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## The economic integration of Spain with the E.E.C: Problems and prospects

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# Kiel Working Papers

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Working Paper No. 10

THE ECONOMIC INTEGRATION OF SPAIN WITH THE E.E.C.

- Problems and Prospects -

by

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Juergen B. Donges

## THE ECONOMIC INTEGRATION OF SPAIN WITH THE E.E.C.

### - Problems and Prospects -

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#### Introduction

1. In 1959/60, there was a radical shift in Spain's economic development strategy from a strongly autarchic to a cautiously outward orientation. A group of neo-liberal technocrats who entered for the first time since Civil War the governmental administration obviously understood that the establishment of the European Common Market (1957) and the introduction of external convertibility by the highly industrialized countries (1958) would accentuate the economic growth path in Western Europe and, thereby, open new possibilities of rapid economic development for Spain. After all, the Government recognized that economic integration is an important device for promoting economic development. This is particularly true if industrialization is considered as a corner-stone of rapid economic and social progress (as was, and is, the case in Spain). The arguments in favour of more integration are too well known to need a detailed elaboration here. Essentially, they refer to the economies of scale that can be achieved in a wider market than the relatively small national one, to the increase of overall efficiency that will result from the more competitive environment, and to the improvement in the allocation of resources that can take place by arriving at a product-mix according to the country's comparative advantage. Whatever the degree to which Spain was able to reap the benefits of integration, the economic boom, which the country has been experiencing since 1960, and which deserves to be regarded as an

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Remark: This paper has been prepared for the Conference on "E.E.C. and the Mediterranean Countries" held at the University of Reading in December 14-16, 1973.

outstanding success story in terms of income expansion as well as of growth and structural changes of production and foreign trade<sup>1)</sup>, proves that the opening of the economy was rewarding thus far.

2. As the Government had great faith in the positive effects of future trade expansion between Spain and the Western European countries, it tried to attain some kind of economic association with the European Economic Community - in spite of the resistance of (also politically motivated) vested interests. In March 1970, eight years after the first official application was made, Spain signed a bilateral preferential trade agreement (PTA) with the E.E.C. By this Agreement, which became effective in October 1970 and covers an initial period of six years, the E.E.C. is committed to grant concessions on Spain's agricultural exports and to provide tariff reductions on Spanish manufactured exports; in return, Spain has to liberalize global quotas formerly applied to agricultural imports from the Common Market and she has to gradually reduce customs tariffs on manufactured imports from the Community. Iron and steel products have been expressively excluded from the Agreement, since they are covered by the former E.C.S.C. For all those who had wanted Spain to become an associate member of the E.E.C., the PTA is far from being a satisfactory arrangement. Whether or not the PTA paves the way for arriving at some sort of formal Spanish membership in the E.E.C. after 1977 is, however, still a matter of conjecture. While most of Spain's leading policy-makers and academic economists think that such an integration is desirable, there are strong objections in E.E.C. member countries which are governed by well-known political considerations. Whatever the outcome, it seems to be certain that for economic reasons both Spain and the E.E.C. ought to be prepared to consolidate and extend their mutual trade relations.

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1) For details see J.B. Donges, "From an Autarchic towards a Cautiously Outward-Looking Industrialization Policy: The Case of Spain", Weltwirtschaftliches Archiv, Vol. 107, No. 1, 1971, p. 48 et seqs.

3. Taking a closer economic relationship as desirable, it appears worthwhile to analyze the Preferential Trade Agreement with a view of detecting threads and promises of the Common Market for the Spanish economy. The major questions to be discussed in this context refer to the relative importance of the Common Market for the Spanish economy, to the pro's and con's of this Agreement in the light of both the recent accession of Denmark, Ireland and the United Kingdom to the E.E.C. and the Community's trade policy towards developing countries, and to the kind of adaptation of Spain's manufacturing sector which is necessary to meet the increasing competition from abroad. The present paper is aimed at critically examining these questions as succinctly as possible. To begin with, some background data on the trade relationship between Spain and the Community are presented.

#### Summary Survey of Spain's Trade with the E.E.C.

4. The E.E.C. is one of the most important markets for Spain's exports and one of the main sources of supply of importable products (Table 1).
  - (a) In 1971, the original Six bought 37.1 percent, and the actual Nine 46.7 percent, of Spain's exports, while their share in Spain's total imports amounted to 32.9 and 41.6 percent, respectively. For some commodity groups these shares are significantly higher, particularly when the enlarged E.E.C. is considered. Examples on the side of Spain's exports are animal and vegetable oils, non-oil related crude materials and foodstuffs. As to imports from the E.E.C., the significance of this area is particularly evident in the case of machinery, transport equipment, basic manufactures and chemicals.

