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## **WORKING PAPER 11**

**Portugal, Spain and the European Union**

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***Abstract***

The purpose of this paper is to use the integration of Spain and Portugal into the European Union as an opportunity to reflect on what has happened to both countries since 1986. It examines the integration process and how it has affected political, economic and social developments in Portugal and in Spain over the last two decades. It will identify the basic changes in the economies and societies of Portugal and Spain that occurred as a result of European integration.

## **Introduction<sup>1</sup>**

After decades of relative isolation under authoritarian regimes, the success of processes of democratic transition in Portugal and Spain in the second half of the 1970s paved the way for full membership in the European Community. For Spain, Portugal, and their European Community (EC) partners this momentous and long awaited development had profound consequences and set in motion complex processes of adjustment.<sup>2</sup>

There was no dispute that the Iberian countries belonged to Europe. This was not just a geographical fact. Spain and Portugal shared their traditions, their culture, their religion, and their intellectual values with the rest of Europe. Moreover, both countries had historically contributed to the Christian occidental conceptions of mankind and society dominant in Europe. Without Portugal and Spain the European identity would only be a reflection of an incomplete body. Iberian countries belonged to Europe. Their entry into the European Community was a reaffirmation of that fact, and it would enable both countries to recover their own cultural identity, lost since the Treaty of Utrecht, if not before.

The Iberian enlargement strengthened Europe's strategic position in the Mediterranean and Latin America, and led to the further development of a European system of cohesion and solidarity. Spain and Portugal offered a new geo-political dimension to the Union, strengthening it southwards, and ensuring closer ties with other regions that have been peripheral to the EC. This process

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<sup>1</sup> Previous versions of this paper have been published in Royo, "The 2004 Enlargement: Iberian Lessons for Post-Communist Europe," as part of the volume Royo, *Portugal, Espanha e a Integração Europeia: um balanço*, and also in Royo "From Authoritarianism to the European Union: The Europeanization of Portugal."

<sup>2</sup> References to the European Economic Community (EEC) or the European Union (EU) can be misleading if the historical period covered extends past the last two decades. This chapter addresses themes in the European Economic Community prior to the introduction of the European Union label in the Maastricht Treaty of 1991. The terms 'the European Community' (EC) or 'the European Union' (EU) are used indistinctly to refer to the European integration process and institutions throughout the article. Similarly, 'Europe' is here always used to refer to the countries that are members of the European Union, either before or after the Maastricht Treaty. In section three when I focus on the ongoing enlargement process, I refer to the EU.

was fostered with the Spanish accession to NATO on June 1982, after a long controversy within the country.<sup>3</sup>

The purpose of this paper is to use the experience of Portugal and Spain in the European Union (EU) as an opportunity to reflect on what has happened to both countries since 1986. It will identify the basic changes in the economies and societies of Portugal and Spain that occurred as a result of European integration.

Entry to the EC has brought many benefits to both countries. In sixteen years Portugal and Spain have successfully turned around the unfavorable conditions of the accession treaties (particularly for Spain). EU membership has improved the access of both countries to the European common policies and the EU budget. At the same time Portugal and Spain's trade with the Community has expanded dramatically over the past fifteen years, and foreign investment has flooded in. One of the main consequences of these developments has been a reduction in the economic differentials that separated each country from the European average. Since 1986, Portugal's average per capita income has grown from 56 percent of the EU average to about 74 percent, while Spain's has grown to 81 percent. The culmination of this process was the participation of both countries as original founders of European Monetary Union in 1999.

From the standpoint of European policy, EC membership mattered to Spain and Portugal because the EC's decisions affected directly the Iberian countries. Indeed, some of the decisions adopted by the EC had an even greater impact over these economies than some decisions of their national administrations. In this regard, entry into the EC has allowed both countries to have influence on decisions taken at the European level, which affected both countries, and over

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<sup>3</sup> The Spanish Socialist Party, PSOE, under its leader Felipe González has led the opposition to integration in NATO. When they won the general election the following October, Mr. González used the threat of exiting the Alliance as a tool to speed the negotiations with the EC. The Socialist government linked the permanence in NATO with the country's accession to the Community and "threatened" the U.S. and the EC members with a referendum about the country permanence in NATO that he had promised during the electoral campaign. In the end Mr. González himself supported Spain's permanence in the Alliance during this referendum, and Spain achieved its objective of joining the Community. Nevertheless, this shows that political considerations, again, were critical during the negotiation process. See Gómez Fuentes 1986, pp. 41-42.

which before accession they had little influence, and in any case, no voting power. Since their accession, Portugal and Spain have played an important role in the process of European integration and have become again key actors in the European arena. At the same time, they have contributed decisively to the development of an institutional design of the European Union that has been largely beneficial to their interests. Finally, Portugal and Spain have participated successfully in the development and implementation of the Single Market and the European Monetary Union (EMU).

The process of integration into Europe has also influenced cultural developments. As part of their democratic transitions and European integration, both countries attempted to come to terms with their own identities, while addressing issues such as culture, nationality, citizenship, ethnicity, and politics. At the dawn of the new millennium it would not be an exaggeration to say that the Spaniards and the Portuguese have become "mainstream Europeans," and that many of the cultural differences that separated these two countries from their European counterparts have dwindled as a consequence of the integration process.

EU integration, however, has also brought significant costs in terms of economic adjustment, loss of sovereignty, and cultural homogenization. In addition, accession has also brought more integration but also fears (exacerbated by issues such as size, culture, and nationalism).

At a time when European countries are on the threshold of major changes the lessons derived from analysis of the Spanish and Portuguese experiences should be instructive to scholars, students, and policymakers working on expansion and integration issues. Moreover, the examination of these two cases will shed new light on the challenges (and opportunities) that less developed countries face when trying to integrate regionally or into the global economy.

The paper proceeds in three steps. I analyze first the consequences of the EU integration for the Iberian countries. In the second section, I examine the challenges presented by the ongoing enlargement of the EU for Portugal and Spain. The paper closes with some lessons for Eastern European countries.

