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Recent Economic Developments in Spain

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Recent Economic Developments in Spain

Summary

Spain's external position, which was in heavy surplus in 1960-61, now appears to be approximately in balance, and Spanish officials expect that this situation will continue for the near future. The shift from surplus to near-balance has been caused by a rapid two-year rise in imports that reflects both a renewed expansion of the economy and the dismantling of most of the former restrictions on imports.

The liberalization of imports has been part of an extensive program begun in July 1959 which has succeeded in restoring Spain to financial health. Inflationary government spending has been terminated, and the balance of payments has shown a spectacular improvement relative to the situation prior to mid-1959. This shift has lifted Spain's gold and foreign exchange reserves from almost nothing to over \$1 billion.

Internally, the economic expansion begun in 1961 has accelerated this year. Earlier, the stabilization program had produced a year-long stagnation in output. Additional important reforms have been taken in recent months to promote foreign investment, to free internal investment from bureaucratic controls, and to reorganize the banking system.

Despite this progress, Spain is expected to experience a long period of further adjustment. Significant restrictions on imports and exchange transactions remain. Spain still avails itself of the "transitional arrangements" under Article XIV of the International Monetary Fund Agreement. The date at which it will assume the "general obligations" of Fund members under Article VIII of the Fund Agreement is not yet in sight, and

in the meantime the Spanish peseta cannot be deemed a convertible currency under Article XIX (d) of the Fund Agreement.

Spain's economy, and especially its foreign trade will be greatly affected if its application to join the Common Market is accepted and existing tariff protection is reduced. In any case, exports will have to expand in order to cover the further rise in imports that will result from the long-range development program to be started in 1963.

External position now nearly balanced

The Spanish payments surplus, which amounted to \$371 million last year, has diminished in recent months, and Spain's external position is now approaching--if, indeed, it has not already reached--a period of approximate equilibrium. For the first time in over three years, official reserves failed to rise in September, and the third-quarter reserve gain was \$43 million compared with \$114 million a year previous. (See Table 1.) The reduction in the surplus is due to rising imports which have increased after a period in which fundamental steps to improve the Spanish economy temporarily resulted in a large excess of receipts over disbursements.

TABLE 1 Spain: Official reserves (Gold and Convertible Currencies)

(in millions of U. S. dollars)

Amounts, end of period

1955 - December	225	1961 - March	560
1959 - June	63	June	661
- December	200	September	775
1960 - March	299	December	863
- June	406	1962 - March	921
- September	479	June	967
- December	541	September	1,010

Quarterly increases, adjusted^{a/}

	<u>1960</u>	<u>1961</u>	<u>1962</u>
Qtr. I	99	49	58
II	107	121	46
III	85	114	43
IV	62	88	

a/ Adjusted for changes in IMF position.

The Spanish stabilization program, initiated in July 1959 to halt inflation, end a series of balance of payments deficits, and improve resource allocation, was based on limitations on internal spending, devaluation of the peseta, and removal of controls. The effects on the balance of payments and international reserves were unexpectedly dramatic, as the country achieved surpluses of \$460 million in 1960 and of \$371 million in 1961. (See Table 2.)

TABLE 2. Spain: Balance of Payments, selected years
(In millions of U. S. dollars)

	<u>1957</u>	<u>1958</u>	<u>1960</u>	<u>1961</u>
1. Trade f.o.b. (payments basis)				
Imports	-693	-785	-688	-1,038
Exports	417	498	745	759
Balance	<u>-276</u>	<u>-287</u>	<u>57</u>	<u>- 279</u>
2. Foreign travel	74	69	247	331
3. Other services	29	2	0	5
4. Private transfers ^{a/}	39	53	58	118
5. Official donations	29	20	33	46
6. Private capital	11	12	107	191
7. Official long-term capital	1	-25	20	21
8. Errors and omissions	<u>1</u>	<u>1</u>	<u>-60</u>	<u>-63</u>
9. Total of above	- 92	-155	460	371
<hr/>				
10. Monetary movements:	<u>92</u>	<u>155</u>	<u>-460</u>	<u>-371</u>
Official reserves	49	40	-341	-323
Other	43	115	-119	- 48

^{a/} Mainly emigrant remittances

Devaluation produced immediate and large increases in receipts. The 1960 gains from tourism were further extended in 1961^{1/}, and another big increase is in prospect for 1962^{2/}. Exports have at least held their initial 1960 gain, although they have not tended to increase since 1960. But the decline in imports in the first year of the program was a temporary phenomenon which by its nature could not persist. Imports fell initially because the disappearance of the previous inflation psychology

^{1/} The number of tourists rose from less than 3 million in 1958 to 5-1/2 million in 1961. In addition, receipts were redirected from the black market to official coffers.

^{2/} In the first eight months of 1962, tourist receipts were 30 per cent higher than in the same months of 1961.

led to an unloading of inventories and a year-long stagnation in economic activity. Since late 1960, imports have been rising rapidly (see Table 3) for two reasons. First, the economy has been expanding since that time. Second, Spain has been progressively removing restrictions on imports over the past three years, as an integral part of the fundamental reforms envisioned by the stabilization program. It is for this latter reason that the pre-stabilization level of imports was quickly surpassed and imports in the first half of 1962 were 75 per cent higher than the 1957-58 average.

