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SPANISH INDUSTRY AND THE IMPACT OF MEMBERSHIP OF THE EUROPEAN COMMUNITY

Michael Noelke
Robert Taylor

Bd Clovis, 39 1040 Bruxelles ☎ (32-2) 230 26 61/77

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TECHNICAL NOTES

1. For Spanish foreign trade statistics, this document uses the sections, chapters and headings of the Brussels Nomenclature (NdB) such as it is applied by the Spanish customs administration (Direccion General de Aduanas).

2. Similarly, economic activities are classified according to the Spanish "Clasificacion nacional de actividades economicas" (CNAE), which varies slightly from its EEC equivalent, the "General Industrial Classification of Economic Activities within the European Communities" (NACE).

3. Monetary values are given in Pesetas, except when it has appeared necessary to give a comparison with the Community. For these operations, conversion rates Peseta/European Unit of Account used are as follows :

	1975	1976	1977	1978	1979	
1 EUA =	71.23	74.8	86.89	97.7	92.6	Pesetas

4. In order to facilitate the appreciation of the size of some figures in Pesetas, these have been converted into U.S. Dollars. Unless otherwise stated, the rate of conversion used is 1 Dollar = 66 Pesetas.

5. Throughout the text, one billion is used instead of 1,000 million.

6. Many tables have been drawn up by the authors themselves on the basis of data given in the quoted source documents. In these cases, the tables as printed are not direct reproductions from these documents.

INTRODUCTION

The present publication is a revised and updated version of a study prepared by the authors between April and October 1979 for the Commission of the European Communities.

It analyses the problems facing the principal sectors of Spanish industry as they prepare for membership of the Community.

The sectoral approach chosen by the authors endevours to highlight the specific problems facing the individual branches of industry investigated. The aim is to identify within each sector those Spanish products which in a relatively short time-span could benefit from Spanish membership of the EEC and those for which major efforts will have to be undertaken to adapt to the new conditions of an enlarged Common Market.

The sectors studied are first of all those which are in or near crisis throughout Western Europe (steel, ship-building, textiles, footwear and petrochemicals); sectors which are undergoing far reaching changes at the European or world levels (motor vehicles and automobile components); advanced technology sectors (electronics and data-processing, aeronautics); sectors which are of specific importance for Spain (paper, furniture, ceramics and glass, toymaking).

If the analysis does not cover all sectors of Spanish industry, the authors believe those examined in this document can nonetheless serve as a guide for the state of Spanish industry as a whole. The sectors in this report accounted for 60% of Spanish exports and 40% of imports in 1978 and more than half of the country's Gross Industrial Product (1).

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(1) see Tables I and II (pages 533 and 534).

The negotiations for Spanish and Portuguese entry into the European Community have just entered their active phase and are, according to the declared wishes of all concerned, to be completed as rapidly as possible. It is possible that by 1983, therefore, the Community will be enlarged from the present nine members to 12 with the accession of Greece and the two Iberian countries.

The method employed by the authors tries primarily to be pragmatic. They have based their research on available Spanish documentation and on meetings and discussions held during two visits to Spain, one in May and the other in June-July 1979.

They had discussions with government officials (including Mr Leopoldo Calvo Sotelo, Minister responsible for relations with the European Communities), experts from ministries, employers organisations, representatives of small and medium-sized industries, trade unions, political parties, sectoral federations. They also met representatives of the Instituto Nacional de Industria, the Bank of Spain and Spanish and foreign commercial banks.

The authors express their thanks to all those in Spain and in Brussels who by their open and willing cooperation helped them accomplish their task.

Brussels, February 1980.

SUMMARY

The present study examines the problems confronting Spanish industry as it prepares to join the European Community. It endevours to identify those industrial products which could benefit fairly rapidly from the enlargement of the Community from nine to 12 members as well as those for which membership of the EEC will require major efforts of adaptation. The first section analyses the general situation of Spanish industry and the factors which will affect its capacity to adapt to the new conditions created by Community membership. The 13 chapters which follow are each devoted to a specific industrial sector. Together, the 13 sectors account for 60% of Spanish industrial exports, 40% of imports and more than 50% of Gross Industrial Product.

Findings of the study

Spain is entering its negociations to join the European Community in extremely difficult economic conditions. The country, more heavily dependent on external sources of energy than the EEC as a whole, has a jobless level and an inflation rate which are both well above the Community average. The transition from the Franco regime to a parliamentary democracy has brought into the open a number of contradictions and conflicting interests which have delayed the creation of a coherent economic policy at national level. Short-term economic difficulties compound traditional structural weaknesses : geographic fragmentation of production units, worse structural and regional imbalances than in the EEC, heavy dependence on foreign technology and capital, delays in applying modern methods of management and marketing etc. In addition, production costs, which in Spain were lower those of the

Community in many sectors, are rising faster than those of the Nine so that this advantage is rapidly disappearing.

Spain does, however, possess a number of assets which can enable it to meet the challenge posed by EEC membership. Among these is the fact that the Spanish internal market is less highly developed than those of many EEC members and therefore has considerably more room for expansion than the latter, where saturation levels have been reached in some cases. In certain sectors like footwear, textiles and even shipbuilding, wage costs are still lower than in the Community (with the exception of Ireland, the United Kingdom and Italy) but Spanish industrialists may not be able to count on this advantage for much longer. Their aim should be, therefore, to seek a greater degree of specialisation in the kind of goods they produce and to concentrate on more technically advanced items with a higher degree of added value. This is the way Spain will be able to insert itself in the new European and international division of labour which is currently being created.

Most of the problems facing Spanish industry would have to be tackled even if Spain were not applying for membership of the European Community. But membership of the EEC will help Spain meet the challenge of adapting to the post-industrial society, provided all 12 members of the enlarged Community have the will and the means to facilitate the necessary structural adjustments and give Spain a sufficient transition period to carry them out. The present document shows, however, that on balance Spanish industry faces more difficulties in adapting to the conditions of an enlarged Common Market than Community firms will have in reinforcing their position on the Spanish market. Part of the reason here is that Spanish tariffs on EEC goods are on average considerably higher than those applied to goods moving in the other direction. The total dismantling of tariff barriers will demand a greater effort on Spain's part than on that of its future partners. But Spain is in a position to benefit from the removal of tariff barriers between the two countries of the Iberian Peninsula.

The Spanish authorities have at their disposal a number of measures to encourage the restructuring of production capacities or the development of new industrial sectors. The public sector, managed by the Instituto Nacional de Industria (INI), can play a capital role in this context since its activities include sectors of heavy industry and industries in difficulty (steel, shipbuilding, motor vehicles, etc) as well as advanced technology sectors like electronics and data-processing.