Table 1 - Relative Importance of the Common Market for Spain's Foreign Trade

Commodity Group <sup>a</sup>	Total Value in US-\$ million		Percentage Share of E.E.C.				Compound Annual Rates of Increase (p.c.) 1962-71		
			Six		Enlarged		World	E.E.C. (Six)	E.E.C. (Enlarged)
	1962	1971	1962	1971	1962	1971			
<b>Imports</b>									
Food and live animals.....	193.16	556.92	10.5	17.1	19.0	22.9	12.5	18.8	14.8
Beverages and tobacco.....	32.92	100.63	2.1	3.3	7.1	21.5	13.2	18.7	28.0
Crude materials except fuels.....	272.99	861.78	8.5	10.6	15.9	17.2	13.6	16.3	14.5
Mineral fuels and related materials.....	246.33	811.69	8.7	4.8	12.2	5.4	14.2	6.8	4.2
Animal and vegetable oils and fats.....	69.93	26.44	7.5	17.0	8.2	20.1	-10.2	-1.7	-0.3
Chemicals.....	135.46	525.82	63.3	53.5	75.1	63.9	16.3	14.1	14.2
Basic manufactures.....	176.63	598.74	51.6	50.6	64.1	64.3	14.5	14.3	14.5
Machinery and transport equipment	404.09	1201.43	50.5	57.7	70.1	69.8	12.9	14.6	12.8
Miscellaneous manufactured articles.....	37.88	251.94	42.5	44.3	54.6	57.4	23.4	24.0	24.1
<b>TOTAL.....</b>	<b>1569.43</b>	<b>4935.65</b>	<b>29.8</b>	<b>32.9</b>	<b>40.6</b>	<b>41.6</b>	<b>13.6</b>	<b>14.8</b>	<b>13.9</b>
<b>Exports</b>									
Food and live animals.....	328.89	634.94	48.7	45.9	70.8	60.9	7.6	6.9	5.8
Beverages and tobacco.....	34.46	93.15	21.0	24.2	67.3	55.4	11.7	13.4	9.3
Crude materials except fuels.....	61.28	100.59	55.2	50.3	67.2	65.6	5.7	4.6	5.4
Mineral fuels and related materials.....	44.65	125.74	11.8	47.0	25.5	57.8	12.2	30.9	22.9
Animal and vegetable oils and fats.....	44.90	177.66	55.8	64.4	58.9	68.8	16.5	18.4	18.5
Chemicals.....	36.31	141.57	22.8	29.5	39.8	39.6	16.3	19.7	16.2
Basic manufactures.....	82.89	590.72	25.7	36.2	42.8	43.6	24.4	29.2	24.6
Machinery and transport equipment	53.52	621.54	13.4	33.1	14.3	39.4	31.3	45.2	42.5
Miscellaneous manufactured articles.....	48.08	448.72	15.2	20.4	24.3	25.1	28.2	32.4	28.6
<b>TOTAL.....</b>	<b>736.01</b>	<b>2937.78</b>	<b>37.4</b>	<b>37.1</b>	<b>55.2</b>	<b>46.7</b>	<b>16.6</b>	<b>16.5</b>	<b>14.5</b>

<sup>a</sup>According to 1-digit SITC. Sub-totals do not necessarily add to the totals because of non-specified trade in commodities.

Source: Calculated from United Nations, Commodity Trade Statistics, various issues.

- (b) The expansion of total trade between Spain and the E.E.C. during the last decade has been remarkable in absolute and percentage terms (when compared with the experience of other semi-industrialized countries), but not more rapid than Spain's total trade. This phenomenon reflects the fact that the country in its attempt to diversify the foreign trade structure, did not rely exclusively on the potentialities of the Common Market but also enlarged trade with other areas of the world, particularly the U.S. and Latin America.
- (c) Among the E.E.C. member countries, West Germany was the most important purchasing market for Spain's export products. In 1971, she bought goods worth about \$ 358 million which represents 32.8 (26.1) percent<sup>1)</sup> of Spain's total exports to the Community. West Germany is followed, in decreasing order of importance, by France with 29.2 (23.2) percent, United Kingdom 18.1 (18.1), Italy 18.3 (14.6), Netherlands 13.3 (10.6), Belgium-Luxemburg 6.4 (5.1), Denmark 1.6 (1.6), and Ireland 0.6 (0.6). From the perspective of the E.E.C. countries, Spain appears, however, as only a marginal supplier in the Common Market: she contributed 1.2 (1.5) percent to that Market's total imports. As far as Spain's imports from the E.E.C. are concerned, 37.1 (29.4) percent came from West Germany in 1971; the other countries followed in the same order as above as sources of supply. Again, Spain's importance as a market for the E.E.C. countries' exports is modest; only 1.7 percent went to Spain in 1971.

5. An analysis of the composition of Spain's exports to and imports from the E.E.C. reveal the following features:

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1) Bracketed figures refer to the enlarged European Economic Community.



- (a) The import structure shows a significant dependence on capital goods. About 43 (41) percent of Spain's total imports from the Community was accounted for by this major product category in 1971; important items were industrial machines, engines, electrical power machinery, office machines, and road motor vehicle parts. Basic manufactures (such as textile yarn and thread, glassware, and non-ferrous metals, apart from iron and steel) and chemicals (such as organic elements, plastic materials, and pharmaceutical products), amounting to approximately 19 (19) and 17 (16) percent, respectively, constituted the next largest commodity groups. This is in line with what one would expect, given the difference between Spain and the E.E.C. with respect to stage of development, capital-labour proportions and natural resource endowments.
- (b) The same holds true for Spain's export structure. Almost one-third of the total value of Spanish exports to the Common Market consisted of foodstuffs (particularly of fish products, oranges and fresh vegetables) in the reference year. Basic manufactures and capital goods also play a noticeable role in Spain's export trade with the E.E.C.: they accounted for about 20 (19) percent and 19 (18) percent of total export value, respectively. The similarities between export and import structure illustrate the importance of intra-industry (rather than inter-industry) specialization in the trade with the E.E.C. Moreover, it should be noted that the broad groups of capital goods include mainly metalworking machinery, passenger cars, and ships, i.e. product-cycle goods in the Vernon-Hirsch-sense, where Spain could become comparatively efficient after catching-up with the (foreign) production technique embodied.
6. When trying to assess whether or not the expansion of trade with the E.E.C. is beneficial to Spain, one can hear arguments in some Spanish quarters that it is not. Those who adhere to this view can cite the evidence that the

value of Spain's exports to the Common Market was in 1971 higher than the imports from the E.E.C. in only 18 (19) out of 45 items. Outstanding instances are fruit and vegetables with an export surplus of \$ 223.5 million (\$ 307.8 million) and olive oil with \$ 107.2 million (\$ 108.9 million). However, it lies in the nature of still being a semi-industrialized country, as Spain is, that there are trade deficits with the far more developed E.E.C. Provided that Spain does not pay higher prices for goods imported from the Common Market than for those available elsewhere, trade deficits can be considered to be a good indicator of benefits (rather than disadvantages) accruing to the country from its trade relations with the E.E.C.; they reflect certainly the extent to which the Community transfers resources to Spain at world prices and to which a rational division of labour is enhanced. That is to say, that all the talks about sign and even size of bilateral trade balances is rather misplaced.