## **Consequences of EU Integration**

### *Political and Sociological Consequences*

A central argument of this paper is that EU membership was decided on the basis of political rather than economic considerations. Nearly forty years of authoritarianism, which kept both Iberian countries in the margins of the process of European integration, increased further their desire to become part of the EC. Indeed, in the second half of the past century, the European Community epitomized in the eyes of the Portuguese and Spanish citizens the values of liberty, democracy, and progress absent in both countries. In the words of a famous Spanish philosopher, Ortega y Gasset, 'Spain is the problem and Europe the solution.' In addition, Iberian entrepreneurs knew that their only future lay in Europe. Belonging to the European club was a mission not to be questioned. After years of relative isolationism, both countries finally joined the European integration process in the expectation that it would help consolidate their newly established democratic institutions, modernize their outdated economic structures and finally, normalize relations with their European neighbors.

Over the last sixteen years Portugal and Spain have undergone profound transformations. The democratic regimes installed in the 1970s have lasted far longer and attained a greater degree of stability than earlier democratic episodes in both countries. EC membership finally ended the political isolation of both Iberian countries. As one illustrious Spanish intellectual stated:

“For the last two centuries Spain has practically been neutralized in the international field. Having our country ceased to be an active element in the process of world history, we Spaniards have lost, not just the necessary mental habits, but also the very notion of sharing our destiny in the march of the Universal History.”<sup>4</sup>

Indeed, EC membership paved the way for the complete incorporation of both countries into the major international structures of Europe and the West, as

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<sup>4</sup> Sánchez Albornoz 1973, p. 281.

well as the normalization of Portugal and Spain's relations with their European partners. Portugal and Spain have become, again, important players in Europe. At the domestic level, Portugal and Spain undertook deep processes of institutional, social, and cultural reforms. Hence, from a political standpoint EU integration has been an unmitigated success, as both countries have consolidated their democratic regimes and institutions. The two processes—European integration and democratization—are thoroughly intertwined.

The EC (and international pressures in general) were unquestionably important in this development.<sup>5</sup> When the European Community was founded, it pledged to protect the principles of peace and liberty. Whatever other difficulties or problems may arise; this was the fundamental objective of the Community. Given this commitment, the still young democracies of Spain and Portugal needed to be given a positive answer regarding their integration. Otherwise, there would be the risk of weakening these new democracies that Europe had committed to defend. This objective was clearly stated by European leaders, “The accession of Spain to the Community emanates from a political purpose, aiming at the stability, the consolidation and the defense of the democratic system in Europe.”<sup>6</sup> The European Commission itself recognized the fact that the integration to the EC was essentially a political choice. The opening of the negotiations was an explicit recognition that major changes had taken place in Spain and Portugal, which needed to be protected and consolidated within the European context. In other words, the political, economic and social stability of Portugal and Spain were perceived as stability factors for the Community itself.<sup>7</sup>

In Portugal and Spain, integration was viewed by the political and economic elites as the best way to consolidate the fragile structures of Iberian democracies, and therefore, Europeanization and democratization were

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<sup>5</sup> The democratization literature has theorized about how external influences may affect democratization processes and has generated a range of concepts. Pridham (2002, 183) outlines the following ones: “diffusion, contagion, consent, penetration, demonstration effect, emulation, reaction, control (or, externally monitored installation of democracies), incorporation, obviously interdependence, and finally conditionality.”

<sup>6</sup> Rippon 1980, p. 107.

<sup>7</sup> González 1980, p. 47.



considered complementary processes. Formal accession negotiations to enlarge the EC began with Portugal in October 1978 and with Spain in February 1979. Accession was viewed as a mean to consolidate political and economic reforms in both countries. After almost forty years of authoritarianism and very little democratic experience, democracy was still uncertain in Iberia. In Spain, the failed *coup d'état* led from Colonel Tejero on February of 1981 was a rude awakening to the reality of the fragility of the new democratic regime. In Portugal the instability and uncertainties surrounding the failed revolutionary attempt of the 1970s highlighted the precariousness of the democratization process. The lessons from both experiences were very important for both countries. Portugal and Spain still had to go a long way to strengthen their democratic reforms and institutions. On the other hand, the Spanish king's firm stance in favor of democracy, as well as the rejection by the overwhelming majority of the population of Tejero's attempt, offered good perspectives for the newborn democracy. In Portugal the excesses and instability of the revolutionary period, exemplified the potential pitfalls of a transition gone adrift. In this context Portugal and Spain's application to the EC sought to strengthen their young democratic processes. Indeed, it is generally acknowledged that the underlying reasons for the integration of Portugal and Spain in the EC were mostly political. Political forces were particularly dominant in shaping the direction of events in the enlargement as well as in determining the terms of accession. In many cases not only the general public but also many political parties had not fully grasped the full economic consequences of the integration.<sup>8</sup>

Some scholars have theorized on the influences that European integration has had on the Iberian democratization processes focusing on its symbolic impact (i.e. "the identification of EU with liberal democracy and political freedom"), the pressures induced by the democratization pre-requisite for membership; the effect of membership prospects on domestic policies and policy direction; and finally, the involvement of political and economic elites in European institutions

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<sup>8</sup>Vaitsos 1982, p. 243.

during negotiations as well as their participation in European transnational networks.<sup>9</sup>

In the Iberian cases the EC played a significant role in the success of this process. In addition to the EC's demonstrative and symbolic influence due to the EC association with democracy and freedoms, the EC had important indirect levers, particularly during the negotiations for accession, to influence the direction of events and the decisions of policymakers and economic actors (i.e., economic incentives). During the early phases of the democratization processes, the most important lever was, obviously, the democratic precondition for EC entry. Brussels defined explicitly the institutional conditions that would satisfy this requirement and European leaders made them very explicit to the Iberian leaders. According to Pridham these conditions included: "the inauguration of free elections; the predominance of parties supportive of liberal democracy; the existence of a constitution; and evidence of a reasonably stable government led, if possible, by a political figure known and approved in European circles."<sup>10</sup> European leaders stated that accession negotiations would not proceed and the application from these countries would not be considered as long as these countries did not demonstrate significant progress in these areas.

In addition, the repetitive refusals to consider the Spanish application for membership during the Franco and Salazar/Caetano years, strengthened the positions of opposition groups and economic actors supporting democracy. They used EC membership as an additional inducement to support democratization and convince the Portuguese and Spanish people of the potential benefits of membership. In addition, democratization processes received explicit support from the EC. Following the failed *coup d'état* of 1981 the European Parliament (and many European leaders) passed a resolution condemning it and expressing support for Spanish democracy. The message was loud and clear: the success of the coup would have resulted in the immediate cancellation of the accession negotiations. The decision to proceed with negotiations, was therefore the ultimate lever in the hands of the EC to push for

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<sup>9</sup> Pridham, 2002, pp. 185-86.

