Construction slowdown threatens Spain's economic boom

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According to a recent report by the International Monetary Fund, the Spanish economy has become "increasingly lopsided" over the last few years. Whereas the construction boom saw 700,000 new homes built in 2004 (more than the combined total in France, Germany, Belgium, Holland and Luxemburg), the manufacturing sector has declined by 0.4 percent in 2005 and export growth has remained stagnant.

The decline in the manufacturing sector can be traced back to the 1980s, when Spain's traditional low-wage status was under threat from locations in Asia and Latin America. This put pressure on Spain's main exports—clothing, textiles and leather.

More recently, renewed pressure on the Spanish economy has come from European Union enlargement to countries in central and Eastern Europe. They have up to 60 percent lower labour costs and specialise in industries such as machinery, electrical goods, textile goods and automobiles, which make up around 40 percent of Spain's trade.

As a result there has been an outflow of capital investment from Spain, with the country experiencing a drop of 50 percent between 2000 and 2004. Recent casualties include textile plants that have closed in Valencia under pressure from Chinese imports and the relocation of some production at Volkswagen-owned SEAT to Slovakia.

Decline in investment has in turn contributed to an overall decrease in the productivity of Spanish labour. In 2005 it dropped by 1.3 percent, the biggest fall of all countries in the OECD.

Spain's "dual economy" is a big concern in ruling circles. In a recent study for the Real Instituto Elcano think tank, Sebastian Royo said, "The real estate bubble has masked the Spanish economy's lack of competitiveness.... In this regard, the Spanish economy's loss of competitiveness is a very worrying development. The current account deficit is a key symptom of Spain's loss of competitiveness."

Spain's trade deficit stands at 7.6 percent of GDP, the second highest among industrialised nations. The European Commission is predicting that it will reach 9.3 percent by 2007, a level which it says is unsustainable.

To turn around Spain's competitiveness analysts have called for yet more structural reforms. Royo says of Spain's membership of the euro-zone: "Contrary to expectations it has not led to a process of deep economic structural reforms that would have fostered the development of an economic growth model based on value-added and productivity."

Financial institutions have also called for a move away from reliance on temporary employment contracts, which currently affects one third of the labour force—more than twice the EU average. These have been used by Spanish firms as a cost-saving device, particularly in the construction and service sectors. However, they are entirely inappropriate in the manufacturing and technology sector, which requires more long-term training.

While analysts say that a more sustained investment in the labour force is needed to make Spanish exports competitive, they are faced with the contradiction that it was the relatively high cost of labour that chased investment away in the first place. According to Royo, "The industrial relations framework does not provide the necessary flexibility (either internal or external) to firms to deploy and organise their labour forces. A central challenge for Spanish firms and employers is to find a balance between the reduction of temporary

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contract levels and the rigidity of certain contracts.”

“Rigidities of certain contracts” refers to the relatively better conditions associated with permanent contracts that some workers enjoy. For the employers it means higher social security contributions and higher dismissal costs (generally 45 days’ pay for every year worked).

The plan was originally to bring these reforms in on an EU-wide basis through the European constitution. Its failure to be ratified amid popular opposition, however, has forced the ruling elites of individual member states to carry out these reforms at a national level. As Royo put it, “The process of economic reforms must be a domestic process led by domestic actors willing to carry them out.”

Ultimately, the cost of making Spain competitive will be borne by the Spanish working class, which has seen wages stagnate and accommodation costs double in real terms during the economic boom. In his study Royo admitted that successive governments “will face growing resistance from the people likely to be hit hardest by the reforms.”

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