DOCUMENTS DE TREBALL

DE LA FACULTAT D'ECONOMIA I EMPRESA

Col.lecció d'Economia

E12/274

The Impact of EU Membership on the Economic Governance of Spain

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Abstract

Spain was not admitted to the then European Economic Community during the Franco's regime for political reasons. Joining the EU on January 1986 was the last and final step forward towards the definitive consolidation of democracy in Spain and the consolidation of the opening of the Spanish Economy.

The results over the first twenty five years of membership have translated into an unprecedented boost of modernization and progress. Spain adopted the "Acquis Communautaire" and received considerable benefits from EU membership, eliminating barriers, following the common policies , re ceiving European funds and adopting the European common currency . From an index of 60 per cent of the European income average in 1986, today's income –even after the crisis that started in 2008- is in the range of 105 per cent. The last three years have been different and difficult due to the severe economic and financial crisis. In this context, this paper analyses how the successive Spanish governments organized the economic governance to adapt to the quantitative and qualitative changes registered in the European Integration.

Resumen

España no fue admitida en la Comunidad Económica Europea durante el régimen de Franco por razones políticas. Integrarse a la Comunidad Europea en enero de 1986 fue el último peldaño hacia la consolidación definitiva de la democracia en España y de la apertura de su economía..

Los resultados de los veinticinco años como miembro de la UE se han traducido en un impulso sin precedentes de modernización y progreso. España adoptó el "Acervo Comunitario" y recibió considerables beneficios de su integración a la Comunidad, eliminando barreras, siguiendo las políticas comunes, recibiendo fondos europeos y adoptando la moneda europea común. A partir de un nivel del 60% del promedio europeo de renta per capita en 1986, el nivel actual –incluso con la crisis que estalló en 2008-
se sitúa en torno al 105 por ciento.

Los últimos tres años han sido diferentes y difíciles como consecuencia de la severa crisis económica y financiera.En este contexto este trabajo analiza como los sucesivos gobiernos de España han organizado la gobernanza económica para adaptarla a los cambios cuantitativos y cualitativos que se han ido produciendo en la integración europea.

Codes JEL: F15, F36, H12, H50, K33, L74, N94

Keywords:European Integration, European Union- Spain relations, European Economic and Monetary Union, , National Government Expenditure and Debt, Euro-crisis

Introduction: The 1970 Spain-EEC agreement

The EEC was a crucial partner for the Spanish economy. As early as 1962. Franco's Government expressed interest in an association with the EEC, possibly leading to eventual full membership. Integration was not possible for political reasons, but a Preferential Trade Agreement Spain-EEC, similar to the EC-Israel Agreement, was signed on June 29, 1970.

This Agreement known as Ullastres Agreement (named after the then Spanish ambassador to the EC and former Minister for Trade) provided the framework for the asymmetrical progressive elimination of trade barriers between Spain and the six member countries of the EEC at that time (Belgium, France, Germany, Italy, Luxemburg, Netherlands) (Granell 1973). This Agreement was challenged by the introduction of the Generalized System of Preferences by the EEC in 1971(Donges 1976) and was extended to the new EC members after the First Enlargement of the EC (in 1973) and the Second Enlargement (Greece in1981). Between 1970 and 1984, the volume of Spanish exports to the EC grew in real terms by 355% paving the way for Spain's formal accession when the political developments in Spain made it possible: after Franco´s death in 1975 and after the first democratic elections[1].

The logic of the membership to the European Community

Since the fall of their respective dictatorships in the middle of the 1970s, countries such as Greece, Portugal and Spain experienced a spectacular transformation into democracies that enabled them to apply for membership in the European Community, which they regarded as the final step on the road back to the heart of Europe (Círculo de Economía 1973). Greece applied for membership in the EC on June 12, 1975; Portugal applied on March 28, 1977 and Spain on July 28 of the same year. In order to consolidate democracy in Greece, Portugal and Spain, the EC approved a Second Enlargement (the first one occurred in 1973 and comprised Denmark, Ireland

[1] Francesc Granell, "A los 25 años del Plan de Estabilización", *El País*, July 27,1984

and UK) based on article 98 of the ECSC Treaty, 237 of the EEC Treaty, and 205 of the EURATOM Treaty.

Negotiations for membership with Greece opened in July 1976, Portugal followed in October 1978, and Spain in February 1979. Greece became a full member of the EC in 1981 but the EC-Spain and EC-Portugal negotiations experienced a delay, and membership was only possible in 1986, following the ratification of the accession Treaty signed in Lisbon and Madrid on June 12, 1985 (Granell 1985).

In Spain, the negotiations for entry were supported with enthusiastic political determination in spite of the skepticism among certain economic sectors concerning the lack of competitiveness of Spanish industry to face the opening of the economy. Sustained growth in the Sixties defused social conflict with the credible promise of higher incomes and better social mobility in the future. It is likely that the possibility of European integration reinforced the expectations of Spaniards about sustained growth in the future. In 1974, Spain attained a per capita income above US$7,000 compared to US$2,000 in 1930. The rapid transformation of Spain in the Sixties had generated a strong middle class that secured popular support for democratization and membership of the EC after Franco's death (Gunther, Montero, Botella 2004).

On the eve of membership in 1984, Spain had a relatively low level of foreign trade. The value of Spain’s exports amounted to some US$23.5 billion and her imports to some 28.8 billion. Imports per capita amounted to US$764 while the equivalent figures were US$1,919 for France, US$1,414 for Italy, US$1,775 for United Kingdom and US$1,061 for Japan. The situation in terms of exports per capita was less favorable still amounting to US$519 while Italy had US$1,281 and France US$1,667. In terms of sectoral structure, Spain presented an image of an underdeveloped country regarding the composition of exports to developed countries and it presented the image of a developed country considering the trade flows to developing countries.

