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EC

The Impact of EC Membership on Portugal and Spain

by C. J. Redston, Aberystwyth*

While the case for Spanish and Portuguese EC membership is largely political, for membership to be a political success it must also be an economic success. Indeed it is economic factors which have ensured that six years after the applications were made, negotiations have not been concluded and that the target date of membership by January 1, 1984, will not be met. What will be the impact of EC membership on the applicants' economies?

There can be little doubt that the motivations and reactions on both sides as regards the issue of Portuguese and Spanish membership of the European Community are predominantly political. EC membership provides the opportunity for both applicant countries to enter the mainstream of European political life, following their return to parliamentary democracy in the mid-1970s. For the Community, enlargement can be seen as a means of strengthening political stability in the Iberian Peninsula which can in turn be viewed as a prerequisite for economic and military security in Western Europe.

However, despite the overwhelming importance of political considerations, the enlargement of the EC has economic implications for all parties involved which cannot be ignored. Indeed, it is economic factors which have ensured that six years after the applications were made, negotiations have not been concluded and that the target date of membership by January 1, 1984, will not be met.

Applicants Lagging Behind

If we examine the economies of Portugal and Spain alongside those of the existing Community members, it is apparent immediately that considerable differences exist between the two sides (with the possible exception of the tenth member, Greece). It would not be inaccurate to refer to the applicants as "newly industrializing countries" (NICs) to distinguish them from the advanced industrialized countries which comprise the EC. While the applicant countries, like other NICs, have progressed rapidly in terms of industrialization during the last two decades, they still lag behind the Community in various aspects.

Both countries have relatively low GDPs per capita. On the basis of current prices and exchange rates, GDP per capita in Spain was 58.9 % of the Community average in 1979. The corresponding figure for Portugal was 24.4 % (source: Eurostat 1981). However, it is likely that these crude calculations exaggerate the differences between the two sides. Calculations made by the EC Commission in 1976 using purchasing power parities gave figures of 64.5 % for Spain and 41.9 % for Portugal. This puts Spain at about the same level as Greece and Ireland and only a small distance behind Italy. On any basis Portugal still lags behind.

Both applicants enjoyed substantially higher growth rates than the six original EC members during the period 1960-1973 but since the oil crisis growth has slowed. For the period 1974-81 GDP growth in Spain averaged 2.4 % per annum. For Portugal the corresponding figure is 3.1 % per annum. These figures compare with EC growth of 2.0 % per annum during the same period. Hence the progress made in closing the gap between the two sides has diminished but not disappeared.

In terms of the structure of the economies there are considerable differences between the applicant countries and the Community as a whole. While the percentage of the labour force in agriculture has fallen markedly in both Spain and Portugal in the last two decades, the two countries still have a much higher percentage of their labour force engaged in agriculture than is the case for the Community average and for any individual member country, with the exception of Ireland and Greece. The relevant figures are Spain 18.8, Portugal 28.6 and 8.0 for the Community average in 1980. Furthermore, in terms of output, agriculture in 1978 accounted for only 8.8 % of GDP in Spain and 14.5 % in Portugal (source: Eurostat 1981). In addition,

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both countries but especially Portugal rely heavily on food imports. The decline in the importance of agriculture has been matched by an increase in the role of the industrial and service sectors.

In order to examine the economic impact of EC membership, we must look in more detail at the structure of agriculture and industry in Spain and Portugal.

Agriculture

In Portugal, agricultural production grew slowly in the 1960s and early 1970s but fell markedly in the first years following the 1974 revolution. The recovery in production from 1978 was reversed by the 1981 drought. In general, yields are substantially lower in Portugal than in other Mediterranean countries. While Portugal has been a net food importer for many years, the decline in output since 1974 combined with the addition of about half a million Portuguese consumers returning from the former African colonies has greatly increased the food deficit. Despite a large trade deficit in agricultural products, exports accounting for only about 30 per cent of imports, Portugal has managed to run a small trade surplus in most years with the EC. This is because imports from the Community account for only about one-tenth of total imports while exports to the EC are about one-half of total exports. Portugal's principal agricultural imports are cereals, cotton and oilseeds. The only significant exports are beverages and fruit and vegetables.

The traditional structure of agriculture in Portugal was very small farms in the north and large estates or latifundia in the south. After the revolution the latifundia were occupied by agricultural workers and run either as collective farms or agricultural co-operatives. Although lands in the south are now supposed to be returned to their former owners, the actual situation remains unclear.