However, the high level of unemployment and the very modest growth rates forecast for Spain make these efforts of adaptation more difficult still. This is one reason why Spain wants before joining the Community to strengthen its position and consolidate its advantages in sectors like shipbuilding, steel, motor vehicles and textiles. The Community will have difficulty in convincing Spain to submit to common disciplines in sectors where special measures are already being taken by the Nine before it actually joins the EEC.

Sectoral summary

Steel : Productivity is lower than the Community average and the technological level of EEC steelmakers has not yet been reached. The collapse of internal demand has forced the industry to export at unprofitable prices just to stay afloat. In its present position, the Spanish steel industry considers it out of place to accept the constraints of the EEC Davignon plan and would prefer to keep a free hand so as to restructure the industry in the way it feels most appropriate.

Shipbuilding : Spain is one of the top shipbuilding nations of the world and has been hit as hard as any by the international crisis in this sector. The government has drawn up a restructuring plan which provides for a 30% cut in production capacities to permit the industry to be in a position to take off again from a more solid base if and when demand picks up again (as forecast) in the mid-1980's. The sub-sector of marine equipment, hard hit too by the crisis, is likely to suffer even more as protective tariffs disappear and the Spanish market opens up to EEC competitors. Spanish shipyards are rated to be competitive for medium-technology vessels (tankers, bulk carriers) and less so for high-technology vessels like containerships.

Motor vehicles : This sector, undergoing profound structural changes worldwide, is a major target for foreign investment in Spain. Investments could total 3.8 billion Dollars in the next five years. Even if not all projects go ahead, it is clear that the Spanish vehicle industry is destined to expand its production capacities, and therefore its export potential, considerably in the next few years. The authorities have recently taken a number of steps to facilitate the restructuring of the industry. The commercial vehicles sector is facing serious difficulties.

Automobile components : The reduction of tariff barriers and the elimination of the present system which imposes high minimum levels of local content on vehicle makers risk causing serious difficulties in this sector. Efforts will have to be made to regroup firms into bigger production units. Local Spanish companies should try to exploit the spare parts market, especially for types of equipment not covered fully by the multinational corporations.

Electronics : Dominated by multinationals, the sector is also heavily dependent on foreign technology. The government is trying to lay the basis for a national data-processing industry and a plan is being prepared. The restructuring of small firms in the electronics sector should be undertaken now. Consumer electronics and electronic components are likely to be the sub-sectors to experience the most difficulties after EEC entry.

Aeronautics : This sector is small in Spain, consisting almost entirely of one group, Construcciones aeronauticas SA (CASA), in which the Instituto Nacional de Industria (INI) has a 65.6% stake. Even if this sector will not generate many new jobs in the future, it can make a contribution to raising the technological level of Spanish industry in general.

Textile and clothing : This sector has been in a crisis situation since 1974 due to the weakness of internal demand and it has taken longer to overcome its difficulties than the EEC textile industry in spite of its higher level of protection. The Community is Spain's biggest trading partner and the surplus in Spain's favour increases each year. Only in silk and woollens is Spain on a competitive level with the EEC. The Spanish government is trying to raise the competitivity level of the industry without however expanding production capacities.

Footwear : In the enlarged Community, Spain will be the third biggest producer of shoes and the second biggest exporter after Italy. After several years of explosive growth, exports will be down in 1979 compared with 1978 levels, when they accounted for 45% of production. If the footwear sector reinforces its efforts in the medium and high-quality product range, it can consolidate its position in the EEC after membership.

Chemicals : This sector is characterised by : domination of multinationals, relatively limited home market, small size of Spanish firms, low productivity, high level of protection, a deficit in nearly all sub-sectors, especially petrochemicals. This is likely to be the sector with most difficulties in adapting to EEC membership, whith the exception of fertilizers which are very competitive.

Paper : Despite its low productivity and relative inexperience in exporting, prospects for the sector are not bad. Consumption rates are still low and Spain is moving towards self-sufficiency in raw materials. However, structural problems and the need to adapt their industry to EEC anti-pollution norms have led representatives of the industry to ask the government for a transition period after EEC membership of at least eight years. Efforts will need to be made to restructure the industry and to concentrate production.

Furniture : The elimination of trade barriers will favour the furniture industry of the EEC more than its Spanish counterpart because its products are of higher quality. Spain, sixth-biggest furniture-maker in Europe, should make an effort to specialise its production, particularly in the areas of period furniture and high-quality hand-made items.

Ceramics and glass : Without direct government help, the dismantling of tariff barriers could cause considerable problems in this sector, which is made up essentially of small firms, often with a low output. The sector, which provides up to 115,000 jobs, has been hard-hit by a fall in home demand and has been able to turn its production to export markets in a limited way only. Ceramic tiles are an exception.

Toys : Industry leaders in this relatively small sector feel that there will be some room to expand sales to the EEC after the removal of tariff barriers. But the alignment of Spain with the Community's Common Customs Tariff (CCT) will ease the entry of imports from very competitive third countries such as Japan and Hong-Kong.

Chapter I

General situation of Spanish Industry on the eve of membership of the european Community and its capacity to adapt to new conditions. Presentation of results.

Spain's negotiations to join the European Community are taking place in extremely difficult economic conditions. The first enlargement of the Community was prepared in a climate of economic expansion; the second is being negotiated against a sombre backdrop of world recession aggravated by repeated increases in the price of oil. Spain, more dependent than the EEC on imported energy supplies, is particularly vulnerable in this respect. (1).

In addition, Spain is experiencing serious internal economic problems as reflected in the weakness of internal demand and levels of inflation and unemployment which are well above the EEC average.

It has been difficult for outsiders to grasp the degree of seriousness of the difficulties confronting Spain because the real situation has been masked by the dynamism of Spanish exports which reached record levels in 1978 and by the fact that in the same year the current accounts balance showed a surplus (500 million Dollars) for the first time since 1973. The current account surplus for 1979 is likely to be well in excess of one billion Dollars.

However, the conditions under which the Spanish economy is operating are very different from those of five or ten years ago. From the start of the 1960's until 1975, Spanish economic and industrial growth rates were higher than those of any of the Northern European industrialised states.

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(1) Primary energy production covered only 24% of internal consumption in 1976. The equivalent figure for the Community was 43 %. See for example the Opinion on Spain's application for membership, Commission of the European Communities (COM (78) 630 final).

This development took place in the wake of a period of general worldwide economic expansion and thanks to a first, albeit limited, step to open the Spanish economy to trade competition and to foreign capital. Spain was able therefore in a relatively short space of time to raise itself from a basically agricultural country to one of the ten top industrial powers of the world.
The kind of economic development that Spain has known since the 1950's has created numerous structural and regional imbalances. Even today, the recent nature of Spanish industrialisation is apparent.