TABLE 3. Spain: Seasonally-Adjusted Imports, Exports, and Trade Balance
(In millions of U. S. dollars; monthly average or month)

	<u>Imports c.i.f.</u>	<u>Exports</u>	<u>Balance</u>
1957	72	40	-32
1958	71	40	-31
1959	66	42	-24
1960 - Qtr. I	55	58	+ 3
II	60	58	- 2
III	56	63	+ 7
IV	69	60	- 9
1961 - Qtr. I	87	62	-25
II	80	54	-26
III	96	57	-39
IV	103	60	-43
1962 - Qtr. I	112	64	-48
April	126	61	-65
May	131	54	-77
June	123	52	-71
July	112	56	-56

Because of the continuing rise in imports, the seasonally-adjusted trade deficit has been increasing for two years. (See Table 3) In 1961 this was largely offset by higher receipts from tourism, emigrant remittances, and private capital inflow, but this year the still larger trade deficit has cut sharply into the reserve gains.

Estimates based on the second-quarter seasonally-adjusted trade deficit (imports c.i.f.) of \$800 million at an annual rate suggest that the

Spanish balance of payments may be nearly in equilibrium. Preliminary estimates based on 1962 data already available suggest that tourist receipts may rise 30 per cent this year to a level of around \$430 million, emigrant remittances may rise one-third to about \$160 million, and the net capital inflow may be not much changed from last year's \$212 million. If imports continue to increase at the rate shown in the past two years, a large deficit will soon emerge. However, Spanish officials believe that the rate of increase of imports will greatly slow down in the latter part of 1962 and that the external position will be roughly balanced in the near future. The drop in seasonally-adjusted imports from \$131 million in May to \$112 million in July may indicate that the slowing in the rate of import expansion has already begun. In any event, reserves of over \$1 billion provide a considerable cushion against any future deficits.

In the years 1959-1961, U. S. economic aid to Spain amounted to about \$100 million annually. But this year, the amount was greatly reduced, and no further aid allocations have been made since mid-1961. But Spain continues to benefit from our expenditure on our military installations in that country.

Further problems remain on the external side

Notwithstanding the fundamental improvements which have been realized, Spain will have to make still further adjustments in its international economic policies if it is to obtain greater benefits from trade and to achieve the goals that it has set for itself. First, Spain still retains more import restrictions than any other OECD country. Pressures to remove those controls can be expected from both outside sources and the now-powerful personalities in Spanish official circles whose ideas on economic

matters are definitely liberal. Second, as the OECD underlined in its 1962 annual review of Spain, efforts to raise exports will have to be made if the Spanish economy is to develop. An ambitious development program will probably get under way in 1963, based on the findings of an IBRD Mission. Official Spanish studies indicate that the program may require a doubling of imports between 1961 and 1967. Finally, taking a longer perspective, tremendous adjustments will have to take place if Spain's application for Common Market membership is accepted, especially since Spanish tariffs would then have to be gradually reduced from their present high levels.

Internal recovery speeds up in 1962

The shock effect of stabilization on internal demand wore off in late 1960. The ensuing recovery was slow in 1961 but picked up speed in the first half of 1962; the OECD reports that in the first half of 1962 the expansion of economic activity was strong. The recovery was based initially on a restocking of inventories, and this year rising fixed investment and consumption have become the main expansionary forces. Accurate indicators of over-all production in Spain are lacking; selected output indexes are shown in Table 4. Production is not suffering from monetary restraints. Although the budget in the first half of this year was still showing a large (and unintentional) surplus, this deflationary force has been much more than offset by a very rapid increase in bank credit.

TABLE 4 Spain: Selected Production Indexes
(1958=100)

	<u>Year</u>			<u>First half</u>	
	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1961</u>	<u>1962</u>
Electricity	106	113	128	128	141
Coal	94	94	99	100	a/ 93
Crude steel	116	125	142	140	a/ 142
Cement	108	108	123	119	133
Sulphuric acid	113	106	102	96	118
Cotton yarn	95	106	117	118	123
Wool yarn	86	89	118	118	118
Rayon yarn	93	96	98	100	108

a/ Production affected by strikes in April-May.

Barring labor difficulties, production is expected to continue to rise in the near future. Over the longer term, the 400-page IBRD report on the economic development of Spain published in October concluded that the prospects for the Spanish economy are "very favorable," and that a 5 per cent annual increase in per capita income should be possible over an extended period.

New reforms instituted

Several new measures have been taken since last spring better to adapt the Spanish economy to the needs of the times. To foster private foreign investment in Spain, restrictions were lifted in April and May on the repatriation of both the earnings from foreign investment and the principal invested. To impart a much-needed flexibility in resource allocation, the first meaningful liberalizations of controls on internal direct investment were made in August and September. These steps give business firms much greater freedom speedily to modify and expand their fixed capital and their production.

Finally, in April Spain passed a banking reform law. One element of the reform, yet to be worked out in detail, is to separate commercial and investment banking by ending the "mixed banking" which has been held detrimental to the nation's economy. A second objective is to make the Bank of Spain a real central bank. A start has been made here--the Bank has been completely nationalized, and its internal organization and personnel are being improved to take over central banking functions. What new functions the Bank of Spain will perform in the field of credit controls cannot yet be determined. In line with a third main purpose of the reform, the government-controlled medium- and long-term credit institutions are being reorganized to improve their efficiency.

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