In 1984, 33.4% of Spanish imports came from the then ten members of the EC while the ten members of the EC imported 49.1 of Spanish exports in the same year. During the same year 50% of foreign investment attracted by Spain came from the EC's ten members and most of the US$1.2 billion remittances of Spanish migrants working abroad came from the EC. In addition, 80% of the yearly tourist income of US$7 billion earned by Spain was spent by EC nationals (Granell 1985). In 1984 the number of foreigners working in Spain was relatively small. Spanish companies had a very low level of investments abroad and the tourist expenditure made by Spaniards abroad was very low.

The Terms of Membership to the EC

In order to start membership negotiations (1979-85), the Spanish Government accepted the principle of adopting Community rules, principles and institutions (*Acquis Communautaire*), recognizing that the negotiations should focus on transitional arrangements (Nin 1980). For the purpose of the negotiations and the adoption of arrangements for the transitional period, the *Acquis Communautaire* had been divided into 19 chapters. As a result of the accession negotiations, a period of seven years was established for dismantling industrial trade barriers. During this period Spain also adopted the EC's External Customs Tariff and the EC Foreign Commercial Policy including the Lomé Convention and the Generalized System of Trade Preferences (Navarro, Alberto in Westendorp 1994). The transitional period allowed for agricultural products was ten years, following a complicated negotiation largely because French farmers who feared competition from Spain's Mediterranean agricultural products. During the negotiations, Spain accepted to put its State monopolies in line with EC requirements and also accepted the EC's competition rules. Spaniards already working in the EC countries received the same rights as nationals of EC countries. Spain adopted the Value Added Tax from 1986. Spain also accepted that Spanish trucks and buses would be obliged under tachometric controls in three to four years. More freedom for capital movements and international settlements had also been agreed. Spain also accepted the EC's environmental rules (Tamames 1999).

The adoption of the EEC's Common Customs Tariff reduced to one-fifth the protection granted by the Spanish Customs Tariff. The reduction in tariff protection passed from 20% to 4%. The EC's Tariff combined with the GSP, the ACP special relations and other agreements opened Spain not only to the European market but to the rest of the world as well, having an impact on some domestic sectors of production that was more important than the impact produced by the high added value products from other EC members not directly competing with Spanish production. The introduction of VAT changed the traditional Spain's system of export subsidies and forced central and regional governments and other bodies, like the Chambers of Commerce, to be much more active in promoting exports to improve the performance of the Spanish economy, and to try to reduce the trade gap. Some declining and non-competitive industries suffered from the enhanced competition from foreign products due to cheaper imports.

In the field of external relations, a specific issue that Spain sought to introduce into the accession negotiations was the need for the EC to establish special relations with the Latin-American countries with which Spain had no special tariff or trade policy arrangements at that time (Granell 1985). The question of the relations with Latin America dramatically changed years later not only because of an increase in trade relations, but because of the vastly increased number of Latin-American immigrants that come to work in Spain and the enormous amount of investment in Latin America by Spanish multinational companies created by privatization of old monopoly companies in the field of utilities (Telefónica, Repsol, Iberia, Endesa…) or by diversification of banking business (Santander-Central Hispano, BBVA). Most of these investments were at least in part a consequence of the increased competition, the bigger firms resulting from the mergers and acquisitions to achieve economies of scale and later in order to complete effectively following in the introduction of the euro. Spain also became involved in EC development assistance to poor countries (Granell 1991 and Navarro in Westendorp 1994).

The initial effects of joining the EC in static terms were unfavorable to Spain in terms of balance of trade, even if in the Treaty of Accession Spanish industry obtained advantageous treatment, except in certain sensitive sectors such as car production and iron and steel. With the phasing out of tariffs, there was both trade creation and the trade diversion which affected agricultural imports from United States and Latin America. This led the EC to compensate the countries affected in the framework of the rules of the GATT.

Nevertheless, the overall effect on Spain of joining the EC was highly positive in dynamic terms. One factor was the integration of Spanish Industry into the European networking of intra-industry trade in added value products. Another factor was the flow of foreign investment into Spain both from Europe and from other countries, mainly USA and Japan, as well as the European transfers of funds to increase the revenue of the farmers and for investment in infrastructure. But some of the dynamic effects were still to come, resulting from the European growth after the 1983-85 economic crisis, and from the creation of new European instruments and policies for developing European regions that were introduced after Jacques Delors became president of the European Commission in 1985.

The consequences of membership for Spain

Comparing with the low growth in 1983-85, the 1986-1991 years had been globally positive for the Spanish economy making it easier for the country to adapt to EC rules (Almarcha 1993). The Socialist Party came to power at the end of 1982 and at the time of presenting the Macroeconomic Convergence Program with the EC in April 1992 there was much pride in the economic performance of the Spanish Economy and even in the new policy of privatization in 1983 (Rumasa). This success came at the price of an increase in the public debt from 31.4% of GNP to 47.1% in the period 1982-95, increasing to 68.2% in the last year of Socialist Party rule (1996).

Since EC membership, Spain has actively participated in the Community policy process guiding the process of European integration during four six-month periods of Spanish Presidency (three under the socialist government: January/June 1989; July/December 1995 and January/June 2010 and one under the Popular Party government: January/June 2002) (Granell 2010). At the same time, Spanish representatives occupied top jobs in the EU's institutions and Spain supported the development of the EC integration in quantitative terms (enlargements), qualitative terms (for development of community policies) and in the efficiency of the European institutions (Viñas 2006).

