

STATE REFORM , ECONOMIC TRANSFORMATION AND GROWTH. THE CASE OF SPAIN

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Dear friends. It gives me great pleasure to make this long trip to South Africa to speak to you today about the Spanish experience of development and government. I would like, first of all, to thank the organisers for their kind invitation to participate in this forum and for giving me another opportunity to express my admiration for the laudable process of transition to democracy in South Africa. Some years ago, on an official trip in my capacity as a minister of the Spanish government, I was able to visit some parts of the country. I was fascinated and I feel most privileged to have the chance to revisit the country now.

I have divided my lecture into three parts so as to be able to contribute more effectively to the debate.

In the first part, I will analyse the background to what, fortunately, is Spain today, a modern democracy, after many years of dictatorship and economic backwardness.

In the second part, I will make a summary of the main phases of the political and economic configuration of Spain within the framework of the democratic system established at the end of the 1970's.

Lastly, I will describe the main questions of the economic debate in Spain. I would like to explain to you in particular about the discussions on the new roles played by the State in the European economic system to which we belong.

I will begin by placing this first section into its historical context. When we talk about problems of development, it is important to make clear that the economic development of Spain occurred later than in other European countries such as the U.K., Germany or France. In fact, after the colonial crisis of 1868 which led to the final collapse of what remained of the Spanish Empire, Spain shut itself off from the rest of the world for many years both politically and economically. With a few exceptions resulting from Spain's neutrality in the first world war and later in the interwar period, economic growth was weak and irregular and this produced a backward mainly agricultural economy. The civil war of 1936-1939 and its after-effects brought a halt to some admirable attempts at social and economic modernisation and opened the gates to a bloody dictatorship. This lasted, in different stages, until the death of General Franco in 1975.

A few historical data will help us to appreciate the degree of underdevelopment at the turn of the century of a country which, in the 17th century,

had been a world leader in terms of territory and military power. This fact serves as a reminder that economic development is not a mechanical process driven by luck or determined by forces of fate or destiny.

REAL COMPARATIVE PERFORMANCE OF THE SPANISH ECONOMY

Real Product per Capita in Spain as a % of:

	Italy	France	Germany	United States
1890	80	56	60	31
1900	79	49	51	27
1913	59	45	41	23
1929	68	46	57	24

Source: Prados, L.Y.V. Zamagri (eds). *El Desarrollo Económico en la Europa del Sur; España e Italia en Perspectiva Histórica.* (Economic Development in Southern Europe: Spain and Italy in Historical Perspective), Alianza Universidad 1992 (page 36).

Spain's income per capita was around 31% of that of the U.S. in 1890. On the eve of the Great Depression (1929) this proportion had fallen to 24%. And it was around 46% of the per capita income in France and 57% of that in Germany.

It is difficult to explain this part of our history. In a very brief summary, it could be said that the process of industrialisation, which began at the end of the 19th century and continued into the twentieth, was carried out within a scenario of intense concentration of business and by means of obvious alliances between political and economic power bases.

It is a misconception to believe that business concentration is a phenomenon of our times, arising from the need for competitiveness, global reach and efficiency. In Spain, as in Europe or the United States, there was a very powerful process of business consolidation in the last decades of the 19th century and the beginning of the 20th. This concentration coincided with the formation of powerful industrial lobbies which demanded and obtained from the Government a system of protection from competition which, according to historians, explains the weaknesses of the industrialisation process and the lack of growth in the Spanish economy. We will now examine the facts briefly.

The Restoration of the Monarch(k)y in 1873 laid the perfect institutional bases for the development of business coalitions who campaigned for a redistribution of power, i.e. interest groups. The fact that the main political elites reached an agreement to take turns in government, so providing political stability, allowed lobbies to emerge: in this situation it was easy to introduce mechanisms for imposing discipline and internal organisation within these lobby groups. The result of this was that the logical business strategy in some sectors focussed on obtaining income from

monopoly situations by imposing legal limits on competition, in this case by customs duties, and on maintaining the internal discipline of the lobbies. Analysis carried out by historians points to the fact that protection from competition was the result of **four main factors**: industrial concentration and imbalance of size, in other words the existence of **a very small number of large companies in relation to the size of the domestic market**; **the geographical concentration of industry**, which facilitated smooth relations and dialogue with regional political elites: **insufficient parliamentary and political control** and, finally, the **financial necessities of the State**, which were directly related to the instrument used to set up monopoly incomes, which at that time was import duties.

These conclusions refer to the textile and steel industries, but can also be applied to the production of electricity, cement, mining, explosives and fuel. In short, during the first third of the century an important part of the Spanish productive system was based on oligopoly markets with strict barriers to competition or, in the words of one historian, in a multi-layered, protective “scheme”, which was later extended and even became protracted before finally becoming all-encompassing during the Dictatorship.