<sup>10</sup> Pridham, 1991, pp. 234-35.

democratization in both countries. In Portugal, following the revolution of April 1974, European governments exerted considerable bilateral pressures to follow through the democratization process.<sup>11</sup> These developments obviously had an impact on Portuguese and Spanish economic and political actors during the transition and contributed to the consolidation of the new democratic regimes. Finally, the Iberian leaders used the fragile and unstable situation of their countries as leverage to push forward the accession process and to obtain financial and institutional support from the European governments, which they used to strengthen their domestic position, as well legitimize the system and the new democratic institutions.

EC membership has also contributed to the consolidation of the Iberian democratic regimes.<sup>12</sup> Pridham argues that membership has had the following impact: First, it helped link “enhanced national self-image with possible feelings for democracy.” In addition, financial contributions from the EC budget as well as the economic benefits of membership (i.e. FDI), contributed to improve economic conditions and mitigated some of the negative effects of liberalization and modernization of the outdated economic structures of both countries. In turn, improved economic conditions and better prospects for social and political stability influenced public opinion and helped to legitimize the new system and to strengthen support for democracy. Membership also forced the Iberian countries to align their institutions to the *acquis communautaire*, which reinforced democratic practices and induced democratic governments to push for administrative reforms and decentralization. (for instance, Portugal reformed its Constitution in 1989 to allow for reprivatization of companies that had been nationalized during the revolution). Finally, membership promoted elite socialization and the development of transnational networks, which, for instance, proved vital for the strengthening of interest groups and political parties (such as the Spanish and Portuguese Socialist parties, which received substantive support from their European counterparts). The development of

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<sup>11</sup> Pridham 2002, pp 188-89 and Pridham 1991, p. 234-35.

<sup>12</sup> Pridham 2002, 194-205.

economic interests and networks at the European level also strengthened the support of economic actors for democracy.

The EC, however, lacked the direct intervention instruments (such as armed intervention) that could have had a systemic effect on the Iberian democratization processes. Hence, it is essential to look at interactions between the international environment and domestic politics. The actors involved in the transition had the powers to influence events and, hence, they were the ones that ultimately determined the final outcomes. Domestic dynamics, are thus, critical. The process of European integration interacted with a wide variety of domestic social, political, and economic factors that shaped the new democracies. In Spain a radical and unparalleled process of devolution to the autonomous regions has led to a decentralized state that has culminated with the development of the State of Autonomies.<sup>13</sup> In Portugal, following the collapse of the revolutionary attempt, the state also undertook a systemic process of modernization. However, the two transitions were substantially different. In Portugal, the road to democracy started with a clear break, the coup of April 25, 1974. In Spain, on the contrary, the transition was more consensus-oriented. These two paths to democracy (among other factors) have resulted in enduring differences in the two Iberian democracies in terms of institutional developments (i.e., in Portugal, a decentralization attempt was defeated in a referendum), economic performance (i.e., Spain has experienced higher levels of unemployment), and collective life (i.e., support for unions and political parties is higher in Portugal than Spain, or differences in labour participation rates). Indeed, European integration has not eliminated major differences between the Iberian countries. In addition, integration cannot explain the broader patterns of political transformation with its clearly identifiable underpinnings in the two countries. These enduring differences illustrate the limitations of research attempts that have sought to causally link the Iberian democratic transitions to internationally rooted and domestically supported

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<sup>13</sup> Supporters of decentralization and the regionalist parties viewed the process of European integration as a model of decentralization, and saw EC integration as an instrument to ensure the decentralization of the Spanish political system. See Alvarez-Miranda, 1996 and Magone 2002, p.229.

pressures for European integration. In the end, as it has been correctly stated by Fishman (2001:8) “the political motivations guiding their assessment of Europe during the crucial years leading up to EC membership were strongly shaped by the Iberian’s held attitudes toward democracy and regime transition, attitudes formed within the context of the distinctive political experience of each case.”

From a sociological standpoint EU membership has also resulted in attitudinal changes that have influenced the political culture of both countries. From the beginning there was strong support from public opinion and elites for the integration of both countries into Europe as a means to consolidate the new democratic regimes. They viewed democratization and European integration as part of the same process. Hence, successive governments in both Portugal and Spain associated European integration with the modernization of their countries and this helped shift public opinion’s attitudes towards their governments and democracy. In addition, other scholars have noted that by allowing for the active involvements of both countries in European institutions, European integration contributed to change the ‘isolationist-fatalist attitude’ of the political classes.<sup>14</sup> Public opinion surveys from *Eurobarometer* and Madrid’s *Centro de Investigaciones Sociológicas* have showed a sustained increase in positive ratings effects for the functioning of democracy. Support for the relationship between the Iberian countries and the EU has been widespread in both countries since 1986 despite fluctuations. This almost unanimous consensus in favor of integration into Europe seems to be the consequence of Portugal and Spain’s need to overcome their historical isolation from the rest of Europe since the nineteenth century until the end of the authoritarian regimes in 1970s. This development contributed to the legitimating of the new democratic system (and thus the consolidation of democracy).

However, the greatest consensus elicited toward the EU is instrumental (particularly in Spain), with levels of diffuse affective support for the EU being low, although high in comparative perspective. The polling data collected by the

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<sup>14</sup> Magone 2002, 225.