Since 1986, Spain has been one of the most pro-European countries and it has always been in favor of deeper EU integration. In this sense, Felipe González cooperated closely with Helmut Kohl, François Miterrand and Jacques Delors, helping to make possible one of the most creative periods in the history of European integration (González 2010). At the same time, Spain did not oppose enlargement where new members were prepared to share the entire EU *Acquis,* and if European Member States were prepared to accept an increase in the European Budget for financing underdeveloped European regions (Solbes 2002).

Prime Minister Felipe González attended the European Council meeting held in Milan in June 1985 as his first important European engagement after the signing of the Accession Treaty and before the ratification of membership. Gonzalez endorsed the White Paper of Jacques Delors introducing the idea of creating a Single Internal Market by 1992 eliminating non tariff, legal and administrative obstacles still impeding the free movement of labor and capital, goods and services in the "Twelve" (including Spain and Portugal). The Single European Act that the Single Market program included provisions on European political cooperation, developed the idea of economic and social cohesion and further advanced the European Monetary System (EMS) which the Spanish peseta joined under its first Presidency of the Council in June 19, 1989.

The decision for the peseta to join the Exchange Rate Mechanism - with a central parity of pesetas 65 per deutschemark and a fluctuation band of 6% - was linked to the need to show to other countries that Spain was a credible partner with an effective anti-inflation policy. The move strengthened the peseta due to an increase in capital inflows which were responding to the high Spanish interest rate differentials with other ERM currencies. However, as a result of persistent inflation and a fixed exchange rate inside the ERM, companies became less competitive, negatively affecting competitiveness and leading to successive devaluations in September 1992 (5%), November 1992 (6%), May 1993 (8%) and March 1995 (7%).

After the ratification of the European Single Act on July 1, 1987 Spain sought to introduce more flexibility into its economy and was able to introduce three hundred measures required to increase freedom of movement under the Single Market program (Viñals 1992). The adoption of EU regulations or transposing the directives has been a continuous process not always easy on Spanish companies, especially as a consequence of the economic recession that began in 1992-93, immediately after the Barcelona Olympic Games, the Seville World Expo and the award of European Cultural Capital to Madrid.

As well as the Single Market, other factors helped to promote Spanish convergence with the European average income levels: the introduction of common currency and low interest rates, the increase of the budgetary appropriations of funds for the poorer regions of the member States in order to enable them to cope better with the increased competition that was expected from the removal of internal barriers in the EC, resources for Research, Education, etc.

The step in the integration process that came with the Treaty on the European Union (TEU) signed in Maastricht in February 1992 enlarged substantially the scope of the European integration introducing new economic policies, a political second pillar and a Justice and Internal affairs pillar. Spanish Ambassador Carlos Westendorp was a key player in the negotiation of the TEU (Westendorp 1994). Among other things the TEU opened the way to Economic and Monetary Union with a European Central Bank, established the criteria for new membership and the macroeconomic convergence criteria required for the introduction of a common currency (the "euro" according to the decision taken at the European Council held in Madrid in December

1995). Spain was concerned to beexcluded as a part of the Economic and Monetary Union since its inception. For that reason, Spain requested during the Intergovernmental Conference on EMU, a long transition period and insisted on the principle that the largest possible number of Member States should participate from the start. Spain accepted the Maastricht Treaty provisions on macroeconomic convergence criteria having in mind that the most likely date for the third stage of EMU (the introduction of the euro) to start would be 1999. During this period, Spain's record regarding the macroeconomic convergence criteria established by the Maastricht Treaty was not satisfactory. Spain faced the risk of not participating in the third stage of EMU.

Spain also supported other elements of the new TEU: the concept of "subsidiary", the notion of an EU citizenship and the establishment of the new Committee of the Regions to formalize consultation with the local and regional authorities. The creation of the Committee of Regions was especially welcomed by Spanish local and regional Governments. They also welcomed the explicit definition of subsidiary even if the concept written in Article 3b of the TEU referred only to relations between the EU institutions and national governments. This concept was only more precisely defined, together with the principle of proportionality, in the European Council meeting held in Edinburgh in December 1992 (then incorporated to the Amsterdam Treaty signed on June 1997). In this sense, it is important to recall that almost in parallel with EU membership, Spain's Constitution of 1978 formally recognized 17 Autonomous Communities. The devolution of powers to regional governments has changed the balance of power between the central and regional government.

At the same time, the new political environment that followed the collapse of the Berlin Wall in 1989 led to a process of German unification for which Helmut Kohl found in Felipe González a strong ally at the EC level[2]. Partly as a result of this support, Kohl accepted the Spanish request for more resources for cohesion policy and for the establishment of a cohesion

[2]Commission des Communautés Européennes (1990): "La Communauté Européenne et l'unification allemande" in *Bulletin des Communautés Européennes*, Supplément 4/90

fund under the so-called Delors II Financial Package that was agreed in the European Council held in Edinburgh in December 1992 (Molle 2007).