#### Nature of the Agreement

7. The extent to which the Agreement will intensify trade relations between Spain and the Community, depends clearly on the degree of effective reductions in tariff and non-tariff protection. In principle, all tradable goods (with the exception of iron and steel products) were regarded as being eligible for liberalization through the Agreement. An examination of the scheme shows, however, that there are important differences in the concessions agreed upon, presumably because of conflicts of interest between the parties.
8. As can be seen from Table 2, Spain's concessions consist of gradual reductions in import protection affecting 71 percent of the country's imports from the E.E.C. in the base year, 1968. The coverage of the E.E.C. concessions is less extensive. In addition, the Community has excluded many products of export interest to Spain because of her

Table 2 - The Profile of Concessions

Spain								European Economic Community							
<u>Product coverage for tariff reductions<sup>a</sup></u>								<u>Product coverage for tariff reductions<sup>a</sup></u>							
Total imports from E.E.C.							\$ 1,200m.	Total exports to E.E.C.							\$ 454m.
-Imports of E.C.S.C. products							\$ 88m.	-Exports of E.C.S.C. products							\$ 5m.
-Duty-free under MFN tariffs and free-port regulations							\$ 185m.	-Duty-free exports under MFN tariffs							\$ 69m.
-Products excluded							\$ 52m.	-Products excluded							\$ 121m.
Product coverage (73 p.c. of total imports)							\$ 875m.	Product coverage (57 p.c. of total exports)							\$ 259m.
<u>Tariff reductions (p.c.)</u>								<u>Tariff reductions (p.c.)</u>							
	1970	1973	1974	1975	1976	1977	Total		1970	1972	1973	1974	1975	1977	Total
List A (\$ 48m.)	10	10	10	10	10	10	60	General List (\$ 70m.)	30	20	10	0	0	0	60
or: (10)	(10)	(10)	(12.5)	(12.5)	(12.5)	(12.5)	(70)	or: (30)	(30)	(20)	(10)	(10)	(0)	(0)	(70)
List B (\$ 271m.)	5	5	0	5	5	5	25	Special List (\$ 9m.)	10	0	10	0	10	10	40
or: (5)	(5)	(5)	(5)	(5)	(5)	(5)	(30)								
List C (\$ 414m.)	5	5	0	5	5	5	25	For agricultural and fishery products there will be tariff reductions in the order of 25 to 100 p.c. (in some cases subject to maximum amount limitations) affecting \$ 180m.							
List D (\$ 142m.)	0	0	0	0	0	0	0	Average tariff cut by January 1977: 47.8 p.c. (51.1 p.c.)							
Average tariff cut by January 1977: 22.9 p.c. (25.0 p.c.)															
<u>Liberalization of Import Quotas<sup>b</sup></u>								<u>Liberalization of Import Quotas</u>							
(a) Only applicable to manufactured products								Total abolition for manufactured products (in some cases there are maximum amount limitations for preferential treatment)							
(b) Consolidation of quota abolitions: 80 p.c. of manufactured imports from E.E.C. = \$ 857m. If new import quotas on the remaining 20 p.c. are established, at least 75 p.c. of the quota has to be allocated to the E.E.C.															
(c) Opening of 84 global import quotas:															
Basic value							\$ 96m.								
+ 13 percentage cumulative increase in six years							\$ 104m.								
							\$ 200m.								
- Maximum limit of 5 p.c. of total imports from E.E.C. for global import quotas							\$ 64m.								
Liberalization of import quotas by January 1967							\$ 136m.								
<sup>a</sup> Reference year: 1968. - <sup>b</sup> Reference period: 1966-68 (average).															

Source: Compiled according to the regulations of the Agreement.

supply potential. This is particularly true of agricultural and fishery commodities, of which only 46.5 percent will enjoy tariff reductions, in some cases (such as oranges, lemons, wine) subject to ceiling limitations and in some others (such as tomatoes, grapes) to time period limitations. But even for a number of manufactured products, some of which are relatively labour-intensive, the E.E.C. was interested in not giving too much; for instance, Spain's exports of cotton and some petroleum products will enjoy only a quantitatively limited preferential treatment, while her exports of cork manufactures, of cotton yarn and thread, and of pile and chenille fabrics have been excluded from the Agreement. This sort of restrictiveness on the part of the E.E.C. is, of course, not surprising at all; it is perfectly consistent both with the Common Agricultural Policy typically aimed at achieving specific social objectives (Article 39 of the Treaty of Rome) at the expense of foreign producers (and domestic consumers) and with the spreading of nationalistic and neo-mercantilistic philosophies within the Community which justify the preservation of actually or potentially "sick" industries at the expense of the well-being of the general public. One may argue that Spain has also tried to protect industries, workers and farmers against the impact of imports from the Common Market. To the extent that this is true, it will lead to a less efficient domestic economy. The point here, however, is that there is simply an asymmetry in the impact of freer trade: assuming equal liberalization policies, it will be much greater in Spain than in the Common Market, because Spain is a marginal supplier in the E.E.C. market for most products (particularly the manufactured ones), while the Community's producers, being far more efficient, might be able to invade the market of the less advanced Spanish economy and to seriously hurt Spanish labourers by putting them out of work. Moreover, the different degrees of development in Spain and the E.E.C. leads one to believe that both affected firms and workers in the E.E.C. are better able to adjust to the impact of imports than firms and workers in Spain.

9. Notwithstanding the restrictive elements in the PTA, the import tariff cuts staged over six years could be advantageous for Spain. On a superficial view, at least, the Agreement represents an improvement compared with the previously existing conditions for her trade with the Common Market. The average reduction of E.E.C. tariffs is, from a relatively low level, 47.8 percent; that of Spain's tariffs is, from a relatively high level, 22.9 percent (Table 1).<sup>1)</sup> Other things being equal, these tariff cuts are bound to increase the magnitude of trade flows between both partners. To what extent, is an empirical question. As the time elapsed since the agreement is very short, it is too early to quantify the mutual trade expansion which has resulted from the PTA. Ex ante estimates may be of some usefulness, but one has to know the price elasticities of demand for imports and supply of exports in both Spain and the E.E.C., and the elasticity of substitution between preferred and non-preferred products in both markets. In view of the well-known conceptual problems involved in the estimation of price elasticities, combined with some shortcomings in the available data, no elasticities (neither in the short nor in the long-run) have been measured. In order to obtain an idea of the possible trade expansion, let us assume infinite demand and unitary supply elasticities for Spain's exports to the Community and infinite elasticity of supply and -0.5 elasticity of demand for the E.E.C.'s exports to Spain. These assumptions imply a growth of Spain's export of the same magnitude as the tariff reductions offered by the E.E.C., while the E.E.C. exports to Spain would increase by roughly 11 percent on average.
10. The trade pattern which is to emerge from the reciprocal tariff concessions is closely related with the allocative effects which the PTA may bring about.