As stated in a study by the Istituto Affari Internazionali of Rome (1), the Spanish economy is most dynamic in medium and low technology sectors such as automobiles, steel and footwear and less so in advanced technology sectors like electronics, plastics and pharmaceuticals. Exports are concentrated in labour-intensive sectors although this trend is changing with a greater percentage being accounted for by high-technology, capital intensive products.

Since 1975, the Spanish economy has had to face two radical changes : firstly,at international level it has had to cope with the impact of the economic slowdown resulting largely from the oil price increases and secondly, at home, it has had to adjust to the political mutations rendered necessary by the death of General Franco.

Inside Spain, the state-controlled capitalism of the Franco era has been gradually replaced by a market-economy system similar to that operating in the main industrialised countries of western Europe.

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(1) Istituto Affari Internazionali : "Spanish industrial growth and international competitivity in view of community enlargement" by Joseph Sassoon and Richard Walker.

Spanish industry, therefore, like the rest of the economy is going through a difficult transitional phase. The principal difficulties exist independently of the problems linked to Spain's integration into the European Community. It should not be forgotten in this context that the Spanish economy is firmly integrated into the economic area represented by western Europe. In all, 46% of Spain's exports are to the Community and 34% of its imports come from the Nine. Moreover, 420,000 Spanish workers have found jobs in the nine EEC members and the country's tourist revenues come mainly from the Community.

The successful integration of Spain into the productive apparatus of the EEC does not depend solely on the capacity to adapt displayed by the Spanish authorities and the Spanish economy. This will also depend, inter alia, on the willingness of the 12 countries of the enlarged Community to implement economic policies capable of solving their structural problems and on the future evolution of the international economic situation. It is clearly easier to carry out structural changes in a period of economic expansion than during a recession.

Industrial structure

Three factors stand out in Spain's industrial structure : the presence of a large number of small and medium-sized enterprises (93.4% of industrial companies have fewer than 25 employees) (1); the large-scale penetration of foreign capital; the important role still played by the state by means of the Instituto Nacional de Industria (INI). The development of Spanish industry in recent years has been largely due to the activities of firms with foreign capital and of INI. No fewer than 29 of the 30 biggest industrial corporations in Spain have either foreign or state participation or are at least dependent on foreign technology (2).

Small and medium-sized companies are present in all branches of industry, trade and services. If they do not make a major effort to regroup into larger units, their existence in certain sectors will be threatened after joining the Community by bigger EEC firms capable of economies of scale and with lower unit costs. This could be particularly true in sectors such as automotive parts and electronic components.

There are sectors, on the other hand, where being small in a positive advantage. This is the case is such areas as footwear, textiles and clothing where large production units are often too rigid to be able to follow rapid changes in taste or fashion among consumers.

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(1) see Table III (page 535)

(2) This figure is quoted in "Spanish industry and the enlargement of the EEC", a paper presented by Messrs Prodi, Cio and Gobbi to the symposium on Spain and the Community organised in Madrid from 18 to 21 January 1979 by the Banco Urquijo.

These are generally speaking sectors where there is a relatively low level of foreign capital.

However, besides the problems specific to each sector, small and medium sized firms are faced with a series of general difficulties at the present time : low level of capitalisation, difficult access to credit (the banking system as a whole is less developed than in the EEC), heavy burden of social security charges, poor management and marketing, lack of exporting experience, etc.

According to figures from the Industry Ministry (1), companies with foreign participation accounted for 47% of turnover of major corporations in Spain in 1975.
The level of foreign participation is highest in the sector of vehicles and transport equipment (81.4%), in electrical engineering (78.6%) and chemicals (77.6%).

Foreign investments more than doubled in one year between 1977 and 1978, going from 28 billion Pesetas (420 million Dollars) to 56.9 billion (860 million Dollars) (2).

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(1) see Table IV (page 536)
(2) see Table V (page 537)

Even although Community firms taken as a whole were the biggest source of foreign investment in 1977 and 1978 with 41.6% and 37.7% of the total, the first EEC country came in third place only behind the United States (23.1% and 24.7%) and Switzerland (20.7% and 15.3%) (1).

The behaviour of foreign-based companies after Spain becomes a member of the Community is not yet clear (2). The relevant decisions will be taken by head offices situated outside Spain, which may find it easier to incorporate Spain into their general European operations once tariff barriers are lifted. Some of them might find there is no longer a justification for keeping a separate production unit in Spain solely for the Spanish market. But on the eve of membership, the rhythm of foreign investment has continued to be fairly intense. According to the Trade Ministry, foreign investments in the first five months of 1979 amounted to 27.5 billion Pesetas (415 million Dollars) exceeding already 50% of the investments for the whole of 1978 (3). During the January-May 1979 period, Community countries were the biggest sources of foreign investment. Holland was in first position, followed by France, Germany and the United States.

The fact that foreign capital is still flowing massively into Spain in advance of the country's membership of the Community indicates that multinational companies are preparing to reinforce their position there not only to serve the national market but also as a springboard to Community markets and those of the third world, particularly Latin America and the Middle East.

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(1) see Table VI (page 538)

(2) Table IX (page 541) lists the major international corporations which are present in Spain.

(3) Figures quoted in <u>Europa Press</u>, 22 Juni 1979.

In addition to the large presence of foreign firms in Spain, the country is also heavily dependent on foreign technology. In recent years, the net deficit for licences and royalties has been in the region of 300 to 400 million Dollars a year (1).

If foreign companies seem to show a certain confidence in Spain's future, their attitude is not shared by some national firms, who are considerably more reluctant to carry out new investments. Industrial investments in 1978 rose in nominal terms by only 2.37% over 1977. In real terms, this represents a reduction of 8.2% over 1977 and comes on top of reductions of 1.7% and 7.1% recorded in the two preceding years. One major explanation for this situation would seem to reside in the difficulty some Spanish industrialists have in adapting to the new political situation in Spain,to the new framework of industrial relations with trade unions and to the gradual introduction of a market economy system.

The role of INI in Spain's industrial structure does not seem to differ fundamentally from that of public enterprises in the present members of the European Community.

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(1) see Table VII (page 539)

(2) figures quoted in Economia Industrial (monthly publication of the Industry Ministry) n° 181 of January 1979 "La inversion industrial en 1978" (see below Table VIII, page 540).

The Spanish authorities are currently examining at the request of the EEC Commission, the extent to which aids granted by INI to companies in its group can lead to a distorsion of free competition. These operations generally take the form of subscriptions to capital increases, subsidies to cover operating losses or the granting of credits on more favourable terms than those obtainable on financial markets.

In 1978, INI was responsible for one third of industrial investments in Spain. Group companies accounted for 10% of Gross Domestic Product and 13% of Spanish exports. They provided 244.300 jobs, or 7% of all jobs in industry (1).