Regarding a possible enlargement of the EC, accepting into the EC certain EFTA/EEE countries, the first mention of this possibility was made by the EC's European Council held in Maastricht in December 1991. Spain accepted from the beginning the request presented by EFTA countries, provided that they were ready to accept in full the *European Acquis* that also included the acceptance by the candidates not only of the traditional *EC acquis* but also of the extensions deriving from the Single European Act and the Treaty of European Union. Spain insisted in two other pre-conditions: the ratification of the TUE before enlargement and the approval of the Financial Perspectives 1993-99 needed for Spain to receive important EU funds . Regarding voting rules in the Council in their initial position, both Spain and the UK wanted to maintain the number of votes required for a blocking minority on decisions to 23 instead of raising it to 27. The issue was only settled by the so-called Ionnina Compromise of March 1994. The Greek presidency said:"The EU should not have undertaken new responsibilities before the Community structure deepens, before we proceed to necessary structural and economic changes, before we satisfy the preconditions set by the Maastricht Treaty" (Granell 1995). During the subsequent enlargement negotiations, Spain feared that with the arrival of new member states in 1995, the likelihood of starting a third stage of EMU before 1999 would have been increased and consequently Spain would face a higher risk of not being ready to join the first group of countries. If Spain had been left outside the leading group of countries, it would have appeared as a major failure for the Socialist government. In this context, at the EU Foreign Affairs Council of December 1993, Spain requested that the candidate countries (at that time Austria, Finland, Sweden and Norway) should be excluded from decisions concerning the passage to the third stage of EMU due to be taken in 1996.

After the 1995 enlargement that brought Austria, Finland and Sweden into the EU, with the full support of Spain, some concerns arose (already present during the second Spanish

Presidency of the Council in the second semester of 1995) about the efficacy of the EU's institutions and about migration policy which were subsequently addressed, among others, in the Treaty of Amsterdam, signed on October 2, 1997. When the Treaty came into effect on May 1, 1999, it provided several amendments to the Treaty of Maastricht. To resolve personal security and immigration issues, the EU was allowed to legislate on civil law. The Treaty also bestowed more power upon the Parliament in the legislative process, and it raised the possibility—albeit under strict conditions—for "closer cooperation" between selected member states. Links between criminal justice systems in the member states were also intensified. A High Representative for EU Foreign Policy was introduced, in a bid to bolster the Union's international profile, and to help to project European values in the outside world. The former Spanish Foreign Minister and former NATO General Secretary, Javier Solana was appointed as the first High Representative for the CFSP (Solana 2010). However, the majority of the Amsterdam Treaty amendments served to tighten the political bond between the Union and the citizen. Perhaps resulting from these measures, in a late 2000 survey, 76% of the Spanish population admitted to feeling "European," compared to 60% in the rest of the EU.

The question of the conduct of the economy to enter in EMU had been important in the last years of the González Socialist government and the first years of the Aznar conservative government after the March 1996 legislative elections (Cuadrado 1996 and Muns 1997). In fact, Aznar came to power promising to fight corruption and illegal practices and to fight against ETA terrorism (GAL) while promising more economic liberalism including tax cuts[3]. However, only a few months after he became prime minister many of his intentions were abandoned because of the need to prepare for the Single European currency. This was at a time of high unemployment (23%) and both domestic demand and consumer spending were stagnant. There was a general

[3] *The Economist*:" The World in 1997", December 1996.

fear that austerity policies demanded by macroeconomic convergence criteria could push the country into recession.

Due to some improvement in the economic situation, Spain in the end met the convergence criteria, making it possible to join the leading group of countries entering into the euro on January 1, 1999. Although interest rates were no longer to be set in Madrid in a Spanish economic policy context, full participation in the euro has never been a divisive issue even during the euro crisis of 2009-2010. In fact, the adoption of the euro has been described as creating a virtuous circle for the Spanish economy (Elias 2001). In the Davos meeting of 2000, Aznar called the euro "a great European success that had brought stability, integration and prosperity"[4]

In the assessment of the updated convergence program for Spain in February 2000, it was pointed out that the macroeconomic projections for 1999-2003 were in line with the requirements of the Stability and Growth Pact and the Broad Economic Policy Guidelines agreed at the Cardiff European Council (June 1998). After the successful application by the Popular Party of the Convergence Program 1994-97, Spain achieved international recognition of success in economic management in December 2001 by being considered as a country with the highest debt rating "AAA" by Moody's Investors services. The Aznar government introduced a Fiscal Stability Law in 2003 that was stricter than the EU Stability and Growth Pact and together with more fiscal austerity the Debt/GDP ratio fell to 55.8% in 2003 with economic growth near 4%, thus helping in the effort to reduce the GDP gap with other EU countries. Only the inflation rate exceeded the required target of 2% (Garmendia 2004).

Against a backdrop of an world economy growing , Aznar enhanced the Spanish position in the EU through a series of reforms that transformed Spain into one of the more robust economies. This included reforms in the tax system and labor market and the privatization of public companies (Telefónica, Endesa, Repsol, Tabacalera, Argentaria, Iberia) generating

[4] Alan Friedman:" Fear of the Future in Europe? Spanish leader attacks economic Intervention Policies", *International Herald Tribune*, January 31,2000.

revenues to reduce the debt burden while reducing the weight of the state companies in the stock market to a less than 0.5%.

Bolstered by Spain's strong economy, Aznar urged his European neighbors to abandon government intervention in the economy (increased taxes, 35-hour working week and so on) and called for building an "economically powerful Europe". Together with Tony Blair he emerged triumphant from the EU European Council in Nice on December 2000 because, in the reweighting of votes decided in view of the Nice Treaty, Britain and Spain gained more weight while succeeding in protecting their national vetoes in the key areas: for UK, taxes and social security, and, for Spain in decisions governing the allocation of future “cohesion funds", the source of some €11 billion in EU subsidies per year to Spain between 2000 and 2006.

