimal commitment of own funds and a labor force essentially free of charge for a period of two years. The authorities were quite firm in arguing that the danger that such large and varied incentives might create the losers of tomorrow had been minimized. They had instituted a selection system that examined prospective rates of return closely; however, awards were still governed by the social urgency to bring new activities to high unemployment areas.

Despite the fact that the recent complicated expansion of various investment and employment incentive schemes points in the opposite direction, the authorities continue to be aware of the disincentives to flexible market reactions inherent in the overregulation of the economy. Recently, they moved to liberalize the opening hours for establishments and virtually abolished rent controls. The former could be an important element in creating new jobs, particularly in the service area, and the latter could provide relief for the ailing construction industry by creating incentives to modernize existing housing. However important these two moves have been, and in the case of liberalization of opening hours, however controversial, there was no further explicit agenda for a further lifting or streamlining of regulations.

5. External policies

The Spanish authorities, recognized that the remarkable export performance in 1984 derived from an equally remarkable confluence of factors: strong growth of foreign demand, continued depressed domestic demand, particularly for investments, and improved competitiveness following the real depreciation of the peseta in 1982/83. Hence, the loss of buoyancy in export performance, which had already become apparent in late 1984, seemed inevitable although protectionist tendencies abroad had damped export activity early in 1985.

The staff agreed that even consolidation of the large gain in export market shares--of over 10 percent in 1984--would constitute a positive outcome for 1985. More generally, in the case of Spain, with structural capital inflows equaling about 1 percent of GDP, running current account surpluses over the medium term did not appear to make sense nor was it necessary for reasons of bringing debt service back to sustainable levels. 1/ But, economic logic argued for letting the current account surplus taper off through an expansion of imports in support of higher domestic growth rather than through complacency regarding export performance. Therefore, some attention should be given to the erosion of the competitive

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1/ For a discussion of the effects of different current account developments on debt-service levels, see Appendix III.

position stemming from the appreciation of the exchange rate, which had brought the peseta, in real effective terms, in the first quarter of 1985 well above its first quarter, 1983 level. Since recent improvements in price performance did not suffice to narrow the inflation differential between Spain and its main markets, an active exchange rate policy was needed to support further improvements in domestic cost and productivity trends at least to the extent of not eroding them (Chart 2).

The competitive situation in Spain and the flexibility with which the Spanish economy can adjust to changes in the competitive environment will be tested with Spain's entrance into the European Communities on January 1, 1986. 1/ The Treaty of Accession of Spain to the EC was signed on June 12, 1985 after complex and protracted negotiations on the terms of accession. 2/ Under the terms on the customs union the first tariff cuts (of 10 percent) are to be implemented two months after the date of accession, and with only a few exceptions, quantitative trade restrictions on industrial products between Spain and the EC are to be eliminated at the time of accession. Over half (52.5 percent) of the total envisaged tariff reduction is to be completed three years from the date of accession (i.e., by January 1, 1989) and by the end of the seven year transition period, Spanish tariffs vis-à-vis third countries also would have been brought down to the level of the EC's common external tariff.

In agriculture, Spain's integration into the common agricultural policy (CAP) is to be gradual with benefits to exports emerging only in the second half of the transition period. The alignment of domestic agricultural prices, which generally are below the CAP prices, is to be achieved, as a general rule, over a period of seven years. Effective January 1, 1986, Spain will introduce the VAT. Negotiations on Spain's contribution to the Community budget were guided by the principle that Spain should not be a net contributor to the EC budget during the transition period and the proportion of Spain's VAT contribution to the EC budget to be rebated during a transition period of six years is calculated accordingly.

The authorities view the accession to the EC both as carrying political benefits and as a means of introducing greater competition into the economy. In view of the far-reaching effects and the long transition period, the authorities felt that it was not only difficult, but not particularly worthwhile, to attempt to quantify the effects of accession at this time. Qualitatively, however, there was little doubt that the initial effects on trade and inflation would be adverse. Little, if any, early gain could be expected for Spanish exports as EC tariffs on Spanish industrial products were already low (averaging about 3 1/2 percent) and quantitative restrictions on industrial products were relatively insignificant. Further, the expected gains

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1/ The Treaty has to be ratified by the national Parliaments of EC member states but this process is expected to be completed during the second half of 1985.

2/ For a detailed discussion of the terms and conditions of accession, see Appendix III to the RED.

for exports of agricultural products were delayed by the terms of the Treaty. Imports, however, could rise significantly in the short term, particularly those of equipment and consumer goods, as protection was reduced and as a wide variety of imported goods became available to Spanish consumers. The authorities reckoned that the increase in imports could at most be US$1 billion in the first year of accession.

The likelihood that a strong tendency toward trade expansion, particularly on the import side, will develop even in the early stages of accession, is supported by the fact that traditionally external trade has played a relatively small role in the Spanish economy. The rather inward-looking policies of the 1950s and 1960s, which aimed toward a high degree of self-sufficiency, led to a situation in which, even by the early 1980s, 70 percent of Spanish enterprises were dealing exclusively with the domestic market. In 1975 only 12 percent of total resources available to the Spanish economy found its way into exports and only 14.6 percent was being imported. Even more telling is the fact that between 1975 and 1985 the share of imports of goods and services in total resources has remained stable at about 15 percent, a trend similar only to that in Japan. On the export side, despite preferential access to the markets of the EC since 1970, the share of resources exported grew quite slowly through 1982 and only jumped, to about 20 1/2 percent, in the last couple of years (Table 5).