The main consequence of the above can be measured in terms of economic growth and relative industrial decline. The **result of the restrictions on competition introduced during the first half of the century was industrial and technological backwardness**. Spain lost ground in relation to Central European countries and also with respect to countries like Italy which had had similar industrial and total product figures at the end of the 19th century. What is more, it seems sure that protection of the Spanish market delayed the process of internationalisation of Spanish industrial companies during the same period.

In conclusion, the differentiating factor for Spanish industrialisation at the end of the 19th century and during the first half of the twentieth was the negligible resistance of the State to the concession of monopoly incomes and the low costs to the interest groups of obtaining them. This meant that **instead of applying oneself and innovating, the best business strategy was to try to obtain privileges and create monopolies**. In this respect, Spain overtook other European countries where the concentration of industrial markets was the result of a long process that began in the 19th Century, but which did not materialise until the depression in the 1930's. In Spain the process was concluded very quickly, before the Great War even, with a degree of restriction on competition that was unheard of, in the rest of Europe.

Some retrospective analyses point to **the existence of a relation between political democracy and legal imposition of barriers to competition**. According to this theory, the weaknesses of democracies such as, for example, pacts between political parties to take turns in government, or the protection of the political elites from electoral competition, tend to reduce the political costs of the granting of privileges and as a result, favour the exercise of economic and political power by lobbies.

This theory has been widely demonstrated in a wide variety of European countries, including Spain, for the period 1900-1930. Thus, the **European countries**

with greater levels of democracy (measured by the ratio between the electoral census and the total population in conjunction with a classification of political regimes as authoritarian, mixed and competitive) tended to apply a lower level of customs duty protection. For these purposes it is worth remembering that in 1930 only 22% of the Spanish population had the right to vote, which put Spain third from last in the ranking of 17 European countries, only ahead of Rumania (16%) and Hungary (6%). Meanwhile, for example, 67% of the British, 50% of the Dutch or 70% of Austrians enjoyed the right to vote.

It was clear, therefore, that if things were to change, then institutional, political, social and economic changes were essential. Unfortunately, the Spanish Republic (1931-1936) was very short-lived and ended in Civil War. What followed was a black period for civil liberties, which, from the 1960's onwards, coincided with a quite significant level of economic growth. This was, however, fraught with the defects that are a normal feature of any structures built under the arbitrary direction of uncontrolled power groups.

The first signs of significant economic growth during the Dictatorship were at the beginning of the 1960's. Prior to this, the politics of economic self-sufficiency supported by the Franco regime, had become unsustainable and had been abandoned. And most important of all, the decision had been taken to open up Spain to the rest of the world, if not in a political, at least in an economic sense. The 1959 Plan for Economic Stability marked the beginning of the dismantling of the autarchic structures and the first step towards the reduction of protectionism based on customs duties and import quotas.

AVERAGE ANNUAL RATES OF CHANGE – SPAIN

June 2001

b) TASAS DE VARIACIÓN MEDIA ANUAL. ESPAÑA

8-Junio-2001 11:37:46

	1960-1965	1965-1970	1970-1975	1975-1980	1980-1985	1985-1990	1990-1995	1995-2000	últimos tres años	último año	año último dato
1. ESPAÑA											
I. PIB per cápita y componentes											
PIB per cápita (miles de PPC en euros)	7,3	5,1	4,3	0,7	1,0	4,3	1,2	3,6	4,0	4,0	2000
Población de 16-64 años/Población total (%)	-0,3	-0,3	-0,1	0,2	0,5	0,6	0,5	0,0	-0,0	-0,1	2000
Tasa de empleo (%) (b)	-0,2	-0,0	-0,5	-2,9	-2,5	2,5	-1,1	2,7	3,3	3,1	2000
Productividad del trabajo (miles de PPC en euros por ocupado) (c)	7,9	5,5	4,9	3,5	3,1	1,2	1,8	0,9	0,7	1,0	2000

Source: Banco de España.

Growth in the immediate post-war period was very low and was disastrous in a qualitative sense. From 1960 onwards it increased substantially giving rise to what became known, in a phrase that was tinged with propaganda, as the “Spanish miracle”. Between 1960 and 1965 the GDP per capita measured in euros and in real terms grew at an average rate of 7.3% per year. And during the next five years it grew at 5.1%. Foreign currency sent home by emigrant workers, the flourishing

tourist industry and the aforementioned opening up to foreign trade, provided the finance for investment in the modernisation of the Spanish economy, and created a society with a high level of industrial activity. Except for some brief periods of slowdown in 1964 and 1967, the economy grew significantly until the first oil crisis in 1973. The world recession at this time revealed the problems arising not only from the dependence on other countries for energy but also those resulting from the industrial make-up of the Spanish economy. A number of industries went into recession and the need for industrial rationalisation towards levels which were more in-keeping with the international structure of prices became clear. This was the case of the iron and steel industry and the shipbuilding industry as well as certain sectors of machinery manufacture and the textile industry, etc.