Even if the budgetary flows between Brussels and Madrid probably have a marginal importance in the framework of the EU/Spain relations because the EU budget is relatively small compared to National and Regional budgets in Spain[5], the question is highly political, however, in view of the fact that public opinion considered that Spain had to be financially compensated for opening its market to imports from more advanced European partners, for supporting the significant effort in investment in infrastructures after accession, for converting regions and sectors affected by globalization, for fighting against unemployment and for adapting Spanish Agriculture under the Common Agricultural Policy.

The next Treaty of Accession signed in Athens (April 2003), which admitted ten new countries in the EU on 2005 (Estonia, Latvia, Lithuania, Poland, Czech Republic, Slovakia, Slovenia, Cyprus and Malta) and the Luxemburg Treaty (April 2005) bringing Bulgaria and Romania to the Union on 2007, called for another period of adjustments.

Regarding the management of the Spanish Economy, the enlargement to 27 meant that Spain saw certain industries delocalizing. Spain also moved to become a net contributor to the EU

[5] Aurora Gallego, “Saldo financiero España-UE en 2009”, *Boletín Información Comercial Española,* num. 3002, December 2010

budget (Roy 2006). This did not seem to concern the Spanish public opinion convinced by Prime Minister Rodríguez Zapatero that the Spanish economy was going up and up and did not need the same level of European regional and cohesion funds.

After the non-ratification of the Constitutional Treaty, the Berlin Declaration of March 25, 2007, on the occasion of the 50th anniversary of the Treaty of Rome, renewed the impetus for major institutional and policy reform, which would soon be realized in the Treaty of Lisbon[6]. Spain, together with Luxemburg, had a pivotal role in the transposition of the un-ratified Constitutional Treaty into the new Treaty of Lisbon[7] that was agreed by the member states on December 13, 2007, effective on December 1, 2009, amending the existing treaties and dismantling the three pillars structure (Piris 2010). Although Spain was the 23rd (fourth to last) country to ratify the Treaty, it did so with an overwhelming majority in both the Senate and lower house of Parliament, and this in a context of economic crisis. The Treaty received the backing of Prime Minister Zapatero and his PSOE party, as well as that of the Popular Party. The Treaty of Lisbon also declared the Charter of Fundamental Rights of the European (previously ratified on December 7, 2000) legally sound. The Charter proclaimed the rights of all EU citizens in areas such as equality, solidarity, rights and justice, in a move that PSOE considered very close to their interests and electoral social promises.

Finally, it is necessary to recall that Spain chaired the rotating presidency of the Council of the EU (the 4th presidency since membership) during the first semester of 2010 (Granell 2010). This meant that during their presidency Spain was responsible for implementing, along with the other European institutions, all the changes in the governance of the UE introduced by the Treaty of Lisbon in a very stormy period, characterized the Debt crisis in Greece, Ireland, Portugal and in other countries. During the Presidency, life was complicated for Spain because of some

[6] Francesc Granell, “Del intento de Constitución Europea al Tratado de Reforma”, *Economía Exterior*, num 42, Autumn 2007.

[7] Navarro, Alberto and Schmit,N., “Por una Europa mejor”, *El País*, January 27,2007

apparent decline in the image and prestige of the EU linked to the euro crisis[8]. The full impact on Spain's position regarding the EU in this period is difficult to assess, but observers around Europe feel that the Spain's place in Europe looks weaker than before at the eve of general elections of November 20.2011 in which the Socialist Party was defeated.