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1) If the E.E.C. reduces the tariffs on products included in the General List by 70 percent, Spain will reduce tariffs for List A by 70 and for List B by 30 percent. As a result, the depth of the tariff cuts will increase somewhat.

- (a) The impact on the allocation of resources is properly judged not from nominal tariffs on products but from tariffs in terms of the value added at which the commodity in question is produced ("effective tariffs"). This is so because the combination of PTA output and input tariffs determine the extent to which a domestic producer will have to operate with a value added lower than what existed before the Agreement.<sup>1)</sup> Ideally, one should therefore try accurately to quantify the new effective rates of tariff protection and then to estimate the subsequent effects of effective tariff changes on trade flows. This approach might be more relevant for Spain than for the E.E.C. As one can reasonably assume that the small share of Spain in E.E.C. trade renders the position of her exporters with respect to E.E.C. producers more or less analogous to that of perfect competitors, they might not be able to influence the output and input prices prevailing in the Common Market; hence the PTA is not likely to reduce the effective protection accorded to E.E.C. producers through the Common External Tariff (CET) below what it would otherwise be.<sup>2)</sup> The protection of Spain's producers, however, is likely to change. The practical and conceptual problems involved in an attempt to

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- 1) The rate of effective tariff protection is usually defined as

$$e_j = (t_j - \sum_{i=1}^n a_{ij}t_i) / (1 - \sum_{i=1}^n a_{ij}), \text{ where } t_j \text{ and } t_i \text{ are the}$$

nominal tariffs on the output and the inputs and the  $a_{ij}$  are the intermediate inputs per unit of output.

- 2) For a detailed discussion of this point and an illustration with some exemplary cases see L. Gámir, Las preferencias efectivas del Mercado Común a España (Madrid: Editorial Moneda y Crédito, 1972), p. 177 et seqs.

quantify those changes are, again, so great that one may want to avoid going too far. For the purpose at hand it was regarded as sufficient to provide some indication of the reduction in effective tariffs; this can be accomplished by means of applying simple rules of thumb. The rough estimates presented in Table 3 are based on the, admittedly somewhat arbitrary, assumption that the nominal tariffs on final products and on the major inputs used in their manufacture have been reduced in a like manner. This means that effective tariffs in Spain will move, more or less, in step with the nominal tariffs. Taking, for the sake of simplicity, the average tariff cuts as indicators of the tariff reductions accorded to all products traded between Spain and the E.E.C., one can then easily obtain the new rates of effective tariff protection.

- (b) Treating the evidence available with due caution, it points towards the conclusion that despite the PTA a tariff structure persists on both sides which is escalated according to the stage of manufacturing undergone by a particular product.<sup>1)</sup> It is evident from the post-PTA effective rates of protection in Spain as well as in the Community that these rates remain, on average, highest for consumer goods, lower for intermediate products and lowest for capital goods. This cascading structure of tariffs entails a discrimination against domestic-raw-material-based and/or labour-intensive export products (mainly processed food

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1) This type of tariff structure for the E.E.C. as a whole has been found by B. Balassa, "Tariff Protection in Industrial Countries: An Evaluation", Journal of Political Economy, Vol. 73, December 1965, pp. 573-594. Although Balassa's estimates refer to 1962 and the Community has since then reduced its external tariffs, particularly as a result of the Kennedy Round, it did so in a way which prevented the cascading phenomenon from disappearing. Some fresh evidence (for 1972) on two Common Market countries - Germany and the United Kingdom -, which was presented recently, corroborates this statement. See J.B. Donges, G. Fels, A.D. Neu et al., Protektion und Branchenstruktur der westdeutschen Wirtschaft (Tübingen: J.C.B. Mohr, 1973), pp. 16-35. - N. Oulton, "Tariffs, Taxes and Trade in the UK: The Effective Protection Approach", Government Economic Service Occasional Papers, No. 6 (1973).

Table 3 - Effective Rates of Tariff Protection in Spain's Industry and Estimated

Effective Rates of Preferences for the E.E.C. Exports, 1968

(percentages)

Industrial branch	Effective Rates of Protection <sup>a</sup>			Effective Rates of Preferences <sup>a</sup>	
	pre-PTA	post-PTA (22.9 p.c.)	post-PTA (25 p.c.)	Col.(1)-Col.(2)	Col.(1)-Col.(3)
	(1)	(2)	(3)	(4)	(5)
<u>Consumer goods</u>					
Knitting mills	47.4	36.5	35.6	10.9	11.8
Clothing	2.6	2.0	1.95	0.6	0.65
Other finished textiles	40.0	30.8	30.0	9.2	10.0
Footwear	102.9	79.3	77.2	23.6	25.7
Leather products	45.5	35.1	34.1	10.4	11.4
Furniture	44.2	34.1	33.2	10.1	11.0
Printed matter	11.0	8.5	8.3	2.5	2.7
Soaps, detergents, perfumes	22.6	17.4	17.0	5.2	5.6
Motor- and bicycles	180.0	138.8	135.0	41.2	45.0
Automobiles	21.9	16.9	16.4	5.0	5.5
Precision instruments	30.8	23.7	23.1	7.1	7.7
<u>Intermediate goods</u>					
Yarn	10.0	7.7	7.5	2.3	2.5
Cloth	169.7	130.8	127.3	38.9	42.4
Cork	78.9	60.8	59.2	18.1	19.7
Lumber	- 0.9	- 0.69	- 0.68	- 0.21	- 0.22
Tanning industry	47.8	36.9	35.9	10.9	11.9
Paper and pulp	51.3	39.6	38.5	11.7	12.8
Manufactures of paper and cardboard	182.9	141.0	137.2	41.9	45.7
Rubber and asbest products	17.6	13.6	13.2	4.0	4.4
Basic chemicals	31.0	23.9	23.3	7.1	7.7
Synthetic materials	112.5	86.7	84.4	25.8	28.1
Plastic materials	29.0	22.4	21.8	6.6	7.2
Other non-basic chemicals	53.0	40.9	39.8	12.1	13.2
Glass industry	47.3	36.5	35.5	10.8	11.8
Cement	23.1	17.8	17.3	5.3	5.8
Other non-metallic minerals	46.3	35.7	34.7	10.6	11.6
Iron and steel	69.9	53.9	52.4	16.0	17.5
Non-ferrous metals	62.4	48.1	46.8	14.3	15.6
Metal castings	108.6	83.7	81.5	24.9	27.1
Finished metal products	37.8	29.1	28.4	8.7	9.4
<u>Capital goods</u>					
Metal industry for construction	93.4	72.0	70.1	21.4	23.3
Agricultural machinery	22.3	17.2	16.7	5.1	5.6
Other non-electrical machinery	26.6	20.5	20.0	6.1	6.6
Electrical machinery	30.0	23.1	22.5	6.9	7.5
Shipbuilding	71.6	55.2	53.7	16.4	17.9
Aircraft industry	- 5.6	- 4.3	- 4.2	- 1.3	- 1.4
Railroad equipment	4.1	3.2	3.1	0.9	1.0

