Spain: From Protectionism to Advocacy of Liberalisation

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Introduction

In the closing years of the twentieth century Spain took a decisive turn towards liberal capitalism. As recently as the early 1980s markets had been protected by a battery of import tariffs and non-tariff barriers. Capital controls restricted inward and outward investment. Services were frequently offered under monopoly conditions, either national monopolies such as Campsa in petrol and Telefónica in telecommunications, or through the provision of territorially based licenses for example in public road transport, or under restrictive statutes such as those limiting savings banks to their locality of origin and regulating the minimum distance between fuel service stations. Building land was strictly limited by local authority planning controls. There were tight controls on property rental and long minimum rental periods for agricultural land. Labour markets were extremely rigid, making it almost impossible to shed staff. Economic relations were everywhere governed by social connections and obscure agreements rather than by contract and transparency. Liberalisation, which had been making inroads into this environment since the 1960s, mainly in terms of international trade, quickened during the 1980s and stepped up a gear in the 1990s. To a considerable extent change was externally imposed. But with the election to office of the People's Party (Partido Popular, PP), Spain emerged as an advocate of liberalisation, demonstrating its credentials through a series of policy initiatives (Ariño Ortiz 2000). In the first six months of 2002, as holder of the presidency of the European Council, it was given a platform on which to display its leadership in this area. The following discussion looks at the process of liberalisation, the particular character, tensions and contradictions of liberalisation within Spain and the contribution of the Spanish Presidency. It concludes with an assessment of the credibility of Spain as an advocate of liberalisation.

The Process of Liberalisation

Economic liberalisation is a process involving changes in the regulatory framework that are designed to free markets (capital, labour, land and product markets) from government intervention, improve their efficiency and correct market distortions. It assumes the withdrawal of public institutions from direct participation in the economy (*privatisation*) and the removal of barriers to the free working of the market (*deregulation*). It implies greater reliance on the market mechanism - "the process by which households' decisions about consumption of alternative goods, firms' decisions about what and how to produce, and workers' decisions about how much and for whom to work are all reconciled by adjustments of prices." (Begg 1997, 8) - to allocate resources. The objective is to create competitive markets and a 'level playing field', which is assumed to produce a more efficient economy that delivers benefits to consumers and more rapid economic growth. In practice, free markets tend to lead to the structural and spatial concentration of resources and to economic volatility. Hence, liberalisation has been accompanied by the creation of new regulatory frameworks designed to ensure competition (*regulation* and *competition policy*) and to promote stable, sustainable growth. Rather than a withdrawal of the public sector from intervention in the economy, the process has been associated with a recasting of the role of the public sector. In this sense, neo-liberalism is a far cry from the *laissez-faire* economics of classical economic theory.

The philosophical roots of economic liberalism lay in the late eighteenth/early nineteenth century writings of Adam Smith, David Ricardo and Richard Cobden (O'Brien 1975). In essence, they focused on the concept of free trade, and on the associated doctrine of *laissez-faire*, which opposed the habit of government to regulate economic life through protectionist tariffs. "Its energies were directed on the one hand to dismantling the economic barriers which had proliferated both within and between countries and on the other in battling against all forms of collective organisation, from the ancient guild to the new trade unions." (Davies 1997, p.802). These ideas were accepted in Britain during the nineteenth and early twentieth century but found a less receptive audience in much of continental Europe, including Spain. Two World Wars, the Great Depression, and in Spain the Civil War, reversed the liberalisation process in the first half of the twentieth century (James 2001).

In the last quarter of the twentieth century belief in the benefits of markets grew. Belief stemmed from the strength of the United States economy and its impressive growth in the 1990s, the 'bankruptcy' of the centrally planned economies, the failure of the Japanese model of development and the breakdown of consensus around the Keynesian 'welfare-state' model in Europe. These developments were accompanied by the rise to absolute economic, political and military hegemony of the United States (Kennedy 2002). In the late 1970s, the Thatcher government in Britain adopted liberal economic thinking as the natural complement to its political philosophy and embarked on a path of economic liberalisation. In much of continental Europe there was not the same ideological support for this 'Anglo-Saxon' liberal model of capitalism. Nevertheless, pressure for the creation of a 'Single European Market', from powerful international institutions dominated by the United States (notably the IMF, the WTO and the OECD, for example see OECD 2002), and from multinational companies, brought partial acceptance of neo-liberalism to continental Europe and indeed to the rest of the world. Liberalisation was not just an economic project, it involved changes in deep-seated social and political relations. Thus, it would not be realised overnight. Moreover, given the variety of forms of capitalism (Coates 2000) and the variety of ways in which economic relations were embedded in society, the pace at which liberalism would advance across Europe would inevitably vary.

In the early years of the twenty-first century Europe appeared to be moving towards a fuller embrace of liberal economic philosophy. In Britain, the Labour government continued to move on with privatisation and public-private finance initiatives. Agreement was reached on further trade liberalisation (under a new round of WTO talks beginning in 2001 in Doha) and the European Union pressed ahead with enlargement. In continental Europe, Britain found an advocate of liberal policies in the right-of-centre People's Party. Following election to office in 1996 the PP launched an ambitious privatisation programme, began introducing structural reforms, public-private finance initiatives (PFI), lowering income tax rates and reducing the budget deficit to zero. The election of right-of-centre governments in Italy in 2001, then in France in mid-2002, disposed these countries too to a more liberal agenda.

However, just as liberal capitalism appeared to have swept all before it, concerns grew over its direction. During the 1990s a series of economic crises associated with large-scale capital outflows disrupted economies from Mexico and Russia, to south-east Asia, Argentina and Brazil. In Britain, the form of privatisation of the railways was recognised as a disaster and there were growing questions over other privatisations and PFI. In the United States the 'miracle' of profit growth appeared to be, at least in part, the outcome of 'aggressive' accountancy practices. Faith in internet and technology stocks evaporated. Stock markets in the US and around the world tumbled. Following the collapse of communism, the discrediting of the Japanese model and the poor performance of the European model, the last remaining successful model of twentieth century economic development was in distress (although it continued to display stronger growth than other 'western' economies).