The mixture of instability in the south and the small size of farms in the north, combined with a high degree of illiteracy amongst farmers does not make for a dynamic agricultural sector. The need to increase food production so as to ease the strain on the balance of payments is of paramount importance. However, despite the existence of price supports for certain commodities, it is impossible to say that the country has a comprehensive agricultural policy.

In Spain, agricultural production has risen, despite some setbacks from exceptionally adverse weather conditions and regardless of a rapid decline in the numbers involved in farming. In other words, productivity has risen. Unlike Portugal, Spain is self-

Table 1
Annual Changes in Output and Prices,
Spain 1974-81

Output (GDP at factor cost and constant prices, annual percentage changes)							
1974	1975	1976	1977	1978	1979	1980	1981
5.9	1.3	3.3	3.1	2.7	0.3	1.5	1.0
Of which: Agriculture							
7.3	-0.2	4.4	-4.3	6.6	-3.3	9.0	-9.6
Industry							
6.2	-0.6	3.4	4.7	1.8	0.6	0.8	0.5
Construction							
4.5	-4.0	-3.9	-2.0	-4.7	-4.9	-4.0	-2.0
Services							
5.7	3.9	4.0	4.4	3.6	1.5	1.2	3.0
Consumer Prices (annual percentage changes)							
15.6	17.0	17.6	24.5	19.8	15.7	15.6	14.6

Source: UN Economic Survey of Europe in 1981.

Table 2
Annual Changes in Output and Prices,
Portugal 1974-81

Output (GDP at factor cost and constant prices, annual percentage changes)							
1974	1975	1976	1977	1978	1979	1980	1981
2.2	-4.7	6.6	5.6	3.1	4.5	5.6	1.6
Of which: Agriculture							
-1.2	-6.5	-1.5	-10.0	4.0	9.0	3.0	-5.0
Industry							
3.7	-8.8	4.3	10.4	3.4	5.2	5.2	1.0
Construction							
3.5	-15.7	5.0	11.0	5.0	-4.0	9.0	6.0
Services							
1.5	2.1	11.2	6.1	2.2	3.8	6.3	3.5
Consumer Prices (annual percentage changes)							
25.1	20.4	19.3	27.3	22.1	24.2	16.6	19.6

Source: UN Economic Survey of Europe in 1981.

sufficient in cereals, apart from being heavily dependent on imports of maize. Although an important exporter of agricultural goods, Spain has an overall food deficit. The main imports are maize, oilseeds and tropical produce. The Community only accounts for around 12.5 % of total agricultural imports. By far the most important export items are fruit and vegetables which account for over half of Spanish agricultural exports. Other important items are beverages and oils and fats. Well over one-half of Spain's agricultural exports go to the EC. Thus Spain has a considerable surplus in its agricultural trade with the Community while managing to run a trade deficit with the world as a whole.

The general structure of agriculture in Spain is similar to pre-revolutionary Portugal. That is to say a very large number of small farms exist alongside a much smaller number of latifundia. While this is not an ideal structure

for agricultural development, the greater degree of stability in Spain has helped make for substantial productivity growth. Furthermore, there is a reasonably comprehensive agricultural policy under which the state guarantees prices for about 60 per cent of total agricultural production. In some cases, including cereals, the system of price supports is very similar to that used in the EC. In the case of olive oil, support is by restrictions on imports of competing vegetable oils. Whilst farm incomes in Spain remain lower than those in other economic sectors, the farming population of Spain has had a greater share in post-war economic development than can be said of farmers in Portugal.

Problem Areas

Precise predictions of the effects of integration with the EC are fraught with difficulty but one can identify the general impact and certain problem areas which arise from the adoption of the Common Agricultural Policy (CAP) by Spain and Portugal.

In the case of Portugal relatively few difficulties will arise for the EC in that with the possible exception of tomatoes and olive oil it is only a marginal producer in relation to existing EC agricultural output. Community preference will lead Portugal to increase imports of cereals, meat, dairy produce and sugar from other EC countries. Since CAP prices are usually much higher than world market prices, this represents a considerable loss for Portugal. The loss will also arise on continuing imports from third countries because Portugal will have to apply the CAP variable levy. The liberalization of vegetable oil imports represents a threat to Portugal's domestic olive oil production which could have serious repercussions for farmers. The problem is much more acute in the case of Spain, however, and it will be discussed together with the Commission's proposed solution below.