This low degree of trade involvement illustrates both the opportunities and the risks the authorities perceive flowing from the early stages of accession. The opening up of the highly protected Spanish market inevitably will exacerbate the problems of those enterprises that currently are loss makers or are just at the margin of profitability. While increased competition in the long run is expected to lead to increased competitiveness of the Spanish economy as well, the past diversification of the production structure, irrespective of comparative advantage, has left a considerable part of both the industrial and market service sectors vulnerable to competition. The ability to respond flexibly and to phase out noncompetitive parts of the economy, a central policy aim of the past several years, will be tested progressively, as protective barriers are lowered. In this respect, the industrial restructuring program that was adopted at the beginning of the 1980s will be supportive of the necessary structural changes.

On the side of price developments, the early effects--with the introduction of the VAT--would be to add at least 2 percentage points to the inflation rate in the first year of accession. Because of the relatively long transition period, the effect of the CAP on domestic agricultural prices will feed in only slowly. A partial offset to the likely price increases is provided by the reduction in import costs as protection through the fiscal system is reduced. 1/ The Spanish authorities

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1/ The protection currently afforded by the imposition of border taxes on imports to equalize for the turnover tax stems from overtaxation on this account, the extent of which, though significant, is not quantifiable. Overrebating of turnover taxes on the export side provides a less significant subsidy as rebates already have been cut by 30 percent.

considered exchange rate policy an important supportive instrument in the integration process. Although it was the official intention to participate in the EMS in the future, this probably would not be feasible over the next several of years.

Table 5. Spain: Trade Involvement Trends, 1975-85

(Ratios; in constant prices)

	Ratio to Total Resources 1/									
	Exports of goods and services					Imports of goods and services				
	1975	1980	1982	1984	1985 2/	1975	1980	1982	1984	1985 2/
Spain	12.1	15.3	17.2	20.6	20.7	14.6	15.8	15.8	15.3	15.3
Austria	23.6	27.2	29.0	29.2	30.2	23.3	27.7	26.5	28.3	28.5
Belgium	33.4	39.2	42.9	44.3	45.1	32.9	39.8	41.3	40.8	41.2
Denmark	22.9	25.5	27.3	27.5	27.8	23.7	24.2	24.1	24.3	24.7
France	16.5	18.8	18.6	20.4	20.8	15.0	19.0	19.9	19.9	20.2
Germany	21.4	23.0	26.2	26.7	28.0	19.4	21.9	22.6	23.0	23.6
Italy	17.0	18.8	20.0	21.4	21.4	14.6	17.9	17.4	18.4	19.3
The Netherlands	35.1	37.1	39.2	40.8	41.3	34.2	37.6	37.7	39.0	38.9
Norway	30.6	33.5	33.1	34.8	33.7	33.9	29.2	30.0	29.7	30.7
Portugal	16.2	20.0	19.5	26.3	...	28.2	30.5	31.0	28.2	...
Sweden	21.9	24.6	26.2	29.2	29.3	22.0	23.4	23.1	23.0	24.0
Switzerland	26.5	29.4	30.1	30.4	31.1	25.2	32.7	31.8	33.7	34.0
United Kingdom	22.3	24.7	24.3	24.4	25.2	21.4	22.4	22.4	23.9	24.4
United States	8.0	10.0	9.2	8.1	7.6	5.5	6.9	7.4	9.0	9.4
Japan	12.1	15.6	17.4	19.7	20.1	12.2	12.2	12.2	12.1	11.9

Sources: OECD; IMF; national sources.
1/ GNP/GDP plus imports.
2/ Estimate.

Capital movements vis-à-vis the EC are to be liberalized on accession, with the exception of specified areas (e.g., Spanish portfolio and real estate investment abroad) for which the transition period was to be three to four years. The authorities had liberalized foreign investment ahead of schedule and, more important, had done so on a nondiscriminatory basis. Accordingly, little effect on foreign investment is expected from the regulatory changes that come with accession. However, the pure fact of entry into the EC, particularly given Spain's geographic location, was expected to generate further foreign investment flows.

The authorities also noted a recent liberalization of payments for travel, which applied nondiscriminatorily. The exchange system in general was liberal, and the authorities intended to move soon to Article VIII status in the Fund.

6. Official development assistance

Offical development assistance (ODA) fell sharply from US$233 million in 1982 to US$71 million in 1983. In relation to GDP it declined from 0.13 percent to 0.05 percent over the period. The authorities believed that the outturn for 1984 would be similar to that in 1983, largely because of the close association between ODA and export credits; with the decline of large projects in aid receiving developing countries, export credits, and by association ODA, had declined as well. Other components of ODA, i.e., technical assistance, food aid, and multilateral aid contributions, also contracted in 1983.