Liberalisation was encountering increasing resistance and this model of development questioned. Resistance was illustrated in anti-globalisation demonstrations (often combining anxiety over a variety of 'liberalisation' issues; Lloyd 2001), fears in Europe over threats to public services, strikes against labour market reform and disillusionment with the benefits of equity investment. Particular criticism was levelled at the IMF from its former president Joseph Stiglitz (Stiglitz 2002). Stronger regulation was called for, new or revised models of supra-national governance and new ways of articulating local aspirations in a global economy. Possibly a new model of development was beginning to form. Certainly, a rift was opening between those pursuing a liberal agenda (including Spain) and those looking for an alternative.

Liberalisation, Regulation and Competition Policy
Liberalisation required changes in the regulatory framework to create more open markets. According to the OECD (2000a, p.14) the regulatory framework includes laws, formal and informal orders and subordinate rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies to whom governments have delegated regulatory powers. Regulation refers to "the diverse set of instruments by which governments set requirements on enterprises and citizens… Deregulation is a subset of regulatory reform and refers to complete or partial elimination of regulation in a sector to improve economic performance." (ibid).

Competition policy lay at the heart of ensuring that regulatory reform actually promotes competition. The message was underlined by the OECD (OECD 1999a, p.3), which stated that: "as regulatory reform stimulates structural change, vigorous enforcement of competition policy is needed to prevent market abuses from reversing the benefits of reform.". The form of reform was important. Hastily implemented regulatory change could easily conflict with existing law (Ariño Ortiz 2000). There was also a requirement for continuous regulatory vigilance, since it was difficult to foresee the outcomes of reforms.

Complex issues were bound up in competition policy. Firstly, there was the paradox that strengthening government intervention could be part of liberalisation. Regulation was ostensibly there to enforce competition (necessitating strong regulators) but it also provided an opening for the government to intervene in industry for other reasons (safeguarding national interests, for example) and created the risk of micro-managing industries. Secondly, there were questions over the definition of markets (both structurally and geographically) and what constituted market abuse? How could pan-European, national or local champions be created without dominating national or local markets? Thirdly, there were justifiable concerns among businesses operating under specific regulators of regulatory risk. Regulators had to respond both to the way businesses reacted to the regulatory framework and to their political constituencies, but businesses could legitimately claim that it was difficult to plan in a changing regulatory environment.

The problem of defining the spatial extent of markets was reflected in there being several administrative levels at which competition policy in the European Union (EU) was exercised - the EU, the Member State and in some cases (as in Spain from 2002) the region. Breaches of competition could occur at any geographical scale. This, and the several tiers of competition administration, left plenty of room for conflict.

At the European level Competition policy was designed to avoid the monopolisation of markets by preventing firms from sharing the European market via protective agreements. Markets could be monopolised as a result of restrictive agreements and concerted practices, or company mergers (although some exemptions were permitted). Policy attempted to prevent one or more firms from improperly exploiting their economic power over weaker firms (abuse of dominant position). It also had to prevent Member States' governments (any public aid) from distorting the rules by discriminating in favour of public enterprises or by giving aid to private sector companies (state aid). However, the following were compatible with the internal market: state aid having a social character; aid granted to make good damage from natural disasters; aid granted to areas of Germany affected by division of the country; aid to develop certain activities or regions; aid to promote projects of European interest; and aid to remedy a serious disturbance in the economy of a Member State. In September 2000 the European Commission approved proposals to place responsibility for anti-trust investigations in the hands of national governments (except in exceptional cases), partly a pragmatic response from the Commission to an unsustainable work load.

A change in tack by the European Commission on take-over policy was signalled by a number of events in June 2002. Until then the Commission had been inclined to assess the impact of mergers purely in terms of market share. In contrast United States anti-trust policy was more permissive, taking into consideration the impact on consumers. However, the Competition Commissioner issued a statement on 4 June that the Commission would be more sympathetic to the argument that a proposed take-over should be allowed if the cost savings that result could be shown to benefit consumers. The same month a ruling by the European Court of Justice quashed a 1999 Commission decision to block a merger between two British travel firms. The European Court also ruled that in respect of 'golden shares' government controls had to be the minimum possible and allow management the right to appeal (except

in the special case of Defence). These rulings (once incorporated into state legislation) would curtail the power of national governments to protect privatised companies, encourage agreement on an EU take-over directive and reduced the obstacles to a new wave of corporate acquisitions and mergers in Europe.

In Spain the first competition law was adopted in 1963 and became effective in 1964. But the law "remained largely unimplemented and unenforced for more than 20 years" (Borrell 1998, p.448). In 1989 a new Competition law (*Ley* 16/1989) brought Spain broadly into line with European law (Velarde et al. 1995, Cases 1998). Two bodies, the Competition Commission of the Ministry for the Economy (*Servicio de Defensa de la Competencia*) and the Competition Court (*Tribunal de Defensa de la Competencia*) were responsible for the enforcement of overall competition policy. Essentially, the Commission decided which cases to investigate and referred these to the Court. It also ruled on the Court's decisions. Thus despite the Court being given greater autonomy and resources in a strengthening of the competition framework under a new competition law passed in 1999 *(Ley de Defensa de la Competencia, Ley 52/1999*; BOE 1999), which came into force in March 2000, the system continued to be criticised for being too close to government, for demonstrating too little transparency and for having insufficient resources. Although the Court took a tough stance on market abuse, the final decision on mergers remained with the government (OECD 2000).