On the credit side, Portugal will have free access to EC markets which should enable it to increase exports of fruit, vegetables and wine. In addition, the continuing devaluation of the Escudo should make CAP prices in the national currency higher than the existing guaranteed prices in Portugal. Thus in general terms farmers in Portugal should benefit. The effect of higher food prices on consumers could be seen as a serious disadvantage of adopting the CAP. With inflation in Portugal running at an annual rate of 34 % in the first quarter of 1983, a further increase in food prices, unless phased in very gradually, could be disastrous.

For Spain, similar arguments regarding the benefits and costs of higher food prices apply as discussed

above in the case of Portugal, although Spain's inflation rate is well under half that of Portugal. However, serious difficulties have arisen during entry negotiations over Spain's potential exports of agricultural products to the rest of the Community. As a major producer of fruit, vegetables, olive oil and wine Spain will present existing producers in France, Italy and Greece with considerable competition. It should also be remembered that the CAP does not provide producers of Mediterranean-type products with the same, generous price guarantees as cereal and dairy farmers. Hence the EC's Mediterranean farmers, who already feel poorly treated by the CAP in comparison with northern farmers, face an additional threat to their living standards. Furthermore, Spain's olive oil producers, at present protected by tariff barriers on competing oils, view EC membership as a serious threat to their livelihood.

Opposition to Spanish entry from France and Italy over the agricultural issue and Spain's concern over olive oil have proved to be major stumbling blocks in negotiations. In June 1982 President Mitterand persuaded the Council of Ministers to ask the Commission to draw up an inventory of the problems and costs likely to arise from Spanish and Portuguese membership. This was little more than a delaying tactic and prompted the European Parliament to reaffirm its backing for enlargement and call for the speedy conclusion of negotiations.

Recent Proposals by the EC Commission

In recent months the EC Commission has put forward two proposals to assist Spanish and Portuguese accession.¹ For olive oil, the Commission proposed a two-stage ten year transitional period after entry. In the first five years Spain and Portugal would be permitted to maintain existing tariff barriers against competing vegetable oils. This would prevent a catastrophic fall in domestic olive oil consumption. It is also suggested that other Community countries might raise their tariffs on imported oils during this period. In the second five years Spain and Portugal would gradually align their duties on oil with those of other members. While the Commission's proposal does not solve the olive oil problem it does at least postpone it.

The Commission's second proposal involves providing 6.6 billion ecus in development aid over the next six years to existing EC Mediterranean areas. Of the total, Greece would receive 38.4 %, Italy 44.5 % and France 17.1 %. The plan calls for the governments

¹ See *The Economist* 5-11 March 1983.

of the three countries to make matching contributions totalling 4.5 billion ecus. Although the proposal is justified by the Commission as a way of lessening inequalities between the northern and southern parts of the EC it is also an attempt to lessen the hostility of farmers in France, Greece and Italy to Spanish and Portuguese accession.

However, under the EC's existing budget constraints, funds for the plan cannot be found. Hence the implementation of the plan and possibly the future of Spain and Portugal rests on there being an agreement on the expansion of the Community's financial resources. This in turn is related to the perennial problem of Britain's budget contribution.

Industry

The principal weakness of Portugal's industry is that it is dominated by sectors at present suffering from over-production in most parts of the world. Textiles, clothing and footwear are the major elements of Portuguese industry, textiles and clothing alone accounting for nearly 30 per cent of the industrial employment. In all these fields competition from other NICs is strong. Attempts to modernize the economy, such as the large-scale Sines project, have been hard hit by the world recession.

After many years of isolation from Western Europe during which its industrial growth was based largely on import substitution, and the colonies provided most markets and raw materials, Portugal sought to establish

trading links with Western Europe in the 1960s. It became a signatory of the 1960 Stockholm Convention which established EFTA and as a less-advanced country was given special terms which allowed it to eliminate tariffs over a much longer period than other EFTA members. In 1972, in view of the first EC enlargement Portugal signed a free trade area agreement with the EC. This agreement was revised and extended in 1975. It provides for the elimination of all tariff barriers applicable to exports from Portugal, with the exception of some "sensitive" products which are subject to quantitative restrictions. Unfortunately, these sensitive products account for almost one-third of Portuguese exports. On the Portuguese side, imports from the Community were divided by the agreement into three categories for which trade liberalization was to be achieved by 1977, 1980 and 1985 respectively. The effect of Portugal's agreement with the EC and its longstanding membership of EFTA is that its industry appears to be less protected than that of Spain. According to Silva Lopes², by 1980 about 80 per cent of all imports from the Nine and EFTA entered Portugal duty free, while for most of the remaining 20 per cent tariffs were very low. This calculation does not take account of non-tariff barriers (which are very difficult to assess) nor the substantial import surcharges which Portugal has from time to time imposed for balance-of-payments reasons.