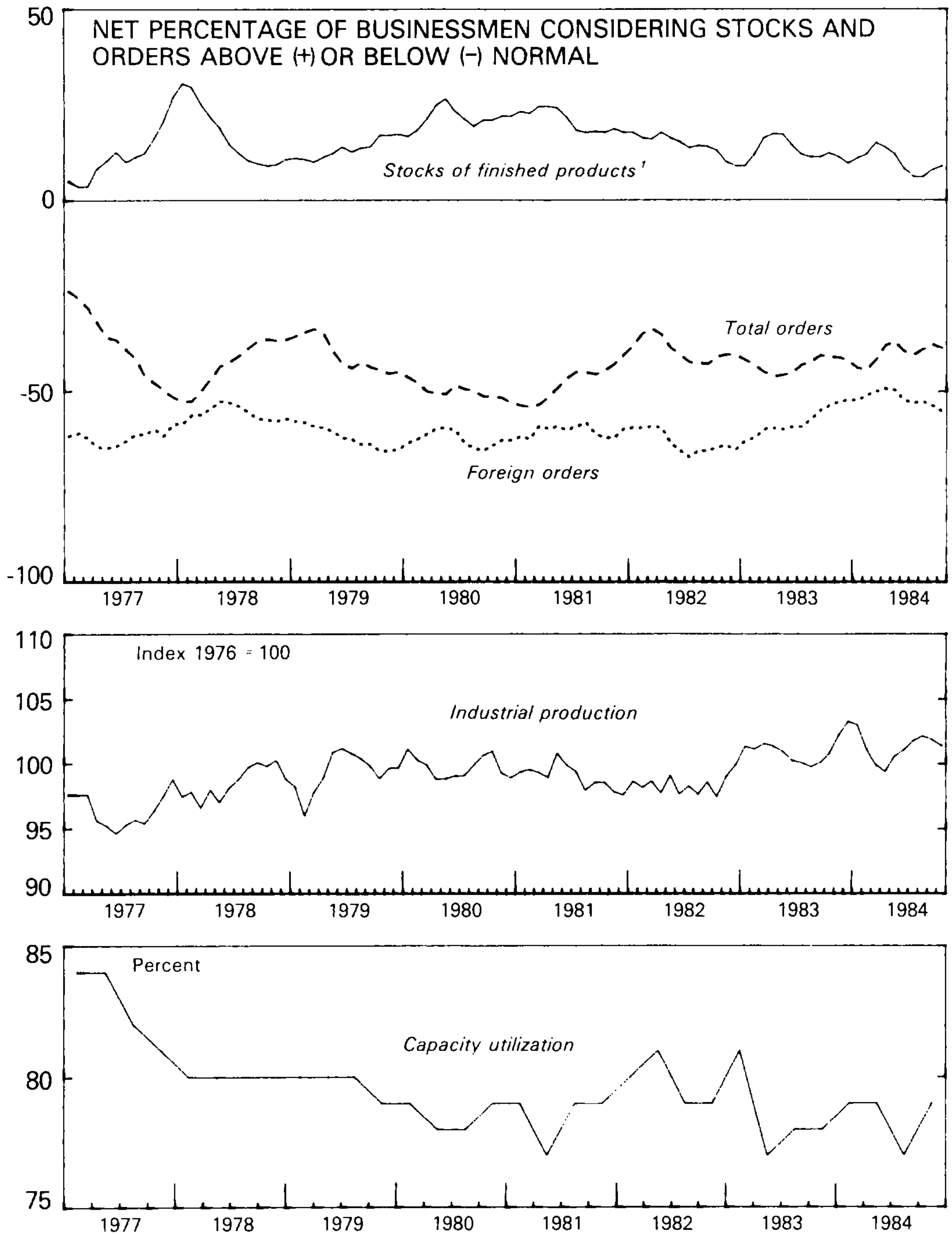
7. Other matters

Given the importance of timely policy action, particularly in a period of considerable change, the ability to read the current state of the economy well has gained in priority, and the authorities have moved to improve the data base available for tracking the economy. Nevertheless, there remains a large amount of work to be done in that respect. For example, while the major macroeconomic variables have experienced sharp movements in the period from 1977 to 1984, the indicators of industrial production remained virtually stable, capacity utilization moved within a very narrow range, and foreign orders steadily were judged to be below normal by around 60 percent of survey respondents (Chart 7). If policy were made on the basis of these indicators, it assuredly would have been at odds with the needs of the time. Thus, there is a pressing need to improve the statistical coverage of both private and public sector activity for tracking developments in the economy and for discerning responses to policy measures.

CHART 7

SPAIN

INDICATORS OF INDUSTRIAL ACTIVITY, 1977-1984



Source: Bank of Spain, Statistical bulletin.

[1] Three month moving average

V. Staff Appraisal

In 1984, the majority of the Government's short-term targets were met. Exports rose sharply; the deceleration of the inflation rate that began in 1983 was sustained and through the year was close to that targeted; wages fell in real terms; the government's basic borrowing requirement fell relative to GDP for the first time in many years--and expenditure trends contributed to this outcome. Although these achievements are important, it is perhaps more important that a number of structural policy changes have contributed to changes in the public's attitudes toward realism and have raised confidence. First, the Government, for the first time in decades, has made clear that it will neither expand its own payroll nor use public funds to absorb failures in the private sector. Second, the social security pension system is being rationalized. Third, in addressing the central problem of creating job opportunities, the Government has brought about general acceptance of the need for moderation of wages in the medium term and has imparted a modicum of flexibility to the labor market. Fourth, the Government has recognized that the existing panoply of special incentives blunts the effectiveness of corrective policy measures, and that its complexity and incessant changes make it miss its targets as well. This progress notwithstanding, the central objective of economic policy, the reduction of the rate of unemployment, has not been met yet.

The failure of labor market conditions to improve can be explained by two major factors. First, although there has been a significant improvement in the cost position of enterprises, the restoration of the balance sheet position of enterprises, from the very low levels of the late 1970s, will take time to be translated into investment activity. The second, and probably overriding, factor in the continued tendency toward labor shedding is the difficulties enterprises face in managing their labor force flexibly. The high cost of laying off labor constitutes a major impediment to job creation as does the rigidity of the wage structure. The measures taken in 1984 to improve the flexibility of labor contracts clearly are important. However, they have only been able to slow, rather than stem, the continued shrinkage of employment. This implies that the level of wages, despite the moderation of wage increases, remains too high. While the policy efforts that attempt to demonstrate this fact to job seekers are innovative, their use of budgetary resources to do so strengthens the tendency of the social partners to look to the budget to solve what inherently are market problems.