In relation to take-overs Spanish law was showing some signs of shifting to a more liberal position and adjusting to the new framework being developed by the European Commission. As part of the 2003 Budget legislation a new law on the framework for acquisitions (*Ofertas Públicas de Adquisición, OPAs*) was being prepared. Nevertheless, hostile take-overs remained practically impossible in Spain even for most of the companies quoted on the Madrid stock exchange because of the widespread use of various forms of protection (for example, large blocs of shares in few hands, limitations on voting rights, restrictions on Board membership). The government continued to exercise a veto on take-overs through its control of the Commission and through the use of a 'golden share' in leading privatised companies (Endesa, Indra, Repsol-YPF and Telefonica). A law passed in 1995 allowed the government to disallow the purchase of more than 10 per cent of the shares of a privatised company or a holding that could reduce the state’s holding to less than 50 per cent (used to frustrate an attempted acquisition of Telefonica) and in the Budget for 2000 the government introduced a law that reserved it the authority to suspend the policy rights that a foreign company with public participation could gain in a Spanish company in a sector recently privatised (used in the take-over battle for the electricity utility Hidroeléctrica del Cantábrico). Moreover, the Deputy Prime Minister, Rodrigo Rato, was on record as saying that in the future evolution of the electricity industry Spanish ownership would be protected: "*lo único que pido es que reserva la españolidad del sector*" (quoted in El País 25 September 2002), underlining the tension between liberalisation and protecting national interests.

Structural divisions in the economy were reflected in the development of regulators covering specific industries, in addition to the two general competition bodies in Spain. There were specific regulators for the banking system, insurance, accounting, the stock-exchange, energy, telecommunications and tobacco. Where structural divisions were dissolving, the ambit of regulators was redefined. Thus the Electricity Market Regulator was reformed to become the Energy Market Regulator (*Comisión Nacional de Energía*, CNE). Similarly the Telecommunications Regulator (*Comisión del Mercado de las Telecomunicaciones*, CMT) took on responsibility for telecommunications, audiovisual businesses and the internet. Many of these regulators faced similar criticisms: insufficient autonomy and transparency in decision making. For example, in two celebrated cases, the acquisition of Hidroeléctrica del Cantábrico in 2001 and the proposed merger of two electricity utilities Endesa and Iberdola, government rather than the regulator decided the outcome. Liberalisation did not mean that the government was prepared to release the reins of control to market forces.

Other important areas touched on by competition policy related to government purchasing and state aid. European legislation required that all large government contracts be opened up to competition. Liberalisation was gradually extending the range of contracts over which this applied. Thus, in 2002 the Spanish government intended to open up to competition the contracts for telephone, electricity, post and fuel services in all public administrations. This offered the benefit of significant cost savings while further demonstrating the government's commitment to liberalisation.

State (and other public sector) aid remained a contentious topic between the European Commission and Member States. While the Commission and private sector competitors frequently claimed that state-aid was being used to favour recipients, governments claimed that aid was being used legitimately to restructure businesses. Spain, like other Member States, was subject to a series of investigations by the Commission. In one major confrontation between the Spanish government and the Commission conflict over payments to Spanish electricity utilities, under what was described as 'costs of transition to a more competitive regime in the electricity industry', was eventually avoided by technical changes in the nature of the payments and an extension to the time period over which payments would be paid. The compromise defused conflict between Spain and the European Commission but demonstrated the issue of regulatory risk since it broke an earlier agreement between the government and the electricity utilities.

Privatisation

Privatisation was the principle process whereby the state withdrew from direct participation in the economy. It was justified primarily on grounds of economic efficiency, but it also brought with it the economic benefits of reducing public sector deficits (crucial in the 1990s for EU Member States seeking to achieve the targets set out in the 1991 Maastricht Treaty and gain entry to the eurozone at the end of the decade) and reducing the government's direct involvement in the labour market (Cuervo 1997, Gamir 1999). For governments seeking a more market-centred ethos in society it brought the political benefit of giving more people a direct financial stake in the economy. In Europe, privatisation as a deliberate economic policy began in Britain in the early 1980s (Wright 1994; Parker 1998). By the 1990s it had been widely adopted in Europe and around the world.

In Spain, the state-owned enterprise sector was reduced from a multitude of diverse companies in the early 1980s to a rump of mainly service businesses in 2002 (Gamir 2001, Montes Gan and Petibo 1998, OECD 1998, Salmon 2001a). By the early 1980s the sector had swollen to its largest historical size. In 1986 there were 180 companies in which the state had a direct majority holding plus hundreds of subsidiary companies and minority holdings (Fernández Rodríguez 1989). It was estimated that between 1980 and 1986 public enterprises accounted for 8 to 10 per cent of the gross value-added of goods and services in Spain (Fariñas, Jaumandreu and Mato, 1989). By 2002 state-owned public enterprises had been reduced to a small number of companies in coal mining, shipbuilding, and certain services notably the post-office, the railways, radio and television, and air and seaport operators. Privatisation began under the Socialist Party (Partido Socialista, PSOE) in the early 1980s as a pragmatic response to industrial problems (Aranzadi 1989). By the mid-1990s it had gained a stronger place in economic policy. Stakes were sold in the state-owned bank Argentaria, the electricity utility Endesa, the oil company Repsol and the telecommunications company Telefonica. But there were no full privatisations of major enterprises. Following the election to office of the right-of-centre PP in 1996 the privatisation programme was accelerated, the objective being to dispose of all state-owned enterprises. At the same time, it was made clear that preference would be given to Spanish capital. From 1996 to October 2002 the privatisations were completed (except for a 'golden share' and residual holdings in some cases) of Argentaria, the steel company CSI, Endesa, the airline Iberia, Repsol, the tobacco company Tabacalera, Telefonica, and the shipping company Transmediterránea. In the process of privatisation national champions were created with international reach (Salmon 2001), assisted by the careful preparation of companies before sale and use of their dominant position in the home market after sale. Employment and investment increased both within the major privatised companies and within the sectors in which these companies operated, services improved and prices fell. Receipts from privatisation were used to pay off the historic debt of the former industrial holding company INI, fund pension schemes for former public enterprise workers and support regeneration programmes in areas adversely effected by the restructuring of public enterprises. Although individuals and specific geographical areas were seriously harmed by restructuring, the welfare benefits from the privatisation of major companies were overwhelmingly positive (Hernández and López 2000). What privatisation did not automatically achieve was market opening and greater competition, it simply transferred state assets to the private sector (Mota 1998). In a few cases the state retained direct control over strategic decisions through a 'golden share'. In all cases the chairmen were appointed by the government (Berenguer 2002).