Madrid's *Center of Sociological Investigations (CIS)* and *Eurobarometer* show that Portuguese and Spaniards feel linked by geographical and affective feelings to Europe and the Europeans. However, they do not identify closely with a so-called "common European culture."<sup>15</sup> The reason for this is that despite a shared history and traditions, there is an absence of a pre-modern common past and a European heritage that would have allowed for the emergence of a unified European identity. Therefore, the image of a "European community" among Iberian people is very weak. Indeed, they perceive the EU as an economic community, not so much as a community of Europeans. The *Eurobarometer* and CIS polling data show that the perceptions from Iberian citizens about the personal and collective benefits derived from EU membership are one of the key factors that help explain for their attitudes towards the process of European integration. Consequently, it is not surprising that polling data show that Portuguese and Spaniards have a utilitarian and instrumentalist concept of the EU—i.e. they evaluate the consequences of membership over issues such as living costs, infrastructures, job opportunities, wages, etc. Iberian citizens develop an implicit cost/benefit analysis and based on this evaluation adopt a position in favor or against European integration. Hence, approval of Europe seems to coincide with the economic cycles: low during economic recessions, and high during periods of economic growth. Finally, when comparing the attitudes of Spanish and Portuguese citizens' vis-à-vis other European citizens the former support the EU more, but also stress further the need to build a social Europe.<sup>16</sup>

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<sup>15</sup> According to *Eurobarometer* (April 1992, EB37.0) to the question: "Do you ever think of yourself as not only (nationality), but also European? Does this happen often, sometimes or never?" 15% of Portuguese and 24% of the Spaniards responded "Often;" 51% of Portuguese and 34% of Spaniards responded "Sometimes;" 32% of Portuguese and 37% of Spaniards responded "Never;" and 1% of Portuguese and 5% of Spaniards responded "DK."

<sup>16</sup> From, CIS: *Opiniones y Actitudes de los Españoles Antel el Proceso de Integración Europea*. Madrid: 1999, pp. 131-32 ; and Magone 2002, pp. 223-33.

**Table 1: Support for EU, EMU, CFSP, and Enlargement**

	EU Membership is Good	Trust the European Commission	Support EMU	Support CFP	Support CSP	Support New Members
Spain	64	56	36	68	76	58
Portugal	55	53	60	57	71	52

*Source: Eurobarometer, 2004 and others.*

Finally, it is important to stress that in terms of political behavior, EU membership has not transformed activism and political participation in Portugal or Spain. Levels of support for democracy as a legitimate political regime, preferably to any other alternative, have usually remained high (around 80 percent of the responses in surveys), and Portuguese and Spaniards declare themselves satisfied with the functioning of democracy. Yet, political cynicism continues to be a major component of political attitudes and the political behavior of Portuguese and Spanish citizens. These countries still have the lowest levels of participation of Western Europe and membership in political and civic associations remains very low. At the same time, citizens do not have a feeling of political influence and express strong sense of ambivalence towards political parties and the political class, which is translated into a rather low interest in politics.<sup>17</sup>

#### *Economic and Social Consequences*

Economic conditions in Spain and Portugal in the second half of the 1970s and first half of the 1980s were not buoyant. The world crisis caused by the second oil shock in the late 1970s and the lack of adequate response from the collapsing authoritarian regimes in both countries intensified the structural problems of these economies. Portugal had been a founding member of EFTA and had lowered its trade barriers earlier, and was theoretically in a better position than Spain. However, Salazar did even less than Franco to encourage entrepreneurship and competition. This factor combined with the costs of the colonial wars, and the disruptions caused by the revolution and near a decade of political upheaval dramatically worsened the economic situation. For instance, in the 1960s Portugal's income per head was about three quarters that of

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<sup>17</sup> Pérez-Díaz, 2002, pp. 280-84 and Magone 2002, p. 232.

Spain, and in the late 1980s it was only one-half. By the time of accession Spain was the EC's fifth-largest economy, and Portugal its tenth.<sup>18</sup>

The economic crisis of the late 1970s and the first half of the 1980s had devastating consequences in both countries and made any additional adjustments caused by the accession to the EC a daunting prospect. In Spain the high unemployment levels, which reached 22 percent on 1986, suggested that any additional adjustment cost would have painful consequences.<sup>19</sup> In addition, the country was unprepared for accession-i.e., Spanish custom duties remained on the average five times higher than the EC's and EC products faced a major disadvantage in the Spanish market because the country had a compensatory tax system and restrictive administrative practices that penalized harder imported products.<sup>20</sup> Slow license delivery was common, and constructors that sold vehicles in the county did not have import quotas to introduce cars into Spain from abroad. Finally, when Spain and Portugal called to the door of the EC for accession in 1977, protectionist institutions-which were incompatible with EC rules-were still fully operative in both countries. For instance, the Spanish government controlled through the I.N.I (National Institute of Industry) a considerable size of the economy, and subsidized public enterprises such as the auto making companies (SEAT, ENASA), as well as the metallurgic, chemical, ship construction and electronic sectors. This situation provided a considerable advantage for Spanish manufacturers, which were highly protected from foreign competition.

In this context, EU integration was a catalyst for the final conversion of the Iberian countries into modern Western-type economies. Indeed, one of the key consequences of their entry into Europe has been that membership has facilitated the modernization of the Iberian economies<sup>21</sup>. This is not to say, however, that membership was the only reason for this development. The economic liberalization, trade integration, and modernization of these economies started in the 1950s and 1960s and both countries became increasingly prosperous over the two decades prior to EU accession.

The economic impact of the EC started long before accession. The Preferential Trade Agreements (PTAs) between the EC and Spain (1970) and the EC and Portugal (1972),

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<sup>18</sup> From "Not quite kissing cousins," in *The Economist*, May 5, 1990, v. 315, n. 7653, p. 21.

<sup>19</sup> Hine 1989, p. 7.

<sup>20</sup> For example, EC vehicles imported to Spain paid a custom duty of 27% to 30,4% plus a compensatory tax of 13%. See Couste 1980, p. 129.

<sup>21</sup> See Tovias 2002



resulted in the further opening of European markets to the latter countries, which paved the way for a model of development and industrialization that could also be based on exports. The perspective of EU membership acted as an essential motivational factor that influenced the actions of policymakers and businesses in both countries. Henceforth, both countries took unilateral measures in preparation for accession including increasing economic flexibility, industrial restructuring, the adoption of the VAT, and intensifying trade liberalization. Through the European Investment Bank they also received European aid (Spain since 1981) to mitigate some of the expected adjustment costs (for instance on fisheries).

In addition, the actual accession of both countries after 1986 forced the political and economic actors to adopt economic policies and business strategies consistent with membership and the *acquis communautaire* (which included the custom union, the VAT, the Common Agriculture and Fisheries Policies, and the external trade agreements; and later the Single Market, the ERM, and the European Monetary Union).