Moderation of labor costs through a broad reduction in employers' social security contributions could be helpful, but needs to be balanced by savings, if the system is to be viable in the medium term. From that point of view, the rationalization of the pension system instituted this year is essential. In the absence of reform, the system would have exerted an unsustainable drain on the budget. But the relief of pressure on the budget that is to be foreseen over time ought not to be taken to create room for shifting the cost of social security to the tax system. Unless the costs of social security are quite explicit and shared equitably between the employer and employee, efforts to bring about a sense of realism regarding the benefit structure are likely to fail. The recent measures that provide relief from social security contributions for employers who convert temporary labor contracts into open-ended ones could prove costly. The intent of the measure is clear, in that it tries to prevent layoffs upon expiration of such contracts, but its result may be to increase market rigidities once more. The flexible contracts have been the major vehicle for taking on labor in recent months, which would have argued for attempting to broaden these possibilities, particularly since the authorities feel that they can make no further contribution toward a lowering of layoff costs.

Structural changes in the labor market that would allow greater wage differentiation and more flexible management of the labor force are necessary, but not sufficient elements for regenerating job opportunities; the continuation of general wage moderation remains a crucial element as well. The shift over the past several years from the expectation that wage awards must be positive in real terms to the acceptance of declines in real wages has been an important achievement of incomes policy. However, wage developments in 1985 give rise to concern in that they posit as a minimum the maintenance of wages in real terms. The inclusion of indexation clauses as a basic tenet in the AES for 1985-86--just at a time when in other countries' reliance on indexation clauses is being reduced--tends to freeze the wage structure and to curtail the ability to maintain competitiveness. This is particularly problematic at a time when inflation expectations seem to be rising. To the extent that current and expected price increases do not reflect changes in the underlying inflation rate, but stem from once-over adjustments, either because of the introduction of the VAT and other tax changes, or changes in the exchange rate, or temporary supply problems, it is important that they not be built into the wage base. Therefore, if the inclusion of revision clauses into wage contracts appears irreversible, the exclusion of the effects of such once-over price changes from the index base would help contain tendencies toward price-wage spirals.

It has been encouraging that the budget constraint on public enterprises is being tightened and that their operating losses appear to have been stabilized. The effects of these improvements on budgetary flows are somewhat obscured by increases in budgetary transfers to those public enterprises whose balance sheets need to be strengthened so as to make them saleable to the private sector. The Government has expressed its determination to resist pressures to extend help if such privatized enterprises once again were to find themselves in difficulties. Still, there remains the question of the future viability of these entities, of the opportunity cost of the funds expended upon them, and the adequacy of the current determination neither to expend further funds nor resume rescue operations down the line.

The translation of the significant improvement in the financial position of private enterprises into increases in investment activity may be slowed if there is a perception that the Government's efforts to free resources for the private sector and to restrain its own recourse to financial markets may not be sustained. Such concern may, indeed, be strengthened to the extent that the improvement in the Government's financial position so far has derived mainly from increases in revenues rather than from visible expenditure restraint. Although the rise in tax revenues has come from a much needed broadening of the tax base as collection procedures have been tightened, a rise in tax revenues--from whatever source--cannot substitute for an expenditure policy that controls the share of resources absorbed by the public sector.

In 1985, unlike last year, there does not appear to be a major conflict between the monetary program and the current targets for real economic growth. However, during the first six months of the year, monetary developments seem to have accommodated a rather higher rate of inflation than had been envisaged. This surely has contributed to the apparent change for the worse in inflation expectations that has been associated with the return to wage indexation, the anticipation of the introduction of the value-added tax, and the spreading feeling that the peseta may weaken down the line. Therefore, the determination of the authorities to stay within their monetary targets, even at the cost of reversing a considerable part of the decline in interest rates that took place in 1984, is essential. This is particularly important because a winding down of inflation expectations and a perception that financial policy will maintain a steady course appear to weigh more heavily in positive investment decisions than does a temporary rise in interest rates--despite the negative effect the latter has on the balance sheets of a highly leveraged economy.

The positive trends on the financial side still will have to overcome the disincentives flowing from the inefficiency of the financial system and in particular the continued channeling of credit to preferential activities through subsidization. The latter has led to further fragmentation of the financial market and appears to frustrate the policy orientation that favors expansion of the activities of medium- and small-sized firms. The Government has begun to implement its intention to reduce the preferential elements in the credit system and has set out a time schedule for halving the investment coefficients. However, further implementation may be delayed, if not actually stopped, by the continued large financing needs of the Treasury.

The shift toward financing the Government's operations through Treasury bills has been positive in that it made the cost of financing the public sector's deficit more explicit and opened the potential for placing short-term government debt with the public at large. However, recent conflicts between the interest rate objectives of the debt managers and the monetary authorities has led to the Bank of Spain placing bills with the banks at a capital loss to itself. This has tended once again to obscure the actual cost of the Government's debt operations. In addition, the spreads at which banks provide treasury bills to the public are so high as to prevent a significant volume of such sales. The latter could have helped contain the monetary effects of financing the public debt and increased the incentive for households to save in financial assets. Whereas currently there appears to be no overt conflict between the demand of the Treasury for financial resources and that of the private sector, there is no question that, on current budget trends, such conflicts will re-emerge at any time that private *investment demand recovers to levels compatible with a reduction in* unemployment.