INI has a direct stake in 71 companies and through these has an indirect participation in 240 others. Those in which INI has a direct stake produced 100% of Spain's natural gas in 1978, 40% of refined petroleum products, 40% of steel, 87% of shipbuilding output and 100% of aircraft production(2).

The activities of INI are centred on the one hand in basic industries and in the primary transformation sector and on the other hand in the development of high technology sectors.

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(1) see Table X (page 543)
(2) see Table XI (page 544).

In addition, the INI has been involved in rescue operations for companies in difficulty in a number of sectors.

Besides the role of the INI, the Spanish system of state aids to industry will also be a major issue during the entry negotiations.
The aids in Spain are both regional and sectoral in character. Among sectoral aids are the creation of sectors of "perferential interest", the establishment of "concerted actions" (public authorities and firms) and the implementation of sector restructuration plans.

Regional incentives include the creation of "development poles", "priority zones for the localisation of industry", "industrial polygons" and "decongestion polygons".
The authorities have also created in less industrialised areas Regional Corporations for Industrial Development (Sociedades para el Desarrollo Industrial - SODI).

Official credits at reduced interest rates are one of the main instruments of state aid. They are financed by the public and private banking sector which must devote a proportion of their deposits (21%) to financing operations defined by the government : public sector credits, export credits, regional and sectoral projects. Official credits play an important role in Spain because the local capital market remains underdeveloped and firms have otherwise to rely on short-term credits, which are expensive and whose terms have to be renegotiated frequently.

External Trade

The elimination of tariff barriers between Spain and the Community will be more difficult for Spain than for the Nine. This is because the Spanish tariff levels are considerably higher than those of the EEC and because Spain applies supplementary protective measures.

Despite the liberalisation measures in operation since 1979 (1), the Spanish market remains highly protected. In practically all industrial sectors, tariffs are higher than those of the Community (2). Tariffs are also reinforced by a system of import taxes (ICGI) and export rebates whose aim is to tax imported good by the same amount as paid by domestic producers through the cascade tax system and to reimburse exporters for the amount of domestic tax actually paid.

It was generally acknowledged by persons interviewed in Spain that the impact of the system goes beyond its declared aim of neutralising the effect of domestic taxes. It has in effect become a supplementary tax to discourage imports and a veiled subsidy on exports.

Certain industrialists in Spain believe that the system can be justified, at least at the export level, because it does no more than compensate the social security contributions borne by firms, which are considerably higher than those paid by companies inside any EEC member state.

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(1) Customs duties were reduced provisionaly according to the formula set out in Table XII (page 545) by Royal Decree 921/1979 of 27 April 1979. The lifting of a large number of quantitative restrictions was announced in a Resolution from th Ministry of Trade published in the Boletin Oficial der Estado (BOE) of 3 May 1979.

(2) For details, see the sectoral analyses in subsequent chapters.

The present system is due to disappear with the introduction in Spain of the Value Added Tax (VAT) envisaged for 1982 or 1983.

Spanish legislation includes other mechanisms which discriminate against imports such as the obligation on companies to use a set amount of locally produced parts and components in their products. This is the case particularly in the motor vehicle industry.

The Community is by far Spain's most important trading partner. In 1977 and 1978, the Nine took 46% of Spanish exports and supplied 34% of its imports.
Spain reduced its trade deficit with the Community from 1.5 billion Dollars in 1977 to 500 million the following year. In 1978, it had a trade surplus with France, the Belgium-Luxembourg Economic Union (BLEU) and Denmark.

After the EEC, the Arab countries, followed by the United States and Latin America are Spain's main trading partners. (1).

However, despite their recent dynamism, Spanish exports represent a relatively small proportion of GDP : 8.8% in 1977 compared with a range of 16% to 47% for the Nine.

As part of an exercise to define the likely impact of the removal of tariff barriers on the Spanish economy, experts have studied the impact on trade flows between the Community and Spain of the 1970 trade Agreement between the two.

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(1) for details, see Tables XIII and XIV (Pages 546 and 547).

The results are not conclusive. They are distorted by the repeated monetary upheavals which have occured since 1971, by the first enlargement of the Community and by the economic slow-down provoked by successive oil price increases (1).

In the present document, therefore, we have concentrated on analysing and comparing the structure of Spain's foreign trade and that of the Community in 1977 and 1978. On the export side, the structures are similar. Although Spain exported a lower proportion of industrial goods than the EEC average (73.9% of total exports against 86.6% for the Community), the Spanish figure is well within the range of the individual member states of the Nine where the figure varies between 65.7% and 92.9%. This is not the case, however, for imports where Spain falls outside the minimum/maximum range of EEC countries. Spain's imports of industrial goods accounted for 51.4% of total imports against a Community average of 78.1% and a range for individual members of 58.3% to 81.4%. This difference would appear to be due to the high level of protection surrounding the Spanish market. It should therefore disappear with the progressive opening of Spain's frontiers with the result that industrial imports could be expected to increase at least to the minimum level of present EEC members (2).

Such a trend towards higher industrial imports by Spain would be additional to the stimulation given to EEC-Spanish trade in the normal course of events following the opening of frontiers between the two.

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(1) see for example ESADE (Barcelona) "La Industria Espanola ante le CEE" (1979) or Francisc Granell in Coyuntura Economica (N° 11/12) "La industria espanola ante la integracion en la comunidad economica europea".

(2) for details , see Table XV (page 548).

In the absence of any increase in the level of domestic demand, it is important for Spain to maintain the dynamism of its export industries. If the Gross Domestic Product (GDP) grew by 2.8% in 1978, this was largely as a result of the strong upsurge in exports.
The recovery of home demand, originally forecast for 1979, did not materialise and the growth rate in real terms is likely to have been between 1.5% and 2%, according to preliminary estimates.

The economic prospects for Spain itself and the depressed international context clearly indicate that the entry negotiations will take place against a sombre economic backdrop for both sides.

The government's medium-term economic programme (1980-83) published in August 1979 (2) maintained an optimistic tone, but more recent forecasts, at least for the short term, have been more modest in their expectations. In an address to bankers in Madrid on 21 December 1979 (3), the Economics Minister, Mr. Jose Luis Leal, forecast a growth rate for 1980 of only 2% but even this figure is being questioned by some private sector economists.

The fight against inflation remains the first priority of the Spanish authorities. They have imposed credit limits and put a brake on the expansion of the money supply, measures which will make any economic recovery even more difficult.

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(1) the evolution of Spanish GDP and its break-down by sector is given in Tables XVI and XVII (pages 549 and 550).
(2) see Table XVIII (page 551).
(3) cf El Pais of 23 December 1979.