But, without doubt, the most important factor for the purposes of our debate is the process that began at the end of the 1970's with the restoration of democracy in Spain in 1977 (first democratic general elections), and continued with the entry of Spain into what is now the European Union. This was a time of important transformations in both institutional and economic terms. The opening-up of the economy, which had been gradually promoted over the previous decades, received a new impulse from the decision by all political forces to build an advanced democracy and, at the same time, to become part of a political and economic Europe, from which Spain had been isolated for many years. This involved considerable efforts in terms of political adaptation to the rules of representative democracy, which meant the dismantling of the institutions inherited from the dictatorship. In this way important changes to the laws on civil rights were introduced; the armed forces and the police were reformed; and a lot of the existing laws were amended to adapt them to the demands of the democratic Constitution passed in 1978. At the same time, far-reaching reforms were carried out in institutions which were particularly influential in the economy. The so-called "vertical unions", formed around workers in the same industry (the only unions permitted in Franco's time), were dispensed with, and a militant trade unionism of freely associated workers appeared, which negotiated working conditions with employers' representatives.

The problems of the political transition in Spain were accentuated by the need to embark on a process of political change which was ridden with uncertainty in the depths of economic recession. For this reason, the first years of the transition to democracy were far from easy and there were even reactionary pressures which were manifested in failed coups d'état. Pressures which were also fuelled by terrorist actions by a number of groups, in particular the Basque group ETA.

However, in 1982 the Socialists were elected and the idea of democracy as a system of parties alternating in office became established. Economic circumstances also changed. Between 1982 and 1986, Spain underwent one of the most important institutional and economic transformations in its history. The modernisation of its economy, the restructuring of crisis-hit industries, and a process of reindustrialisation that went beyond traditional economic sectors, were all actively promoted. At the same time a modern fiscal system was created, with a broad base of taxpayers and a modern tax administration system to ensure effective collection. Also, a great leap forward was made in the setting up, later than in other European countries, of what is commonly referred to, as the Welfare State. A generalised pensions scheme and a system to protect people against different risks, which were comparable with those

existing in the rest of Europe. An educational system that guaranteed free and compulsory education until the age of 16 and the creation of dozens of universities across the country with very attractive entry conditions. A public health system offering free health care and well-equipped facilities. These social and institutional changes were also combined with an enormous boost to the nation's capital assets in terms of investments in transport and infrastructure.

In an institutional sense, the most important transformation of Spain was the quasi-federal structure laid out in the Constitution. A country with a geographical surface area of 500,000 km² was organised into 17 Autonomous Regions, with wide-ranging legislative and economic powers, so doing away with the old historical centralisation of power in Spain. Without doubt, Spain is today one of the most decentralised countries in Europe if not the world. I must admit that the design of the Spanish regional government system was inspired by the will and the intention to reach a broad consensus in which different regional cultures could co-exist. Some of these regions had their own language and specific political parties. It was a complex historical problem that had to be tackled and which was not without risks. The result, in my opinion, has contributed to making a much stronger state than the old centralised one. It has been legitimated by the democratic process and proven the capacity of the Constitution to integrate the geographical, cultural and political diversity of Spain into a new structure. The problem that has yet to be solved is that of Basque terrorism, which has produced almost 1,000 deaths, the majority during the democratic period. However, strange as it may seem, considering its political origins, ETA does not respond to questions of political decentralisation and it has degenerated into a killing machine with no political future. Perhaps in the questions and answers section I can go into this issue in a little more detail.

The historical phase that begun in 1986 with Spain's entry into the European Community is the consolidation of a long process of adaptation of its economic, social and institutional structures. The initial fears of competition from other more developed European countries, after the dismantling of the customs protection and the formation of a single market, were soon overcome, and, as I mentioned earlier, Spain went through one of its brightest economic periods.

Between 1985 and 1990 per capita growth was 1.5 percentage points higher than the European average. The difference, although reduced, was maintained in later years. In fact, in the last five years (1995-2000), the Spanish economy has grown annually at a rate of 1.3 percentage points higher than the European average.