EU membership also facilitated the micro and macro economic reforms that successive Iberian governments undertook throughout the 1980s and 1990s. In a context of strong support among Iberian citizens for integration, membership became a facilitating mechanism that allowed the Iberian governments to prioritize economic rather than social modernization and hence, to pursue difficult economic and social policies (i.e., to reform their labor and financial markets), with short-term painful effects. Moreover, the decision to comply with the EMU Maastricht Treaty criteria led to the implementation of macro and microeconomic policies that resulted in fiscal consolidation, central bank independence, and wage moderation.

Nevertheless, the process of EC integration, also brought significant costs in terms of economic adjustment, and loss of sovereignty. Under the terms of the accession agreement signed in 1985 both countries had to undertake significant steps to align their legislation on industrial, agriculture, economic, and financial policies to that of the European Community. These accession agreements also established significant transition periods to cushion the negative effects of integration. This meant that both countries had to phase in tariffs and prices, and approve tax changes (including the establishment of a VAT) that the rest of the Community had already put in place. This process also involved, in a second phase, the removal of technical barriers to trade. These requirements brought significant adjustment costs to both economies.

Since 1986 the Portuguese and Spanish economies have undergone profound economic changes. EU membership has led to policy and institutional reforms in the following economic areas: monetary and exchange rate policies (first independent coordination, followed by accession to the ERM, and finally EMU membership); reform of the tax system (i.e. the introduction of the VAT, and reduction of import duties); and a fiscal consolidation process. These changes have led to deep processes of structural reforms aimed at macroeconomic stability and the strengthening of competitiveness of the productive sector. On the supply side, these reforms sought the development of well-functioning capital markets, the promotion of efficiency in public services, and the enhancement of flexibility in the labor market. As a result markets and prices for a number of goods and services have been deregulated and liberalized; the labor market has been the subject of limited deregulatory reforms; a privatization program was started in the early 1980s to roll back the presence of the government in the economies of both countries and to increase the overall efficiency of the system; and competition policy was adapted to EU regulations. In sum, from an economic standpoint the combined impetuses of European integration and economic modernization have resulted in the following outcomes:

**Figure 1: The Iberian Economic Transformation**



In terms of *static effects*, EC accession has resulted on trade creation in the manufacturing sector. Indeed, it has had dramatic effects in trade patterns.<sup>22</sup> As a matter of fact, in the early 1980s the Spanish economy was the least open to industrial trade of any of the EC members. Hence, the participation in a custom union like the EC, has resulted in the dismantling of trade barriers for the other members of the union. Trade liberalization also exposed the highly protected and non-competitive sectors of the economy to foreign competition.<sup>23</sup>

Some EC products already had preferential access to the Portuguese and Spanish market as a result of the 1972 and 1970 Preferential Trade Agreements (PTAs). Trade

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<sup>22</sup> The framework for section on trade draws from Robert C. Hine, “Customs Union Enlargement and Adjustment: Spain’s Accession to the European Community,” in *Journal of Common Market Studies*, Volume XXVIII, No. 1. September 1989.

<sup>23</sup> Imports of manufactured goods in 1986 were equivalent to 11.0 percent of Spain’s GDP. On the other hand, the relatively closed nature of the Spanish industry was also reflected in the amount of industrial exports which were only 10.9 percent of GDP. In the EC the averages were 14.4 percent and 27.7 percent of GDP respectively. Hine 1989, p. 7.

creation was reasonably expected given the high level of protection (particularly in Spain) before accession to the EC as well as the similarity of the structure of industry in Portugal, Spain, and the EC.<sup>24</sup> Accession did not have negative consequences on non-EC suppliers because Spain and Portugal's tariffs on non-EC imports were aligned to the common external tariff, which in general was much lower than Iberian tariffs on non-EC imports prior to accession. Furthermore, as a result of the 1970 and 1972 PTAs Spain and Portugal had already benefited from a substantial cut in the external Common Customs Tariff, therefore Iberian exports to the EC did not have discriminatory effects on other non-EC suppliers. Finally, the opening of the Portuguese and Spanish markets has led to an increase of intra-industry trade, and hence less acute labor adjustments problems.

At the same time, however, for the Iberian manufacturers accession to the Community has also resulted in more competition. Since Portuguese and Spanish nominal tariffs averaged 10-20 percent before EC entry, and generally speaking manufacturing EC products were cheaper and more competitive, membership has resulted in an increase of imports from the EC and therefore, on a worsening in the balance of current account (and the closure of many industrial enterprises in Iberia). The intensity of the adjustment, however, has been mitigated by the behavior of exchange rates and by the dramatic increase in the levels of investment in these two countries. Spain and Portugal have been attractive production bases since they both offered access to a large market of 48 million people, and a well-educated and cheap—compared with the EC standards—labor base. In the end, the transitional periods adopted in the treaty to alleviate these adjustment problems and the financial support received from the EC played a very important role minimizing the costs for the sectors involved.

Portugal and Spain had benefited from their Preferential Trade Agreements with the EC on manufacturing products. However, these agreements left both countries outside of the Common Agricultural Policy (CAP). While the

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<sup>24</sup> For instance, since the late 1950s Spain had been moving away from industries based on low-technology, low capital requirement, and unskilled labor like textiles, leather, shipbuilding and food, towards more capital intensive industries that required more labor skills—like chemicals, or vehicles. See Hine 1989, pp. 9-12.

composition of GDP had changed significantly in both countries throughout the 1960s, in the 1970s agriculture was still a critical sector for the Portuguese and Spanish economies with more than 10 million people—17 percent of the population—living from it in Spain. Spanish agriculture accounted for 9 percent of GDP and its agricultural output was 16.5 percent of the Community total. In Portugal the share of agriculture represented 16 percent in 1973 (down from 23 percent in 1961).

The Iberian governments (particularly the Spanish one), however, were much more effective in achieving reasonable compromises in the manufacturing sector during the accession negotiations, than they were in the agricultural sector. Arguably, this might have happened because in the industrial sector the governments had to satisfy their workers (an important electoral constituency), as well as the union, which were well organized and had influence in the ruling parties. On the contrary, Iberian farmers (particularly in Spain) were not so well organized and hence were not as effective pressuring for a better agreement. It is also true that on agriculture some EC members, particularly France, held more intransigent positions during the negotiations.