<sup>a</sup>For method used see text. Non-traded inputs were treated as goods with no tariffs. The figures have not been adjusted for the extent to which the system of protection defends an over-valuation of the peseta.



and consumer goods) in the manufacture of which Spain may have a comparative advantage and the E.E.C. as a whole a comparative disadvantage. It follows that, whatever the real impact of the PTA on Spain's exports to the Common Market, a good deal more exports could be achieved if the Agreement had produced more rational tariff structures. It is a matter of conjecture whether the PTA reflects the weak position of Spain in the E.E.C. trade and, consequently, also in the negotiations, or whether the Spanish Government was not aware of the need to formulate its bargaining strategy in terms of effective rates of protection.

- (c) The likelihood that the effective rates of tariff protection in the E.E.C. will not be affected by the PTA and the fact that most of the initial common external tariffs are already relatively low might seem to be an argument against the significance of the E.E.C. preferences for Spain's exports. This would be wrong for at least three reasons. First, the tariff preference enables Spanish exporters, owing to their assumed price-taker position, to raise their price (net of CETs) for products they want to sell in the Common Market up to the level at which the preferential tariff-inclusive sale price equals the price in the Community.<sup>1)</sup> Second, the margin of preference enjoyed by Spanish exporters compensates them, partially or totally, for the negative effective protection imposed by Spain's tariff structure and which they

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1) The margin for price increase related to value added at international prices reflects the rate of subsidy which is accorded to Spain's exporters. The magnitude of this subsidy appears important, as is shown by L. Gámir, The Common Market, the U.K. and the Effective Preferences to Spain (mimeographed, February 1973). The subsidies, which have been calculated on the basis of 1970 tariffs and value added for 26 manufacturing branches and assuming a 70 percentage tariff cut in the E.E.C., varies between 1.5 percent (shipbuilding) and 42.9 percent (fabrication of cellulose, paper and cardboard), the unweighted average being 24.2 percent.

were facing to the extent that they had to pay tariff-inclusive prices for material inputs<sup>1)</sup>, while they obtained (only) the Common Market prices on their export sales. In other words: the subsidy component of Spain's effective tariffs on exportables into the E.E.C. will become positive, while the tariff preferences granted by Spain to E.E.C. exporters will reduce the degree of implicit taxation of value added obtainable in exporting to the Common Market; in extreme cases, the effective tariff protection of Spain's exports can become - so far as trade with the Community is concerned - positive. Third, all this reduces the bias against exporting inherent in Spain's tariff structure and might encourage firms to increase their production for export at the expense of third (non-preference-receiving) countries with whom Spain is competing.

11. To sum up the picture obtained so far: the PTA could be regarded, at the time it was concluded, as an important step in the direction of intensifying the economic relations between Spain and the E.E.C., as well as of encouraging Spain's exports and promoting the country's economic development (although it has accomplished less than what had been intended). Politically, it had the immense value to "force" the Spanish Government to do what is good for the country from a social economic point of view (i.e. to liberalize its trade), but what had been much more difficult to undertake without the Agreement because of the resistance offered by powerful inward-lookers. Indicative of this is the fact that the trade liberalization process which so vigorously began in 1959/60 was losing momentum during the late 1960s.

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1) There is a kind of drawback-scheme in Spain, but it does not reimburse export firms for tariffs paid (directly or indirectly) on all inputs used in the production of exportables.

12. Now, however, there is the question of whether or not the value of the PTA to Spain's export sector is likely to be reduced by both the unilateral Generalized System of Preferences for developing countries (GSP), implemented by the E.E.C. in July 1971, and the accession of Denmark, Ireland and the United Kingdom to the Community, which became effective in January 1973.<sup>1)</sup>

- (a) The GSP, despite being subject to a number of shortcomings, is doubtless far more generous than the PTA, particularly as far as manufactures are concerned.<sup>2)</sup> Since industrial exports of 91 developing countries and 47 so-called dependent territories are admitted in principle free of customs duties by the E.E.C. member countries, Spanish exporters, who have to pay tariffs, are in a disadvantageous position in comparison with their competitors in the GSP-receiving countries (particularly Argentina, Mexico, Hong Kong, Singapore, and Yugoslavia). This is especially true of consumer goods, which are still relatively highly protected in the E.E.C.; and it holds true even if one recognizes that the geographical proximity of Spain to the Common Market may offset part of the competitive disadvantage resulting from the GSP. The discrimination against Spain would become more serious, if the GSP, which the United States is planning to enact, also excludes Spain.<sup>3)</sup>

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- 1) It should be noted in addition that the concessions offered to Spain by the original Six seem to be inferior to those granted through bilateral agreements to Greece (1962), Morocco (1970), Tunisia (1970) and Turkey (1964, 1970). By contrast, the PTA appears superior to the agreements concluded by the E.E.C. with other countries of the Mediterranean basin, such as Cyprus (1972), Egypt (1972), Malta (1971), Israel (1970) and Lebanon (1972).
- 2) For a comparative analysis see R. Tamames, Acuerdo preferencial CEE/España y preferencias generalizadas (Barcelona: Dopesa, 1972).
- 3) This is quite likely to happen because the U.S. Trade Reform Act of 1973, according to current plans, provides for the denial of preferences to those countries which extend preferential treatment to the export products of another developed country or group of countries.