AVERAGE ANNUAL RATES OF CHANGE. DIFFERENTIAL SPAIN-EU. June 2001

b) TASAS DE VARIACIÓN MEDIA ANUAL. DIFERENCIAL ESPAÑA-UE

8-Junio-2001 11:38:05

	1960-1965	1965-1970	1970-1975	1975-1980	1980-1985	1985-1990	1990-1995	1995-2000	últimos tres años	último año	año último dato
2.2 DIFERENCIAL DE TASAS ESPAÑA-UE											
I. PIB per cápita y componentes											
PIB per cápita (miles de PPC en euros)	3,3	1,2	1,9	-1,9	-0,3	1,4	0,1	1,3	1,4	0,8	2000
Población de 16-64 años/Población total (%)	-0,1	0,0	-0,1	-0,2	-0,3	0,5	0,5	0,0	-0,0	-0,0	2000
Tasa de empleo (%) (b)	0,1	0,2	-0,2	-2,6	-1,3	1,5	-0,3	1,6	1,9	1,6	2000
Productividad del trabajo (miles de PPC en euros por ocupado) (c)	3,3	1,0	2,2	1,0	1,3	-0,6	-0,1	-0,4	-0,5	-0,7	2000

Source: Banco de España

In this way, the process of opening up Spanish markets, which begun years earlier, was brought to fruition with Spain becoming one of the most open economies of Europe (in the year 2000, the sum total of exports and imports of goods and services was 61% of GDP). The result of this broad modernisation was an inevitable improvement in the real comparative position of Spain with respect to its European partners measured in terms of per capita income. In 1960, at the beginning of the process of liberalisation of the Spanish economy, per capita income was 59.8% of the average of the EU. In the year 2000, this measurement of social welfare had reached 82.8% of the EU average. A long process of improvement which must still be continued today.

Within the context of these ideas I would now like to draw some conclusions and touch, in passing, on some of the main questions of debate in Spain today.

1. The first point worth highlighting is that, in the last 20 years, Spain has made a great leap forward in social and economic terms, which has changed beyond recognition the old backward inward-looking Spain set up during the first half of the twentieth century and consolidated during the dictatorship of General Franco.

2. The most important event of this period, along with the restoration of democracy, was the integration of Spain into Europe from which it had been isolated both politically and economically.

3. The transition to democracy in Spain is the result of a large-scale national agreement to overcome the conflicts of the civil war and the dark period of dictatorship. Both, the left and right-wing, took part, as well as the main nationalist political parties of the regions.

4. At the moment, the main problems of Spain revolve around the need to create a long-term economic strategy that is capable of bringing Spain up to the same economic level, in real terms, as the most advanced economies in Europe. This process, up to now very successful, must now centre on a strategy of

investment in human and technological resources to which both the public and the private sector must contribute in their own fields.

5. Spain is committed to maintaining the objectives of macro-economic stability, stability of prices and a balanced budget, because of its membership of the euro zone (Stability and Growth Agreement). These goals do not raise unbeatable problems for an economic policy aimed at real economic convergence of Spain with other countries. On the contrary, they become guarantees for a healthy, long-lasting period of growth.

6. At the same time, gains in efficiency and the improvement of the competitiveness of the Spanish economy are closely-linked with the continuation of the process of economic liberalisation. The ongoing processes in Europe in the energy and telecommunications industries and, in general, in the different service sectors, have led to an improvement in the market mechanisms in these and other sectors as a result of a stricter control of the regulations governing competition. Strange as it may seem, the left-wing in our country do not criticise the current centre-right government for its excessive liberalisation of the economy. On the contrary, we believe it could have gone further. Or, to be more precise, that part of the liberalisation carried out so far has only served to remove companies that enjoyed monopoly status from the public sector so creating private quasi-monopolies. The privatisation of State-owned companies began during the Socialist government of which I was a member. In recent years this process has accelerated a great deal. Unfortunately, privatisation has not been complemented with a process of liberalisation and the result is a blatant concentration of economic power which in no way contributes either to democratic transparency or to economic efficiency.

7. Throughout the process I have described here the role of the State has been very varied. We inherited the institutions from the dictatorship and its means of political and economic intervention. We had to reform them radically to give the market a larger role without losing the capacity for political leadership in the process. We are now confronted with new debates. We do not believe that the State should be at the helm of the most important industries nor should it directly provide most of the goods and services that people require. For this reason it was necessary to privatise state-owned companies. Today only coal remains in public hands, for the simple reason that it is not a profitable business. But the State no longer produces cars, nor does it refine oil, or generate electricity or gas and neither does it produce fertilisers for agricultural use.

However, we believe in the need for an efficient State that guarantees clear rules to regulate economic activity and can intervene where the market is shown to be ineffective. For example, in the provision of public investment (communication and transport especially) human capital (the educational system and the guarantee of health care) and technological investment (by supporting basic research and promoting technological progress). And of course, the State must be required to establish a reliable macro-economic policy, which generates confidence as well as guaranteeing fair competition between private economic agents. Without doubt this is one of the roles of the State that has acquired particular relevance of late and, as I mentioned earlier, this has become a subject of great debate with the centre-right government in Spain. Again, as long ago in history, the centre-right preaches the

excellence of competition while taking care of monopolies. And the left-wing, mostly represented by socialists, has to battle in favour of a deeper and fairer competition.

Thank you very much for your attention