Within the Moncloa Agreements between the government, employers and trade unions, the government succeeded in bringing inflation down from its record level of 26.4% in 1977 to 16.5% at the end of 1978. But the improvement has not continued largely because of the increased oil bill. The annual rate at the end of 1979 was probably around 16% against 11%-12% for the European Community. For 1980, Mr. Leal forecast a modest reduction of one point.

The government programme expected the total wages bill to go up by about 14% in 1979, the upper limit of the 11%-14% range set by the authorities. According to the Economics Ministry, the salary increases in 1978 within the framework of collective wage agreements rose by 22%. In its draft budget for 1980, the government's aim was to limit rises, at least in the public sector to 12.5%. But a framework agreement worked out since then between the employers and the Socialist trade union, the UGT, has set a range of 13%-16% for negotiated wage increases in 1980.

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(1) Ministerio de Economia "La negociacion colectiva en 1978".

Unemployment

Efforts by the government to bring inflation under control have had a negative effect on the level of joblessness in Spain. Unemployment has risen steadily since 1977 and exceeded 9% of the working population at the end of 1979.

The unemployment crisis and the modest growth forecast for the next twelve months will render more difficult efforts to increase productivity and reinforce the competitiveness of Spanish goods.

During 1979, contacts between employers and trade union leaders centred on the revision of existing labour regulations and ways of increasing labour mobility. The present legislation dates from the Franco era and in effect makes the dismissal of workers for economic reasons very difficult if not virtually impossible.

The employers would like to be able to lay off workers in times of economic recession. It is clear that the trade unions are not ready to accept a reduction in this type of job protection, particularly in the present economic circumstances.

The constant increases in labour costs and the introduction of data-handling equipment will severely limit the services sector's capacity to absorb redundant workers from industry and agriculture who lose their jobs as productivity rises and modern techniques are applied.

The expanding sectors of industry are too small and too few to reverse the tendency towards increasing unemployment. The authorities are pushing to expand the high-technology sectors of industry such as electronics and data-processing, but these are sectors which are capital rather than labour-intensive.

In absolute figures, the number of jobless rose, according to the National Statistical Institute, from 831,000 at the end of 1977 to 1,083,000 at the end of 1978 and 1,128,000 at mid-1979.

As a percentage of the working population, the progression was from 6.3% at the end of 1977 to 8.3% at the end of 1978 and 8.7% six months later.
The unemployment level is 26.5% among young people in the 14 to 19 age group and 16.9% for the 20-24 year-olds (1).

The regional distribution of unemployment is very uneven. In the poorer provinces in the south of the country, it can reach 18% (2).

The trade unions dispute the official figures and claim for example that those classed by the National Statistical Insitute as having a marginal activity should be included with the jobless and not with those in work.

Spain's unemployment problem risks getting worse in the future for several reasons. Firstly, the population growth at current and forecast rates is higher than in the Community (3), which risks increasing pressures on the labour market. According to expert analyses, it would require 160,000 new jobs every year just to stabilise unemployment at its present level. This alone would require a real annual growth rate of 5% (4). In addition, emigration does not at the moment present a safety valve as in the past for excess labour. The countries that normally welcomed migrant labour are themselves struggling through difficult economic conditions. According to a study by the Banco de Bilbao (5), 490,000 migrant workers returned home from abroad in the 1973-1978 period while only 227,000 left Spain, a net inflow of more than a quarter of a million.

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(1) Instituto Nacional de Estadistica : Encuesta de Poblacion activa (January-march 1979) page 20. See Table XIX (page 552)

(2) see Table XX (page 553)

(3) see Table XXI (page 554)

(4) cf for example Joaquin Leguina in "Seminario Franco-espanola sobre problemas actuales de la economia del empleo" in the series Estudios y Seminarios published by the Economics Ministry (November 1978).

(5) quoted in El Pais of 30 August 1979.

Costs, productivity and competitiveness

The methodological and analytical difficulties surrounding any attempt to establish a meaningful international comparison of costs and productivity are legion and the results of any such attempt should be treated with the utmost caution. To our knowledge, there is no complete comparison EEC-Spain in this sector which has been done in recent years. We have based our research on what is available on the separate aspects of these problems.

This analysis, together with our conversations with specialists in the administrations and among industrialists and labour leaders, has led us to two general conclusions :

a) despite wide variations among the different industrial sectors, Spain can no longer be considered as a country with low labour costs.
b) the Spanish level of productivity is lower than that of the Community in virtually all the key sectors of the economy.

As far as wage costs go, several attempts have been made recently, particularly in West Germany, to draw up a comparitive table of salary costs at the international and European level. One of the most recent, by the Dresdner Bank (1), shows that salary costs in Spain as of Spring 1979, were 10% higher than those of the United Kingdom and was only 22% and 24% inferior to those of Italy and France.

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(1) Dresdner Bank : "Wirtschaftsberichte" (N° 31/3) September 1979. See Table XXII (page 555).

OECD figures confirm that salary costs in Spain are rising more rapidly than in the member countries of the European Community (1).

According to an index published jointly by several professional groups in the metalworking sector in Spain, labour costs more than tripled between September 1974 (when the basic index was 100 points) and May 1979 (when it stood at 312.4 points) (2).

The share of Social Security costs borne by Spanish companies, which are considerably higher in Spain than in Community countries, add a further element of distorsion to salary costs. The Moncloa agreements committed the government to increasing its share of the costs from 8.2% in 1978 to 20% in 1983. But already the 1983 deadline has been put back for 12 months in the government's medium-term economic programme. (3)

Spanish employers claim that the burden of social security costs harms the international competitiveness of Spanish firms. It is clear that as far as employment is concerned the level of employer contributions discourages hiring new staff. In its latest Economic Survey of Spain, the OECD describes them as being the "equivalent of a payroll tax which penalises employment directly in a country faced with a serious unemployment problem" (4).

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(1) For details see Table XXIII (page 556)

(2) "Indices de costes de materiales y mano de obra" published jointly by the Associacion espanola de maquina herramienta (AFM), Associacion nacional de fabricantes de equipos para buques (INDUNARES), Associacion nacional de fabricantes de bienes de equipo (SERCOBE), and the Associacion nacional de construcciones metalicas (SERCOMETAL).

(3) See Table XXIV (page 557).

(4) April 1979.

The problem is posed today with even greater urgency because numerous firms have taken advantage of the recent fiscal amnesty to declare their true level of salaries. These were traditionally declared as being below their real level because it limited social charges paid by companies which were fixed in proportion to their total wages bill. Employees were happy to go along with the system because it gave them a lower declared (and therefore taxable) income than was actually the case.

The growth of productivity levels in Spain, although less rapid than in the past, has remained higher than that of Community members (1). The annual average has fallen from 5.5% for the period 1970-74 to 3.4% for 1975-78. It dropped further however in 1979.