The integration of Spain and Portugal in the EC offered opportunities for both trade creation and trade diversion in agriculture. Since Spain and Portugal had been kept out of the CAP before accession, EC membership gave better access conditions to Iberian agricultural exports to the Community. This was particularly true given the good quality of these products and their lower prices—compared with those of the EC. At the same time, the increase of Portuguese and Spanish agricultural exports to the Community displaced imports from other countries. The main source of adjustment problems was trade creation because greater import penetration led to a contraction in domestic production. For Spain one of the main challenges of accession was the result of the regional diversity of its agriculture because it has not been easy for farmers affected by the CAP to switch to other products given the differences in the environment, weather, and fertility conditions.<sup>25</sup> From an agricultural standpoint the fears of trade diversion materialized to some extent after accession (in favor of other EU members such as Italy, or France), which contributed to increasing migration from rural areas to the cities.

At the time of accession, it was considered that a critical factor to determine the final outcome of integration would depend upon the pattern of investment,

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<sup>25</sup> Hine 1989, pp. 16-18.

which would bring about important *dynamics effects*. Spain and Portugal had a number of attractions as a production base including; good infrastructure, and educated and cheap labor force, and access to markets with a growing potential. In addition, EC entry would add the incentive of further access to the EC countries for non-EC Iberian investors—i.e. Japan or the U.S. As expected, one of the key outcomes of integration has been a dramatic increase in foreign direct investment, from less than 2% to more than 6% of GDP over the last decade. This development has been the result of the following processes: economic integration, larger potential growth, lower exchange rate risk, lower economic uncertainty, and institutional reforms. EU membership has also resulted in more tourism (which has become one of the main sources of income for Spain).

Another significant dynamic effect has been the strengthening of Iberian firms' competitive position. As a result of enlargement Iberian producers gained access the European market, which provided additional incentives for investment and allowed for the development of economies of scale, resulting in increasing competitiveness. By the 1980s Spain and Portugal were already facing increasing competition for their main exports—clothing, textiles, leather—from countries in the Far East and Latin America, which produced all these goods at a cheaper costs exploiting their low wages. As a result of this development, the latter countries were attracting foreign investment in sectors were traditionally Portugal Spain had been favored. This situation convinced the Iberian leaders that their countries had to shift toward more capital-intensive industries requiring greater skills in the labor force but relying on standard technology—e.g. chemicals, vehicles, steel and metal manufacturers. In this regard, Portugal and Spain's entry to the EC facilitated this shift. Both countries gained access to the EC market, thus attracting investment that would help build these new industries. Finally, Portugal and Spain also benefited from the EU financial assistance programs—i.e., the European Regional Development Fund, the Social Fund, the Agriculture Guidance and Guarantee Fund, and the new created Integrated Mediterranean Program for agriculture, and later on from the Cohesion Funds.

EU integration has also allowed both economies to become integrated internationally and to modernize, thus securing convergence in nominal terms with Europe. One of the major gains of financial liberalization, the significant decline in real interest rates, has permitted Portugal and Spain to meet the Maastricht convergence criteria. Indeed, in January 1<sup>st</sup>, 1999 Spain and Portugal became founding members of the European Monetary Union (EMU). At the end, both countries, which as late as 1997 were considered outside candidates for joining the euro-zone, fulfilled the inflation, interest rates, debt, exchange rate, and public deficit requirements established by the Maastricht Treaty. This development confirmed the nominal convergence of both countries with the rest of the EU.

**Table 2: Compliance of the EMU Convergence Criteria for Portugal, 1986-1997**

		<b>1986</b>	<b>1990</b>	<b>1996</b>	<b>1997</b>
Inflation*	%	13.1	13.6	2.9	1.9
General Government Deficit	% GDP	6.4	5.6	3.2	2.5
General Government Gross Debt	% GDP	68.0	66.9	65.0	61.4
Long-term Interest rates	%	19.5	16.8	8.6	6.4

\*1986 and 1990: CPI; 1996 and 1997: HCPI (Harmonized Consumer Price Index). *Sources:*

European Commission and Portuguese Government.

**Table 3: Compliance of the EMU Convergence Criteria for Spain, 1993-1997**

<b>Year</b>	<b>Inflation (% growth)</b>	<b>Long-Term Interest rate</b>	<b>Public Sector Deficit (as % of GDP)</b>	<b>Government Debt (as % of GDP)</b>
<b>1993</b>	4.6	10.2	6.9	60.0
<b>1994</b>	4.7	10.0	6.3	62.6
<b>1995</b>	4.7	11.3	7.3	65.5
<b>1996</b>	3.6	8.7	4.6	70.1
<b>1997</b>	1.9	6.4	2.6	68.8

*Source: Commission and EMU Reports, March 1998.*

The EU contributed significantly to this development. Art. 2 of the Treaty of Rome established that the common market would "promote throughout the Community a harmonious development of economic activities" and therefore lower disparities among regions. While regional disparities of the original EC members were not striking (with the exception of Southern Italy), successive enlargements increased regional disparities with regard to per capita income, employment, education, productivity, and infrastructure. Regional differences led to a north-south divide, which motivated the development of EC structural policies. The election of Jacques Delors in 1985 as president of the Commission led to renewed efforts to address these imbalances. They culminated in the establishment of new cohesion policies that were enshrined in the 1986 Single European Act, which introduced new provisions making economic and social cohesion a new EU common policy. In this regard, the regional development policy emerged as an instrument of solidarity between some Europeans and others. Since the late 1980s the structural funds became the second largest EU's budgetary item. These funds have had a significant impact in relationship to the investment needs of poorer EU countries (see Table 3) and have made an impressive contribution to growth in aggregate demand in these countries (see table 5):



**Table 4: Gross Fixed Capital Formation versus Community Support Frameworks**

	Percent GFCF Due to EU Support		Percent of GFCF vs. CSFs*	
	1989	1993	1989	1993
Portugal	7.7	9.9	20.6	27.7
Spain	2.9	4.1	5.8	8.0

\*CSFs include the private sector expenditures entered into the financing plan of the CSF

*Source:* Kesselman et al., *European Politics in Transition*. Data: EC Commission, *Fourth Annual Report on the Implementation of the Reform of the Structural Funds, 1992*, Com (93) 530, Brussels, 29 October 1993, 84.