Although with the determination of the authorities to remain within their monetary targets, the achievement of the current economic forecasts for 1985 appears within reach, the importance to speed progress in correcting the underlying imbalances is heightened by the need to move into 1986 from as balanced an economic position as possible. The effects of the accession to the European Communities will begin to be felt in 1986 with the reduction in protection associated with the first round of tariff cuts and, even more, with the adoption of the value-added tax. From that point of view, the external financial position allows considerable room for the necessary adjustment. The surplus on the external current account in 1985 is not likely to fall far short of US$2 billion dollars. Given the relatively low level of savings, the structural inflow of investment capital, and the viable external debt position, maintenance of a current account surplus over the medium term carries no logic. Thus, an erosion of the surplus as resource allocation improves under the impetus of trade liberalization and increased competition is not a cause for concern.

But the ability of the economy to respond positively to increased competition depends on progress in reducing domestic rigidities. There appears to be a feeling that, if necessary, the impact of the reduction in protection can be taken care of in part through an adjustment of the exchange rate--particularly following the effective appreciation of the peseta in 1984-85. However, over the medium term, an active exchange rate policy cannot substitute for action to increase the responsiveness of the economy to competitive stimuli, to control inflationary pressures, and to dismantle the increasingly complex special incentive and regulatory system, all of which interfere with the return to a sustainable growth path capable of absorbing the unemployed.

The recent measures to liberalize invisible payments and foreign investment flows are welcome, and particularly the fact that this liberalization has been done nondiscriminatorily. The intention to undertake soon the obligations of Article VIII of the Fund's Articles of Agreement is welcome as well.

Finally, the importance of an adequate information base to allow assessment of the success or otherwise of policy measures needs to be stressed. Since existing data gaps may interfere importantly with the efficiency of policy implementation, the staff feels a need to reiterate its recommendation that some priority be given to the improvement of both the availability and quality of data.

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

VI. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision in concluding the 1985 Article XIV consultation with Spain, in light of the 1985 Article IV consultation with Spain conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Spain continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions.

Table 6. Spain: Main Economic Variables, 1981-85

(Percentage changes)

	1981	1982	1983	1984 1/	1985 2/
Demand and output (in real terms)					
Private consumption	-0.9	0.7	0.6	-0.8	1.1
Public consumption	1.5	6.5	3.8	3.0	3.0
Fixed investment	1.0	-2.5	-1.0	-3.0	2.5
Stockbuilding 3/	-1.3	--	--	-0.05	0.3
Total domestic expenditure	-1.5	0.7	0.6	-0.8	1.9
Exports of goods and services	6.9	7.1	7.6	15.4	2.5
Imports of goods and services	-2.8	4.5	-0.6	1.0	2.0
Foreign balance 3/	1.8	0.6	1.7	3.0	0.15
GDP	0.2	0.9	2.3	2.2	2.1
Industrial production	-1.0	-1.1	2.7	0.9	2.0
Wages, costs, and prices					
Wages per person (industry) 4/	15.4	13.5	13.0	9.6	9.0
Productivity (industry)	4.6	5.3	5.5	4.7	4.0
Unit labor costs (industry)	10.6	7.8	7.1	4.7	4.8
Consumer prices	14.6	14.4	12.2	11.3	8.9
GDP deflator (at factor cost)	13.6	13.4	11.7	10.7	8.4
Employment	-3.1	-1.2	-0.9	-1.9	-0.5
Unemployment rate (average levels)	15.0	16.9	18.4	20.4	21.3
Disposable income of households	14.2	14.8	12.9	10.0	10.1
Savings ratio (levels)	6.9	6.8	6.7	6.6	6.5

Source: Spanish authorities.

1/ Provisional.
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: Selected Financial Indicators, 1980-85

	1981	1982	1983	1984 1/	1985 2/
			(As a percent of GDP)		
Fiscal indicators					
General Government					
Revenues	31.0	30.7	32.6	32.5	33.1
Of which:					
Direct and indirect taxes	14.5	14.2	16.1	16.7	17.2
Social security contributions	13.2	13.3	13.6	12.8	12.5
Expenditures	35.3	37.8	39.4	40.1	39.6
Current expenditures	30.0	31.4	33.3	33.6	34.0
Capital expenditures and net lending	5.3	6.4	6.1	6.5	5.6
Current balance	1.0	-0.6	-0.7	-1.1	-0.9
Overall balance	-4.3	-7.1	-6.8	-7.6	-6.4
General government borrowing requirement	4.8	6.8	7.0	8.2	6.4
		(End of period; percentage change except as otherwise indicated)			
Monetary variables					
M_3	16.0	14.0	12.9	11.5	11.0
ALP	17.0	16.6	15.9	13.2	13.0
Total domestic credit expansion 3/	19.2	19.1	15.1	11.9	13.1
Domestic credit to the public 4/	16.4	14.8	9.4	1.6	8.2
Domestic credit to the General Government	38.9	44.7	41.8	49.2	25.8
Share of credit to the public sector in domestic credit	25.2	33.9	48.6	89.7	54.8
			(In percent)		
Interest rates					
Three-month interbank rate	16.2	16.2	20.0	14.8	12.5 5/
Unregulated lending rate 6/	17.4	17.5	17.6	18.2	16.6 5/
Unregulated deposit rate 7/	12.4	12.9	12.7	12.5	10.9 5/

Sources: Ministry of Economics and Finance; Bank of Spain; and staff estimates.

1/ Provisional.
2/ Official targets.
3/ By the credit system and the money markets.
4/ Private sector and public enterprises.
5/ May.
6/ Rates on commercial bank loans of one to three years.
7/ Deposits of one to two years.