The appreciation of the Peseta since its 20% devaluation in July 1977 has adversely affected the international competitiveness of Spanish industry. According to calculations done by the Bank of Spain (2), the advantage created by the devaluation had disappeared by the end of 1978.

In its Boletin economico (4), the central bank stated that the Peseta appreciated 25.7% against the Dollar between July 1977 and March 1979 and by 7.5% against a basket of EEC currencies. Certain industrial circles would like to see another major devaluation in order to restore international competitiveness. But it seems that the monetary authorities have other priorities.

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(1) See Table XXV (page 558)

(2) See Table XXVI (page 559)

(3) In the issue dated March 1979.

A modification by several points in the Peseta exchange rate could have just as great an impact on trade flows as a modest reduction in customs duties.

In the competition for export markets, Spanish industries can no longer profit from their former advantage, particularly compared with EEC firms, of relatively cheap labour. As pointed out in preceding pages, Spanish salary costs are now as high as in the United Kingdom and Italy in many instances and they are rising faster than productivity. A salary cost advantage still exists in some sub-sectors such as furniture and toys. In others, it is neutralised by the low level of productivity.
Productivity, measure in terms of output per worker, is lower in sectors with automated production lines such as certain types of clothing (shirts, for example) and also in the sector of automobile components.

Having caught up with the mainstream of the industrialised countries as far as salary costs are concerned, Spain can no longer withstand competition from developing countries or state-trading nations for a series of products, traditional and new, which are destined for mass markets and whose production is based on the intensive use of unskilled labour.

The integration of Spain into the customs union with the EEC will expose its industry to increased competition from the present and future members of the Community and with third countries, especially those with whom the EEC has concluded preferential trading agreements. In order to adapt to the new international division of labour and to maintain its share of national or export markets, Spanish industry will be subject to redoubled pressures.

This process of adaptation will be most difficult for small and medium-sized firms in the traditional sectors of industry like textile and clothing, mechanical engineering and paper.

In many branches of industry, good management is often a key factor in determining the success or failure of a firm. This is the case for the textile industry of the Nine (1) and is equally valid for the equivalent sector in Spain and for all other sectors where small and medium-sized companies are numerous. In addition, management problems are often evident in Spain among leading corporations.

Many industrial sectors in Spain are only now discovering the potential of export markets. This is particularly true of sectors like paper, furniture, toys and ceramics. They still have a long way to go, therefore, to improve their sales and marketing networks and their knowledge of foreign markets.

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(1) Comission of the European Communities :"Orientations generales pour une politique sectorielle textile/ habillement" (COM (78) 362 final) P.7.

Another obstacle to industrial development in Spain can be found in the absence of a sophisticated financial market. There is relatively little competition between major commercial banks and the services offered are not as comprehensive as those available to Community companies. There is little credit available for medium and long-term operations. Banks prefer to invest directly in companies that appear to them to be profitable or to grant short-term credits which generally to not go beyond six or 12-month maturities. The financing system works to the detriment of small and medium-sized companies.

As part of its policy gradually to open up the Spanish financial market, the government authorised in 1979 the establishment in Spain of subsidiaries of 15 international banks. These banks will probably concentrate on major clients, neglecting small firms. The foreign banks, although limited in the range of operations and services they can offer, hope to make a major contribution to the development in Spain of real money and capital markets. Their international networks will also enable them to offer services and facilities which did not exist or were present only in limited form in Spain until now.

Presentation of results

The foregoing analysis highlights certain problems which are common to different sectors of Spanish industry, particularly the need to raise productivity levels and to reorientate production towards more specialised items and goods with a higher element of value added.
This analysis is continued in more depth in the sectoral chapters which follow.

The problems facing Spanish industry are so diverse in nature that a study of this kind cannot be limited to looking at the impact of removing current obstacles to trade between the two partners.

In any case, the problems of the enlargement of the Community cannot be solved merely by the simple harmonisation of legislation or by extending the existing customs union to the three new members.

We have tried therefore to do more than classify the different industrial branches according to whether they are well or badly placed to benefit immediately from Spain's adhesion to the Common Market. Others have already done this work (1), which is certainly of interest. It enables those sectors to be identified for whom EEC membership will aggravate their problems and which need to take urgent action to improve their situation. We have also endevoured to stress the factors which determine the degree of dynamism and competitiveness of particular sectors and which affect the capacity of Spanish companies to resist international competition and benefit from joining the Community.

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(1) cf for example the study already quoted by ESADE of Barcelona.

Table A which follows contains a list of these factors. For each one of them we have tried to indicate whether the impact on the average competitiveness of a particular sector is positive or negative. In order to take account of the various situations existing within each sector, we have used a graded scale as follows : ff, f, ffd, fd, fdd, d, dd.

The letter "f" is used for favourable and "d" for detrimental. The repetition of a letter means therefore very favourable (ff), very detrimental (dd), generally favourable (ffd) or generally detrimental (fdd). The combination fd means the impact is neutral.

It is evident that, despite this effort at precision, any attempt at classification includes a large number of simplifications. It cannot take fully into account that different competitive factors have a different level of importance from sector to sector. In addition, we have utilised only a limited number of factors, while acknowledging that there may be others we have not used which could be determining factors for one of other of the individual sectors.

Our Table, therefore, does no more than to try to give a general and necessarily schematic idea of the factors which will influence positively or negatively the performance of different sectors of Spanish industry once trade barriers are removed.

The following preliminary remarks should be made concerning the different factors of competitivity used in the table :

-- Dynamism of home market : more emphasis has been put on the potential for growth of consumption in the medium term than on the present level of demand which is generally very weak. In certain sectors such as paper, petrochemicals, motor vehicles and household appliances, Spanish industry stands to benefit from the fact that consumption levels are still relatively low in Spain and that an increase in purchasing power will lead to increased consumption. For these same products, the consumption level in countries with higher living standards is near to saturation point.

-- Dynamism of export markets : the criteria here is current demand and expected future expansion.

-- Impact of government procurement : the existence of the state as a client can have a positive influence on industrial development. This is the case in electronics (especially for communications systems), data processing, shipbuilding, steel and aeronautics. Theoretically, the preference given to national companies when awarding official contracts should disappear once Spain joins the Community, but existing practice among the Nine show that they too have a long way to go before the letter of the Treaty of Rome is fully respected in this particular context.

-- Growth rate of production and of exports : the growth rate of exports is undoubtedly the most valuable indication of the international competitiveness of a given product. This can be verified most easily on export markets or on the Community market for those products which already have free access to the EEC.

One must not forget however that in the past two or three years, internal demand in Spain has been so weak that many companies have been forced to sell on export markets just to stay in business at prices which excluded any possible profit margin. This is why in the past three years, the <u>profit situation</u> of Spanish companies has been so poor. This is the case for steel, shipbuilding, ceramics and glass, paper and textiles.