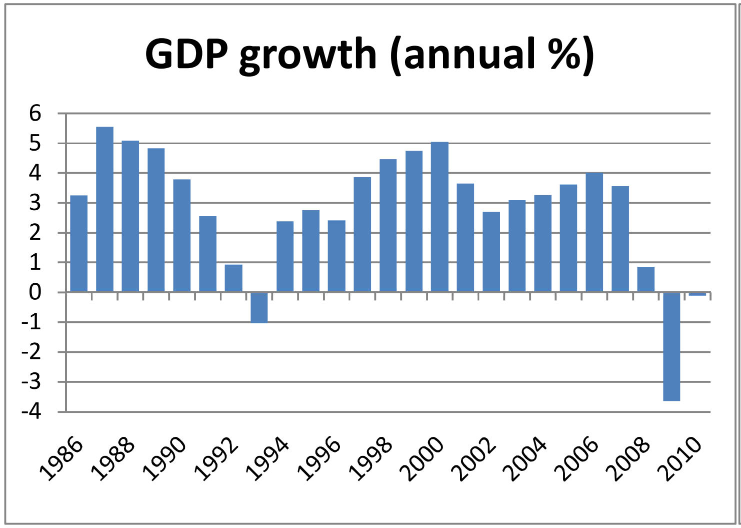
The economic impact of membership

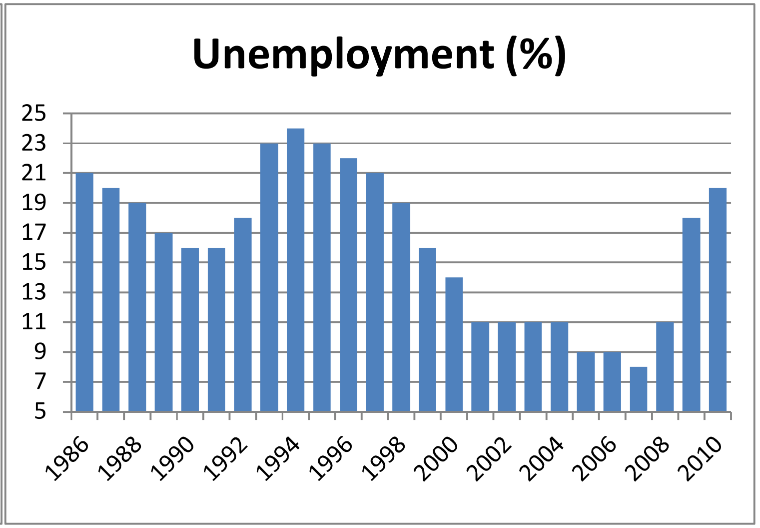
Between 1985 and 2007, Spain's output growth was very fast (except in the period that followed the 1992 Olympics in Barcelona, the World Exhibition in Sevilla and the Madrid European Cultural capital) due to various factors only in part associated with membership to EU. Between 1986 and the year before the creation of the euro (1998), Spain had an average yearly growth of 3.1% rising in some years to nearly 5%, the fastest in the OECD. The initial twenty-one years of Spain's involvement in the European Union were therefore a period of economic good fortune, leading to many improvements in the country from major construction in infrastructure, to the unemployment rate falling from 18% to 10%. Spain became the 8th largest economy in the world (Piedrafita 2007). Between 1985 and 1990 , when Spain received a massive inflow of foreign investments and EU funds , the country had the highest rate of job creation in the OECD, the industrial base was broadened and Spain ranked first in the OECD in terms of per capita GDP growth.In 1991 Spain's per capita GDP was 79,8 per cent of the EU average. Spain came third – after Switzerland and Germany – in The Economist's 1993 ranking of the most attractive countries to live in.

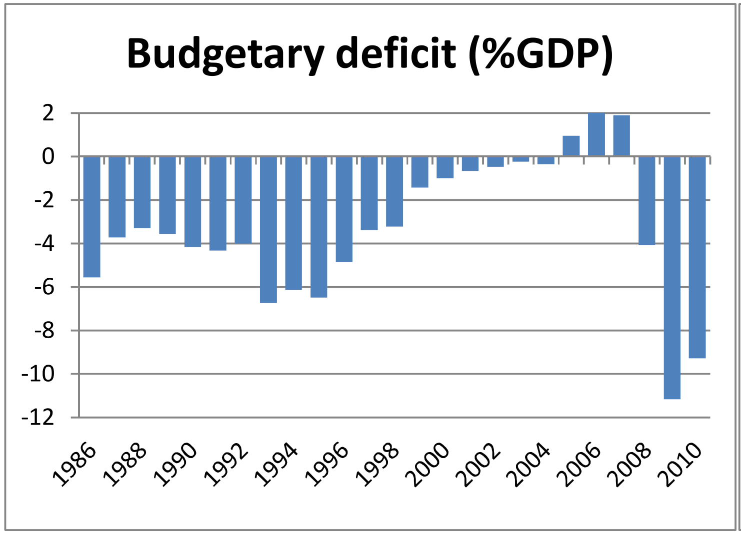
Spain also improved its weight within the EU economy moving from 8% of the Union's GDP to 9.7%. Between 2000 and 2006, Spain provided more than half of the new jobs within the

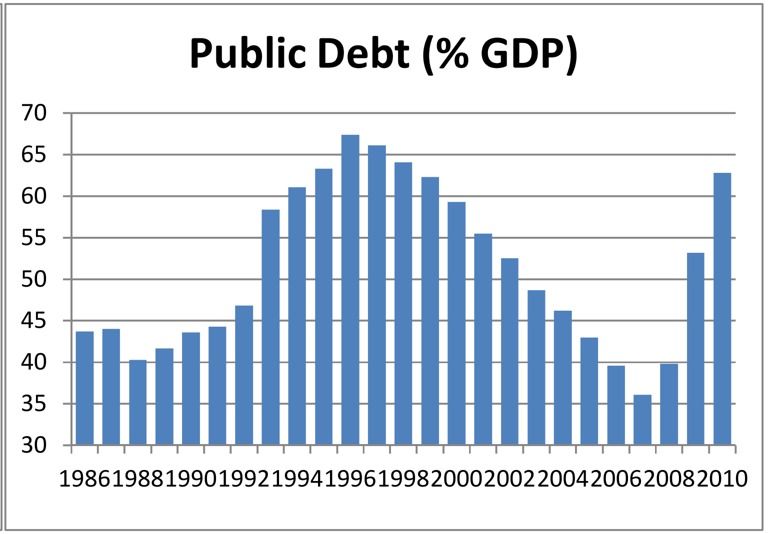
[8] Stelzer,Irwin, Euro-zone song is an ode to indecisión, *The Wall Street Journal*, December 20,2010

25 Years of Spain in Europe: governments of F. González(1986-96), J.M. Aznar (1996-2004) and J.L.R. Zapatero (2004-2011)









EU. Spain, in the past a country of emigration, became a net receiver of millions of foreign workers. Spanish multinational companies and banks expanded around the World, mainly Latin America. The Spanish economy expanded by 64.6% in the first twenty years of its membership, while the rest of the EU averaged an increase of 47.9%. Incomes in Spain rose from 71% of the average income in the EU 15, to more than 90% in 2006. Inflation fell to only one point above that of the euro zone, an impressive feat considering it was originally six points above the average. Public spending experienced a major increase from 25% of Spain's GDP in 1978, to reach 40% in 2006. Motorways developed as well: from 2,000 kilometers in 1985 to 10,000 kilometers in 2002. This greatly improved communication and cut costs in goods and services. The beneficial additions to the infrastructure sector also greatly improved the tourism industry, which in 2006 accounted for 12% of GDP and 10% of employment. Still, despite this growth, Spain did not benefit in all aspects of its economy in the initial years of membership. Some sectors remained stagnant and in need of improvement. High-technology production is one of the fields where Spain has had a notable stagnation.