- (b) The enlargement of the E.E.C. is likely to add to the erosion of the value of the PTA. This is particularly true of agricultural products. The main cause lies in the fact that tariffs on agricultural imports in the Three, before their accession to the E.E.C., were considerably lower than the tariffs of the original Six (weighted average nominal tariffs were 12 and 21 percent, respectively); besides, the Three previously granted direct subsidies to aid their agriculture, while the Six have implemented a system of variable import levies which soaks up any attempt of third-country suppliers to expand exports by selling at prices below the internal target price in the E.E.C. The enlargement of the E.E.C., therefore, implies a substantial increase of protection in an area which is very important for Spain (more than 50 percent of Spain's agricultural exports go to the United Kingdom). In addition, the envisaged equalization of the Three's agricultural prices with those of the original Community is likely to encourage farmers to expand their output and in turn to raise the level of self-sufficiency and reduce import needs to be satisfied by third countries. On the other hand, the high trade barriers prevailing against agricultural imports from Spain prevent E.E.C. consumers from changing their consumption habits in favour of items that Spain could offer at lower prices. As far as manufactured products are concerned, the new situation does not look as bad. But even here the Three granted in many cases (particularly in the consumer-goods industry) lower effective protection to domestic producers than did the original Community<sup>1)</sup> and they will have to change this now in the course of

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<sup>1)</sup> It is interesting to see in this context that - in 1972 and taking into account the Kennedy Round effects - the average effective rate of tariff protection for the manufacturing industry as a whole (excluding food, beverages and tobacco) was 6.4 percent in the United Kingdom as compared to 10.1 percent in Germany. The nominal tariffs were, on average, 3.8 and 7.8 percent, respectively.

the progressive introduction of a customs union between the Six and the new entrants. To the deterioration of the conditions of market access for Spain's exporters, one has to add trade diversion effects which are likely to result from the fact that the dismantling of intra-E.E.C. tariffs (as the Three become integrated into the Community) will place producers inside the enlarged Community (even the less efficient ones) in a better competitive setting than Spain's suppliers. Finally, it should be mentioned in passing, that the trade structure between Spain and the Three differs greatly from that between Spain and the Six. If the acceding countries adopted the PTA in its original form, they would therefore reach an even lower coverage than that of the PTA, especially as far as agricultural products are concerned. It follows from all the above that while the Three would get easier access to the Spanish market, Spain's exports have to overcome new trade barriers.<sup>1)</sup> The phasing out of the Commonwealth preferences can be expected only to partially offset the negative impact on Spain's exports of the E.E.C. enlargement. On the one hand, Commonwealth countries have been given the option to apply either for an association or a preferential trade agreement with the enlarged E.E.C.; on the other hand, the United Kingdom, as well as Denmark and Ireland, will adapt their preferential schemes for developing countries to the Community's GSP.

Although the answers to the questions raised are bound to be speculative, I am strongly inclined to expect the GSP plus the widening of the E.E.C. to have a certain diversionary impact on Spain's export trade. Needless to say, the loss of exports to the

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1) In the meantime, the E.E.C. has recognized the urgent need to revise the Agreement with Spain. But no concrete solutions to the problem have so far been found, with the exception of an enlargement protocol concluded in December 1972, according to which the original PTA will not be applied to the trade relations between Spain and the three new members until new negotiations have taken place.

preferred developing countries as well as to the enlarged Community is not likely to occur in the form of a decline in absolute values. What one has to expect is that Spain's exports to the Common Market will be less than what they otherwise would have been.

### The Challenge to Spain's Industry<sup>1)</sup>

13. Notwithstanding the above arguments, the preferential treatment of trade between Spain and the E.E.C. is certainly of value to both sides, provided the export supply potential of the beneficiaries is high.<sup>2)</sup> Producers of the Community ought to have no difficulties in expanding their exports to Spain in response to the tariff reductions. For Spain's manufacturers, however, the integration with the Common Market represents a greater challenge. Will they be able to compete effectively with the many highly efficient E.E.C. industries in the markets of Spain and the Nine? What kind of policies is the Spanish Government to follow in order to bring about the indispensable structural improvements and to strengthen the international competitiveness of the country's industry?

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1) I leave out agriculture in the following remarks because agricultural trade presents a number of special problems which deserve more attention than can be devoted in the limited space available for this paper. An interesting analysis of the issues involved is provided by L. Gámir, Las preferencias efectivas del Mercado Común a España, op. cit., Ch. 2.

2) Of course, it is not only preferential treatment that matters when assessing the effects of the integration process. The outcome will depend on a great variety of factors (such as selling price, quality, terms of payment and of delivery, and marketing) which determine the degree of competitiveness with respect to foreign suppliers.

14. Judging from Spain's economic performance after 1959, which has been analyzed elsewhere<sup>1)</sup>, one may be inclined to face the future with reasonable confidence. Reaction of entrepreneurs to the intensification of foreign competition during the process of import liberalization proved the ability of many Spanish firms to improve organizational and technological efficiency in production rather quickly. And the spectacular increase in Spain's manufactured exports during the 1960's can be ascribed in not too small a proportion to an improvement of international competitiveness within Spanish manufacturing industry. It is, therefore, not unreasonable to expect Spanish industry to be capable to exploit the opportunities of increasing integration in the future too. The availability of excess capacity, combined with the relatively low export-to-output ratio, indicates that output for exporting into the Common Market may be expanded in many cases at constant costs; where that is not possible, exporters might still be able to compete by selling their products marginally priced.

15. However, one can hardly overlook the fact that Spain is still in the process of becoming an industrialized economy and that, subsequently, she is still beset with a number of basic structural problems, which might make it difficult for domestic producers to compete successfully for market shares at home and abroad as well as to consolidate achieved export positions.