**Table 5: Estimated Annual impact of Structural Funds, 1989-1993**

	Average Annual Growth Rate (89-93)	Estimated Impact
Spain	1.5	0.2
Portugal	2.6	0.7

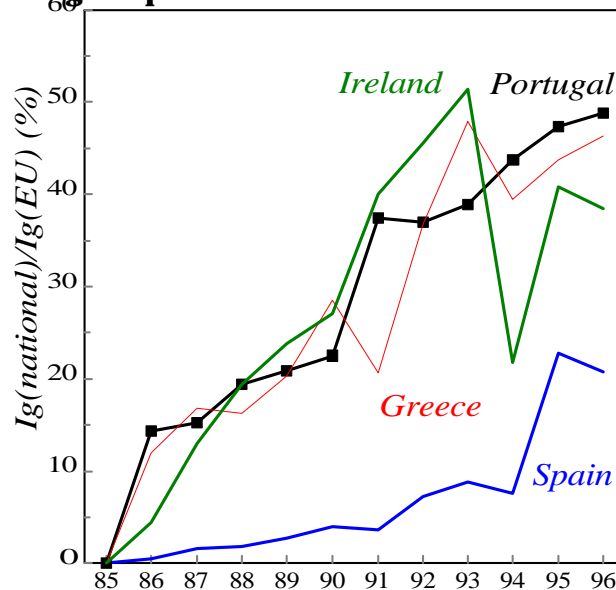
*Source:* Kesselman et al., *European Politics in Transition*. Data: EC Commission, *Fourth Annual Report on the Implementation of the Reform of the Structural Funds, 1992*, Com (93) 530, Brussels, 29 October 1993, 84.

Indeed, the structural and cohesion funds have been the instruments designed by the EU to develop social and cohesion policy within the European Union, in order to compensate for the efforts that countries with the lowest per capita income relative to the EU (Ireland, Greece, Portugal and Spain) would need to make to comply with the nominal convergence criteria. These funds, which amount to just over one-third of the EU budget, have contributed significantly to reduce regional disparities and foster convergence within the EU. As a result major infrastructural shortcomings have been

addressed and road and telecommunication networks have improved dramatically both in quantity and quality. In addition, increasing spending on education and training have contributed to the upgrading of the labour force. In sum, these funds have played a prominent role in developing the factors that improve the competitiveness and determine the potential growth of the least developed regions of both countries.<sup>26</sup>

During the 1994-1999 period, EU aid accounted for 1.5% of GDP in Spain and 3.3% in Portugal. EU funding has allowed rates of public investment to remain relatively stable since the mid-1980s. The percentage of public investment financed by EU funds has been rising since 1985, to reach average values of 42% for Portugal, and 15% for Spain. Moreover, the European Commission has estimated that the impact of EU structural funds on GDP growth and employment has been significant: GDP rose in 1999 by 9.9% in Portugal and 3.1% in Spain. In the absence of these funds public investment will be greatly affected.

**Figure 2 : Percentage of public sector investment financed with EU funds**



Source: Sebastián 2001, p.28

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<sup>26</sup> See Sebastian, Miguel, 2001: "Spain in the EU: Fifteen Years May not be Enough" p. 25-26. Paper presented at the conference *From Isolation to Europe: 15 Years of Spanish and Portuguese Membership in the European Union*. Minda de Gunzburg Center for European Studies, Harvard University. November 2-3.

The combined impetuses of lowering trade barriers, the introduction of the VAT, the suppression of import tariffs, the adoption of economic policy rules (such as quality standards, or the harmonization of indirect taxes), and the increasing mobility of goods and factors of production that comes with greater economic integration, have boosted trade and enhanced the openness of the Portuguese and Spanish economies. After 1999, this development has been fostered by the lower cost of transactions and greater exchange rate stability associated with the single currency. For instance, imports of goods and services in real terms as a proportion of GDP rose sharply in Spain (to 13.6% in 1987 from 9.6% in 1984), while the share of exports shrank slightly (to 15.8% of GDP from 16.6% in 1984, and from 17.1% of real GDP in 1992 to 27% in 1997). As a result, the degree of openness of the Portuguese and Spanish economies has increased sharply over the last sixteen years. Henceforth, changes to the production structure and in the structure of exports, indicators of the degree of competitiveness of the Portuguese and Spanish economies (i.e., in terms of human capital skills, stock of capital, technological capital) show important improvements, although significant differences remain in comparison to the leading developed economies (which confirms the need to press ahead with the structural reforms). These achievements verify that in terms of economic stability Spain and Portugal are part of Europe's rich club. Their income levels, however, remain behind the EU average:

**Table 6: Divergence of GDP per Capita 1980-2003**

	<b>1980</b>	<b>1985</b>	<b>1990</b>	<b>2000</b>	<b>2003</b>
EU Totals	100.0 %	100.0%	100.0%	100.0%	100.0%
Spain	74.2	72.5	77.8	81.0	85.8
Portugal	55.0	52.0	55.7	74.0	74.0

*Source:* European Union.

This data shows that nominal convergence has advanced at a faster pace than real convergence. Indeed, 'fifteen years have not been long enough.' Portugal and Spain's European integration has revealed both convergence and divergence, nominal and real. Since 1997 inflation in Spain has exceeded the EU average every year. In Portugal real convergence has been slowing down each year since 1998, actually turning negative in 2000 and with both real and nominal divergence expected to increase until 2003. While there is significant controversy over the definition of real convergence, most scholars agree that a per capita GDP is a valid reference to measure the living standards of a country. This variable, however, has experienced a cyclical evolution in the Iberian countries with significant increases during periods of economic expansion and sharp decreases during economic recessions. Since the adhesion of Spain to the EU in 1986 per capita income has increased "only" 11.5 percent and Portugal's 14.2 percent. Ireland's, in contrast, has increased 38 percent. Only Greece with an increase of 6.8 percent has had a lower real convergence than Spain and Portugal. A possible explanation for this development has been the fact that while Spain has grown between 1990 and 1998 an average of 2.1%, Portugal has grown 2.5%, and Ireland 7.3% over the same period. This growth differential explains the divergences in real convergence. Other explanations include: the higher level of unemployment (15.4 percent in Spain); the low rate of labor participation (i.e., active population over total population, which stands at 50 percent, which means that expanding the Spanish labor participation rate to the EU average would increase per capita income to 98.2 percent of the EU average); the inadequate education of the labor force (i.e. only 28 percent of the Spanish potential labor force has at least a high school diploma, in contrast with the EU average of 56 percent); low investment in R&D and information technology (the lowest in the EU, with Spain ranked 61-spending even less proportionally than many developing countries including Vietnam-in the World Economic Forum's *Global Report of Information Technologies 20002-2003*); and inadequate infrastructures (i.e. road mile per 1000 inhabitants in Spain is 47 percent of the EU average and railroads' 73 percent). The inadequate structure of the labor market with high dismissal costs, a relatively centralized collective bargaining system, and a system of unemployment benefits that

guarantees income instead of fostering job search, have also hindered the convergence process.<sup>27</sup>