² Quoted in L. Tsoukalis: *The European Community and its Mediterranean Enlargement*, London 1981.

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Hans-Eckart Scharrer/Warren Hesse/Henry Krägenau

JAPANS WIRTSCHAFTSENTWICKLUNG, AUSSENHANDEL UND WETTBEWERBSFÄHIGKEIT

(Japan's Economic Development, Foreign Trade and Competitiveness)

Japan's trade and current account surpluses have increased considerably since the beginning of the seventies. Particularly the USA and the European Community felt the effects of the Japanese export offensive, with the growth of Japanese imports lagging distinctly behind. The imbalance of trade not only encouraged protectionist tendencies in the industrial countries, but also raised the question as to the reasons – both those relating to the economy as a whole and those relating to economic policy – behind Japanese competitiveness and, in particular, as to the role of the exchange rate of the yen in the balance of payments adjustment process. This is also the subject of this study, which was conducted for the Federal Ministry for Economic Affairs.

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While some restructuring of the Portuguese economy has taken place, there being in particular a rapid growth in the production of machinery and transport equipment – mostly for domestic consumption rather than export – the industrial base remains narrow. In the 1960s government efforts at industrial restructuring revolved around large-scale projects. The Sines scheme, centred on a deep-water port with the intention of creating industrial zones in the surrounding area, is the principal example. However, this project proved to be overambitious, although it is partly a victim of the world recession. The petro-chemical complex is well behind schedule and the entire iron and steel project has been dropped. The government still hopes to attract small and medium-sized firms to take advantage of the industrial infrastructure.

Government efforts at intervention have been more successful where they have concentrated on aids to private industry. Government-funded investment and manpower training have proved helpful in the footwear, ceramics and glass, marble and granite industries.

It is evident that much of Portugal's recent industrial development and especially export growth is dependent upon foreign investment. Official statistics indicate that by 1975 companies with foreign participation accounted for 16.6 % of total value added in the manufacturing sector. While the overall figure is not high, foreign investment played a major role in sectors such as electrical and non-electrical machinery, rubber products, transport equipment, basic metals and chemicals. Evidence also suggests that foreign companies are more export-oriented than domestic ones. Even in a traditional sector such as clothing, the export lead has been taken by foreign-controlled firms. This seems to indicate a lack of local entrepreneurship and suggests that as in non-European NICs foreign firms have established manufacturing export activities in Portugal to take advantage of its low wage level. The implications of this will be discussed below.

Spain's industrial development has taken a different path to that of Portugal. Spain did not sign a preferential trade agreement with the EC until 1970 and had no agreement with EFTA until 1979. As a result Spanish industrialization has taken place behind tariff barriers. However, the much larger size of the Spanish market gave the policy of import substitution a much longer lease of life than in Portugal.

The structure of industry is more diversified than that of Portugal. Textiles account for about 16 % of industrial employment, food processing 13 % and metal manufacturing 29 %. The decline in traditional sectors

of manufacturing and the growth of metal industries, particularly capital goods and transport equipment has been a notable feature of Spanish industrialization.

The diversification of Spain's industrial structure is reflected in its trade with the Community and the rest of the world. The structure of exports is much more diversified than that of Portugal with much less reliance on the traditional labour-intensive goods. Textiles account for no more than 2.5 % of total exports while clothing and footwear account for only 6 %. The most dynamic export growth has taken place in the sector producing machinery and transport equipment, the share of which rose from about 2 % to 28 % over the period 1960 to 1980. Within this sector transport equipment alone accounts for more than half of total exports. This figure is partly a result of the establishment of the Ford plant in Valencia which has a strong export orientation.

Foreign capital has played an important role in the development of the Spanish economy. Spanish statistics are not particularly helpful in this field but we can make use of the indicator devised by the Spanish Ministry of Commerce which relates the amount of capital subscribed by or acquired by foreigners to the nominal value of shares issued by Spanish companies between 1967 and 1971. Of special importance is the foreign penetration in chemicals (48 %), food products (20 %), machinery and transport equipment (28 %), paper and printing (25 %), and mining (22 %). Unlike Portugal the local market, rather than the export market seems to have provided the main incentive for most of the foreign direct investment in Spain.