Trade Liberalisation

Trade liberalisation, defined by Caves, Frankel and Jones (1990, p.536) as "the removal of tariffs, subsidies, quotas, and other barriers to trade…" was promoted on a multilateral basis throughout the second half of the twentieth century by the General Agreement on Tariffs and Trade (GATT), thence the

World Trade Organisation (WTO). A series of trade rounds brought greater trade liberalisation among a growing number of member states. The Uruguay Round (1986-94) brought average tariff reductions of one-third by developed countries, agriculture, textiles and clothing into the negotiations, and agreements on services (GATS), intellectual property (TRIPS) and trade-related investment (TRIMS). A new round of negotiations concentrating on agriculture, GATS, TRIPS and TRIMS was initiated through the Doha agreement in 2001. Within this global framework, European countries promoted trade through their own bilateral and multilateral agreements and through free trade areas, notably the European Economic Community (thence the European Community) and the European Free Trade Area (EFTA). By the end of the twentieth century trade in the European region was dominated by the regulatory framework of the European Single Market and the European Economic Area.

In Spain trade liberalisation transformed the economy from autarchy in the late 1950s to an open economy, integrated closely into Europe (Salmon 1995a). Liberalisation was initiated in 1959 with the 'Stabilisation Plan' agreed with the World Bank and the Organisation for European Economic Cooperation (later renamed the Organisation for Economic Cooperation and Development, OECD). Further trade agreements liberalising trade within Europe included the Preferential Trade Agreement with the EEC in 1970, a trade agreement with EFTA in 1979, thence accession to the European Community and adoption of the Single Market Agreement in 1986, followed by transition to the European Union (EU) trade regime and completion of the single market on 1 January 1993 (Tovias 1995). By the mid-1990s Spanish trade policy was fully integrated into the Common Trade Policy of the EU, with free trade between Member States and external trade governed by the Common External Tariff and the various agreements made between the EU and third parties. As a result of trade liberalisation, merchandise trade grew from less than 20 per cent of GDP in the 1960s, to around 25 per cent in the 1970s, over 30 per cent in the early 1980s, thence to around 45 per cent in 2001, bringing Spain broadly into line with other large EU economies. If services were added, the proportion rose to over sixty per cent (Salmon 2001c and Sanz Serrano 2002). Apart from trade creation, EU integration led to a concentration of trade within this region. EU trade as a proportion of all trade rising from less than one-third of imports and half of exports in 1980 to some two-thirds of imports and three-quarters of exports. Thus, with the principal exception of agricultural products, in 2002 markets in goods in Spain were relatively open to world competition. For Spain, it would be a particular test of liberalisation policy to open this remaining market and accept market-based reforms to the Common Agricultural Policy (CAP). It was, after all, the largest net recipient of funding through the CAP (Economist 2002a).

Liberalisation of Capital Markets

Liberalisation of capital markets developed in the 1970s, when the United States and most of the larger western economies removed their capital controls, and continued throughout the last quarter of the twentieth century. By the end of the century, liberalisation coupled with the application of enabling information and communications technologies had transformed capital markets into one of the most global of all markets. However, a series of financial crises highlighted the potential for destabilisation posed to economies by the liberalisation of capital markets. For some, the threat of financial turbulence provided a powerful reason for financial integration into a strong regional currency bloc, for others it was time to impose some form of control over international capital movements.

In theory a single European financial market was created by 1 January 1993. On that date, for example, the Second Banking Directive entered into force, which established the principle of a single EU-wide licence, allowing banks and other credit institutions to set up branches and offer services throughout the Community. In practice, even by May 2002, the Economic and Financial Committee of the European Commission concluded that “the EU still does not have a fully integrated financial market” (European Commission 2002a, p.3). Proposed reforms touched on fundamental issues of political economy, not least of which was economic sovereignty. Moreover, during the Spanish Presidency in 2002, the whole process of liberalisation was overtaken by the collapse of world stock markets, fears of recession, concerns over accountancy practices and the fight against terrorism. These demands diverted attention towards measures to re-establish confidence in company accounts, improve corporate governance and strengthen the financial mechanisms for combating terrorism.

Financial market integration was strongly market driven, reflecting the globalisation of capital flows. Banks developed networks around the world. Spanish banks, for example, became market leaders in Latin America. In Europe there were moves towards consolidation of stock-markets. But providers of

financial services continued to face obstacles – legal, regulatory, competition, tax, technical or political – to cross-border activity within the EU. In retail activities there were also natural barriers to integration such as language and culture, and the importance of proximity, suggesting that retail markets would remain more local than wholesale ones. Thus, although there were some minor cross-border bank mergers and alliances in Europe, by mid-2002 there had been no major acquisitions. In the euro area less than five per cent of bank branches were owned by banks from other European Economic Area countries (ibid, p.17).

Strengthening the internal market in financial services was identified as an important goal at the Cardiff Council in March 1998. By the time of the Lisbon Council in March 2000 a single financial market was seen as critical to the completion of the single European market and a catalyst for economic growth and the development of a knowledge-based economy. Major developments had taken place by 2002, including the adoption of one currency among twelve Member States, but there was still no such thing as an EU-wide market for financial products. Against this background the European Commission was seeking to establish one money and one capital market with one set of financial rules within the EU by 2005.

The Commission's main instrument for achieving a single financial and capital market was the Financial Services Action Plan (FSAP), a set of 42 proposals (five more were added by 2002) including an EU-wide cross-border merger/take over code. The Plan was adopted by the Commission in May 1999. Specifically, it set key priorities and a schedule of legislative and other measures for achieving three strategic objectives: to set up a single market for wholesale financial services, to make retail markets accessible and safe and to modernise the rules on prudential supervision and monitoring. The Plan also recommended that the Council of Ministers and the European Parliament adopt, by the end of 1999, proposals for directives on collective investment undertakings, distance sales of financial services and electronic cash. The Lisbon Council underlined the importance of progress on achieving integration in financial and capital markets, urging the conclusion of a new European-wide take-over regime by the end of 2002 and completion of the full FSAP by 1 January 2005. At the Stockholm Council in March 2001 a target of 1 January 2003 was set for the completion of that part of the FSAP dealing with the securities and risk capital markets.