-- <u>Level of import penetration</u> : in those areas where foreign imports already occupy a major place in the Spanish market, it will be even more difficult for Spanish firms to secure a bigger market share, unless they try to specialise in new products. In the table, a low level of import penetration is described as favourable. But this can of course result from the real competitive capacity of the national industry or alternatively it may be that imports are low because protectionist barriers are high. The table does not permit this distinction to be made. A favourable situation, in many cases, may not survive the opening of tariff frontiers.

-- <u>Impact of import liberalisation on Spain and on present community members</u> : the integration of Spain into the customs union means it will have to eliminate its obstacles to free trade which are considerably greater than those of the Nine.

This will impose a greater burden on Spanish companies than on those of the Community. On the other hand, Spain will profit more from the elimination of trade barriers with Portugal than vice-versa.
Very few Portuguese products are in fact competitive with Spanish goods (1).
Among the exceptions are certain types of wood pulp, textiles and cork products. The opening of trade frontiers can play a positive role in the longer term if it forces companies to increase their productivity and specialise production in items for which they are competitive. In other cases, however, it can lead to the disappearance of marginal companies, thereby aggravating the unemployment problem.

-- State of preparation for membership : the fact that they have been preparing for several years for integration into the EEC has certainly had a positive influence on the Spanish steel industry, as well as on shipbuilding and textiles. The problems that could confront one side or the other are already well know to both.

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(1) We have not been able in this document to examine this aspect in more detail, but this opinion is widely held in industrial circles in both Spain and Portugal.

In the steel and textile sectors, the Community has tried to limit imports from Spain. For all three sectors it has undertaken consultations in order to get firms to take "adequate autonomous measures" to avoid the creation of additional production capacities.

-- Availability of raw materials : this factor plays a favourable role for Spanish industry in the paper sector (wood), fertilisers (pyrites, sulphur etc.) and to a lesser extent for steel (iron ore).

-- Presence of multinational corporations : these are nearly always the most competitive in any given sector and they occupy a dominant place in a number of industrial branches. This is the case for chemicals, motor vehicles, automotive components, electronics and date-processing, marine equipment. Foreign companies generally have numerous advantages including easier access to credit (through their parent companies), more advanced technology, well developed export networks, and an excellent knowledge of world markets. If the presence of international corporations helps raise the technological or competitive level of a sector (the sole criteria used in the table), it is nonetheless clear that their domination in a given sector can pose major problems.

By the same token, reliance on foreign technology can raise the technological level in a particular sector, but at the same time it means that the industry in question has no option but to follow technological innovations which originate elsewhere, robbing it of any innovative potential.

-- Incidence of salary costs : the criterion used here is whether wage costs are higher in Spain or in the principal competitor countries of the European Community.

-- Impact of vertical integration in an industry : the existance of other industries upstream or downstream from a particular sector is generally an advantage for local industry. This is the case for steel, motor vehicles, shipbuilding, paper and cardboard, petrochemicals, plastics, etc.

The other factors used in the table and which influence the competitiveness of at the sectoral or company level are sufficiently clear as not to require separate comment.

Table A

FACTORS WHICH INFLUENCE THE COMPETITIVENESS OF DIFFERENT SECTORS OF SPANISH INDUSTRY

Factors concerning demand for products

1. Dynamism of home market (present and future demand) ....
2. Dynamism of export markets ....
3. Impact of government procurement policies ....

Recent performance

4. Production growth rate ....
5. Export growh rate ....
6. Trend of Profits ....

International competition and impact of trade liberalisation

7. Degree of import penetration ....
8. Impact of import liberalisation in Spain ....
9. Impact of import liberalisation in EEC (plus Greece and Portugal) ....
10. State of preparation for membership ....

Factors which influence competitiveness primarily at sectoral level

11. Availability of raw materials and other inputs ....
12. Impact of the presence of multinational companies ....
13. Impact of dependence on foreign technology ....
14. Impact of wage costs ....
15. Impact of vertical integration ....
16. Availability of commercial networks ....
17. Impact of state aids or of state participation ....

Factors which determine competitiveness at sectoral and company level

18. Present level of technology ....
19. Availability of skilled labour, technical expertise, etc. ....
20. Availability of infrastructure, transport, etc. ....

Factors which determine the competivity primarily at company level

21. Dimension of companies ....
22. Ease of access to credit ....
23. Specialisation of production ....
24. Innovative capacity ....
25. Level of management, marketing, etc. ....
26. Age of installations ....
27. Other factors affecting productivity ....

	Steel	Shipbuilding	Motor vehicles	Automobiles components	Electronics Data-pro-cessing	Aeronautics	Textiles	Footwear	Chemicals Petro-chemicals	Paper	Furniture	Ceramics and glass	Toys
1.	d	d	fd	fd	f	f	f	fd	f	f	f	ffd	fd
2.	d	d	fd	fdd	f	f	?	fd	d	?	ffd	fd	f
3.	f	f	-	-	f	f	-	-	-	-	-	-	-
4.	d	dd	ffd	fd	fd	f	fdd	fdd	dd	fdd	ffd	fd	ffd
5.	ff	d	ff	fdd	fdd	fdd	ff	fdd	?	ff	ff	fd	ffd
6.	dd	dd	fd	fd	fd	ffd	fdd	fd	d	dd	fd	fdd	f
7.	ff	ff	ff	ff	d	d	f	ff	dd	ffd	f	fd	f
8.	dd	dd	dd	dd	fdd	-	fdd	ffd	d	f	d	fdd	d
9.	ff	fd	fd	fd	fd	-	ff	f	?	dd	f	f	f
10.	f	ffd	fd	d	fd	fd	f	f	f	fd	ffd	fdd	ffd
11.	fd	f	fd	ffd	-	-	f	fdd	d?	f	ffd	f	f
12.	fd	-	ff	f	ff	f	?	-	ff	?	-	fd	-
13.	-	f	ff	ff	ff	ff	-	fd	ff	d	ffd	f	-
14.	ffd	ffd	ffd	ffd	f	ffd	f	ffd	f	fd	f	fd	f
15.	f	f	f	f	f	fdd	f	f	f	ff	fd	f	-
16.	f	f	ff	ffd	f	f	fdd	f	f	ffd	fd	fd	fd
17.	ff	ff	ffd	ffd	ffd	f	ff	fd	f	f	-	fd	-
18.	ffd	fd	fd	fdd	d	fdd	fdd	fdd	ffd	fdd	fdd	fd	fd
19.	f	f	f	f	fd	f	fdd	ffd	f	f	f	f	f
20.	ffd	fd	f	f	f	f	ff	f	ff	ff	f	f	ff
21.	fdd	f	fdd	fdd	fdd	fd	fdd	ffd	fdd	fdd	fdd	fd	f
22.	f	fd	f	fd	fd	fd	dd	d	f	fdd	d	fd	d
23.	fd	fd	fd	fd	fdd	fd	fdd	ffd	d	fdd	ffd	fd	ffd
24.	fd	fdd	ffd	fd	fd	fd	d	fdd	d	d	fdd	fdd	fd
25.	fd	fd	ffd	fd	fd	fd	fdd	fd	f	d	fdd	fd	fd
26.	ffd	ffd	fd	fd	fd	fd	fd	fd	f	d	fd	fd	fd
27.	fdd	fdd	fdd	fdd	fd	fd	d	fdd	d	d	fdd	fd	fd

In Table B, we have tried to group under four headings (from A to D) the principal products of the sectors analysed in this study according to their competitiveness at European level in the hypothesis of membership of the Community. There are relatively few items for which membership of the Community will cause no, or few, problems (colums A and B). Most subsectors of Spanish industry must therefore make considerable efforts to adapt to the new conditions of an enlarged Common Market.