(a) One serious structural weakness is due to the proliferation of firms and to the small scale of production in many enterprises. This is even true of those sectors like the chemical

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1) See the author's articles: "From an Autarchic towards a Cautiously Outward-Looking Industrialization Policy", op. cit., p. 55 et seqs. - "Spain's Industrial Exports: An Analysis of Demand and Supply Factors, Weltwirtschaftliches Archiv, Vol. 108, No. 2, 1972, p. 198 et seqs. - "Shaping Spain's Export Industry", World Development, Vol. 1, September 1973, p. 19 et seqs.

industry, iron and steel industry and transport equipment, in which the minimum efficient size requirements are, for technical reasons, quite high. Of all manufacturing firms in Spain, about 90 percent employ less than 50 persons; the Gini-index of concentration in total manufacturing is not higher than 0.5 (the theoretical upper limit being unity); the value added per employee in Spain's industry reaches only 40 percent of the Community's productivity level; a similar gap exists as to the volume of sales per employee; and Spain has only 65 manufacturing firms with an annual turnover of more than US-\$ 25 million, while the corresponding number in, say, Germany is 390 and in France 360. All this results in cost disadvantages vis-à-vis E.E.C. manufacturers.

- (b) Additional structural problems have shown up in the form of a lack of specialization among firms, a partial obsolescence of installed equipment, the use of manual rather than industrial production techniques in some branches, a fragmentation of distribution lines, a lack of standardization of products, an unbalance of quality standards within branches, a lack of integration of production lines within individual firms, an inadequate provision with finance (particularly working capital) the protection of employees against lay-off, an overstaffing and a more-than-one-occupation attitude of employees in a number of enterprises controlled by the public "Instituto Nacional de Industria", a reluctance among many entrepreneurs to adapt imported technologies to market size and resource endowments, and a poor performance of management in many firms. Under such circumstances the competitive position of the Spanish industry in the markets cannot but remain weak.
- (c) What are the implications of these structural weaknesses for industrial prices in Spain? If Spanish manufacturing firms tend to suffer, on average, from structural backwardness compared with enterprises in the E.E.C., their costs and prices would be higher than in the



Common Market. If one looks around in Spain, one will find much evidence which lend support to this conclusion. More formally, this view has been tested by computing ratios of Spanish to E.E.C. prices for 275 industrial items. The results are summarized in Table 4. No precise meaning should be read into these figures which can only indicate, in a rough manner, the order of magnitude involved. Bearing all qualifications in mind, it can be seen that in 9 out of 16 branches Spanish domestic prices are higher than the corresponding E.E.C. prices; most out of line are paper products, iron and steel, and non-ferrous metal products. The iron and steel industry illustrates particularly well the scope of the problem in question. Although material input prices and labour costs do not put Spanish steel-makers in an unfavourable position, actual prices of, for instance, flat products are up to 20 percent higher in Spain than in the Community. This fact is bound to inhibit many other industries, for which steel is a major material input, from being efficient producers (at least as long as Spain's industrial legislation requires domestic industries to use Spanish steel even if it could be purchased more cheaply abroad).

16. The Spanish Government is aware that the solution of all these problems, which largely date back to the pre-1959 period, cannot be left entirely to the marketplace. What is required, at least temporarily, is the comprehensive formulation of policies providing the right signals for reorganizing and modernizing the industrial sector so that private firms can undertake the appropriate actions themselves. The policy guidelines of the Third Four-Year-Plan (1972-75) are directed to that end. A well-conceived structural policy must include, among other things, the establishment of minimum plant sizes for new investments, the promotion of mergers among Spanish firms and between Spanish firms and foreign partners, the concentration of sales through the creation of producer associations, a relaxation of the severe restrictions on the dismissal of unneeded workers, and devices

Table 4

Ratios of Spanish to E.E.C. Prices<sup>a</sup>, 1967 - 69

Commodity group	Number of items	Mean ratio (unweighted)	Standard deviation of single ratios
Processed food	20	0.721	.16
Beverages	6	1.032	.65
Textile products and clothing	24	0.886	.27
Footwear	12	0.813	.19
Paper products	6	1.190	.22
Printed matter	7	0.641	.12
Basic industrial chemicals, pharmaceutical products and toilet preparations	49	0.974	.36
Glass products and ceramics	6	1.040	.14
Iron and steel	19	1.117	.21
Non-ferrous metal products	5	1.140	.09
Finished manufactures of metal	9	0.866	.14
Non-electrical machinery	7	1.054	.07
Electrical apparatus	37	1.086	.32
Ships	6	1.065	.11
Automotive industry	36	1.008	.13
Jewellery, toys, musical instruments	26	0.893	.35

<sup>a</sup> Prices charged to final purchasers of commodities.

Sources: Calculated from Comisaría del Plan de Desarrollo Económico y Social: Industria básica del hierro y del acero, Madrid 1968. - Instituto Nacional de Estadística: Precios al consumidor en los países del Mercado Común y en España, Madrid 1970. - Data provided by Spanish firms.

to carry out quality controls. In addition, the restructuring of industries, which was started in the First-Four-Year Plan Period (1964-67) by means of establishing "industrial growth centers" and "concerted actions" of firms and the Government, is to continue.<sup>1)</sup> And so is the expansion of the infrastructural network on a proper scale (particularly in the field of education and manpower training). The Government should not contemplate the possibility of granting special protection to industries which are, and will remain, unable to withstand competition from abroad; otherwise substantial inefficiencies in resource allocation would arise which entail (static and dynamic) costs for the economy as a whole. It should envisage, on the other hand, the promotion of export activities so that they are given the same chances to develop as import substituting industries. Such a structural policy is likely to impose severe strains on the weaker firms and workers, while the stronger parts of the industries will gain in form of higher productivity and real income. Some provisions are then indispensable to compensate for the losses of all those affected by the integration process and the concomitant shifts of production; such assistance would also neutralize resistance against structural readjustment which may not be felt any longer as being an unjust hardship but as a temporary sacrifice involved in a promising long-term venture.<sup>2)</sup>

#### The Outlook

17. The prospects for intensifying economic relations between Spain and the E.E.C. in the future appear somewhat ambiguous.