The Barcelona Council in March 2002 renewed the commitment to the FSAP and its timetable. In particular, it requested that by the end of 2002, the Council and the European Parliament should adopt under co-decision a further eight legislative measures on top of the 26 already completed: the proposed Directive on Collateral; Market Abuse; Insurance Intermediaries; Distance Marketing of Financial Services; Financial Conglomerates, Prospectuses and Occupational Pension Funds and the International Accounting Standards Regulation (ibid, 22). The Economic and Financial Committee also recommended that the Commission should deliver some legislative proposals, notably a new Directive on cross-border mergers (10th Company Law Directive), take-over bids and revision of the Investment Services Directive before the end of 2002 (European Commission 2002b).

Following the Barcelona Council, a Council Meeting on 7 May 2002 dealt with Directives on market abuse and financial conglomerates. The Council confirmed political agreement on a draft directive on Market Abuse. The directive would replace the 1989 Directive on insider dealing and widen its scope to cover market manipulation (relevant to the fight against terrorism). Political agreement was reached on a common position on the draft Directive on financial conglomerates. The aim of the directive was to ensure the stability of financial markets, to establish common standards for the supervision of financial conglomerates and to introduce level playing fields and legal certainty between financial institutions. A Council meeting of 4 June 2002 dealt with the Prospectus Directive, the Pension Funds Directive and progress with the FSAP. The draft Prospectus Directive was designed to lay down common rules for European securities markets. There was also some movement on the Directive on Institutions for Occupational Retirement Provision (Pensions Funds Directive). Despite this progress, in mid-2002 the Financial Services Policy Group in their sixth half yearly report on the FSAP concluded that significant challenges remained to complete the Plan by the timetable set.

In Spain financial and capital markets were gradually opened from the 1970s. Liberalisation was substantially enhanced in the 1980s with membership of the European Community and in response to international agreements, market forces and domestic economic policy requirements. Companies were

permitted to transfer capital abroad and procedures for investing in Spain became progressively easier. Huge volumes of capital flowed into the country in the late 1980s taking significant stakes in the economy (Salmon 1995a). In the late 1990s net inward direct investment was replaced by net outward direct investment as many Spanish companies raced to grow their businesses and diversify away from domestic markets, especially through investment in Latin America (Salmon 2001b and SGE 2002). Legislation increased competition between commercial banks and savings banks, particularly that which allowed savings banks to expand beyond their 'home' region. There was also growing competition from foreign banks, which were allowed to open full branches from 1978 (following the First European Banking Directive in 1977). The insurance sector was extensively penetrated by foreign capital and foreign firms were given access to the stock-exchange. Further measures to incorporate the FSAP into Spanish law were outlined in the Draft Finance Law (*Proyecto de Ley de Medidas de Reforma del Sistema Financiero*) presented to parliament in April 2002 (the revised text being due in November 2002). The Law proposed far-reaching regulatory reforms of financial markets, the credit market and the insurance market. The law would also include new institutions to protect investors, make money laundering more difficult, up-date the mechanisms for supervising the financial sector and require the rotation of auditors.

The financial services sector, especially banking, was particularly sensitive because of its position at the core of the economy. Overall, in Spain there was strong competition in retail banking and vigilant supervision (OECD 2001). However, there were tests of the commitment to liberalisation on the horizon. One of these was loosening existing local political influence over savings banks and securing an orderly consolidation of the savings bank sector. An amendment to the Draft Finance Law restricting voting rights in savings banks suggested that there remained political limits to liberalisation.

Liberalisation of Network Services

Energy markets: In the second half of the 1990s the European Commission introduced framework directives covering the electricity and gas industries. Oil markets were generally more open as a result of less dependence on a fixed network and the multinational nature of the industry. Both Electricity and Gas Directives set a timetable for market opening, with choice being given first to large consumers. In neither case was there a schedule for complete liberalisation. They required a vertical separation of infrastructure ownership from the operation of services over the infrastructure through the unbundling of different types of electricity and gas businesses (separation of accounts and not the complete break-up of vertically integrated businesses) and access to the transport and distribution networks. In 2001 the European Commission presented further proposals to achieve full liberalisation of electricity and gas markets by 2005 and placed renewed emphasis on increasing the capacity of cross-border transmission networks. These actions reflected the concentration on the difficult task of liberalising energy markets and network services generally (Henry and Matheu 2001), a particular focus of attention during the Spanish Presidency.

Liberalisation in the oil industry in Spain commenced with the break-up of the oil monopoly Campsa in the 1980s and the passage of the Oil Industry Law in 1992 (*Ley de Ordenación del Sector Petrolero*, BOE 1992). Under this Act all aspects of the oil market were liberalised, including imports, distribution and marketing, bringing the regulatory regime in Spain into line with that in the European Community (Sala Arquer 1996 and Salmon 1995b). But the government continued to intervene in the price structure, access to essential infrastructure by non-owners was difficult, and establishing retail networks was hindered by planning restrictions and petrol station concession arrangements (OECD 1998). In 1997 the former state-owned oil company Repsol was fully privatised (except for a 'golden share' held by the government). A further stimulus to liberalisation was provided by the 1998 Hydrocarbon Law and a package of liberalisation measures introduced in June 2000 (Villa Ezcurra 2000). Ownership of the oil transportation and logistics company, CLH (*Compañía Logística de Hidrocarburos*), which owned most of the oil storage capacity and oil pipeline system), was opened to companies other than the three refiners in Spain (Repsol-YPF, Cepsa and BP), enabling easier access by other companies to oil storage and transportation facilities and more transparent charging for using these facilities. Simultaneously CLH was required to lower charges for using its facilities. In an attempt to reduce the dominance of the two major incumbents in the oil retail market (Repsol-YPF and Cepsa), Repsol-YPF was prevented from opening new service stations in the following five years and Cepsa in the following three years. Hypermarkets were also required to open service stations. However, the fact remained that apart from the slow process of building new service stations the only other way into the market was through the

acquisition of existing networks or the acquisition of supply contracts as they come up for renewal. Unless Repsol-YPF was forced into disposals, it would take a long time to make significant inroads into the over 40 per cent of all outlets that it controlled.