Further signs of stagnation can be found in the productivity rate. Though employment had increased, productivity remained constant. This means that less work in terms of added value was being done per person. Two contributing factors to this stagnation were the greater use of temporary and more precarious contracts for workers, and an insufficient use of new technologies. Temporary contracts can boost employment; however, with staff rotating frequently, workers may not receive proper training or integrate fully into the work force and are thus unable to use newer, more complicated technologies. The question of unemployment is a constant issue to be solved in Spain. Jacques Delors, the former President of the European Commission drove home this point when he told the European Council in Copenhagen in June 1993 that while the EU's economy expanded 73% in real terms between 1970 and 1992 and employment rose 7 per cent , Spain registered the highest growth (93 per cent) although its level of employment declined 2 per cent (Chislett,1994).

Technological development has tended to lag behind the rest of the European Union: for every 100 patents filed by the average EU nation, Spain files only 18. This is largely due to the fact that Spain falls far behind the rest of Europe in spending on Research and Development. Spain's investment in R&D accounted for only 1.07% of its GDP, whereas the European Union's average was 1.95% of GDP. Technological development is a significant challenge against the background of the Lisbon strategy and the Europe 2020 strategy in which the EU aimed to make the EU's economy "the most dynamic and competitive knowledge-based economy in the world, capable of sustaining economic growth with more and better jobs and greater social cohesion."

More recently much of the favorable statistics on the initial twenty-one years of membership have shifted within Spain. The recession has exposed some of the weaknesses in Spanish development, some of which can be traced to involvement within the European Union. Certain industries have suffered greatly as a result of the recession, and Spain's ties to the European Union through the euro are probably inhibiting a recovery. Some Spanish savings banks – which account for 42% of the country's banking assets – are in difficulty following the collapse of the decade-long housing boom, which has left them a large volume of bad loans and potentially heavy losses World[9].

At the same time the Vicepresident and Minister of Economy of the Zapatero's government Elena Salgado pointed out erroneously that Spain's Banks aren't going Bust and on the Contrary, Madrid's financial sector reforms are a model for Europe and for the World[10]

The construction industry symbolizes the problems of the Spanish economy. Between 1995 and 2008 Spanish house prices tripled in nominal terms, and doubled in real terms. This was explained by young people leaving the parental homes earlier, a rise in immigration, the country's popularity among European buyers of secondary residences, low interest rates for mortgages and

[9] Sara Schaeffer Muñoz,S and Jonathan House," Spain steps in again to help savings banks", *The Wall Street Journal*, January 20, 2011.

[10] Elena Salgado: "Spain's Banks are going Bust", *The Wall Street Journal*, June 22, 2011.

generous fiscal incentives to buy a house. Spain's construction industry accounted for 12% of its Gross Domestic Product. It brought in immigrants seeking work and provided lending and borrowing opportunities in the private sector. Over a decade, land prices rose by 500%; in 2007 construction led to an addition of 800,000 housing units. However, when the bubble burst, this contributed to an unemployment rate of around 20% and forced some immigrants that had originally found work in Spain to return home[11].

The first reaction of the Socialist government to the crisis was to spend more in order to stimulate the economy and to continue social expenditure to preserve social peace. This effort in expenditure and the reduction of tax revenues due to the decrease of economic activity led to an increase in the public deficit for the central and regional governments. Financing the debt on the international markets was a challenge against a background of indecision and uncertainty in the handling of the European euro crisis[12]. This led to an increase in prices to be paid for debt issued by the Ministry of Finance of the Government of the "Kingdom of Spain" and by the Regional Governments[13]. However, according to the analysis of Goldman Sachs in a recent study, Spanish public debt is unlikely to exceed 90% at the peak, hardly a case of insolvency and reducing the risk of a liquidity crisis that might force Spain to seek external assistance similar to the so-called bailouts of Greece. Portugal and Ireland. In addition, concluded that Spain's gross government debt stood at 64% of GDP, well below the levels of Portugal (83%), Ireland (97%) and Greece (140%), with a "prospective burden debt" similar to those of "safe" France and Germany today[14].

In May 2010 Prime Minister José Luis Rodríguez Zapatero, at last, changed economic policy and declared that painful cuts would be needed in the Spanish Welfare State[15].

[11] Suzanne Daley and Raphael Minder: "Newly built towns haunt banks in Spain", *New York Times*, Dec, 17,2010.

[12] Marcus Walker and Neil Shah. "Spain hit with Credit downgrade", *The Wall Street Journal*, April 29, 2010

[13] Joseph Stiglitz,"Stiglitz alerta a España de una posible crisis a la argentina", El Economista, 4 Oct 2010

[14] Irwin Stelzer : Spain can still avoid financial doom The Wall Street Journal, January 24,2011.

[15] Financial Times Special Report. "Spain.After the bust, a time for adjustment", June 11, 2010

Taking account of budgetary legal limits and the requirements of the European Pact for Stability and Growth, and seeing the reality of the situation in the markets for debt (and after talks with the European Commission, the European central Bank and the IMF) Spain was forced to curb public spending [16]. In this context the government set out a program of reform to reduce the 11.1% budget deficit in 2009 to 9.3% in 2010 and 6% in 2011, reforming social security and pensions, freezing salaries in the public sector, increasing VAT normal rate from 16% to 18% and increasing other taxes. The Trade unions immediately reacted with a general strike held on September 29, 2010.