Table 8. Spain: External Developments, 1981-85

	1981	1982	1983 1/	1984 1/	1985 2/
			(Percentage changes)		
Trade developments					
Imports, c.i.f. 3/					
Unit value	30.3	12.8	21.7	10.5	7.0
Volume	-7.0	3.5	-1.0	0.3	1.6
Exports, f.o.b. 3/					
Unit value	16.9	12.5	17.3	12.5	6.0
Volume	8.2	6.3	7.2	18.3	3.0
Market growth	2.7	0.4	-0.1	5.9	4.5
			(In millions of U.S. dollars)		
Balance of payments summary					
Trade balance, f.o.b.-f.o.b.	-10,115	-9,181	-7,709	-4,051	-3,955
Services	3,443	3,476	3,776	5,306	5,617
Of which:					
Tourism	5,709	6,122	5,942	6,882	7,036
Investment income	-2,410	-2,429	-2,275	-2,223	-2,000
Transfers	1,692	1,581	1,161	814	350
Current balance	-4,981	-4,125	-2,772	2,069	2,012
(As a percent of GDP)	(-2.6)	(-2.3)	(-1.7)	(1.3)	(1.2)
Capital balance	4,274	790	2,451	2,418	2,102
Of which:					
Changes in net foreign position of banks	638	53	452	1,228	--
Long-term capital	4,294	1,840	3,106	3,299	-955
Overall balance	-706	-3,335	-321	4,487	--
Memorandum items:					
Gross official reserves 4/	11,422	8,272	8,019	12,573	
In months of imports 5/	5.6	3.5	3.3	5.6	
Spanish pesetas per U.S. dollar (period average)	92.3	109.9	143.4	160.8	
Nominal effective exchange rate (percent change) 6/	-6.6	-2.5	-12.6	3.6	
Real effective exchange rate (percent change) 6/7/	-5.8	-0.2	-11.5	3.3	
Medium- and long-term external debt 8/	27.2	28.8	29.5	29.6	
Debt service ratio 9/	21.5	20.8	20.4	24.0	

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

1/ Provisional.

2/ Official estimates.

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 35 trading partners in 1980.

7/ As measured by relative consumer prices adjusted for exchange rate changes.

8/ End of period, in millions of U.S. dollars.

9/ Debt service on medium- and long-term debt of the public and nonfinancial private sector in relation to exports of goods and nonfactor services.

Fund Relations with Spain

(As at end-July 1985; in millions of SDRs)

I. Membership status

Spain became a member of the Fund in 1958. Spain continues to avail itself of the transitional arrangements in Section 2 of Article XIV of the Articles of Agreement.

A. Financial Relations

II. General department

(a) Quota: SDR 1,286 million.

(b) Total Fund holdings of pesetas: SDR 907.8 million (70.6 percent of quota).

(c) Fund credit: none.

(d) Reserve tranche position: SDR 378.2 million.

(e) Current operational budget: the Spanish peseta is included in the current budget to the amount of SDR 39.3 million on the transfer side, of which SDR 17.4 million has been used. On the receipt side the amount in the budget is SDR 17.8 million, none of which has been used so far.

(f) Lending to the Fund (in millions of SDRs): Spain is not a participant.

III. Stand-by or extended arrangements and special facilities

A one-year stand-by arrangement in the enlarged first credit tranche, equivalent to SDR 143.2 million, was approved in February 1978, but was not drawn upon. In February 1978, Spain purchased its whole entitlement (SDR 572.1 million) under the oil facility, and a further SDR 98.8 million under the compensatory financing facility.

IV. SDR department

(a) Net cumulative allocation: SDR 298.8 million.

(b) Holdings: SDR 207.48 million, or 69.5 percent of net cumulative allocation.

(c) Current designation plan: the peseta is included in the current plan for a maximum amount of SDR 29.4 million, of which SDR 15.0 million has been used.

V. Administered accounts

Not applicable.

VI. Overdue obligations to the Fund

None.

B. Nonfinancial Relations

VIII. Exchange rate arrangements

Spain has maintained a managed float of the peseta since 1974. The exchange rate has weakened since the second half of 1979, as the external position deteriorated. Between the second quarter of 1979 and the third quarter of 1982 the peseta depreciated by 40.7 percent with respect to the U.S. dollar and by 21.4 percent in nominal effective terms, but only by 13.4 percent in real terms. On December 6, 1982 the peseta was devalued by 8 percent with respect to the dollar in response to intense speculative pressures. In real effective terms, the exchange rate is estimated to have depreciated by about 9.7 percent in 1983. The real exchange rate is estimated to have appreciated by 3.5 percent in 1984 and by 2.0 percent during the first two quarters of 1985.

IX. The last Article IV consultation was concluded at EBM/84/126 (8/10/84), at which time the following decision was taken:

> 1. The Fund takes this decision in concluding the 1984 Article XIV consultation with Spain, in light of the 1984 Article IV consultation with Spain conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).
>
> 2. The Fund notes with satisfaction that Spain continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions.

Spain is on a 12-month consultation cycle.