The situation of certain products is not sufficiently clear cut to put them into one of the four columns of the Table. In order to show the maximum degree of nuances possible, these have been inscribed across two columns.

ESTIMATE OF THE AVERAGE CAPACITY OF SPANISH PRODUCTS TO WITHSTAND INTEGRATION INTO THE EUROPEAN COMMUNITY

A B C D

Steel

light and heavy sections
bars
reinforcing rods
special steel
hot and cold rolled plate
strip
coils
flat products

Shipbuilding

oil tankers
bulk-carriers
fishing vessels
cargo vessels
containerships
Ro-ro
refrigeration ships
LPG and LNG tankers
exploration platforms
paint
deck equipment
diesel engines
pumps
electronic equipment

Motor vehicles

private cars
light utility vehicles
heavy trucks
tractors

Automobile Components

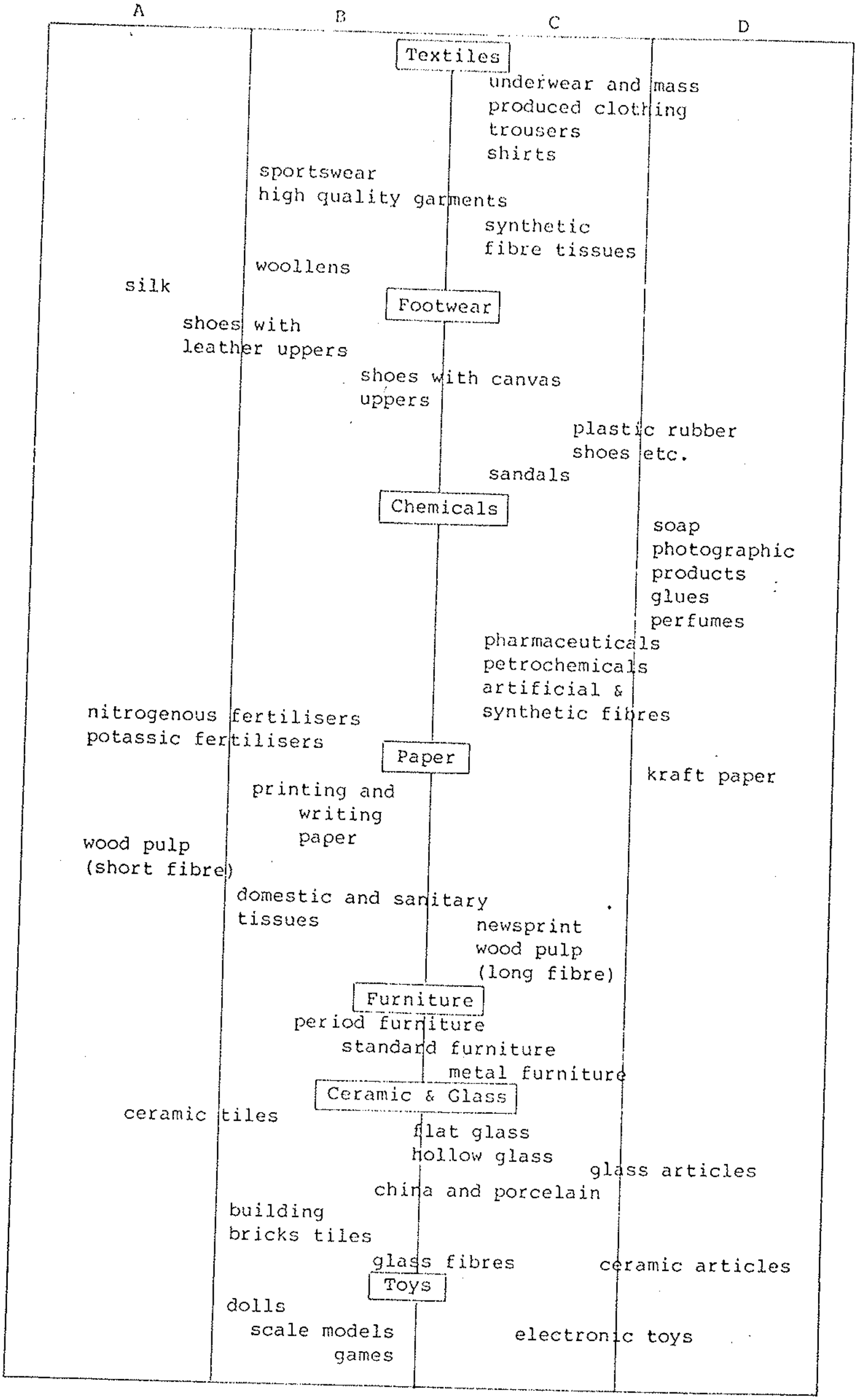
Tires
transmission equipment
electronic equipment
engine parts
pumps
sheet metal for body-work

Electronics

telecommunications
electronic components
data processing equipment
consumer electronics
household appliances

Aeronautics

parts for international programmes
light aircraft


A
B
C
D
Textiles
underwear and mass produced clothing
trousers
shirts
sportswear
high quality garments
synthetic fibre tissues
woollens
silk
Footwear
shoes with leather uppers
shoes with canvas uppers
plastic rubber shoes etc.
sandals
Chemicals
soap
photographic products
glues
perfumes
pharmaceuticals
petrochemicals
artificial & synthetic fibres
nitrogenous fertilisers
potassic fertilisers
Paper
kraft paper
printing and writing paper
wood pulp (short fibre)
domestic and sanitary tissues
newsprint
wood pulp (long fibre)
Furniture
period furniture
standard furniture
metal furniture
Ceramic & Glass
ceramic tiles
flat glass
hollow glass
glass articles
china and porcelain
building bricks tiles
glass fibres
ceramic articles
Toys
dolls
scale models
games
electronic toys