At the same time the Spanish Parliament agreed upon in August to introduce a Constitutional Change to limit budget deficits with the full support of the Socialist and the People's Party that was on the opposition benches at that time.

Even if Spanish Socialist government officials said that the worst of the crisis was over, the People's Party , international organizations and many independent experts remained skeptical[17]. In fact contradictory forecasts about the economic perspectives of growth indicate how difficult it is to predict the course of the downturn that is battering the Spanish Economy and how difficult is to give credit to the Keynesian ideas about the role of stimulus spending in boosting economic growth, or to focus on repairing the financial system and to curb public expenditure.

The construction industry's rate of expansion in Spain was one of the important components of the growth. Spain had the largest number of mortgages per capita, and was the most "overbuilt" country in the European Union. But prices since the recession have dropped the least. Making matters worse is that the scale of unsold units, and mortgage problems among households, is so great that the banks are unable to produce accurate data and statistics to

[16] Francesc Granell. "La crisis griega como referente para España",*Catalunya Empresarial*, April-May 2010

[17] José María Aznar, "What's wrong with Spain", *The Wall Street Journal*, December 13, 2010.

demonstrate how severe the problem is. Some believe that banks are withholding mortgages putting up additional property for sale in the fear that it will continue to hurt real estate prices.

During the period of prosperity that Spain experienced up to 2007-08, prices and wages rose rapidly which, though were temporarily beneficial, caused a large trade deficit and a growing increase in the external debt required to finance the current account imbalance. Following the bursting of the bubble, Spain was left with unit production costs that seriously damaged its competitiveness within the European Union. The large fall in employment partly reflected attempts by firms to rationalize production in the face of strong labor cost pressures in an effort to become more competitive abroad.

It would not necessarily help for Spain to leave the euro that it adopted in 1999 and devalue. For example, Spain needs to import more advanced technology from abroad and that would cost more with a depreciated currency. Investors might begin to transfer their money out of Spanish banks to other European banks in order not to lose the strength of the euro. But the same euro that during ten years contributed to the strong development of Spain is presently trapping Spain in a high-cost situation, which is contributing to the persistence of high unemployment[18].

According the European Commission the Spain's GDP had only increased at a rate of 0.9% in 2008 and 0.7% in 2011, while declined at 3.7% in 2009 and 0.1% in 2011. At the end of 2011 the rate of Unemployment reached 21% and the Public Debt rose to 69.6% of the GDP from 40.1% in 2008. The Rating Agencies are very negative about the Public and Private Debt of Spain and that is not helping to tackle with the Structural Reforms needed at the end of the 25th anniversary of the Spain's Membership to the EU.

[18] Paul Krugman," The Spanish Prisoner", *New York Times*, November 28, 2010

The future economic governance of Spain with the People's Party's Rajoy Government

The last three years have shown that continuous prosperity for Spain within the European Union's economy is uncertain. Weaknesses and problems with the system have been revealed; however, if Spain can restructure in order to weather the storm of the current crisis using the help that is available within the European Union, then it will certainly come out far stronger down the road as a result[19].

Recessions help to show weaknesses and mistakes made by government, public bodies, banks and saving banks, and private industries. If Spain and the rest of the European Union can learn from these mistakes, then Spain and other weaker European countries are likely to see a return to the growth that they had enjoyed throughout the initial years as a member of EC and EU. Spain and its European family have maintained a primarily beneficial relationship throughout twenty five years. This relation will hopefully resume after the present crisis has been overcome, if the Administration is embarking on some serious signal-sending to convince the world that it's on the case and committed to at least keeping the deficit as a share of GDP to historically acceptable levels , with the aid of the instruments of anti-crisis created by the EU during 2010 in order to create a permanent rescue fund that would come into being in 2013 and with the support of the European Central Bank to provide liquidity to Spanish Banks and to buy Spanish Debt in the markets if the economic recovery is not advancing faster than expected.

This ECB support would also demonstrate the commitment of the European institutions, Germany and France and all the euro zone countries to avoid the failure of the euro as a political project. [20]

The Spanish government has criticized rating agencies for lowering the nation's credit rating. Meanwhile, Spanish Government launched a negotiation for a higher retirement age and

[19] The Economist " The party's over", Special Report, November 8, 2008

[20] Francesc Granell , "La complicada modificación del Tratado de Lisboa", *Cuadernos de Información Económica FUNCAS*, Nov-Dec 2010.

seeking to establish more flexible labor markets and a better connection between wages and productivity. At the same time, central and regional governments trying to balance their budgets and there is an ambitious program for aligning banks and savings banks with the requirements established by Basel Committee on Banking solvency.

Today the challenge is not only to solve the short-term budgetary and financial sector problems, but to create a more competitive economy based on a different growth model that promotes rising productivity and Employment. Spain needs to compete not only in Europe but also in the world markets to avoid a declining in its weight in the European and world economy.

As the new Rajoy's Government Minister of Economy and Competitiveness, Luis de Guindos, pointed out[21] the Peoples's Party's Government economic Challenge is to develop a policy in which Fiscal Consolidation to offset the impact of the unexpected jump in the 2011 public deficit to 8%, must be matched with bold structural reforms to foster growth and Employment.

The new Minister for Foreign Affairs and former Member of the European Parliament J.M. Garcia Margallo had declared that Spain will continue to act as a cooperative and loyal member of the European Union and described the reforms taken by the Rajoy's Government at the end of 2011 as fully consistent with the new economic governance framework agreed upon at the EU level.

[21] Luis de Guindos, " Our Plan for Reviving Spain" *The Wall Street Journal*, January 19, 2012

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