The Spanish Electricity Industry Act, 1997 (*Ley de Ordenación del Sector Eléctrico,* BOE 1997) transposed the European Electricity Directive into Spanish law. The Act placed Spain among the leading countries in Europe in terms of deregulation of the electricity supply industry, going further than the EC Directive required and in a shorter time span (López de Castro 2000). Production and marketing were not regulated, economic and technical management, transport and distribution were regulated. Key points in the Act were: freedom to build new electricity generation capacity; the creation of a competitive electricity wholesale market; freedom of access to the electricity grid for transport and distribution; freedom to sell electricity; progressive freedom for the consumer to choose their electricity supplier (choice for all consumers by 2007) and the unbundling of activities. The State guaranteed the supply of electricity throughout the national territory, although state planning would be indicative except in relation to transmission facilities and aspects related to town and country planning (OECD 1999b). After the introduction of the Act additional regulations sought to improve access to different parts of the electricity system and adjust the pricing regimes. Moreover, the date by which all consumers would have choice over supply was brought forward to 1 January 2003, two years ahead of the EU schedule.

All elements of the electricity supply system were privately owned by 2002, except for a public holding in the electricity grid operator, Red Eléctrica de España (REE). Spain acted to increase the cross-border transmission of electricity, intending to create with Portugal an Iberian electricity market in 2003 and to raise its interconnection capacity from 3 per cent of the market in 2001 to 11 per cent by 2005 and 13 per cent by 2011, ahead of the EU schedule (although these projects faced stiff environmental opposition). In generation, new companies were entering the market by building generating stations, or through acquisitions. An Italian utility acquired a number of plants from the largest electricity company Endesa (forming the fifth largest electricity utility in Spain, Viesgo), while the smallest company of the former 'big four' in Spain, Hidroelélectrica del Cantábrico, was also acquired by foreign interests (subject to government approval in September 2002 because of public capital in the foreign group). Nevertheless the two leading electricity producers in Spain, Endesa and Iberdrola, constituted a near duopoly with close to 80 per cent of the electricity market in autumn 2002. Although prices fell, large consumers of electricity complained that prices in the deregulated market were higher than those in the regulated one (Carcar 2002). The principal dilemma for the government was its reliance on private companies to build the capacity needed to meet demand while at the same time pressing down on prices and ensuring continued market opening. It would also have to resolve its position on foreign ownership.

Liberalisation of the natural gas market in Spain was set in place by the Hydrocarbon Law (*Ley de Hidrocarburos,* BOE 1998). As with the Electricity Act, this followed two criteria: freedom of action by businesses coupled to a guarantee by the government to safeguard energy supplies. The natural gas transport (high pressure) and distribution (low pressure) systems remained regulated. In principal there was open access to these systems, to gas reception points, storage facilities and regasification plants for third parties. Such access was gained through negotiation, disputes being handled by the National Energy Commission (CNE). Payment was through a toll set by the government. Sales companies could be set up following authorisation. This contrasted with the existing practice of granting area based concessions for distribution and sales, which had developed to cover the whole of the country. The majority of these involved holdings by the dominant natural gas transport company, Enagas, and other energy companies plus local finance. As with the electricity system, there was a staged reduction in the threshold for consumers qualifying to choose their gas supplier. The initial schedule for complete liberalisation was dramatically accelerated from an initial date of 2013 to January 2003 for all consumers and to January 2005 for gas distribution. Once again, the objective was to promote competition and contribute towards easing inflationary pressures in the economy. Once again, it demonstrated the scale of regulatory risk (Quinto and Sanz 2000).

Despite liberalisation, one company, Gas Natural, remained the dominant natural gas supply company in Spain in Autumn 2002, with some 80 per cent of the market. In fact, it was a de-facto integrated monopoly with the oil company Repsol, which owned 45 per cent of Gas Natural. Much of the gas infrastructure remained under the control of one company, Enagas, which was separated from Gas Natural to become an independent company in June 2002, following government legislation. The sale allowed other operators into the new Enagas and provided an opportunity for a more transparent pricing regime. The model for the operation of the new company was similar to that adopted for the oil transportation company CLH. A further measure to liberalise the market was the award by the government in October 2001 of 25 per cent of the gas coming through the Magreb pipeline from Algeria to six companies for three years: the four electricity majors in Spain and the foreign oil companies BP and Shell. By autumn 2002 a number of companies had acquired natural gas supplies on which they could endeavour to build distribution contracts and thereby create more competition in the natural gas market.

Overall, with the exception of coal that remained heavily protected, a strong start was made in liberalising energy markets in Spain. But there remained a wide gulf between de-jure and de-facto liberalisation (see for example European Commission 2001). Critical constraints continued to apply especially in terms of access to infrastructure, increasing cross-border energy flows, and the embedded political and social relations of production (including business governance). Planning permission remained an obstacle to the development of new facilities. More especially, energy companies had responded to the changing business environment by transforming themselves into diversified energy or more broadly based utility groups. In addition, although the different activities in electricity, gas supply and oil had been unbundled, close links remained between these activities, many of which operated within the same group of companies. The government faced difficult challenges in preventing markets that were formally dominated by public enterprise monopolies simply slipping under the control of private oligopolies. It would also need to balance commitments made to consumers over lower prices, security of supplies, demands made by business for pricing and regulatory regimes that made investment attractive (including settling the position in relation to payments to the electricity utilities in respect of the so-called 'costs of transition' to a competitive environment), and its own policy targets in relation diversifying energy sources (as stated in the National Energy Infrastructure Plan 2002-11), the environment and the economy. Liberalisation left the government with considerable influence but little direct control over business decisions.