From a social standpoint, this was a decade and a half of political stability, associated with an overall strengthening of the State's financial and budgetary capacity, and with a significant increase in social expenditures. The overall architecture of the system has been maintained but there was a substantive growth of the amount of benefits, with a consequent upgrade of social standards, as well as a movement toward the institutionalization of social dialogue, with the signature of social pacts. For instance, in 1980 expenditure on social protection was 18.1 percent of GDP in Spain and 12.8 percent of GDP in Portugal, much lower levels than the EU average at that time (24.3%) and only higher than that of Greece (9.7%). Since EU accession, despite an increase of 3.4 percent of the resources dedicated to social protection in Spain (the Spanish welfare state grew significantly in size during this period and expenditures on social protection over GDP increased by 50 percent), the differential with the EU average has not been reduced but has rather increased from 6.2 points in 1980 to 6.8 points in 1997. Portugal, starting from lower levels of social protection, has been more successful reducing the differential with the EU average by 50 percent. Spain, however, continues to show a higher intensity of protection (per capita expenditure on social protection) than that of Portugal. In the end, the Portuguese and Spanish welfare states have undergone a deep process of change in qualitative terms, entailing both the introduction of several universal policies and a broader extension of tax-funded non-contributory benefits and services. At the same time, the need to transpose EEC's regulatory framework, the *acquis communautaire* (i.e. in the fields of labour and working conditions, equality of treatment for women and men, free movement of workers and health, and safety at work), and the role played by the structural funds has contributed widely to this development.

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<sup>27</sup> From "La Convergencia Real a Paso Lento," in *El País*. Monday February 14<sup>th</sup>, 2000.

## **Conclusions**

For the Iberian countries the EU symbolizes modernization and democracy. In Iberia, the European integration process has facilitated the reincorporation of both countries to the international arena, has contributed to the legitimacy of the new democratic regimes, has acted as a buffer in controversial issues (such as the process of decentralization in Spain, or the implementation of economic reforms), and has facilitated and accelerated the process of convergence and modernization of financial, commercial, and manufacturing structures. The idea of Europe became a driving force that moved reforms forward and it was a fundamental factor for bringing together political stabilization, economic recovery, and democratic consolidation. As we look to future research agendas, it is important to stress that while the majority of the research in this project has focused on the policy effects and the influence of EU policies on the Iberian countries, it is also imperative to study the impact of EU membership on domestic institutions.<sup>28</sup>

Despite all the significant progress accomplished over the last and half decades, the Iberian countries still have considerable ground to cover. At a time in which the European Commission is reporting that the EU is 'losing the battle on competitiveness,' in a list of 44 indicators, including economic performance, reform, employment, and research, Portugal and Spain (together with Greece) are among the worst countries in the majority of the areas.<sup>29</sup> Lack of political willingness to reform and sluggish growth will hinder further the convergence process. At the same time, differences in economic performance will be exacerbated within the EU by the accession of the central and eastern European states. Indeed, with the new 10 member states joining in, there is an increasing

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<sup>28</sup> See Morlino 2002.

<sup>29</sup> See "The EU 'is losing battle on competitiveness'," in *Financial Times*, Monday January 13, 2003, p.3. Spain has lost 3 positions (is listed at number 20) in the last Globalization Index published by *Foreign Policy* (January/February 2003, no. 134, p. 60) and Portugal is listed at 14. In addition the *World Economic Forum* has placed Spain and Portugal among the least competitive countries in the European Union (only Greece is behind) in its *Report on Global Competitiveness*. This report examines economic conditions in 80 countries focusing on two main indexes: MICI (Microeconomic Competitiveness Index), which measures the quality of business development, and the GCI (Growth Competitiveness Index), which examines growth perspectives in 5-8 years based on macroeconomic stability.

risk of a “two-tier” Europe where some countries will do better than others. The EU has limited direct powers to force outcomes. The experiences of Portugal and Spain show that the influence of indirect EU recommendations on policy and demonstration effects has been greater than direct action. Hence, it is not surprising that European states, and particularly the Iberian countries, are failing to live up to the ambitious targets established in the European Council of Lisbon in March of 2000, which aimed at making the EU more competitive<sup>30</sup>.

From an economic convergence standpoint, given the existing income and productivity differentials with the richer countries, regardless of enlargement the Iberian states will have to continue increasing their living standards to bring them closer to the current EU average. For this to happen, it is necessary that their economies grow faster than the other rich European countries. This will require further liberalization of their labor structures (both internal and external), as well as increasing competition within their service markets, and developing a better utilization of their productive resources. In addition, convergence will also demand institutional reforms in R&D policies, in education, improvement of civil infrastructures, as well as further innovation, an increase in business capabilities, more investment in information technology, and better and more efficient training systems. Finally, a successful convergence policy will also demand a debate about the role of public investment and welfare programs in both countries. In the Iberian countries increases in public expenditures to develop their welfare state have caused unbalances in their national accounts. Yet, both countries still spend significantly less in this area than their European neighbors (i.e. Spain spends 6.3 points less in welfare policies than the EMU average). Effective real convergence would demand not only effective strategies and policies, but also a strong commitment on the part of Spanish and Portuguese citizens to this objective.

While EU membership facilitates (and in many cases ameliorates) adjustment costs and provides impetus for reforms, the experience of the Iberian countries shows that this is no substitute for the domestic implementation of reforms,

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<sup>30</sup> From "La Convergencia Real a Paso Lento," in *El País*. Monday February 14<sup>th</sup>, 2000

which should proceed further in areas such as labor, product, and capital markets. The success of enlargement and institutional reforms will hinge to a considerable degree in the ability of European leaders to implement reforms in the face of domestic resistance and increasing skepticism about enlargement. The enlargement process and the approval of the new Constitution will largely determine the future of Europe. Lack of progress will bring institutional paralysis and losses of competitiveness. The survival of the European model is at stake.



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