Basic Data

Area	504,800 square kilometers
Population (mid-1982)	37.83 million
Labor force (end-1984)	13.19 million
GDP per capita (1984)	Ptas 685,559 (SDR 4,033.4)

Use and supply of resources (1984)	In billions of pesetas	In per cent
Private consumption	17,309.7	66.7
Public consumption	3,162.1	12.2
Fixed investment	4,634.0	17.9
Stockbuilding	66.7	0.3
Gross domestic expenditure	25,172.5	97.1
Exports of goods and services	6,042.7	23.3
Imports of goods and services	5,280.5	20.4
Gross domestic product	25,934.7	100.0

Selected economic indicators (annual percentage change)	1982	1983	1984
Real GDP (at market prices)	0.9	2.3	2.2
Private consumption (at constant prices)	0.7	-0.6	-0.8
Fixed investment (at constant prices)	-2.5	-1.0	-3.0
Industrial output	-0.5	2.9	2.0
Exports of goods (in pesetas)	21.0	28.0	33.1
Imports of goods (in pesetas)	17.6	20.1	10.8
Employment	-1.2	-0.9	-1.9
Unemployment rate (average level)	16.9	18.4	20.4
Unit labor costs in industry	7.8	7.1	4.7
Consumer prices	14.4	12.2	11.3
GDP deflator (at market prices)	13.7	11.9	11.4
Broad money supply, M3 (end of period)	14.0	12.9	11.9
Total liquid assets, ALP (end of period)	16.6	15.9	13.2
Total domestic credit expansion (end-year)	19.1	15.3	11.6
Share of credit to the public sector in total domestic credit (levels)	33.9	48.0	92.1
General Government overall balance (as a percent of GDP)	-7.1	-6.8	-7.6

Balance of payments (in millions of SDRs)	1982	1983	1984
Exports of goods, f.o.b.	19,322	18,654	22,493
Imports of goods, f.o.b.	27,638	25,866	26,446
Net services and transfers	4,496	4,619	5,972
Balance of goods, services, and transfers	-3,820	-2,593	2,019
Net capital movements	799	2,293	2,359
Overall balance	-3,021	-300	4,378
Foreign exchange reserves (end of year)	6,548	6,683	11,679

Source: Data provided by the Spanish authorities.

Alternative Medium-Term Scenarios for the External Debt

The large current account surplus in 1984, which is expected to be more or less maintained in 1985, and the fall of international interest rates, prompted the Spanish authorities both to refinance and to prepay some outstanding maturities. As a consequence, the level of outstanding debt is being reduced sharply and the ratio of debt service to exports of goods and services should decline from 24 percent in 1984 to 22.8 percent in 1985. Exports, which rose very fast in late 1983 and early 1984, should be adversely affected by the abolition of export rebates, while the gradual reduction of tariffs and quotas as a result of Spain's accession to the EC should bolster the currently cyclically depressed import level, paraticularly in 1986 and 1987.

Scenario A of the attached table is based on the assumption that exports recover markedly after a slowdown in 1985 and 1986, while imports grow at a slower rate after the initial impact of the accession. This would imply a fall in the current account surplus to around US$600 million in the period 1988-90, with the debt-service ratio declining to 10.9 percent of exports of goods and services in 1990. Scenario A-1 is built essentially on the same premises, but attempts to show the sensitivity of the results to interest rate assumptions, since a 1 percentage point increase in the interest rate level above that assumed in Scenario A raises the debt-service ratio from 10.9 to 11.7 percent at the end of the period.

Scenario B assumes that exports recover after the current and prospective setback, but given the high starting base, they increase somewhat more slowly than imports, which are buoyed by the recovery of domestic demand and trade liberalization. Under these assumptions, the current account surplus is eroded by 1988 and the reemerging deficit reaches US$1.2 billion by 1990. As a result, the debt-service ratio rises to 11.6 percent of exports of goods and services. Given the assumption that official reserves remain unchanged, gross borrowing, which by 1990 would amount to US$1.5 billion in Scenario A, would rise to US$3.3 billion in Scenario B.

Scenario C, which perhaps presents the most realistic pattern, assumes that exports hold at their 1984 ratio to GDP of 20.7 percent, in itself quite an achievement. On the other hand, the opening up of the Spanish market would bring about a structural increase in the propensity to import, so that the ratio of imports to GDP is assumed to rise by 1 percentage point each in 1986 and 1987 from 18.8 percent in 1985 and to remain at 20.8 percent thereafater. In this case, the current account moves into deficit of around US$1 billion by 1987 and stays around that deficit level for the remainder of the period. The debt-service ratio, while declining throughout the period, at 12.1 percent of exports of goods and services, is 1.1 percentage point higher than in Scenario A. Gross borrowing at US$3.2 billion by 1990 is quite similar to that required in Scenario B. Outstanding debt at the end of the period is US$17.4 billion in Scenario A, US$18.9 billion under Scenario A-1, US$21 billion in Scenario B, and US$24.2 billion in Scenario C.