Postal services: In postal services state monopolies dominated throughout the European Union in the late 1990s, with a few exceptions notably in Finland and Sweden. In addition to the general concerns over liberalising network services, particular disagreements surrounded questions over how much of a monopoly was required to finance the Universal Service Obligation (USO, the guarantee to customers of a universal standard of service at a single price, regardless of where they lived) and in which areas (direct mail, parcels, express delivery etc.). Despite these issues, postal services were recognised as an

integral part of the knowledge economy and central to the completion of the European internal market. In 2002 there was already no postal monopoly in Finland and Sweden. In Germany (Deutsche Post) and the Netherlands (TPG) former state monopolies had been partially privatised and operated commercial subsidiaries (DHL and TNT respectively). Simultaneously, liberalisation had begun to present new challenges to regulators, notably the cross-subsidisation by incumbent operators of commercial services. As in other sectors, liberalisation required strong and agile regulatory arrangements.

The Spanish postal service 'Correos y Telégrafos' (Correos) was one of the most liberal in Europe in 1997 and remained so in 2002. Thus the European Postal Directive (1997) made little immediate difference to services in Spain. Post-offices were already becoming sales points for a variety of financial products, competition existed for courier and parcel services, urban mailing, and inter-urban and international mailing over 2 kg. The remaining system was moving towards liberalisation under the Postal Law 1998 (*Ley Postal*), which transposed the European Postal Directive into Spanish law, creating the framework for regulating postal services in Spain with the objective of guaranteeing a universal service, while providing for a degree of competition. Correos was designated as the Universal Service Provider. The reserved area (USO) was defined as postal money orders, inter-urban ordinary mail (equal to or less than 350 gm or five times the ordinary letter rate), urban and international ordinary mailing (letters less than 2 kg and parcels less than 10 kg), national and international direct advertising mailing and consignments of books, and the stamp retailing monopoly (though this was to be phased out over 4 years). The Postal Law also paved the way for a possible privatisation of Correos, the first step in this process being taken in 2000 through legislation to convert the state enterprise into a limited liability company. In July 2001 it began trading as a state limited company (*Sociedad Anónima Estatal*).

In 2002 postal services in Spain remained largely under the monopoly of Correos, which accounted for some 90 per cent of the market for document transport and non-urgent packages. Further gradual liberalisation under a new European Postal Directive passed in June 2002 would open up Community postal services in three stages: From 1 January 2003 competition in post weighing more than 100 gm, or three times the standard price of a letter and cross-border post; from 1 January 2006 the reserved area threshold lowered to 50 gm or 2.5 times the standard letter rate (42 per cent opening); followed by possible full liberalisation from 1 January 2009. This gradual process would allow time for Correos to improve efficiency and diversify. However, like other state monopolies faced with liberalisation, it would have a difficult struggle to implement the changes needed to compete with specialist-service operators, while maintaining its public service obligation. The key strategic decisions for the government would be if and when to privatise the company. Privatisation of Correos would push the limits of the privatisation deeper into the heart of public services.

Rail transport: At the European level, liberalisation in railways was considered disappointing by the mid-1990s. Hence, after a long debate the Council approved the Directives that constituted the First Railway Package 2001 (February 2001): Directive 2001/12/EC on development of the European Community rail network (includes separation of operation from infrastructure); Directive 2001/13/EC on the concession of licences to rail companies and Directive 2001/14/EC on charges for using rail infrastructure. The European Commission also decided to liberalise international rail freight. Licences would be granted for companies to transport freight internationally on specified lines from 2003, the trans-European freight network) and on all lines from March 2008. In 2002 this schedule was revised to 2006 and widened to create full liberalisation of rail freight services by the same date through extending to opening to national freight services.

Rail transport - operation and infrastructure - in Spain in 2002 remained largely the responsibility of the public company Renfe. However, steps towards liberalisation were gradually being taken. From the mid-1980s Renfe was subject to performance targets in exchange for government finance (*contratos programas*). Then from 1990 Renfe began to reorganise itself into distinct business areas, one of the pioneers in Europe to take this step. To solve the problem of financing the building of railway infrastructure the PP created the Railway Management Infrastructure Company, GIF (*Gestor de Infraestructura Ferroviarias*), in 1996. This was charged with constructing, financing and managing new lines (initially the High Speed line to Barcelona and the French frontier) using public and private funding. From 2001 Renfe was required to produce separate accounts for each business area, bringing it closer to a form of holding company (Ramos Melero 2002).

The shape of further liberalisation in the railways would be influenced by the experience of railway privatisation in other countries, notably in Britain. It was likely that the GIF would acquire responsibility for the whole of the wide gauge and European gauge network, but that it would remain a public company. Private finance was already entering the industry, for example through participation in infrastructure development, freight operations and property development. Spain had taken significant steps in adapting to the market, but some crucial decisions lay ahead that would test the limits of liberalisation.

Telecommunications: Liberalisation in the world telecommunications industry developed in the 1980s with the privatisation of the national telecommunications company BT in Britain and the break up of AT&T in the United States (the latter resulting in the formation of a large number of small companies or 'baby-bells', which were subject to a wave of consolidation following deregulation in the mid-1990s). Liberalisation was accompanied by rapid and far-reaching technological changes, which dissolved the structural boundaries of the traditional market core in fixed-line voice telephony, and by globalisation, which dissolved the geographical boundaries of markets. In addition, the sector was at the epicentre of events at the beginning of the new millennium which threatened the last remaining 'successful' model of late twentieth-century economic development, Anglo-Saxon liberalism.

Telecommunications companies and media companies responded to the combined pressures of liberalisation and technological convergence by metamorphosing into international conglomerates such as the US headquartered AOL-Time Warner, the Japanese based Sony Corporation and the French based Vivendi. In Spain the phenomenon was reproduced in the national telecommunications company Telefonica, reformed under the leadership of Juan Villalonga from 1997 to mid-2000 into an aggressive private company spanning the coalescing markets of telecommunications, media and information technologies (TMT). Further geographical expansion in Latin America, transformed the former domestic operator into the largest telecommunications company in the region. Within the TMT sector were a host of new markets (in addition to fixed-line telephony) that were attractive to existing telecommunications companies, since they provided opportunities for rapid growth, diversification away from mature and increasingly competitive markets, and economies of scale and scope (using existing facilities to enter new markets). These new markets included: wireless communication (mobile phones using the radio-wave spectrum); data transmission; fibre-optic cable (transmitting TV, voice and data); media (TV, radio, film, theatre, print, video games); internet and computing. Innovation was also spurred by the race to gain technological leadership through securing the acceptance of 'standards'.