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1) For an evaluation of some of the results obtained so far, see L. Gámir et. al., Política Económica de España (Madrid: Guadiana de Publicaciones, 1972), Ch. 13.

2) The apparent cost to the Spanish Government of adjustment assistance could be partly matched by simplifying and rationalizing the present complex system of industrial incentives, which provides in many cases excessive benefits to firms, which contains a great deal of overlapping and which cause the Government a substantial loss of revenue (estimated in the order of US-\$ 500 million annually).

- (a) Spain has a vital stake in expanding trade with a highly developed economic area such as the Common Market, having actually a population of 253 million and a per-capita income of US-\$ 2,500 and, subsequently, one of the highest purchasing powers in the world. On the other hand, Spain can become an increasingly important market for E.E.C. exports and direct investments due to the undisputed high development potentialities of the country.
- (b) This means that the Spanish Government should carry on the process of gradually opening-up the national economy; the political leaders, as well as public opinion and the individual sectors of economic life, are, in the majority, ready to continue this venture.<sup>1)</sup> Larger balance-of-trade deficits, which are likely to arise in this context, might not cause foreign-exchange problems of any kind; they can be offset by earnings stemming from foreign tourism (which are expected to remain very high), by long-term capital inflows from the E.E.C. on which the PTA might have a favourable influence, and by export expansion itself, which might accelerate once Spanish entrepreneurs become more outward-minded.<sup>2)</sup>

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- 1) A case for a stronger economic integration of Spain with Latin America, instead of the E.E.C., has been made by a few respectable Spanish economists. See, for instance, R. Tamames, Estructura Económica de España, 6th edition (Madrid: Guadiana de Publicaciones, 1971), p. 771 et seqs. Although it has to be recognized that Spain may find some marketing advantages in the Latin American countries, I really believe that from Spain's national point of view there are no either-or-alternatives between integration with the E.E.C. and integration with Latin America. Spain can afford to have both and it would probably be contrary to her interest to neglect the value of an economic approximation to the Community.
- 2) As a matter of fact, an increasing number of Spanish entrepreneurs are beginning to understand that the key to future industrial growth is the foreign market. One can already observe that firms are paying more attention than in the past to studying foreign markets, to participating in international fairs and to differentiating their products by trade marks and customers service. For an interesting study on Spain's export entrepreneurs see J. Viúdez, "The Export Behaviour of Spanish Manufacturers: An Evaluation of Interviews" Kiel Discussion Papers, No. 25, November 1972.

If despite all this a balance-of-payments problem arises there is always the possibility of exchange-rate adjustment to ensure equilibrium.

- (c) No doubt, the motivation for economic integration with the E.E.C. will rapidly disappear if the Community's attitude towards Spain shows no awareness of this country's economic and commercial interests. The E.E.C. should, therefore, accept more rapidly than hitherto the pressure of competition from Spain. This pressure is most unlikely to cause what E.E.C. countries euphemistically call market disruption.<sup>1)</sup> Where individual firms are exposed to serious dangers, this would be a reliable indication that they have ceased to be internationally competitive. This is likely to happen especially with labour-intensive activities due to labour-scarcity in the Community. The firms concerned must be made to understand that they should not try to embark upon defensive investment but respond to changing conditions by retreating from their traditional locations and shifting, instead, the compromised segments of their production, as well as their know-how, to the lower-wage country Spain.

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1) If this argument is applied to the other Mediterranean countries, with which the E.E.C. has concluded a preferential trade agreement, one may run into a "fallacy of composition": While the impact of increasing imports from Spain upon the Common Market will be small, the total impact of imports from all Mediterranean countries can nevertheless be large. Whether or not this view is right, is an empirical question. If it is, it does not weaken our argument but points to the need for a far-reaching adjustment assistance policy in the Community which encourages "declining" domestic industries to transfer their factors of production to activities of greater comparative advantage. As it is well known, the E.E.C. has already accepted the rationale of adjustment assistance - when she established the European Social Fund to help those effected by increased intra-European industrial competition. Contrary to common belief, I am convinced that in-depth research would reveal even rapidly increasing imports from Spain and the other Mediterranean countries to do not significantly aggravate existing problems arising from changes in demand structure, from technological progress and from competition by other developed countries.

This would be in the interest of the Community itself: the emigration of workers from Spain (actually about 1.6 million) would become less urgent and reduce, subsequently, both the environmental costs on the E.E.C. and the activity drain and the social problems in Spain; consumers in the E.E.C. countries would benefit from a greater supply of less expensive goods; and the reallocation of resources would have a positive effect on the Community's productivity growth and, hence, widen the scope for increases in real income.

18. Some people may doubt that the E.E.C. will really behave in a liberal spirit. They may question whether the neo-mercantilists among the Nine will be ready to desist from preserving comparatively inefficient industries. And whether long-sighted economic arguments can prevail over the power of political prejudice. Moreover, critics may argue that the Community has, after the enlargement, an even more diversified production structure so that the member countries may consider the gains from more trade with Spain (and other third countries) as too low to risk political unrest resulting from increasing import competition. I must admit that I have doubts of this type too, particularly because Spain does not have a countervailing power at all. But I am not (yet) so sceptical as to throw up my hands in despair. It should be reasonable to expect that, sooner or later, politicians in the Community will learn how to think and act in terms of economic and social welfare. The one-sided preoccupation of the governments with the interests of producers is less readily tolerated today, particularly by the younger generation, than it once was. One can already perceive incipient signs of an emerging consumer lobby which may be able to counter protectionism. In addition, there seems to be a growing concern about accelerating inflation in a number of major industrialized countries, including Germany, France, and the United Kingdom. If the control of inflation is going to obtain, in the medium run, higher priority than the fight against unemployment, the gradual cutting of

import trade barriers may be regarded as a means of reducing inflation to rates, which are socially and politically more acceptable. Nevertheless, it may well be the case that all these considerations are a matter of wishful thinking. Then, the prospects for Spain's economic integration with the E.E.C., are of course, not as rosy as they could be. The natural reaction in Spain would be one of disappointment, frustration and hesitancy about Europeanization, with obvious implications for the country's economic order and political system.