If we consider the impact of Community membership on industry in the two applicants, in Portugal this impact may be limited by virtue of the country's existing European trade links. Given that the low level of tariffs in Portugal is an accurate reflection of the real degree of protection accorded to Portuguese industry the elimination of these tariff barriers will not be felt too strongly by Portuguese industry. On the export side, Portugal already enjoys tariff-free access to Community markets but the eventual removal of quotas will be an important benefit. It is an indicator of the relative bargaining strength of the two parties that Portugal has agreed to an arrangement whereby its textile exports will be restricted during the first four years of Community membership. Even when restrictions are lifted, Portugal will face powerful competition from non-European NICs which indicates that diversification of the economy is essential. Furthermore, Portugal is bound to face trading problems as long as inflation continues at a high rate. Continuing devaluations of the Escudo help the

trade balance but add to the inflationary pressure in a small open economy.

Although Spain has a more diversified economy than that of Portugal, the fact that it has been developed behind a tariff wall makes Community membership more of a challenge. The EC's tariffs against Spanish industrial goods are low in any case, hence Spain cannot expect much benefit in selling to Community markets from tariff elimination alone. The elimination of Spain's own tariffs will open her domestic industry to much greater European and world competition.

Studies undertaken by Spanish economists³ suggest that in general it is the traditional sectors of the economy that are most likely to benefit from free trade. Food products, leather and footwear, wood and furniture, transport equipment and oil products are at the top of the list. Among the least competitive sectors which would suffer from EC membership are electrical appliances, industrial and agricultural machinery, office equipment and chemical products.

Preservation of Centre-Periphery-Relationship?

In the long term the main dangers for both Spain and Portugal of EC membership may lie in the fact that in broad terms they seem to be following the path of the industrialized countries one or two steps behind. In effect, Spain's and Portugal's present comparative advantage lies in branches of industry in which the rest of the Community has lost or is losing its competitive edge. Under free trade with Europe the two applicants may be forced to specialize more in these sectors of present comparative advantage. At the same time both countries face a massive challenge from non-European NICs whose lower wage levels give them an advantage in traditional labour-intensive commodities. The position of Spain and Portugal will not be made any easier by the fact that as EC members they will have to adopt the Community's preferential trading policies toward developing countries.

If the new members of the Community are forced into specializing in branches of industry which are declining in other EC countries, it will preserve the centre-periphery relationship which has been said to typify the relationship between the EC and the applicant countries.⁴ In this model the centre provides technology, sophisticated industrial goods and capital. The periphery offers markets, basic industrial goods and raw

materials, including labour. Since technological development is carried out in the centre, the periphery becomes increasingly dependent on the centre for any improvement in its economic structure.

Continuation of such a relationship carries considerable danger for the EC. Firstly, in such an enlarged Community there would be more call for protection from NIC imports with possibly serious consequences for world trade. Secondly, it is unreasonable to expect that the long-term aspirations of Spain and Portugal would be satisfied by a second-rate economic status within the enlarged Community.

Need for Financial Assistance

While we have emphasized that the case for Spanish and Portuguese membership is largely political, it cannot be denied that for membership to be a political success it must also be an economic success. The Community must ensure that industrial development in Spain and Portugal is as broadly based as possible. It is inevitable that financial assistance from the EC will be required if the new members are to achieve the structural economic reforms that will enable them to face the challenge of Community membership and in time close the gap which separates them from the other members. This implies that the EC budget will have to develop as a specific redistributive device. To date, such international transfers as have taken place within the EC have been mainly the result of the often perverse workings of the CAP.

It is interesting to note that a computer simulation made by the Commission⁵ of the impact of Spain and Portugal on the 1980 budget indicated that the cost of membership would be small. Assuming that both countries would comply with all existing EC requirements the cost to the budget was estimated at being between 700 million and 1200 million ecus. Even the larger figure is lower than the normal margin of error in estimating the annual cost of the CAP. The small size of the estimated cost derives from the fact that as net food importers Spain and Portugal will pay substantial agricultural levies to Brussels.

The low cost of membership not only strengthens the case for an early conclusion to the membership negotiations but should also make it easier for the Community to find some additional funds to help Spain and Portugal successfully adjust to EC membership. The wrangling between the existing members over the financing of the Community, however, does not allow one to be optimistic in these matters.

³ Quoted in L. Tsoukalis, *op. cit.*

⁴ See for example, D. Seers, B. Schaffer and M. L. Kiljunen: *Underdeveloped Europe, Atlantic Highlands, New Jersey, 1979.*

⁵ See *The Economist*, 13-19 November 1982.