Telecommunications policy in Spain was mainly driven by the requirement to meet European Commission Directives and World Trade organisation commitments (OECD 1999c). Internally, liberalisation was prompted by the desire to reduce inflation and pressure from consumer groups and competing companies. Deregulation, started in 1987, but moved slowly until the passage of new EC Directives in the mid-1990s (notably the 1996 Directive on the implementation of full competition in EU telecommunications markets). These spurred the full privatisation of the national monopoly telecommunications company Telefonica (except for a government held 'golden share') and were transposed into Spanish law in legislation in 1997 (*Ley* 31/1997) and the General Telecommunications Law of 1998 (*Ley* 11/98). Within this regulatory framework Telefonica was designated as the Universal Service Provider (USP) at least until 2005 (the state licence contract having been drawn up in 1991 initially for 30 years, then revised in 1997). In theory, beyond this USP licence, there was full competition, only restricted in some cases by licences. The first private fixed-line and mobile-phone licences were granted in December 1998 (11 months after many other EU countries), breaking the monopoly of the incumbent operator.

Regulatory reform in the telecommunications sector in Spain was advanced by autumn 2002, with consumer choice of service provider, a guarantee of number portability and tariffs that had fallen substantially, especially for long-distance calls. Nevertheless, Telefonica continued to dominate the telecommunications market with over 80 per cent of the fixed-line market, control over the network infrastructure and close to half the mobile-phone market (CMT 2002). Market opening was only gradually occurring through legislation and the requirements imposed by the telecommunications regulator (CMT). For example, a package of urgent liberalisation measures introduced in June 2000 to reduce inflationary pressure, included measures to reduce internet and long-distance call charges and to open-up the local loop (the last section of line connecting consumers with the telephone network) by January 2001 (Miguel

de la Cuétara 2000). In addition, a fourth mobile phone licence was granted. In April 2002 the CMT approved a substantial reduction in the charges made by Telefonica to competitors wishing to use the local loop. But bolder steps were necessary to promote competition and ease the pressures on existing companies (none of the other operators were profitable). The CMT on introducing its tariff reductions in April 2002 said that after 15 months of theoretical opening the existing mechanism of liberalisation had not yielded its expected results. It also emphasised the obstacles to competitors marketing ADSL services, who had gained only 5 per cent of the market. Hence, a further liberalisation package was introduced in autumn 2002 including positive discrimination (for example in tax and discount plans) for competing companies. In exchange, prices would fall more slowly after 2003 than in previous years and the government declared that it would end the price-cap on Telefonica's tariffs by 2005 if by that time there was real competition in the market. This offered more certainty over tariffs and thereby less regulatory risk. As in the energy sector, the government was trying to strike a balance between its liberalisation goals, its promises to consumers and its desire not to damage major national companies.

Labour Market Reforms

Labour market reform was the most politically sensitive areas of liberalisation in Spain. Job security and rigid employment contracts developed during the Franco regime passed into the Workers Statute in the early 1980s. The introduction of fixed-term contracts in the mid-1980s led to a dual labour market, in which about one third of the labour force had fixed-term contracts and very little job security (along with those working in the black economy), while two-thirds continued to benefit from a high degree of security (Rigby and Lawlor 2001). From an economic efficiency perspective, two thirds of the labour force formed an inflexible labour market which had to be reformed, a step constantly referred to in OECD reports (OECD 2000b and 2001). The Socialist government (PSOE) introduced reforms in 1994, which contributed to their election defeat in 1996. Stiffer reforms followed the election to office of the PP, which once negotiations with trade unions broke down moved away from consensus politics to direct action. Reforms were designed to increase the flexibility of the labour market, making hiring and firing workers easier and, according to neo-liberal arguments, promoting employment. Most controversial were reforms passed in May 2002, which led to the first General Strike since 1994 (following the labour reforms that year). However, by autumn 2002 the government was giving ground on the reforms, suggesting either that liberalisation in this market was testing its limits for the moment.

Conclusion

In less than a decade, Spain shifted from being one of the more protected markets in continental Europe to one of the more liberal. This involved sweeping changes in the regulatory environment, which in turn were changing the business and the cultural environment. Markets for goods were opened up to international competition, a start made on opening markets in services, and further reforms to land and labour markets introduced. The People's Party demonstrated their belief in liberalisation across a range of economic policies, implementing an extensive privatisation programme and transposing European Union directives both ahead of time and above the minimum requirements. The PP could justifiably claim to be advocates of liberalisation. It was appropriate, therefore, that one of the main themes of the Spanish Presidency should be liberalisation. Despite considerable political distractions momentum in this area was maintained, though no major new initiatives were developed.

Liberalisation, however, was tempered by national interest and political realities, which diluted the credibility of the PP as converts to open and competitive markets. Perceived national interest took precedence over economic philosophy. In the privatisation process, strong national companies were created, allowed to dominate markets and protected from acquisition. Without European-wide agreement the government was not going to change its stance on foreign acquisitions, especially by foreign companies with public capital. In relation to the Common Agricultural Policy and European Structural Funds, the government showed no sign of giving ground to less intervention. Above all the government was unwilling to release the reins of control over the economy. They may no longer have been musicians but they were still trying to conduct the orchestra.

The question remained over whether there were limits to liberalisation. Areas where there was entrenched protection but a strong political lobby, as in the savings banks, remained protected. There appeared to be limits on how far the government was willing to confront the trade unions in making labour market reforms. The limits of liberalisation in public services were being tested in postal services and rail transport. It remained open as to whether or not liberalisation would push on into the heart of the

welfare state: education, health, social security and social services (although these already included private sectors). In 2002, Spain was moving along the liberalisation path. It had demonstrated its liberalisation credentials and taken a lead in continental Europe. But it had not fully committed itself to the liberal capitalism model. It was perhaps time to reflect on the balance between public and private sector involvement in the economy and more broadly the direction of development in Spain and in the rest of Europe.

6 October 2002

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