Spain: Illustrative Medium-Term External Debt Projections, 1986-90

	1984	1985	1986	1987	1988	1989	1990
Scenario A							
Assumptions							
Current account balance							
(In millions of US$)	2,069	1,848	1,213	672	599	593	578
(In percent of GDP)	1.3	1.1	0.7	0.4	0.3	0.3	0.2
Interest rates	10.9	9.5	8.5	8.5	7.5	7.5	7.5
Main results							
Ratios to exports of goods and services							
Debt service	24.0	22.8	17.1	15.8	13.8	10.8	10.9
Amortization	15.0	15.25	11.1	10.6	9.7	7.3	8.0
Interest payments	9.0	7.6	5.9	5.2	4.0	3.4	2.9
Ratios to GDP							
Outstanding debt	18.3	15.8	13.8	12.2	10.6	9.0	7.5
Interest payments	2.0	1.6	1.2	1.1	0.8	0.7	0.6
Exports of goods and services	22.1	20.6	20.6	20.6	20.7	20.8	21.0
Scenario A-1							
Assumptions							
Current account balance							
(In millions of US$)	2,069	1,848	937	387	311	300	282
(In percent of GDP)	1.3	1.1	0.5	0.2	0.2	0.1	0.1
Interest rates	10.9	9.5	9.5	9.5	8.5	8.5	8.5
Main results							
Ratios to exports of goods and services							
Debt service	24.0	22.8	17.8	16.6	14.5	11.5	11.7
Amortization	15.0	15.2	11.1	10.6	9.7	7.3	8.5
Interest payments	9.0	7.6	6.7	5.9	4.7	4.1	3.5
Ratios to GDP							
Outstanding debt	18.3	15.8	14.0	12.5	11.0	9.6	8.1
Interest payments	2.0	1.6	1.4	1.2	1.0	0.9	0.7
Exports of goods and services	22.1	20.6	20.6	20.6	20.7	20.8	21.0
Scenario B							
Assumptions							
Current account balance							
(In millions of US$)	2,069	1,848	1,213	672	--	-600	-1,200
(In percent of GDP)	1.3	1.1	0.7	0.4	--	-0.3	-0.5
Interest rates	10.9	9.5	8.5	7.5	7.5	7.5	7.5
Main results							
Ratios to exports of goods and services							
Debt service	24.0	22.8	17.1	15.8	13.9	11.2	11.6
Amortization	15.0	15.2	11.1	10.6	9.8	7.4	8.2
Ratios to GDP							
Interest payments	9.0	7.6	6.0	5.3	4.2	3.7	3.4
Outstanding debt	18.3	15.8	13.8	12.2	10.9	9.8	9.1
Interest payments	2.0	1.6	1.2	1.1	0.8	0.8	0.7
Exports of goods and services	22.1	20.6	20.6	20.6	20.5	20.5	20.6
Scenario C							
Assumptions							
Current account balance							
(In millions of US$)	2,069	1,848	776	-1,051	-948	-929	-942
(In percent of GDP)	1.3	1.1	0.4	-0.5	-0.5	-0.4	-0.4
Interest rates	10.9	9.5	8.5	7.5	7.5	7.5	7.5
Main results							
Ratios to exports of goods and services							
Debt service	24.0	22.8	16.8	15.8	14.1	11.4	12.1
Amortization	15.0	15.25	10.8	10.3	9.5	7.2	8.2
Interest payments	9.0	7.6	5.9	5.4	4.5	4.1	3.8
Ratios to GDP							
Outstanding debt	18.3	15.8	14.1	13.3	12.4	11.4	10.4
Interest payments	2.0	1.6	1.2	1.1	0.9	0.9	0.8
Exports of goods and services	22.1	20.7	20.7	20.7	20.7	20.7	20.7

Sources: Bank of Spain; and staff estimates.

1/ *Covers all medium- and long-term borrowing, including the borrowing done through* resident banks.

Note: For all the scenarios other main assumptions are: (a) real GDP growth is assumed to be 2.3 percent in 1985 and 3 percent per annum for the 1986-90 period; (b) In scenario A, exports of goods and services are adversely affected in 1986 by the elimination of the subsidy element in the export tax rebates, but the rate of increase recovers steadily thereafter; in scenario B, they recover but at a slower rate; in scenario C they are held at a constant 20.7 percent of GDP; in scenario A and B imports of goods and services *rise sharply in 1986 and 1987, but their rate of growth slows down in 1988-90*; in scenario C imports of goods and services represent 18.8 percent of GDP in 1985, 19.8 percent in 1986 and 20.8 percent in 1987-90; (c) net transfers are US$350 million in 1985, US$600 million in 1986-87, US$650 million in 1988 and US$700 million in 1989-90; (d) net direct investment grows by 10 percent annually; (e) a net short-term capital outflow of US$1.3 billion per year (f) amortization payments on new debt are based on the assumption of a four-year grace period and four equal payments in the following four years; and (g) official reserves are held constant, implying a decline in the reserve/import ratio over the period.

Spain - Statistical Issues

1. Outstanding statistical issues

a. Monetary accounts

The Bureau of Statistics is in the process of implementing in IFS the recommendations of a technical assistance mission in money and banking statistics. The major changes from the existing presentation include: (a) improvements in the classification of assets and liabilities, as a result of the new bank returns adopted by Spain's financial institutions; and (b) expanded coverage of financial institutions in the deposit money banks' sector to cover not only the private banks and savings banks but also the credit cooperatives and money market intermediaries (SMMD's).

b. Government finance

The 1984 GFS Yearbook includes data through 1981 in the derivation and statistical tables for the consolidated central government and in the statistical tables for regional and local governments. The corresponding 1982 data were delivered last March by Ms. Mateos from the Ministry of Finance (a participant in the 1985 GFS course). Queries regarding these data were discussed and a reply to these queries as well as 1983 data are expected.

c. General economic data

A major revision in the compilation of trade volume and unit value indices has been underway for some time, although the updating of previously computed indices was discontinued after 1979.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Spain in the July 1985 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Banco de Espana, which during the past year have been provided on a timely basis.

Status of IFS Data

		Latest Data in July 1985 IFS
Real Sector	National accounts	1984
	Prices: Industrial	February 1985
	CPI	March 1985
	Production: Industrial, seasonally adjusted	January 1985
	Employment	Q4 1984
	Earnings: Wages	February 1985
Government Finance	Deficit/Surplus	March 1985
	Financing	March 1985
	Debt	1981 (annual data only)
Monetary Accounts	Monetary authorities	March 1985
	Deposit money banks	March 1985
	Other financial institutions	March 1985
Interest rates	Discount rate	April 1985
	Call money rate	April 1985
External sector	Merchandise trade:	
	Values	April 1985
	Unit value (exports)	1979
	Balance of payments	1984
	International reserves	April 1985
	Exchange rates	May 1985